The Technology M&A Review

Third Edition

Editors
Michael J Kennedy and Dana Kromm

The Law Reviews

THE TECHNOLOGY M&A REVIEW

THIRD EDITION

Editors
Michael J Kennedy and Dana Kromm

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PREFACE

Welcome to the third annual *Technology M&A Review*. As was the case in prior editions, much of the comparative data we use is based on a 'half-year' convention, with liberal reference to calendar year over calendar year data. Although certainly not by design or foresight, this 'half-year' convention better highlights the ups and downs caused by covid-19 in 2020, the incredible tech M&A bounce-back in 2021, and 2022's half-year bevy of negative factors – inflation, the Ukraine war, and their compounded effect on the supply chain and production and productivity.

Whereas 2021 demonstrated technology M&A's 'champions jog' around the M&A track, the first half of 2022 revealed some porosity in the tech armour and its slowed pace. After at least 20 years of accommodating monetary policy (i.e., cheap money), the Federal Reserve (the US central bank) has been forced to raise interest rates to combat the highest US inflation since the 1970s. The geopolitical power calculus also changed in an instant with Russia's invasion of Ukraine, China's quasi-alignment with Russia and its more aggressive posture on the world stage. In addition, we should not downplay covid's continuing effects on social and government relationships nor its and the invasion of Ukraine's impact on global trade and increasing the appetite for protectionism.

In the United States, the public markets continue to deal with these issues and their weight (with an overall downward value slope from their peak). Depending on when one measures during the first half of 2022, large technology companies such as Facebook and Google lost roughly US$1.5 trillion in value. This is from an all-time high base. However, by mid-August 2022, the Nasdaq had rallied and was up 20 per cent from its June 2022 low, and was 'only' down 16 per cent for the year.

Under the Biden administration, the US antitrust authorities have been and will continue to be aggressive in challenging M&A technology transactions under various theories, but other regulatory authorities, as well as individual states, also have technology in their cross hairs from a tax, content, 'buy America', privacy and patriotic perspective. For the first time since 2011, venture capitalists are cutting back on technology and growth investments. In addition to the publicly announced hiring freezes, it is common knowledge to those who practice in the technology area that other hiring freezes and lay-offs are underway. Despite these headwinds, technology still accounted for approximately 47 per cent of worldwide M&A value in the first half of 2022.

While the technology M&A sector shares its DNA with other sectors, it is a growth sector and is designed to be changeable. We all intuitively know one cannot change the design of a gas turbine on the fly, but one can change a lot in the technology space very quickly. For most technology applications that do not involve life or death functions, there is no competitive limit on the rate of change. There was, in effect, no social media industry in

2000, and now it is quite difficult to actually describe it – and yet it is huge. There have been unbelievable advances in, inter alia, food production and power plants since 2000, but no one considers these growth industries. These industries' advances are considered, consciously or unconsciously, recipients of technology but not creators.

This book's goal is to both highlight the similarities and differences between technology M&A and 'normal' M&A, without taking too much time to try to define what technology and 'normal' M&A are. One of its unstated premises is that because of technology's importance, effective M&A technology lawyering necessarily involves and requires a broad set of legal skills across many practice disciplines; that requirement will likely increase as governments and interest groups from all areas focus on the sector. The sector is critical because it is 'where the money is', where the anticipated growth is and where, at least in the Western world, the political battles are and will be waged.

At least in August 2022, technology M&A in the United States is robust compared to other sectors. Despite any further changes in regulation or monetary policy, compared to other sectors its prospects are, and will continue to be, relatively better.

Michael J Kennedy and Dana Kromm
Paul Hastings LLP
San Francisco
August 2022

Chapter 12

UNITED STATES

Michael J Kennedy and Dana Kromm[1]

I OVERVIEW

Overall M&A activity in the first half of 2022 fell substantially from comparable 2021 activity levels. In the first six months of 2022, US merger values dropped by approximately 35 per cent to US$827 billion compared with the 2021 first half amount of US$1.3 trillion.[2] The number of deals involving US companies fell approximately 25 per cent from comparable first-half 2021 numbers, with the second quarter showing a greater decline than the first. Of course, this decline is from a record-breaking full 2021, and 2022 will likely remain in the top five years even for M&A activity absent a disastrous second half. US M&A activity accounted for roughly 47 per cent of global M&A by value.

When looking at sector performance, the technology, media and telecom (TMT) sector accounted for roughly 47 per cent of North American M&A by value but suffered a percentage decline of approximately one-third from comparable 2021 figures.[3] Middle market deals with a value of US$251 million to US$5 billion dominated by number.

The technology sector has done remarkably well[4] on a comparative and absolute basis since the 'dot-com' bust. Its giants, Apple, Facebook, Microsoft, Amazon, Netflix and Google (FAANGM) continue to make significant acquisitions in 2022.[5] The private equity segment has been quite active, with many funds combining to accomplish mega-deals that neither could fully commit to alone, though activity levels and exits dropped in the second quarter of 2022, and that trend looks to continue in the third quarter of 2022. Special purpose acquisition companies (SPACS), the darlings of 2021, have fallen off precipitously from 2021 levels owing to poor performance, stock market declines and enhanced regulatory pressure from the Securities and Exchange Commission (SEC). There is growing evidence that venture capital is shifting capital away from technology 'growth' sectors, at least in additional round fundings, which could have a negative impact on the number of available targets for sale in

1 Michael J Kennedy and Dana Kromm are partners at Paul Hastings LLP. The authors thank and acknowledge all colleagues who contributed their time and expertise to this chapter, including Michael Wise, Sherrese Smith, Ziemowit Smulkowski, Jane Song, Daniel Stellenberg, Scott Flicker, Richard Horvath (partner Dechert LLP), Lindsay Sparks, John Gasparini, Erica Lee and many others.

2 See KPMG "Appetite for M&A Remains Strong Despite Economic Headwinds", June 2022.

3 See Ion Analytics – "First Half 2022" – Down at Halftime (data from Dealogic).

4 Albeit, with the Biden administration and other worldwide regulators mounting attacks on the antitrust, content regulation, privacy, data use and liability fronts which could affect the sector.

5 See, e.g., Microsoft's acquisition of Activision Blizzard; Google's acquisition of Mandiant; and Amazon's July 21, 2022 agreement to acquire One Medical.

the future. Despite the relative activity decline from the record 2021 year, in the first half of 2022 technology still accounted for the lion's share of all North American M&A by value, so it is the largest (but less 'hot') sector.

If anything, covid-19 (and its variants) has continued the acceleration of the digital, online and virtual transformation of Western society, with software and its necessary hardware infrastructure enabling a continuation of business on a scale unimaginable 20 to 30 years ago. A very large portion of these businesses and their employees, markedly in the technology sector, have been able to continue functioning relatively unscathed by working remotely and remaining connected enough to pursue and achieve their business plans. Software, social media, cybersecurity, remote access and virtual meeting companies have flourished during the covid-19 crisis, and these changes in behaviour will be lasting, as has been evidenced in Ukraine's defence against Russia. As of 30 July 2022, FAANGM accounted for 20.4 per cent of S&P 500's market capitalisation with a 13.6 per cent share of its forward earnings.[6]

It is not surprising that the telecom and media prongs of the TMT sector have also fared relatively well in 2022. A large portion of the digital world travels through telecom pipes and networks, and while the elixir of the melding of technology and content has never concluded its convergence into a separate business category (see the *Warner/Discovery* deal for an example of decoupling the segments), digital content streaming and content providers have all had a relative uptick as people get relief and entertainment at home, perhaps binge-watching while working remotely. Intense competition and advertising sensitivity in this sector will continue to put pricing pressure on Netflix and all other larger players.

Although technology has its own vulnerabilities in terms of high valuations, security, government regulation and the 'world should be smaller' political attacks, as has been the case since the 1920s, it will continue to take on a larger share of GDP, transform society and be subject to physical and political attack given its predominant role in Western society.

The technology sector is flypaper for political, activist and regulatory attention. In large part, the areas of interest or attack involve:

a relative size;
b privacy;
c importance of technology to the host country;
d cybersecurity (both from an offensive and defensive perspective); and
e the relevant company has too much political influence or control over speech (and filtering).

The relative size and influence prongs involve an age-old argument that large company X either stifles competition or, less analytically, is too big. On the political side, this generally involves congressional hearings where the main theme is, in effect, that Facebook or Google, etc., is 'just too big – let's break them up'. This is akin to earlier arguments in the 1980s about breaking up AT&T and to those in the 1990s about breaking up Microsoft. It is a particularly US habit to reflexively want to break up success stories.[7]

6 Yardeni.com, Industry Indicators: FANG GMs – 29 July 2022.
7 Note that Google and Facebook emerged during Microsoft's supposed dominance, and that Apple, which was at the time one of the companies noted as being destroyed by Microsoft, has done quite nicely.

A second area of sector vulnerability on the political and social side relates to the vast amount of data collected and stored in, and easily retrievable from,[8] the cloud's exponential repository of structured and unstructured information. In the United States (see Section X), there are 50 separate privacy regimes and federal privacy controls. In a paper world, to have a data breach someone had to steal or copy an actual piece of paper or, better yet, (from the spy's and movie producer's perspective) copy it with a tiny camera hidden in a pen. Today, users of technology voluntarily expose, share, publicise and give away vast amounts of information and expect it to remain private. The technology sector has to navigate the maze of collecting the data it does, informing its users of its policies and, at some level, telling and assuring users that 'their' data is safe. Given the inherent value of some of that information, this is impossible to achieve. Technology companies, and most Western companies of size, are always on the defence side of cybersecurity because, in effect, they have a treasure that others cherish, and invading the cloud does not generally involve taking or ruining someone's physical territory or assets.[9] While this is why security software and cybersecurity companies are doing well, it does not mean that a shift to the defender will occur. Acting offensively has its own risks.[10]

The expansion of both jurisdiction and funding for the Committee on Foreign Investment in the United States (CFIUS) under the Foreign Investment Risk Review Modernization Act (FIRRMA) of 2018 strongly delivered on the promise to create an even more robust foreign direct investment review environment in the United States and globally.[11] Most notable has been CFIUS's 'activist' approach to reviewing Chinese and other foreign investments in technology start-ups, including those not voluntarily notified to the CFIUS.[12] This development has been coupled with a proliferation – fuelled by pandemic-induced supply chain security concerns – of similar foreign investment screening mechanisms in other major economies, focused on protecting domestic technology and other critical industries from foreign influence.

For its part, the United States continues to ramp up supply chain security measures, including both the carrot of a US$52 billion-plus subsidies in domestic semiconductor manufacturing and the stick of restrictions against foreign content and, particularly, Chinese involvement in key technology and R&D sectors.

The unprecedented scope and scale of economic sanctions, export controls and financial restrictions unleashed by the United States and its allies in the wake of Russia's invasion of Ukraine heralds the West's major response to Russia's worldview. The major Western economies have undertaken a highly coordinated 'whole of governments' approach not previously thought possible to try to choke off technology, energy and industrial exports to and investments in Russia. Every agency of the US government is playing a role, ranging

8 31 July 2017, Richard Yhieme speaking to the DefCon 25 hacker conference said: 'Privacy is nonexistent. It does not exist in the way it existed. The 20th century framework in which we think about those things is effectively ending.'

9 Stuxnet, an alleged Israeli worm, reportedly ruined one-fifth of Iran's nuclear centrifuge capability using now ancient tactics compared to current ransomware attacks.

10 See Open Access Government (18 December 2019) 'Hacking back: the dangers of offensive cyber security'. In short, hacking back can be illegal: one can hack back (or be fooled in to hacking back) at the wrong target, can, for example, disable a power grid, or artificial intelligence used in hacking back can 'learn' bad behaviour. Attacking back also increases the odds of a more concerted counter-attack.

11 See Section V.

12 See Section V.

from the Treasury Department's Office of Foreign Assets Control and Financial Crimes Enforcement Network, to the Department of Commerce's Bureau of Industry and Security and to the Department of Homeland Security's Customs and Border Patrol, with the various divisions of the Department of Justice preparing to pursue enforcement actions against violators. The combined impact of the global economic contraction caused in part by the effects of the invasion and the complex global trade landscape created by increased regulation are formidable headwinds for cross-border technology M&A activity.

II YEAR IN REVIEW

Consistent with the general decline in M&A activity from 2021, mega-deals declined by a third in the first half of 2022 compared with 2021.[13] The largest include Microsoft's acquisition of Activation Blizzard (US$68.7 billion), Broadcom's acquisition of VMware (US$61 billion), Twitter's pending and uncertain acquisition by Elon Musk (US$44 billion) and Vista Equity Partners' acquisition, together with Evergreen Partners, of Citrix (US$16.5 billion). In the technology sector, software acquisitions continue to dominate deal volume. IT services, streaming, social media and e-commerce also remained active. The initial public offering (IPO) window slammed 'closed' in the technology sector as SPACS crashed and investors rotated out of growth stories primarily driven by inflation fears and concomitant effects on 'growth company' valuations.

In the United States, SPACS, which played an outsized role in M&A in general and a large role in the technology space in 2021, predictably crashed as the stock markets fell from their record high and the performance a SPAC-purchased targets lagged. A SPAC, glossing over a host of regulatory rules, is essentially a company that raises equity and then goes public on a securities exchange and with the SEC in the United States. It has no business other that seeking out acquisition candidates to purchase. Because SPACS are generally under a two-year deadline to find and close a target acquisition before losing equity funding, they are perceived to be aggressive bidders in terms of price. As a public company, a SPAC, which can pay for an acquisition in its own stock or cash, and more frequently, a mix, needs its own shareholder vote to approve a transaction. There were 589 SPAC IPOs in 2021; in the first half of 2022, there were 27 SPAC IPOs. As mentioned above, SPACS suffer from increased SEC actual and proposed regulation, a fair number are under investigation and that, coupled with the decline in equity markets, prompted many SPAC investors to demand redemption, which led to a decline in the SPAC stock prices. SPACS, as buyers, are unlikely to be a meaningful buy-side M&A force in the near future; they themselves will be potential targets if they purchased a viable business (albeit at a steeply discounted price from 2021 values).[14]

During at least the height of covid-19, US M&A lawyers were fearful, when on the 'sell side', that buyers could or would invoke a 'material adverse effect' clause to terminate or modify acquisitions agreements in the buyer's favour. Although there were some notable renegotiations, the US courts (in particular, the Delaware Court of Chancery) essentially took the position that covid-19 was not a material adverse effect (MAE) because its effects were not durationally significant (i.e., covid is a transitory phenomenon that does not per se affect long-term value). The US-style MAE clause continued its long-term evolution to prefer deal certainty by effectively excluding any covid-19 effect from the MAE definition, as well

13 PWC: Technology Deal Insights: Mid-year 2021.

14 FactSet Insight, U.S. IPO Activity Drops Dramatically in the First Half of 2022 – July 14, 2022.

as tax and operating covenants. The result of this practitioner conformity to deal certainty in any large deal is that any covid-19, pandemic or related effects are the buyer's risk unless expressly negotiated out of the contract.

III LEGAL AND REGULATORY FRAMEWORK

In the United States, federal law is overlaid onto the laws of each of the 50 states, so in any given transaction all 50 state laws could be relevant as well as federal law. The M&A market is further divided between companies that are publicly listed on the New York Stock Exchange, Nasdaq or over-the-counter market,[15] and those that are private.[16] Though somewhat of a simplification, private companies are not generally subject to the bulk of US securities laws, which are the 1933 Securities Act (the 33 Act) and the 1934 Securities Exchange Act (the 34 Act). Both public and private companies are subject to the laws of their state of incorporation.

The vast majority of sizeable companies, both public and private, are incorporated in the state of Delaware.[17] Delaware has developed a quite flexible and accommodating corporations code, and a very efficient commercial court, known as the Court of Chancery, that can hear and decide complicated business disputes in a timely manner. Over the past four decades Delaware has promulgated a number of decisions that set forth the principles that govern a company's and its board of directors' actions in the context of an acquisition.[18]

Although almost four decades old, the seminal Delaware case in the M&A context is *Smith v. Van Gorkom*.[19] The basic holding in *Van Gorkom* is that the board of directors of a selling corporation is entitled to the protections of the business judgement rule absent gross negligence on the part of the board (known as a breach of the duty of care) or a breach of the duty of loyalty. The business judgement rule is actually a presumption that a plaintiff must overcome to win its case. The presumption is that the board has acted in a manner to satisfy its duties. To satisfy its duty of care, the board must show that it was reasonably informed of relevant facts, essentially a process check that functionally requires creating a record of factual awareness and discussion. The duty of loyalty focuses more on the absence of conflicts of interests by the selling company's directors. There are various sub-lines (à la Chess) of cases putting extra glosses on this general rule in the context of hostile transactions, defensive actions and interested party transactions, but the general rule of *Van Gorkom* is the starting point of analysis.[20] Unlike many other jurisdictions, the Delaware Corporations Code allows

15 There are effectively the three market exchanges.

16 For our purposes, a company with publicly traded debt, but no publicly traded equity, is considered private.

17 Delaware also provides for general and limited partnerships (LPs) as well as limited liability companies (LLCs). Again, for commercial businesses of meaningful size, most would be organised as Delaware corporations unless, for non-public companies, particular legal or business reasons dictate a different choice.

18 See, e.g., 'Business Judgement Syllogism', *Mergers & Acquisitions in the High-Tech Environment*, PLI (1999), Michael J Kennedy.

19 *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985).

20 See, e.g., *Unocal Corp v. Mesa Petroleum*, 493 A.2d (Del. 1985); *Revlon Inc v. MacAndrews & Forbes Holdings, Inc*, 506 A.2d 173 (Del. 1986), *Paramount Communications, Inc v. Time Inc*, 571 A.2d 1140, 565 A.2d 280 (Del. 1989), *Paramount Communications Inc v. QVC Network Inc*, 637 A.2d 34 (Del. 1994) and *Corwin v. KKR Financial Holdings, LLC*, 125 A.2d 304 (Del. 2015).

51 per cent of the shareholders to generally decide the outcome of votes on a sale. There is an active plaintiff's bar in Delaware and other states that effectively polices compliance with the Delaware standards, as well as any federal laws.

In transactions where the buyer is issuing securities to the shareholders of the seller, the 34 Act requires that a proxy statement be given to the shareholders of the selling company. The proxy rules generally require an extensive description of the transaction (including a detailed description of the board process followed in reaching the decision to sell). Applying the same materiality standard as developed by federal courts, Delaware courts also have provided guidelines for the type of information to be disclosed in proxy materials to stockholders when voting on a transaction (including a private transaction). In general, the time frame to comply with these rules and to have a stockholders' meeting is three to four months. In friendly transactions involving public companies where a stock issuance is not exempt from the 33 Act, mergers are usually the chosen means of acquisition. It is also possible to do a public tender offer directly to the shareholders of the target, and this method is almost always used in hostile transactions. The 34 Act has a separate section of rules that apply to tender offers that generally mirror the information required in a proxy statement.[21] There is a slight potential timing advantage to a tender offer over a merger, but its main appeal is that it is an offer directly to the shareholders. These 33 Act, 34 Act and Delaware governance rules apply equally to technology and non-technology companies.

Under US federal law, any business combination above a certain size cannot be closed until a filing is made by both the buyer and seller under the Hart-Scott-Rodino Antitrust Act (HSR).[22] This filing is then reviewed by either the Department of Justice (DOJ) or the Federal Trade Commission (FTC) who can functionally approve a combination by letting the 30-day waiting period lapse or granting early termination during that 30-day period, make a second request[23] for additional information, or challenge the transaction in court or before an administrative judge. As a general matter, the standards used by the US antitrust authorities have historically focused on the impact of a transaction on consumers, although there is current momentum at both agencies to take a broader approach to assessing potential harms, consistent with how the European Union and many other jurisdictions have focused on impacts to competitors, as well as potential incentives to innovate and impacts on data sharing and privacy in merger reviews. Given the worldwide proliferation of home regime antitrust laws and the presence of technology companies in many jurisdictions, a key portion of any technology acquisition agreement is which jurisdictions to condition a deal's closing on obtaining antitrust approval. The accepted current custom is to specify a list of antitrust regimes that will act as closing conditions – and the buyer takes the risk of non-approval elsewhere. Jurisdictions with 'voluntary' notice regimes, such as the United Kingdom, can raise difficult judgement issues because, even though an antitrust filing is not required by law and, thus, is not necessarily a clear candidate for a closing condition, the relevant regulatory agency has the ability to call in a transaction for investigation. These countries need to be handled on a case-by-case basis. If the transaction is challenged, the authorities can easily add six months to more than a year to closing, which is often too much time for either technology company to wait.

21 See, generally, Section 14 of the 34 Act, and Regulation 14D.

22 The HSR dollar thresholds are adjusted annually.

23 A second request essentially is a subpoena demanding the production of all documents that bear on each company's competitive position and can be quite burdensome.

An emboldened and more active CFIUS has taken seriously its expanded powers under FIRRMA.[24] Mandatory filings, including for minority investments in critical technology companies, have combined with CFIUS's pre-existing voluntary filing regime and increased scrutiny of non-notified transactions that were not submitted for review to ensure that the US government is actively involved in screening foreign investment in the technology and other critical sectors for national security concerns. Early-stage investors, including investment funds with foreign participation, must now confront CFIUS risks in most deals in the technology sector. And the CFIUS is not acting alone. The Department of Commerce has signalled that it will start implementing new rules and procedures to review participation by 'countries of concern' (including China) in the supply chain for information and communications technology services.[25,26]

Finally, absent the myriad of other potential state and federal laws,[27] the basic underlying acquisition contract will be governed by state law. When indemnification is available, the remedies for breach of warranty, what constitutes a material adverse effect, what level of effort must a party use to satisfy a covenant, etc., are all questions of state law generally. Most US state laws are a mixture of statute and common law, and they can differ in applicable standards. For example, the Delaware and New York treatments of sandbagging differ materially,[28] which can be outcome-determinative in a dispute. Transactions involving public companies generally have no indemnities, while private company deals vary from absolute indemnities to none.

IV KEY TRANSACTIONAL ISSUES

i Company structures

Most publicly listed companies will be corporations, although some in the real estate or energy industries may be structured as master limited partnerships (LPs). In the private M&A market, most (by value) sellers and buyers will be corporations, but in this market there are more LPs and limited liability companies (LLCs). The primary difference between a corporate structure and a LLC or LP structure is tax. LPs and LLCs can in effect elect their treatment for US income tax purposes (either under default rules or the check-the-box regime). LLCs and LPs that are treated as either partnerships or disregarded entities (which are most LLCs and LPs) are not taxed on income for federal and most state laws – they are pass-through entities with no entity-level income tax. Corporations are taxed on income at the entity level. On the corporate, LLC and LP entity level, all three forms are fairly flexible in their use. Subject to any mandatory provisions imposed by the state of formation, these entities can provide for different classes of stock or equity interests in whatever manner, terms or priority as is desired by the parties. In the United States, then, the choice of entity is usually tax-driven. Although, in private transactions, entities structured as partnerships for income

24 See Section I and V, *infra*.

25 See CFIUS Reform under FIRRMA, Congressional Research Service (21 February 2020).

26 This goes beyond the current US–China battles. Essentially, covid-19 and its commercial impact has focused sovereign states on protecting what they have in a world where connectedness has suffered a setback or created its own threats.

27 Pension laws, sales tax, privacy laws, Federal Communication telecom approvals, etc.

28 Delaware adopts a moderate pro-sandbagging position. In New York, if a buyer knew of a breach based on seller disclosure it will not be protected unless the contract is explicitly to the contrary.

tax purposes (which can include LLCs and LPs) are generally preferred principally because of the single level of income tax that applies to their income and the ability to structure a future sale as, in effect, an asset sale for income tax purposes, there are also benefits associated with using corporations, and typically, foreign and tax-exempt investors can only invest in entities that are treated as corporations for income tax purposes or passive partnerships whose only assets consist of stock of corporations. For a publicly traded entity, subject to special industry issues, such as in real estate or oil and gas or energy, investors prefer a corporate structure because they do not have to be concerned about current income or loss associated with a security (which would be the case in a pass-through entity), but only the gain or loss from the sale of the security.[29,30]

ii Deal structures

Ignoring joint ventures, there are only four structures that are used to transact M&A: a merger; a stock purchase; tender offers (generally in the public setting); and asset sales.

Mergers

In public company acquisitions, the predominant form used is a statutory merger. In a transaction where the buyer is purchasing the target company for cash, the structure will be what is known as a reverse triangular cash merger. What this means is the buyer creates a new corporation (Newco), which then merges with and into the target corporation, and the shareholders of the target corporation receive cash in exchange for their shares. The end result is the target company becomes a wholly owned subsidiary of the buyer.[31] Under Delaware law, all that is required to approve a merger is a vote of 50.1 per cent or more of the outstanding voting shares of the target corporation, and all stockholders are then paid the deal consideration subject to a right to demand appraisal if available. It is possible to do direct mergers (of target corporation into buyer) or forward triangular mergers (seller into Newco), but these are rare and, if done, are always done for tax reasons.[32] Mergers can also be effected using a mix of cash and buyer stock consideration. In the private setting where the seller is a corporation and has numerous shareholders, a reverse triangular merger will usually be the choice of structure.

Stock purchase agreement

In the private setting, stock purchase agreements will sometimes be used in lieu of a merger agreement, especially if the number of sellers is limited. A stock purchase agreement is a contract between the buyer and each of the owners of the target corporation. Obviously, in a situation where one enterprise owns a subsidiary it wishes to sell or carve out, a stock purchase would be chosen because there is only one seller. Similarly, in tightly held or venture-type companies, it may be possible through the compressed ownership to have all stockholders sign a stock purchase agreement. Similarly, private equity-backed companies

29 More and more private transactions are structured with no contractual indemnities (other than for ownership and authority representations) given the availability of representation and warranty insurance.

30 Historically, most venture-backed technology companies have been established as corporations with common equity and a series of convertible-preferred stock issued to the venture investors. Private equity structures can be byzantine in structure involving on and offshore funds and co-investors.

31 See Section 251 of the Delaware General Corporation Law.

32 See Section 368 of the Internal Revenue Code.

are frequently structured so that all of the equity owners hold through a common holding company structured as an LLC and LP, and such holding company can act as a single seller in a share or unit purchase transaction and then distribute the sale proceeds to its owners. Often, however, the target corporation has grown (whether through option exercises or other issuances of shares) and has a diverse and large number of equity holders, even if only a few own the majority of shares. In this situation, particular stress is put on the drag-along provisions in either the organisational documents of the target corporation or shareholders' agreement.[33] Primarily for this reason, because under Delaware law mergers only require 50.1 per cent approval, a merger will usually be the preferred structure.

Tender offer

A tender offer is really just an offer to the public stockholders to enter into, in effect, a share purchase agreement. In the United States, tender offers are typically used in hostile transactions. This is because a tender offer is technically a direct offer by the buyer to each of the equity holders of the target corporation. Unlike a merger, a tender offer need not be statutorily approved by the board of the target, although the target board has ample defensive weaponry at its disposal.[34] The other situation where a tender offer might be advantageous is in a competitive situation where the 'high' bidder in the auction perceives a timing advantage to using a tender offer, whether for regulatory reasons or otherwise.

Asset sales

Asset sales happen a fair amount in the technology space. Large technology buyers will often buy the intellectual property (IP) assets of smaller or failing businesses. Asset sales are also not unusual in a bankruptcy or dissolution setting. The other primary context where an asset sale might be seen is where the seller corporation is selling a business entity at a loss to what it bought it for or has enough tax attributes to offset any tax gain. Finally, assets sales are common in carve-out transactions where a larger company is only selling a portion of its business or one of its business lines. Recall that corporations incur an entity-level tax when they sell an asset, so any disposition of asset sales proceeds to the selling entities' shareholders would be taxed again absent offsetting tax attributes if there were a gain.

iii Sale process structures

Any proposed technology company sale of a meaningful size will unusually involve a seller banker running a well-known process, although larger sellers, when disposing of a business unit or division, may run the process directly. As the market for technology companies has evolved over the past 30 years, it has become extremely efficient. There are very few proprietary deals, and sellers and buyers are heavily covered by investment bankers of all brackets, as well as, inter alia, private equity specialists and venture capital.

The typical process will start with a 'teaser' and outreach by a banker to a wide list of potential buyers. Any interested buyer then must sign a non-disclosure agreement if it

33 Typically, either in the private technology company's charter or in a stockholders agreement, there will be a drag-along contractual provision allowing, in effect, the controlling shareholders to force the other shareholders to sell (on the same terms as the controlling shareholders) – thus replicating the result that can be obtained in a merger regardless of the chosen structure.

34 The target board must give its recommendation for or against, or be neutral, and can always adopt a poison pill (a 'shareholders' rights plan') to negate any tender offer timing advantage.

wishes to participate in the auction. In a normal auction process, the interested parties will be invited to submit a first-round bid, indicating proposed value, management equity and deal certainty terms. After this, bankers and board cull the herd of potential bidders and there may be a round two, or open data room, with the goal of choosing a finalist. Recently (in the past five years), a number of technology bidders have chosen to try to pre-empt the process timing and put bids in early with a 'time fuse',[35] and have succeeded in pre-empting the auction, gaining exclusivity and winning.

In the technology sector, players seem to all be aware of each other, but can have drastically different views as to value that are generally not driven by synergies. In this sense, sell-side bankers play a large role in gauging each potential bidder's appetite and ability to pay and close. Under Delaware law, at least in public transactions, bankers play an important process role on the sell side, as *Van Gorkom* and its numerous progeny essentially dictate a fairness opinion by the sell-side banker. This fairness opinion has been the subject of intensive forensic dissection.[36] Unlike the era before 2001, accountants rarely disagree on the base treatment of a transaction, but they play a large role in how the buyer's equity structure will be built, as, for example, in a private equity purchase. The seller and buyer's lawyers play a large part in the process, both by being able to engage with multiple bidders, dealing with opposing counsel and, primarily in a public setting, understanding how the sale process will be viewed by the courts if challenged.

iv Acquisition agreement terms

Acquisition terms differ markedly between transactions involving public companies and those private companies being acquired by a public company.

Public transactions

Transactions between public companies can be for all stock of the buyer, a mix of stock and cash or cash only.[37] In a merger between two public companies, the representations and warranties will roughly be symmetrical, although if the buyer is substantially larger than the target, the buyer will likely give only basic representations. Typically, both sides' representations and warranties will be qualified by an MAE clause.[38]

The US-style MAE clause is typically structured to exclude any external financial market effect, acts of God, effects related to the announcement or pendency of the transaction, (now) any pandemic including covid-19, or any other event, save one that materially and adversely affects the business or financial performance of the target or the giver of the representation taking into account these exclusions. The MAE clause is admittedly at its core circular (except for the exclusions, and that is why the exclusion list keeps showing), and a recognised 'punt' by the parties to deal with an issue later if need be. Some agreements are more specific in defining an MAE by stipulating that, for example, unknown liabilities in excess of US$XX million constitute an MAE, but this type of provision is rare even in private deals, and rarer still in public transactions. Case law has put a gloss on the interpretation of the MAE clause

35 In effect offering a perceived high price that expires unless the auction is ended.

36 See, e.g., *Functional Fairness* (PLI 1999; Michael Kennedy).

37 A merger of equals would involve something like 50 per cent ownership by each company and could be structured by the formation and use of a new company to effectively own both companies.

38 Readers can view the *Forescout* MAE clause by going to 'sec.gov', typing in 'Forescout' in the Company filing box and reviewing Annex A to Forescout's proxy statement filed on 24 March 2020.

beginning with the *Tyson* case holding that a material adverse effect needs to be durationally significant. Only one Delaware decision post-*Tyson* has found in favour of a buyer invoking an MAE clause to terminate a transaction.[39] Because the representations and warranties in a public deal are MAE-qualified and stylised to a great degree, the real action, as it were, is in making sure that the accompanying disclosure schedule (which is not made public) adequately discloses any risk that could give rise to an MAE.

Pre-closing covenants typically address primarily: any operating constraints between signing and closing; the level of effort needed to obtain regulatory approvals; no-shop and go-shop provisions; the degree of general effort level to get the deal done (including financing cooperation); any remedial actions required; and employee treatment.

Operating constraints do not differ materially between technology and non-technology deals, though sometimes one sees restrictions on exclusive licensing or the extension of subscription periods – in general, these covenants require each party to continue to operate in the ordinary course of business, the level of efforts required to obtain regulatory approval and generally go to antitrust and CFIUS approvals.[40] The level of efforts required can range from best efforts to commercially reasonable to reasonable.[41] In any technology deal with a real risk (i.e., a foreign-controlled buyer), the standard would be effectively a best efforts clause accompanied by a meaningful reverse break-up fee if government approval were not obtained. On the antitrust side, there is no real difference in approval versus non-technology deals; the parties will negotiate the relevant standard, which may include best efforts, hell or high water, a disposition or sale threshold or litigation covenant, together with a reverse termination antitrust fee.[42] If anything, technology counterparties have been more willing to litigate with the government in those deals involving a large cap buyer, otherwise they tend to be terminable if the government puts up meaningful resistance (either by contract or by setting the outside date 'short' so as to not allow a meaningful fight).

Under Delaware case law, the target board in a public transaction will have a fiduciary out that allows it to change its recommendation of the transaction or to accept a higher offer from a third party, or both, after signing. The general flow of these provisions is essentially the same in all public deals whether involving technology, oil and gas or retail services. In effect, if the target board reasonably concludes that its fiduciary duties require it to do so, it can generally respond to incoming proposals and, if it finds a third-party proposal superior to the existing deal, terminate that deal and enter into the new deal, so long as it pays the termination fee.[43]

Where technology transactions differ from non-technology public company transactions is the treatment of equity incentive awards. Often a technology company will have a bewildering array of incentive equity, ranging from options, restricted stock units, phantom equity, long-term incentive plans that are tied to stock performance over some period of time, and other exotic forms of equity-based compensation triggered to, inter alia,

39 *Akorn, Inc v. Fresenius*, 198 A.3d 724 (Del. 2018).

40 Although now there are virtually no inbound Asian, or especially Chinese, transactions, prior to 2019 virtually all such deals had reverse break-up fees for CFIUS failure.

41 See, e.g., *'Best Efforts' Standards Under New York Law: Legal and Practice*, Glasser Legalworks 2004 (David Shine).

42 For an excellent analysis of antitrust reverse break-up fees, see Dale Collins' annual study at https://www.antitrustunpacked.com/?itemid=74.

43 These termination provisions almost always allow the initial buyer to match any higher bidder, and the match process can go multiple rounds.

the target stock price, returns on equity and multiples of capital thresholds and the domicile of the individual. Each one of these often has a different tax treatment, must be dealt with in the acquisition agreement and often have formulas that, kindly put, may have been understood when drafted but the passing of time often obscures how the particular incentive plan or unit is actually supposed to work. Because technology companies historically have a larger proportion of their capital structure in incentive equity than at base industrial companies, the complexities of dealing correctly with these incentive securities in the acquisition agreement are real.[44]

Although theoretically possible, no public company acquisition agreements have any general indemnities: essentially, the representations and warranties serve only as closing conditions and diligence items, and then with the MAE overlay. It is possible to layer in an earn out structure, but this has traditionally only been done in the biotech and pharma area.[45]

Private transactions

Transactions between private companies, or with a public company as a buyer of a private company, differ materially from public-to-public transactions.

Indemnity

Private transactions can mirror public transactions in having no indemnification, a 'public-style deal', but most will have some degree of indemnification. The areas of focus tend to be around ownership and infringement of IP, taxes, export and import control, security and privacy. IP indemnities can last for a limited time, or up to the statute of limitations. Often this has to do with issues related to ownership of the underlying technology, security breaches, compliance with certain laws, use of open-source software, whether employees have properly assigned inventions and whether that assignment works under local law.[46]

Indemnities for pre-closing taxes, primarily income or sales taxes, or related to the onshore or offshore structure of the ownership of the underlying IP are common by number in smaller transactions. The proper accounting, for example, for multi-year software customer deals can affect both tax and generally accepted accounting principles (GAAP) accounting. Complicated licensing structures and transfer pricing arrangements are common in the technology sector and can be called into question by any number of national and international authorities. In the United States, with its 50 sovereign states, the determination of whether an IP licence, subscription or commercial arrangement gives rise to a sales tax in one or more states is often a complex and uncertain inquiry.

US law restricts the export of certain types of technologies, ranging from certain blanket permitted types, types with restrictions (usually by prohibition to the 'exported to' country) or not permitted at all. The law is dynamic and complicated, and one often finds that a young technology company has not complied, perhaps, in all respects. Because the fines for non-compliance can be severe and press coverage adverse, technology buyers, particularly strategic buyers, focus intensely on export and import issues.

44 Often, the largest part (by words) of the purchase price section is the numerous sections dealing with incentive equity.

45 See, e.g., 'Paying Attention to Biotech M&A Earnout Payments' in Life Sci VC (22 February 2012).

46 It is more than a common occurrence that employee IP assignments are 'misplaced' or are only backward-looking and do not convey IP created during employment.

In deals involving software companies, there is always a question of whether the target company has complied with the open-source rules. Any sophisticated buyer will have done diligence on or have as a closing condition compliance with open-source requirements, and often adds a condition of remediation. This is also sometimes accompanied by some type of post-closing indemnity.

Fiduciary outs

Although there are exceptions, the fiduciary outs that are ubiquitous in public company deals are virtually non-existent in private technology deals. This is so because following the *Omnicare* case, almost all private deals are structured such that the requisite number of stockholders (those having the required voting power) approve the transaction immediately after the agreement is signed.[47] Under Delaware law, the board's fiduciary obligation to keep open the possibility of a better deal ends when the stockholders have approved the deal.[48,49,50]

IP

The IP reps (as to ownership, infringement, licensing, etc.) are highly negotiated in private deals, unlike in public deals where they tend to replicate themselves, and often also serve as the basis of a separate indemnity in private deals. Here, one has to deal with the issue of forthright disclosure in the disclosure schedules versus known facts and the desire of the owners to sell without any 'bad' disclosure, and without the possibility of an indemnity claim – two business desires that conflict. This is often the most difficult task that the general counsel of the target has to navigate.

Employees

In a big buyer, small target, transaction the buyer will often insist on a closing condition to the effect that a certain number of senior management be employed at closing or a certain percentage of employees agree affirmatively to be employed by the buyer, or both. The target should generally resist these seller requests because of the obvious moral hazard issue, but often some version of this construct is unavoidable. In that situation, the seller normally insists that the employees subject to the buyer's demand agree (by entering into a contingent employment agreement) with the buyer condition at signing, effectively removing it as a closing condition.

MAE

Historically, private targets were not able to obtain an MAE overlay on all of their representations and warranties. In the majority (by number) of private technology transactions, the target will not get an MAE overlay on the technology and compliance representations, or will do so

47 Typically, 50.1 per cent is all that is needed, in addition to any preferred stock class or series vote.

48 *Omnicare, Inc v. NCS Healthcare, Inc*, 2003 WL 1787943 (Del. 4 April 2003).

49 After *Omnicare*, in private companies with control shareholders, the shareholder vote is structured as a written consent without a meeting, so the vote happens in effect at signing of the agreement.

50 This also highlights the importance of having a well-drafted drag-along provision.

only to have that overlay be partially discarded for the purposes of indemnity obligations.[51] Where the announcement of a transaction might have a negative effect on the target, private technology companies succeed to a greater degree in excluding any negative effect from the MAE definition. For example, in a transaction where the buyer and seller overlap on the sale or product side, the target should never agree to a closing condition or materiality hurdle that does not exclude the effect of customers delaying purchases from the target to see how the deal plays.

v Financing conditions

Almost all private deals of any size will have a financing component as hence an implicit financing risk, as most will be for cash. It is extremely rare for any US deal to be actually conditioned on financing, and even rarer in the technology sector. As most technology deals are either a 'big' buying a 'small' or involve venture or private equity, historically these deals have been, and continue to be, financed with equity or from trusted ready-debt sources eager to lend to the technology industry.

vi Private equity

Starting from almost zero in the late 1990s, private equity buyout funds have become a major player in the technology M&A space. Initially inventing a growth (and negative accounting earnings) leverage buyout technology model, these funds have played a large part in the maturity, sophistication and efficiency of the technology M&A industry. Starting somewhat arbitrarily from Silverlake's acquisition by of Seagate in 2000,[52] these funds have multiplied, and have been successful not only because of financial management skills, but because of their core belief in technology's growth value. They occupy the area between public buyer and private seller, and being both, by definition, are serial buyers and sellers. When selling assets between themselves, they can do public style deals; when selling to large corporate buyers, they can accommodate some indemnity exposure, and when competing to buy a hot asset, they can eliminate or be aggressive about taking a regulatory risk. They generally do not have the horizontal merger risk that a straight-up merger between two direct competitors has, and although their deals almost always require debt financing, it is not at the levels that were required of classic late 1980s Wall Street levels. Moreover, the most successful of these funds have and market as an advantage their core operating abilities because they all have extensive operating knowledge of the relevant industry, dedicated operating principles to grow value and operating partners that provide services from recruitment to acting as temporary chief executive officers.

Because of the implicit nature of some level of debt financing in the acquisition agreement with a private equity buyer, there will usually be some minimum time period before

51 This effectively gives the seller certainty of closing if an MAE has not occurred but leaves it with an indemnity obligation with a lower level of materiality usually defined as losses in excess of a deductible – typically between 0.5 to 1 per cent of deal value. However, in larger private transactions, and almost always in sales involving a large private equity seller, there will be an MAE overlay.

52 The author represented Seagate.

closing where the fund buyer does not have to close to allow it to market the debt portion of the purchase price: rarely will the funding be a condition, and if for some reason the debt is not funded and specific performance is not available, there will always be break-up fee.[53]

Private equity buyers concentrate more on third-party advisers for diligence (accounting, IP investigative firms, insurance and benefit providers, etc.) so their areas of focus tend to be on earnings, cash flow and closing risks. They also tend to be much more focused on executive compensation, the degree of the incentive compensation pool and structuring the incentive pool to pay out only when return targets are achieved.[54,55]

vii Specific performance and damages

Since the early 2000s,[56] Delaware courts have granted specific performance of merger agreements. The general remedy approach in acquisition agreements involving a private equity buyer (and cash deals) has been to obtain equity and debt commitment letters that match the gross purchase price plus transaction costs and have the acquisition agreement provide that if all conditions to closing are satisfied (but for those to be satisfied at closing such as payment and other ministerial deliverables), the seller can then bring an action in Delaware to specifically enforce the acquisition agreement. In a transaction where the equity commitment does not equal the purchase price, this means that the debt providers too need to be willing to lend. For this reason, US debt commitment letters have *SunGard*[57] provisions that match the MAE and other provisions of the acquisition agreement.

Of course, most buyers will assert some breach by the seller or the occurrence of a MAE, or both, to bolster its claim that it does not have to close (see, e.g., *Forescout/Twitter*). In those circumstances, the issue of breach would be dealt with in a trial over whether the buyer's allegations were valid. Assuming the lenders were still bound by their commitment letters, or there is an equity commitment letter for the entire purchase price, then if the seller prevailed, the court would order specific performance and the deal would close.[58] The uncertainties of litigation sometimes result in the seller accepting a reverse termination fee or a renegotiated deal.

53 A reverse break-up fee, generally between 3 to 6 per cent of deal value, will often be used when the buyer is not willing or able to use equity for the entire purchase price. The fee functionally covers the situation where the debt providers do not fund when closing conditions are otherwise met.

54 Typical incentive pools cover between 8 to 12 per cent of the equity capitalisation on a fully diluted basis.

55 For the most part, simple equity options are no longer used. It is more common to see restricted (or quasi) stock units used, some of which vest over time and some only if certain return hurdles (IRR, multiple of capital returned, etc.) occur, so that management only makes money if the fund makes money above the hurdle.

56 For some early history on specific performance of merger agreements and merger agreement covenants, see 'The Challenges for Sellers in Obtaining Effective Remedies in M&A Transactions', Bloomberg BNA, Mergers & Acquisitions Law Report (3 September 2012).

57 See Section VI.

58 Assuming the lenders were still committed.

In a situation where the buyer is willing to fund its equity commitments but the lenders wrongfully refuse to fund, then the buyer would be required to pay the reverse termination fee. The drafting of these provisions and their interplay, although in use for over 20 years in the modern form, are not works of art or examples of clarity of exposition.[59]

One cannot get both specific performance and a reverse termination fee, and the reverse termination fee is the cap on damages.[60]

All of the fiduciary duty, damages, proxy disclosure, potential conflicts between types of investors (private equity and management), specific performance availability and pace of modern transactions require a high degree of familiarly with Delaware law and, in turn, have forced Delaware law to evolve. The past half-decade has seen a shift in Delaware jurisprudence with likely far-reaching consequences.[61] The Delaware courts have placed protective signposts that offer companies, directors, stockholders and acquirers greater certainty through two critical developments: greater judicial deference to deals where agency concerns have been mitigated and to the freedom to contract.

Greater judicial deference in stockholder litigation

The most significant development in Delaware law is the concerted effort to give greater deference to transactions negotiated at arm's-length, provided that the parties adopt appropriate procedural safeguards that mitigate agency risks. These safeguards have a common focus on director independence, disclosure and process.

Restoring the business judgement rule to public company sales

Delaware law unequivocally states that the business and affairs of a corporation are managed by the board of directors, not the stockholders.[62] Delaware law gives great deference to the decisions of independent directors.

Most US transactional lawyers are facially familiar with *Revlon* 'duties' – when a company is put up for a sale that would lead to a change in control, the directors are to try to obtain the best price 'reasonably available' for stockholders.[63] While these *Revlon* 'duties' do not change the fundamental duties of care and loyalty in the business judgement rule, they impact how Delaware courts review a transaction resulting in a change in control. Instead of the deferential business judgement rule, where directors are presumed to act with due care and in the best interests of the corporation, *Revlon* arguably (but incorrectly) requires directors to prove they satisfied a duty to somehow maximise stockholder value.[64] The *Revlon* framework posed its own challenges. By inviting a court to enquire into the director decision process, *Revlon* deviated from Delaware's foundational principle of director primacy. And

59 They often have multiple 'notwithstanding any other provision. . .' overrides that are difficult to parse. Both the MAE and specific performance clauses are a part of the Twitter/Elon Musk dispute as of the date of this chapter. Because that involves ongoing litigation, we have not offered any comment on the Twitter case.

60 The banks will also assume that the reverse fee is the damage cap and get their exposure similarly capped for potential tort exposure by inserting *Xerox* provisions.

61 See, for prior shifts, *Moran v. Household International, Inc*, 500 A.2d 1346 (Del. 1985); *Revlon, Inc v. MacAndrews & Forbes Holdings, Inc*, 506 A.2d 173 (Del. 1986); *Unocal v. Mesa Petroleum Co*, 493 A.2d 946 (Del. 1985); *Unitrin, Inc v. American General Corp*, 651 A.2d 1361 (Del. 1995); *Paramount Communications, Inc v. QVC Network, Inc*, 637 A.2d 34 (Del. 1994).

62 8 Del. C. §141(a).

63 *Revlon*, 506 A.2d 173; *QVC*, 637 A.2d 34.

64 *QVC*, 637 A.2d at 45.

because directors were essentially required to prove they satisfied their duties, *Revlon* made it difficult to obtain a pleading stage dismissal. The Delaware Supreme Court addressed this problem in *Corwin v. KKR Financial Holdings, LLC*.[65]

Corwin restored the business judgement rule for many transactions. First, *Corwin* generally applies outside of conflicted transactions with controlling stockholders.[66] Second, *Corwin* provides that the informed and uncoerced vote of a majority of disinterested stockholders restores the protection of the business judgement rule, protecting the directors' approval of the transaction from judicial review.[67] Practically, unless a stockholder alleges at the pleading stage a material omission or misstatement in the relevant proxy materials or offering documents, *Corwin* requires the dismissal of a complaint.[68]

Corwin's effect has been significant. *Corwin* fully restored the pleading stage protection of the business judgement rule for transactions negotiated at arm's-length between disinterested boards. It also goes a step further. Even if a transaction is approved by interested directors (and without a controlling stockholder), *Corwin* extends business judgement rule protection upon the disclosure of the purported conflicts, which are often technically present in many technology deals because of tiered capital structures or cross-ownership or dual customer and provider relationships.[69]

A path to deference for controlling stockholder transactions

For many years, controlling stockholder transactions presented a challenge in Delaware. The reason is simple. A controlling stockholder stands on both sides of a transaction and poses a potential undue influence over the value or procedural fairness of the process.[70] Delaware courts have historically reviewed controlling stockholder transactions pursuant to the entire fairness rule, requiring directors to prove the fairness of both the process and the price of a transaction.[71] Because fairness is a fact-intensive question, these cases were not subject to dismissal at the pleading stage and required courts to engage in after-the-fact judicial second guessing – a task Delaware judges reluctantly performed.[72]

In 2014, the Delaware Supreme Court spoke. In *Kahn v. M&F Worldwide Corp (MFW)*, the Delaware Supreme Court established a process whereby, before any substantive economic negotiations take place, the parties can agree that the transaction will be pre-conditioned on the uncoerced approval by an independent special committee of the board and a majority of the disinterested stockholders.[73] Doing so replicates the benefits of arm's-length negotiations and could subject any lawsuit challenging the transaction to dismissal pursuant to the business judgement rule.[74] Since it was decided, Delaware courts have frequently addressed *MFW*'s

65 125 A.2d 304 (Del. 2015).

66 *In re USG Corp S'holder Litig*, 2020 WL 5126671, at *14 (Del. Ch. Aug. 31, 2020).

67 id. at *13.

68 id. at *2.

69 *Larkin v. Shah*, 2016 WL 4485447 (Del. Ch. Aug. 25, 2016).

70 *Tornetta v. Musk*, 2019 WL 4566943, at *4 (Del. Ch., Sept. 20, 2019).

71 If the transaction was approved by disinterested directors or a majority of minority stockholders, the court could shift the burden of proof from the directors to the plaintiff challenging the transaction. *In re Cox Communications, Inc S'holders Litig*, 879 A.2d 604, 616 (Del. Ch. 2005) (citing *Kahn v. Lynch Communication, Inc*, 638 A.2d 1110 (Del. 1994)).

72 id. at 606-07.

73 88 A.3d 635 (Del. 2014).

74 id.

requirements and continue to offer guidance, including for non-merger transactions.[75] While its requirements are rigorous, a conservative application of *MFW* should be always considered, particularly where corporations have stockholders who, while not holding a majority of shares, have sufficient power to exercise actual control. *MFW*'s potential gift – an early dismissal avoiding the cost of further litigation – is worthy of close consideration.[76]

De facto deference to transaction price in appraisal

Delaware law has a third layer of certainty for transactions, this time in appraisal actions. Appraisal litigation creates the same problems previously posed by *Revlon* and controlling stockholder transactions: a properly perfected appraisal case requires a judicial determination of the fair value of the sold company plus statutory interest. In most circumstances, an appraisal petition is not subject to a pleading stage dismissal. While Delaware law has not changed to allow a pleading stage dismissal of an appraisal petition, both the Delaware legislature and the Delaware Supreme Court have taken steps to remove many of the economic incentives that have driven appraisal litigation in the past.

First, in 2016, the Delaware legislature amended the Delaware Corporation's Code to provide that the surviving corporation (or its parent) in a merger could prepay an appraisal award to the dissenting stockholders. By prepaying, the surviving corporation can avoid the statutory pre-judgment interest on the value of the prepaid amount, removing a major economic incentive that had led to appraisal arbitrage.[77] Second, starting in 2017, the Delaware Supreme Court issued a series of opinions that gave appraisal litigants an *ex ante* expectation of what a final appraisal award would likely be.[78] While not recognising a presumption, the Delaware Supreme Court held that the deal price, less synergies, is a strong indicator of fair value when a process in which interested buyers all had a fair and viable opportunity to bid.

The prepayment option combined with the predictability of deal price for appraisal valuation offers certainty for three reasons. First, by treating a fairly negotiated merger price as the strongest evidence of fair value, courts can avoid the judicial second-guessing inherent in a valuation conducted years after a merger closes. Second, to determine whether the merger price, less synergies, is a strong indicator of fair value, the Court of Chancery has signalled it will review a merger process similar to how it would conduct a *Revlon* analysis,[79] thereby incentivising companies and their advisers to follow the same processes that have been developed over the past 40 years. Third, treating the negotiated merger price as the best evidence of fair value gives the surviving corporation an easy way for determining the prepayment amount if it wishes to eliminate statutory interest charges.

75 See, e.g., *Flood v. Synutra*, 195 A.3d 754 (Del. 2018); *Olenik v. Lodzinski*, 208 A.3d 704 (Del. 2019); *Salladay v. Lev*, 2020 WL 954032 (Del. Ch., Feb. 27, 2020); *Tornetta*, 2019 WL 4566943.

76 Cf. *Cox*, 879 A.2d at 606-07.

77 If the surviving corporation overpays, however, and the Court of Chancery awards a lesser amount than what was prepaid, the surviving corporation is not entitled to a refund of the amount overpaid. See *In re Appraisal of Panera Bread Co*, 2020 WL 506684 (Del. Ch. 2020).

78 *Verition Partners Master Fund Ltd v. Aruba Networks, Inc*, 210 A.3d 128 (Del. 2019); *Dell, Inc v. Magnetar Global Event Driven Master Fund Ltd*, 177 A.3d 1 (Del. 2017); *DFC Global Corp v. Muirfield Value Partners*, LP, 172 A.3d 346 (Del. 2017).

79 *In re Stillwater Mining Co*, 2019 WL 3943851, at *24 n.13 (Del. Ch. Aug. 21, 2019).

Curtailing frivolous merger litigation

After *Corwin* and *MFW*, Delaware courts took an additional step to curtail stockholder litigation. Since at least the Court of Chancery's decision in *In re Transkaryotic Therapies, Inc*,[80] stockholder plaintiffs challenged merger transactions before the scheduled stockholder vote. The reasoning had been that the best way to address disclosure violations in merger proxy materials was to rule on the adequacy of those disclosures before the vote.[81] This well-intentioned reasoning led to a boom in needless merger disclosure litigation.

In the years after *Transkaryotic*, almost every public company merger valued at more than US$200 million was challenged by a stockholder class action complaint alleging that proxy or information disclosure was deficient. Chancellor Bouchard put an end to this practice in *In re Trulia Stockholder Litigation*.[82] In *Trulia*, Chancellor Bouchard positioned Delaware courts so that they would no longer approve disclosure-only settlements.[83] The effect was immediate: a sudden drop-off of disclosure complaints being filed in the Court of Chancery.

Where did these disclosure complaints find their home? First to US state courts, until many companies adopted forum by-laws requiring state corporation law claims to be brought in the Court of Chancery.[84] Now these disclosure claims are brought on an individual basis in the United States district courts pursuant to Section 14 of the 34 Act, which, given the general supremacy of federal law in the United States, state law forum by-laws are powerless to stop. In response, targets sometimes issue supplemental disclosures that moot the Section 14 claims and then pay a mootness fee to the stockholders' counsel.

Pending amendment to the Delaware General Corporation Law will provide additional certainty

A recent, concerning trend in merger litigation has been plaintiffs bringing disclosure claims arising from proxy materials against the officers of Delaware corporations. Plaintiffs' attorneys brought these claims because the organisational documents of most Delaware corporations exculpate directors from monetary liability for claims for breach of the fiduciary duty of care, as is permitted by Delaware statutes. On the other hand, officers to date were not the effective beneficiaries of this statutory protection. Thus, if a plaintiff pled a technical misstatement in a proxy statement (e.g., failing to accurately summarise a term in the merger agreement), the officers who signed or prepared the proxy statement could face potential monetary liability for a breach of the duty of care and, because of contractual or organisational document provisions indemnification obligations, such monetary liability could also be a liability of the buyer.

The Delaware General Assembly recently took action to close this potential avenue of merger litigation. The assembly passed an amendment to the Delaware General Corporation Law permitting stockholders to exculpate officers from breaches of the duty of care for stockholder claims brought directly against the officers.[85] That amendment is awaiting action

80 954 A.2d 346 (Del. Ch. 2008).

81 id. at 362.

82 129 A.3d 884 (Del. Ch. 2016).

83 id. at 896-98.

84 See *Boilermakers Local 154 Retirement Fund v. Chevron Corp*, 73 A.3d 934 (Del. Ch. 2013).

85 The amendment would not permit officers to be exculpated from duty of care claims either brought by the company or derivative claims brought on the corporation's behalf by its stockholders.

from the governor of Delaware. If the amendment becomes law, one can expect that newly formed corporations will include these provisions in their organisational documents and existing ones will seek stockholder approval to include these protections.

Offering certainty through contract

Delaware courts have also increasingly deferred to a freedom to contract regardless of the consequences that may be visited on a less-than-careful commercial party.

The Court of Chancery decision in *Vintage Rodeo Parent, LLC v. Rent-A-Center, Inc.* exemplifies how a Delaware court will hold a sophisticated party to its contract even if a mistake has been made.[86] The issues in *Vintage* were elegantly simple: Vintage entered into a merger agreement to acquire Rent-A-Center; the merger agreement included an end date that could be extended by either party by three months if antitrust approval were still pending; if the end date were reached without an extension, however, then either party could terminate the agreement. Shortly before the end date, Rent-A-Center's board determined that it was no longer in its interest to close the transaction; and after Vintage mistakenly failed to extend the end date before the agreement's expiry, Rent-A-Center terminated the agreement.[87] The court held these sophisticated parties to their 'heavily negotiated' agreement and affirmed Rent-A-Center's termination of the agreement despite Vintage's clear mistake in failing to properly extend the end date.[88]

In addition, while Delaware is well known for having a firm public policy against frivolous fraud claims, '[i]t is equally true that Delaware prides itself on having and adhering to a body of efficient commercial laws and precedent in which sophisticated contracting parties' voluntary agreements are enforced as written'.[89] Thus, Delaware courts routinely enforce a sophisticated party's contractual agreement that it did not rely on non-contractual statements when entering into an agreement even if enforcing such anti-reliance provisions requires the dismissal of nominal fraud claims.[90,91]

Finally, of recent importance has been the high burden that Delaware courts impose on buyers attempting to terminate merger agreements because of a purported MAE.[92] To date, only one Delaware case has permitted a buyer to exit a merger agreement based on the occurrence of an MAE.[93] In that case, the target experienced a significant year-over-year 51 per cent decline of its adjusted EBITDA[94] and had misled the Food and Drug

86 2019 WL 1223026 (Del. Ch. Mar. 14, 2019).

87 id. at *1-2.

88 id. at *3.

89 *Infomedia Group, Inc v. Orange Health Solutions, Inc*, 2020 WL 4384087 (Del. Super. July 31, 2020).

90 id.; see also *Collab9*, *LLC v. En Pointe Technologies Sales*, LLC, 2019 WL 445412 (Del. Super. Sept. 17, 2019); *ChyronHego Corporation v. Wight*, 2018 WL 3642132 (Del. Ch. July 31, 2018).

91 See also *Oxbow Carbon* at 202 A.3d 482 (Del. 2019) for the court's refusal to use the covenant of good faith and fair dealing to fix a mistake.

92 *Hexion Specialty Chems, Inc v. Hunstman Corp*, 965 A.2d 715, 739 (Del. Ch. 2008); *In re IBP, Inc S'holders Litig*, 789 A.2d 14, 68 (Del. Ch. 2001).

93 *Akorn, Inc v. Fresenius Kabi AG*, 2018 WL 4719347 (Del. Ch. Oct. 1, 2018).

94 Earnings before interest depreciation and amortisation.

Administration about data integrity issues.[95] Outside of these extraordinary facts, Delaware courts have remained steadfast in denying buyers' attempts to terminate deals based on the purported existence of an MAE.[96]

Despite the difficulty of proving an MAE, however, there was an initial flurry of litigation in the months after the start of the covid-19 pandemic related to busted deals and the assertion of MAEs. The filing of such litigation has abated, with many of the cases filed being voluntarily dismissed.[97] Only a small number of the covid-related busted deal cases have resulted in a judicial determination of the merits, albeit partially.[98] Echoing the self-inflicted wound of Vintage (see above), Realogy attempted to force the closing of the sale of its Cartus Corporation subsidiary to SIRVA Worldwide. This attempt failed because of Realogy's unforced error. Specifically, Realogy filed suit not only against SIRVA, the purchaser of Cartus, but also against the funds that owned SIRVA. Vice Chancellor Zurn held that, pursuant to the unambiguous language of the transaction documents, the naming of the funds as defendants 'automatically and immediately' terminated the funding conditions that were a prerequisite to specific performance.[99] Because of its mistake, Realogy could not force SIRVA to close the deal, once again demonstrating that Delaware courts will apply the unambiguous language of a contract notwithstanding the economic results that may follow.

The court's order approving the termination of the acquisition of luxury hotel properties by MAPS Hotels from AB Stable demonstrated the differences between MAE clauses and ordinary course covenants.[100] MAPS sought to terminate the then-pending acquisition based on, among other factors, a breach of a MAE provision because of the extraordinary impact the pandemic had on the hotel properties, and a failure of an ordinary course covenant as a result of the hotels deviating from their historic business practices. The court rejected MAPS' MAE argument, finding that the pandemic and its effects, as a natural disaster or calamity, was excluded from the parties' definition of a MAE. The court, however, accepted the argument that the decision to shutter the hotels and their restaurants, to lay-off employees, and to reduce services constituted a deviation from the hotels' past practices of conducting business, particularly where those actions were taken before any government orders issues mandating those restrictions. It did not help *AB Stable*'s case where the court noted a number of instances when AB Stable failed to disclose important facts to the buyer. While other court decisions have since rejected attempts by buyers to invoke MAE or ordinary course provisions to get out of a deal, the AB Stable decision highlights the different allocation of risks between the buyer and seller through MAE and ordinary course covenants, and why careful consideration must be given not only to the drafting of MAE clauses and other covenants, but also to how to communicate with a buyer that arise after signing and before closing.

95 See footnote 94.

96 *Channel Medsystems, Inc v. Boston Scientific Corp*, 2019 WL 6896462 (Del. Ch. Dec. 18, 2019); *Hexion Specialty Chems, Inc v. Hunstman Corp*, 965 A.2d 715 (Del. Ch. 2008); *Frontier Oil v. Holly Corp*, 2005 WL 1039027 (Del. Ch. Apr. 29, 2005); *In re IBP, Inc S'holders Litig*, 789 A.2d 14 (Del. Ch. 2001).

97 See, e.g., *Bed Bath & Beyond, Inc v. 1-800-Flowers.com, Inc*, C.A. No. 2020-0245-VCG; *Oberman, Tivoli & Pickert, Inc v. Cast & Crew Indie Services, LLC et al*, C.A. No. 2020-0257-PAF; *Realogy Holdings Corp v. SIRVA Worldwide, Inc*, C.A. No. 2020-0311-MTZ; *SP VS Buyer, LP v. L Brands, Inc*, C.A. No. 2020-0297-JTL; *Forescout Technologies, Inc v. Ferrari Group Holdings, LP*, C.A. No. 2020-0385-SG.

98 See *Realogy Holdings Corp v. SIRVA Worldwide*, 2020 WL 4559519 (Del. Ch. Aug. 7, 2020).

99 id. at *7-8.

100 *AB Stable VII LLC v. MAPS Hotels and Resorts One LLC*, C.A. No. 2020-310-JTL.

viii Financing

Technology M&A transactions are financed with debt or equity or a blend of both. If debt is used to fund an acquisition, lenders typically require an equity contribution equal to at least 30 to 50 per cent of the total capitalisation of the target company, which is calculated to include the aggregate amount of debt and equity (including the value of rollover equity) used to fund the acquisition.

Debt financings usually include a term loan facility, the proceeds of which are used to fund the acquisition consideration and transaction expenses, and a revolving loan facility, which is typically available up to an agreed-upon amount at closing to fund transaction expenses and otherwise available after closing to fund working capital and for general corporate purposes. These revolving credit facilities are customarily cash flow revolvers that are not subject to a collateral borrowing base (but, depending on the market, may be subject to a leverage covenant, which will restrict borrowings to an amount not causing the borrower to exceed an agreed upon debt-to-EBITDA or annualised recurring revenue ratio). Credit facilities for technology companies may also include a delayed draw loan facility, which allows the borrower to draw down additional term loans during an agreed period post-closing (typically not longer than 24 months) primarily used to fund growth capital expenditures and permitted acquisitions.

Maintenance financial covenants are financial covenants that are tested as the end of the fiscal month or quarter. A substantial portion of larger syndicated deals do not include a maintenance financial covenant, which are referred to as covenant-lite loans deals. Maintenance financial covenants may include a leverage covenant, interest covenant, fixed charge covenant and liquidity covenant. In technology deals, lenders may agree to test annualised recurring revenue to debt for purposes of the leverage financial covenant in lieu of testing EBITDA-to-debt, depending on the growth stage of the borrower.

Unless the debt is investment grade, the debt financing will typically be secured by a lien on substantially all of the assets of the borrower and, subject to certain tax and other legal and cost considerations, its wholly owned subsidiaries. The perfection of these liens at closing are customarily limited to liens that may be perfected solely by the filing of a financing statement under the applicable Uniform Commercial Code (every US state has its own version), a pledge of the equity interests of the borrower and any guarantors located in the United States to the extent any certificates evidencing such equity interests are readily available and, in certain cases, the filing of short form IP security agreements with the United States Patent and Trademark Office (USPTO) and the United States Copyright Office.

In the event that a transaction is funded with debt financing and is subject to an acquisition agreement that contemplates a separate signing and closing, the acquirer will need to obtain a debt commitment letter, an executed copy of which is typically required to be delivered to the seller at the signing of the transaction. The debt commitment letter should provide that the lender, or syndicate of lenders, commits to fund the debt financing at closing of the acquisition subject to the satisfaction of the expressly stated conditions precedent contained in the letter. If the acquisition agreement does not have a buyer financing condition (which excuses the buyer from consummating the transaction if debt financing is not available and is extremely rare), then the debt commitment letter should include *SunGard* provisions, which came about in response to the removal of the buyer's financing condition in most large acquisition agreements.[101] *SunGard* language is common in acquisition debt commitment letters and should provide that the only lender conditions at closing will be:

a those representations and warranties relating to the target in the acquisition agreement that, if they cannot be satisfied on the closing date, would allow the buyer to terminate the acquisition agreement (effectively incorporating the MAE condition in the acquisition agreement);

b certain specified representations and warranties set forth in the credit agreement that are in the control of the buyer (and typically do not relate to the operation of the target business); and

c the perfection of liens at closing will be limited to filings of financing statements under the Uniform Commercial Code, and perfection of equity pledges and all other perfection steps (such as execution and delivery of control agreements and mortgages) will be permitted to occur post-closing (typically within 30 to 90 days after closing).

To remove the conditionality of the debt financing buyer requires the arrangers of the debt financing to approve the form of acquisition agreement and related disclosure schedules. The debt arrangers' review of the acquisition agreement is customarily focused on the provisions relating to the financing, such as timing of closing, the obligations of the target to assist with obtaining the financing, and the MAE definition (as this definition is typically used in the no material adverse change condition in the debt commitment letter). In addition, the debt arrangers will require that the acquisition agreement include certain lender protective provisions in the acquisition agreement. These provisions are commonly referred to as the Xerox provisions, as they were first publicly used in Xerox Corporation's 2009 merger with Affiliated Computer Services, Inc.[102] The *Xerox* provisions are intended to protect the debt financing sources from becoming the subject of litigation by the seller in the event the acquisition does not close, and require that any actions against the debt financing sources relating to the acquisition will be brought in the venues (almost universally New York) agreed to by the debt financing sources in the debt commitment letter.

ix Tax and accounting

Tax considerations always influence the structuring of technology transactions. These considerations include:

a the structure of the acquisition vehicle;

b whether to structure the transaction as an equity transaction or an asset transaction;

c the tax treatment of any equity or deferred consideration issued to the sellers;

d whether the acquisition provides an opportunity to optimise the tax structure of the target and its subsidiaries;

e the placement of acquisition financing in the structure;

101 These certainty of funds provisions are referred to as *SunGard* provisions as they were first used in the 2005 debt commitment letter issued in connection with the acquisition of SunGard Data Systems. A copy of this debt commitment letter can be found at https://www.sec.gov/Archives/edgar/data/789388/000119312505074184/dex99b1.htm.

102 A copy of the agreement and plan of merger, dated 27 September 2009, by and among Xerox Corporation, Boulder Acquisition Corp and Affiliated Computer Services, Inc, can be found at https://www.sec.gov/Archives/edgar/data/108772/000119312509199142/dex21.htm.

f monetisation any of the target's existing tax attributes;
g the indemnity for the target's historical tax exposure;
h addressing tax exposures identified in due diligence; and
i structuring incentives for management.

A US strategic buyer buying a US target will typically not need to form a new acquisition vehicle to effect an acquisition; it will frequently use one of its existing US entities to act as the buyer in the transaction. The one exception is a transaction structured as a merger, in which case the buyer entity will typically form a transitory merger subsidiary that will merge into the target with the target shareholders receiving a mix of cash and potentially other consideration (all stock deals are also possible) and the target acting as the surviving entity in the merger.

In the case of a US private equity fund or other financial buyer, a structure will be created below the fund into which the financial buyer will make its investment. A threshold question with these structures is whether it will be a pass-through structure down to the operating company level or a structure where there is a corporation (or an entity treated as a corporation for US tax purposes) between the operating business and the investment by the financial buyer. In the United States it is much more common to have operating businesses structured as pass-throughs in part because the US rules allow entities that have corporate characteristics such as an LP or LLC to be treated as partnerships for income tax purposes. There are benefits and detriments to both kinds of structures and there is no unified view among financial buyers as to the preferred structure. The main advantage of a pass-through structure is a single level of tax on any operating income and the ability to deliver a step-up in the tax basis of the target's assets to a future buyer that can be depreciated and amortised by the buyer for tax purposes. The main advantage of a corporate structure is simplicity and a lower tax rate on operating income. Another tax-driven reason for using a corporate structure (and this is frequently the case in the technology space) is that initial shareholders of certain start-up corporations that hold their shares for more than five years can also exclude a portion of their gain on sale from taxable income resulting in a zero per cent tax rate. A corporate structure may also be required where the investors include foreign or tax-exempt investors as they face adverse tax consequences if they invest in pass-through structures. Practically, because companies in the technology space are frequently structured as corporations from inception, there may not be an opportunity to structure an investment as a pass-through structure because while a conversion of a pass-through structure to a corporate structure can typically be accomplished without a tax cost, a conversion from a corporate structure to a pass-through structure under most fact patterns results in a significant tax liability. Even if a pass-through structure all of the way down to the operating business is not desired or not possible, a pass-through vehicle such as an LLC or an LP may be used at the very top of the structure to facilitate a future exit and allow for tax-efficient management incentives.

From a buyer's perspective, structuring an M&A transaction as an asset purchase for income tax purposes is generally the most tax-efficient structure as it creates a step-up in the basis of the target's assets up to the enterprise value of the target adjusted for any tax-deferred rollover by the sellers. The majority of any step-up is typically amortised for tax purposes over 15 years (i.e., the US amortisation period for intangible assets acquired a part of an acquisition of a business) although allocation to some assets can create a full benefit in the year of the transaction. Even where the target is a foreign entity and, therefore, usually not subject to US taxation, structuring the acquisition as an asset purchase for income tax purposes should help from a US income tax perspective by reducing the buyer's global tax rate and also make US tax compliance with respect to the foreign target easier, and the sellers, especially if they are foreign, may be totally agnostic regarding the structuring required to achieve asset sale treatment. For a buyer to obtain the tax benefits of an asset purchase, the actual M&A transaction does not have to be structured as an asset purchase from a corporate law perspective, and there are frequently a number of non-tax and even tax reasons for structuring a transaction as an equity purchase for corporate law purposes. Instead, the US tax rules provide that a number of equity transactions for corporate law purposes can be treated as asset purchases for income tax purposes. Depending on the underlying transaction, such deemed asset purchase treatment can be automatic, or require the buyer or both the buyer and seller to make a specific tax election, or require the seller to engage in pre-closing restructuring. Such elections include elections under Sections 336(e), 338(g), 338(h)(10) and 754 of the US Internal Revenue Code. Because such elections and pre-closing restructuring of a target can create significant value for a buyer but can also be detrimental to sellers and require sellers' cooperation, it is key that the opportunity for any elections or pre-closing restructuring is identified early in the M&A process, and that the parties affirmatively address the possibility of making elections early in the process.

From a sellers' perspective, structuring an M&A transaction as an equity purchase (which is also treated as an equity purchase for income tax purposes) is generally the most tax-efficient structure as it typically results in any gain being taxed at currently favourable capital gains rates. Depending on the structure of the target and other facts, structuring a transaction as an asset purchase (or a transaction that is treated as an asset purchase for income tax purposes) can result in significant additional tax to the sellers. Although that is not always true, for that reason (and various non-tax reasons) sellers will usually want to structure their M&A transactions as a sale of equity.

In the case of financial buyers and to a lesser extent in the case of strategic buyers, the consideration for a target will frequently include non-cash consideration. Non-cash consideration can include rollover equity issued by the buyer or a buyer parent entity, seller notes and earn outs. From a seller's perspective, the main tax issue with receiving any non-cash consideration is deferring the recognition of the associated income until a future liquidity event to avoid creating a tax liability without corresponding liquidity to pay the tax. From a buyer's perspective, the main tax issue is that providing the seller with deferred consideration may make some or all of the transaction ineligible for step-up in the target's assets. That should not matter where step-up is otherwise not available. For example, where the target is a standalone US corporation (which is a typical structure for entities in the technology space) and the transaction is structured as a purchase of the equity of the target, step-up is generally not available, and a buyer can provide sellers with rollover equity on a tax-deferred basis as part of the consideration for the target without a detriment to the buyer. The ability of a seller to receive buyer or parent equity on a tax-deferred basis depends on a number of factors, including the tax classification of the target, the tax classification on the buyer and the portion of the consideration consisting of equity. Generally, it is easier for financial buyers to issue rollover equity on a tax-deferred basis for a new portfolio investment because such investments provide for most flexibility in terms of designing the holding company structure to facilitate the issuance of rollover equity on a tax-deferred basis. Depending on how a portfolio investment is structured, it may be more difficult to structure tax-deferred rollover for add-on acquisitions; generally, a structure with an LLC or LP on top as a holding entity that is treated as a partnership for income tax purposes provides the most flexibility and is one reason that LLCs and LPs are even used on top of structures that do not provide for pass-through treatment all the way down to the operating business because of an intervening corporation interposed in the structure.

Especially where the sellers are foreign or the target group includes entities in various jurisdictions, the acquisition of the target group may provide opportunities to optimise the target structure under the buyer's post-closing ownership period. Typically, these include pushing debt down into various geographies, which sometimes requires the separate acquisition of various members of the target group, adding foreign holding companies to facilitate efficient repatriation and eliminating ownership chains that do not make sense from the perspective of a US buyer. For example, while foreign parent corporations frequently will form US subsidiaries, it is typically inefficient for a US buyer of a foreign parent corporation to own a US subsidiary through the foreign parent. This is both because any dividends from the US subsidiary intended to eventually reach the US parent would need to leave the United States and then return to the United States as they are distributed up the ownership chain, potentially becoming subject to withholding tax twice in the process (a direct US subsidiary to US parent dividends should not be subject to tax in the United States), and because the US parent and its indirect US subsidiary cannot consolidate for US tax purposes where there is an intervening foreign corporation in the ownership chain between the US parent and the indirect US subsidiary.

Another structuring consideration is the placement in the structure of any acquisition financing. Generally, in an all-US structure the placement of the acquisition financing in the target group does not have an impact from a US federal income tax perspective because the buyer and the target group will typically file a consolidated income tax return that allows the netting of income and expenses across the consolidated group. The answer may be different at a US state level if members of the group file in states that do not provide for the equivalent of federal tax consolidation returns. In those US states, absent additional planning, the debt interest expense may become stranded away from the operating income that it could otherwise reduce. The analysis becomes more complicated in cross-border structures where the cash flow that will be used to service the debt is generated in various geographies. In those structures it is often helpful to 'push debt down' into the subsidiaries that are generating cash flow. That can be done by either having third-party lenders lend directly to the foreign subsidiaries (that assumes that the lender is able to lend directly to a foreign borrower, which is not always the case) or with intercompany debt from the US parent of the group. Any debt pushdown can reduce the overall effective tax rate of the group by providing for direct payments to foreign lenders, creating tax deductions in the foreign subsidiaries for interest expense, having interest (versus dividend) withholding rates to apply to any interest payments, and providing for the non-taxable return of any principal of the debt. Prior to the US 2017 tax reform, debt pushdowns could also reduce the overall tax rate of the group by reducing the amount of dividend income from foreign subsidiaries either by having the foreign subsidiaries pay their debt directly or by structuring a portion of the repatriation of debt from the foreign subsidiaries as a repayment of debt principal. The US 2017 tax reform eliminated the need to do that for US corporate borrowers, but debt pushdowns to foreign subsidiaries remain beneficial for non-US tax reasons and for non-corporate US parent entities.

Generally, target companies in the technology space will have tax attributes and an M&A transaction may create additional tax attributes. These are typically net operating losses (NOLs) and tax deductions resulting from the M&A transaction, which can offset the target's taxable income for the year of the transaction and create additional NOLs. Historically, sellers could monetise NOLs created as the result of a transaction by carrying them back to previous years and obtaining a refund of taxes paid in those years. The ability to do that with US federal NOLs was eliminated by the 2017 US tax reform, was reinstated for a limited period of time pursuant to the 2020 CARES Act, and is now again eliminated. Otherwise, any target NOLs (and other tax attributes) that are not utilised in pre-closing tax periods will remain with the target and be available for usage post-closing by its buyer subject to significant limitations on their usage.

The indemnity package for historical tax exposures ranges from traditional transactions with a pre-closing tax indemnity, an indemnity for breaches of the tax representations and warranties from the sellers to no indemnities at all in public style deals where the buyer has no recourse against the sellers. Generally, the larger the value of the transaction the more likely it is that it will have a public style deal indemnity construct for taxes (and other pre-closing liabilities). The biggest driver of the market in that direction over the past few years has been the growth of the representation and warranty insurance (RWI) market. The existence of RWI has bridged sellers' desire to walk away without any contingent exposures and buyers' desire to be protected for unknown liabilities. Under this indemnity construct, current income taxes that are known are sometimes included in indebtedness (which results in a dollar-for-dollar reduction to the purchase price) as buyers will not have any further opportunity to pursue sellers for such taxes once the debt and other customary post-closing adjustments are completed (and the RWI policy will not cover known liabilities). Current non-income taxes are typically addressed through the net working capital adjustment as was the case prior to the shift away to no-indemnity deals.

There are two tax issues that are repeatedly identified in M&A deals in the technology space in the United States: tax on deferred revenue accrued but not included in taxable income as of the closing date, and historical sales tax exposure. Companies in the technology space frequently have deferred revenue for book purposes and the US tax rules allow a limited deferral of the associated income for tax purposes. Generally, under these rules, tax income and book income associated with deferred revenue match for the first year, and then any remaining amount deferred for book purposes is included in income for tax purposes in the second year irrespective of the remaining book deferral. That means that as of the time of closing, a target may have a future tax liability on revenue that was received prior to the closing and, but for the tax accounting rule described above that permits a limited deferral, would have been included in income of the target in a pre-closing tax period, with any tax imposed on such income being the responsibility of the sellers either through the accrual for current income taxes in indebtedness or the pre-closing tax indemnity. Ultimately, this becomes a business issue, but it is relatively common in software transactions for buyers to agree to accept the responsibility for taxes on any deferred revenue based on the argument that that tax-deferred revenue not included in income pre-closing tax periods is created in the ordinary course of business and the business will keep growing.

Technology companies frequently have issues with historical sales tax exposure. Generally, companies that sell certain goods and less often certain services are required to collect sales tax from their customers. The sales tax rules can be difficult to comply with in part because they are state-specific (and most but not all US states charge a sales tax) and generally require a company to determine where it is subject to sales tax (i.e., whether it has nexus in a particular jurisdiction) and whether its sales are subject to sales tax in those states. Historically, a company had to have a physical presence (e.g., employees or an office) in a state to be subject to sales tax, but that is no longer the case and a certain level of sales into a state is sufficient to trigger a sales tax liability. Sales of software and software services provide unique challenges for purposes of any sales tax analysis as it is often very fact-specific without uniformity among the states. If any sales tax issues are identified as part of the diligence process, they can be economically significant because sales taxes are typically a function of gross revenue (and not taxable income), any known issues identified in due diligence will be excluded from any RWI policy, and if any such issues are left un-remedied, any resulting indirect exposure for the buyer (as the new owner of the target) is theoretically open-ended, because in most of the instances where sales tax issues are identified, the relevant statute of limitations applicable to the tax authorities' ability to collect such sales taxes (and impose interest and penalties) will never begin to run because the relevant tax returns have never been filed.

After the transaction closes, the buyer will typically implement an incentive plan for management. Strategic buyers will typically include the target's employees in their own plan and financial buyers will create a new plan. The target's management may also be asked to rollover a portion of their existing management incentives into the buyer structure. Depending on the form of the existing management incentives and the buyer structure, a rollover can be accomplished on a tax-deferred basis. Generally, management incentives can include shares in a corporation, profits interests (which require that the issuer is an LP or LLC taxed as a partnership for US income tax purposes and are one driver of structures that include an LP or an LLC on the top of the structure), options, restricted stock units and phantom plans. Shares and profits interests currently afford management the opportunity to be taxed at favourable capital gains rates on exit, and profits interest can be granted to management without any current income event. Options, restricted stock units and phantom plans can also be structured to avoid a tax event to management on grant, but typically result in management being taxed at ordinary income tax rates on exit and the issuing company having a comparable compensation deduction for income tax purposes.

Generally, US GAAP applies in the United States.

The last several years in the United States have been marked by a number of changes in the US federal tax rules that are relevant to M&A transactions and the election of President Biden in 2020 made additional significant changes likely.

The tax reform enacted at the end of 2017 included a reduction in the corporate income tax rate from a top rate of 35 per cent to a rate of 21 per cent, wholesale revisions of the rules governing the foreign income of US taxpayers, conformity between income recognition for book and tax purposes, codification of rules governing recognition of income associated with deferred revenue for tax purposes, a reduced tax rate on the income of businesses conducted through partnerships and other pass-through structures and a new three-year holding period requirement to obtain favourable long-term capital gains rates on carried interests (i.e., interest in future appreciation of portfolio investments that is issued to sponsors of private equity and venture capital investment funds).

As this chapter was being written, the Senate passed a bill that includes a new 15 per cent minimum tax imposed on financial statement ('accounting' and not taxable) income of companies with more than US$1 billion of such income. This new tax is of particular relevance to companies in the technology space because there are frequently significant differences between their book income, accounting statement income and tax income owing to differences in the accounting rules that apply for book purposes and tax purposes. Although advertised as only applying to a small number of taxpayers because of the US$1 billion limitation, the provision includes aggregation rules that can combine separate companies for purposes of the $1 billion test. In one version of the bill, the aggregation rule was modified to explicitly apply to unrelated portfolio companies of private equity and other investment funds. Under that construct, companies with less than US$1 billion of financial statement income would become subject to the 15 per cent minimum tax. This expansion of the aggregation rule was removed prior to the final passage of the bill in the Senate pursuant to an amendment offered by Senator Thune that was also supported by some Democratic senators. The bill still needs to pass the House of Representatives and be signed by the President to become law but that is likely to occur because of the Democratic control of the House of Representatives.

x Cross-border issues

HSR notification process

Under the Hart-Scott-Rodino Antitrust Improvements Act (HSR Act),[103] mergers, acquisitions and joint ventures must be filed with the US antitrust authorities pre-closing if, as a result of a transaction, a party will hold at least US$101 million[104] in voting securities, assets or noncorporate interests (an amount adjusted annually for inflation). This is referred to as the size of transaction test. Where the value of the transaction is below US$403.9 million,[105] there is also an applicable size of person test requiring that one party to the deal has annual net sales or total assets of US$20.2 million[106] or more, and the other party has annual net sales or total assets of US$202 million[107] or more. The size of person limitation does not apply in transactions valued above US$403.9 million. If the thresholds are met, the parties may not consummate a transaction until they have complied with the waiting periods set forth in the HSR Act.[108] Both the acquiring party and the acquired party are subject to the requirement to provide information under the HSR Act.

The first step in the HSR review process is the filing of an HSR notification and report form for certain mergers and acquisitions. This is a 10-page form that seeks basic information on each party's business, including its areas of operation, its sales and its subsidiaries, affiliates and shareholders. The form also requires attachment of documents, including annual reports, confidential information memoranda and certain documents analysing the transaction. The parties can make an HSR filing once they have executed a contract, agreement in principle, or letter of intent to merge or acquire. Along with the filing, each party must also submit an affidavit that attests to its good faith intention to complete the transaction described in the filing.

If the FTC or DOJ have questions or concerns about a transaction during the initial 30-day waiting period, a member of agency staff will call counsel for the parties to notify them that a preliminary investigation is being opened. During this time, the parties may meet with the staff or provide documents to show that the transaction will not generate

103 Hart-Scott-Rodino Antitrust Improvements Act, 15 USC. §18a.
104 Current threshold, adjusted annually for inflation.
105 ibid.
106 ibid.
107 ibid.
108 There are many additional rules and exemptions that must also be taken into account when assessing HSR reporting requirements, but the size of transaction and size of person tests are the most important pieces for determining whether a transaction must be reported.

anticompetitive effects (e.g., higher prices, reduced output). The relevant agency may also issue a voluntary request letter to each of the parties, which asks them to submit additional documents that may aid in assessing the competitive impact of the transaction.

At the conclusion of the initial waiting period, the reviewing agency must either allow the transaction to proceed or instead issue a request for additional information and documentary material, commonly referred to as a second request.[109] Second requests require the parties to gather and produce large volumes of documents and data regarding their respective businesses, competition and the transaction.[110] The issuance of a second request also holds the transaction open – the parties are prohibited from closing the transaction or otherwise combining operations while they respond. During this period, the agency may also conduct investigational hearings, similar to depositions, of certain key individuals in each company. All of these fact-gathering efforts are in support of the agency's attempt to predict whether the transaction will result in anticompetitive effects, such as higher prices or reduced output or innovation. In another departure from historical norms over the past years, the FTC and DOJ acknowledged in 2021 that they had been sending 'warning letters' to some parties at the close of the 30-day waiting period, in lieu of issuing a second request.[111] These warning letters note that the agency has not concluded its investigation and that if the parties close, the DOJ or FTC may later determine that a challenge to the transaction is warranted. As a result, parties are advised that if they close, they 'do so at their own risk'. The reason for issuing such letters rather than preventing the parties from closing through issuance of a second request has not been announced publicly. One of the FTC's Republican commissioners has publicly questioned the practice, noting that in spite of these letters, there are no ongoing investigations into these deals. In any event, the warning letters appear to be relatively rare, and most potentially problematic transactions continue to face the traditional second request process.

Once the parties both certify that they have complied with the second request, the agency has 30 additional calendar days (the final waiting period) to analyse the transaction. After the final 30-day waiting period expires, the reviewing agency must either allow the transaction to proceed or file an action in a US federal court seeking an injunction to block the transaction. If the reviewing agency seeks an injunction, the parties must litigate the legality of the merger or abandon the transaction unless a settlement can be reached. A full second request investigation generally ranges from six to 12 months, not including

109 It is also possible for the parties to withdraw their HSR filing and resubmit it, giving the reviewing agency a second 30-day review period to determine whether the transaction should be cleared. This may only be done once. It is a useful strategy if the parties believe they can convince the staff to clear the transaction without issuing a second request, but there are still unresolved issues at the end of the first 30 days.

110 For an example of a second request, visit https://www.ftc.gov/system/files/attachments/hsr-resources/model_second_request_-_final_-_october_2021.pdf.

111 As of 4 February 2021, the FTC announced a 'temporary suspension' of grants of early termination, citing as reasons the transition to a new administration and the 'unprecedented volume of HSR filings'. Although the announcement indicated that the suspension would be 'brief', after six months grants of early termination had not resumed, and there has been no further guidance from the FTC or DOJ regarding when things would return to normal.

litigation.[112] Parties may attempt to allay concerns about anticompetitive effects through divestitures or behavioural restrictions. If a remedy is agreed to, it will be formalised in a consent decree with the investigating agency.

HSR trends in high-technology deals

In the United States, technology companies face increased scrutiny on a number of fronts. Antitrust has been frequently used as a means of reining in perceived negative impacts by this sector, as well as on political and social trends. Indeed, several prominent members of Congress even advocated (ultimately unsuccessfully) for a moratorium on all mergers and acquisitions for the duration of the covid-19 emergency to blunt anticompetitive deals involving the acquisition of small, struggling companies. Meanwhile, the most prominent high-technology firms are being targeted by antitrust probes and inquiries in Congress, by state attorneys general and by the federal antitrust enforcement agencies. Even smaller companies face this heat, particularly during merger review. At both the DOJ and the FTC, the staff attorneys are increasingly concerned with a perceived ability of technology companies to grow by acquiring smaller rivals, thereby reducing the overall competition and diversity in relevant markets.

Current emphasis on increased antitrust scrutiny of tech deals has had limited impact to date

The Biden administration has publicly made antitrust enforcement a priority, and President Biden's picks for FTC chair and DOJ Assistant Attorney General for Antitrust both indicate that those agencies will aggressively pursue investigations in the technology space. Lina Kahn, President Biden's choice to head the FTC, is an outspoken critic of large tech platforms like Google and Facebook, and was a contributor to the 2020 House Antitrust Subcommittee report that called for breaking up large technology companies. Commissioner Kahn was sworn in on 15 June 2021. A second Democratic commissioner, Alvaro Bedoya, was sworn in on 16 May 2022, giving the Democratic appointees a 3-2 majority on the Commission and opening the door for more aggressive implementation of a pro-enforcement agenda. At the DOJ, President Biden on 20 July 2021 nominated Jonathan Kanter to lead the agency's antitrust enforcement efforts. Kanter is an outspoken proponent of aggressive antitrust enforcement and also a critic of Google and other technology firms. Both appointments guaranteed that the trend toward more aggressive targeting of the high technology space will be a high-value agenda item for the next several years.

While the new agency heads have been outspoken in their concerns about high-tech deals, to date there is still much uncertainty about the degree to which merger scrutiny will be directly impacted. In January 2022, the FTC and DOJ announced a joint public inquiry seeking input regarding their existing guidelines for evaluating mergers, including comments specifically on the 'unique characteristics of digital markets'.[113] In addition, the agencies have held several 'listening forums' seeking input on antitrust concerns from market

112 The duration of a second request can be shortened by extensive preparation before the HSR filing is made and during the initial waiting period. Such an accelerated strategy, however, requires alignment between the merging parties, as substantial compliance with the second request is not effective unless both parties have certified compliance.

113 https://www.justice.gov/opa/pr/justice-department-and-federal-trade-commission-seek-strengthen-enforcement-against-illegal.

participants, including a forum on technology markets on 12 May 2022.[114] Kanter and Khan both commented on the need to address potentially anticompetitive deals in the high-tech space, including scepticism about acquisitions of nascent competitors that might otherwise grow to challenge larger tech players.

Meanwhile, there have been some suggestions from the FTC's Premerger Notification Office that it may seek to adjust reporting requirements to catch more tech transactions. The FTC released a report in September 2021 noting that many acquisitions by large technology firms are not subject to mandatory HSR reporting for various reasons, including because the deals fall below the size of transaction threshold and because they may be subject to certain exemptions. The Premerger Notification Office appears interested in tightening up these requirements so that more technology deals are reported, but no draft regulations have yet been issued.

Multi-sided market analysis an area of focus

The DOJ and FTC have been wrestling with the proper way of accounting for multi-sided platforms in high-technology sectors when conducting merger analysis. In a 2018 Supreme Court decision, the court determined that efficiencies on both sides of the platform should be accounted for in an antitrust analysis. One of the most recent cases to deal with multi-sided platforms in a merger review context is *Sabre/Farelogix*, which the DOJ investigated during 2019 and early 2020.

Sabre/Farelogix concerned the two-sided platform for airline bookings. Traditionally, bookings have been managed through global distribution systems (GDS) that connect travel agents looking to make bookings with airlines offering available seats. Sabre is one of the largest GDS providers. The DOJ complaint alleged that the next-generation booking software developed by Farelogix was a threat to Sabre's legacy GDS. The DOJ argued that if the transaction went forward, Sabre would no longer be constrained in its negotiations, and would therefore be able to charge higher prices and have less incentive to innovate. In litigating the transaction, the parties emphasised the need to consider impacts on both sides of the GDS platform – airlines and travel agents. Adopting this approach, the district court concluded that while Sabre was indeed a multi-sided platform (selling services to both airlines and travel agents), Farelogix (a software developer for airlines) was only operating on one side of the platform. Based on this, the district court ruled out, as a matter of law, competition between single-market sellers and their multi-sided counterparts.

After winning in court, Sabre and Farelogix ultimately abandoned their deal as a result of opposition from the UK Competition and Markets Authority. The DOJ then asked the Third Circuit Court of Appeals to vacate the district court decision as moot, which it did on 20 July 2020. However, foreshadowing that more disputes over multi-sided platforms are to come, the Third Circuit panel noted that the decision to vacate 'should not be construed as detracting from the persuasive force of the district court's decision, should courts and litigants find its reasoning persuasive'.[115] Unsurprisingly, multi-sided markets were a key topic of discussion in the FTC/DOJ technology listening forum in 2022, and further developments in agency approaches in this area seem inevitable.

114 https://www.ftc.gov/news-events/events/2022/05/ftc-justice-department-listening-forum-firsthand-effects-mergers-acquisitions-technology.

115 *United States v. Sabre Corp*, case No. 20-1767 (3d Cir. 20 July 2020).

Focus on private equity may impact future tech deals

The FTC and DOJ have suggested a need for increased scrutiny of private equity transactions, many of which involve high-tech companies. In a recent merger challenge relating to private equity consolidation, the FTC's Democratic commissioners opined that the agency must be attentive to the fact that private equity acquisitions 'in some instances distort incentives in ways that strip productive capacity, degrade the quality of goods and services, and hinder competition.'[116] Their critique included pointed criticism of leveraged buyouts, which 'saddle businesses with debt and shift the burden of financial risk', and roll-up strategies in which private equity-backed buyers 'accrue market power', and 'reduce incentives to compete'. The DOJ has likewise suggested increasing concern over private equity purchases, noting that 'certain private equity transactions and conduct suggest an undue focus on short-term profits and aggressive cost-cutting.'[117]

While these criticisms are not limited to high-tech deals, private equity plays a key role in many high-tech sectors by incentivising start-ups that have innovative approaches to challenge the status quo. To the extent that the FTC and DOJ are more aggressively targeting private equity in connection with a broader uptick in overall enforcement as noted above, this will inevitably drive delays for at least some private equity-packed merger activity.

V NATIONAL SECURITY LEGAL AND REGULATORY FRAMEWORK

No review of the legal landscape impacting technology M&A would be complete without a discussion of US regulations and control regimes restricting foreign investment in, ownership of and access to various classes of assets, businesses, data and technology, all in the name of national security.

The effects of these measures – particularly the foreign investment review process carried out by CFIUS (or the Committee) – can be seen in high-profile Executive Branch orders demanding divestment of Chinese interests in US technology companies or prohibitions on the transfer of US goods and design know-how to designated Chinese entities. The Russian invasion of Ukraine in February 2022, and the unprecedented wave of sanctions and export controls imposed by the United States on Russia, in tight coordination with allied nations led by the United Kingdom and the European Union, further vaulted national security regulations to the forefront of global commerce. The trend is unmistakeable. US regulatory oversight of cross-border technology transactions has tightened, with Congress passing and administrative agencies implementing sweeping changes to law and policy in the form of expanded review jurisdiction, increased economic sanctions and an ever-broadening definition of what capabilities and information come within the ambit of national security warranting protection from foreign investment and access. Investments involving cutting-edge

116 Statement of Chair Lina M. Khan Joined by Commissioner Rebecca Kelly Slaughter and Commissioner Alvaro M. Bedoya in the Matter of JAB Consumer Fund/SAGE Veterinary Partners, Commission File No. 2110140, Federal Trade Commission (June 13, 2022), https://www.ftc.gov/system/files/ftc_gov/pdf/2110140C4766KhanStatement.pdf.

117 Dep. Asst. Atty. Gen'l Andrew Forman, *The Importance of Vigorous Antitrust Enforcement in Health Care* (June 3, 2022), https://www.justice.gov/opa/speech/deputy-assistant-attorney-general-andrew-forman-delivers-keynote-abas-antitrust#:~:text=That%20is%20precisely%20why%20we%20must%20aggressively%20enforce,care%2C%20additional%20lifesaving%20innovations%2C%20and%20more%20good-paying%20jobs.

technology have become subject to this increased scrutiny, especially when there is a concern that sensitive technologies and IP will be transferred to a country that is not strategically aligned with the United States.

The result is a complex and ever-evolving set of rules that considerably impact M&A, leveraged finance and private equity transactions, particularly in the technology sector.

i Foreign investment review: the role of CFIUS

Legal underpinnings of CFIUS review

Under Section 721 of the Defense Production Act, the President of the United States has long held the power to block 'any merger, acquisition or takeover' of a US business by a foreign-owned or -controlled entity if 'there is credible evidence that the foreign entity exercising control might take action that threatens national security'.[118] CFIUS is an interagency body chaired by the Secretary of the Treasury that exercises the President's national security review power. CFIUS has authority to review transactions, whether proposed or completed, that could result in control of a US business by a foreign person[119] to ascertain a potential threat to US national security.

In conducting its evaluation, CFIUS will assess whether a foreign investor is from a country with which the US has conflict or misalignment of strategic interests and whether the foreign investor is controlled by a foreign government. (Investors controlled by foreign governments typically present more national security concerns than purely private, commercial enterprises.) CFIUS will also evaluate whether the targeted US business engages in activities that are sensitive from the standpoint of national security (e.g., participation in the defence supply chain, dealings with sensitive US government agencies or information, providing services that implicate cybersecurity concerns, access to information affecting the safety and security of US citizens), including whether the US business manufactures, supplies or distributes critical technologies or is part of US critical infrastructure.

Until recently, the statute and regulations contemplated that filings with CFIUS were elective, triggered by the submission of a joint voluntary notice by the parties.[120] Following a filing, the Committee would conduct a review of the transaction for possible national security concerns. At the conclusion of this process, CFIUS would either clear the transaction (with or without mitigation conditions) or recommend that the President block it for reasons

118 Defense Production Act, §721; 50 USC. §4565. The term control is defined broadly to mean 'the power, direct or indirect, whether or not exercised, through the ownership of a majority or a dominant minority of the total outstanding voting interest in an entity, board representation, proxy voting, a special share, contractual arrangements, formal or informal arrangements to act in concert, or other means, to determine, direct, or decide important matters affecting an entity'. 31 CFR §800.208.

119 The term 'foreign person' means any foreign national, foreign government or foreign entity; or any entity over which control is exercised or exercisable by a foreign national, foreign government or foreign entity. 31 CFR §800.224.

120 CFIUS has authority to initiate a review on its own and invite the parties to submit information; the Committee is also empowered to issue interim orders barring parties from closing a transaction to permit time for completion of the review, or (in the case of transactions that have already closed) orders requiring that the foreign party divest its interest. For these reasons, parties to a transaction raising potential national security sensitivities are usually well-advised to submit a notice voluntarily, ideally prior to a planned closing.

of national security. If parties received clearance, they secured a legal safe harbour against future intervention by the Committee or the President (subject only to certain extraordinary exceptions, such as a material omission or misstatement of fact).

In the second term of the administration of President Barack Obama, as the strategic and economic rivalry between the United States and China began to intensify, the United States pivoted to a more aggressive posture against Chinese acquisition of US technology and sensitive personal data, including Chinese investment in US technology companies. After the inauguration of President Donald Trump in January 2017, CFIUS scrutiny of Chinese-led deals (and also of other foreign investment transactions in the technology and data sectors) dramatically increased. Congress responded to calls that CFIUS be given broader jurisdiction to review transactions, including not just foreign takeovers but also minority investments in particularly sensitive sectors.

On 13 August 2018, then-President Trump signed the Foreign Investment Risk Review Modernization Act of 2018, which included broad new authorisations and significant revisions to the CFIUS process. Among other changes, FIRRMA gave the Committee a mandate to review minority investments through which a foreign investor could gain management rights in, or access to non-public technical information generated by a US business that deals in critical technologies, critical infrastructure or sensitive personal information. Moreover, for the first time, FIRRMA defines a category of transactions for which submission to CFIUS is now mandatory, under threat of penalty.[121]

Parties to a transaction subject to CFIUS's jurisdiction have two options for notifying CFIUS of a proposed transaction (whether the notification is voluntary or mandated under the rules). The traditional process involves the submission to the Department of the Treasury of a notice, a detailed description of the parties, the transaction and the US business to be acquired, the contents of which are dictated by requirements in the regulations.[122] Depending on the complexity of a transaction, the review process can be quite involved, stretching from 45 to 90 days or more. In FIRRMA, Congress directed CFIUS to implement an alternative, more streamlined declaration process, intended to result in a determination within 30 days. However, for many complex transactions, this streamlined process is unlikely to secure a clearance, often requiring the parties to go through the full notice process anyway to obtain the safe harbour.

Every cross-border transaction that involves foreign investment in or acquisition of a US business (including assets that taken together comprise an existing US business) must be evaluated to determine whether it falls within the scope of CFIUS's review and jurisdiction.

Key impacts of FIRRMA on CFIUS review of technology M&A deals

As noted, FIRRMA introduced far-ranging changes to the CFIUS process and extended review jurisdiction to categories of transactions not previously subject to scrutiny. A detailed treatment of those changes is beyond the scope of this summary. However, two impacts of the law that bear directly on takeovers involving US technology companies are an expanded focus on transactions involving companies dealing in critical technologies, critical infrastructure and sensitive personal data, and the treatment of transactions involving certain investment funds.

121 The Department of Treasury implemented the new authority in an overhaul to CFIUS's regulations, most of which went into effect on 13 February 2020. 31 CFR Part 800.

122 31 CFR §800.502.

Focus on the 'TID US business'

FIRRMA requires increased CFIUS scrutiny of foreign investments, including minority investments, in US businesses deemed to be engaged in the most national security-sensitive activities. To implement this, CFIUS introduced a new concept: the TID US business. A TID US business is one that, in some manner, trades in specified technology, infrastructure or data.[123]

A technology TID US business is one that '[p]roduces, designs, tests, manufactures, fabricates, or develops one or more "critical technologies"'.[124] Critical technologies, in turn, means items (goods, software, and technology and, in some cases, services) that:

a are subject to heightened US export controls (including under the International Traffic in Arms Regulations, the Export Administration Regulations, and the Department of Energy or the Nuclear Regulatory Commission export regulations); or

b become designated in subsequent rulemaking as one or more emerging or foundational technologies.[125]

Determining whether a US target deals in critical technologies is a key threshold question and one that is highly fact-specific and technical.

An infrastructure TID US business is one that performs specified functions with respect to covered investment critical infrastructure, as specified in a new Appendix A to the CFIUS regulations.[126] Appendix A describes certain systems ranging from terrestrial, submarine and satellite telecommunications, industrial resources, energy generation, transmission and storage facilities, financial markets and technologies, maritime and aviation ports, and public water systems. The list is significant because, in the past, CFIUS has generally asserted broad discretion to determine, on a case-by-case basis, which types of infrastructure came within its jurisdiction. The list of covered investment critical infrastructure serves to narrow CFIUS's purview over critical infrastructure only to those assets listed.

A data TID US business is one that '[m]aintains or collects, directly or indirectly, sensitive personal data of US citizens'.[127] Sensitive personal data is defined as identifiable data collected by a US business that targets or tailors products or services to certain sectors of the government or one that has in the past year collected data on more than one million individuals (or has expressed a demonstrated objective to do so) in the following categories:

a certain financial data that could be used to determine an individual's financial distress;

b consumer credit report data;

c insurance application data;

d heath records;

e electronic communications between third-party users;

f geolocation data;

g biometric data;

h data for generating a government identification card;

i data concerning government personnel security clearances; and

123 31 CFR §800.248.

124 31 CFR §800.248(a).

125 31 CFR §800.215. See also discussion of emerging and foundational technologies, *infra*.

126 31 CFR §800.248(b).

127 31 CFR §800.248(c).

j data in an application for a government personnel security clearance or an application for employment in a position of public trust.

Sensitive personal data also includes genetic test results.

Even a minority foreign investment in a TID US business triggers CFIUS jurisdiction when the transaction entitles a foreign investor to at least one of three types of rights:

a access to any material non-public technical information possessed by the business;[128]

b membership or observer rights on (or the right to nominate an individual to) the governing board of the TID US business;[129] or

c any involvement (other than through the voting of its shares) in certain substantive decisions of the TID US business regarding the relevant technology, infrastructure or data.

Moreover, the concept of a TID US business is central to the new mandatory notification requirements under CFIUS. Specifically, two categories of transactions must be notified to CFIUS (either through the long-form notice procedure or the short-form declaration process) at least 30 days prior to closing.[130]

First, a notice is required for a foreign investment (including either a takeover or a minority investment with specified control or access rights) in a TID US business that produces, designs, tests, manufactures, fabricates or develops one or more critical technologies, with minor exceptions.[131]

In addition, a CFIUS notice is mandatory for certain acquisitions of or investments in a TID US business by an investor in which a foreign government has a substantial interest.[132] The detailed discussion of the industries, technologies and activities that can render a company a TID US business in the FIRRMA regulations serves as an important signal to the marketplace as to which classes of acquisition targets warrant careful CFIUS scrutiny. So much of what makes up the technology sector of the US economy involves touchpoints with critical technologies, critical infrastructure and sensitive personal data. Parties to any M&A deal implicating these factors should consult with qualified US CFIUS counsel as a central element of transaction planning.

128 31 CFR §800.211(b)(1). Material nonpublic technical information is information, not available in the public domain, that, in the case of an infrastructure TID US business, '[p]rovides knowledge, knowhow, or understanding . . . of the design, location or operation of covered investment critical infrastructure, including vulnerability information such as that related to physical security or cybersecurity'; or in the case of a technology TID US business, is 'necessary to design, fabricate, develop, test, produce, or manufacture a critical technology, including processes, techniques, or methods'. 31 CFR §800.232(a).

129 31 CFR §800.211(b)(2).

130 Penalties for failing to make a mandatory filing are stiff. A person who does not comply can face penalties of up US$250,000 or the full value of the transaction, whichever is greater. 31 CFR §800.901(b).

131 31 CFR §800.401(c).

132 31 CFR §800.401(b). No mandatory filing is required if the investment is made by an 'excepted investor'. The criteria for qualifying as an excepted investor are complex, but they essentially require that the investor be, or be almost exclusively controlled by, nationals, governments and entities of an 'excepted foreign state'. For the time being, CFIUS has designated Australia, Canada, New Zealand and the UK as excepted foreign states.

Treatment of certain investment funds

In FIRRMA, Congress provided for a specific carve-out from CFIUS jurisdiction for acquisitions undertaken by certain US-controlled investment funds that include foreign limited partner investors. This is particularly relevant for investments in the US technology sector, which are often made by private equity, venture and other funds that include participation by foreign capital. If certain criteria are met, 'an indirect investment by a foreign person in a TID US business through an investment fund that affords the foreign person (or a designee of the foreign person) membership as a limited partner or equivalent on an advisory board or a committee of the fund shall not be considered a covered investment'.[133] To qualify:

a the fund must be managed exclusively by a general partner, managing member or equivalent who is not a foreign person;[134]

b the foreign person must not sit on or have the right to appoint a member to an advisory board or committee that:
  - has authority to approve, disapprove or otherwise control investment decisions of the fund;
  - has authority to approve, disapprove or otherwise control decisions by the general partner, managing member or equivalent 'related to entities in which the fund is invested'; or
  - provides the foreign person access to material non-public technical information;[135] and

c the foreign person must not otherwise have the ability to control the fund.[136]

This fund clarification provides parties a valuable guide for how best to address CFIUS jurisdiction over a transaction by carefully structuring foreign participation in an investment fund context. CFIUS will, in its review of an acquisition or investment by an LP or equivalent structure, scrutinise the underlying investment documents to evaluate the rights, entitlements and authorities conferred on foreign investors. Where possible, these documents should be drafted to address in clear terms aspects of the limited partner and managing member relationship that touch upon the criteria outlined by the new regulations as described above.

Finally, the regulations clarify that, where a foreign government-controlled entity invests solely as a limited partner or non-managing member in a fund with a general partner, managing member or equivalent, that foreign government's interest, at any level of equity, will not be counted as a substantial interest in the fund's investment in a TID US business sufficient to trigger a mandatory filing with CFIUS.[137] This provision will go a long way to limiting the CFIUS obligations and exposures of a fund that takes in equity from foreign sovereign wealth or government retirement fund investors solely as limited partners.

133 31 CFR §800.307.

134 31 CFR §800.307(a)(1) and (2).

135 31 CFR §800.a(3)–(6).

136 31 CFR §800.a(4).

137 31 CFR §800.244(b). With additional constraints on ownership, information sharing, etc.

Impacts of CFIUS on recent technology transactions

CFIUS review was once regarded as necessary only for transactions involving military supply chains or large-scale infrastructure, or in circumstances posing clear espionage risks. Times have changed, driven by two factors: a number of advanced technologies have direct and indirect national security implications, and access to sensitive personal data of US citizens is something that certain nation states are seeking to obtain and exploit.

The government is particularly focused on maintaining technological superiority over strategic rivals, especially China.

ii Committee for the Assessment of Foreign Participation in the United States Telecommunications Services Sector (previously, Team Telecom)

CFIUS is not the only regulatory regime focused on reviewing the national security implications of foreign ownership in the technology sector. In the case of regulated telecoms infrastructure, an interagency process led by the DOJ and the US Department of Homeland Security regularly conducts national security reviews of transactions that could result in foreign control of an entity holding licences issued by the Federal Communications Commission (FCC).

This group of agencies, colloquially known as Team Telecom, long operated on the basis of interagency agreements and ad hoc norms. On 4 April 2020, President Trump issued an Executive Order establishing a Committee for the Assessment of Foreign Participation in the United States Telecommunications Services Sector (previously known as Team Telecom). The Order formalised the Team Telecom process, adding procedures not unlike those followed by CFIUS, with an initial review and secondary assessment period. At the conclusion of the review, the Committee can issue an unconditional grant of approval for transfer of an FCC licence, grant approval conditioned upon standard or non-standard mitigation measures, or ask the FCC to deny an application or otherwise revoke the affected licence or licences. As the FCC and executive branch have jointly increased attention on telecommunications national security issues in recent years, these reviews have expanded in scope alongside those of other transaction review functions.

iii Export control regulations that affect technology transactions

Laws primarily directed to regulating foreign access to commodities, materials, software and technology can have dramatic impacts on technology transactions, especially those involving information that has military or classified applications. Some aspects of these laws are expressly triggered by proposed foreign control over companies that handle this type of information. Others, however, are implicated by the broad concept that restricted transfers of controlled information can occur in the course of activities undertaken in connection with a foreign takeover, including due diligence, facilities inspections, technology licensing arrangements and even employment of foreign nationals.

The following US export controls and various defence and military regulations may impact tech transactions.

Export Administration Regulations: 'dual-use' and civilian export controls

The Export Administration Regulations (EAR), administered by the Bureau of Industry and Security (BIS) of the Department of Commerce, is the primary set of rules regulating the export of civilian, dual use items. These are items that have significant commercial and non-military application, but heightened control over foreign access is still warranted for reasons of national security, nuclear, chemical and biological non-proliferation, missile technology controls or law enforcement considerations. An extremely wide variety of goods, software and technology are subject to heightened controls under the EAR. The restrictions on a particular export of these items will depend primarily on the specific export classification at issue, the destination of the export and, in some cases, the end use or end-users. These classification levels and other triggers for restriction are set forth in the EAR.[138] Importantly, categories of classification subject to heightened control include most forms of commercial encryption technology, as well as sophisticated electronics, computing and navigation or process controls.

Unless an item is exempt from all control (e.g., as in the case for some fundamental research or information in the public domain), transfer to a non-US person can be subject to some level of restriction. Covered items that do not meet a specific heightened control classification under the EAR are still designated under a default, or category, known as EAR99. EAR99 items are freely exportable without special authorisation (or licence) from BIS, except in specified circumstances, including exports to countries or nationals subject to US sanctions or transfers to sanctioned or denied persons.

Importantly for technology transactions, a restricted export can occur in a variety of ways, including through oral or visual disclosures or through email communications.[139] Release or disclosure of controlled technology or software source code to a foreign national is also an export, even when it occurs within the United States.[140] Because non-US person employees of an acquirer might access controlled technology, either in due diligence or in the course of employment or other business post-closing, most M&A transactions require an analysis to determine whether export controls are implicated. The Export Control Reform Act (ECRA), which was enacted in 2018 as part of the same legislation that included FIRRMA, established an inter-agency process led by the Commerce Department to identify emerging and foundational technologies that are deemed essential to US national security and not otherwise already controlled under the EAR. The ECRA provides for a notice and comment period for the proposed designation of certain technology as an emerging and foundational technology. The impacts on technology transfers of heightened controls over emerging and foundational technologies could well remake the landscape for technology M&A for years to come.[141]

138 An item falls into a heightened control category if it meets the criteria of an export classification control number on the US Commerce Control List, published in the EAR.

139 The EAR controls both exports and re-exports of covered items. An export is the transmission or transfer of an item outside of the United States, whether physically, electronically (e.g., via email or website download) or otherwise. A re-export is the transfer or transmission (by whatever means) of an item from one foreign country to another foreign country. Re-exports of US-controlled items are often subject to similar types of restrictions as exports.

140 This kind of transfer is referred to as a deemed export, and the level of control is determined by the requirements that would be imposed on a physical export of the technology or source code to that foreign person's country of nationality. Similarly, a deemed reexport occurs when US-controlled technology or software is released or disclosed outside of the United States to a national of a third country.

141 Among other things, the designation of a particular technology as emerging or foundation as a result of the ECRA process automatically results in heightened CFIUS review for any proposed takeover of a US company dealing in such technology, because under FIRRMA the definition of critical technologies for CFIUS purposes includes 'Emerging and foundational technologies controlled under section 1758 of the

International Traffic in Arms Regulations and National Industrial Security Program Operating Manual

Specific regulatory processes can also be triggered for proposed takeovers of technology firms that are engaged in defence activity (manufacture or export of defence articles or provision of defence services), while firms that hold security clearances from the government to receive, access or store classified information must observe certain foreign ownership restrictions.

Under the International Traffic in Arms Regulations (ITAR),[142] an entity engaged in the manufacture or export of defence articles (including defence technology) or the provision of defence services must be registered with the Department of State, Directorate of Defense Trade Controls (DDTC). The items subject to controls under ITAR are specified on the US Munitions List (USML) and include traditional military hardware, as well as space and satellite technologies and even certain cybersecurity tools and technology.[143] The ITAR requires that a registrant must notify DDTC 'at least 60 days in advance of any intended sale or transfer to a foreign person of ownership or control of the registrant or any entity thereof'.[144] Filing such a notice can trigger a further evaluation of the transaction and the acquiring party, and can even result in a referral to CFIUS for formal review.

The US National Industrial Security Program (NISP) encompasses the processes and requirements by which companies and individuals can be granted security clearances to receive, access or store classified information. Only US-incorporated entities are permitted to hold security clearances and employ cleared individuals, who themselves must be US citizens. Any transaction (including a takeover) that could result in foreign ownership, control or influence (FOCI) over a cleared entity must be reviewed by the US Department of Defense (DOD).[145] Specifically, companies that hold a security clearance must file an updated Standard Form 328 (SF 328) whenever there is a 5 per cent or greater increase in the ownership of their voting or investment-right stock by a foreign interest.[146] The DOD will then review the transaction to determine whether the foreign ownership stake will cause the cleared entity to be regarded as under FOCI.[147] Failure to mitigate FOCI (including by divesting the foreign ownership or ring-fencing that interest though proxy or other approved means) can result in loss of clearance.

Export Control Reform Act of 2018 (50 USC 4817)'. 31 CFR §800.215(f). The US government's effort to identify emerging and foundational technologies for additional control has largely stalled both in the inter-agency process and in consultations under the multinational export controls regime known as the Waasenaar Arrangement.

142 22 CFR Part 120 et seq.,

143 The USML can be found at 22 CFR Part 121.

144 22 CFR §122.4(b).

145 See the National Industrial Security Program Operating Manual of 2006 (DDD 52202.M), Section 2-300 et seq.

146 See DOD Industrial Security Letter 2009-03, p. 1.

147 See DOD 52202.M Section 2-301 (outlining factors that may be considered in making a FOCI determination).

VI IP PROTECTION

i IP protections available under US law in technology M&A

Proprietary technology and IP rights protecting technology are often the most important assets of a technology business. As a result, IP issues play a key role in technology M&A transactions. The following is a brief overview of IP protections available under the laws of the United States and key areas of focus during IP diligence in technology M&A.

In the United States, a combination of federal and state laws is available to protect IP. In general, proprietary technology may be protected through copyrights, trade secret rights, trademark rights and, in some instances, patent rights.

Patents

A patent protects an invention. In the United States, patent protection is provided under the United States Patent Act of 1952 (Patent Act).[148] The United States is also a party to the Paris Convention[149] and Patent Cooperation Treaty.[150] For an invention to be patentable under the Patent Act, the invention must be useful, novel and not obvious.[151] To obtain a patent, an applicant must submit an application that describes and claims what the applicant purports to be the invention. A patent may issue after an examination by the United States Patent and Trademark Office (USPTO) if the claimed invention meets all of the requirements necessary for an invention to be patentable. Once a patent issues, the owner has the right to exclude others from making, using, offering to sell, selling or importing the patented invention.[152] Unlike other countries, the United States permits an application to be filed on a provisional basis to preserve the filing date.[153] A provisional application need not include any claims describing what the applicant purports to be the invention and is not examined, but the provisional application must be converted into a utility application that includes the claims within one year of the filing date. Many applicants take advantage of the provisional filing regime in the United States to get the earliest filing date. Patentable subject matter includes any new and useful process, machine, manufacture or composition of matter, or any new and useful improvement thereof.[154] However, patenting a software invention is a bit more complicated in the United States. In general, laws of nature, natural phenomena and abstract ideas are excluded from the subject matter that is eligible for patent protection. It is sometimes challenging to patent a software invention, because a software invention is often considered to be an abstract idea, and an abstract idea that is merely implemented on a generic computer is not patentable. However, some software inventions are patentable because novel and useful applications of an abstract idea are patentable.[155]

148 Title 35 of the United States Code.

149 Paris Convention for the Protection of Industrial Property provides reciprocal filing rights by allowing an applicant to file an application in their home country first to receive the priority filing date and subsequently file in other Member States within 12 months for a patent application.

150 The Patent Cooperation Treaty provides an international filing system.

151 See 35 USC. §§101–103.

152 See 35 USC. §271.

153 See 35 USC. §111(b).

154 35 USC. §101.

155 See *Alice Corp v. CLS Bank International*, 573 US 208 (2014).

Copyrights

A copyright protects an original work of authorship fixed in a tangible medium of expression. In the United States, copyright protection is generally provided under the United States Copyright Act of 1976 (Copyright Act).[156] The United States is a member of multiple treaties affecting copyrights, including the Berne Convention for the Protection of Literary and Artistic Works.[157] The types of works protected under the Copyright Act include:

a literary works;
b musical works;
c dramatic works;
d pantomimes and choreographic works;
e pictorial, graphic and sculptural works;
f motion pictures and other audiovisual works;
g sound recordings; and
h architectural works.[158]

The Copyright Act has no specific reference to software, but in most instances, the source code and the graphical user interface of computer software are believed to qualify for copyright protection as a literary work.[159] The question of whether an applicable programming interface (API) can be copyrighted was raised in a dispute between Google and Oracle, where Oracle claimed copyright protection in Java application programming interfaces (API) and alleged infringement by Google for copying a portion of the API. The Supreme Court recently reviewed this case, but did not decide on whether the API is copyright protected but instead assumed that the copied lines of the API can be copyrighted and held that Google's use of the copied lines of the API was 'fair use' and therefore not an infringement.[160] A copyright grants its owner the exclusive right to, and to authorise others to, reproduce, prepare derivative works of, distribute, publicly perform and publicly display the copyrighted work.[161] A copyright arises automatically on fixation of the expression in a tangible medium and, although registration with the US Copyright Office is available, it is not necessary for the purpose of obtaining a copyright, and most software companies elect not to register as one of the registration requirements is to provide at least a portion of source code, which the software owner prefers to keep as a trade secret.[162] However, registration is a prerequisite for enforcing a copyright against a third-party infringer. Unlike in many other countries, in the United States, moral rights are limited to works of art only protected under the Visual Artists

156 Title 17 of the United States Code.
157 See US Copyright Office Circular 38a.
158 17 USC. §102.
159 See 1 Nimmer on Copyright §2A.10 (2017).
160 *Google LLC v. Oracle America Inc*, 593 US (2021). (The Supreme Court concluded that Google's copying of the Java SE API, which included only those lines of code that were needed to allow programmers to put their accrued talents to work in a new and transformative program, was a fair use of that material as a matter of law.)
161 See 17 USC. §106.
162 US Copyright Office Circulate No. 61.

Rights Act of 1990.[163] An author of a work of visual art has the right to claim authorship and to prevent intentional distortion, mutilation or other modification of that work which would be prejudicial, and to prevent destruction of work of recognised stature.[164]

Mask works

The Semiconductor Chip Protection Act of 1984 (SCPA) protects mask works that are fixed in semiconductor chips.[165] To be protected under the SCPA, a mask work must be original and registration with the US Copyright Office is required to secure protection.[166] An owner of a mask work has the exclusive right to reproduce the mask work by optical, electronic or other means, to import or distribute a semiconductor chip product in which the mask work is embodied, and to induce or knowingly cause another person to do any of the foregoing acts.[167] Although mask work rights are available to semiconductor companies, registration and enforcement of mask work rights are not widespread because of the limited protection afforded under the law.

Trade secrets

Trade secret law has traditionally been governed by state law, which in most states corresponds to the Uniform Trade Secrets Act, but today, trade secrets are also protected under the federal Defending Trade Secrets Act of 2016 (DTSA).[168] Therefore, trade secret owners now have the option to enforce their trade secret rights in a state court or a federal court. Although there are some differences in the definition of trade secrets, if the information has value because it is not generally known to others and the owner has taken reasonable precautions to protect its secrecy, then the information is potentially protectable as a trade secret under both laws. However, there are additional protections provided under the DTSA. The DTSA provides a whistleblower immunity to protect individuals who disclose trade secrets to the government for the purpose of reporting or investigating a suspected violation of law, and an employer has an obligation to provide notice of such immunity in contracts with its employees.[169] If an employer fails to do so, the employer may not be awarded exemplary damages or attorneys' fees against the employee who did not receive the notice.[170] The DTSA also permits the court to issue an *ex parte* seizure order to prevent the propagation or dissemination of the trade secret in extraordinary circumstances.[171] Trade secrets are typically protected through contractual nondisclosure obligations and by restricting access to the information.

Data

Although there are many federal and state laws regarding privacy and security aspects of data, there is no IP law in the United States that is specific to data protection. Data collections may be protected as copyright, to the extent they are not functional and meet the requirements

163 17 USC. §106A.
164 ibid.
165 17 USC. §§901–914.
166 17 USC. §902.
167 17 USC. §905.
168 18 USC. §1836, et seq.
169 18 USC. §1833.
170 18 USC. §1833.
171 18 USC. §1836(b)(2)(A)(i).

of the copyright law, and specific data may be protected as trade secret information, assuming that access to the information has been limited and the data otherwise satisfies the requirements of trade secrets.

Trademarks

A trademark, which generally refers to a word, name, logo or symbol that is used to identify the source of goods or services, may be protected under federal law, the Lanham Act[172] and state law. A trademark may be registered with the USPTO or may be registered on a state-by-state basis through the applicable state's trademark office. An unregistered trademark may still be protected under common law based on usage in commerce. There are, however, certain advantages in registering the trademark with the USPTO, including nationwide trademark protection, *prima facie* evidence of validity, constructive notice[173] and incontestability after five years of use.[174] In the United States, an applicant may file an intent to use (ITU) application for a trademark that has yet to be used.[175] Once the application has been reviewed and approved by the USPTO and the applicant can show evidence of usage in commerce, then the trademark will be registered. Although an ITU application cannot be assigned until a verified statement of use has been filed, there is an exception for assignment to a successor to the business to which the mark pertains.[176]

ii IP diligence

Ownership of IP

For technology M&A transactions, the most important part of the IP diligence is to verify that the target business actually owns what it purports to own in terms of technology and IP rights. An important initial step in verifying ownership is to understand the target business's development history, including how and where its key proprietary technology originated, who was involved in the development (whether employees or contractors) and where the development took place.[177]

Developments by employees

In the United States, an employer does not automatically own all IP created by its employees within the scope of employment. An employer has ownership of copyrights in works of authorship created by its employees within the scope of their employment through the work made for hire doctrine under the Copyright Act.[178] However, unlike the IP laws in some other countries, this is not likely to be true with respect to other forms of IP, such as inventions and patents resulting from those inventions. The general rule under US law is that an inventor owns his or her invention. An exception to this general rule is that an invention

172 15 USC. §§1051 et seq.

173 15 USC. §1072.

174 15 USC. 1065.

175 15 USC. §1051(b).

176 15 USC. §1060(a).

177 While US law would apply to employees and contractors located in the United States working for US companies, US companies often use individuals outside the United States for development. In such cases, the laws of the country where those individuals are residing or the governing law of the agreements with such individuals, or both, will apply.

178 See 17 USC. §201.

created by an employee is owned by his or her employer, if the employee was specifically hired to invent, but this is a high standard under US law.[179] For an employer to own all IP created by an employee within the scope of his or her employment, there needs to be a written IP assignment. Without such an assignment, the employer may have only a limited right to use the IP developed by such employee referred to as the 'shop right' doctrine.[180]

Developments by independent contractors

A business that hires individuals as independent contractors is even less likely to own the resulting IP in the United States for several reasons. First, the work made for hire doctrine is a copyright-specific concept and does not apply to inventions or patents. Second, the work made for hire doctrine applies only to certain categories of works specified under law, if created by an independent contractor.[181] Typically, works performed by an independent contractor do not fit within these categories. Software developed by an independent contractor, for example, generally does not qualify.[182] Finally, the independent contractor and the business that hired the independent contractor must agree in writing that the work will be considered a work made for hire.[183] Therefore, unless the independent contractor has assigned its, his or her IP to the business that hired it, him or her, it, he or she likely retains ownership in such IP. Without such an assignment, the business may have a limited implied, non-exclusive licence to use such work created by the independent contractor at best.

Proprietary information and inventions agreements

For the reasons discussed above, it is important that a target business has IP assignments from employees and independent contractors who have developed technology for the business. These agreements are typically called proprietary information and inventions agreements or something similar.

When reviewing these types of agreements, it is important to confirm that the applicable agreement contains a properly drafted assignment provision. Specifically, the law in the United States is clear that the assignment must be drafted as a present-tense assignment (e.g., 'employee hereby assigns . . .'), as opposed to an agreement to assign. A provision such as 'the IP shall be owned by or an employee shall assign the IP' are generally interpreted to be a mere covenant to do so in the future and not an effective present assignment.[184]

Despite this relatively clear law on IP ownership, it is not unusual to encounter during diligence of a technology business either a lack of IP assignments altogether or IP

179 *United States v. Dubilier Condenser Corp*, 289 US 178 (1933).

180 *Lariscey v. the United States*, 949 F.2d 1137 (Fed. Cir. 1991).

181 The work created by an independent contractor must be one of the following to constitute work made for hire under US copyright law: a work for use as a contribution to a collective work; a work that is part of a motion picture or other audiovisual work; a translation; a supplementary work; a compilation; an instructional text; a test; answer material for a test; or an atlas. See 17 USC. §101.

182 See 6 Nimmer on Copyright §27.02 (2017) ('[C]omputer programs are not among the categories of work enumerated in the current Act that are eligible for specially commissioned status upon execution of the proper agreement . . .').

183 See 17 USC. §101. However, note that under Section 3351.5(c) of the California Labor Code, an independent contractor who agrees to a work made for hire provision in a written agreement is deemed to be an employee. Therefore, any agreement with an independent contractor that could be subject to California law may want to omit a work made for hire provision.

184 *Arachnid, Inc v. Merit Indus., Inc*, 939 F2d 1574 (Fed Cir 1991).

assignments that are incorrectly drafted. If the issue is lack of proper drafting of existing IP assignments, and the individuals at issue are still in relationships with the target business or these assignments have further assurance provisions that permit the target business to seek additional documents to effectuate the purpose of the original intent of IP ownership, then the acquirer will typically propose that additional IP assignments be executed as a closing condition, or if the IP at issue is less than material, then the acquirer can require new assignments post-closing.

Working with university staff

Many US technology companies, in particular startup companies, often work with professors or researchers from universities. For example, a professor or researcher may be either one of the founders of the target business or a consultant or technical adviser to the business. Sometimes, even graduate students may be involved as interns or consultants. In these cases, additional diligence is required to verify that there is no overlap between the work these individuals have performed for the business versus the work they have performed for the universities. Even if these individuals have properly assigned their IP rights to the target business, the business may not actually own the developed IP because of the individual's pre-existing obligations to the university. Most research universities in the United States have IP policies that describe what IP rights are owned by the universities. In general, IP university policies require that IP created within the scope of or related to employment with the university or created using any resources of the university, including any research performed at the university or using funding provided to the university, are owned by the university. Most universities also permit outside consulting activities, provided that the individual has complied with the consulting policy requirements, which often require a limited number of consulting hours and notice to or approval by the university.

Jointly developed IP

Technology businesses will often collaborate with others, such as suppliers or customers, and can potentially create jointly developed technologies through these collaborations. In the case of joint development, it is important to know what the rights and obligations are with respect to the jointly developed technology. Although the parties to a joint development effort can always determine rights and obligations through a mutual agreement, they often fail to do so. In the absence of an agreement, the underlying IP rights to the jointly developed technology will in the United States be jointly owned by those parties. For jointly owned copyrighted work, each owner has the right to use and may license the work to third parties and may transfer the owner's ownership interest in the joint work to a third party, all without obtaining permission of the other joint owner. However, joint ownership of copyright is by default subject to a duty of accounting to the other joint owner, unless the parties have agreed to otherwise.[185] For patentable inventions, each owner would have the freedom to use and to license the invention without a duty of accounting.[186] However, both owners will have to participate to enforce a jointly owned patent against third-party infringers.[187]

185 See 1 Nimmer on Copyright §6.12 (2017). This includes a duty to account to the other joint owners for a ratable share of the profits realised from the joint owner's use of the work and of the profits realised from licensing of the work.

186 See 35 USC. §262.

187 *STC.UNM v. Intel Corp.*, 767 F.3d (Fed. Cir. 2014).

Licensed IP

Restrictions in inbound licences

It is fairly common that technology businesses licence-in technology from third parties. It is not unusual to find that the target business has licensed-in technology or IP rights from third parties, and these are often more than just standard off-the-shelf software. These licences can be material to the conduct of the business. In that case, a buyer should verify that the scope of the in-licence granted is sufficiently broad to cover the target company's existing business and contemplated future business. It is very typical for a US-style licence agreement to include at least some form of restriction on assignment. Even if the agreement is silent as to assignability, the default rule under US law is that a non-exclusive licence is not assignable. In addition, if the sale of the technology business is for less than the entire business of the seller or substantially all of the assets of the seller, then there is a good possibility that not all technology and IP rights owned by the seller and necessary for the operation of the acquired business will be transferred to the buyer. As a result, it may be necessary for the seller and the buyer to negotiate a license agreement, where the buyer receives a license to the technology and IP rights retained by the seller.[188]

Open-source software

If a target business offers any software licences, including as a software service, to third parties, it is a virtually certainty that the target business uses open-source software. Usage of open-source software is quite common for software providers as the quality of open source is often quite good because of peer review, and usage shortens development cycles and costs. In general, there are two types of open-source software: restrictive and permissive. Restrictive open source (also referred to as copyleft or viral open source) requires modifications, derivative works, or works (including proprietary works) containing or based on the open source, when distributed, to be licensed under the same open-source terms. Permissive open source, on the other hand, requires only the original open source and not the modifications, derivative works, or works containing or based on the open source, to be licensed under the same open-source terms. Examples of restrictive open-source licences are the GNU general public licence version (GPL), the GNU lesser public licence (LGPL), and Affero general public licence (AGPL). An LGPL licence is often used for libraries and is less onerous than GPL in that LGPL allows for dynamic linking of proprietary code with open-source code (although not static linking or integration) without subjecting the entire linked work to an LGPL licence. AGPL expands the scope of distribution to include software offered as a service. Because the usage of restrictive open source can potentially jeopardise the value of proprietary code, it is not unusual for an acquirer to require an open-source audit as part of the IP diligence.

Rights granted to third parties

Many technology companies, whether they have software-focused businesses or hardware-focused businesses, tend to license some IP rights to third parties such as customers, service providers and suppliers. While most of the licences granted by a target business are

188 The license agreement between the seller and the buyer could include cross licenses, where the buyer licenses back to the seller a license to the transferred technology and IP rights for use by the seller in operating the retained business.

likely to be non-exclusive licences granted in the ordinary course of business, one should identify whether the target business has granted any exclusive licences or other licences outside the ordinary course of business.

In addition, if the target business licenses any proprietary software to third parties, it will be important to determine whether it has licensed any source code or has entered into any source code escrow agreements and what the release conditions are. Although, in most cases, the release conditions are bankruptcy and insolvency-related, a change in control of the target business could be one of the release conditions as well.

Standard-essential patents

Some technology companies participate in standards-setting organisations (SSO), which are intended to develop standards and technology to promote compatibility and integration. However, many SSOs have IP policies or require members to enter into agreements that require contribution or licensing of IP by the members or a covenant not to assert the IP of the members. As an example, some require the members to agree to grant licences to its patents to others that are implementing the specifications enacted by the SSOs under reasonable and non-discriminatory terms, if such patents are essential to implement such specifications. This obligation can further extend, not only to the IP owned by the technology business that participated in the SSO, but also to all of its current and future affiliates, which will include the buyer of the business after the transaction is closed. Therefore, the buyer can potentially and unintentionally subject its patents to the licensing obligations as a result of acquiring the business.

IP infringement risks

Typically, the IP diligence will include a review of actual or potential IP-related claims and proceedings involving the target business. If that business is subject to any infringement claim by a third party, an evaluation of the likelihood of success or failure of the claim, the likelihood of an injunction and potential liabilities, needs to be undertaken to assess the need for a reduction in price, escrow or indemnity.

For a technology business, patent infringement claims tend to be the most material, because patent infringement claims are the most costly to address. If a target business is subject to a patent infringement claim, one of the first questions to ask is who is the party asserting the claim? If the party asserting the claim is a competitor or an entity who is in the business of proving products or services, and the target is found to infringe, then there is a potential for an injunction, which could result in serious consequences. On the other hand, if the party asserting the patent is a non-practicing entity (NPE), then the party asserting the patent may be unable to obtain an injunction under US law or the patents at issue may be subject to a mandatory licensing obligation. Many NPEs grant paid-up licences for a lump sum payment and, therefore, these claims are mostly about negotiating the right settlement payment. If a claim by an NPE has already been settled with other parties, in many cases, these licences may limit the scope of the licence upon a change in control. For example, the licences will often not extend to the acquirer or its other affiliates, but even with respect to the target business, the licences may become frozen in time to the products and services existing at the time of the acquisition and only to modifications or evolutions of those products, and do not extend to any new products or services of the target. On the other hand, if a claim by an NPE has not been settled, then an acquirer may be concerned that after the acquisition, the combination of the acquirer and the target company may become a bigger target, with the NPE seeking even greater settlement payment. A paid-up settlement prior to the consummation of the M&A transaction is often preferred by an acquirer.

If a target business is found to infringe, the damages in the United States can be significant compared to other countries, and US patent law includes the doctrine of wilful infringement, which imposes treble damages on any person or entity that wilfully infringes a patent.[189] One common way to mitigate a potential finding of wilful infringement is to obtain an opinion of counsel concluding that the relevant patent is not infringed or is invalid or unenforceable. An acquirer will want to know whether the target business has obtained an opinion. The target business may resist sharing its opinion with the acquirer for fear of waiving any attorney–client privilege as a result of disclosure. The parties may be able to rely upon the common interest doctrine. There are a number of cases that apply the common interest doctrine and protect attorney–client privilege on the basis that the potential acquirer and seller have a common interest, to the extent the acquisition of the target is near completion.[190] However, some courts will take a narrower view of the common interest and require the common interest to be primarily legal in nature, as opposed to merely commercial in nature.[191]

Mitigating identified IP risks

Upon completion of the IP diligence, many acquirers will wish to mitigate the risks identified during the diligence process. There are a variety of ways to mitigate these risks, including through additional representations, warranties and indemnities in the purchase agreement, additional closing conditions and implementation of mitigating steps.

For example, open-source issues that require the replacement of certain open-source code or issues in IP assignments with existing employees that require new IP assignments can be addressed both pre- and post-closing. Some risks, such as if a target business is subject to an existing IP litigation, may be addressed through a separate indemnification where the seller of the business may agree to take on some or all of such risks.

VII EMPLOYMENT ISSUES

i Misclassification of independent contractors

Employers should be wary when hiring individuals as independent contractors because US courts have expanded the definition of employee to include individuals once considered independent contractors, giving those people rights and benefits that inure to a traditional regular US employee–employer relationship; this can result in significant unexpected costs. In general, potential liability for the incorrect classification of a person as an independent contractor arises from incorrect tax withholding and reporting and denial of employee medical benefits. Wages paid to employees in the United States are reported on a Form

189 See 35 USC. §284.

190 See, e.g., *Hewlett Packard Co. v. Bausch & Lomb, Inc*, 115 F.R.D. (ND Cal 1987); *Tenneco Packaging Specialty & Consumer Prods, Inc v. S.C. Johnson & Son, Inc*, No. 98 C2679, 1999 US Dist. LEXIS 15433 (N.D. Ill. 9 September 1999).

191 See, e.g., *American Bottling Co. v. Repole*, 2020 Del. Super. LEXIS 225 (Del. Super. Ct. May 12, 2020).

W-2 and are subject to applicable withholding, and there are related employer payroll taxes. Service fees paid to contractors are reported on a 1099, with no withholding and no payroll tax obligations.

US law and analysis of whether an independent contractor should be classified as an employee is constantly evolving. Historically, the US Internal Revenue Service used a 20-factor test to determine whether a service provider was an independent contractor or employee.[192] Simplified, the 20-factor test focuses on the degree of control on how services are performed. States have begun to adopt their own standards for determining independent contractor status, potentially creating a situation where an individual may be a contractor for federal tax purposes but an employee for state tax purposes. Effective 1 January 2020, California codified the 'ABC' test resulting from the 2018 California Supreme Court decision in *Dynamex Operations West Inc v. Superior Court of Los Angeles*.[193] In *Dynamex*, the court determined an employer must prove the following three elements (A-B-C) to rebut the presumption that a worker is an employee:

a a worker is free from the control and direction of the hiring entity in connection with the performance of the work;

b a worker performs work that is outside the usual course of the hiring entity's business; and

c a worker is customarily engaged in an independently established trade, occupation or business.[194]

In the technology industry, employers often experience surges in demand that cause a need for a larger workforce in a short period (or vice versa). In addition, many individuals prefer to provide services as contractors instead of employees and, when labour is in tight supply, employers may be willing to bring on a service provider as a contractor if that is the easiest way to acquire talent. Acquirers typical take a target's workforce as is. An acquirer should carefully review a target's employee and contractor classification decisions so as to avoid misclassification liability post-closing.

ii Misclassification of overtime-exempt employees

The technology workforce is often highly educated and highly compensated. Companies often, without thought, classify all employees as exempt from the overtime requirements of the Fair Labor Standards Act (FLSA). Misclassifying an employee as exempt may result in large monetary penalties for not paying overtime compensation for hours worked over 40 per week up to three years prior to the date of the claim; and additional penalties for other wage and hour compliance failures (such as not providing required meal and rest breaks).

The FLSA provides that the following categories of employees are properly classified as exempt: (1) white-collar workers, such as executives, administrators, professionals and outside salespersons; (2) computer professionals; (3) workers in industries such as transportation, bulk oil distribution, domestic service, forestry, retail service, communications and agriculture; and (4) employees working under special certificates, such as full-time students, learners, apprentices and disabled employees. To qualify for one of the above FLSA exemptions (meaning, in general, the employee is not eligible for overtime), employees must generally

192 Revenue Ruling 87-31.

193 4 Cal 5th 903.

194 California Labor Code Section 2750.3.

satisfy specified tests regarding their job duties and annual salary. Given the potential large liability resulting from a misclassification, it is important to review classification decisions as part of the diligence process.

iii Non-competition agreements

Recognising that the focus of many technology acquisitions is the acquisition of key talent, preventing employees from resigning and joining a competitor is often a key value concern. State law continues to evolve in favour of supporting the free movement of talent, making enforceability of non-competition agreements more and more difficult. California, Washington and Massachusetts are leading this evolution.

In California, 'every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void'.[195] While an employer may prohibit an employee from joining a competitor during employment, absent an exception to this statue, an employer cannot prevent an employee from resigning and joining a competitor. Some California courts have interpreted this statute broadly such that customer non-solicits, employee no-hire provisions and, recently, employee non-solicit provisions, have all been determined to be non-competes in violation of California law.

The most relevant California exception in M&A is the sale of business exception.[196] Simplified, significant shareholders selling a business may agree to refrain from competing with the business for a reasonable period of time. A significant shareholder is anyone owns a meaningful equity interest in the company being sold, with courts generally determining that meaningful requires equity holdings of at least somewhere between 7 to 0.1 per cent at the lower end. Note that an option holder is not a shareholder and, as a result, it is common to require key employees to exercise stock options prior to a transaction closing so that key employees can be treated as shareholders. Massachusetts adopted new non-compete limitations effective 5 October 2018.[197] Under this law, a non-compete duration is limited to 12 months, and non-competes will not be enforced against employees whose employment was terminated without cause. Furthermore, to support a non-compete, an employer must provide garden leave payments as in non-US jurisdictions of at least 50 per cent of the employee's base salary. There is no sale of business exception in the Massachusetts statute as is the case in California.

Washington adopted new non-compete limitations effective 1 January 2020.[198] Among other requirements, this new law limits non-competes to only employees earning more than US$100,000 per year and requires garden leave payments (generally, continued payment of base salary) to support a non-compete for employees who have been laid off. As with Massachusetts, there is no sale of business exception in the Washington statute. Numerous other US states have non-compete legislation that imposes various limitations. However, even in states (or non-US jurisdictions) without a specific statute, a non-compete generally will not be enforced unless it can be shown that the non-compete is reasonable in duration and scope and protects a legitimate business interest of the former employer.

On 9 July 2021, President Biden signed an 'Executive Order on Promoting Competition in the American Economy'. In this Executive Order, President Biden calls on the Chairman of

195 California Business and Professions Code 16600.

196 California Business and Professions Code 16601.

197 Massachusetts General Laws Chapter 149, §24.

198 Washington Revenue Code §49.62.020.

the FTC to adopt rules to 'curtail the unfair use of non-compete clauses and other clauses or agreements that may unfairly limit worker mobility'. This action is the first step in President Biden fulfilling his campaign promise to eliminate unfair non-competition agreements. The Chairman of the FTC has not taken any action, but clearly the use of non-competition agreements will come under fire in the most mobile workforce ever.

iv Retention arrangements

Many acquirers struggle with the question of how best to compensate newly acquired employees. This is particularly problematic for a strategic buyer. It needs to provide appropriate incentives to motivate newly acquired employees while being cognisant to not overcompensate those same employees with respect to the buyer's similarly situated current employees. Many strategic buyers will continue, or assume, a target company's equity compensation plans. Leaving the target's unvested awards outstanding mitigates the need to provide new equity compensation, while the remaining vesting schedule provides an immediate retention programme. However, it is also common to provide an additional retention pool to further incentivise and motivate new employees. Often, this is a cash-based programme of a specified amount that vests either subject to continued employment (most commonly one-third per year over three years) or upon satisfaction of target company performance objectives.

v Section 280G Internal Revenue Code

Section 280G of the Internal Revenue Code of 1986, as amended, and related Section 4999 work together to impose a 20 per cent excise tax on compensatory change in control-related payments to certain individuals and deny the paying of corporation deductions on those same payments. Together, these code sections are commonly referred to as the golden parachute rules.

The golden parachute rules apply to: (1) officers; (2) the 1 per cent most highly compensated target employees when ranked by compensation paid over the past 12 months (which often overlaps with the officer group); and (3) 1 per cent shareholders. These individuals are referred to as disqualified individuals. In the event a disqualified individual receives compensatory change in control payments that exceed three times his or her average annual taxable income paid by the target company or a related company for the five years prior to the year in which the change in control occurs (or, if shorter, for as long as the individual provided services), then all amounts in excess of one times his or her average taxable annual income is subject to the 20 per cent excise tax and loss of deductions.

The determination of what is a compensatory change in control payment is broad. In general, this captures all payments, compensatory in nature that a disqualified individual receives because of a change in control. Obvious payments are transaction bonuses and deal-related equity vesting acceleration. However, there is a presumption that any out-of-the-ordinary course payments provided in the 12 months prior to a change in control, and any severance paid in connection with a termination of employment within 12 months following a change in control are compensatory change in control payments. The presumption may be rebutted with clear and convincing evidence that the payments would have been made in the absence of a change in control. Compensatory change in control payments also include payments made after a change in control pursuant to agreements entered into before a change in control; however, payments made pursuant to agreements entered into after a change in control, even if immediately after closing, are not compensatory change in control payments. In addition, amounts received because of someone's status as a shareholder (including as a vested option holder) are not compensatory change in control payments.

Two exceptions are commonly used to exempt amounts from the application of the golden parachute rules. First, amounts that are reasonable compensation for future services are exempt. This exemption is less useful than it may seem, as any amounts greater than recent historical compensation likely are not reasonable. With that said, a replacement equity grant, relatively consistent with prior grants, often will qualify as reasonable compensation for future services.

The more commonly used exemption is the shareholder approval exemption. Available for private companies only, if more than 75 per cent of disinterested[199] voting power approves payments, the approved payments are exempt under the golden parachute rules.

VIII DATA PROTECTION

i Overview

Data privacy and security considerations arise in almost all transactions but are at their most prominent in transactions involving technology companies. Where a business being acquired is built online or relies on customer data as a key element of its product, the fundamental strength of the business depends upon the integrity of its networks and databases, and the thoroughness with which it protects personally identifiable information and complies with applicable law. The consequences of breaches, unauthorised disclosures and non-compliance can be severe not only financially, but reputationally and operationally as well. And in an increasingly digital world, these issues present themselves in nearly all transactions – not only those involving obviously data-driven enterprises.

Data privacy and cybersecurity concerns include not only the obvious customer and employee privacy and security concerns, but also marketing, healthcare and other aspects of a business's operations. Many of the issues that arise constitute whole practice areas on their own; in conducting privacy and cybersecurity diligence, the key is to ask the right questions.

This is complicated in the United States by the absence of any generally applicable data privacy law. States like California have adopted laws at the state level, and the California Consumer Privacy Act (CCPA) has set the tone nationwide, with Virginia, Utah, Connecticut and Colorado (at time of writing) recently enacting laws. But as yet, there is no US equivalent to broad regimes such as the European Union's General Data Protection Regulation. Privacy and data security requirements stem from a patchwork of sector-specific federal laws and regulations, which in conjunction with state laws and international regulations applicable to US-based companies with global reach create a complex compliance environment. As a result, counsel conducting diligence in such transactions have an array of lines of inquiry to follow.

199 Meaning the shares of any individual whose payments are subject to approval are considered not outstanding so that such individual does not vote to approve his or her payments or the payments to anyone else.

ii Key laws and regulations

CCPA

The CCPA gives California residents important new rights in relation to their personal data. Like the European Union's Global Data Protection Regulation (GDPR), the CCPA also appears to have extraterritorial effect (see below for further discussion), and organisations should therefore conduct an analysis to confirm whether they will fall within the remit of the CCPA and, if so, what steps, if any, they need to take towards compliance.

The CCPA provides protections and rights in relation to the personal information of California residents. In the simplest terms, a resident is an individual who lives in California and the rights provided under the CCPA do not cease to exist when the individual leaves California for a provisional period, such as a holiday. However, the CCPA caveats this slightly by clarifying that it does not apply to the collection or sale of personal information 'if every aspect of that commercial conduct takes place wholly outside of California'.

To fall within the scope of the CCPA, an organisation must:

a collect the personal information of California residents (either directly or through a third party);

b be for-profit, therefore excluding, for example, not-for-profit charities or public authorities;

c 'do . . . business in the State of California';

d determine the purposes and means of processing, like a controller under the GDPR; and

e meet one of the following conditions:
- the business must generate annual gross revenue in excess of US$25 million;
- the business must receive or share personal information of more than 50,000 California residents annually; or
- the business must derive at least 50 per cent of its annual revenue by selling the personal information of California residents.

The CCPA also applies to any entity that controls or is controlled by a business that meets the requirements above, and that shares common branding with such a business. Where the CCPA applies, it imposes requirements including notices to be provided to data subjects, requirements for processing and deletion of data, and obligations to respond to requests for access and deletion of data. Its scope is broad, and the penalties for non-compliance severe, particularly under the private right of action.

In 2021, even before the CCPA fully took effect, voters approved the California Privacy Rights Act (CPRA) by ballot initiative, establishing a dedicated enforcement agency and further expanding the scope of the law to new categories of information. Set to take effect over the course of 2023, these new rules (and the new regulator) will further complicate the privacy landscape in the United States.

Other state privacy laws

Following in California's footsteps, others states, led by Virginia and Colorado, are starting to enact generally applicable data privacy laws as well. While California's generally sets the high-water mark in terms of stringency (particularly as amended by the CPRA), these state-specific laws set to take effect over the course of 2023 add additional wrinkles to compliance obligations and more avenues of diligence inquiry to understand where a business may have gaps impacting the risk assessment of a transaction.

Illinois Biometric Information Privacy Act

While it has been on the book (and occasionally enforced) since 2008, Illinois' Biometric Information Privacy Act has garnered increased attention in recent years as the growth of biometric data collection has grown. The law includes protections addressing the gathering, storage and destruction of biometric information, including requirements for consent, security protections and deletion. In 2020, social video app TikTok was sued by several minors for alleged violations of the law, the latest in a string of lawsuits alleging violations by companies against their customers and against employees.

Health Insurance Portability and Accountability Act

While not applicable to all entities, the Health Insurance Portability and Accountability Act (HIPAA) Privacy and Security Rules impose a variety of strict compliance requirements on covered entities and business associates. HIPAA's requirements can also apply to companies that self-insure their employees' health plans. Given the sensitivity of health data, HIPAA compliance is critical.

GDPR and EU–US Privacy Shield

Perhaps the world's most widely known and widely applicable data privacy and data protection regime, the GDPR applies to the processing of personal data (information that directly or indirectly identifies an individual). The GDPR has extraterritorial scope, meaning it can apply when: (1) the personal data being processed belongs to a person outside the EU; (2) the personal data is being processed outside of the EU; or (3) the organisation processing the personal data is not itself established in the EU. The GDPR was implemented to build on previous legislation while also introducing new principles, rights and obligations, protecting the rights and freedoms of individuals and their personal data while harmonising data protection legislation across the EU. Under the GDPR, regulators can impose fines of up to €20 million or 4 per cent of annual global turnover. The GDPR also sought to increase the focus and attention on security of data, strengthening the obligations upon organisations holding data and introducing a mandatory reporting obligation for personal data breaches.

GDPR compliance has become its own industry, and while comprehensive GDPR compliance audits are not commonly a part of the transactional diligence process, it is important to consider GDPR issues given the potential scale of liability.

One key wrinkle in evaluating privacy issues in a potential transaction is the cross-border flow of data. European courts invalidated the US–EU Privacy Shield framework in 2020 and, while European regulators have issued new standard contractual clauses to enable some data flow, there remains a great deal of uncertainty, which is also a result a great deal of risk associated with the movement of data from Europe abroad and, particularly, to the United States.

Telephone Consumer Protection Act and Controlling the Assault of Non-Solicited Pornography and Marketing Act

The Telephone Consumer Protection Act (TCPA) and Controlling the Assault of Non-Solicited Pornography and Marketing Act of 2003 (CAN-SPAM) govern privacy practices associated with telemarketing, text messaging, commercial faxing and email. TCPA litigation has rapidly expanded in recent years and is a highly complex area of law. While

CAN-SPAM compliance is in some respects more straightforward, the common thread in both bodies of law in transactional diligence is looking to see whether a business has a plan to ensure compliance.

Payment Card Industry Data Security Standards

While not a body of law (rather, the Payment Card Industry Data Security Standards (PCI-DSS) are an industry-defined standard), compliance with the credit and debit card industry's standards is critical for any entity accepting cards for payment and processing those transactions. Software companies who provide systems used to support e-commerce or that interact with payment pages must also be mindful of their strict requirements and steep penalties for non-compliance.

iii Approaching privacy and data security diligence

Privacy and data security diligence in technology transactions primarily relies on legal practitioners ensuring they ask the right questions during initial diligence (to help get the lay of the land). As much as it is important to know what to look for, however, it is also important for counsel to know their own limitations, particularly with respect to technical expertise. Diligence functions are not full audits, and most attorneys are not, in any event, technically proficient enough to substantively evaluate cybersecurity practices, technical security measures or the substantive content of all the policies that contribute to a robust privacy and data security programme. Counsel should know, and advise their clients of, the limitations in their expertise; where technical issues are critical, specialists within a firm, or specialist technology consultants, can be brought in (as is done with tax and accounting matters) to bring necessary expertise to bear.

iv Key practice tips

Understanding the scope of data

It is critical to understand what information a company holds about individuals, who those individuals are (particularly their nationality), where the data is stored, and how it is used and shared. Nearly all companies have data about employees in connection with the employment relationship, but beyond that, companies collect information about customers, about users, about competitors, and about potential customers and users of their services. Understanding what this data is helps define the scope of the diligence exercise: if a company holds information about European citizens, for instance, that is an immediate indicator that GDPR compliance needs close examination; if they hold data only about their employees, and they have no operations in California, on the other hand, CCPA compliance is likely to be less of a concern.

Another useful approach is to ask a target company which legal frameworks they consider themselves subject to, and ask that they explain the factors leading to those conclusions. Responses to such inquiries often provide not only substantive insight into areas of further inquiry but also provide a sense of the maturity of privacy compliance functions and the attention paid by management to such issues. A company that can provide clear, well-reasoned answers has at least taken the time to think things through (though in many cases, the answer is simply that companies haven't thought about such issues – exactly the sort of thing that is good to uncover in a diligence exercise).

Understanding the privacy framework in place

Enquiring about the status of data protection policies and practices, including looking at privacy policies, can indicate how proactive the company is about managing data privacy issues. Privacy policies published on websites are a great resource of information even before initial diligence responses are received. If a privacy policy contains CCPA or GDPR notices, that indicates the company had some reason to believe they needed to address those laws. A smart counsellor will enquire as to why. Because so much of privacy and data security is consumer-facing and user-facing, publicly available information can in many cases be just as valuable as confidential data room documents.

Evaluating the approach to security

Information security presents myriad challenges to companies of all shapes and sizes, and there is no one-size-fits-all approach. Two of the best starting points are to ask for copies of all information and data security-related policies and plans (such as business continuity plans, incident response plans, mobile device policies, access controls, data and change management policies, physical access policies and so forth), and for copies of any third-party privacy and cybersecurity audits. In particular, reports of SOC2 Type 2 audits are frequently valuable not only for the information they contain (which details the information security controls companies have, as well as the infrastructure which underlies their data systems), but also for the evidence they provide of a company's attention to these types of issues. It is also increasingly common for companies to conduct, or be required as a condition of insurance coverage to conduct, penetration testing and vulnerability scans. The reports of these (or the absence of such activities) are another good indicator of the maturity of a company's security function.

IX SUBSIDIES

Direct government subsidies are rare in the United States, and governments (federal and state) do not typically own commercial properties.

X DUE DILIGENCE

In the United States, virtual data rooms are ubiquitous and offered by a variety of vendors. The data room is usually populated in stages, especially in an auction setting, and is configured to cover recurring main topical areas (governing documents, financial statements, taxes, material contracts, etc.), and other areas that a buyer may request of particular importance. The US practice is not to treat everything in the virtual data room as having been disclosed to the buyer for the purposes of qualifying the representations and warranties or materiality, and so this differs, for example, from the UK approach.

If the buyer is a large strategic entity, most diligence will be done by its internal business and legal staff, supplemented by diligence conducted by outside counsel in cases where the buyer feels the need to access outside counsel resources or expertise. Most large strategic buyers have a standard diligence playbook and list of diligence requests.

Except in obvious cases of non-relevance, it is usually not wise to avoid these diligence requests as they will generally not be easily waived. It is usually more constructive to try to limit the breadth of the requested data and to quickly try to find personnel matches between the buyer and seller so as to create mini-teams to work through diligence requests. Private buyers will generally have the same categories of diligence requests, but typically rely on outside counsel and advisers on matters of general diligence, tax, accounting, IP viability and strength, marketing and employee benefits. Typically, private buyers can move quickly through diligence, and have more flexibility in determining what is enough, because the reporting level is usually from outside service providers directly to the decision makers.

The areas that receive intense focus in technology transactions involve:

a ownership and strength of the IP (whether patents, software or otherwise);
b use of open-source software;
c export licences and compliance for products to foreign jurisdictions;
d employee assignments of IP to the employing entity;
e compliance with privacy laws;
f cybersecurity and strength of protection culture;
g churn rates for customers;
h tax position and compliance;
i compliance with the US Foreign Corrupt Practices Act and CFIUS;
j antitrust (both US and foreign); and
k now, various sanction regimes.

The end result of the diligence process is typically memorialised in a due diligence memorandum given by the legal team to the client (or internal business or legal head). In private equity transactions, this memorandum is usually also shared with the lenders and their counsel, so particular care needs to be given to the contents of the due diligence memorandum as it will not be an attorney–client privileged document for US legal purposes.

Depending on the state of the market and the desirability of the asset, the due diligence period can last for several months, and as quickly as a week or two on the legal side. Investment bankers for the target will front-load business financial diligence and then put a short fuse on the legal diligence side and terms of the sale contract when the bankers feel they have a hot asset. In these types of fast-moving deals, strategic buyers often suffer a disadvantage because some cannot move at the requested speed, while private equity buyers can move extremely fast if convinced by the business case so long as the debt markets are open.

XI DISPUTE RESOLUTION

In the United States, most disputes involving M&A are brought in state or federal courts. Some larger buyers insist on arbitration. If the acquisition agreement has a provision adjusting the purchase price for working capital, disputes over these provisions are usually settled by negotiation and, if not, by an arbitral-type decision by an accounting firm.

XII OUTLOOK

History shows no prognostication or reticence in expressing views, deeply held and certain, about what will happen to the local and world economy over the next 12 to 24 months, decade or millennium. In the US technology space, the predictions of doom and gloom were quite wrong for the second half of 2020 and woefully wrong for all of 2021. The technology space, as we saw, was euphoric until the early spring of 2022.

Although the Western world seems generally to have moved beyond the *Tale of Two Cities* imposed by covid-19, its effects linger and the intervening shock events of rampant inflation, a land war in Europe made by Russia against Ukraine, a geopolitical shift in aggressive power projection, coupled with what is now a real energy crisis and supply chain systemic threat, calls into question the growth power of the technology sector. On the social side, technology has enabled everyone to speak, and by the listening audiences to be heard, while there is no Goldilocks recognition – it seems like everyone who loves technology is matched by a hater of sorts. So, in a broad sense, technological advances are being resisted by many and enjoyed by all.

Unless unduly burdened by governments, technology companies will do quite a bit better over the next 24 months than all other categories. They are better adapted to meeting challenges and quicker to fail when wrong. As such, technology M&A will also do better than its counterparts. Yet the sector will likely have its growth wings snipped by government backlash. As the technology sector has been the largest-growing portion of GDP in the last 80 years, let us hope its wings are not unduly clipped. Although inflation might seem to be the approaching 1970s levels, on any sober reflection, no one should want to revisit that decade economically, except perhaps, for its music.

Appendix 1

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Michael Kennedy is a partner in the private equity and mergers and acquisitions practices at Paul Hastings, based in the firm's San Francisco office. Since 1984, he has concentrated on the corporate areas of mergers, acquisitions, divestitures, corporate partnering, joint ventures and corporate governance, with an emphasis in the technology, emerging growth, healthcare, biotechnology and media industries. He has extensive experience in the private equity and leveraged buyout industries as well as decades of experience in technology M&A and transactions.

Mr Kennedy frequently lectures at corporate seminars and continuing legal education forums.

Mr Kennedy has written numerous articles concerning M&A, shareholder litigation and related topics. For over a decade, starting in the late 1990s, Mr Kennedy was an adjunct professor teaching M&A technology transactions at UC Berkeley School of Law.

He holds a JD from New York University, 1984, and a BA from Yale University, 1981.

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