Podcast: Tech transactions in the spotlight

The following is a transcript of an episode of the Freshfields podcast looking at technology transactions

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John Fisher: Welcome to this edition of the Freshfields podcast. This is part of our board memo series. My name is John Fisher, I'm head of US technology and life sciences M&A in the Silicon Valley Office of Freshfields. Today we will talk about technology M&A transactions and I have with me two colleagues: Aimen Mir, who led CFIUS review on thousands of transactions prior to joining Freshfields and works very closely with me on almost all of my US M&A deals and joint ventures. We also have Alan Ryan, who has spent most of his career in Brussels but now also works with me in the Silicon Valley office and is a critical resource for Silicon Valley companies on global M&A deals, because he knows not only a lot about US antitrust issues but he is one of the foremost authorities on global antitrust issues. It's great to have that resource with us in California.

Technology M&A deals are fundamentally different from non-technology M&A deals. Technology deals are almost always driven by some combination of the following trinity: intellectual property, data and people. Data is a regulated asset, [so] where it is transported, stored, what data is collected, they are all key, and it's crucial that the board understand all of that when approaching M&A.

And, people - you want to retain the value of the transaction, so engineers, scientists, founders – retaining and keeping them happy is key. So, oftentimes, a board, when approaching a technology acquisition, even if buyside needs to put on their sellside hat and understand, for example, the tax implications of the deal on those employees, it's critical that there are no surprises and that the employees that you're acquiring feel good about the process and are not surprised by any of the deal terms.

If people, IP and data are driving your transaction that really impacts every aspect of the deal. So, as a board, the first step that I recommend is really to understand the deal structure, the motivations and the terms of the transaction – so that the board can understand why management seek to pursue or pose a transaction – the important aspects of the transaction, (strategic as well as financial) and why a particular deal structure has been chosen (for example, merger, tender offer, asset purchase or sale). And then, terms should be checked to see how they compare against current market practice.

M&A deals typically have three key components: economic allocation – this is your purchase price and the provisions that adjust upward or downward the purchase price; risk allocation – your reps and your warranties and indemnities; and then, deal certainty. Typically, two of the critical factors in deal certainty are FDI [foreign direct investment] regimes and antitrust, and my colleagues Aimen and Alan will address both of those.

So, in addition to understanding the motivation and terms, having an up-to- date understanding of the board's fiduciary duties are key. For example, are there recent developments impacting the fiduciary duties or particular aspects of the transaction that impact the fiduciary duties. I think it's critical to understand and address any director or management conflicts of interest. Not only can conflicts of interest lead to sub-optimal

deal terms, they also can change the level of scrutiny applied by courts when a deal is challenged. So, it's critical that boards understand any financial or other incentives that management or certain directors may have that can cause them to, for example, advocate for one outcome over another. These conflicts of interest can include employment agreements, change-of-control payments, wanting to, what I call "empire build" and be part of a larger organization following closing. Also old-fashioned economic interest in the counterparty or the target in an M&A deal.

Finally, it's critical to understand on deal certainty the deal mechanics. So, are there regulatory barriers that this particular transaction would need to overcome, and how would an acquisition be financed. And, on the regulatory barrier piece I'm now going to turn over to my colleague, Aimen, who spearheads CFIUS and FDI review for Freshfields on our global transactions.

| **Aimen Mir**: Thanks very much, John. Technology, data and people – they're not only driving tech deals but they're also at the core of the government's national security considerations in this age. And what that means is that the pressure on the government to actually regulate in these areas is only increasing for the foreseeable future, and it will often be at the expense of commercial efficiency and opportunity.

So taking CFIUS for example, CFIUS is now a consideration for US companies not just when they are receiving directly investment from a foreign person or selling off a business line, but even if they are receiving minority investment that gives a foreign person even an observer seat on the board, or if they are co-investing with a foreign person, or if they are contributing assets to a joint venture with a foreign person.

So, understanding these regulatory frameworks is more important than ever in thinking about what deals to pursue, execution risk, exit strategies and so on. And it's also important for US companies to recognize that these issues and these concerns are front of mind for regulators globally. So, major investment hubs; Germany Japan, France, Italy, Spain, Australia and even a bill just introduced in the UK that will go into force in the first half of next year are all focused on reviewing investment and in particular foreign investment to assess the risks. And while China will continue to be a leading consideration in almost all these jurisdictions – and I should note as an aside that China will, regardless of a change in administration here in the US, continue to be a leading consideration for CFIUS and other regulatory processes. But it's not just about China. Even buyers from friendly countries have the prospect of having to accept conditions that could constrain their commercial decision-making when it involves sensitive technology, data and infrastructure. So, the bottom line is that it's more important than ever for boards thinking about technology transactions to have a meaningful understanding of what the government's security interests are and how they could affect their transactions. So, with that let me turn it over to Alan for his thoughts on antitrust and merger control considerations.

| **Alan Ryan**: Thank you very much, Aimen. So, my name is Alan Ryan, I'm an antitrust partner, I've spent most of my career in Brussels, as John said, and I'm now delighted to be able to speak to you from California. And, this is very topical because 2021 is going to mark the beginning of a step change in antitrust enforcement of tech transactions.

Antitrust in tech has already become a political issue, you will have seen that, not only with the various decisions and the fines that the European Commission has levied on certain US tech companies, but also, with the US election campaign and the mandate for increased antitrust enforcement of the new Biden administration. The new administration is going to lead to a major change in the review specifically of tech transactions in the M&A space, and that's from two perspectives – first of all substantively and secondly international cooperation.

Many tech transactions involve a major tech company buying out a start-up tech company; it is the exit strategy for many investors in start-ups. And, the antitrust authorities are now openly saying that they regret not having enforced the antitrust laws or not having challenged a number of these transactions. They are what they call “killer acquisitions”; it’s emerging technology which could represent a competitive threat to the established and large tech players, which they are then buying out. The antitrust authorities are now worrying that many of those tech transactions actually involved the acquisition and, therefore, the snuffing out of, potentially competitive technology which could have overturned the established pecking order.

In the USA those transactions have been and can always be reviewed, even if they fall below the HSR reportability threshold, but very few of them have. And, the theories of harm that the antitrust authorities would want to bring have not been developed very clearly.

The big change here is now that with the new administration they will be, the agencies will be looking to develop those theories of harm, but also with international cooperation. Most of these deals involve companies that do have sales in many countries around the world, they are potentially reviewable across the globe. But, many countries have relatively high reportability thresholds and these deals have fallen below those thresholds. The EC, the European Commission, has now announced a major policy change; it’s a power that it always had, which is to request, politely, a review of the transaction from a national antitrust authority, even if that authority itself didn’t have the power to review it. It is an interesting point under Article 22 of the EU Merger Regulation.

But they’ve never taken such a referral unless the referring authority actually did have the power to review it. They have now announced that they will be taking those referrals even when they don’t, which means that they will now be able to review the majority of these smaller tech transactions which, as we said earlier, are precisely the killer acquisitions that they are looking for.

That and the increased cooperation then with the USA means that we can expect them to be discussing the theories of harm on these specific cases in the future. And, this is likely to be the major area of change for agencies on both sides of the Atlantic and, indeed, around the world in future.

The bottom line, therefore, means that for investors looking for an exit strategy and for acquirers the antitrust assessment of transaction at the beginning of the deal will need to be much more thorough, because there will be challenges to some of these deals, which even in 2020 went through under the radar. That calls for more contingency planning on the deal in case the challenge happens, and for a reserve gameplan to be in place to deal with it should it happen. And, importantly, circling back to John, for the M&A agreement then to cater for all these possibilities.

Now, with that, on our side, we are obviously gearing up for this increased enforcement in 2021 and beyond and looking forward to working very closely then with our colleagues John and, of course, Aimen. Thank you very much.