

M&A ACADEMY

**Technology in M&A Transactions – What Parties Care
about When Buying and Selling Technology**

**Speakers:
Nancy Yamaguchi and Khoa D. Do**

Tuesday | March 19, 2024

Outline

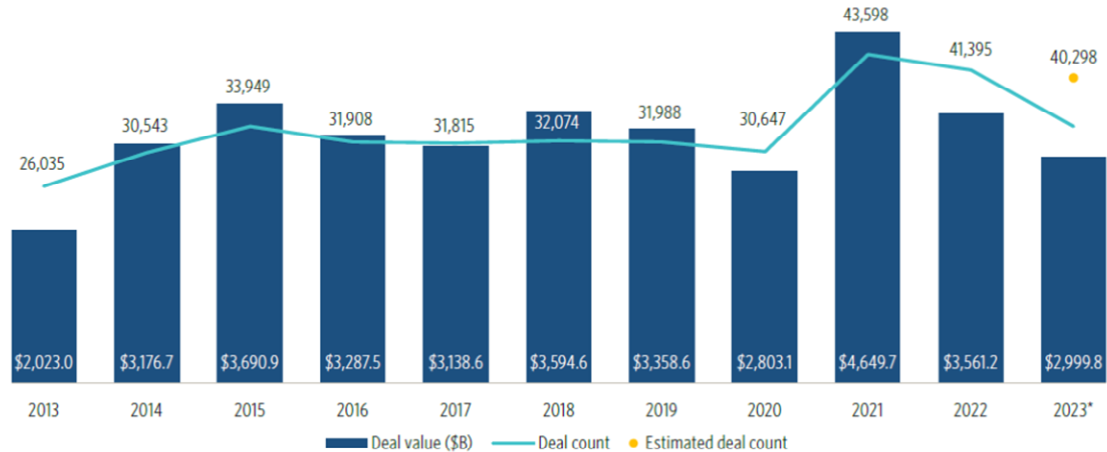
1. Global M&A Review and Top Trends in 2024
2. Controlling Stockholders in Technology M&A



Global M&A Review Top Trends In 2024

Global M&A Review

M&A Activity Over the Past Decade



Source: PitchBook • Geography: Global • *As of December 31, 2023

- 2023 – second weakest year in exactly a decade
- Total deal value = \$3 trillion → 15.8% decrease from 2022

Global M&A Review

Behind the Numbers



High Interest Rates



Economic Uncertainty



Regulatory Headwinds

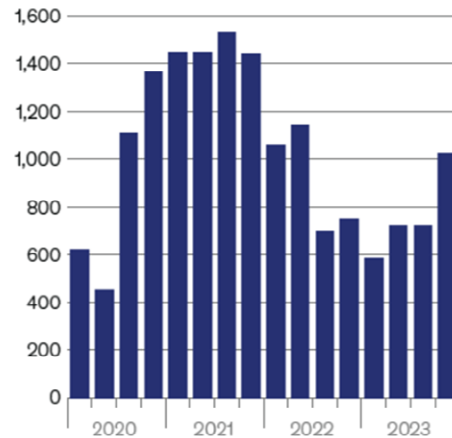


Geopolitical Tensions

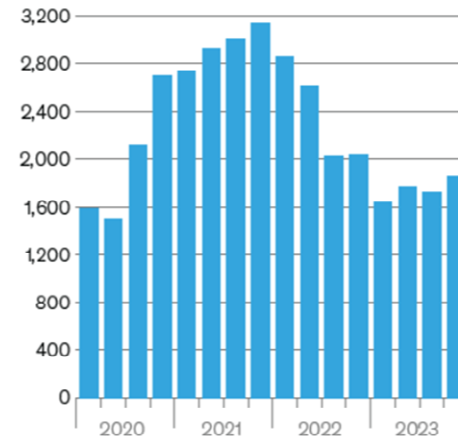
Global M&A Review

Global M&A Activity Jumped in Q4 2023

Deal value by quarter, \$ billion



Number of deals by quarter



¹Deals announced (and not withdrawn) of value greater than \$25 million.
Source: Dealogic; McKinsey analysis

Global M&A Review

Tech M&A Highlights in 2023

Acquirer	Target	Rationale	Value (billions)
Cisco Systems	Splunk Inc.	To provide security analytics across different devices and environments	\$28.0
CPP Investments, Silver Lake	Qualtrics	Expanding enterprise cloud software platform	\$12.5
Nasdaq, Inc	Adenza Group, Inc.	To add risk management, regulatory, and capital markets software and technology	\$10.5
Francisco Partners, TPG	New Relic	To gain access to New Relic's technology and intellectual property and work with management to continue investing in research and development	\$6.5
Concentrix Corporation	Webhelp SAS	To strengthen its end-to-end CX value proposition	\$4.85

Deal data has been sourced from Capital IQ, Pitchbook, and KPMG analysis and majorly excludes asset purchases/minority purchases. The values and volumes data cited are for U.S. deals announced between 1/1/2023 and 12/31/2023. Deal values are only presented based on publicly available deal data and are not exhaustive. Previously published statistics may be restated to incorporate new data and/or any changes.

Top Trends in 2024

Generative AI in M&A



Antitrust

National Security



Rep & Warranty Claims

Shareholder Activism



Top Trends in 2024

AI M&A | Key Drivers

- AI infrastructure companies enhancing core products
- Enterprise software companies answering market needs
- Vertical players accelerating use of AI
- Startups exiting sooner

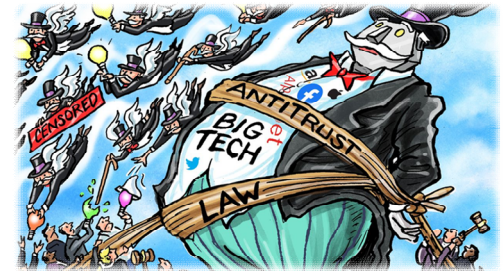


Top Trends in 2024

Antitrust | Growing Scrutiny

Aggressive Enforcement and Major Shifts in Review Process

- Agencies remain aggressive despite skepticism from courts
- New Merger Guidelines indicative of paradigm shift
- Enforcement abroad on the rise



Top Trends in 2024

National Security | Amped Up

- U.S. Review Hyper-Focused on High-Risk Sectors (CFIUS)
- Expansion of Global Foreign Direct Investment Review Regimes
- U.S. Outbound Investment Review (Reverse CFIUS)
- Increase in Global Sanctions and Export Controls



Top Trends in 2024

Representations & Warranties Insurance Claims (RWI)

- New types of claims
- Longer wait for claims payouts
- Delays dues to inadequate information



Top Trends in 2024

Shareholder Activism | Continued Impact on M&A

- Activists push for or complicate M&A efforts
- SEC modernizes beneficial ownership filings
- Anti-ESG Movement



Key Takeaways

A photograph of a modern building's glass and metal facade at dusk. The building features a grid of dark metal beams and large glass panels. A prominent, sharp spire is visible on the right side of the frame. The sky is a deep blue, and the overall lighting is dim, suggesting twilight.

Key Takeaways: Global M&A Review and Top 2024 Trends

- In 2023, global M&A activity fell to its lowest level in 10 years
- *Rising interest rates, ongoing economic uncertainty, regulatory headwinds and geopolitical tensions* were major factors behind the downturn in global M&A
- The M&A market showed signs of recovery in Q4 2023
- Technology M&A was a top choice for dealmakers – accounting for 27% of deal value
- Top trends for global M&A in 2024
 - Generative AI
 - Antitrust
 - National Security
 - RWI
 - Shareholder Activism
- Looking forward – what to expect for global M&A in 2024
 - Dealmakers anticipate the M&A environment will continue the trend from Q4 2023 and improve
 - Assets that did not come to market in the down year of 2023 will fuel active dealmaking in 2024
 - Corporates will sell assets that do not fit with their strategy; private equity will sell aging portfolio companies

Controlling Stockholders in Technology M&A

Controlling Stockholders in Technology M&A Transactions

Fiduciary duties - the basics

- Corporate fiduciaries (i.e. directors, officers, controlling stockholders) must act in the best interest of the corporation and all of its stockholders
- Duty of care
- Duty of loyalty
- Duty of oversight

Controlling Stockholders in Technology M&A Transactions

Standards of review under Delaware law:

- Business Judgment Rule (BJR) – presumption that corporate fiduciaries met their fiduciary obligations
- Enhanced Scrutiny – the so-called “Revlon Duties”
- Entire Fairness – “most onerous standard” under Delaware law because conflicts of interest exists. Defendants must prove “entire fairness” – both fair price and fair dealing.

Controlling Stockholders in Technology M&A Transactions

- In most technology M&A deals, there are “controlling stockholders” (e.g. **preeminent founders or serial entrepreneurs, Superstar CEOs, high profile venture capitalists, angel and strategic investors**) that may have conflicts of interest in an acquisition, sale or merger of the company. Even minority stockholders may be deemed to have “control” under Delaware law.
- What is “control”
 - Ownership of 50% or more of the voting securities; or
 - **Exercises control over the business affairs of the corporation**
- Implications of “control”
 - Controlling stockholder owes fiduciary duties to the corporation and all of its stockholders
 - Controlling stockholder will be scrutinized under the **“entire fairness” standard**

Controlling Stockholders in Technology M&A Transactions

- “Control” by minority stockholders may be found under these scenarios:
 - Right to elect a majority of the Board of Directors
 - **Domination and coercion** over the Board of Directors and its decisionmaking process (“**inherent coercion**” of the Board as a controlling stockholder)
 - Close **personal relationships** with members of the Board of Directors
 - Veto rights to block the corporation from raising new financing and taking other important actions
 - “**Outsized influence**” over the company and the Board, including through high status roles like CEO, Chairman and/or founder
 - Commercial or business relationships with the company through material agreements (e.g. key supply agreements, management agreements ceding managerial authority, etc.)
- “Control Group”
 - Coordination with other stockholders
 - A “control group” exists if there is a “**legally significant connection**” to work towards a common **goal** (Sheldon v. Pinto Tech. Ventures, L.P., Del. 2019)

In re KKR Financial Holdings LLC Shareholders Litigation (Del. Ch. October 14, 2014)

- Noteworthy case, involving “the novel claim that a holder of less than one percent of the stock of a Delaware corporation was a controlling stockholder and thus owed fiduciary obligations to the other stockholders of the corporation”
- KKR acquired KKR Financial Holdings LLC (“KFN”) in a merger valued at \$2.6 billion, a 35% premium
- KKR owned less than 1% of KFN at the time of the acquisition
- KFN was dependent on a “management agreement” with KKR Financial Advisors LLC (“KFA”), KKR affiliate
- KFN had the right to terminate the management agreement, but had to pay a termination fee of 4x the sum of the average annual management fees for the two years preceding the termination
- KFN’s public filings describe KFN’s dependence on KFA: “We have no employees...we are completely reliant on our Manager” (KFA)
- However, the court held that there was no reasonable inference that KKR controlled the Board of Directors of KFN, “which is the operative question under Delaware law for determining whether a stockholder is controlling”
- Did KKR control the KFN Board such that the KFN Board “could not freely exercise their judgment in determining whether or not to approve and recommend to the stockholders a merger with KKR”

In re Pattern Energy Group Inc. Stockholders Litigation (Del. Ch. May 6, 2021)

- Under certain facts, **even non-stockholders may be deemed a “controlling stockholder”** through exerting **“soft sources of power”**
- Former stockholder and lead plaintiff brought post-closing class action claims against Pattern Energy Group Inc. (the “Company”), its private equity investor (“Riverstone”), its upstream supplier (“Developer 2”) (together, the “Entity Defendants”), the special committee of the Board of Directors of the Company and the conflicted directors and officers of the Company (the “Officer Defendants”) for breach of fiduciary duties in a cash acquisition of the Company by a buyer preferred by Riverstone
- The court denied the defendants’ motion to dismiss because “Plaintiff may establish that the Officer Defendants and Entity Defendants constitute **a control group owing fiduciary duties**” and explained that the **entire fairness** standard of review may apply
- The court held that plaintiff’s “control group theory **aggregates** the Officer Defendants’ **stock holdings** and **management roles** with the Entity Defendants’ **contractual, operational, and structural pull**, even though the Entity Defendants are **not stockholders**” of the Company or Developer 2
- The Court pointed out that “liability for breach of fiduciary duty therefore extends to **outsiders who effectively controlled the corporation**”

In re Tesla Motors, Inc. Stockholders Litigation (Del. June 6, 2023; Del. Ch. April 27, 2022)

- In 2016, Tesla acquired SolarCity, a publicly traded Delaware corporation that installed and financed solar photovoltaic systems, in a stock-for-stock merger valued at \$2.6 billion
- SolarCity background:
 - SolarCity was founded by Elon Musk's cousins, Peter Rive and Lyndon Rive
 - Musk was Chairman of the SolarCity Board of Directors from inception until the closing of the Acquisition, and was SolarCity's largest stockholder (approx. 22%)
 - In 2015, SolarCity in liquidity crisis
 - SolarCity issued "Solar Bonds" to SpaceX and Musk to finance its operations
 - In early 2016, Lyndon Rive called an emergency management meeting, which Musk attended
- Tesla Board process:
 - Musk presented the acquisition proposal to the Tesla Board, which the Board initially rejected
 - In May 2016, the Board approved moving forward with the acquisition, with **Musk and another director (Kimbal Musk) recusing themselves**
 - Other directors had **varying degrees of conflict**, but **no independent special committee was formed**
 - Only one director on the Tesla Board was independent and led the deal negotiations with SolarCity

In re Tesla Motors, Inc. Stockholders Litigation (Del. June 6, 2023; Del. Ch. April 27, 2022)

- Timeline of the deal:
 - July 31, 2016 – merger agreement between Tesla and SolarCity signed
 - October 12, 2016 – Tesla and SolarCity file definitive proxy statements
 - November 17, 2016 – approx. 85% of the Tesla stockholders voted in favor of the Acquisition
 - November 21, 2016 – the Acquisition closes
- Tesla stockholders' claims:
 - Several stockholders bring claims against Tesla, Musk and other members of the Board of Directors of Tesla for breach of fiduciary duties and other claims
 - Plaintiffs claim that Musk breached his duty of loyalty as a “controlling stockholder” as well as a director of Tesla by “orchestrat[ing] Board approval of the Acquisition, which unfairly provides SolarCity’s stockholders...with excessive value” and harmed Tesla by “causing Tesla to bail out an insolvent SolarCity.”
 - The trial court rejected the defendants’ motion to dismiss, finding that it was “reasonably conceivable that Musk, a minority blockholder, was Tesla’s controlling stockholder and exerted control over the Tesla Board”

In re Tesla Motors, Inc. Stockholders Litigation (Del. June 6, 2023; Del. Ch. April 27, 2022)

- Because there was a reasonable inference that Musk was a “controlling stockholder,” the court applied the **entire fairness standard of review** (not BJR) and reviewed the fiduciary duty claims with the “**highest degree of scrutiny** recognized in our law”
- Musk’s position at Tesla:
 - Co-founder of Tesla
 - Largest stockholder of Tesla (approx. 22%)
 - Chairman of the Tesla Board of Directors from April 2004 to November 2018
 - Continuously served as Tesla’s CEO since October 2008
- The trial court found:
 - Musk “regularly exercised **control over Tesla’s Board**” and possessed “**outsized influence**” over Tesla and its Board
 - Musk dominated the Board “during the process leading up to the Acquisition against the backdrop of his **extraordinary influence within the Company generally**”
 - There were “Board level conflicts that **diminished the Board’s resistance to Musk’s influence**”
 - Musk assumed “**managerial supremacy**”

In re Tesla Motors, Inc. Stockholders Litigation (Del. June 6, 2023; Del. Ch. April 27, 2022)

- Delaware Supreme Court held that “Musk carried his heavy burden [of proof]” and “[w]e are convinced that the record supports the conclusion that **the Acquisition was entirely fair.**”
- Entire fairness (fair price, fair dealing):
 - Tesla Board’s process included “several redeeming features that **emulated arms-length bargaining to the benefit of Tesla stockholders**”
 - Musk’s control was “**effectively neutralized** by a board focused on the *bona fides* of the Acquisition”
 - An “**indisputably independent director**” **led the negotiations** of the Acquisition
 - Musk did not engage in “pressure tactics that went beyond ordinary advocacy to encompass aggressive, threatening, disruptive or punitive behavior”
 - “**While involved, Elon did not impede the Tesla Board’s pursuit of a fair price**”
 - “[P]reponderance of the evidence reveals that Elon’s influence **did not degrade the entire fairness of the Acquisition**”

In re Tesla Motors, Inc. Stockholders Litigation (Del. June 6, 2023; Del. Ch. April 27, 2022)

Various merits of the Acquisition included:

- Back in 2006, Musk made a public announcement that “Tesla’s mission is to accelerate the world’s transition to sustainable energy” and “to help expedite the move **from a mine-and-burn hydrocarbon economy towards a solar electric economy**”
- “Tesla declared that it would enter the solar energy industry long before Elon proposed the Acquisition; the Tesla Board decided the timing was right to acquire a solar energy company based on an evaluation of **legitimate business considerations**”
- As of the closing of the Acquisition, SolarCity delivered substantial value to Tesla, including 15,000 employees, **\$200 million per month in business**, over 300,000 customers, over \$3 billion in future cash flows, net assets in excess of its market capitalization, **at least \$150 million per year in cost synergies**, **Tesla booked \$89 million gain on the Acquisition**
- There was an **“astronomic rise in Tesla’s stock price post-Acquisition** is noteworthy...hindsight suggests that Elon is right when he asserts that, once valued as a car company, **Tesla is now valued as a ‘first-of-its-kind, vertically integrated clean energy company’**”
- “[T]here can be no doubt that the combination with SolarCity has allowed Tesla to become what it has for years told the market and its stockholders it strives to be – an agent of change that will **‘accelerate the world’s transition to sustainable energy’**”

Tornetta v. Musk (Del. Ch. January 30, 2024)

- Tornetta, a shareholder, brought suit against Tesla, Musk and other members of Tesla's Board of Directors for breach of fiduciary duty, unjust enrichment and other claims for awarding Musk a new equity compensation plan with a **\$55.8 billion maximum value**
- The largest executive compensation plan "ever observed in public markets by **multiple orders of magnitude** – 250 times larger than the contemporaneous median peer compensation plan and over 33 times larger than the plan's closest comparison, which was Musk's prior compensation plan"
- The court applied the entire fairness standard of review:
 - conflicted-controller transaction; and
 - **majority of the Tesla Board had conflicts of interest**
- The court held that Musk is a "controlling stockholder" dominating the process resulting in Board approval of his new compensation plan:
 - Musk's status as a **"Superstar CEO"**
 - Musk enjoyed **"thick ties with the directors tasked with negotiating on behalf of Tesla"**
 - **"Control mindset"** of the Board

Tornetta v. Musk (Del. Ch. January 30, 2024)

Board of Directors of Tesla (“Meet The Decision Makers”):

1. Elon Musk
2. Kimbal Musk, brother
3. Antonio Gracias – Compensation Committee
4. James Murdoch
5. Ira Ehrenpreis – Chair of Compensation Committee
6. Brad Buss – Compensation Committee
7. Robyn Denholm – Compensation Committee
8. Linda Johnson Rice – independent and disinterested
9. Steve Jurvetson – on long leave of absence

Tornetta v. Musk (Del. Ch. January 30, 2024)

Antonio Gracias (Compensation Committee)

- On the Tesla Board since 2007 and the Compensation Committee since 2009
- A “close friend” of Musk
- 20-year friendship with Kimbal and investor in Kimbal’s businesses
- Founder and manager of PE firm, Valor Equity Partners
- Third largest individual investor/stockholder in Tesla
- Admitted that Musk gave him “dynastic or generational wealth”
- Over \$1 billion interest in entities controlled by Musk
- Serves on Board of SpaceX
- Served on Board of SolarCity
- Close personal relationship with Musk

Tornetta v. Musk (Del. Ch. January 30, 2024)

James Murdoch:

- Former CEO of 21st Century Fox and media/entertainment executive
- Operates a privately-held investment company
- Investment company invested approx. \$50 million in SpaceX
- Murdoch personally invested approx. \$20 million in SpaceX
- Received \$35,000 cash for serving on Tesla Board
- Owns 10,485 shares of Tesla, which Murdoch purchased on the market (not compensation)
- Met Musk in the 1990s and friends since 2006/2007 when Murdoch bought a Tesla Roadster
- Gracias and Musk invited Murdoch to join the Tesla Board after a family vacation together
- Close personal relationship with Musk and his brother

Tornetta v. Musk (Del. Ch. January 30, 2024)

Ira Ehrenpreis (Chair of Compensation Committee)

- On the Tesla Board since 2007
- Chair of Compensation Committee since 2009
- Chair of the Nominating and Corporate Governance Committee since 2009
- Founder and managing partner of DBL Partners
- Received stock options for 865,790 shares of Tesla stock
- Gained over \$200 million in income in 2021 from Tesla stock
- Held interests worth at least \$75 million in other Musk-controlled entities
- Personal and professional relationship with Musk
- Tweets regarding Musk
- Relationship with Kimbal Musk (brother)

Tornetta v. Musk (Del. Ch. January 30, 2024)

Brad Buss (Compensation Committee)

- Former CFO of SolarCity
- Earned approx. \$2 million in compensation from Solar City
- Made approx. \$17 million in compensation from Tesla as a Board member
- Received \$24 million from sale of Tesla shares as part of Board compensation
- Approx 44% of his net worth to Musk-controlled entities
- Resigned from the Tesla Board after the Musk compensation plan was granted

Robyn Denholm (Compensation Committee)

- Buss recommended that Denholm join the Tesla Board
- Became Chair of the Tesla Board after Musk's 2018 settlement with the SEC requiring Musk to relinquish his position as Chair
- Previously led the SolarCity acquisition negotiations as an independent director
- Made approx. \$17 million in compensation from Tesla as a Board member
- Received \$280 million from sale of Tesla shares as part of Board compensation, which she described as "life-changing"

Tornetta v. Musk (Del. Ch. January 30, 2024)

- “**Transaction-Specific** Control” (dominates Board approval process for a specific transaction) vs. “**General** Control” (control over the business affairs of the corporation)
- Musk as “controlling stockholder”:
 - Musk’s approx. 22% block “gives him a **sizable leg-up**” for stockholder votes and influence over the Board
 - “**Managerial supremacy**” and “**maximum influence**” over managerial decisions, decision makers and the approval process
 - “Most **powerful trifecta of roles** within a corporation – CEO, chair and founder”
 - Musk has “power to direct operational decisions at Tesla”
 - “**Superstar CEO**” is “relevant to controller status”
 - Majority of the Board were beholden to Musk through business, financial and personal ties
 - Board unable or unwilling to rein in Musk
 - **Musk free of Board oversight**
 - Changed his title to “Technoking” without consulting the Board

Key Takeaways



Key Takeaways: Controlling Stockholders in Technology M&A

- Who has “control”?
 - Mathematical majority vs. “Control” over business affairs of corporation
 - “Control group”
- “Transactional Control” and “General Control”
 - Actual control over the transaction at issue
 - Influence and domination of the Board, management and decision making
- Focus on Board approval process and relationship to controlling stockholder
 - Was the majority of the Board disinterested and independent?
 - Did the controlling stockholder prevent the Board from freely exercising its independent judgment?
 - Did the controlling stockholder have the power to extract retribution (e.g. removal)?
- Avoid entire fairness review through procedural safeguards:
 - Consult independent experts – outside counsel, financial advisor
 - Special committee of the Board with independent, disinterested members
 - Board members fully empowered to say “no” to a transaction without fear of retaliation
 - Conditioning the deal upfront on a majority of the disinterested stockholders
 - Fully informed, uncoerced majority vote of non-controlling or unaffiliated stockholders

Questions?

Biography



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Nancy Yamaguchi advises global technology companies on cross-border mergers and acquisitions (M&A), strategic and venture capital investments, joint ventures, strategic alliances, technology transactions, and licensing. Nancy is ranked Band 1 for Corporate/M&A: Deals in Asia by *Chambers* and recognized by clients as having "a business mind and tremendous attention to detail." In addition, they note that "she is great at negotiation and everything legal and is extremely helpful in concluding multinational deals." Nancy is a member of Morgan Lewis's Committee on Foreign Investment in the United States (CFIUS) working group, advising both US and non-US technology companies on CFIUS compliance issues.

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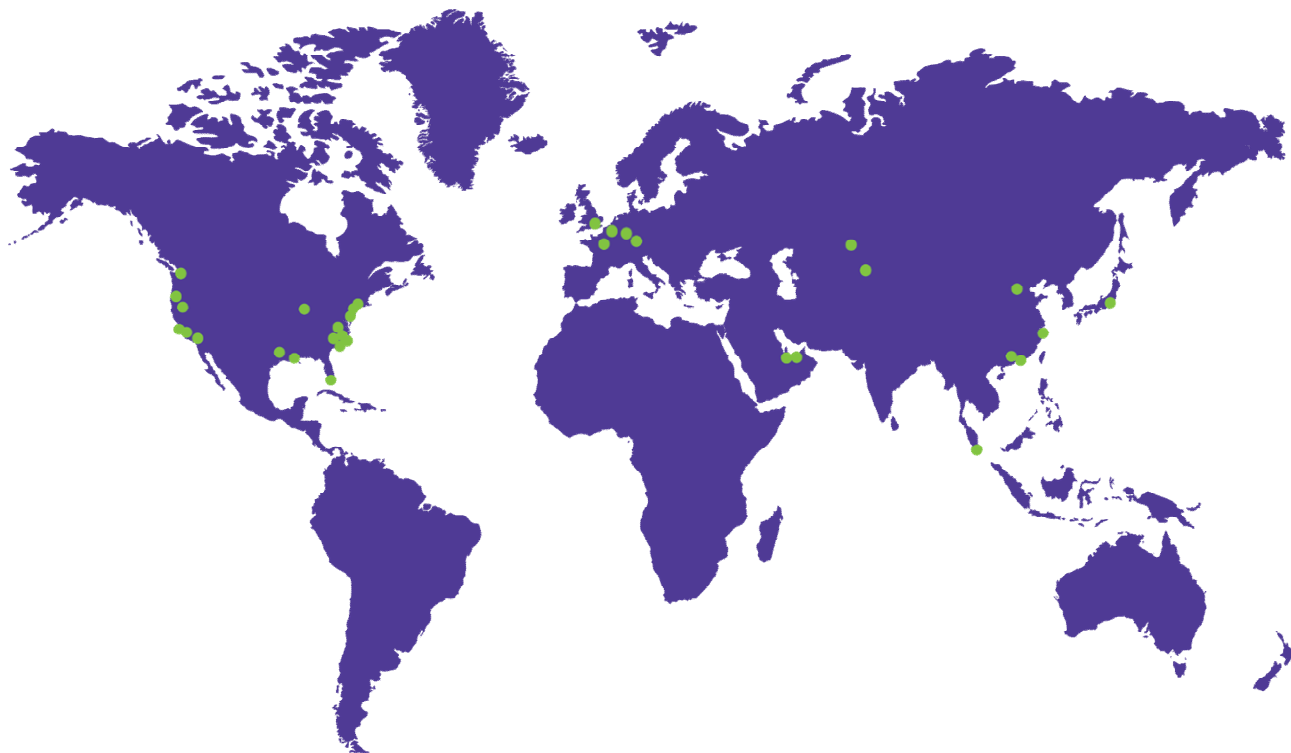
With more than 25 years of experience, Khoa D. Do focuses on strategic and private equity mergers and acquisitions (M&A) transactions, ranging from midmarket to large-scale acquisitions involving publicly traded and privately held corporations. Khoa advises technology companies and private equity firms on a range of transactions, including strategic mergers and business combinations, asset and stock acquisitions, and complex cross-border acquisitions. He also represents clients on tender offers, divestitures, and spinoffs. Khoa's technology-focused clients come from the software, semiconductor, cybersecurity, life sciences, and sports and entertainment industries.

Our Global Reach

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Latin America
Middle East
North America

Our Locations

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Dallas
Dubai
Frankfurt
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