

AGENDA

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Opinion

Five Questions Boards Should Ask About M&A Risk

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Five years of global U.S. growth has finally revitalized a dormant M&A market, as deal volume surged 75% year-over-year to \$1.75 trillion as of late June, bringing valuations closer to pre-crisis levels. Acquisition announcements spanned all industries in 2014, from telecoms — AT&T's \$67 billion bid for DirectTV — to the biomedical field: Medtronic's planned \$43 billion acquisition of Covidien.

Robert Zinn is a practice area leader at global law firm **K&L Gates**, where he is a member of the global boardroom risk solutions team.

But as the pace of dealmaking increases, so do the risks. Drugmaker AbbVie's board dropped a takeover of Ireland's Shire after the Obama administration restricted the tax benefits of such tax inversion deals. The strategy reversal means AbbVie must pay Shire a \$1.64 billion breakup fee. Meanwhile, the Comcast-Time Warner Cable merger faces anti-trust scrutiny.

To help boards understand M&A risks better, *Agenda* contacted Robert Zinn, a practice area leader at law firm **K&L Gates**, where he is a member of the global boardroom risk solutions team. Below are five questions that Zinn believes all boards should ask about the pending risks of M&A transactions.

1. Are our assumptions about synergies realistic?

Directors can fail to understand assumptions regarding synergies that underpin a company's buy decision. Board members should insist that management present a carefully developed integration plan as part of the pre-closing acquisition process. As an example of a hot-button item, companies often underestimate the timing and cost to rationalize a European or Australian target company's workforce post-acquisition. In those jurisdictions, there are significant contractual and statutory employment entitlements, requiring complex consultation with affected employees. These factors could inject real timing and monetary impediments to a successful acquisition.

2. Are we thinking about what our key shareholders want?

Shareholder activism is here to stay. It comes in many forms and with different goals, timing requirements and sensitivities to boards and management teams. But the shared aim is a desire to improve performance and generate returns for investors. In recent years, activists began closely scrutinizing a company's deal sourcing methodology and acquisition approach. And they're not afraid to voice their views of pending deals and, in some cases, even to encourage transactions that they view as beneficial.

A passive, reactionary approach is not the order of the day. Directors need to think like activists and do three things: ensure that their management teams regularly review strategic alternatives; model promising acquisition targets; and have a deep understanding of the financing markets.

3. What are we doing to minimize business and legal risk?

Many directors who monitor risk management issues during the company's sale lose focus when their companies are looking at buy-side deals. This can be a real mistake. In addition to legal liability that may result from a poorly structured process, acquiring companies face significant business risks associated with disorganized practices. Overall, directors must set a "tone at the top" for acquisitions that implies meeting high standards in every regard.

4. What are we doing about cyber-security risk?

Serious cyber-security incidents can go undetected for long periods after closing. This means a merger or acquisition can be, and often is, consummated before either the acquiring company or the target become aware of a possible cyber-security incident. When an acquisition is on the horizon, directors should direct management to undertake a cyber-security assessment of the target company as part of their deal due diligence.

5. Do we have adequate historic or deal-specific insurance?

Failure to consider insurance coverage adequately can make a good deal go bad. And the risks can rise in any number of unintended ways. Companies can fail to document the intended allocation of insurance rights and duties in the underlying transactional documents properly. They can also not properly insure adequate directors and officers coverage and struggle to address gaps in the target company's insurance program.

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