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# Emerging Life Sciences Companies

second edition

## Chapter 29

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Overcoming the Unique Challenges in  
Private vs. Public Life Sciences M&A

## Chapter 29

# OVERCOMING THE UNIQUE CHALLENGES IN PRIVATE VS. PUBLIC LIFE SCIENCES M&A

In order to overcome the challenges that face a life sciences company such as yours in a merger or acquisition, you need to understand the differences between private companies' and public companies' reasons for entering into a merger or acquisition, the different structures for private and public merger and acquisition deals, and the limitations that are placed on structures for public companies. The following outline sets forth some of the key points in understanding these unique challenges.

### Drivers

- A. Big Pharma seeking new products
- B. Biotechs have attractive assets
- C. Pressure on biotechs to grow
- D. Biotechs more realistic about risks
- E. Challenging equity market conditions
- F. Biotech pressure toward commercial scale and growth
  - 1. M&A to build fully integrated pharmaceutical company
  - 2. Biotech-biotech deals to grow critical mass
- G. Weak companies attracted to each other
  - 1. Company with products but no cash attracted to company with cash and no products
  - 2. Could be companies that raised a lot of cash but now face product problems
  - 3. Few alternatives
- H. Buy vs. build
  - 1. Geographic locations and facilities
  - 2. Experienced management teams
  - 3. New product areas (biologics, vaccines)

## **Drivers vs. Collaborations**

- A. Control over clinical trials and IP
- B. No diligence obligations
- C. No (or limited) governance diversion
- D. No exclusivity encumbrances
- E. Keep 100% of profits
- F. Defer portion of purchase price

## **Constituencies**

- A. Company
  - 1. Looking to grow company
  - 2. Add commercial products
  - 3. Corporate partnering deals
  - 4. Financing needs
- B. Investors
  - 1. Looking for route to liquidity
  - 2. Looking for highest possible valuation
  - 3. M&A higher valuations than IPO markets
  - 4. See M&A as viable alternative to IPO
- C. Licensors
  - 1. Could be affected—agreements need to be reviewed
  - 2. Universities, research institutes, other biotechs, large pharmaceutical companies pruning pipelines
- D. Licensees
  - 1. Could be affected—agreements need to be reviewed
  - 2. Other biotechs, big pharmas, and specialty pharmas
- E. Collaboration partners
  - 1. May need consents
  - 2. Could be encumbrance on acquisition
  - 3. Could grow into M&A

- F. Need to confirm: scope of rights; assignable (depending on M&A structure); no noncompete issues

### **Alternatives**

- A. Financing/IPO
- B. Collaboration
- C. Next stage of growth
- D. Remain independent
- E. Biotechs are considering all alternatives
  - 1. Depends on offers
  - 2. Will likely weigh both M&A and collaboration offers

### **Preliminary Issues**

- A. Timing of transaction
  - 1. Strength of IP
  - 2. Clinical data
  - 3. Remaining funding
- B. IP
  - 1. Status of patent filings and issuances
  - 2. Clinical data
    - a. Status of completed trials and availability of data
    - b. Status of ongoing trials
    - c. Trials about to be started, and acquiror input
  - 3. Sufficient remaining funding will permit flexibility in timing and independence in negotiations
- C. Preparation
  - 1. Due diligence will be thorough
  - 2. Must have house in order
    - a. Public company should have everything material organized via public filings, but still need other items organized
    - b. Public disclosures will engender more questions for fulsome explanation

3. Sarbanes-Oxley
  - a. Public targets: compliance due diligence needed
  - b. Private targets: present postclosing integration compliance challenges and expenses

### **Ancillary Documents and Disclosure Issues**

- A. Confidential disclosure agreements
  1. Mutual
  2. Standstill
- B. Bid letters
- C. Disclosure obligations for public companies
  1. Generally no disclosure event until definitive agreement is executed
  2. Close trading window
  3. “No comment” policy
  4. Continued disclosures on routine items
    - a. Earnings announcements
    - b. Periodic filings
    - c. Clinical trial results
  5. Triggers for disclosure
    - a. Update prior statements
    - b. Rumors that trigger unusual trading activity
    - c. Stock exchange inquiries
- D. Representations
  1. Public targets: enhanced representations of financial condition, SEC filings, internal controls, off-balance-sheet arrangements, and whistleblower issues
- E. Public announcements
- F. Disclosure provisions
  1. Agreement addresses announcements and interim period disclosures
  2. Tension between confidentiality and material disclosure obligations if public company

## M&A Variations

- A. Outright acquisition
  - 1. Tender offer
    - a. Public target
    - b. Two-step deal, faster than merger proxy
    - c. New tender offer “best price” rule
  - 2. Mergers and stock deals
    - a. Need to consider change of control provisions
    - b. Forward merger need to consider assignment provisions
    - c. Take all assets and liabilities
    - d. Indemnification probably not available
      - (i) Yes, if acquiring subsidiary
      - (ii) Maybe, if acquiring private company
      - (iii) Maybe, if acquiring public company with majority shareholder
  - 3. Asset deal
    - a. Can reduce liability exposure
    - b. Will assets acquired be sufficient to run business?
    - c. Indemnification probably available
- B. Partial deal structures
  - 1. Product deals
  - 2. Partial deal structures
    - a. Majority stake with large public block; usually biotech has IPO in trouble
    - b. Continued participation in upside and future potential IPO
    - c. Examples:
      - (i) GSK-Theravance: Collaboration with broad option; equity with GSK call on 50% of equity at fixed price and Theravance shareholders put at lower price
      - (ii) Novartis-Idenix: Collaboration with broad option; 54% equity from shareholders for cash plus contingent payments; Idenix IPO

- (iii) Gilead-Corus: \$25MM equity investment with option for remainder
  - d. Where option for future products, strange dynamic if not exercised (hurts equity investment if “subsidiary” has gone public, like Idenix)
- 3. Spin-out of undervalued assets into new company to be owned by former investors, such as:
  - a. Peninsula-J&J: Cerexa spun off; later acquired by Forest
  - b. Conforma-Biogen: Cabrellis spun off; later acquired by Pharmion
- 4. Governance
  - a. Acquiror seat(s) on board but that could lead to complex agreements for decisions on related transactions
  - b. Shareholder representative in private company deals, if contingent payments
- C. Form of consideration
  - 1. Cash
  - 2. Stock
    - a. Exchange ratios/collars
    - b. If target is public: two variables to measure
    - c. S-4 for public acquiror’s stock
  - 3. Combination: if shareholders do not elect to receive cash they will receive stock
  - 4. Adjustments
    - a. Net asset and net worth tests
    - b. Adjustments for specific liabilities not resolved at closing (based on balance sheet/income statement)
  - 5. Contingent payment setoffs
    - a. Contingent payments
    - b. Essentially milestones
    - c. Diligence obligations
    - d. Private target needs to consider IRC 409A issues
    - e. Examples:
      - (i) OSI–Cell Pathways (public target)
      - (ii) Biogen Idec–Conforma

(iii) Cephalon–Saldemix

D. Timing of transaction

**Other Agreements and Issues**

A. Shareholder stock purchase

B. Voting

C. State law on business combinations

D. Rights plans

E. Indemnity (e.g., private target holdback or majority shareholder)

F. Stock purchase agreement

1. Private or public majority shareholder

2. In public company, issue whether shareholder obligation to sell will track board recommendation

3. Voting agreement

G. Public targets

1. Business combination and control share statutes

2. Poison pills/rights plans

**Pending Closing**

A. No-shop clauses, which are typical in all deals, public or private

B. Fiduciary outs/break fees

1. Typical only in public deals

2. Permits target to terminate for a “superior proposal”

3. Can have “force the vote” provisions

a. Requires merger to be submitted to shareholder vote regardless of whether board has changed its recommendation

b. Omnicare: “Force the vote” plus voting agreements that assure approval were found unreasonable by Delaware Court

C. Shareholder approval

1. Private target

a. State law requirements

b. Line up requisite vote in advance

2. Public target
    - a. Proxy statement
    - b. Disclosure of background of merger
    - c. Fairness determination and financial advisor fairness opinion
  3. Appraisal rights
- D. Stock registration
  - E. Consents
  - F. Hart-Scott-Rodino Act