

Key Provisions of Acquisition Agreements

February 2016

The Definitive Document and Ancillaries

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The Definitive Document and Ancillaries

- Types of Definitive Agreements
 - Merger Agreement
 - Stock Purchase Agreement
 - Asset Purchase Agreement
- Support Agreements from Major Stakeholders
 - Stockholder Voting or Lockup Agreements
- Ancillary Agreements
 - Non-Compete / Non-Solicitation
 - Escrow
 - Transition Services
 - Employment Agreement
 - Licenses
 - Stockholders Agreement
 - Registration Rights Agreement

Key Provisions of All Acquisition Agreements

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Key Provisions of All Acquisition Agreements

- Virtually all acquisition agreements have the same basic structure:
 - **Description of the Deal:** what is being purchased, structure of the acquisition and how/when it will be paid for
 - **Representations and Warranties:** statements of fact and assurances made by the parties that help determine the quality, nature and risks of what is being acquired
 - **Covenants:** promises to take certain actions before and after closing
 - **Conditions:** what must happen before the parties are obligated to close the deal
 - **Indemnification:** allocation of risk for breaches of representations, warranties and covenants
 - **Termination:** when and how the parties can walk if the deal doesn't close and the consequences of walking

Describing the Deal

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Describing the Deal

- Identification of assets and liabilities
 - **Asset Purchase** – “all or substantially all” vs. specified assets
- Deal structure/mechanics
 - **Merger** – direct, forward triangular, reverse triangular, multi-step, spin-offs)
 - **Stock Purchase** – direct stock purchase vs. tender offer
- Amount and Form of Consideration
 - Cash, buyer securities, assumption of debt/liabilities, exchange of assets (real property, personal property, IP), or some combination
- Amount and Timing of Payment(s)

Describing the Deal (cont'd)

- Purchase Price or Balance Sheet Adjustments
 - Working capital is predominant purchase price adjustment; included in 83% of private target deals in 2014 (*2015 ABA Deal Point Study*)
 - Some other types of adjustments include: earnings, debt, assets, and cash (and the majority of deals used some combination of these metrics to determine the appropriate adjustment, if any)
- Holdbacks/Escrow
 - Holdback = buyer retains funds; Escrow = funds held by third party
 - Triggers may include a specified date, or occurrence of certain post-closing conditions

Describing the Deal (cont'd)

- Earnouts
 - Only included in 26% of private deals (*2015 ABA Deal Points Study*)
 - Can be used to bridge a valuation gap, and often based on various financial metrics (with EBITDA or earnings being most common);
 - May be used as a potential incentive for incumbent management/owners
 - But present some degree of risk for future disputes and/or litigation

Representations and Warranties – Purposes

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Representations and Warranties – Purposes

- The representations and warranties (“R&Ws”) section is “where the rubber meets the road,” because R&Ws:
 - Force Disclosure
 - Disclosure schedules work in tandem with and qualify the R&Ws
 - Allocate Risk
 - Identifies which parties are responsible for certain items, including which party will assume the risk of unknown conditions and liabilities
 - Can Serve as Closing Conditions
 - A party may not be required to close if the facts presented materially differ from what actually occurred
 - Often required to have a bring-down of R&Ws
 - Establish a Basis for Indemnification
 - Depending on the scope and survival of R&Ws set forward in the parties’ agreement, a breach of a representation or warranty can serve as the basis for a claim for indemnification by the breaching party

Representations and Warranties – Content

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Representations and Warranties – Content

- General Matters:
 - Organization and authority of seller
 - Due execution
 - Board and stockholder approvals (*i.e.*, approval vote required)
 - Governmental, third-party and stockholder consents
 - No conflict or violation
 - Adequate capitalization and clear title
- Business Matters: Identification of the transferred business and its characteristics
 - Title to and sufficiency of assets
 - Material contracts
 - Financial statements (*e.g.*, “fairly presents, in all material respects, . . . in accordance with GAAP”)
 - Internal controls

Representations and Warranties – Content (cont'd)

- Business Matters (cont'd):
 - Current litigation
 - Undisclosed liabilities (**all** liabilities vs. **GAAP** liabilities)
 - Absence of changes (*e.g.*, no MAE)
 - Compliance with applicable law (local, state, federal) and other rules/regulations
 - Full Disclosure (10b-5) Representation (no untrue statements or omission of material fact(s) that would be misleading)
 - SEC filings
 - IP
 - Real Estate
 - Environmental
 - Employment Matters, ERISA and Employee Benefits
 - Tax
 - Company specific (*i.e.*, inventory; customers; A/R)

Representations and Warranties — Issues

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Representations and Warranties – Issues

- Who is making the R&Ws?
 - Selling stockholders vs. selling company, but buyer may also make certain R&Ws as well
 - Because liability may attach if R&Ws turn out to be incomplete, misleading or false, directors and officers will rarely be the party who personally makes any representation or warranty
- Date/Timing of Accuracy of R&Ws
 - “When made” (at signing) vs. “Bring Down” (at closing)
 - Or from a particular date
 - “As of December 31, 2009” vs. “Since January 1, 2010”

Representations and Warranties – Issues (cont'd)

- Qualifying the R&Ws
 - Materiality/Material Adverse Effect (MAE)
 - **MAE**: an event that “threaten(s) the target’s earning potential in a manner that is of significant duration.” (*In re IBP Inc.*, Del. Chancery Ct.)
 - Carefully evaluate exceptions to and carve-outs of MAE
 - Avoid “Double Materiality” Carveout (qualifies materiality in “bring down” component)
 - Majority of private target deals in 2014 included a buyer-friendly “double materiality scrape” with materiality qualifications of R&Ws disregarded for purposes of indemnification (*2015 ABA Deal Points Study*)
 - Knowledge
 - Actual v. Constructive
 - Whose knowledge?
 - “Due inquiry”

Representations and Warranties — Disclosure Schedules

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Representations and Warranties – Disclosure Schedules

- Disclosure schedules are a road map for due diligence
- Anything listed on the disclosure schedules qualifies the R&Ws
 - Can prevent buyer from objecting to closing
 - Can preclude bringing a claim for indemnification post-closing
- Each representation must be reviewed in conjunction with the disclosure schedules

Certain Representations — Material Contracts

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Certain Representations – Material Contracts

- Material Contracts
 - Identify all material contracts
 - May be identified by category type or dollar amount
 - Purpose of representations
 - Provides universe of important and/or material contracts
 - Shows validity and enforceability of these contracts
 - No breaches by either side
 - No amendments or modifications

Certain Representations — Consents / Conflicts

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Certain Representations – Consents / Conflicts

- The “No Conflicts/Consents” representation generally states that the transaction will not violate or conflict with (or result in a breach of any provision of):
 - The governing documents of the representing party, including its certificate of incorporation and bylaws
 - Applicable Law/Regulations
 - Material Contracts
 - May require certain consents and waivers to move forward with deal
 - Hart–Scott–Rodino Act (“HSR”) antitrust requirements
- Also may require the representing party to seek and receive appropriate consents from:
 - Government
 - Third-Parties
 - Interaction with Closing Conditions

Certain Representations — Intellectual Property

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Certain Representations – Intellectual Property

- Intellectual Property
 - Identification of owned and licensed IP
 - Set forth in disclosure schedules
 - Exceptions for commercially available software
 - Valid ownership of intellectual property necessary to operate seller's business
 - Assert that there has been no infringement:
 - By seller
 - By third parties of seller's IP
 - Open source issues
 - Status of licenses
 - In-bound
 - Out-bound
 - Interaction with "Contract" representation

Pre-Closing Covenants

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Pre-Closing Covenants

- Operation of Business between Signing and Closing
 - Affirmative requirements and negative restrictions
 - Beware of premature integration, control (sharing of competitively sensitive information)
- Completion of Deal
- Regulatory Consents
 - Applicable government/regulatory entities
 - HSR/Antitrust approval
- Other Consents
 - Third-party consents
 - Stockholder approval
- Notification of Certain Matters
 - One party may be required to inform the other if certain things occur
- Publicity

Pre-Closing Covenants (cont'd)

- No-Shop Provisions
 - Generally will broadly prohibit seller from soliciting, offering, encouraging, negotiating alternative proposals with potential buyers, providing information to an alternative bidder, or waiving outstanding standstill agreements with third parties. However, certain deals may include limited permissions for the seller's board to provide certain information (subject to confidentiality agreement) to other buyers and to consider a "superior proposal" if one is made
 - Procedural restrictions may provide buyer with:
 - **Advance-Notice and Information Rights:** buyer receives notice of any acquisition proposal and its terms (or a copy thereof) and updates on any negotiations
 - **Matching Rights:** Buyer has a period of time within which to match any superior bid, or may have the right to continually match or top other bids

Post-Closing Covenants

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Post-Closing Covenants

- Non-Competition
 - Geography, duration and scope
 - Reasonableness is key
 - More likely enforced in context of Stock Purchase Agreement vs. an Employment Agreement
- Non-Solicitation of Employees
 - Duration and scope
- Employee Benefits
- Tax Matters
- Stockholder Release
- Continued Confidentiality
- Other Transition Issues

Closing Conditions

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Closing Conditions

- Purpose of Closing Conditions
 - After consents have been obtained, is the business on the table the one that buyer contracted to buy?
 - Have legal requirements been satisfied?
 - Have ancillary agreements been delivered?
- Types of Closing Conditions
 - Bring-down of R&Ws
 - Compliance with covenants
 - Absence of litigation (including any litigation challenging the transaction)
 - Regulatory approvals
 - Third-party and stockholder consents
 - Appraisal Rights
 - (Availability of) Financing

Closing Conditions (cont'd)

- Types of Closing Conditions (cont'd)
 - Absence of Material Adverse Effect
 - Key employee hires / retention of specified employees
 - Execution of ancillary agreements

Indemnification

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Indemnification

- Scope of Indemnification
 - Inaccuracies of R&Ws
 - Breaches of covenants
 - Fraud
 - Specific retained or assumed liabilities
 - Tax, Environmental, Litigation, etc.
 - Sandbagging – whether party seeking indemnification is affected by its investigation or knowledge of certain breaches
 - **Pro-Sandbagging** – party’s right to indemnification is not affected by their investigation or knowledge of whether the other party’s R&Ws are/were correct and covenants are/were complied with
 - **Anti-Sandbagging** – no party is liable if the party seeking indemnification for a loss knew of the breach (which caused the loss) before closing

Indemnification (cont'd)

- Survival Period
 - “Title” and “Deal” Representations
 - Business Representations
 - Certain “Specialty” Representations (Tax, Environmental)

Indemnification (cont'd)

- Limitations on Indemnification
 - Basket (deductible v. threshold)
 - De minimis deductible (e.g., claims below \$5,000)
 - Cap
 - Unlimited, purchase price or fraction of purchase price
 - Exclusions from cap/basket (*2015 ABA Deal Points Study*)
 - Fraud (carve-out included in 80% of private target M&A deals)
 - Capitalization, Due Authority, Due Organization (72%, 85%, 80%, respectively)
 - Title to/Sufficient of Assets (16%)
 - Taxes (74%)
 - Specified liabilities (e.g., known litigation) on disclosure schedule
 - Calculated net of taxes and insurance proceeds
 - Duty to mitigate damages
 - Sole and exclusive remedy
 - Right of setoff

Indemnification (cont'd)

- Security for Post-Closing Obligations of Seller
 - Depends on credit of seller
 - Escrow
 - Holdback
 - Letter of credit
- Processing Claims
 - Notice and other requirements

Termination

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Termination

- Definitive Agreement may be terminated:
 - By mutual consent of parties
 - By one party, if the other party is in breach
 - After the “drop-dead” date
 - Because of the failure to obtain required regulatory approval (e.g., HSR)
 - In the event of a permanent injunction
 - If stockholder approval is not obtained
 - If the target board changes or withdraws its recommendation
 - Due to buyer’s failure to obtain financing

Post-Signing

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Post-Signing

- Communication/Publicity
 - Parties may decide on timing and scope of how to notify certain parties of the ownership transition
 - Employees, customers, suppliers, stockholders, other bidders
- Satisfying Conditions to Closing
 - HSR and other required regulatory approvals
 - Contractual and other third-party consents
 - Seller stockholder approval, if necessary
 - Preparation or execution of ancillary agreements
 - Preparing for the closing

Post-Signing (cont'd)

- Preparing for Integration
 - Both buyer and seller need to be mindful of antitrust laws as they make preparations to integrate their respective businesses after closing (violations may result in fines, penalties and delays)
 - Buyer and seller need to continue to operate as separate businesses between signing and closing and refrain from sharing pricing or other competitively sensitive information during this time period

Post-Closing

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Post-Closing

- After closing, the deal team hands over the business to the business team (including new management)
- Post-Closing Actions under Definitive Agreement
 - Working Capital and other Post-Closing Purchase Price Adjustments
 - Adjustment may involve one or more financial metric
 - May involve holdbacks or escrow release
 - Earn-Out Payments
 - Providing (or allowing access to) necessary financial information to determine whether earn-out requirements have been satisfied
 - May involve various conditions, accelerations and offsets
 - Tax Payments/Filings
 - Future Assurances Covenant
 - Indemnification Claims