

NEGOTIATING ACQUISITION AGREEMENTS IN TOUGH TIMES

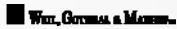


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Acquisition Agreements

- BASIC TYPES
 - Stock Purchase Agreement
 - Asset Purchase Agreement
 - Merger Agreement
- CONSIDERATIONS
 - Ownership structure of target business
 - Does the Buyer want to pick and choose assets and liabilities?
 - Will the acquisition structure affect the consents and approvals that will be required?
 - Tax considerations
 - Should the Buyer do a merger or a stock purchase?
 - Are there numerous shareholders?
 - Are the parties concerned about triggering appraisal rights under state law?
 - How will the transaction structure work with the financing, if any?



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Public vs. Private Deals

- Consideration
 - Often fixed in a public deal
 - Private deals – various purchase price formulas; adjustments based on enterprise value, net working capital or EBITDA (or a combination); earn outs
- Less extensive reps and warranties in public deals – reliance on SEC filings and other publicly available information
- Often no fiduciary out in private deals and thus no “deal protection” issues
- No post-closing indemnification in public deals
- Pay attention to stock exchange rules and SEC rules (e.g., tender offer rules, proxy rules, going private rules, etc.) in public deals...and sometimes private deals too.



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General

- Buyer goals:
 - ensure business is in the same condition at closing as when agreement is signed (providing “second look”)
 - disclosure through representations and warranties
 - post closing indemnification for breaches (private only)
- Seller goals:
 - certainty of closing
 - certainty of proceeds
 - limitation on liability

Structure of the Agreement

- Recitals
- Conveyancing
- Purchase Price (calculation and adjustment)
- Closing and Termination
- Representations and Warranties
 - Company
 - Selling Stockholders – ownership and authority
 - Purchaser

Structure of the Agreement (Cont'd)

- Covenants
 - Pre-closing
 - Post-closing
- Conditions to Closing
- Survival/Indemnification
- Miscellaneous (including definitions)

Representations and Warranties

- Representations and warranties constitute the Seller's and the Company's formal description of the shares being sold and the underlying business, its financial condition and other relevant matters
- Scope of representations and warranties is very important because they typically serve as the basis for closing conditions and indemnification
 - **Seller Objective:** narrow, specific representations and warranties heavily qualified by materiality and knowledge qualifications
 - **Buyer Objective:** broad representations and warranties
- Representations and warranties also serve as additional diligence/comfort for Buyer

Representations and Warranties

- Typical reps:
 - Organization and Good Standing
 - Title to shares being sold
 - Capitalization
 - Absence of certain events, including Material Adverse Change (MAC)
 - Consents of third parties
 - Financial Statements
 - No Undisclosed Liabilities
 - "Special" reps – tax, ERISA, environmental, IP
 - Compliance with Laws
 - Sufficiency of assets
 - 10b-5 rep vs. no other disclosures
 - Internal controls (SOXA §404)

Representations and Warranties

- As of what date are reps made?
 - Made at signing and most "brought down" to closing
- Who makes them? Who has to "stand behind them"?
- Scope
 - Materiality qualifiers
 - Knowledge qualifiers
- Purpose of Disclosure Schedules

Representations and Warranties

- Selling Stockholder representations (usually several, not joint)
- Purchaser representations (investment reps and others reps regarding financing and Purchaser's ability to pay the purchase price)
 - Purchaser also will make business reps if stock is part of consideration paid to Seller

Covenants

- Most acquisition agreements are first executed and then closed at a later time
- This "gap" between signing and closing may result from the need for regulatory approvals, third party consents, financing, etc.
- Covenants are promises to perform (affirmative covenants) or to refrain from performing (negative covenants)
 - Pre-closing covenants govern the activities of the parties in the gap period between signing and closing
 - Post-closing covenants govern performance following closing of the transaction for a specified period of time

Covenants

- Pre-closing covenants generally serve three purposes:
 - Create obligations to get the deal closed
 - Assure Purchaser that the target business will be maintained in the same condition it was when the acquisition agreement was signed
 - Create obligations to take or refrain from taking certain actions prior to closing

Covenants

- Typical Pre-Closing Covenants
 - Making of HSR and other governmental filings
 - Reasonable best efforts to take all actions necessary to close the transaction (“hell or high water”, best efforts, commercially reasonable efforts, objective standards)
 - Access to information
 - Conduct of Business - affirmative (ordinary course of business) and negative (prohibitions on certain specified activities without Purchaser consent)
 - Notice of developments
 - Confidentiality and publicity

Covenants

- “No-Shop” clause
 - stop negotiations; don’t start new ones
- “Go-Shop” clause
- Indemnification of D’s and O’s; requirements to purchase and maintain insurance
- Update Schedules (and effect on closing, post-closing indemnification)

Covenants

- Post-closing covenants
 - Litigation support
 - Non-compete
 - Non-solicitation of employees
 - Employment matters
 - Confidentiality

Closing Conditions

- Conditions that must be satisfied or waived (if possible) before the parties are obligated to close the transaction
 - Mutual
 - One-Way
- Closing conditions do not impose liability
 - Failure of Seller to satisfy one or more of Purchaser's conditions will not give Purchaser an independent right to sue Seller
 - Purchaser must find a breach of a representation and warranty and/or covenant to have a cause of action against Seller

Closing Conditions

- Seller cares about certainty of closing
 - Seller wants minimal conditions
 - Seller wants to limit conditions to things within its control
- Buyer cares about not being obligated to buy a business that has changed for the worse or being obligated to close until it has financing

Closing Conditions

- Possible conditions:
 - Accuracy of representations and warranties ("bring down")
 - Performance of covenants in all material respects
 - No MAE
 - Officer's closing certificate
 - No injunctions
 - HSR and governmental approvals
 - Delivery of shares; Delivery of purchase price

Closing Conditions

- Possible conditions (cont'd)
 - Execution and delivery of ancillary agreements (e.g., Purchaser guaranty; Employments agreements; Escrow agreement)
 - Third party consents
 - Receipt of financing
 - Solvency opinion
 - No litigation (governmental vs. third party)
 - Other closing deliverables (director resignations, legal and/or financial opinions, FIRPTA certificates)

Indemnification

- Events giving rise to indemnification of Purchaser post closing
 - Breach of representations or warranties
 - Breach of covenants
 - Taxes (often a separate indemnity to allocate pre and post closing tax liability)
 - Employee Benefits
 - Environmental
 - Other (specific agreed upon items)

Indemnification

- Events giving rise to indemnification of Seller
 - Breach of representations or warranties
 - Breach of covenants (post-closing obligations important)

Limitations on Indemnification

- Survival of Representations and Warranties -- (How long does Purchaser have to discover problems and make a claim?)
 - Typically, at a minimum, time necessary for Purchaser's accountants to complete an audit cycle
 - Title to shares and authority representations typically survive indefinitely
 - Tax representations typically survive until the applicable statute of limitations
 - Any representation that is particularly sensitive (*e.g.*, environmental, employee matters) survive as long as the parties are willing to let it survive
 - Distinguish between representations and covenants

Limitations on Indemnification

- Responsibility for Indemnity
 - If more than one Seller, must consider whether joint and several liability for indemnification is appropriate
 - May have to distinguish between "controlling stockholders" and others
 - "Financial" investors may resist joint and several liability
 - If there are several Sellers, consider contribution agreements and/or Seller's representative (Escrow Agreement)
 - Private equity sponsors on sell-side strongly resist post-closing indemnification liabilities

Caps, Thresholds and Baskets

- Sellers often seek to cap overall liability on indemnity to limit maximum exposure
- Sellers often seek a minimum dollar threshold of claims below which Purchaser may not seek indemnification (exclude "de minimis claims")

Caps, Thresholds and Baskets

- Sellers often seek basket or “deductible” so that the Purchaser can only seek indemnification for a basket of claims that in the aggregate equal or exceed some amount; alternative may be a threshold so that Purchaser can get indemnification from first dollar as long as threshold amount is exceeded (commonly called a “tipping” basket)
- Limitations should only apply to breach of representations and warranties and not to breaches of covenants or other specific indemnities (*e.g.*, excluded liabilities)

Other Limitations/Remedies

- Impact of insurance or recoveries from third parties
 - Obligation of indemnified party to pursue insurance or other recoveries
- Effect of tax benefits
 - Issues as to timing of recovery and rate
- Limitation on consequential, incidental, punitive and other damages
- Breach of contract and other causes of action still exist absent an exclusive remedies provision
