

An Overview of the Mergers and Acquisitions Process

June 21, 2011 • 3:00 p.m. Eastern

Presented by David S. Sanders
Partner
Foley & Lardner LLP



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Today's Presenter



David S. Sanders

David is a partner in Foley's Washington, D.C. office. He is co-chair of the firm's Transactional & Securities Practice and co-chair of the Trade Secret/Non-Compete Specialty Practice.

David's practice is concentrated on mergers and acquisitions, joint ventures, employment, non-compete and trade secret issues, leases, general corporate matters, and the drafting and negotiation of all types of contracts and corporate documents. He is a member of the Commercial Transactions & Business Counseling, Private Equity & Venture Capital, and Real Estate Practices, as well as the Sports, Medical Devices, Emerging Technologies, and Health Care Industry Teams. He also serves on the firm's Diversity Committee.

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Chapter 1: The Beginning – First Contact How Do the Parties Meet?

- I. For an experienced buyer, this may occur before attorneys are brought in
- II. For an inexperienced buyer or seller, attorneys should be involved at this stage
- III. The process could start with an investment banker or business broker. Investment bankers or business brokers know the business and can be proactive about finding deal partners. Other times, clients know the deal partners.
 - A. Strategic buyer versus financial buyer
 - B. These agreements cover compensation, confidentiality, tails on when compensation is received that are subject to negotiation
- IV. Roll-Up

Chapter 1: The Beginning – First Contact How Do the Parties Meet? (cont.)

- V. If seller is sophisticated, seller will require a confidentiality agreement or non-disclosure agreement. The basic terms of a confidentiality/non-disclosure agreement are as follows:
 - A. Parties
 - B. Definition of proprietary information or confidential information (and exclusions)
 - C. What you can use the information for and who you can share it with
 - D. Your obligations with respect to your “representatives” breach of the confidentiality agreement
 - E. Duration

Chapter 1: The Beginning – First Contact How Do the Parties Meet? (cont.)

- F. What happens if a court requires production of the Confidential Information
- G. Attorneys should keep a copy as a record of disclosure. Why?
- H. Destruction includes deletion of electronic data not recoverable except by extraordinary data salvage methods
- I. Non-solicitation of employees? (not including general, non-targeted solicitations)
- J. Other common terms not covered: restrictions on trading in public securities; no representation as to accuracy

Chapter 1: The Beginning – First Contact How Do the Parties Meet? (cont.)

- VI. Review of financial information and face-to-face meeting between buyer and seller (lawyers generally excluded; but not always)
- VII. Offer made on term sheet or general parameters discussed. Term sheet would generally be a short-form letter of intent and would contain:
 - A. Parties
 - B. Acquisition type (stock, asset, merger)
 - C. Purchase price and components (cash, notes, stock, earnout)
 - D. Working capital or balance sheet net asset value formula (depends on business type and type of assets, *i.e.*, is it a services based business, where you look more to receivables and payables and to future revenue streams, or is it more of a manufacturing business where machinery and equipment have substantial values and inventory and raw materials may be more important)

Chapter 1: The Beginning – First Contact How Do the Parties Meet? (cont.)

- E. Post-closing obligations
 - 1. Employment agreements or consulting agreements with principals
 - 2. Non-competes
- F. Projected signing/closing dates
- G. Legally important language: neither party is bound by any terms and conditions unless and until the parties enter into definitive agreements, and nothing in the term sheet binds the parties to enter into any such agreements

Chapter 2: Letter of Intent and Due Diligence

- I. Letter of Intent
 - A. All provisions in the term sheet, described in more detail. Examples:
 - 1. Instead of referring to a five-year promissory note, you might also discuss that there will be equal, annual payments of principal and interest under the notes and you might refer to the notes as unsecured and subordinated
 - 2. Any earnout would be described in specific detail, probably with examples
 - 3. Instead of referring to a net asset value formula or a working capital projection, there might also be a range of expected values
 - 4. Buyer would want to make clear its right to exclude certain liabilities (big law suits you know about, contingent liabilities, promissory notes to insiders, pension plans, etc.)

Chapter 2: Letter of Intent and Due Diligence (cont.)

- B. Access to information to conduct due diligence/buyer will not unreasonably disrupt the business of seller
- C. Public announcement of transaction. Very specific about who can be told what when, and from whom. Seller will lose employees if word of the deal gets out in the wrong way. Yet, a publicly traded company may have obligations under law or as required by the SEC or NYSE (or other exchange)
- D. Some sort of confirmation of confidentiality with respect to confidential information
- E. No-shop clause/agreement to tell buyer of any other offers
- F. Who bears each component of expenses of the transaction
- G. Continue to conduct business consistent with past practice

Chapter 2: Letter of Intent and Due Diligence (cont.)

- H. Subject to documentation, just like the term sheet, but there will be more specificity, including a reference to customary indemnification provisions, representations, warranties, covenants, conditions, etc.
- I. Nothing in the letter of intent is binding on the parties except (usually) the confidentiality obligations, no public announcements and no-shop clause. Nothing requires the parties to enter into an agreement, and negotiations can be terminated at any time by any party without penalty or liability...
 1. Unless there is a break-up fee
- J. Who drafts the agreement? This is important. Control of the documents can be critical, both with respect to negotiation and cost containment.

Chapter 2: Letter of Intent and Due Diligence (cont.)

- II. Due Diligence - Why? What are you trying to learn? What is your role? What are the roles of your accountants and attorneys?
 - A. Corporate due diligence: articles, bylaws, stock ledgers, minutes, etc.
 - B. Financial/operational matters: list of liabilities, including remote and contingent liabilities, financial statements, accounts receivable and payable reports (including aging), inventory, outside consultant reports and valuations, lists of referral sources/customers by volume, etc.

Chapter 2: Letter of Intent and Due Diligence (cont.)

- C. Litigation: lists of all pending, threatened or potential litigation, pleadings and descriptions of material matters, demand letters from lawyers, audit letters, injunctions, and court orders currently binding the target
- D. Indebtedness: bank documents (secured or unsecured?), letters of credit, security agreements, insider loans, car loans, postage machines, etc.
- E. Government regulation: sometimes broken up separately as taxation/environmental, health and safety matters. Depends on the industry, but there should be OSHA reports, tax returns, notice of any audits, EPA issues.

Chapter 2: Letter of Intent and Due Diligence (cont.)

- F. Management and employees/labor: pension plans, health plans, benefit plans, option plans, employment agreements, inventions and non-compete agreements, employee manual and other policies, EEOC filings, NLRB filings, insider transactions, etc.
- G. Intellectual Property: patents and applications, blocking patents, existing infringers, copyrights, trademarks, service marks, corporate names, licenses, verify ownership of software, etc.
- H. Real property: facility list, leases, mortgages, property insurance, deeds, title insurance policies, EPA reports, if any

Chapter 2: Letter of Intent and Due Diligence (cont.)

- I. Personal property: asset list, depreciation schedule, personal property leases (e.g., car leases), equipment lists (may need to be comprehensive based on business being purchased)
- J. Insurance: all policies, including employment liability, D&O, general liability, business interruption, etc.
- K. Contracts and commitments not otherwise disclosed: joint ventures, marketing and sales agreements, business contracts (e.g., service contracts with target's clients); confidentiality agreements; purchase documents from other transactions
- L. Diligence items not provided by target: e.g., lien searches, publicly available documents (public filings, perhaps of a parent corporation that is publicly traded), Internet. Is the target qualified to do business everywhere it should be? Review Secretary of State websites

Chapter 3: The Purchase

I. Purchase Agreement

- A. Sale and purchase of shares/assets: description of what is being purchased. What are the purchase price and the forms of consideration (cash, stock, notes, earnout)? Pre-closing transfers; post-closing adjustments for working capital, definition of net asset value; closing deliveries (stock certificates, title to assets)
- B. Closing; closing date
- C. Representations and warranties concerning the company

Chapter 3: The Purchase (cont.)

- D. Representations concerning the sole stockholders
- E. Buyer's representations
- F. Covenants
 - 1. How the parties will conduct themselves and the business between signing and closing
- G. Additional agreements. Post-signing agreements.
 - 1. E.g., required employment agreements and consents to the assignment of agreements such as leases; tax matters

Chapter 3: The Purchase (cont.)

- H. Closing conditions: events that must occur in order for each party to agree to proceed to closing
- I. Termination, amendment, waiver, indemnification, etc.
 - 1. Termination: conditions under which either party can walk away from the deal without penalty
 - a. MAC Clauses
 - 2. Each party bears its own fees and expenses, unless agreed otherwise

Chapter 3: The Purchase (cont.)

- 3. Indemnification: this is a major subject of negotiations. Basically, buyer is buying a company based on seller's representations and warranties about the business of the company, as we have discussed. If those representations and warranties turn out to be incorrect, or if seller does not fulfill the post-closing agreements, buyer needs recourse.
 - a. Indemnification generally applies for breach of any representation, warranty, covenant or agreement as well as any liability not reflected or reserved against on the balance sheet, subject to certain caveats
 - b. Other forms of buyer protections: escrows; holdbacks
 - J. Miscellaneous (e.g., defined terms; boilerplate)

Chapter 3: The Purchase (cont.)

- II. Disclosure schedules: these are the exceptions or clarifications to the agreement, principally the representations and warranties. Often times, these schedules can allocate liabilities with respect to specific matters.
 - A. Seller and its accountants and attorneys will devote significant time to the disclosure schedules, which are critical in setting forth exceptions and clarifications to the representations and warranties, thereby protecting seller from indemnification claims
 - B. Buyer generally works with its accountants and attorneys to make sure that the information disclosed is accurate and complete and does not materially affect the buyer's valuation of the business being purchased

Chapter 3: The Purchase (cont.)

- III. Ancillary Documents
 - A. Promissory notes
 - B. Employment agreements
 - C. Non-compete agreements
 - D. Earnout examples
 - E. Bill of sale (asset deal)
 - F. Assignment and assumption of liabilities (asset deal)
 - G. Officers' certificates
 - H. Legal opinions (current trend)
 - I. Closing checklist/working group list

Chapter 4: Post-Closing

- I. Integration of the new business and its employees (clients generally do this without lawyers):
 - A. Human Resources/Benefits
 - B. Customers
 - C. Suppliers
 - D. Name changes
 - E. Other transition issues
- II. Closing binders on CD/DVD

Contact Me

David S. Sanders

Foley & Lardner LLP
3000 K Street, N.W.
Suite 600
Washington, DC 20007
P 202.295.4020
dsanders@foley.com

www.Foley.com

