

MERGERS AND ACQUISITIONS BASICS



COLLECTIVE EXPERIENCE . COLLABORATIVE CULTURE . CREATIVE SOLUTIONS

LAWYER'S ROLE IN THE PROCESS

1. Legal Advice

- Legal Structure
 - Asset Sale
 - Stock Sale
 - Merger
- Legal Risks
 - Due Diligence
 - Transaction Risks
- Documentation
 - Drafting/review

2. Negotiation

- Deal Terms
- Legal Documents

LAWYER'S ROLE IN THE PROCESS



2. Negotiation Continued

- Ethical Obligations
 - Confidentiality of Information (Rule 1.6(a))
 - A lawyer shall not reveal information relating to the representation of a client, including information protected by the attorney-client privilege under applicable law, unless the client gives *informed consent*, the disclosure is impliedly authorized in order to carry out the representation, or the disclosure is permitted by division (b) or required by division (d) of this rule.
 - Truthfulness in Statements to Others (Rule 4.1)
 - In the course of representing a client a lawyer shall not knowingly do either of the following:
 - (a) make a false statement of material fact or law to a third person;
 - (b) fail to disclose a material fact when disclosure is necessary to avoid assisting an illegal or fraudulent act by a client.

LAWYER'S ROLE IN THE PROCESS



2. Negotiation Continued

- Ethical Obligations
 - Communications with Persons Represented by Counsel (Rule 4.2)
 - In representing a client, a lawyer shall not communicate about the subject of the representation with a person the lawyer knows to be represented by another lawyer in the matter, unless the lawyer has the consent of the other lawyer or is authorized to do so by law or a court order.

3. Bottom Line—Understand how you can add value

- Legal Expertise
- Experience
 - For many clients only 1 major transaction in a lifetime
 - Negotiation skills
- Business Knowledge

PRE-TRANSACTION CONSIDERATIONS

PRE TRANSACTION CONSIDERATIONS



1. Members of Team

- Investment Bankers/Business Brokers
 - Auction-Style offering
 - Advice to Seller regarding evaluation of offer
 - Advice to Seller regarding valuation
 - Negotiation
- Accountants
- Consultants
 - Business area experts
 - Environmental
 - Regulatory

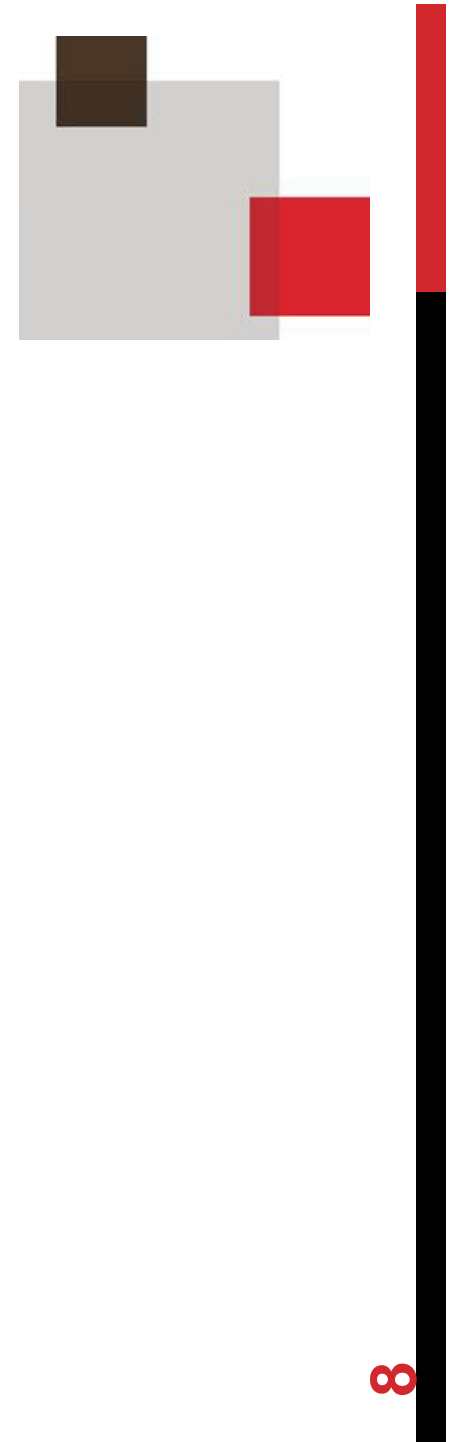
PRE-TRANSACTION CONSIDERATIONS



2. Sale Process

- Seller—Auction or Negotiated Sale
- Buyer—Tender offer or Negotiated Sale
- Confidentiality Agreement
 - Mutual—Protect both buyer and seller
 - Necessary first step in auctions
- Letter of Intent
 - Is it useful?
 - Psychological commitment of business owner
 - Grant of exclusivity to buyer
 - Hart-Scott filing issues
 - Will the negotiation take time and duplicate effort which could be spend directly on definitive document?

DUE DILIGENCE



DANGER

 **RADIATION** 

DUE DILIGENCE

Categories of Legal Due Diligence Information:

- Basic Corporate Documents
- Real and Personal Property
- Financial Statements
- Tax Matters
- Litigation
- Environmental Matters
- Intellectual Property
- Labor and Employee Matters
- Employee Benefit Plans
- Securities Laws
- Foreign Operations

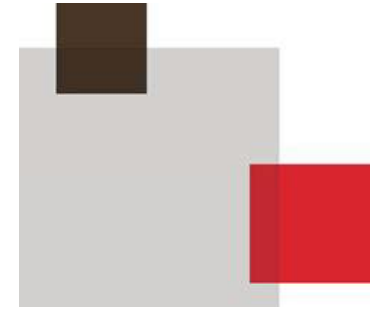




1. Due Diligence—Seller

- Seller should start assembling due diligence materials prior to commencing sale process
- Create electronic Data Room
- Review materials, if possible
 - Correct obvious issues, if possible, such as:
 - Unsigned contracts
 - Expired Financing Statements
 - Corporate Authorizations
 - Consider whether materials affect deal structure:
 - Contractual restrictions on assignability
 - Multi-employer Plan issues

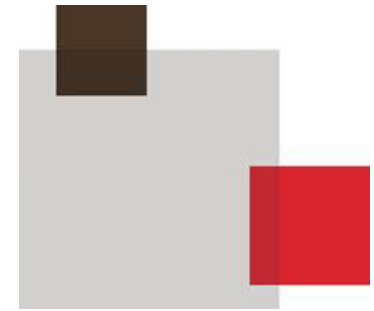
DUE DILIGENCE



1. Due Diligence –Buyer

- Determine business objectives of Buyer
- Request materials important to those objectives; supplement the form due diligence request list
- Review materials with respect to effect on business objectives; for example:
 - Where objective is to obtain sales force, what is the contractual/non-compete landscape for these employees
 - Where objective is to obtain key patent rights, what is the patent ownership situation; what freedom to operate due diligence has been undertaken

COMMON DUE DILIGENCE ISSUES



Stock Transaction	Shared Issues	Asset Transaction
<ul style="list-style-type: none">• Title/Ownership of company stock• Identifying potential liabilities• Terms of key contracts• Comfort with operations – as is	<ul style="list-style-type: none">• Nature and condition of Target's assets• Title to Assets• Timing/Regulatory consents	<ul style="list-style-type: none">• Ability to transfer title to assets• Identify liabilities• Sufficiency of assets

FREQUENT DUE DILIGENCE AREAS OF CONCERN

- **Environmental:**
 - Permits
 - Phase I/Phase II issues
 - Asbestos/PCBs
 - Removal
 - Adjacent properties
- **Products liability:**
 - Claims history
 - Design defect
 - Dangerous product
 - Regulated product

FREQUENT DUE DILIGENCE AREAS OF CONCERN(CONT'D)

- **Benefit Plans:**
 - Underfunded plans
 - Multi-employer Plan Withdrawal
 - “Rich” plans
 - Self-insured/transition
- **Intellectual Property:**
 - Infringement
 - Know How/Trade Secrets
 - Works Made for Hire
 - Misappropriation
 - License rights

FREQUENT DUE DILIGENCE AREAS OF CONCERN(CONT'D)



- **Consents and approvals**
 - Approvals required by organizational documents and state law
 - Board Approval
 - Shareholder Approval
 - Regulatory Approvals
 - HSR Filing and Waiting Period
 - Licenses and permits
 - Contractual Consents
 - Contract Assignment procedures/risks (e.g. anti-assignment provisions) in Asset Deals
 - Contracts with Change of Control Provisions in Stock/Merger Deals

STRUCTURING THE DEAL

Asset Agreement



Vs.

Stock Agreement



Vs. Merger



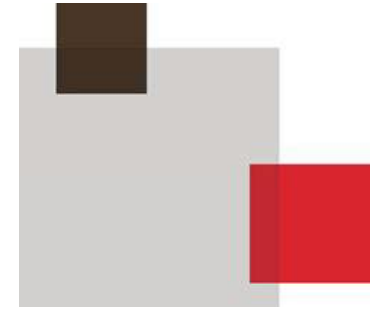
3 BASIC METHODS OF ACQUIRING A BUSINESS

1. Purchase of Target Company's Assets
2. Purchase of Target Company's Stock
3. Merger with Target Company

FACTORS IMPACTING DEAL STRUCTURE

- **Commercial Considerations**
 - Transition of employees
 - Transition of Customers and Suppliers
 - Pre-closing liabilities
- **Tax Considerations**
 - Taxation of sale proceeds
 - Double Taxation
 - Capital Gains vs Ordinary Income
 - Basis Step-up
- **Third Party Consents**
- **Deal process and timing**

STOCK DEAL

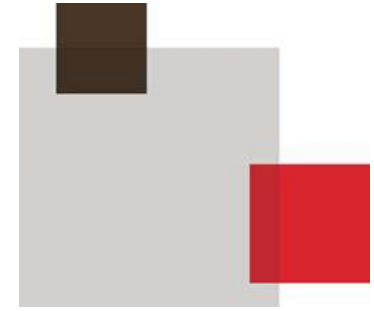


- **Seller:** Shareholders
 - Recognize capital gain on sale of investment
 - No Double Taxation
 - These advantages usually not available for partnership/LLC
- **What is Being Purchased:** Ownership interest in the Company
 - Take all assets and all liabilities.
 - Same company.
 - Unless make a tax election under certain circumstances – the company does not receive step-up basis in assets (less depreciation deduction)
- *Usually Preferred* by Seller

STOCK DEAL (CONT'D)

- Formalities and Corporate Documents
 - Stock powers and certificates from all shareholders

ASSET DEAL



- **Seller:** The Company
 - The Company is taxed on the any gain on sale of assets
 - Double-Taxation for C-Corps: the Shareholders are taxed on liquidating distributions
 - Liabilities remain with the Company
- **What is Being Purchased:** Some or all of the Assets (e.g. equipment, inventory, material contracts)
 - May be possible to “Cherry Pick” individual assets and liabilities
 - Third-Party consents to transfer assets (contracts, leases)
 - Some liabilities transfer as matter of law
 - Typically, the Buyer has a step-up depreciable basis on the assets
 - Liabilities assumed only as agreed
- *Usually Preferred* by Buyer

ASSET DEAL (CONT'D)

- **Formalities and Corporate Documents**
 - Director and Shareholder Approval
 - Instruments of Transfer (Bill of Sale, Assignment and Assumption, Deeds, Intellectual Property)
 - Licenses and permits

MERGER

A merger is a legal combination of two companies; the effect of the merger is governed by statute. Normally, one company is merged into another company, with one of the original companies being the surviving company and the other company being merged out of existence. Generally similar to Stock Deal.

- Typical Reasons:
 - Ability to use buyer stock as some or all of the purchase consideration on a tax-free basis
 - Ability to obtain 100% ownership without agreement of all Shareholders

MERGER (CONT'D)

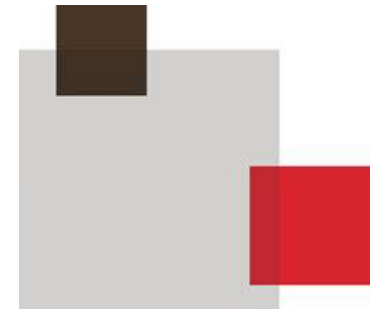
- **Formalities and Corporate Documents**
 - Director and Shareholder Approval by Target
 - Director and possible shareholder approval by Buyer and/or Buyer merger subsidiary
 - Buyer may form subsidiary to merge into target
 - Merger Certificate filed with Secretary of State of home state of both merger parties
 - Statutory form and payment of consideration in tax-free mergers must comply strictly with all applicable regulations

THE TRANSACTION PROCESS

PRELIMINARY AGREEMENTS

- **Terms of the Deal**
 - Letter of Intent
 - Memorandum of Understanding
 - Term Sheet
- **Other Preliminary Agreements**
 - Confidentiality Agreement
 - Exclusivity Agreement

LETTER OF INTENT/TERM SHEET



- Establish Terms – high level
 - *Nonbinding*
 - Structure
 - Price
 - Covenants
 - *Binding Terms*
 - Access
 - Conduct of Business
 - Exclusivity
 - Confidentiality
 - Expenses



LOI STARTS THE PROCESS

Proposed Definitive Agreement. As soon as reasonably practicable after the execution of this Letter, the Parties shall commence to negotiate a definitive purchase agreement (the "Definitive Agreement") relating to Buyer's acquisition of the Assets, to be drafted by Buyer's counsel. The Definitive Agreement would include the terms summarized in this Letter and such other representations, warranties, conditions, covenants, indemnities and other terms that are customary for transactions of this kind and are not inconsistent with this Letter. The Parties shall also commence to negotiate ancillary agreements to be drafted by Buyer's counsel, including (i) an escrow agreement, (ii) a bill of sale, and (iii) an assignment and assumption agreement.

EXCLUSIVITY

In consideration of the expenses that Buyer has incurred and will incur in connection with the proposed Transaction, Seller agrees that until such time as this Letter has terminated in accordance with the provisions of paragraph 8 (such period, the "Exclusivity Period"), **NEITHER IT NOR ANY OF ITS REPRESENTATIVES**, officers, employees, directors, agents, stockholders, subsidiaries or affiliates (the "Seller Group") shall **INITIATE, SOLICIT, ENTERTAIN, NEGOTIATE, ACCEPT OR DISCUSS, DIRECTLY OR INDIRECTLY, ANY PROPOSAL OR OFFER FROM ANY PERSON OR GROUP OF PERSONS OTHER THAN BUYER AND ITS AFFILIATES** (an "Acquisition Proposal") to acquire all or any portion of the Business or the Assets, whether by merger, purchase of stock, purchase of assets, tender offer or otherwise, or provide any non-public information to any third party in connection with an Acquisition Proposal or enter into any agreement, arrangement or understanding requiring it to abandon, terminate or fail to consummate the Transaction with Buyer.



PURCHASE AGREEMENT

- Parties
- Agreement to Sell
 - Stock or other ownership interest
 - Accurate list of assets and discrete list of liabilities assumed
- Consideration
 - Form of Payment – Cash; Earn-Out; Promissory Note
 - Escrow
 - Working Capital Adjustment
- Asset Deal ONLY – Mechanics of transferring assets



PURCHASE AGREEMENT – REPS & WARRANTIES

- **Common Limitations to Scope:**
 - Materiality
 - Knowledge Qualifier
 - Scheduled Information

COMMON SELLER REPS & WARRANTIES

- Legal authority to consummate transaction
- Duly organized
- Compliance with laws
- Good title to the assets
- No Third Party Consents Required
- Condition and Sufficiency of Assets
- Financial Statements fairly represent financial condition of the business
- No undisclosed liabilities
- Accounts Receivable reflected properly
- Tax matters
- Litigation matters
- Information regarding material contracts
- Employee matters
- Environmental matters
- Intellectual Property matters
- Real Property matters
- Brokers' Fees



COMMON BUYER REPS & WARRANTIES

- Legal authority to consummate transaction
- Brokers' Fees
- Sufficient funds to complete transaction
- Merger Agreements including Buyer stock
 - Existence
 - Due Organization
 - Securities Law Compliance
 - Financial Statements
 - Other Disclosures

PURCHASE AGREEMENT - COVENANTS

- **Pre-Closing Covenants (delayed sign & close)**
 - In effect between signing and closing
 - General: Operation of business, access to information, cooperation
 - Specific:
 - Release of guarantees/mortgages/indebtedness
 - Obtaining consents

PURCHASE AGREEMENT - COVENANTS



Post-Closing Covenants:

- Nondisclosure, Noncompete and/or Nonsolicitation
 - Years/territory/exceptions
- Indemnification
 - Survival Period
 - Types of Losses Covered
 - Limitations:
 - Basket/Deductible
 - Cap
- Wrong pockets
- Removal of excluded assets
- Dispute resolution—General/Indemnification/Earnout-Escrow
- Rights to Intellectual Property - use of TMs and Names

COMMON CONDITIONS TO CLOSE

- Satisfactory completion of due diligence
- Financing (if applicable)
- Required Approvals
 - All Consents/Key Consents
- Execution of Ancillary Agreements
- Key Employees entering into employment agreements
- No injunctions/legal constraints on transaction
- Delayed Closing ONLY - Bring-down of the representations & warranties



POST-CLOSING

- **Filings**
 - Merger Documents with Secretary of State (Mergers)
 - Deeds/Mortgages (Asset Deal)
- **Announcements**
 - Press releases
 - Employee announcements
 - Vendor/Customer announcements
- **Administrative Matters**
 - Consents which were not a condition of closing

POST-CLOSING (CONT'D)

- **Administrative Matters (Cont'd)**
 - Human Resource issues
 - New Hire Procedures (Asset Deal)
 - Plan Coordination (Health Care, Pension, etc.)
 - Custody of Books and Records
- **Earn-Outs**
 - Seller—Provide required information
- **Indemnification Claims/Escrow**
 - Buyer—Set tickler for review before expiration of deadlines
 - Seller
 - Respond to all claims per contract procedure
 - Require timely payment of escrow amounts



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