



Anatomy of an M&A Transaction

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Always exceed expectations through teamwork and excellent client service.

Getting to “Yes”

- Clients want to get the deal done
- Appreciating the client’s goals and risks tolerances
- Mitigate risk with business goals in mind
- Understand leverage and power
- Value creation vs. value capture
- Careful to casually use “deal breaker”
- Being pragmatic – it is about finding reasonable means to achieve closing



PART I: NEGOTIATED TRANSACTIONS

Principal Methods of Acquiring a Business

- Acquiring Equity (stock, membership interests, etc.)
- Acquiring Assets
- Mergers (many different forms)

Determining the Form of Transaction

Depends on multiple factors, including...

- Commercial considerations
- Legal and tax considerations
- Third-party consents
- Deal process and timing

Stock Acquisitions

- Buyer acquires outstanding stock from Target's stockholders
- Buyer acquires all assets and assumes all liabilities of Target as a matter of law
- Minimal third-party consents
- Generally no filing requirements
- Cumbersome if there is a large number of stockholders

Asset Acquisition

- Buyer takes on only those assets and liabilities identified
- Generally requires additional documents of transfer
 - Bill of Sale – Tangible Assets
 - Assignment and Assumption Agreements – Contracts
 - Deeds – Real Property
 - IP Assignments – IP transfers
- More third-party consents

Successor Liability on Asset Transfers

- **Buyer can be held liable for Seller's liabilities if a court determines any of the following:**
 - Buyer expressly or impliedly assumed the liabilities
 - Transaction is deemed a “de facto merger” under state law
 - Transfer was fraudulent or there was an intent to defraud creditors
 - Buyer continues essentially the same operations or product line of Seller
- **Certain pension and environmental liabilities may follow the business under federal law**
- **Buyer may be responsible for certain of Seller's taxes under state and local tax laws**

Mergers

- Buyer or its subsidiary merges with Target
- Buyer acquires all assets and assumes all liabilities of Target as a matter of law
- May be necessary if there are too many stockholders to negotiate with directly
- Subject to state law and filing requirements
- Structure of merger may still require third-party consents
- Dissenting stockholders will likely have appraisal rights under state law

Merger Structures

- **Forward Merger** – Target merges with and into Buyer.
- **Forward Triangular Merger** – Target merges with and into Buyer subsidiary.
- **Reverse Triangular Merger** – Buyer’s subsidiary merges with and into Target. Target survives and becomes Buyer’s subsidiary.

Public Mergers

- **One-Step Merger: Long-Form Merger**
 - Target files a proxy statement with SEC
 - Target receives clearance before distributing to stockholders
 - Target's stockholders approve transaction
- **Two-Step Merger: Hybrid of Tender Offer and Merger**
 - Step One: Buyer completes tender offer to acquire Target's stock directly from stockholders
 - Step Two: Buyer completes a back-end merger to acquire the balance of the shares
 - Two-step mergers for cash consideration can sometimes be completed more quickly, as fast as six weeks, because SEC review is simultaneous with distribution of tender offer materials

Tax Considerations

- **Buyers generally prefer asset deals**
 - Results in stepped up basis in Target's assets
 - Allows Buyer to take greater depreciation and amortization deductions
 - Minimizes taxes on a subsequent disposition of the assets
- **Sellers generally prefer stock deals**
 - Results in single level taxation at the stockholder level
 - Asset deal results in double taxation at the Target level on sale of the assets and at stockholder level on the distribution of proceeds
- **Section 338(h)(10) election allows a stock deal to be treated as an asset deal for tax purposes**

Always consult a specialist for tax advice!

Tax Treatment of Mergers

- **Forward Mergers and Forward Triangular Mergers: Generally Asset Deals**
- **Reverse Triangular Mergers: Generally Stock Deals**
- **Tax-Free Reorganization: Only if Buyer's (or its affiliates') stock is used as a significant portion (in some cases, all) of the merger consideration**

Always consult a specialist for tax advice!

Part II: Fiduciary Duties and Level of Scrutiny

Directors' Fiduciary Duties

- **Duty of Care**

- Act on an informed basis after due consideration of relevant information and appropriate deliberation
- Reliance on advice from experts (financial and legal advisors) selected with reasonable care is permitted
- Documentation for basis of decisions is essential

- **Duty of Loyalty**

- Act in a manner believed to be in the best interests of the corporation and its stockholders
- Act in good faith
- No “self-dealing”
- No appropriation of “corporate opportunities”

Business Judgment Rule

- Default standard of review applicable to directors' decisions
- Court will defer to, and not second guess, decisions made by directors who have fulfilled the duties of care and loyalty
- Bare rationality test
 - Prevents courts and stockholders from interfering with managerial decisions made by a loyal and informed board *unless* the decisions cannot be “attributed to any rational business purpose”

Intermediate or Enhanced Scrutiny

- **Applies to:**
 - board's approval of sale of control transactions
 - board's adoption of defensive mechanisms in response to an alleged threat to corporate control or policy
- **Examines the substantive reasonableness of both the board's process and its action**

Revlon

- **Duty to maximize stockholder value**
 - Best price
 - Non-consummation risk
- **Sale of Control or Change of Control transactions**
- **Once board makes decision to embark on change of control transaction**
- **Board retains flexibility to design sale process**
- **Does NOT apply to:**
 - Sale of company with a controlling stockholder to a third party
 - Pure stock-for-stock mergers between two non-controlled companies
 - Transaction in which minority of consideration is cash

Unocal

- Applies to adoption of defensive measures against potential threats to control
- **Two-pronged test:**
 - Board must show it had reasonable grounds for believing that a danger to corporate policy and effectiveness existed; AND
 - Board must show the defensive measure was reasonable in relation to the threat posed and not coercive or preclusive
- Applied even in friendly deals, to termination fees, force-the-vote provisions, expense reimbursements and no-shop provisions
- Courts will consider the effect of all deal protections taken as a whole

Entire Fairness

- **Most onerous standard of review**
- **Imposes the burden of proof on directors to show the fairness of both the price and process**
- **Applies to any of the following:**
 - A majority of the board has an interest in the decision or transaction that differs from the stockholders in general
 - A majority of the board lacks independence from or is dominated by an interested party
 - The directors or a controlling stockholder stand on both sides of a transaction
 - A controlling stockholder receives additional consideration to the detriment of the other stockholders
- **Court will consider both process (fair dealing) and price (fair price) holistically**

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- **Subjecting conflicted controlling stockholder transactions from the outset to the approval of both an effective special committee and the non-controlling stockholders in a fully informed, uncoerced vote may lower the standard of review from entire fairness to business judgment rule**
- **Requirements:**
 - Controller conditions the transaction on the approval of both a special committee and a majority of the minority stockholders
 - Special committee is independent
 - Special committee is empowered to freely select its own advisors and to say no definitively
 - Special committee meets its duty of care in negotiating a fair price
 - Vote of the minority is informed
 - There is no coercion of the minority



Part III: Outline of an M&A Transaction

Outline of an M&A Transaction



Nondisclosure Agreements

- Protects Seller's confidential information
- Narrows Buyer's use of confidential information to evaluate, negotiate and consummate the transaction
- Usually keeps the fact of discussions confidential as well
- Limits information sharing to representatives often with a need to know and where recipient remains liable for any breaches
- Impact of narrowing the definition of the transaction to "negotiated" or "mutually beneficial"
- Back-to-back NDAs
- Prevents company from being put "in play"

Exclusivity and Standstill

- In NDA or separate agreement
- **Exclusivity:**
 - In exchange for Buyer's investment of time and resources, Target agrees not to negotiate with other parties or solicit bids for a given period of time
- **Standstill:**
 - Restricts Buyer from purchasing Target's stock or taking certain other actions without Target's approval
 - Used in a public context to prevent a hostile bid after the Buyer has seen Target's confidential information

Letter of Intent or Term Sheet

- Often used in the private company context to reflect the business deal
- Signed but often not binding, except with regard to certain provisions such as exclusivity and confidentiality
- Less common in public company context where potential disclosure obligations must be considered

Legal Due Diligence Sources

- For publicly listed Target, a significant amount of information is available from the SEC
 - Form 10-Ks
 - Form 10-Qs
 - Form 8-Ks
 - Proxy Statements
- Rating agency reports
- Subscription services of company information
- Target's responses to diligence requests and subsequent follow-up requests

Legal Due Diligence Key Contract Clauses

- **Assignment**

- Target may not assign any of its rights under this Agreement without prior written consent
- Typically not triggered in stock acquisition or reverse triangular mergers
- Watch for state statutes that treat any change of control as an assignment

- **Change of Control**

- No merger, consolidation or acquisition of Target with, by or into another corporation, entity or person; any change in the ownership of more than 50% of the voting capital stock of Target; or any assignment of this Agreement by operation of law may not occur without prior written consent

- **Termination Rights**

- Be aware that in addition to consent, some agreements grant termination rights or penalties for assignment or change of control

Other Legal Due Diligence Considerations

- Target capitalization and takeover defenses
- “Most Favored Nations” provisions
- Noncompetition obligations
- Exclusivity obligations
- Other provisions which restrict operations
- Term and termination provisions of key contracts
- Earn-out or indemnification liabilities
- Confidentiality restrictions

Legal Due Diligence Specialist Areas

- Antitrust
- Employment and labor
- Environmental
- Intellectual property
- Litigation
- Real estate
- Regulatory
- Tax

Private Equity Buyers

- Often perform more diligence than strategic buyers
- Thinking ahead to exit
- Lack certain operational capabilities and need to understand what Target has (payroll, IT, etc.)
- Relationship with management considerations
- Full diligence memorandum is often required by lenders in a leveraged buyout

Buyer and Target Are Competitors

- Competitors are prohibited by law from sharing certain information (e.g., pricing)
- Target may be more wary of sharing certain information (e.g., customer names)
- Parties may redact sensitive information or develop procedures to further limit access
- Target can strategically push a Buyer into a transaction by over-disclosing (or just alleging it) and raising the specter of litigation

Disclosures That Create Antitrust Risk

- Current or prices, fee schedules, pricing policies, pricing formulas, plans, or other competitive terms of sale (e.g., financing, rebates or installation)
- Current or future profit margins, or profitability targets on specific products or projects
- Detailed cost information
- Strategies or policies relating to marketing or competition
- Forward-looking competitive information (e.g., marketing plans, sales, promotional plans, strategic plans and new product plans)
- Information about present customers
- Proprietary technologies of a confidential nature
- Other potential mergers, acquisitions or joint ventures

Overview of the Definitive Agreement

- Preamble & Recitals
- Definitions
- **[Purchase and Sale][The Merger]**
- **[Closing][Effect of the Merger on Capital Stock]**
- Representations and Warranties of **[Seller][the Company]**
- Representations and Warranties of **[Buyer][Parent and Merger Sub]**
- Covenants
- Tax Matters
- Conditions to Closing
- **[Indemnification]**
- Termination
- Miscellaneous

Acquisition Agreement
Merger Agreement

Parties

- **Stock Purchase Agreement:**
 - Buyer and Target's stockholders (Sellers)
- **Asset Purchase Agreement:**
 - Buyer and Target
- **Reverse Triangular Merger:**
 - Buyer, a newly created Buyer subsidiary and Target
- **If Buyer is newly formed, add Parent Guarantor**
- **If Seller is disposing of substantially all of its assets, add a Seller Guarantor**

Stock Purchase and Purchase Price

□ Stock Purchase Agreement

- Purchase of Stock

- Seller shall sell, transfer, convey and deliver, and Buyer shall purchase, all of the Target Stock free and clear of all Liens...

- Payment of Purchase Price

- Buyer shall pay by wire transfer of immediately available funds the Purchase Price *minus* (A) the Escrow Amount; (B) the Indebtedness Payoff Amount; and (C) the Transaction Expenses...

Asset Purchase

□ Asset Purchase Agreement

● Purchased Assets vs. Excluded Assets

- Seller shall sell, transfer, convey and deliver, and Buyer shall purchase, free and clear of all Liens other than Permitted Liens, all of Seller's right, title and interest in, to and under all of the assets which relate to, or are used or held for use in connection with, the Business (collectively, the "Purchased Assets")...
- Purchased Assets shall not include the following assets: (a) contracts that are not assigned; (b) Organization Documents of the Seller; (c) Benefit Plans; (d) the scheduled assets; and (e) Seller's rights under this Agreement.

● Assumed Liabilities vs. Excluded Liabilities

- Buyer shall agree to assume and pay, perform, and discharge the following Seller liabilities and no other liabilities: (a) trade accounts; (b) liabilities for Assigned Contracts to the extent such arise after the Closing Date; (c) scheduled liabilities...
- Buyer shall not assume or pay, perform, or discharge any other liabilities of Seller...

Asset Purchase Price

□ Asset Purchase Agreement

- Purchase Price

- The aggregate purchase price for the Purchased Assets shall be \$[___], subject to adjustment pursuant (the “Purchase Price”), plus the assumption of the Assumed Liabilities and paid in accordance with this Agreement.

- Purchase Price Adjustment

- Within 60 days after the Closing Date, Buyer shall prepare and deliver to Seller a statement setting forth its calculation of Closing Working Capital, which statement shall be substantially in the form as the schedule.
- The “Post-Closing Adjustment” shall be an amount equal to the absolute value of the Closing Working Capital *minus* the Target Working Capital. If the Closing Working Capital is greater than the Target Working Capital, Buyer shall pay to Seller an amount equal to the Post-Closing Adjustment. If the Closing Working Capital is less than the Target Working Capital, Seller shall pay to Buyer an amount equal to the Post-Closing Adjustment.

Earn-Out

- **Following the Closing, Buyer agrees to make an additional payment to Seller upon the terms in the Agreement**
- **Earn-Out Payment Amount**
 - The Earn-Out Payment shall be equal to (i) the product of (x) [____] multiplied by (y) the difference between (A) the Adjusted EBITDA (2022)...
- **Earn-Out Statement**
 - Within 30 days after the preparation of the audited financial statements with respect to the Business for the one-year period ending on Dec. 31, 2022, Buyer shall deliver to Seller a report setting forth the Adjusted EBITDA (2022)...
- **Operation of Business**
 - Until Dec.31, 2022, Buyer shall operate the Business in good faith in the ordinary course of business consistent with past practice...

Mechanics in Merger Agreement

- Determine surviving company
- File Certificate of Merger with Secretary of State of formation jurisdictions
- Decide which organizational documents will survive or must be modified
- Appoint directors and officers of surviving company
- Convert stock of Target and Buyer as necessary
- Disburse payment for Target's stock to stockholders
- Develop procedures for addressing dissenting stockholders exercising appraisal rights

Representations and Warranties

- Seller's reps are extensive and cover important facts about Target, the stock or assets being sold, and the Seller's right to enter into the transaction
- A publicly listed Target's reps are more limited
 - Significant information is available in mandatory SEC filings and subject to the antifraud provisions of the federal securities laws (mainly Rule 10b-5)
 - No one has liability for breaches after the closing
- In a cash deal, Buyer's reps are usually limited to its ability to consummate the transaction, its solvency, and certain securities laws matters
- If Buyer is issuing stock, reps cover the business of Buyer
- Reps given by both sides are conformed

Disclosure Schedules

- **Qualify the representations and warranties given in the definitive agreement**
 - Lists
 - Exceptions
- **If something is in the disclosure schedules, Buyer won't be able to terminate the transaction or seek post-closing indemnification on that basis**
- **Need to be prepared in close collaboration with executives who know the business**

Sample Seller or Target Reps

- Organization and Authority
- Capitalization
- Subsidiaries
- No Conflicts
- Financial Statements
- No Undisclosed Liabilities
- Absence of Certain Changes
- Material Contracts
- Sufficiency of Assets
- Litigation
- Permits
- Compliance with Laws
- Intellectual Property
- Real Property
- Environmental Matters
- Taxes
- Employment and Labor Matters
- Employee Benefit Matters
- Insurance
- Books and Records
- Brokers
- Full Disclosure/Independent Investigation
- Sandbagging

Material Adverse Effect

- Purpose
- Definition
 - “Material Adverse Effect” means any event, occurrence, fact, condition or change that is[, or could reasonably be expected to become, individually or in the aggregate,] materially adverse to (a) the business, results of operations, [financial condition][condition (financial or otherwise), prospects], or assets of Target, or (b) the ability of Seller to consummate the transactions contemplated hereby [on a timely basis]

Buyer Favorable
Seller Favorable

Material Adverse Effect (continued)

provided, however, that “Material Adverse Effect” shall not include any event, occurrence, fact, condition or change, directly or indirectly, arising out of or attributable to: (i) general economic or political conditions; (ii) conditions generally affecting the industries in which Target operates; (iii) any changes in financial or securities markets in general[, **including any disruption thereof and any change in prevailing interest rates**]; (iv) acts of war (whether or not declared), armed hostilities or terrorism, or the escalation or worsening thereof; (v) **any action required or permitted by this Agreement [or any action taken (or omitted to be taken) with the written consent of or at the written request of Buyer; (vi) any changes in applicable Laws or accounting rules, including GAAP or the enforcement, implementation or interpretation thereof; (vii) any matter of which Buyer is aware on the date hereof; or (viii) the public announcement, pendency or completion of the transactions contemplated by this Agreement; (ix) any natural or man-made disaster or acts of God; or (x) any failure by Target to meet any internal or published projections, forecasts or revenue or earnings predictions (provided that the underlying causes of such failures shall not be excluded)]...**

Buyer Favorable
Seller Favorable

Material Adverse Effect (continued)

[; provided further, however, that any event, occurrence, fact, condition or change referred to in clauses (i) through (iv) immediately above shall be taken into account in determining whether a Material Adverse Effect has occurred or could reasonably be expected to occur to the extent that it has a disproportionate effect on Target compared to other participants in the industries in which Target operates].

Buyer Favorable
Seller Favorable

10b-5 and Full Disclosure Reps

- No representation or warranty by Seller in this Agreement, the Disclosure Schedules or any Ancillary Document contains any **untrue statement of a material fact**, or **omits to state a material fact** necessary to make the statements contained therein, in light of the circumstances in which they are made, **not misleading**.
- Seller does not have Knowledge of any fact that has specific application to Seller (other than general economic or industry conditions) and that may materially and adversely affect the assets, business, prospects, financial condition or results of operations of Seller that has not been set forth in this Agreement or the Disclosure Schedule.

Waiver of Fraud and Misrepresentation Claims

- Except for the representations and warranties contained in Article [x], none of Seller, Target or any other Person has made or makes any other **express or implied representation or warranty**, either written or oral, on behalf of Seller or Target.
- Buyer has conducted its **own independent investigation**, review and analysis of the business, results of operations, prospects, condition (financial or otherwise) or assets of Target, and acknowledges that it has been provided adequate access to the personnel, properties, assets, premises, books and records and other documents and data of Seller and Target for such purpose.
- Buyer acknowledges and agrees that in making its decision to enter into this Agreement and to consummate the transactions contemplated hereby, Buyer has **relied solely upon its own investigation** and **the express representations and warranties** of Seller set forth in Article [x] of this Agreement.

Sandbagging Reps

- **Pro Buyer**

- The right to indemnification based upon any representation or warranty shall not be affected by any investigation conducted or any Knowledge acquired at any time, whether before or after the execution and delivery of this Agreement or the Closing Date, with respect to the accuracy or inaccuracy of such representation or warranty

- **Pro Seller**

- No party shall be liable for any Losses resulting from or relating to any inaccuracy in or breach of any representation or warranty in this Agreement if the party seeking indemnification for such Losses had Knowledge of such Breach before Closing

Pre-Closing Covenants

- **Affirmative Operating Covenants**

- Conduct the business in the ordinary course of business consistent with past practice
- Use reasonable best efforts to maintain and preserve intact the current organization, business and franchise of Target
- Inform Buyer of any material adverse change to Target's business
- Make all regulatory filings
- Make efforts to satisfy closing conditions

- **Negative Operating Covenants**

- Not to take or permit any action that would cause any of the changes, events or conditions described in the adverse changes representation
- Refrain from soliciting other bids

Restrictive Covenants

- **Types of Covenants:**

- Nonsolicitation of customers
- Nonsolicitation of employees
- Noncompetition

- **Key Considerations:**

- Scope of business
- Territory covered
- Length of restricted period

- **Mergers:**

- Restrictive covenants may be contained in separate agreements with stockholders

Closing Conditions

- **“Bring down” of reps**
 - MAE can be covered by bring down or be a specific closing condition
- **Parties’ performance of all obligations under the Agreement**
- **No legal action, injunction, or restraining order challenging closing**
- **Consents and approvals**
 - Corporate approvals required by organizational documents and state law
 - Contract consent (change of control; anti-assignment clauses; landlord, lender, customer, supplier)
 - Antitrust approvals for FTC and DOJ
 - Other regulatory approvals
 - Publicly listed Buyer issuing greater than 20% of outstanding stock as consideration requires stockholder approval
- **Release of liens**

Termination Rights

- **Parties may terminate in certain specific circumstances**
 - Mutual written consent
 - By non-breaching party if other party's breach gives rise to a failure of a closing condition by a drop dead date
 - By either party if there is a law or final governmental order restraining or enjoining the transaction
 - On the drop dead date if closing conditions have not been satisfied
- **Questions of damages in certain cases**

Indemnification (Private Transactions)

- **Indemnity:**

- Breaches of reps and covenants
- Specific/line-item indemnities

- **Key Considerations:**

- Survival
- Cap
- Exclusion of certain damages
- Basket
- Escrow
- R&W insurance

- **Related Provisions:**

- Duty to mitigate
- Insurance proceeds; tax benefits
- Third-party claim procedures
- Assumption of defense
- Materiality scrape
- Sandbagging
- Right to offset
- Exclusive remedies

Public Merger Considerations

- **No-Shop**

- Restrict Target from negotiating with other parties or soliciting alternative bids
- Fiduciary duty out allows directors to accept a superior proposal

- **Break-Up Fee**

- Payable to Buyer if Target's stockholders:
 - do not approve the transaction because the board recommends a superior proposal
 - walk away from the deal and soon after complete a transaction with another party (between 1-4% of deal value)

- **Delist and Reregister Stock**

- Post-closing, Target's stock must be delisted by filing SEC's Form 25 and reregistered by filing the SEC's Form 15

Ancillary Documents

- **Asset Purchase**
 - Bill of Sale
 - Assignment and Assumption Agreement
 - IP Assignment
 - Real Property Deeds
- **Stock Purchase**
 - Stock Power
 - Stock Certificate
- **Merger**
 - Certificate or Articles of Merger

Ancillary Documents (continued)

- **Other Ancillary Documents**
 - Officer Certificates
 - Resignations and Employment Agreements
 - Escrow Agreement
 - Transition Services Agreement

Thank You



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