

M&A Purchase Agreements: Issues and Considerations

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Party Objectives

- Buyer
 - Obtain information relating to Seller and Business
 - Fair purchase price
 - Maximize indemnification rights
 - Tax efficiency
- Seller
 - Maximize purchase price
 - Minimize payment risk
 - Limit indemnification
 - Tax efficiency

M&A Transaction Process

- Pre-sale actions
- Preliminary agreements
- Due diligence
- Purchase Agreement and Ancillary Agreements
- Closing

Pre-Sale Actions

- Business/Life Goals and Objectives
 - Talk to financial planner and CPA
 - Identify legacy goals/initiatives
- Getting Business Ready for Sale
 - Advisory Team
 - Business valuation
 - Books and records (financial and legal)
 - Management succession plan
- Marketing of Business

Preliminary Agreements

- Confidentiality Agreement
 - Confidential Information definition
 - Restrictions on disclosure and use
 - Return of Confidential Information
- Letter of Intent
 - Basic deal terms
 - Non-binding
 - Exclusivity

Due Diligence

- Purpose
 - Business/Financial
 - Legal
- Request/Checklist
 - Organizational Documents
 - Financial Information/Documents
 - Contracts
 - Employee Information/Documents
 - Tax Information/Documents
 - Litigation
 - Customer/Supplier Information
 - Assets (Tangible)
 - Liabilities
 - Intellectual Property
 - Permits/Licenses
 - Insurance
- Access to Information
 - Hard copy vs. DropBox
- Informing Management/Employees
- **Caution: Keep your Eyes on the Ball (Business)!**

Transaction Structures

- Asset Sale
- Stock (Equity) Sale
- Rollover Transaction
- Simultaneous vs. Delayed Sign and Close

***Focused primarily on asset transfers**

Negotiation of Purchase Agreement Terms

- Recitals/Identity of Parties
- Purchase Assets and Excluded Assets/Assumed Liabilities and Excluded Liabilities
- Purchase Price and Allocation
- Closing
- Representations and Warranties
- Covenants
- Closing Conditions
- Indemnification
- Termination
- Miscellaneous

Identity of Parties

- Identity of Seller Parties
 - Issues with solvency and creditworthiness (for purposes of representations and indemnification)
- Identity of Buyer Parties
 - Issues with solvency and creditworthiness (for purposes of deferred purchase price obligations)

Purchased Assets

- Cash
- Inventory
- Components of working capital
- Tangible personal property
- Trade names, trademarks, service marks, domain names
- Other intellectual property
- Permits
- Business records
- Telephone numbers
- Contracts
- Claims and causes of action (warranties, indemnities, etc.)
- Goodwill
- Accounts receivable
- Work in process
- Prepaid expenses
- Intangibles
- Deposits
- All non-excluded assets

*Buyer should seek to define as “all assets other than the Excluded Assets”

Excluded Assets

- Corporate records
- Shareholder assets
- Excluded contracts
- Causes of action related to excluded assets or retained liabilities
- Insurance policies
- Tax assets
- Employee benefit plans
- Other excluded assets

*Seller should seek to define as “all assets other than the Purchased Assets”

Assumed Liabilities

- Trade accounts payable
- Liabilities and obligations under assigned contracts (post-Closing)
- Liabilities with respect to employees (post-Closing)
- Liabilities for taxes relating to the ownership and operation of the Business and Purchased Assets (post-Closing) and certain transfer taxes

*Seller should seek to define as “all liabilities other than the Excluded Liabilities”

Excluded Liabilities

- Liabilities or obligations arising from the ownership and operation of the Business and Purchase Assets prior to Closing
- Liabilities or obligations relating to Excluded Assets
- Liabilities for taxes relating to the Business or Purchase Assets prior to Closing
- Liabilities with respect to employees prior to Closing
- Others?

*Buyer should seek to define as “all liabilities other than the Assumed Liabilities”

Purchase Price

- Closing Cash Payments
- Guaranteed Deferred Payments
 - Promissory Note
 - Escrow
- Net Working Capital Adjustments
- Earn-outs
- Allocations

Net Working Capital Adjustments

- Adjust purchase price based on difference between Working Capital used to determine purchase price and actual Working Capital at closing
- Working Capital - current assets (to the extent included in the “Purchased Assets”) less current liabilities (to the extent included in “Assumed Liabilities”)
- Process is critical
 - Seller prepares closing balance sheet and related Working Capital calculation
 - Right of Buyer to review and dispute
 - Dispute resolution procedure

Earn-outs

- Buyer vs. Seller Objectives
- Based on reserve, net income, EBITDA, etc.
- Process and dispute resolution
- Guarantees
- Acceleration Events

Purchase Price Allocation

- Seller typically prefers that as much of the purchase price as possible be allocated to assets that result in long term capital gain, such as goodwill, rather than assets that generate ordinary income (such as depreciable property subject to recapture)
- Buyer typically prefers that as much of the purchase price as possible be allocated to assets that will generate tax benefits on an accelerated basis (such as inventory and short-lived depreciable fixed assets)
- No requirement that Buyer and Seller agree on the allocation, but the allocation is less likely to be challenged if the parties that bargained at arm's length report the transaction consistently

Closing

- Simultaneous vs. Delayed
- Location/Process
- Deliverables

Representations and Warranties

- Purpose
- Typical Seller Representations and Warranties
 - Organization and Qualification
 - Authority
 - No Conflicts; Consents
 - Financial Statements
 - Material Contracts
 - Title of Tangible Personal Property
 - Real Property
 - Sufficiency of Assets
 - Full Disclosure vs. No Other Representations and Warranties
 - Intellectual Property
 - Legal Proceedings
 - Compliance with Laws; Permits
 - Environmental
 - Employee Benefits
 - Employment Matters
 - Taxes
 - Brokers
- Typical Buyer Representations and Warranties
 - Organization
 - Authority
 - No Conflicts; Consents
 - Legal Proceedings
 - Sufficiency of Funds; Solvency
 - Brokers
 - Independent Investigation

Representations and Warranties

- “Joint and several” versus individual responsibility
- Use of “Knowledge” qualifiers
 - Definition of “Knowledge”
- Use of materiality qualifiers
- Seller and advisors should carefully review operational representations and warranties and assist in preparation of disclosure schedules

Covenants

- **Pre-Closing Covenants**
 - Conduct of Business Prior to Closing
 - Access to Information
 - Approval and Consents

- **Post-Closing Covenants**
 - Employees and Employee Benefits
 - Confidentiality
 - Restrictive Covenants
 - Retention of Books and Records
 - Public Announcements
 - Taxes
 - Cooperation and Further Assurances

Closing Conditions and Deliveries

Structure of Transaction

- Simultaneous “Sign and Closing” vs. “Delayed Closing”
 - Finance contingency
 - 3rd party consents
 - HSR approval
 - Licenses/Permits

Deliveries by Seller and Owners

- Payoff letters and UCC terminations
- Good standing
- Bill of Sale
- Assignment and Assumption Agreement
- Resolutions
- Third party consents
- Deeds?
- FIRPTA?

Closing Conditions and Deliveries

- Deliveries by Buyer
 - Purchase Price
 - Promissory Note
 - Security Agreement; Deed of Trust
 - Bill of Sale
 - Assignment and Assumption Agreement
 - Resolutions

Indemnification

Indemnification by Seller and Owners

- “Joint and several” or separate
 - Contribution obligation/agreement
- Categories of indemnification by Seller and Owners
 - Breach of representation or warranty
 - Breach of covenant
 - Excluded Liabilities
 - Operation of business prior to Closing

Indemnification

Indemnification by Buyer

- “Joint and several” or separate
- Breach of representation or warranty
- Breach of covenant
- Assumed Liabilities
- Operation of business after Closing

Limitations on Indemnification

▪ **Deductible vs. Basket**

- Deductible: No liability unless and until losses exceed \$_____ (“Deductible”), at which point only liable for losses in excess of the Deductible.
- Basket: No liability until losses exceed \$_____, but liable for all losses once threshold met.

▪ **Caps**

- In no event shall aggregate liability for indemnification exceed \$_____ amount (or % of purchase price).
- Caps, deductibles and baskets usually don’t apply in case of fraud or intentional misrepresentation
- Survival period
- “Fundamental Representations” may receive separate treatment as related to any deductible or basket, any cap and/or survival period.
- Issues regarding giving effect to “knowledge” and “materiality” qualifiers in loss determination.

Limitations on Indemnification

- Obligation to mitigate losses
- Tax benefit offset
- Insurance proceeds offset
- Limitations on categories of recoverable damages
- Exclusive Remedy

Termination

- Party Objectives
- Triggers
 - Mutual Consent
 - Transaction Illegal or prohibited by law
 - Failure of closing conditions to be satisfied (or once it becomes apparent that closing conditions will not be satisfied) by Drop Dead Date

Miscellaneous

- Expenses
- Notices
- Counterparts
- Successors and Assigns
- Applicable Law and Venue
- Waiver of Jury Trial/Arbitration
- Specific Performance

Ancillary Agreements

- Bill of Sale
- Assignment and Assumption Agreement
- Employment Agreements
- Promissory Note and Security Agreements
- Noncompetition Agreements

M&A Tax Issues

- Deal Structure – Asset vs. Stock Sale
- Personal Goodwill
- Purchase Price Allocation
- Rollover Transaction
- Choice of Entity (Buyer)
- Deferred Payments (Seller Treatment)
- Incentivizing Management
- Opportunity Zone Investments