MAJOR LEGAL STEPS IN AN M&A TRANSACTION

This article is meant to give a broad overview and a general sense of an M&A transaction from a transactional lawyer's perspective. We think it helpful to keep things as simple as possible and divide the major steps of a transaction as follows: pre-deal, beginning, middle and end. Of course, others could divide the transaction into smaller or different steps and nothing ever occurs perfectly, but the point here is to give an overview.

Pre-Deal

Once the buyer and the seller have identified[1] that they wish to explore a possible transaction, they will sign a confidentiality agreement so that both sides can exchange business information without concern that such information will be released to the public. The buyer will want to have information about the seller's past business operations, accounts receivables, account payables and inventory. It will want to know about its suppliers and customers, who buys what and how much. The buyer will want to know about trends in the seller's business specifically and any external factors affecting the business either positively or negatively. The buyer is essentially trying to gauge the strength of the seller's business as well as how the seller's business and personnel will fit into the buyer and how easy or hard the integration process will be. The buyer faces (at least) two sets of transaction costs—the cost to buy the business and the coats to integrate the business.

Although most of the information flows from seller to buyer regarding the seller's business, the seller may request information about the buyer such as a description of the types of deals that the buyer has completed recently, typical structure of the buyer's transactions and other matters of concern. The seller may ask about the private equity firm or credit facility that is funding the transaction. If the buyer has purchased similar companies in the past, they will have a track record that the seller can investigate.

If the buyer is satisfied with the preliminary results of its business due diligence—as there is always additional information uncovered along the way—then the two sides can execute the letter of intent.

Deal: Beginning

The execution of the letter of intent (the "LOI") is the official beginning of the transaction.[2] It sets out the transaction on paper, often for the first time, creating focus, momentum and energy around the deal. Typically a few pages long, this letter sets out basic information about the potential Buyer and what they intend to offer the Seller for their business. The LOI will be referenced throughout the deal for everything from correct names and addresses of the parties to formulating the basic terms of the key transaction agreements. It is the first document that every professional reads prior to beginning her work. Because of this, mistakes in the LOI cause a great deal of miscommunication. The LOI is non-binding in most respects, merely setting forth the intention of the parties to enter into definitive agreements, except one—the parties agree to exclusively work with each other on the deal at hand during a certain set period of time. This "exclusivity" gives comfort to the buyer that its deal is not being shopped around to other buyers behind its back.

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[1] This article assumes that buyer and seller has found each other and that they wish to further explore a transaction. Of course, the process of finding each other is a long and involved, typically taking many, many hours of research to identify potential targets, as well as discussion and negotiation to narrow the potential targets to real transaction possibilities.

[2] Please note that sometimes a buyer and seller could execute an LOI ***before*** conducting business due diligence. Buyers may want to obtain exclusivity (meaning the seller will only talk to the buyer) before expending time, energy and funds to conduct the activities needed to do a deal. And the exclusivity provision is contained in the LOI.

The Buyer will send a *legal* due diligence list (as opposed to the previous *business* due diligence list) to the Seller requesting certain corporate documents from the Seller. This can include incorporation documents, capitalization and shareholder information, employee matters such as company organization chart, employee benefit plans, insurance plans and information, inventory lists and other documents regarding same, customer, supplier and vendor agreements, intellectual property, litigation matters, environmental matters including permits and inspection logs. The legal due diligence process is document focused and seeks to determine whether there will be legal impediments to the transaction such as whether consents are needed to assign certain contracts, whether permits can be assigned, whether particular assets need to be handled differently such as an intellectual property transfer, whether certain agreement need to be terminated before the transaction can occur or whether certain resolutions will be needed from certain principals to sell all or substantially all of the assets.

The legal due diligence is a long and complicated process. The documents must be retrieved, copied, sent over, reviewed and summarized. That is usually done in a due diligence memo where the attorneys flag possible issues or problems in the materials for the business persons to know, understand and address prior to the deal closing.

<u>Deal: Middle</u>

Agreement Drafting

This is the beginning of the heart of the transaction. Major transactional documents begin with a Purchase Agreement, either an asset purchase or a stock purchase depending on the structure of the deal, followed by Consulting Agreements, Employment Agreements and a Lease of Real Property. These major documents are drafted by the Seller with the exception of the Lease which is usually drafted by the Buyer. The ancillary documents are the Bill of Sale, Assumption and Assignment, Resolutions, Certificates from both Buyer and Seller and any consents from vendors that may be needed. The ancillary documents are often drafted by the Buyer.

Negotiation

This is the heart of the transaction. Lawyers from both sides will get on the phone or meet in person to negotiate the major provisions of the deal. This meeting often happens after a few drafts have circulated between the parties over the course of a few to several weeks. If the attorneys are experienced in negotiating M&A deals, a few lengthy conversations may resolve most of the outstanding items. Typical hot spots for negotiation in M&A deals are closing conditions, covenants, subordination, and baskets. Negotiation is the part of the transaction where the most progress is made in the shortest amount of time. It will set the pace for the rest of the deal so it is key to select a lawyer who is experienced in negotiating these types of transactions as the details are so very important.

Third Party Consents

The Seller may have some contracts that may need to be assigned to the Buyer. These contracts may often be large and contribute the majority of inventory for the Seller and thus, a major reason why the Buyer is purchasing the Seller's business in the first place. These contracts should be disclosed in legal due diligence but if not, must be disclosed on the schedules. This portion of the transaction may take some additional work for both parties because the Seller may need to meet with the contractor to obtain the assignment. These meetings may be sensitive for the Seller due to the relationships that they have cultivated over the years with their vendors and supplies and should be handled with the upmost sensitivity.

Schedules and Attachments

The Schedules fully disclose the Seller's business to the Buyer. The schedules contain all Seller's tangible property, purchased assets, excluded assets, current liabilities, permits, owned intellectual property, affiliate transaction and indebtedness. The schedules will be organized according to the provisions and representations in the Purchase Agreement. The Seller may need some guidance as to how the Buyer prefers to format the Schedules. The schedules are usually disclosed closer to the end of the deal because they contain so much confidential information and should the deal go south, the Seller would want to protect their business.

Deal: End

Signing and Closing

The signing and closing concludes the transaction and can often be the most chaotic time because all documents must be finalized and the actual transfer of the business takes place. The signing of the documents often happens electronically, with the Seller's counsel and Buyer's counsel each having their clients sign their perspective signature pages and then will send them to the opposing counsel to hold them in escrow until the closing call. At the closing call, all parties will be on the phone with their respective counsels and will state that they have all the documents and information needed to close. Upon confirmation, both parties will release their signature pages to the other side and the funds will be initiated. Oftentimes the Buyer will be present for the closing to announce to the employees that they are the new owners.

Post-closing Items

In most transactions, there are a number of items that will be handled post-closing. These may include UCC original searches, assignments, UCC termination statements and post-closing allocation. Once the post-closing items have been wrapped up, a closing set of all the final documents will be complied and sent to both the Seller and the Buyer to keep for their files.

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