

# The Business Lawyer's Expanding Role in Facilitating Small and Mid-Sized Merger and Acquisition Transactions

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**B**UYERS AND SELLERS OF COMPANIES look to their legal counsel for guidance on a wide variety of strategic, regulatory, and financial tasks beyond the obvious roles typically played in the due diligence process and in preparing and negotiating the acquisition documents. In a larger “Wall Street-style” transaction, the advisory team is often very large and the role of counsel is often narrower and more clearly defined. However, in deals involving smaller and mid-sized companies, the role of the business lawyer is often expanded to include a wide variety of responsibilities from financial advisor, to corporate strategist, to creative problem solver, to quasi-investment banker, to emotional sounding-board, to family business counselor. To be an effective advisor in one or more of these roles, a business lawyer will need to really understand the key aspects of the client’s business model and plans, as well as trends in the client’s industry. Effective advising may also require training and expertise in fields as wide-ranged as strategic planning, accounting and finance, tax, and even psychology.

It is critical to understand that for many sellers of a business that has been owned and grown over a long period of time, the sale of the company will not only be the most important financial event of their lives but also the most emotional. An effective business lawyer will help his or her client prepare for this transaction at an early-stage in the process, with a focus on a legal audit to identify potential problems and prepare for the buyer’s due diligence request, the review of the offering memorandum, the review of the projected valuation and pro forma or restated financials, and estate planning and related issues which will be relevant following the closing of the transaction. In a future article for the *Business Law Brief*, I will discuss the lawyer’s role in representing sellers of small and mid-sized companies in greater detail. The chart below provides an overview of each attorney’s role which is driven by the role of the client in a given transaction.

This article focuses on the **role of the buyer’s counsel**. As counsel to a company which will be acquiring other businesses, it is critical that the business lawyer ensure that the client has gone through the Acquisition Planning process in order to

Roles of Counsel: <i>Merger &amp; Acquisition Transactions</i>		
	<u>Seller's Counsel</u>	<u>Buyer's Counsel</u>
<u>Early Stage</u>	<ul style="list-style-type: none"> <li>Legal audit/preparing for the due diligence process</li> <li>Review of Offering Memorandum and presentation materials</li> </ul>	<ul style="list-style-type: none"> <li>Assist the development of the Acquisition Plan and screening process</li> <li>Preliminary due diligence on wide range of targets</li> </ul>
<u>Letter of Intent/ Due Diligence</u>	<ul style="list-style-type: none"> <li>Prepare document/data room for due diligence</li> <li>Review and negotiate Letter of Intent</li> </ul>	<ul style="list-style-type: none"> <li>Legal and strategic due diligence on target</li> <li>Review and negotiate the Letter of Intent</li> </ul>
<u>Acquisition Documents</u>	<ul style="list-style-type: none"> <li>Review and negotiate the definitive documents</li> <li><i>Narrow</i> the representations &amp; warranties and covenants and shift allocation of risk</li> </ul>	<ul style="list-style-type: none"> <li>Review and negotiate the definitive documents</li> <li><i>Widen</i> the scope of the representations &amp; warranties and covenants and shift allocation of risk</li> </ul>
<u>Post Closing</u>	<ul style="list-style-type: none"> <li>Enforce any post-closing compensation terms/covenants</li> <li>Work with seller on asset/estate protections and post-closing projects</li> </ul>	<ul style="list-style-type: none"> <li>Enforce post-closing obligations of the seller</li> <li>Work on post-closing integration issues</li> <li>Work with buyer on asset transaction</li> </ul>
	<u>Regulatory Counsel</u>	<u>Third Party Counsel</u>
	<ul style="list-style-type: none"> <li>Works to obtain regulatory approvals to allow for the closing of the transactions</li> <li>Advises on post-closing regulatory issues</li> </ul>	<ul style="list-style-type: none"> <li>Represents the debt and equity sources of capital that may be required to finance the transaction</li> <li>Represents lenders, venture investors, vendors, customers, landlords etc. that may be required to approve the proposed deal</li> <li>Investment bankers and other advisors may also have their own counsel</li> </ul>

define the goals, objectives, screening processes, and selection criteria for the proposed transactions.

## Acquisition Planning

ONE OF THE KEY CRITICAL TRANSACTIONAL SUCCESS DRIVERS for buyers of companies is the preparation and execution of an Acquisition Plan. The Acquisition Plan: (1) analyzes key trends in the target’s industry, (2) identifies the method for finding candidates, (3) defines the criteria which will be used to evaluate candidates, (4) sets forth the targeted budgets and timetables for accomplishing the transaction, (5) defines the price ranges to be considered, (6) articulates the amount of external

capital which will be required to accomplish the transaction, (7) identifies the internal and advisory teams for the transaction, and (8) sets forth the decision-making and approval process. One of the goals of the Acquisition Plan is to “narrow the field” of candidates as quickly as possible to avoid wasting time and resources. Other benefits of having a well-prepared Acquisition Plan include:

- providing a road map for the company’s leadership to follow;
- informing shareholders of key objectives;
- reducing professional and advisory fees;
- mitigating the risk of doing a transaction that a client will later regret;
- identifying post-closing integration challenges well in advance; and
- informing sellers of your plans for the company on a post-closing basis.

In today’s marketplace, it is especially important to the seller (particularly if an earn-out is part of the deal, *or* if the seller’s compensation will include issuance of company stock *or* if the compensation will involve any significant deferral of seller consideration as discussed below) to understand, accept, and

**“[T]he Acquisition Plan should always answer the fundamental question: How will the buyer’s professional management or brand equity enhance the performance or profitability of the seller’s company?”**

respect the buyer’s acquisition strategy and growth Plan for the consolidated companies on a post-closing basis. Well-prepared Acquisition Plans are valuable negotiation tools for the buyer when approaching sellers who are naturally concerned with the value and continued growth of the buyer’s stock.

The Acquisition Plan also identifies the value-added efficiencies and projected cost-savings which will result from the proposed transaction(s). Therefore, the Acquisition Plan should always answer the fundamental question: *How will the buyer’s professional management or brand equity enhance the perform-*

*ance or profitability of the seller’s company?* These objectives may vary, but generally include a desire to accelerate growth in revenues and profits, strengthen the buyer’s competitive position, broaden existing product lines, or break into new geographic markets or market segments as part of a diversification strategy. The heart of the plan will identify the “*Targeted Industries*” and the “*Criteria for Evaluating Candidates*” within the targeted industries. The Acquisition Plan will also identify:

- the targeted size of the candidates;
- the source of acquisition financing (including the logistics for obtaining the capital, where necessary, and the targeted amount and method of payment to the seller);
- the method for bringing candidates to the buyer’s attention (e.g. internal search vs. use of intermediaries vs. dealing with unsolicited offers, etc.);
- the desired financial returns and/or operating synergies to be achieved as a result of the acquisition;
- the minimum/maximum ranges and rates of revenues, growth, earnings, net worth, etc., of the seller which would be acceptable to the client and the client’s Board of Directors;
- the impact on existing shareholders of the company;
- the likely competing bidders for qualified candidates;
- the members of the acquisition team and each of their roles;
- the nature and types of risks which you are willing to assume versus those which will be unacceptable;
- the desired geographic location of the target companies;
- the desired demographics and buying habits of the seller’s customers;
- the plans to retain or replace the management team of the target company (even though this policy may vary on a target-by-target basis, it is recommended to include a section addressing the preliminary plans in the Acquisition Plan);
- the buyer’s willingness to consider turnaround or troubled companies (again, each buyer will have a different tolerance level as to what condition the seller should be in – some buyers want and prefer the “cost-savings” of buying a “fixer-upper” and others prefer matters to be pretty well intact when they “move-in”);
- the buyer’s tax and financial preference for asset vs. stock transactions;
- the buyer’s openness to full vs. partial ownership of the

seller's entity or willingness to consider a spin-off sale, such as the purchase of the assets of an operating division or the stock of a subsidiary; and

- the buyer's interest or willingness to launch an unfriendly takeover of a publicly-held company or buy the debt from the largest creditor of a privately-held company.

### The Narrowing of Acquisition Criteria

BUYERS OF COMPANIES ARE MORE SPECIALIZED and more focused than ever. From the buyer's perspective, developing a set of defined acquisition criteria and having the discipline to stick to the criteria is the real art of M&A. Open-ended requests for deal flow seem to be a thing of the past because buyers are increasingly better focused on what they really want, which leads to higher quality deals. Provided that the Acquisition Plan addresses all of the issues listed above, it should be relatively easy to define the criteria and screen the candidates. It is typical for the criteria to include a combination of the following:

- history of stable financial and growth performance during different market cycles and conditions;
- market leader in industry niches and geographic regions (recognized brand names with established market-share);
- products with life cycles that are not too short-term or susceptible to obsolescence or rapid technological change;
- strong management team with research and development capability and technological know-how;
- stable and economically favorable relationships with customers, vendors, lenders, and lessors;
- room for growth (or excess) capacity in manufacturing or production;
- range of current or potential claims or litigation in the \$\_\_\_\_\_ to \$\_\_\_\_\_ range;
- sales range in the \$\_\_\_\_\_ to \$\_\_\_\_\_ million level with minimum earnings before income and taxes at \$\_\_\_\_\_ million, with an aggregate set of post-closing obligations (e.g. liabilities, union contracts, etc.) not to exceed \$\_\_\_\_\_;
- purchase price range from \$\_\_\_\_\_ to \$\_\_\_\_\_ and seller must be willing to accept up to \_\_\_\_\_% of its consideration in buyer's stock and an additional \_\_\_\_\_% of the consideration will be contingent on the performance of the seller's company on a post-closing basis (exact method, such as earn-out, to be determined);

- geographical location is desired in the states of \_\_\_\_\_, \_\_\_\_\_, and \_\_\_\_\_ or within a \_\_\_\_\_ mile range of the buyer's principal headquarters; and
- existing management team must agree to remain in place for up to \_\_\_\_\_ years.

Naturally, the buyer and its team are not likely to find *all* of these criteria in *each* candidate. Rather, the buyer and its team must be ready to mix and match and accept some compromise in the rigid criteria. However, the buyer must also be careful not to overlook "too many warts" which will result in a deal that will be regretted later.

Again, the goal is to compare the acquisition objectives described in the Acquisition Plan with the strengths and weaknesses of each seller to ensure that the acquisition team



has a clear idea as to *how* the targeted companies will complement the buyer's strengths and/or mitigate the buyer's weaknesses. The specific qualitative and quantitative screening criteria help the buyer and its team ensure that the right candidates are selected. The screening criteria are intended to "filter out" the wrong deals and mitigate the chances of post-closing regrets and problems.

## Keys To Preparing an Effective Acquisition Agreement

FOLLOWING THE NEGOTIATION AND EXECUTION of the Letter of Intent and concurrent with the due diligence process, the buyer's lawyer will typically begin preparing the definitive Acquisition Agreement and related documents. Preparing an effective Acquisition Agreement starts with the business lawyer for the buyer understanding the key issues and challenges to the closing of the transaction, the key factors motivating the transaction, and the special issues and risks that need to be dealt with in the documents based upon the results of the due diligence process. The motivation for the deal to occur and the underlying goals and objectives for the



transaction on a post-closing basis will often affect the structure of the transaction (e.g., stock vs. asset acquisitions), pricing and valuation issues, and the ability to obtain necessary third party or governmental approvals.

### Structuring the Deal

THERE ARE VIRTUALLY AN INFINITE NUMBER of ways in which a corporate merger or acquisition may be structured. There are probably as many potential deal structures as there are qualified and creative transactional lawyers and investment bankers. The goal is not to create the most complex structure, but rather to create a structure which fairly reflects the goals and objectives of the buyer and seller. Naturally, not all of the objectives of each party will be met each time — there will almost always be some degree of negotiation and compromise. Virtually all structures, even the most complex, are basically either mergers or acquisitions at their roots, including the purchase or consolidation of either stock or assets.

The creativity often comes in structuring the deal to achieve a particular tax or strategic result, or to accommodate a multi-step or multi-party transaction.

At the heart of each transaction are the following key issues which will affect the structure of the deal and the terms of the Acquisition Agreement:

- How will tangible and intangible assets be transferred to the purchaser from the seller? At what price and according to what terms?
- What issues, discovered during due diligence, may affect the structure of the deal?
- What liabilities will the purchaser assume? How will risks be allocated among the parties?
- What are the tax implications to the buyer and seller?
- What are the long-term objectives of the buyer?
- What role will the seller have in the management and growth of the underlying business after closing?
- To what extent will third party consents or governmental filings/approvals be necessary?
- What arrangements will be made for the key management team of the seller (which may not necessarily be among the selling owners of the company)?
- Does the buyer currently have access to all of the consideration to be paid to the seller or will some of these funds need to be raised from debt or equity markets?

There are a wide variety of corporate, tax, and securities law issues which affect the final decision as to the structure of any given transaction. Each issue must be carefully considered from a legal and accounting perspective. However, at the heart of each structural alternative are the following basic questions:

- Will the buyer be acquiring stock or assets of the target?
- In what form will the buyer's consideration to the seller be made (e.g., cash, notes, securities, etc.)?
- Will the purchase price be fixed, contingent, or payable over time on an installment basis?
- What are the tax consequences of the proposed acquisition structure?

Once the deal structure has been determined, due diligence has been completed, valuations and appraisals conducted, terms and price initially negotiated, and financing arranged, the acquisition team must work carefully with legal counsel to structure and begin the preparation of the definitive legal documentation which will memorialize the transaction. The drafting and negotiation of these documents usually focuses on the

past history of the seller, the present condition of the business, and a description of the rules of the game for the future. The documents also describe the nature and scope of the seller's representations and warranties, the terms of the seller's indemnification of the buyer, the conditions precedent to closing of the transaction, the responsibilities of the parties during the time period between execution of the purchase agreement and actual closing, the terms and structure of payment, the scope of post-closing covenants of competition, the deferred or contingent compensation components, and any predetermined remedies for breach of the contract.

The heart and soul of the Acquisition Agreement is, in many ways, merely a tool for *allocating risk*. The buyer will want to hold the seller accountable for any post-closing claim or liability which arose in relation to a set of facts which occurred while the seller owned the company or which occurred as a result of a misrepresentation or material omission by the seller. The seller, on the other hand, wants to bring as much finality to the transaction as possible to allow some degree of sleep at night. When both parties are represented by skilled negotiators, a middle ground is reached both on general as well as on specific issues of actual or potential liability. The buyer's counsel will want to draft changes, covenants, and representations and warranties that are strong and absolute. The seller's counsel will seek to insert phrases like "... except insignificant defaults or losses which have not, or are not likely to, at any time before or after the closing, result in a material loss or liability to or against the buyer..." that leave some wiggle room for insignificant or non-material claims. The battleground will be the indemnification provisions and any exceptions, carve-outs, or baskets that are created to dilute these provisions.

The following chart is designed to be a diagnostic tool to ensure that all parties to the transaction understand the acquisition documents, and to ensure that all key categories of issues have been addressed, and that the definitive documents are reflective of the business points reached between the parties.

Consideration	Mechanics	Allocation Of Risk
<ul style="list-style-type: none"> <li>Structure</li> <li>Scope of purchase</li> <li>Price</li> <li>How/when paid</li> <li>Deferred consideration/security</li> <li>Earn-outs and contingent payments</li> <li>Other ongoing financial relationships between buyer &amp; seller</li> <li>Employment/consultant agreements</li> <li>Post-closing adjustments</li> </ul>	<ul style="list-style-type: none"> <li>Conditions to closing</li> <li>Timetable</li> <li>Covenants (including covenants not to compete)</li> <li>Third party and regulatory approvals</li> <li>Schedules (exceptions/substantiation)</li> <li>Opinions</li> <li>Dispute resolution</li> </ul>	<ul style="list-style-type: none"> <li>Representations and warranties ("R&amp;W's") two-way street (due diligence driven)</li> <li>Indemnification</li> <li>Holdbacks and baskets</li> <li>If seller is taking buyer's stock or notes, then R&amp;W's are a two-way street</li> <li>Collars</li> <li>R&amp;W insurance</li> <li>Methods for dealing with surprises</li> </ul>

## Keeping Merger & Acquisition Deals on Track: Managing the Deal Killers

ANOTHER KEY ROLE OF BUYER'S COUNSEL – in fact, the role of *all* lawyers to the transaction – is to work hard to keep the deal on track. The first step in keeping a transaction heading in the right direction and toward closing (and greatly increasing the chance of deal killer avoidance) is to have strong communication and leadership by and among all parties and key players to the transaction. As in football, each team (e.g., buyer, seller, source of capital, etc.) should appoint a quarterback who will be the point person for communication and

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coordination. Too many lines of communication, like too many chefs in one kitchen, will create confusion and misunderstanding — which are fertile conditions that allow a deal killer to pollinate. The more that the quarterbacks coordinate, communicate and anticipate problems with the various members of their team, and promptly discuss key issues with the quarterbacks of the other teams, the greater the chances that the transaction can and will close.

Some of the key tasks of the buyers counsel as the “transactional quarterback” to keep the transaction on track towards closing include:

- formulate a master game plan/timetable (with realistic expectations regarding financial and post-closing objectives)
- build the right internal and advisory teams
- communication and teamwork
- orchestration and leadership
- momentum and timetable accord
- avoid emotion (“don’t call my baby ugly syndrome”), buyers (and sellers) must avoid falling in love with a given transaction
- start early on governmental and third party approvals
- creative problem solving
- cooperation and support from financing sources

## Diagnosing the Source of the Problem

WHEN A POTENTIAL DEAL KILLER DOES ARISE, each quarterback should first diagnose the source of the problem. Where is the issue coming from and what can be done to fix it? A deal killer for one party may not be a deal killer for another party. Take a look at the chart below. The old adage “where you stand often depends on where you sit” clearly applies here. For example, a loan with a higher lending rate than anticipated may significantly alter the attractiveness of the transaction from the buyer’s perspective but may be viewed as a non-issue for the seller.

The Source of the Problem Will Dictate the Solution			
<b>Seller</b>	<u>Stakeholders</u> <ul style="list-style-type: none"> <li>Minority shareholders</li> <li>Key employees</li> <li>VC investors</li> <li>Family members</li> </ul>	<u>Third party Approaches</u> <ul style="list-style-type: none"> <li>Regulatory</li> <li>Lenders</li> <li>Lessors</li> <li>Unions</li> </ul>	A L L
<b>Buyer</b>	<u>Sources of Capital</u> <ul style="list-style-type: none"> <li>Debt</li> <li>Equity</li> <li>Mezzanine</li> </ul>	<u>Professional Advisors</u> <ul style="list-style-type: none"> <li>Lawyers</li> <li>CPA’s</li> <li>Investment bankers</li> <li>Consultants</li> </ul>	P A R T I E S

Once the source of the deal killer has been analyzed, the respective quarterbacks should focus on the specific type of deal killer involved. Most deal killers can, and should be, resolved — either with creative restructuring, effective counseling, or precision document redrafting. Some deal killers cannot be resolved (they are just too sizeable) and other deal killers should not be resolved (like trying to squeeze a square peg into a round hole).

## Curing the Transactional Patient

ALTHOUGH A DETAILED DISCUSSION OF THE TOOLS available to “kill a deal killer” is beyond the scope of the article — and is probably as broad as the number of tools available to the Orkin® man to kill the hundreds of different insects and rodents — some of the more common tools are listed below. For the quarterback of the buyer and seller, the first step is to ensure that the transaction *can* and *should* be fixed. If so, these tools can be very valuable in mending a broken deal:

- earn-outs/deferred and contingent post-closing consideration
- representations, warranties, and indemnities may be used to adjust allocation and assumption of risk (weighting of priorities issues)
- adjusting the post-closing survival period of R&W’s
- holdbacks and security interests
- closing date audits

- third party performance guaranties/performance bonds/escrows
- M&A insurance policies
- restrictions on sales by the seller of the buyer’s securities issued as part of the overall consideration
- recasting of financial projections and retooling post-closing business plans

Business lawyers for both buyers and sellers should understand that bad deals deserve to die a peaceful death and hopefully without the need for litigation. Not all transactions are meant to be closed: (a) at this time; (b) at this valuation; (c) between these parties; or (d) under these terms and conditions. But if a transaction can be saved, then it should be saved. The quarterback on each team must have the transactional experience, the business acumen, and the communication skills that are necessary to diagnose the source and nature of the problem, as well as enough familiarity with all of the available tools to get the transaction back on track toward closing.

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