

## N of 1: Negotiating Against What's “Market” in M&A Transactions

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<https://www.dorsey.com/newsresources/events/event/2016/11/corporate-counsel-symposium-2016>

1. PowerPoint Presentation
2. *The Impact of Transaction Size on Highly Negotiated M&A Deal Points*,  
Eric Rauch and Brian Burke, *The Business Lawyer*; Vol. 71 (Summer 2016)  
(Copies available upon request, contact [dorseyU@dorsey.com](mailto:dorseyU@dorsey.com))

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### Deal Structuring

**You are an in-house M&A lawyer at Company X. Henry, a Corporate Development Associate at your company, comes to you with a question regarding a term sheet for an acquisition. Henry does not have a lot of experience structuring deals. He and the potential target are having trouble bridging a valuation gap. Amazingly, Henry has heard that deal studies show that 75% of all deals are straight cash. He asks you for alternatives. Do you have any advice to help Henry bridge the valuation gap?**

**Change in facts: Henry informs you that this may be an M&A transaction coupled with an operating joint-venture and the target has operations overseas.**

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## Earn Outs

Henry negotiates a term sheet involving an earn out. He is exulted in the corporate development department. You instruct your outside counsel, Charlie, to draft a purchase agreement. The first draft you receive from Charlie is silent on earn out efforts/covenants. What do you think?

- ABA study says: 77% of earn out deals do not include express disclaimer of fiduciary relationship and 58% do not include statement that buyer may operate post-closing in buyer's discretion

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## Earn Outs

**Change in facts #1:** The other side is insisting on post-closing covenant that would require Company X to use commercially reasonable efforts to maximize the earn out. You have resisted. You get a call from Henry's boss, Olivia. Olivia tells you the CEO of Company X really wants this deal. Olivia says that Company X always acts in a commercially reasonable manner, so agreeing to the standard should be a meaningless give. What do you tell Olivia?

**Change in facts #2:** You are the seller in a competitive bidding process with three very interested bidders. How much importance do you give to the fact that one buyer will agree to a commercially reasonable efforts post-closing covenant?

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## Indemnification Parameters

**Negotiations on the purchase agreement begin. You have reached an impasse with seller's counsel, Maddie, regarding the escrow and indemnification parameters. Maddie sends you a draft purchase agreement with indemnification parameters that are exactly in line with the ABA deal study findings.**

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## Indemnification Parameters

- **Escrow: 7.5% of purchase price**
- **Basket: .5% of purchase price, deductible**
- **Cap: 10% of purchase price**
- **No express right to set off against earn out**
- **Survival: 18 months**
- **Exceptions to cap, basket, survival: Capitalization, Authority, Organization, Taxes, Fraud**

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  - Fact Change: This is a healthcare deal.
  - Fact Change: This is a pre-revenue medical device transaction.
  - Fact Change: This is an international deal.
  - Fact Change: This is a \$10,000,000 deal v. a \$1,000,000,000 deal.
  - Fact Change: Seller is requesting we rely on rep and warranty insurance.

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## Reps and Warranties

**Negotiations continue. On an all-hands call, Olivia and her counterpart at the target direct you and Maddie to walk through reps and warranties and reach agreement quickly. Olivia and her boss, Will, have told you numerous times “we don’t really care how you reach agreement on reps and warranties but don’t do anything to upset the deal or to subject Company X to any real risk”.**

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## Reps and Warranties

- **Knowledge standard: constructive knowledge of a limited number of individuals (Consistent with ABA deal study)**
- **Role of disclosure schedules**
- **Undisclosed liabilities rep: only liabilities that would be disclosed in accordance with GAAP (41% in the ABA study)**
- **Materiality scrape only for determination of damages (57% in ABA study)**
- **Silent on sandbagging (56% in ABA study)**

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## Closing Conditions

**Olivia informs you that there will be approximately a 30 day time period between sign and close. In her latest draft, Maddie has proposed the following with respect to Closing Conditions:**

- **Representations and warranties must be true only at closing (37% in the ABA study) and except to the extent inaccuracies do not constitute a MAC (24% in ABA study)**
- **No express or back door MAC condition (9% in ABA study)**
- **Legal proceeding condition relates only to pending proceedings (not threatened proceedings) (55% in ABA study)**
- **No dissenters' rights condition to closing (51% in ABA study)**

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## Take Aways

- **Exceptions to deal points are where lawyers add value**
- **Industry matters**
- **Know your clients' objectives**
- **Jurisdictional differences drive different standards**
- **No substitute for good diligence**

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## Questions?

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**Source: Private Target M&D Deal Points Study (Including Transactions Completed in 2014) American Bar Association, M&A Market Trends Subcommittee, Mergers & Acquisitions Committee, <http://apps.americanbar.org/dch/committee.cfm?com=cl560003>**

**Opinions of panelists do not necessarily reflect the opinions of their employer.**