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MEMORANDUM

Process for Merger & Acquisition Transactions
2021

This memorandum is an overview on the due diligence, negotiation, signing, and closing stages of a merger or acquisition (after a Letter of Intent or Term Sheet is signed), including the related mechanics and documents with which the parties to the transaction will need to be familiar. It is intended to give a general procedural overview of such a transaction. If a public company is involved in the transaction there are usually additional matters to consider.

Initial Preparation

If not done prior to the LOI or Term Sheet, the parties should enter into a non-disclosure agreement (NDA). Since the selling entity will be disclosing a large amount of confidential information to the prospective buyer, at least a unilateral NDA is critical. It may be appropriate to have a mutual NDA if both parties will be disclosing confidential information to the other party.

Parties consider the closing at the earliest stages of a transaction. The deal structure itself is often shaped by closing considerations. For example, a party buying a business may buy stock instead of assets because closing a stock acquisition is typically much easier than closing an asset acquisition.

When the transaction structure is selected and the deal begins, the parties consider and identify closing requirements. Issues such as third-party consents, stockholder approvals and other types of consents and requirements are discussed at initial organizational meetings.

Ideally, the parties establish transaction teams (attorneys, bankers, accountants, consultants, etc.) prior to or about the time of signing the LOI or Term Sheet. Additionally, the seller should work with its transaction team to set up a data room with documents for the due diligence process and address any business or legal issues before providing the buyer access to the data room. It is best for the seller to gather the information requested by the potential buyer and providing it to them in an organized and concise fashion will raise less questions later in the deal and ensure a competitive price.

Due Diligence

Due diligence is the investigation of a person or business. In the context of mergers and acquisitions, the parties use the due diligence process to gather information about each other and about the business or assets that are for sale. Although the seller occasionally conducts due diligence on the buyer, the due diligence process is usually more significant for the buyer.

In any significant merger or acquisition the buyer gathers information about what it is buying before making a commitment. Primarily, the buyer uses this information to decide whether the proposed acquisition is a sound commercial investment. In an extreme case, a buyer may decide to abandon the transaction after performing due diligence, but more commonly, a buyer uses the information to negotiate contractual protections (such as indemnification) or to adjust the purchase price. A due diligence inquiry should establish the following key information about the target business:

- Confirm that the seller has good title to the stock or assets of the target business.
- Investigate potential liabilities or risks.
- Confirm the value of the target business.
- Identify steps necessary to integrate the target business.
- Learn more about the operations of the target business.
- Identify any impediments to the transaction, such as third-party consents, a required stockholder vote, or prohibitions on transfer.
- Determine whether any ancillary documents will be needed.

The scope of a due diligence investigation is determined by many factors. It is important to determine the scope at the outset because it influences how many people are needed, how much time is required, whether outside experts are engaged, and depth of review.

Sometimes the seller will make due diligence materials available at the outset of a transaction, but often a buyer must submit a due diligence request for information. A due diligence request is a list of questions and requests for documents organized by topic. Information can include documents as well as access to management and key employees. The initial due diligence request is usually supplemented by further requests as the negotiations proceed and as the buyer learns more about the target business.

The size of a due diligence request depends on the scope of the due diligence review. For example, in a stock acquisition the due diligence request should cover the entire company. On the other hand, if the buyer is only acquiring real estate assets, the request will be limited to materials relating to those properties. Although a due diligence request must be broad enough to include a wide range of information, counsel will tailor its due diligence questions to the specific target business and the industry it operates in.

Due diligence is a necessary part of any significant acquisition. The due diligence findings can impact the transaction in the following ways:

- Purchase price. If a due diligence finding affects the valuation of the target company, the buyer may adjust the purchase price. For example, if counsel discovers a $10 million liability that was previously unknown, the buyer may reduce their offer by that amount.
- Representations and warranties. A buyer often uses the representations and warranties as protection against unknown liabilities. If counsel discovers that certain permits are very important to the operation of the business, the buyer will likely insist on a full representation and warranty that the target business is in compliance with all permits. If this representation and warranty turns out to be false, the buyer can seek indemnification post-closing.
- Indemnification. If counsel discovers a liability that the buyer is unwilling to acquire, the seller may agree to indemnify the buyer for that specific liability. For example, the seller may indemnify buyer for any costs or expenses incurred in connection with particular litigation.

- Disclosure schedules. The buyer uses its due diligence review to verify the disclosure schedules. Ideally the buyer should have an opportunity to investigate anything that the seller lists on the disclosure schedules. If the disclosure schedules are inconsistent with the buyer's due diligence findings, the buyer may negotiate to add or remove certain disclosures.
- Deal termination. In extreme situations, due diligence findings may cause a party to terminate the transaction (known as deal breakers). There may be certain issues which either drastically affect the value of the target business or otherwise impact the buyer's desire to make the acquisition. For example, if a buyer is acquiring a company primarily for its supply channels and then discovers that none of the supply contracts are binding, the buyer may choose to terminate the deal. It is important to identify any deal breakers early so that counsel can focus on these issues and communicate any findings to the client as soon as possible.
- Pre-closing covenants. The due diligence findings may raise issues that the buyer wants the seller to correct prior to the closing. For example, if there are title defects in assets the buyer is acquiring, it may require the seller to correct these defects prior to closing.

In order for each party to provide and review the requested documents and information counsel will often setup a site or data room that will allow parties to review documents provided.

Third Party Consents

One must carefully consider when to contact third parties who are required to consent to the transaction. For example, if a target company requests consent from its landlord to transfer its lease to the buyer and the deal is later terminated, there can be negative consequences to the target company. In addition, if the parties are bound by a confidentiality agreement restricting disclosures about the deal, one should ensure the parties agree on procedures in advance regarding third party consents.

If one of the parties is a public company there are usually additional confidentiality and disclosure concerns.

Signing and Closing: Simultaneous or Gap?

There may be a period of time between signing and closing or they may take place simultaneously. A simultaneous signing and closing eliminates transaction risk during any intervening period. For example, the target company may suffer an environmental disaster or lose a key contract with an important customer after signing but before closing. Before signing, the parties can spend a lot of time negotiating who should bear the risk of such events. This risk can be eliminated altogether if signing and closing are simultaneous.

On the other hand, a simultaneous signing and closing may not be possible for legal or practical reasons. The deal can, for example, be conditional on third party or stockholder approval.

During the period between signing and closing there are several actions one or both of the parties must take, such as:

- Request and receive required third party consents.
- Apply for and receive regulatory approval.
- Hold stockholders' meetings.

- For sellers, conduct their business in the ordinary course (for example, sellers usually cannot enter into significant agreements or borrow money after signing a transaction agreement).
- The parties usually bring down their respective representations and warranties made in the transaction agreement. This ensures a party that the representations and warranties made by the other party at the signing remain accurate at the closing.

Signing

When signing and closing are not simultaneous, there is a separate signing stage. This is usually a less complex process than the closing and fewer documents are involved.

In some deals, parties exchange signature pages before the actual signing (or closing, as applicable) but the pages are not officially "released" or effective until the parties specifically say so. This is known as holding the pages "in escrow" and is an informal process without specific written escrow documents.

Parties do this to ensure a smooth closing by having all the documents ready. Sometimes a closing is delayed until a particular approval is received or a filing is made.

Pre-Closing

The pre-closing is a practice run of the closing that usually takes place the day (or night) before the closing. At the pre-closing, the parties lay out all of their closing documents and identify remaining issues so they can be resolved before the closing.

Good organization and preparation is critical at this stage of the process. The pre-closing is typically the last chance to ensure that everything is ready for the closing. The main goal is to avoid surprises and last-minute scrambling at the closing, especially when such things can be avoided. Corporate paralegals and secretaries can provide help in this process and often have a lot of experience in closing transactions which involve many documents.

Closing

Parties typically begin to realize the benefits of the transaction at the closing and this can be the most satisfying part of the deal.

In-person or Virtual Closing?

Signing and closing meetings have evolved over the past one or two decades. Historically, closings occurred in large conference rooms with multiple copies of all closing documents carefully arranged for signature by principals in person. Certified checks and all other applicable documents would be delivered to all appropriate parties who were usually all at the meeting.

Due to advances in technology, closings can be handled completely by phone, fax, e-mail and wire transfer without an in-person meeting.

Traditional in-person closings still occur, so consider at the outset what type of closing is best for the transaction. In addition, some transactions (for example, a sale of real estate) require that some documents be signed in person so virtual closings are not always possible.

Parties Present at the Closing

Whether the closing is virtual or in person plays a large role in which parties are present at the closing. At in-person closings, representatives of both parties and their counsel are almost always present. In addition, if there are other parties involved, such as accountants and bankers, they will usually send representatives as well.

In virtual closings, the attorneys typically run the process from their offices. Closing documents are e-mailed, faxed and delivered to the relevant parties.

What Happens at the Closing

Closings are often fast-paced events with simultaneous meetings and actions. While each deal has different requirements, the following events typically take place at a closing:

- All closing documents are delivered.
- The consideration is delivered (such as bank checks, wire transfers, delivery of stock certificates, and so on).
- All required filings are made, such as amendments to charter documents.

Post-Closing

Most deals include obligations that must be satisfied after the closing. These are referred to as post-closing conditions or obligations. These obligations may be formally required by the transaction documents, good faith agreements between the parties or just part of the standard deal process, such as delivering copies of closing documents to the parties. Typical post-closing obligations include:

- Making certain state filings, such as an amendment to party's certificate of incorporation to change its name.
- Receiving certain third-party consents not received at the closing.
- Satisfying obligations required by the transaction documents.
- Filing press releases.
- Distributing sets of closing documents to the parties.

There is generally no formal post-closing process or meeting. Each post-closing document, condition and obligation is typically delivered and satisfied on an individual basis. However, post-closing issues should be dealt with as soon as possible.

Signing and Closing Documents

When deals sign and close simultaneously there is no need for separate signing and closing procedures or documents. When there is a gap between signing and closing, different documents are delivered at each phase.

Signing Documents

Common signing documents include:

- The principal transaction document, such as the stock purchase agreement or merger agreement and related disclosure schedules.
- Agreed to (but unexecuted) forms of important ancillary documents and agreements, such as promissory notes, employment agreements and escrow agreements. Even though executed at the closing, the parties usually agree to the forms of certain ancillary agreements at the signing to avoid unexpected complications before the closing.
- Copies of board and stockholder consents.

Closing Documents

Common closing documents include:

- Closing certificate (sometimes referred to as an officer's certificate). This certificate is used when there is a gap between signing and closing. In the certificate, a party's officer typically certifies, with respect to the principal transaction agreement, that:
  - all of the representations and warranties are true and correct as of the date of the certificate;
  - all covenants and agreements have been duly performed; and
  - all conditions precedent have been satisfied.
- Secretary's certificate. In this certificate, a party's corporate secretary certifies certain matters relating to the closing, such as verifying that the party's relevant resolutions and charter documents are in full force and effect as of the closing date. In addition, the secretary's certificate often identifies which parties are authorized to sign transaction documents on behalf of the party (this is referred to as the "incumbency" section of the certificate).
- Board and stockholder consents authorizing the transaction.
- Legal opinions.
- Executed ancillary agreements and documents.
- Wire transfer instructions (if there is an electronic transfer of funds).
- Consideration (for example, cash or stock) for what is being bought.
- Side letters covering certain agreements between the parties not reflected in the transaction agreements. Sometimes parties enter into side letters instead of formally amending other agreements.
- Evidence of all third party consents.
- Regulatory approvals (for example, the expiration of the waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976).
- Evidence of the release of any liens.
- Required filings (for example, amendments to charter documents).

Closing Documents: Public Companies

If a party to the deal is a public company, certain other types of documents must be considered for the signing, closing and post-closing, such as:

- Press releases.
- SEC filings, such as Form 8-K filings, registration statements and proxy statements.
- Stockholder communications.
- Stockholder consents.

Conclusion

As illustrated above, consummation of a merger or acquisition is a multi-step and multi-faceted process. Our goal is to make the process as straight-forward and successful for our clients as possible. We greatly enjoy working with our clients, on both the buy side and sell side, to prepare for, negotiate, structure, consummate and close merger or acquisition transactions. If you have any questions, please do not hesitate to contact us.