MERGERS & ACQUISITIONS I: OVERVIEW AND TRANSACTION TYPES: DEAL POINTS

April 2022

I. Executive Summary

This is the first of a series of advisories on Mergers and Acquisitions (M&A). Like our "Raising Capital through Private Placements," "SPACs: A Private Equity and IPO Alternative," "International Joint Venture Agreement Checklist" and others, all available at Kurtin PLLC Whitepapers and Advisories, following the discussion are "Deal Points" on important considerations in the purchase or sale of a business: what to do, and *what at all costs not to do*. This advisory will give a general M&A overview. Future editions will drill down on issues like tax considerations driving M&A transactions and transaction structures; preliminary documentation like letters of intent, memorandums of understanding and term sheets; due diligence; transaction documents; securities; antitrust (competition), foreign investment review and technology export rules; employment; and industry-specific regulatory regimes.

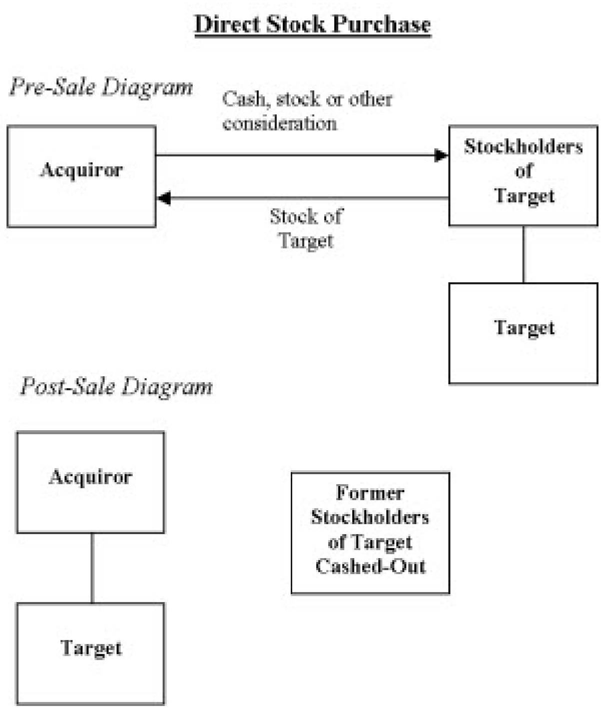
II. M&A Overview

M&A is a catch-all term used collectively to refer to a variety of transactions by which a business entity or person (the "Acquiror") acquires all or the majority of the stock or assets of another business (the "Seller" or "Target"). Negotiated, as opposed to unsolicited or hostile, M&A transactions are essentially contractual arrangements, involving a Stock Purchase Agreement, Asset Purchase Agreement or Merger Agreement that routinely contains certain elements. Among these are a description of the basic transaction contemplated by the agreement; the acquisition or merger consideration or purchase price, in what form it is to be paid (cash, stock, a hybrid of both or other), and how it may be adjusted to take account of the occurrence or non-occurrence of certain contingencies; "conditions to closing," the failure of which to be satisfied relieves the beneficiary party from its obligation to close the transaction after the deal is signed; representations and warranties by Target and Acquiror that a certain state of affairs exists as of the date of the agreement's signing, and in some cases, as of closing; affirmative and negative covenants, promises by Target and Acquiror to either do something or refrain from doing something or to preserve a represented state of affairs; termination provisions, which provide for when a transaction can be called off after signing but before closing; and others, such as choice of governing law and dispute resolution provisions.

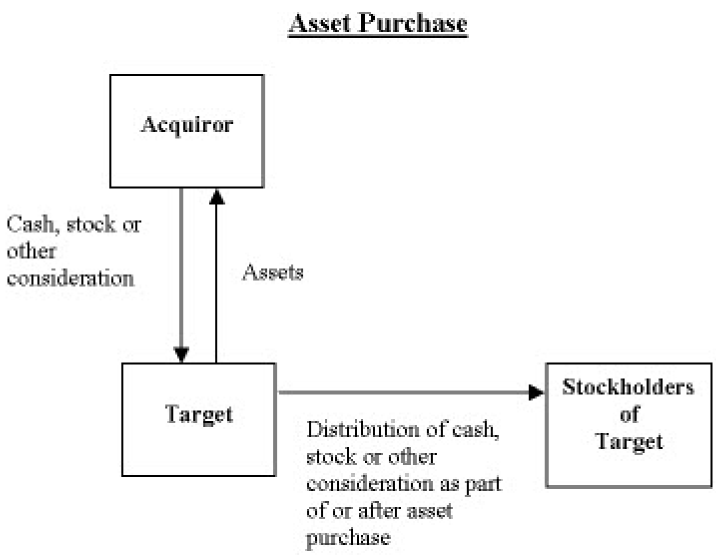
III. Typical M&A Transaction Structures

M&A transaction structures fall into three basic categories: (a) a Stock Purchase, in which the Acquiror acquires all or most of the Target's stock; (b) an Asset Purchase, in which the Acquiror acquires all or significant portion of Target's assets out of the Target's ordinary course of business (for example, not merely buying all of Target's existing inventory that it sells in the normal course of business, but the means of creating or obtaining further inventory); and (c) a Merger, which is a means of combining two businesses by a merger procedure set forth in a state's corporate law statute, in which one of the companies is the "Surviving Entity" and the other is merged into it and ceases to independently exist. As one would think, the Surviving Entity is normally the Acquiror, but not always, as will be discussed below.

a. Stock Purchase. A Stock Purchase is ostensibly the simplest M&A transaction type. It can be accomplished as simply as by Acquiror's executing a Stock Purchase Agreement with Target's shareholders. The Target is not a party to the transaction, but becomes Acquiror's subsidiary.



b. Asset Purchase. In an Asset Purchase, the transaction is usually directly between Acquiror and Target. Target does not become a subsidiary of Acquiror; it continues to be owned by its current shareholders, who do not directly receive the acquisition consideration. All other things being equal, the Asset Purchase is the preferred structure for a Acquiror, because it can pick and choose among Target's assets rather than take (and pay for) assets and assume liabilities it may not want, as it does in a Stock Acquisition.



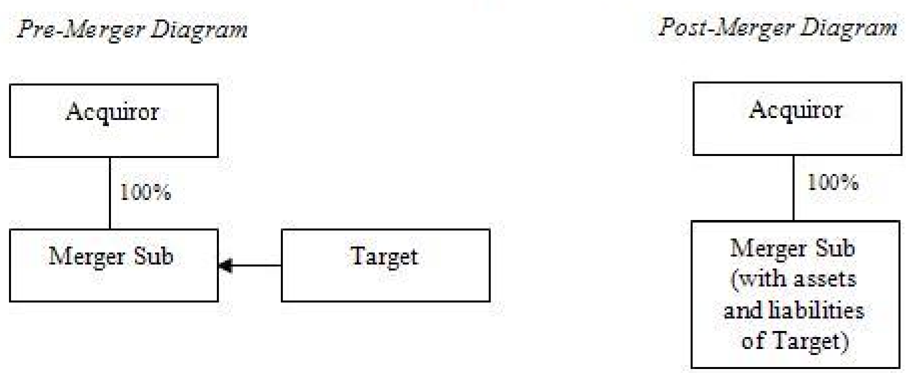
c. Merger. Mergers are a transaction form created and governed by state corporation statutes such as the Delaware General Corporation Law. The use of a statutory merger provides both ease and established legal certainty. When the certificate of merger is filed with the Secretary of State of the state of incorporation, one company merges into the other, the first company's legal existence ends, and title to its assets and liabilities transfer automatically to the Surviving Entity.

In a Direct Merger, Target merges directly into the Acquiror, which is the Surviving Entity. In a Reverse Merger, Acquiror merges into Target and it is Acquiror that ceases legally to exist. In a Forward Triangular Merger, Acquiror forms a subsidiary ("Merger Sub") (or uses a pre-existing subsidiary) in order to serve as a vehicle for the merger, Target merges into Merger Sub, and Merger Sub is the Surviving Entity and subsidiary of Acquiror. In a Reverse Triangular Merger, Merger Sub merges into Target, and Target is the Surviving Entity, becoming a subsidiary of

Acquiror. The Reverse Triangular Merger format in particular can allow Acquiror to remain separate from, and structurally unaffected by, the core transaction, while allowing Target to become an intact operating subsidiary of Acquiror. The Reverse Triangular Merger structure also often allows Acquiror to take control of Target without triggering anti-assignment provisions in third-party contracts to which Target may be bound. The need to obtain third-party consents and the assignment clauses of agreement to which Target is a party can be a significant factor in driving transaction structuring. Some third-party agreements can represent so much of Target's enterprise value that a failure to obtain the third-party consent to assignment could derail the transaction.

Direct Merger

Forward Triangular Merger



IV. Deal Points

Deal Point No. 1: Don't sneer at the LoI, MoU or Term Sheet. Don't sneer at the Letter of Intent (LoI), Memorandum of Understanding (MoU) or Term Sheet. As often as not they embody the *de facto* or binding structure of the deal, and advantages casually given away by treating the LoI, MoU or Term Sheet as a low level document not requiring serious attention may never come back.

Deal Point No. 2: The business case should drive the deal and deal structure, not vice-versa. This sounds like a bromide. Think again. Overcomplicated deal structures and deal documents are a stock in trade of many Acquirors and, sad to say, many Acquirors' law firms. About two years ago, we were called in to help on the buy side with a piece of a not terribly large or complicated deal, one which had a few, but only a few, wrinkles because some industry-specific government regulation and multiple pieces of real property subject to assignment restrictions had to be addressed. The client's lead law firm, a large but not especially elite regional firm, had drafted the equivalent of a Stock Purchase Agreement (the Target was a Limited Liability Company, or LLC, so what was being purchased were technically "membership interests," not stock) that was 75 pages long and so grossly byzantine that I had trouble reading it. It was apparent that Target, and Target's small, local attorneys, could not make head or tail of the document, and that the deal, which Target wanted to do at least as much as Acquiror did, was stalled for weeks on end for that reason alone. The transaction was finally dragged over the finish line, but it was painful to see, and of course several times more expensive than it should have been. The deal could have been done on far simpler and shorter papers.

Deal Point No. 3: Like MoU's, LoI's and Term Sheets, Due Diligence should not be an afterthought. Nobody loves doing due diligence. What's even less lovable than due diligence is a nasty surprise after a deal is signed up that doesn't provide an excuse from closing or so obviously breach a representation, warranty or covenant as to justify termination or at least a significant purchase price adjustment. Of course due diligence should be scaled to the size of the deal, but that doesn't mean it should be blown off, unless the Acquiror has made an affirmative decision that it wants to complete the acquisition come hell or high water, whatever warts post-closing tearing-off of band aids may reveal. There may be a business case for that, but it should be as a result of affirmative decision-making. More Deal Points in the next M&A edition!

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