# MERGERS & ACQUISITIONS 6: ASSET PURCHASES: DEAL POINTS

December 2024

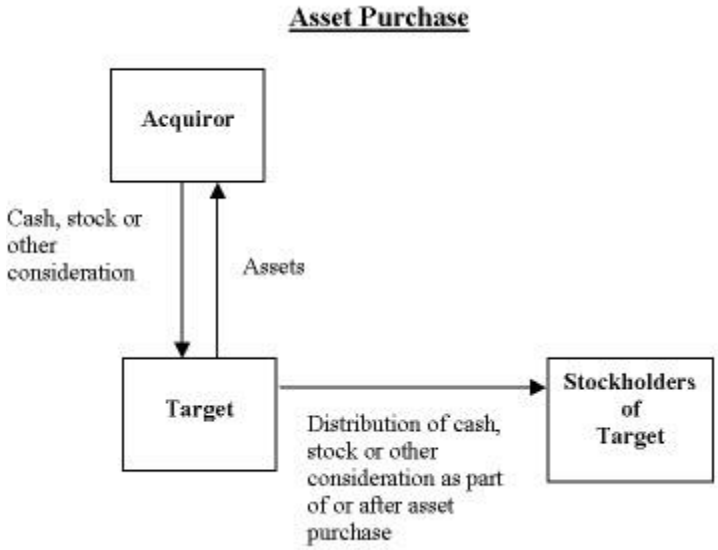
## I. Executive Summary

This is the sixth of our series of expanded and updated advisories on Mergers & Acquisitions (M&A). Like the first five in the series, "Mergers & Acquisitions 1: Overview and Transaction Types" (**M&A 1**); "Mergers & Acquisitions 2: Tax Structuring Considerations" (**M&A 2**); "Mergers & Acquisitions 3: Structuring Payment" (**M&A 3**); "Mergers & Acquisitions 4: LOIs, MOUs and Term Sheets" (**M&A 4**); and "Mergers & Acquisitions 5: Stock Purchases" (**M&A 5**), it is meant to offer to business executives, in-house counsel and their professional advisers an M&A guide both accessible and of practical use when embarking on an M&A transaction in their own business. This advisory will discuss Asset Purchases and their principal deal document, the Asset Purchase Agreement. Some material in Part III of this advisory will repeat material from "Stock Purchases," on the assumption that not all readers preparing for an Asset Purchase transaction will have read "Stock Purchases." All advisories in the series will be available on our website at **Kurtin PLLC Mergers & Acquisitions**.

Following the discussion in each advisory in the series are "Deal Points" on considerations in the purchase or sale of a business that we often raise when we handle these types of transactions for our clients: what to do, and *what at all costs not to do*. Future editions in the series will drill down on issues in Statutory Mergers; securities law considerations, especially when public reporting companies under the Exchange Act are parties to the M&A transaction and there is a substantial federal securities law regulatory compliance overlay to the transaction (Public M&A); antitrust (competition) law issues, which are likely to change substantially in 2025 as a result of the U.S. presidential election in November 2024; financing the M&A transaction, such as by issuing stock or incurring debt; foreign investment review and technology export rules; employment and equity-based compensation; Cross-border M&A (where Acquirer and Target are domiciled in different countries); due diligence and corporate governance; M&A of bankrupt or distressed Targets; hostile takeovers; spin-offs, "going private" and leveraged buyout transactions; specialty transaction structures within the M&A paradigms; and industry-specific regulatory regimes. A progressively cumulative glossary of defined technical terms used will appear at the end of each advisory in the series.

II. Asset Purchases

Unlike the paradigm Stock Purchase discussed in **M&A 5**, in which the transaction is between Acquirer and Target's shareholders, in an Asset Purchase, the transaction is usually directly between Acquirer and Target, since Target owns the assets being sold (variations can arise when an Acquirer acquisition subsidiary, like a Merger Sub, is formed to hold the purchased assets, or when an asset to be purchased is owned by a Target shareholder and perhaps licensed or leased by it to Target, in which case the Target shareholder may become a party to the transaction. This is common in transactions in which IP licensed to Target or real property leased to Target is involved. In the general case, Target does not become a subsidiary of Acquirer in the transaction; it continues to be owned by its current shareholders, who do not directly receive the Acquisition Consideration. After distribution of the Acquisition Consideration received by Target to Target's shareholders, the Target is normally liquidated. All other things being equal, the Asset Purchase is the preferred structure for an Acquirer, 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.




An "Asset Purchase" in the context of M&A transactions implies a transaction involving all or most of Target's assets, not merely a purchase of assets in the ordinary course of Target's business, such as purchasing its inventory or surplus equipment or machinery. If all, or nearly all, of Target's assets are

acquired, Target is left a shell company, which is usually (although not necessarily) wound up and dissolved post-transaction, with the Acquisition Consideration and any remaining assets and liabilities finally distributed to Target's shareholders (there are cases in which it makes sense to continue Target's corporate existence post-transaction, such as Target's shareholders wanting to use it for another purpose, perhaps with assets excluded from the M&A deal and left with Target, such as relating to a core business or ancillary business line after divesting the other parts of the business). Also, Target shareholders may receive a "stepped-up tax basis" in Target's remaining assets (akin to the stepped-up tax basis described in **M&A 2,** Section III when making Tax Code sections 338(g) and (h)(10) elections for Stock Purchases to be treated as "deemed asset sales"), meaning that the tax basis of the assets is adjusted to equal their fair value at the time of the adjustment as compared to the transaction purchase price, which may confer a meaningful tax benefit to Target shareholders later on.

Like Stock Purchases, the paradigm Asset Purchase transaction is taxable to the parties, which realize full gain or loss on the transaction. However, as with Stock Purchases, in a properly structured stock-for-assets Asset Purchase transaction, in which Target's assets are acquired using only Acquiror's or its affiliate's voting stock, the transaction can qualify for "tax-free" treatment under Tax Code §368(a)(1), in this case §368(a)(1)(C), in which Target recognizes no tax gain (or loss) on the transaction, as explained in **M&A 2** section II(c). "C" Reorganizations are Asset Purchase acquisitions in which "substantially all" of the Target's assets are acquired using only the Acquirer's voting stock (or only the stock of a corporation under Acquirer's control, such as an acquisition sub or other subsidiary), disregarding Acquirer assumption of Target liabilities. In practice, per IRS guidance, "substantially all" usually means that at least 90% of Target's net assets and 70% of its gross assets must be acquired in the transaction, and some of the consideration, usually up to 20%, may be in cash, which would be taxable as Boot. Assuming those conditions are met, the Asset Purchase transaction diagramed above would qualify as a tax-free reorganization under §368(a)(1)(C). However, if cash or other consideration other than Acquirer stock were used for more than 20% of the Acquisition Consideration, the same Asset Purchase transaction structure might not be granted tax-free reorganization status, and Target and Acquirer would realize a taxable gain or loss on the entire transaction, naturally ultimately reducing the benefit of the transaction to their shareholders.

III. Asset Purchase Agreements

The principal document in an Asset Purchase transaction is the Asset Purchase Agreement. Many of the elements of an Asset Purchase Agreement are similar to those in a Stock Purchase Agreement as described in Stock Purchase Transactions (see **M&A 5**, section III. Since readers planning an Asset Purchase will not necessarily have read Stock Purchase Transactions, we will cover the common elements again here, drawing distinctions in those elements' purpose and use in an Asset Purchase where appropriate. Following are the most significant items treated in most M&A Asset Purchase Agreements, not necessarily in the order in which they would appear in the agreement itself.

a. Definitions: Just as we have defined terms for this M&A Deal Points series, which when introduced eliminate the need to re-explain them each time, Stock Purchase Agreements will invariably have a definitions section, often at the beginning, sometimes at the end, sometimes pitched out to an annex or schedule. Definitions are often inattentively or dismissively treated, not only by M&A parties, but by their attorneys too, but they can influence the whole transaction and the post-closing result. See below, ***Deal Point No. 1: Don't sneer at the defined terms, use them and use them consistently.***

b. Transaction Description: A concise statement of what Target assets are to be purchased (generally defined as "Acquired Assets," "Included Assets" or something similar) and which excluded ("Excluded Assets" or something similar), and what liabilities and debt are to be assumed. Depending on the Target and the type of transaction, broad categories of assets to be acquired might be set forth (inventory, equipment, real estate, cash and cash equivalents, notes, accounts receivable, intellectual property, etc.), with only specifically listed assets excluded (sometimes "scheduled out"), so that anything not specifically listed as an Excluded Asset is deemed an Acquired Asset and included in the acquisition. On other transactions, the reverse method might be used, with only specifically listed or scheduled assets to be acquired, and everything not specifically listed deemed excluded from the transaction. It is important to remember that an Asset Purchase Agreement is a private contract between Acquirer and Target, and the exclusion of liabilities or obligations does not as a legal matter prevent a third party from suing Target (or Target's shareholders if Target has been liquidated and dissolved). This is a main reason, along with assuring that Target owns and has the right to convey its assets, that it is critically important to obtain third party consents to the transaction, whether by assignment of contract, novation, or otherwise. Whether any particular tax-free or tax-advantaged treatment for

the transaction will be sought in the structuring should be identified in the transaction description or later in the Asset Purchase Agreement (see Section II, above, and **M&A 2**).

c. Acquisition Consideration: The Acquisition Consideration, the purchase price for Target's Acquired Assets, and how it is to be paid should be set forth early in the Asset Purchase Agreement (see **M&A 3**). Is the Acquisition Consideration to be paid by Acquirer in cash, stock, assumption of Target's debt or some hybrid? Is stock to be issued by Acquirer to use as Acquisition Consideration? What will be the attributes/privileges of stock issued for the transaction: common stock, preferred stock or convertible preferred stock (liquidation, conversion, redemption privileges, registration rights in the case of a public offering, etc.)? Is an existing class of stock to be used, or will a new class be authorized? If the Acquisition Consideration is a mix of cash and stock, is there a cash election for the Target? Are there any Acquisition Consideration control devices in place, such as Fixed Exchange or Fixed Value ratios, Collars, Caps or Floors, that could alter the purchase price to be paid (see **M&A 3**, Section III)? Is any third-party financing to be obtained by Acquirer to fund the Acquisition Consideration? What type of financing is to be obtained, and to what extent will the transaction be contingent on that financing being obtained? In general, payment of Acquisition Consideration in full at closing is the default, but it is possible to structure payment in installments, subject to post-closing adjustments (see below) with a portion of the Acquisition Consideration held back, perhaps in a third-party escrow, sometimes called "Contingent Earnouts," contingent on the post-Closing business hitting certain milestones, or certain Representations, Warranties and/or Covenants proving to be true.

d. Acquisition Consideration or Purchase Price Adjustments: Whether any pre-closing or post-closing discoveries or events can cause an adjustment to the Acquisition Consideration short of termination of the Asset Purchase pre-closing or rescission post-closing; these can be any variety of negotiated events: a pre-closing change in Target valuation relating to failure to obtain financing; failure to obtain a third party consent; failure to obtain assignment of a third party contract; failure to obtain a regulatory approval; a change in Target stock price; due diligence revelations; events not disclosed in due diligence or scheduled exceptions to Representations and Warranties, such as undisclosed pending or threatened litigation; or issues relating to accounting, such as changes to expected accounts receivable or cash on hand, which might adjust the purchase price up or down.

e. Closing: When closing of the transaction will occur and under what circumstances should be set out.

f. Closing Deliveries: Each party's required deliveries at Closing, from certificates to executed documents to certified checks or wire transfer receipts.

g. Conditions to Closing: A list of conditions to each party's obligation to close the transaction, the failure of which to occur will excuse that party's obligation to close, such as that all previously made Representations and Warranties continue to be true as of Closing; that all Affirmative or Negative Covenants have been fulfilled as of closing; that no "Material Adverse Change" or "Material Adverse Event" as defined in the Asset Purchase Agreement affecting Target's business has occurred (often called a MAC or MAE clause); that all third-party consents and regulatory approvals have been obtained; that insurance coverage commitments have been obtained; that "fairness opinion" letters on the fairness of the transaction to Target and Target's shareholders have been obtained (usually a feature of Public M&A); and others. Conditions to Closing are usually tied to Termination rights if a condition has not been satisfied within a given time period.

h. Representations and Warranties: Each party's undertaking that a something is true and can be relied upon as of the date of the Asset Purchase Agreement signing and (usually) will continue to exist until the Closing. Some are very basic and nearly universal: that each party is properly formed and organized; in good standing in its home jurisdiction of domicile and every jurisdiction in which it does business; has no liens, tax or otherwise, against it, etc.; that the M&A transaction has been duly authorized by proper corporate action; that the transaction will not contravene any law, regulation or third-party right; that except as listed in an annexed schedule, there are no material undisclosed liabilities or contingencies like debts, threatened or pending litigations or administrative/regulatory proceedings, etc. Other Representations and Warranties are more technical, specific to the parties and transaction, and asymmetrical, made by only one party and not the other: that the Target owns and has the right to convey the Acquired Assets; that a certain material Target third party contract is in good standing and has not been breached; that the Target has certain government licenses and permits in place and in good standing; that Target owns or has the right to use (by license, assignment or otherwise) certain

Intellectual Property and the extent and duration of those rights; that Target and any subsidiaries have not incurred or guaranteed any more than a stated level of indebtedness. Representations and Warranties are generally tied to Conditions to Closing and Termination rights, such that the failure of a Representation or Warranty to be true as of signing the Asset Purchase Agreement signing or at Closing can justify the other party in refusing to close or Terminate the transaction, or justify a purchase price adjustment up or down, depending on whether Acquirer or Target was at fault. In some deals, discovery of a Representation or Warranty breach post-Closing can justify a purchase price adjustment, especially when part of the Acquisition Consideration was held back in escrow or otherwise, to be paid after the Closing as a Contingent Earnout.

In contrast to a Stock Purchase Agreement, in which the fundamental reason for these basic representations and warranties is to establish that Target, which is itself what Acquirer is purchasing, is what Acquirer believes it to be (i.e., a company properly formed, in good standing, with no unknown material liabilities, contingent or otherwise; see), the fundamental reason for these Representations and Warranties in an Asset Purchase Agreement is to establish that Target owns and has a right to sell its assets to Acquirer, since Target itself is not being acquired. Sometimes that is relatively simple, such as showing bank accounts, bills of sale for office equipment, title deeds to real property, etc. Sometimes it is more complex, such as establishing the right to convey a license to real property or a leasehold interest in real property, in which, depending on the asset, a third-party consent may be necessary to obtain (for example, a real property lessor's assignment of the lease, a patent holder's assignment of the patent or patent exploitation rights or a IP licensor's transfer of the license to Acquirer).

In some cases, third party consent may be unobtainable, leading to a carve-out of that asset from the Acquired Assets in the deal and probably, if significant enough, a consequent purchase price adjustment. In some cases, failure to obtain a necessary third-party consent might actually tank the deal. After all, the transaction is an Asset Purchase; there is always a potential straw that would break the camel's back, and asset or assets that, if they cannot be included in the deal, make the whole transaction not worthwhile for Acquiror. Obtaining third-party consents is normally Target's primary responsibility, since Target has a pre-existing contractual relationship with the third party, although Acquirer will often be expected to reasonably cooperate in the effort. For example, if the third party wants some information on Acquirer before giving its consent (financial means to pay the third-party license fees, lease rental, etc., Acquirer is

normally required to reasonably cooperate in giving adequate assurances to the third party. However, that Acquirer obligation must be included in the Asset Purchase Agreement, often as an Acquirer Affirmative Covenant (see subsection III(n) below).

i. Covenants: Sometimes confused with Representations and Warranties, but different in that they not representations that a state of affairs exists and will continue to do so until Closing, but each party's promises either to do something (or continue doing something) until and sometimes after Closing (Affirmative Covenants) or to refrain from doing something until/until after Closing (Negative Covenants). Examples might include Target Covenants to maintain various regulatory approvals or licenses (Affirmative), or not to let an approval or license lapse (Negative); not to compete with the Acquirer and the acquired business after Closing, etc. Covenants are also generally tied to Conditions to Closing and Termination rights, such that a Covenant breach can justify the non-breaching party in refusing to Close and/or Termination of the Asset Purchase.

j. Indemnification: Indemnification rights, the right of one party to claim against another for indemnification from third-party claims. There are also "carve-outs" to indemnification rights, such as when a generally indemnified type of event has a subset that might occur without either party being at fault, or when an indemnified event falls short of an agreed-to threshold in potential damages. There are even sometimes "exceptions to carve-outs."

k. Ancillary Documentation: In nearly any Asset Purchase M&A transaction, there will be ancillary documents to the Asset Purchase Agreement, such as bills of sale and other asset conveyance documents, investment agreements, financing documents, security agreements, Intellectual Property license and assignment agreements, employment and equity-based compensation agreements (stock option or stock grant plans, etc.), real estate leases or conveyance documents and others. The Asset Purchase Agreement will often pitch a list of ancillary documents out to a schedule, and their due execution and delivery will often be Closing deliveries and Conditions to Closing.

l. Compliance with Law: The parties will frequently negotiate obligations (whether by Covenant or otherwise) to comply with applicable laws, such as those governing foreign corrupt practices or bribery, technology export restrictions, foreign investment controls, money laundering and others.

m. Key Employee Lock-ups and Equity-Based Compensation: Often, key Target employees will sign employment agreements with the post-transaction company and the terms of employment are included, as are stock option or other stock rights plans for selling Target or other shareholders. Obtaining key employee employment agreements to work for the Acquirer can be a Covenant and a Condition to Closing.

n. Board, Officer and Committee Representation: Often, the Asset Purchase Agreement will set out post-closing board of directors representation on Acquirer, officer positions and representation on Acquirer committees.

o. Due Diligence: Due diligence, the scope of the parties' disclosures to each other before the M&A transaction closes, should be outlined in the Asset Purchase Agreement as they were in the LOI, MOU or Term Sheet. As a general matter, most of the due diligence is sought by Acquirer of Target information, especially if the Acquisition Consideration is cash. Due diligence issues in an Asset Purchase Agreement will frequently be mentioned but otherwise pitched out to a "due diligence checklist," in which the items required to be produced by each party are set forth and tied to Conditions to Closing.

p. Confidentiality: Confidentiality as to due diligence production and other information exchanged between the parties during the transaction is often one of the most critical issues in the transaction, continued in the Asset Purchase Agreement after the Preliminary Document stage and one of the most frequently sought to be binding on the parties.

q. Regulatory Approvals: Any federal, state, local or non-U.S. governmental or regulatory approvals required for the transaction as a Condition to Closing are often part of the Asset Purchase Agreement, including by when must they be obtained, whose responsibility it is to do so, and what are the consequences of failing to obtain regulatory approvals, bearing in mind that doing so is not fully in the responsible party's control? Are there foreign investment or foreign ownership issues? Are there technology export issues? Are there Foreign Corrupt Practices Act or money laundering issues? Do licenses need to be obtained or assigned from Target to Acquirer, or the need for them waived? Often, the need for regulatory approvals is the biggest

cause for delay in closing a transaction after signing the Asset Purchase Agreement or even in one terminating without closing.

r. Major Contracts and Third-Party Consents: Major Contracts may materially affect deal value, and, like regulatory approvals, may require third party approvals not completely within the parties' control. The Asset Purchase Agreement, following up the Preliminary Document, should deal with major contracts, what third party consents are needed, and whose responsibility it is to obtain them.

s. Termination and Effects of Termination: If there is a failure of a condition to close, such as a material and uncured breach of Representation, Warranty or Covenant; another material breach of the Asset Purchase Agreement; a failure to obtain financing or to obtain a critical regulatory or third-party approval; or there is delay beyond a certain point in doing so, whether the non-breaching party may terminate the Asset Purchase transaction. Some breaches may give the non-breaching party the right to terminate immediately; some may give the breaching party the chance to cure the breach before Closing or allow for a purchase price adjustment to reflect the damage caused by the breach. There are sometimes "break-up fees" provided for to the non-breaching party to compensate it for its transaction time, effort and costs, and the opportunity costs of not have sought or obtained a deal with another party. If one or both parties cannot close the transaction, for example for failure to obtain financing or a critical regulatory or third-party approval, or there is delay beyond a certain point in doing so, how is it to be handled? The Asset Purchase Agreement should plan for those contingencies to the extent known by addressing under what circumstances the transaction can be terminated and whether and under what circumstances the terminating party may have the right to a "break-up" or termination fee from the other party to compensate for the time and money spent working on the transaction, forgoing discussions with other Sellers or Acquirers, and so forth.

t. The "Boilerplate:" Almost invariably, the final article of every Asset Purchase Agreement will have sections derisively known as the "boilerplate" or "general" provisions. Like the definitions, the boilerplate does not always repay the sneers. Some provisions, like choice of governing law, choice of dispute resolution forum, assignment rights, confidentiality, third party beneficiaries, releases, rules of construction and others may provide critical rights; like the definitions, they should not be dismissively treated.

IV. Deal Points

***Deal Point No. 1: Don't sneer at the defined terms, use them and use them consistently.***

We made this point at the top of section III(a). An in-house general counsel friend swears that if he can write a contract's definitions sections, he almost doesn't care what's in the rest of the document. We're not sure that we'd go that far, but we get his point. Also, a lot of lawyers skip glassy-eyed over the definitions section, and let things go into them unremarked that are time bombs for their clients – that's the extension of my friend's point. Worst of the worst are M&A lawyers who go to the trouble of defining terms in the definitions section and then forget to use them in the text, or don't use them consistently. I had this come up a few years ago, when a highly specific and negotiated defined term list of "Indemnifiable Events" was ignored by opposing counsel in the text, allowing a non-listed event to also creep in and be subject to indemnification by his client. And…it actually happened. That's like seeing a vampire lurking outside your second-floor window, opening the window and saying "come on in." It's amateur hour, a low percentage move. Don't sneer at the defined terms.

***Deal Point No. 2: Any non-cash-paid-in-full-at-closing Acquisition Consideration is in some measure contingent and should require a premium over a cash on the barrelhead deal.***

Any non-cash-on-the-barrelhead deal is in some measure contingent, and Acquirer should pay more overall than if paying cash in full at Closing. Cash on the barrelhead should command a premium over any non-cash-on-the-barrelhead deal. A cash-on-the-barrelhead offer is superior to a non-cash-on-the-barrelhead offer and should cost an Acquirer less for the same acquisition than the non-cash competing deal.

***Deal Point No. 3: A cash-for-assets deal is generally assumed to be, for Target and Target shareholders, simple and final; that as long as they get their cash through Target's post-Closing liquidation, they're happy. But they still need to be careful not to expose themselves to future claims based on breaches of Representations, Warranties, Covenants, etc., or to third-party claims. In a stock-for-assets deal, Target shareholders may ultimately become Acquirer shareholders, and should be as interested in Acquirer's status as Acquirer is in Target's.***

The "cash-out-and-walk-away" aspect of a cash-for-assets deal for Target is overstated; Target shareholders may still have potential liabilities from Target breach of Representations, Warranties or Covenants and, potentially, fraud. All that means that Target directors, officers and shareholders should be paying attention to the negotiation of the deal overall and the Asset Purchase Agreement and ancillary agreements. A stock-for-assets deal may ultimately make Target shareholders into Acquirer shareholders, and they should be as interested in Acquirer's Representations, Warranties, Covenants, financials and other indicators of Acquirer status and health as Acquirer is interested in Target's status and health.

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**Mergers & Acquisitions: Deal Points**
**Cumulative Glossary**
**Appendix 1**

1. **Acquirer (or Acquiror, Buyer or Purchaser):** the purchaser, or "buy side" party in an M&A transaction, whether an Asset Purchase or a Stock Purchase, which acquires all or the majority of the stock or assets of another business. In a Merger, the parties are not technically purchaser or seller, but when one party is clearly the dominant party in the transaction and is often the Surviving Entity (though not always, as in the case of a Reverse Merger), that party can be thought of as the Acquirer.

2. **Acquisition Consideration:** the purchase price paid by Acquirer to Target in an M&A transaction, whether in cash, stock, assumed debt or a combination thereof.

    a. **Acquired Assets (or Included Assets):** in an Asset Purchase, the assets that are included in the acquisition by Acquirer, as opposed to "Excluded Assets," which are not included and remain with Target.

    b. **Contingent Earnout:** a portion of the Acquisition Consideration held back until a set post-closing period, whether in escrow or by Acquirer itself, pending the post-closing business hitting certain milestones, or Representations, Warranties and/or Covenants turning out to be true.

3. **Asset Purchase:** a transaction by which one party to an M&A transaction purchases all or the majority of the assets of another party. Distinguished from a sale by Target in the ordinary course of business, as in selling a part of its inventory, or surplus equipment not needed for continuing its business operations.

4. **Asset Purchase Agreement:** a contractual agreement serving as the principal document by which an Asset Purchase is effected.

5. **Boot:** the cash or other non-stock portion (including debt assumption) of Acquisition Consideration in an M&A transaction intended to be a tax-free reorganization under Tax Code §368(a)(1), which, even if the transaction is treated as tax-free by the IRS, will be taxable to Target and/or Target shareholders. If the Boot exceeds the permissible percentage for the type of tax-free reorganization intended by the parties, the entire transaction may be denied tax-free status, not just the Boot portion.

6. **Cash Election Merger:** an M&A transaction in which Target shareholders are granted an election period to decide whether to accept stock or cash as all or part of the Acquisition Consideration.

7. **Closing:** the closing of an M&A transaction, which can occur after or simultaneously with the signing of the Stock Purchase Agreement, Asset Purchase Agreement or Merger Agreement, depending on the agreement's terms.

8. **Conditions to Closing:** the enumerated conditions in a Stock Purchase Agreement, Asset Purchase Agreement or Merger Agreement, the failure of which to occur is a breach that can justify the non-breaching party in not closing the transaction, and which, subject to rights to cure, can lead to Termination of the transaction.

9. **Contingent Earnouts:** An agreement in an M&A transaction to hold back part of the Acquisition Consideration until sometime after Closing to assure that Target hits covenanted milestones post-Closing, or to assure that, post-Closing, certain other Covenants, Representations, or Warranties turn out to be true. An example might be an agreement to hold back part of the purchase price for a certain period to assure that Target is able to collect a represented amount of receivables, or that Target turns out to have a represented amount of cash on hand post-Closing. Contingent Earnout funds may be placed into escrow or just remain post-Closing executory payment obligations of Acquirer, contingent on the specified milestones or other conditions being met.

10. **Covenants:** Sometimes confused with Representations and Warranties, but different in that they are not representations that a state of affairs exists and will continue to do so until Closing, but each party's promises either to do something (or continue doing something) until and sometimes after Closing (Affirmative Covenants) or to refrain from doing something until/until after Closing (Negative Covenants). Examples might include Target Covenants to maintain various regulatory approvals or licenses (Affirmative), or not to let an approval or license lapse (Negative); not to compete with the Acquirer and the acquired business after Closing, etc. Covenants are also generally tied to Conditions to Closing and Termination rights, such that a Covenant breach can justify the non-breaching party in refusing to Close and/or Termination of the transaction.

11. **Cross-border M&A:** M&A transactions in which Acquirer is domiciled in one country, and Target in

another country. For purposes of this M&A: Deal Points series, one of those countries in which either Acquirer or Target is domiciled is the United States.

12. **DGCL:** the Delaware General Corporation Law, serving as a paradigm corporation statute in the U.S., and frequently the basis of incorporation by U.S. companies, wherever physically based, that intend to do business across the U.S. as well as inbound subsidiaries of non-U.S. companies wishing to have operations in the U.S.

13. **Due Diligence:** the scope of the parties' disclosures to each other before the M&A transaction closes, generally buttressed by deal protections in the form of warranties, representations, covenants and linked rights of indemnification, termination, conditions to closing and others.

14. **EBITDA:** Earnings Before Interest, Taxes, Depreciation and Amortization, a common accounting metric.

15. **Exchange Act:** the Securities Exchange Act of 1934, as amended, governing resales of already-issued securities, both debt and equity, and the periodic reporting obligations of publicly registered companies.

16. **Financial Investment:** an investment in one company by a financial investor such as a venture capital or private equity firm by purchase of a minority of the company's stock rather than all or a majority of the company's stock and therefore not constituting an M&A transaction. Financial Investments are distinguishable from Strategic Investments (see below) in that the venture capital or private equity firm generally invests solely for return on investment and eventual "exit event," although a venture capital or private equity firm may have a strategic element in trying to assemble a group of "portfolio companies" that have a strategic relationship in a given industry.

17. **Fixed Exchange Ratio:** Where not all the Acquisition Consideration is in cash, parties can also allocate risk of pre-closing volatility through adjustable pricing formulas. In a Fixed Exchange Ratio, each of Target's shares is converted into a fixed number of Acquirer's shares based on a negotiated and fixed exchange ratio. Under a Fixed Exchange structure, the dollar value of the fixed number of Acquirer shares received by Target/Target shareholders can rise or fall in the period after the deal is signed and

when it closes, thereby changing the value of the Acquisition Consideration, either as a result of Acquirer's business performance, market reaction to the pending deal, or general market/industry conditions incidentally affecting Acquirer. Fixed Exchange Ratios are most common in larger, stock-for-stock "merger of equals" transactions, since both parties share the risk of movement in Acquirer's share price. Fixed Exchange Ratio transactions are also traditionally common in sectors of perceived volatility, such as the tech sector, and Acquirer's resulting position that volatility risk in its stock price should be shared.

18. **Fixed Value Ratio:** In a Fixed Value Ratio transaction, the exchange ratio that floats and Target shareholders receive a fixed dollar value of Acquisition Consideration, however many Acquirer shares that works out to cost. The formula usually provides for measuring Acquirer's stock price during a negotiated period of days or weeks prior to closing or a meeting of Target's stockholders to approve the transaction. A Fixed Value pricing formula is used to insulate Target's shareholders from risk from changes in Acquirer's share value prior to closing, whether from the Acquirer's business performance, market reaction to the pending deal, or general market/industry conditions incidentally affecting Acquirer. Fixed Value Ratio transactions are traditionally most common when one party is clearly Acquirer and the other clearly Target, rather than in the "merger of equals" context and, unlike in Fixed Exchange Ratio transactions, pose the risk for Acquirer that it may have to issue more shares to purchase Target's shares if Acquirer's share value declines during the measuring period, which may reduce the stock value and dilute existing Acquirer shareholders (of course, a rise in Acquirer's stock value prior to closing will allow it to close the transaction on fewer shares). Also, in Public M&A, hostile bidders often use Fixed Value Ratio structures because they have more appeal for Target shareholders, who may be solicited under a tender offer and are more likely to tender based on a known dollar compensation for their shares.

19. **Intellectual Property or IP:** A copyright, trademark, service mark, patent, trade secret, certain kinds of confidential information, whether registered or not, or limited or unlimited right to use any of the foregoing, by license, assignment or otherwise.

20. **Internal Revenue Service or IRS:** The U.S. federal tax regulatory and enforcement agency.

21. **Joint Venture or JV:** JVs usually imply a formal collaboration short of Merger or acquisition between

two or more enterprises through a newly formed business entity or contract, as opposed to "Strategic Alliances," which usually involve two or more parties working to achieve a specific goal of mutual interest while remaining independent.

22. **LLC:** a limited liability company organized under a state's LLC statute, generally offering the limited liability protection for shareholders of corporations with the "pass-through" taxation of partnerships (i.e., not taxed at the LLC level, but taxable income or loss is "passed through" to the owners, called "members," equivalent to a corporation's shareholders). Also usually featuring less burdensome management and governance costs and formalities than equivalent corporations.

23. **LP:** a limited partnership under a state's limited partnership statute (usually modeled on the Uniform Limited Partnership Act), generally offering the limited liability protection for shareholders of corporations with the "pass-through" taxation of partnerships (i.e., not taxed at the LP level, but taxable income or loss is "passed through" to the limited partners, equivalent to a corporation's shareholders). Also usually featuring less burdensome management and governance costs and formalities than equivalent corporations.

24. **M&A:** generally used abbreviation for "Mergers & Acquisitions," a catch-all term sweeping up Stock Purchases, Asset Purchases and Mergers, all involving the legal or *de facto* acquisition of all or a majority of one business's stock or assets by another business.

25. **MAC (or MAE) Clause:** a clause in an M&A principal transaction document setting out negotiated Material Adverse Changes or Material Adverse Events the occurrence of which will justify the party prejudiced by the MAC or MAE in not closing the transaction and terminating it. Sometimes a cure period to allow the offending party to remedy is allowed; sometimes the prejudiced party will give the offending party an extension of time, postposing closing without terminating the agreement, if the parties believe that the MAC or MAE is curable and both parties want the deal to close. As indicated, MAC and MAE clauses are generally linked to Conditions to Closing, Termination rights, Representations and Warranties, and Covenants.

26. **Merger (or Statutory Merger):** a process set forth in the company law statutes of the individual states by which two companies merge with each other, leaving one company or its subsidiary as the Surviving Entity, while the other company merges into that company or its subsidiary and ceases to exist as a

separate legal entity.

a. **Direct Merger:** A Merger structure in which Target merges directly into Acquirer, which is the Surviving Entity, while Target ceases to exist.

b. **Reverse Merger:** A Merger structure in which Acquirer merges into Target, which is the Surviving Entity, while Acquirer ceases to exist.

c. **Forward Triangular Merger:** A Merger structure in which Acquirer forms a subsidiary (**Merger Sub**) (or uses a pre-existing subsidiary), Target merges into Merger Sub, Merger Sub is the Surviving Entity and a subsidiary of Acquirer, while Target ceases to exist.

d. **Reverse Triangular Merger:** A Merger structure in which Merger Sub merges into Target, Target is the Surviving Entity and becomes a subsidiary of Acquirer, while Merger Sub ceases to exist.

All these Merger structures are diagrammed in **M&A 1**.

27. **Merger Agreement (or Agreement and Plan of Merger):** a contractual agreement serving as the principal document by which a Merger is effected.

28. **Merger Consideration:** the Acquisition Consideration in a Merger.

29. **Preliminary Document: (MOU, or Memorandum of Understanding; LOI, or Letter of Intent; or Term Sheet. Also, NDA, or Non-Disclosure Agreement, which may be part of an MOU, LOI or Term Sheet or a standalone Preliminary Document):** forms of preliminary documentation used to set a framework for an M&A transaction and confidentiality before executing documents like an Asset Purchase Agreement or Stock Purchase Agreement. Some terms in preliminary documentation may be binding on the parties for a certain period, for example confidentiality or exclusivity, while others are usually not binding.

30. **Public M&A:** M&A transactions involving a Target that is a public reporting company under the Exchange Act, requiring a substantial Exchange Act and SEC regulatory overlay of requirements for the

transaction.

31. **Representations and Warranties:** Each party's undertaking that a something is true and can be relied upon as of the date of the Stock Purchase Agreement, Asset Purchase Agreement or Merger Agreement signing and (usually) will continue to exist until the Closing. Some are very basic and nearly universal: that each party is properly formed and organized; in good standing in its home jurisdiction of domicile and every jurisdiction in which it does business; has no liens, tax or otherwise, against it, etc.; that the Target shares being purchased (and issued, in the case of Acquirer stock being used as Acquisition Consideration) are fully authorized, issued, outstanding and non-assessable, or that Target assets being purchased are Target's property, free and clear encumbrances, liens or other third-party claims; that the M&A transaction has been duly authorized by proper corporate action; that the transaction will not contravene any law, regulation or third-party right; that except as listed in an annexed schedule, there are no material undisclosed liabilities or contingencies like debts, threatened or pending litigations or administrative/regulatory proceedings, etc. Other Representations and Warranties are more technical, specific to the parties and transaction, and asymmetrical, made by only one party and not the other: that a certain material Target third party contract is in good standing and has not been breached; that the Target has certain government licenses and permits in place and in good standing; that Target owns or has the right to use (by license, assignment or otherwise) certain Intellectual Property and the extent and duration of those rights; that Target and any subsidiaries have not incurred or guaranteed any more than a stated level of indebtedness.

32. **SEC:** the Securities and Exchange Commission, the U.S. federal securities regulator.

33. **Securities Act:** the Securities Act of 1933, as amended, governing initial issuances of securities, both debt and equity.

34. **Stock Purchase:** a transaction by which one party purchases all or the majority of the stock of another party. Distinguished from a minority investment by one party in the other, which is not an M&A transaction.

35. **Stock Purchase Agreement:** a contractual agreement serving as the principal document by which a Stock Purchase is effected.

36. **Strategic Investment:** an investment in one company by another by purchase of a minority of the company's stock rather than all or a majority of the company's stock and therefore not constituting an M&A transaction. Strategic investments are often made by a company vertically aligned with the other company, for example to assure its upstream supply chain or downstream distribution network. Sometimes, a strategic investment is made as a "toehold" or "foothold" as a prelude to a later full M&A acquisition.

37. **Surviving Entity:** the company that continues its corporate existence and operations following a merger, or the company (Acquirer, Target or other depending on the transaction structure) that continues its existence with the assets and/or stock of the acquired company.

38. **Target (or Seller):** the seller, or "sell side" party in an M&A transaction, which sells all or the majority of its stock or assets to another business, the Acquirer.

39. **Tax Code:** the U.S. Internal Revenue Code, 26 U.S.C., as amended.

40. **TCJA:** the Tax Cut and Jobs Act of 2017.