

Theirs and Yours, but Not Ours: Counsel's Role in Mergers and Acquisitions

BY WILLIAM C. STALEY

Attorneys have special roles in the sale or purchase of businesses. For many sellers, this is the biggest transaction in their lives and will determine the quality of their retirement years. Buyers want assurances that the business will perform as the seller has represented.

Ideally, attorneys should be involved before the client shakes hands on a deal -- and definitely before the letter of intent is prepared. The attorneys raise issues that the principals might not have considered. Examples of important issues that counsel can address are:

- Buying assets vs. selling stock
- Income and sales tax issues
- Material items about which the seller cannot give strong representations
- Skeletons in the closet
- Limits on the seller's willingness to indemnify the buyer for failed representations

The attorney also guides the client in balancing the complexity of the transaction against the transaction costs. Examples of this perspective include:

- Payment in cash with strong seller representations and indemnification (low transaction costs) vs. a contingent purchase price or earn-out

- Seller financing and a structured bonus plan for the seller as manager-employee and covenant not to compete (high transaction costs)

Taking the time to prepare a more detailed letter of intent can minimize negotiation time later when the definitive documents are prepared. Generally, the buyer's attorney prepares:

- Letter of intent
- Purchase agreement
- Covenants not to compete
- Employment agreements
- Consulting agreements

The seller's attorney usually prepares:

- Promissory notes
- Security agreements and guarantees (if any)
- Leases or licenses from the seller to the buyer

Sometimes, an attorney insists on preparing documents that the opposing attorney should prepare. This will probably result in more negotiating time and more iterations of the documents to reach an ultimate agreement.

Attorneys who have mergers and acquisitions experience can give clients a sense of the process, the issues to expect the other side to raise and what is reasonable to demand and to

[This space intentionally left blank.]

concede. By giving the client insight into what the other side is thinking, counsel can minimize the risk of the parties digging in their heels over an insignificant point and killing the deal. However, the attorneys always represent their clients, not the deal.

An investment banker can help salvage the deal when the parties and their attorneys have reached an impasse. Often the banker has seen more deals, or more deals in a particular industry, than the attorneys. The investment banker, who is usually paid on closing, really represents the deal.

The banker speaks to both principals and, to the chagrin of the attorneys, often gives the principals a second opinion on their attorneys' advice. The banker can

answer the valuation question that attorneys are often asked, but which they can seldom answer. A banker can protect the seller's board of directors with a fairness opinion.

Many investment bankers specialize in middle market companies. If the purchase price is less than \$2 million, the parties are likely to use a business broker instead of an investment banker, and they are less likely to seek legal advice.

The attorney can assist early in the transaction by recommending that the principals use an investment banker or business broker. This is especially helpful in the following situation: the business owner has not groomed or "shopped" the business, but has been approached by a prospective buyer with an attractive offer.

The owner wants to start the sale process right away. However, that owner might find a much better offer if the owner hired an investment banker to help groom and market the company. The principals will feel better about the transaction and it will proceed more smoothly with an experienced intermediary.

The attorney for the seller should encourage the seller to groom the business for the sale and to prepare for the due diligence process. The attorney can help manage how the seller reveals its trade secrets and identifies its key employees and vendors.

Few attorneys have all of the legal expertise needed for a merger or acquisition transaction. Counsel often needs advice from tax, real estate, environmental, labor, ERISA or other specialized attorneys, as well as environmental consultants. If the seller is involved in litigation, the buyer will probably want a litigation attorney to review each case; the seller's attorney should protect the seller's attorney-client and work product privileges. The parties' accountants are usually deeply involved in the due diligence process.

Parties often fare best when they sign the sale documents and close at the same time. Signing the documents and closing later is necessary only if third party consents or licenses are needed. Often, the buyer pays the purchase price by wire transfer, so at the closing, the parties sign documents but do not exchange them until the seller's bank confirms that the transfer has been completed.

Almost every sale of a business requires many documents. After the closing it is helpful for each attorney's office to prepare a bound or velobound volume with copies of all of the documents and a table of contents. Sometimes it is helpful to include a closing memorandum to indicate the order in which the documents were signed. If the attorney has a digital camera, it is nice to take a photo of everyone at the closing and to include that in the bound volume.

The Business Law Section of the American Bar Association publishes excellent form books for sales of businesses and also guides on the sale process. ✎

William C. Staley, a tax and business law attorney in Woodland Hills, frequently represents buyers and sellers of business interests. He can be contacted at (818) 936-3490 and bill@staley.com.

[This space intentionally left blank.]