Practical Matters

September 25: Mergers, Acquisitions, Joint Ventures and Novations

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CASSIDY LAW

Our Presenters

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Agenda

- Factors in Deciding on a Transaction
- Types of Transactions
- Managing Risk
- Federal Government Contract Considerations

Factors in Deciding on a Transaction

Business Considerations

- What is the goal
- Does the transaction fit with your business strategy
- Are the products, services, technology going to expand your offerings or are they similar
- Access to new markets: geographic, customers
- Cultural fit of the organizations
- What is the reputation of each business
- How capable are the leaders/owners
- Cost and time to integrate

Legal Considerations

- Anti-trust implications
- Implications of foreign invest
- Implications of foreign interest
- Tax implications
- Cost and time of lawyers, due diligence, investment bankers
- Can contracts be transferred
- Are you buying legal issues?

Non-Disclosure

- Merger & acquisition negotiations begin with parties signing confidentiality or non-disclosure agreement (NDA)
- Typically agreed to and signed before any information is exchanged and precedes letter of intent
- NDA’s protect a seller's confidential information and ensure that the negotiation process remains confidential
- Puts seller at ease, particularly where buyer competes with seller/is part of the same industry
- It is important to protect seller's information with an NDA so that potential disclosure does not negatively affect their business

Non-Disclosure Agreements

- Need to protect your intellectual property, personnel, competitive advantage
- Confidentiality requirements
  - Define “confidential information” – what it includes and what it excludes
  - How information is to be protected
  - Duration of restriction (depends on jurisdiction and type of information being protected)
  - What happens if breached (what remedies are available to you)
  - Notice requirements for data leak

Types of Transactions

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Merger

- A merger is the absorption of one corporation into another
- The surviving corporation acquires all the assets and liabilities of the corporation getting absorbed
- The "merged" corporation forms a new legal entity under one corporate name
- The Boards of Directors of the two companies approve the combination
- Mergers typically always need Shareholders' approval
- Different types of structures of Mergers (direct, forward subsidiary, reverse triangular, one-step, two-step)

Acquisition

- An acquisition is when one company purchases most or all of another company's (target's) shares to gain control of that company
- Two main types: stock purchase and asset purchase
- Acquiring more than 50% of a target firm's stock and/or assets allows the acquirer to make decisions without shareholder approval
- Acquisitions can be friendly, hostile, or bailout
  - Friendly: target firm agrees to be acquired
  - Hostile takeover: target firm does not agree to the acquisition
  - A bailout takeover: a financially stable company takes control of a financially weak (target) company to help it turn around its prospects without liquidating its assets

Stock Purchase

- When the buyer purchases the stock of the target company directly from the target's shareholders
- After the purchase, the target company's business, assets, and liabilities continue unaffected by the purchase
- Stock purchases may be preferable when the buyer wishes for the target company's business operations to continue after the purchase
- In most common circumstances, consent from third parties is not required to approve the transaction, but certain consents/notices may be needed post close
- Successor liability issues may arise
- Change of control consents may be required

Asset Purchase

- When the buyer purchases specific assets of the target
- Buyers may prefer an asset purchase because they can avoid buying unwanted assets and liabilities
- Generally, no liabilities are assumed, unless specified
- An asset purchase usually results in better tax treatment for buyers vs. a stock purchase
- One risk to buyers is that they may fail to purchase all the assets they need to effectively run the company
- Listing different assets and valuing their costs is time consuming and increases transaction costs
- Inadvertent successor liability issues
- Assignment consents are needed on assigned contracts

Joint Venture

- When two or more parties agree to use their resources together to carry out a discrete objective or set of objectives, a separate entity is formed
- They can be formed between any legal structure: Corporations, Partnerships, LLCs
- Joint ventures are usually formed for short-term projects
- Joint ventures may be dissolved after the objective is reached
- Joint ventures are owned by the original firms that led to its creation
- Benefits of joint ventures are their cost savings, leveraged resources, combined expertise, and ability to enter foreign markets through partnering with local businesses
- They require less commitment compared to mergers because they are limited to a discrete goal

Type of Joint Venture: Mentor-Protégé

- Designed to enhance the small business’ capabilities
- Improve small business ability to compete
- Mentor & Protégé can form a joint venture to pursue work
- Protégé can convey up to 40% equity to mentor in order to raise capital
- Government must approve of the relations, and reviews annually
- JV must promote development for protégé, not just way to seek small business set-asides

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Protégé Requirements

- Small business with industry
- Must have a proposed mentor prior to applying for the program
- Generally, may have only one mentor at a time

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Mentor Requirements

- Mentor helps with technical and management approach
- Mentor can help with non-set aside opportunities
- Able to carry out its responsibilities to assist the protégé
- Good character, integrity
- Not debarred or suspended
- Capable of providing value to a protégé firm based on its:
  - Capabilities
  - Business operations
  - Fed govt contracting experience
  - Knowledge

Affiliation – Can "Grow" Your Business

- "Affiliates" have revenue and employees aggregated for purposes of "small" business status
- No one fact or set of facts defines when affiliated
- Government looks at "totality of the circumstances"
- Government looks to see who "controls" the entities
- Joint Venture may be affiliation
- Common Management
- "Identity of Interest"

Before You Partner –
Know How It Will Impact Your Status

Managing Risk

Warning…. The Devil Is In The Details….

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What is Due Diligence?

- Due diligence is the best way of managing risk and critical to a successful transaction
- Due diligence is an investigation of a potential investment to discover information and confirm whether it will be a prudent decision for the buyer to make the deal
- Due diligence allows the buyer to collect information and confirm important facts about the seller e.g. contracts, finances
- Due diligence usually begins when the Letter of Intent (LOI) is signed
- Due diligence can last several weeks to several months, depending on the complexity of the transaction
- In conducting due diligence, the full nature of the company's operations must be audited, including its:
  - assets, liabilities, financials, contracts, obligations, leases, real estate, client agreements, warranties, employment matters, litigation, environmental issues

Impact of Due Diligence

- It's critical that acquiring companies allow for enough time and resources to complete this process thoroughly
- Diligence affects:
  - Price
  - Structure of transaction
  - Reps and warranties
  - Limitation of Liability
  - Indemnities
  - Disclaimers
  - Escrow/holdback
  - Disclosure Schedules
  - Closing Conditions
  - Insurance
- Companies, target companies, and lawyers must completely understand all the risks involved in the transaction
- Materiality Qualifiers

Due Diligence Covers

- Employment and Human Resources
- Tax history and filings and issues
- Financial statements and accounting practices
- Export compliance
- Anti-Corruption compliance
- Federal Government contract compliance
- Review of all contracts, customers
- Review of supply chain
- Review of distribution process
- IP, patents, copyright, trademark, tech
- Insurance
- Liquidity
- Real estate
- Board and governance structure
- MUCH MUCH MORE – want to know what you are buying

Indemnification

- Indemnification clauses provide reimbursement to the aggrieved party (usually buyer) to cover losses resulting from breaches of seller's representations, warranties, or covenants
- Indemnification clauses legally outline how Company A will be compensated by Company B for the losses they suffer after a transaction closes
- Example:
  - Company A has acquired Company B. Post close, Company A is sued by a customer, alleging he was injured by Company B's product. The injury occurred prior to the transaction, but the claim was brought post-close. Company B should indemnify Company A for this claim.

Limiting Liability

- Two kinds of limitations:
  - Limiting the <u>type</u> of liability (direct damages)
  - Limit the <u>amount</u> of liability (up to a certain $, should be proportionate to its value to the parties)
- Typically, you want both types of limitations if you'rethe party that will be responsible for paying damages
- In M&A transactions, there will often be agreements that limit the ability to collect on indirect or punitive damages
- Limitation of liability clauses are meant to encourage buyers and sellers by providing them a safety net
- Disclaimers of warranties can be a form of limitation of liability as well

Representations and Warranties

- Representations are the target company's assurances of its current state of business
- Warranties are the target company's statements regarding its future operational health
- Reps and warranties are critical because they tell the story of the current state of business and future prospect, and lay out the indemnification procedures if there is a breach
- Representations and warranties provide
  - Information: buyer may learn as much as possible before signing the agreement
  - Protection: buyer may cancel or renegotiate if the information discovered contradicts the representations and warranties
  - Support: provide the framework for indemnification after closing

Representations and Warranties

- Corporate organization, good standing
- Authority to enter the transaction
- Absence of conflicts
- Title to Assets
- Government Consents
- No undisclosed liabilities
- No material adverse changes in business
- Compliance with Laws (including FCPA, federal government contracting, export)
- Intellectual Property Rights
- Condition/Sufficiency of Assets
- Employment Matters (Key Employees, Strikes/Work Stoppage/employment proceedings)
- Employee Benefits/ERISA compliance (funding/fiduciary duties)
- Real Estate
- Litigation, investigations, audits, disputes

Words Matter …

Students Cook & Serve Grandparents

On Thursday, September 9, Gorman School hosted the first annual Grandparent's Day.

All Grandparents were invited to a school wide pancake breakfast. Upper grade students served as excellent chefs, as well as taking respon-

Punctuation Matters …

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Punctuation Matters …

Twenty-five dollar bills

=

$25

Twenty five-dollar bills

=

$100

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Words Matter…

- “Actual” Knowledge requirement
- “Reasonable” inquiry requirement
- Who is making the representations and warranties
- What is the definition of: supplier, distributor, contract
- “Notwithstanding anything in this Agreement…”
- “…for the benefit of…”
- “…hereby grants all right, title and interest in…”
- Have 5 days to ….
- Definition of software

Federal Government Considerations

Novation

- Generally, cannot transfer government contract to another party, UNLESS the government authorizes the transfer
- Novation generally REQUIRED when:
  - Buyer buys all assets and assumes all liabilities
  - All contractor's assets involved in performing the government are transferred in merger or corporate consolidation
  - Forming a new proprietorship partnership
- Novation generally NOT REQUIRED when:
  - Stock purchase, with no legal change in contracting party
  - Contracting party remains in control of the assets and performs the contract
- If the government does not agree and the original contractor does not perform, government may terminate contract for default

Export Compliance

- If have export controlled materials need to comply through deal process:
  - Dual use: export controlled, “EAR”
  - Military, Law Enforcement, Intell use only: “ITAR”, International Traffic in Arms Regulations
- Exporting means providing non-U.S. persons, whether in or outside of the U.S export controlled items, technology or information by:
  - Shipping or carrying items out of the U.S.
  - Transferring or disclosing:
    - Verbally
    - Electronically
    - Visually – through a video meeting
    - Providing Access to a database or a network
    - Electronic means – eg. emails, databases, networks
- MUST have controls in place during deal to prevent this

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Foreign Investments

The Committee on Foreign Investment in the United States (CFIUS)

- Mandatory CFIUS review of certain transactions involving foreign investment in the U.S.
- Transactions are broadly defined to include:
  - Mergers, acquisitions, joint ventures, leases, and other investments
- Designed to protect U.S. national security and competitive advantage
- Investment that may result in foreign **ownership** or **control** of a U.S. Technology, Infrastructure, or Data (TID) business
- Must submit details of the transaction to CFIUS to approve the deal – generally takes weeks or even months, depending on size
- CFIUS can block, modify, or undo transactions
- NEED TO PLAN FOR THIS IN DEAL TIME LINE

Foreign Direct Investment

- Purchase of an interest in a company by an entity or person outside of the country where the company is located
- May be a physical and direct purchases e.g. opening plants, buying factories
- The purchase can be of a substantial stake in a company or to buy it outright
- Results in capital investment **but** can also influence personnel, management, and operational decisions
- Establishes effective control over the business or the ability to influence its decision-making

Foreign Indirect Investment

- Purchase of stakes or positions in a company by a company outside of the country where located
- The purchaser usually involves corporations, financial institutions, and private investors
- Stakes are purchased on a foreign stock exchange
- Also known as a Foreign Portfolio Investment
- Indirect investment includes equity instruments such as stocks and debt instruments such as bonds

Foreign Ownership, Control or Influence (FOCI)

- Applies to contractors with classified contracts
- FOCI occurs when:
  - A foreign interest has the power, whether direct or indirect, to influence operations and decision-making
  - This interest an lead to unauthorized access to classified information
- Must notify Defense Counter Intelligence and Security Agency (DCSA) if any discussions, consultations, or agreements may lead to effective foreign ownership or control
- Whether FOCI – factual, detailed analysis considering whether non-U.S. entities are:
  - Major customers
  - Investors
  - Providing debt, loans
  - Leasing real estate
  - JV, or other business relationship

QUESTIONS?

THANK YOU FOR YOUR TIME.