Selling the Privately Held Company

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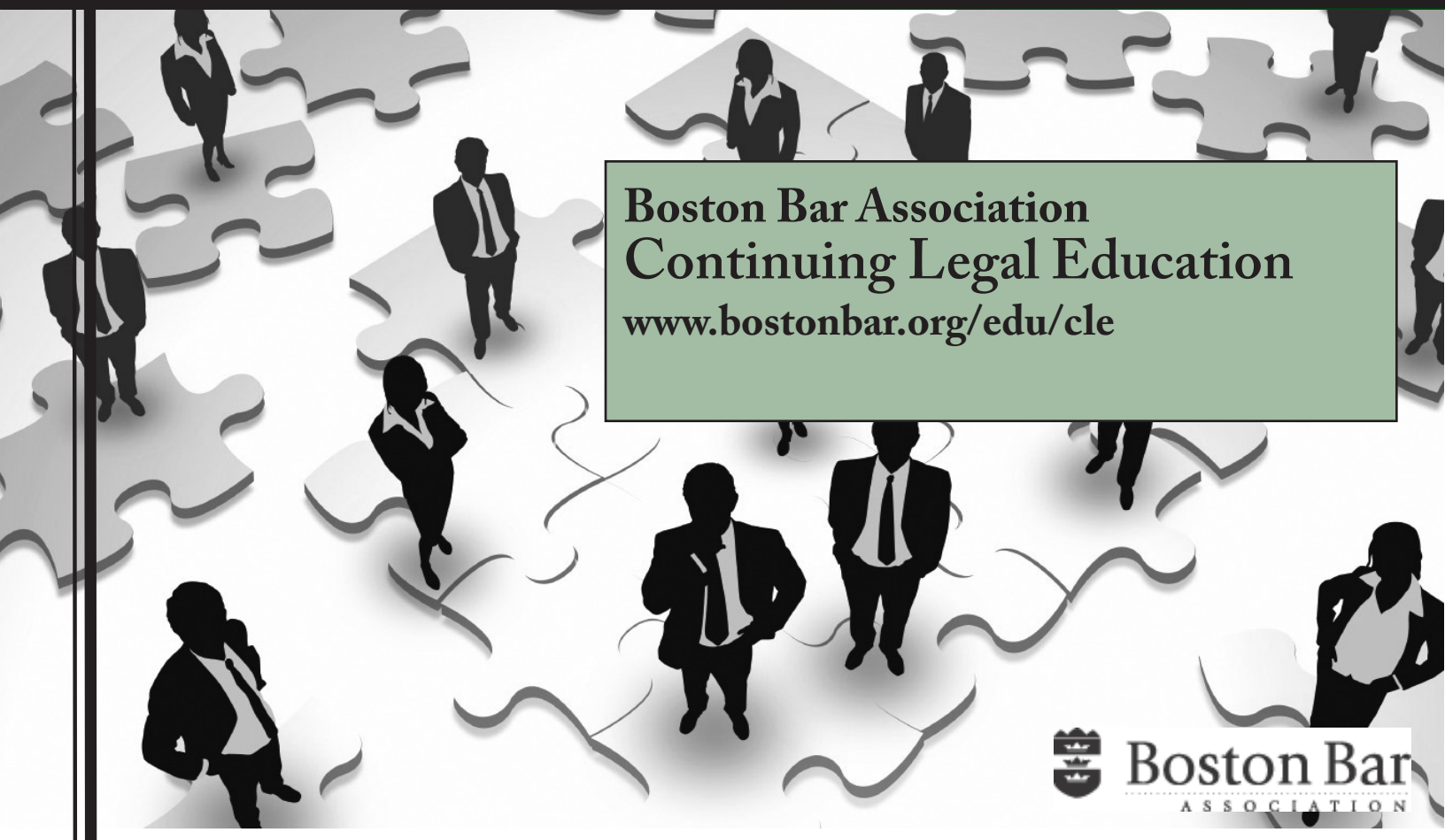

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SELLING THE PRIVATELY HELD COMPANY
By: Steven C. Browne, Gitte J. Blanchet, Priya C. Howell and Ryan Sykora

Introduction

It is difficult to imagine a more "bet the company transaction" than a sale of the company. If the transaction fails to close, the company may be viewed as "damaged goods", will have suffered business disruption due to the distraction of management during the sale process and will have incurred significant legal fees. If the transaction closes but the limitations on the sellers' liability are not adequate, the sellers may end up having to return all or a significant portion of the purchase price to the buyer. For less experienced sellers, the sale process can be confusing, frustrating and difficult. Failing to properly prepare for the sale and to manage the sale process can lead to a loss of value, increased risk of the deal failing to close, and post-closing indemnification claims.

Sellers who are prepared for and well-advised in the sale process are more likely to obtain the highest value in the transaction, complete the transaction, and minimize post-closing problems. They also are more likely to attract and retain competitive bidders throughout the sale process. Legal counsel can play a very important role in ensuring an effective and efficient sale process.

The following are some practical recommendations for sellers' counsel, both in-house and external, in conducting the sale process.

Involve Experienced M&A Counsel

Let's face it, M&A isn't easy. Knowledge of market terms and trends is critical. There are tried-and-true ways of addressing specific issues and lots of pitfalls and traps for the inexperienced. Experienced M&A counsel usually knows what the lawyer on the other side will say before he or she says it. The words in the acquisition agreement really do matter and often are determinative of key issues with significant money on the line. Sellers' counsel must know the case law that affects M&A transactions, including with respect to fiduciary duties. M&A typically involves numerous substantive areas, including tax, intellectual property, antitrust, labor and employment, employee benefits, import/export compliance, privacy and others. The lawyer who guides the sale process does not have to be an expert in all these disciplines, but he or she has to have enough familiarity with them to spot the issues and to be able to guide the experts in resolving the issues. Being an excellent lawyer simply is not enough. The seller needs assistance from experienced M&A counsel who has the proper experts available to assist. Many companies use their existing corporate lawyer to represent them in the sale process - and this may be fine - so long as he or she is an experienced M&A lawyer or involves an experienced M&A lawyer in the process.

Educate Your Client

Whether you are in-house counsel or external counsel, it is very important that you educate your client. Some Board members, executives or in-house counsel may be very sophisticated, having sold many companies. Others may be going through the process for the first time. Most likely

there will be a mix of both. Do not assume that your client knows as much as you do about the sale process. Communication and education are keys to a successful outcome and it is up to you to help your client help you negotiate a successful sale.

Explain to your client the sale process from start to finish. Explain your client's roles in the process and the duties, including fiduciary duties, involved. Help your client understand the likely timing of the transaction, the various steps involved, the agreements that will be drafted and negotiated, and the issues that are likely to arise. Help teach your client to *Focus on What Really Matters* as described below.

Get the House in Order

Selling a company is like selling a home. You clean it up, fix the problems and prepare for the sale so as to obtain the highest price possible. You also move as fast as possible so as to minimize the opportunity for things to go awry.

Sellers' counsel should conduct its own due diligence of the company and think about the company as if it is the buyer's counsel. Identify the issues that will affect the purchase price, slow down the process or result in the buyer wanting greater post-closing indemnification protections. Fix those that you can and be prepared with a detailed explanation of those that you cannot. It usually is best to be forthcoming on due diligence issues and present them in the best light possible without stretching the truth. If the buyer discovers an issue on its own it is more likely to assume the worst about the problem and it may assume that the seller was hiding the issue. The general sense that the buyer obtains regarding the "cleanliness" of the company, together with the specific issues it finds, will impact such key issues as the purchase price, the size and length of the indemnification escrow, the remedial actions that the buyer will require pre-closing, the closing conditions, and the caps on indemnification.

Conducting due diligence will also allow you to streamline the preparation of the disclosure schedules to the acquisition agreement. Preparing disclosure schedules is a difficult, time-consuming process. The more work the company does early in the process the more likely it will be able to *Get the Deal Signed* faster.

Control the Process

When you are representing the seller, time is your enemy - the shorter the period to signing and to closing the better. The period prior to closing is the period during which material adverse changes can occur to the business, financial results can disprove management's financial projections, and events beyond your control can affect the transaction. Many things can happen that might result in a reduced purchase price, more onerous deal terms or the deal falling apart.

As sellers' counsel you should make every effort to control the timing of the transaction. This means not only managing your own client but also doing your best to keep the buyer and its counsel on track. Educate your client on the process and the need for speed. Try to obtain time commitments from the buyer's counsel on delivery of the first draft of the acquisition agreement. Prepare a timeline and ask the buyer to commit to it. Commence work on the disclosure

schedules as early as possible. Do not spend excessive time marking up and negotiating every provision of the acquisition agreement - focus on what matters and keep the process moving. Understand what consents and approvals will be required both pre-signing and pre-closing and have a strategy for obtaining them.

In addition, try to avoid the "CFO bottleneck". This is not a knock on CFOs, but rather recognition that the CFO is critical to both the due diligence and disclosure schedule processes. The CFO will face incredible demands on her or his time. As legal counsel you need to prepare the CFO for what is coming and convince the CFO to utilize available resources to keep the process moving. The CFO knows that he or she can best gather most of the required information and frequently will try to do all the work. Obtaining proper help for the CFO can significantly shorten the deal timeline and help *Get the Deal Signed*. Particularly important: help the CFO get the due diligence datasite up and populated as fast as possible so the buyer can begin its due diligence promptly after the letter of intent is finalized.

Focus on What Really Matters

Sell-side lawyers sometimes lose sight of what really matters. They raise every issue they can think of, prepare extensive mark-ups of the acquisition documents and waste time and money. They refuse to let minor issues go and negotiate every possible point. Rarely is this in the client's best interest. The key is to *Focus on What Really Matters*.

There are four things that really matter when representing a company in the sale process: *Obtain the Best Price, Get the Deal Signed, Maximize Deal Certainty,* and *Protect the Price.*

Obtain the Best Price. The importance of *Obtaining the Best Price* is obvious. The sellers' lawyer can help by preparing the company for sale and managing the sale process to get to a signing and closing as fast as possible. Fixing due diligence problems, being forthcoming about issues that cannot be fixed, and positioning the company to appear professionally managed all help *Obtain the Best Price*. Preparing the Board and management for the sale process also will help them negotiate for and *Obtain the Best Price.*

Get the Deal Signed. The risk of the deal terms (including purchase price) changing or losing the deal entirely decreases dramatically once the definitive acquisition agreement has been signed. Thus, *Getting the Deal Signed* is critical. Keep the process moving. Don't allow the buyer to delay. Use timelines and checklists. Get the buyer to specify any conditions to signing early in the process and focus on satisfying those conditions. Do not over-lawyer the acquisition agreement and negotiate immaterial points. Focus on what matters and *Get the Deal Signed*.

Maximize Deal Certainty. Once the acquisition agreement has been signed, it is critical to get the deal closed - which means the sellers' counsel needs to *Maximize Deal Certainty*. Minimize the closing conditions, especially closing conditions that are not within the company's sole control. Seek objectivity in the closing conditions so that the buyer does not have the ability to exercise its judgment or discretion to determine whether a closing condition has been satisfied. Make sure that the acquisition agreement requires the buyer to consummate the transaction within a short period after the closing conditions are satisfied. Clean up due diligence issues

early in the process so that they do not end up as closing conditions. Review the cooperation covenants and termination provisions to ensure that the buyer must work with the seller to get to closing and that the seller has the opportunity to cure problems before the buyer has the right to terminate the acquisition agreement.

Protect the Price. No seller wants to give money back to the buyer after the closing. Sellers' counsel should focus on the provisions of the acquisition agreement that can result in a reduction of the purchase price or require the sellers to return a portion of the purchase price to the buyer after the closing. These include provisions regarding the payment of expenses, filing fees, and transfer taxes, as well as direct reductions to the purchase price for insufficient working capital levels or cash or for "indebtedness" that is too broadly defined.

Pay special attention to the indemnification provisions. Limiting the survival periods for the representations and warranties, the size and length of the escrow and the number of indemnification items (i.e., "Fundamental Representations") that are not capped by the escrow are all critical to a successful sell-side transaction. Negotiate for a significant deductible applicable to all types of indemnification claims. Focus carefully on the definition of "Losses" and try to include mitigation of damages concepts. To the extent that you are only going to win a limited number of points in the negotiation process, this is the place to expend your capital and win some points. Not only do you have to *Obtain the Best Price*, you also have to *Protect the Price*.

Conclusion

The sale of a privately held company is a complicated "bet the company" transaction. By focusing on what matters, the sellers' counsel, whether in house or external, can have a significant impact on the sale process and can deliver real value to the company and its shareholders.

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