



# PRELIMINARY CONSIDERATIONS IN SELLING THE COMPANY

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Presented to:



# Today's Agenda

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# Banker Engagement Letters

# Banker Engagement Letters

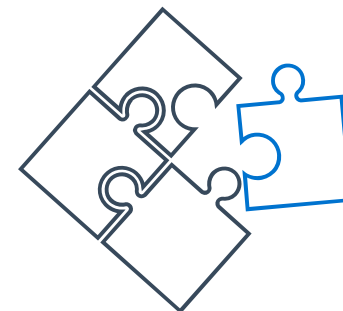
- What constitutes a transaction that gives rise to a broker fee?
  - Asset Sales
  - Minority Financings
- How does the fee get measured?
  - Enterprise value (cash, debt, transaction expenses)
  - Earnouts
  - Escrows
  - Management Rollover
  - Payments to management
  - Break-up fees

# Termination and Tail

- Term and Termination
  - Notice
- Tail
  - Duration
  - Signing vs Closing
  - What types of transactions give rise to tail payment?



## Other Negotiated Terms



- Expenses
  - Caps
  - Exceeding the Cap
  
- Indemnification
  - Defining losses
  - Bad faith / gross negligence
  - End-around when indemnification is unavailable
  - Broker's right to consent to settlement
  - Asset sales

# 2

## NDA's with Bidders

# Form NDA

- Designating Confidential Information
- Representative breach
- Non-solicit
  - Who does it cover?
  - How long?
  - Introduced or made aware of through transaction?
  - Carve-outs?
- Residuals
- Term and Termination



3

Term Sheets

## Part 3 – Term Sheet

- Term Sheet vs Definitive Agreement
- Exclusivity & Termination
- Treatment of Unvested Equity
- Earnout
  - Buyer standard of performance
  - How measured
  - Buyer change of control



# Rep and Warranty Insurance

## Hypothetical Terms - \$500mm deal

Term	More Seller Favorable	More Buyer Favorable
Amount of Insurance	\$50mm	Same
Insurance Retention	\$5mm; dropping down to \$2.5mm after 12 months	Same
Indemnity Escrow	\$2.5mm	\$5.0mm
Deductible or Basket	Deductible	Basket
Size of Deductible / Basket	\$2.5mm	Same
Insurance Cost	3-4% of amount of coverage (e.g., \$1.5-2.0mm)	Same
Who Pays Insurance Cost	Buyer	Split 50/50

# Other Indemnity Terms

- Survival terms under Rep & Warranty Insurance
  - Reps
  - Survival
  - Cap
  - Basket / Deductible
- Fraud
  - How defined
  - Company fraud vs. Seller fraud
- Arbitration





## Working Capital

- Working Capital
  - Setting WC target or methodology
  - WC escrow / holdback
  - Cash / Debt
  - Post-closing adjustment delivery period
  - Standard for post-closing adjustment
  - Deferred revenue

## Closing Conditions

- Accuracy of Reps & Warranties / Compliance with Covenants
- No MAE
- Financing (break-up fees)
- Antitrust approvals
- Litigation (government vs. third party)
- Stockholder Approval / Appraisal Rights
- Third Party Consents

# Restrictive Covenants & Management Agreements

- Management
  - Non-compete terms / duration
  - Employee / Customer non-solicit
- Key Stockholders
  - Employee non-solicit
- Employment packages for management
- Retention pool



# 4

## Getting Organized





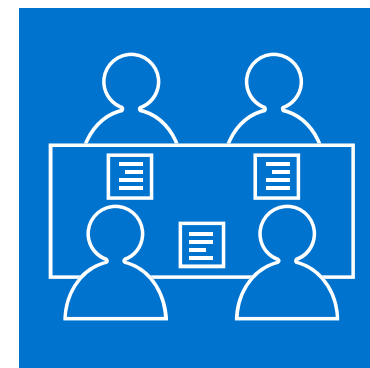
## Getting Organized

- Preparing your own diligence request list
- Setting up a data room
- Sell side Quality of Earnings
- Sell side Bid Draft of Purchase Agreement
- Disclosure Schedules
- Tax Returns

# 5

## Considerations for the Board

# Board Considerations



- Fiduciary Duties
- Duty of Care
  - Act on an informed basis after due consideration and deliberation
  - Must have all reasonably available and relevant information, devote sufficient time to consideration and obtain advice from legal and financial advisors – *Smith v. Van Gorkom* (1985)
  - Exculpation from monetary liability available to directors (not management)
    - DGCL 102(b)(7) and Certificate of Incorporation
- Duty of Loyalty
  - Duty to make decisions in the best interests of the corporation and its shareholders (no “self-dealing”)
  - Encompasses good faith – “intentionally acts with a purpose other than advancing the best interests of the corporation...” – *Stone v. Ritter* (2006)
  - No exculpation from monetary liability

## “Revlon” Duties

- Revlon duties apply when a company embarks on an all-cash or substantial cash transaction (~50%) – whether on its own or in response to an unsolicited offer.
- Board may “Just Say No” if reasonably determines that remaining independent will yield greater value to stockholders than a sale.
- Board has a duty to **maximize stockholder value in the short term** and to obtain **the highest price reasonably available**.
  - Board may consider non-price factors that go to likelihood of consummation (e.g., financing and background of bidder)
    - *In re: Dollar Thrifty* (2010) – no violation accepting \$41 bid from Hertz versus \$46.50 from Avis due to financing and antitrust risk
  - However, when comparing offers that are comparable in timing and likelihood of consummation, must look solely to price
- Board must engage in a **process that would reasonably be expected to yield the most value for the Company's stockholders.**

# Standards of Review

## ■ Business Judgment Rule

- “Directors’ decisions are presumed to have been made on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.” – *Painter v. Marshall Field* (1981)

## ■ Enhanced Scrutiny

- Applied to review and adoption of defensive mechanisms – *Unocal v. Mesa Petroleum* (1985) and approval of a sale of control – *Revlon v. McAndrews* (1986)

## ■ Entire Fairness

- Applies when presumptive protections of BJR have been rebutted:
  - Majority of board has an interest different from common stockholders
  - Majority of board lacks independence or is dominated by an interested party
  - Controlling stockholder stands on both sides of a transaction
- Two components:
  - Fair dealing – timing and manner of process and approvals
  - Fair price – price that a reasonable seller, under all the circumstances, would regard as within a range of fair value

# Reliance on Information from Others

- In discharging duties, Board may rely on information, opinions, reports and statements (including financial statements or other financial data) presented to the Board by:
  - Officers or employees of the Company reasonably believed to be reliable and competent in the matters presented;
  - Legal counsel, public accountants, investment bankers and other persons as to matters reasonably believed to be within their person's professional or expert competence; and
  - A committee of the Board (if you do not serve on such committee), as to matters within the committee's designated authority, if reasonably believed to merit confidence.
  
- Board may not rely on the foregoing (and will not be acting in good faith) if Board has knowledge that makes the reliance unwarranted.
  - Financial advisor will be expected to disclose any actual or potential conflicts of interests of which they are aware so can be managed appropriately – *In re Del Monte Foods* (2011) and *In re Rural Metro Corp.* (2014)

# Sale Process Considerations

- Board has substantial latitude to define a sale process:
  - Revlon does not set out a specific route that a board must follow – *C&J Energy Svcs v. City of Miami Gen. Emps.* (2014)
  - “In the absence of self-interest..., the actions of an independent board of directors...are protected by the business judgment rule.” – *Mills Acquisitions Co. v. Macmillan, Inc.* (1989)
- Must demonstrate “body of reliable evidence” to conclude that the best price reasonably available was obtained:
  - In evaluating whether satisfy Revlon, the Court determines “whether the defendant directors employed a reasonable decision-making process and reached a reasonable result” – *In re Rural Metro* (2014)
- To comply with Revlon, Board must make an informed decision about maximum value reasonably available and about the most effective process reasonably likely to achieve it given all the circumstances.



# Sale Process Types

- Public Auction:
  - Public announcement that board considering strategic alternatives.
  - Highest likelihood of identifying all possible bidders and fully exploring value.
    - Can be effective even if only one bidder surfaces given publicity of process.
  - For public companies, reduces risk of activism from stockholders seeking a sale of company.
  - Company still controls timing and execution.
  
- Pre-Signing Market Check (w/o announcement):
  - Board gauges potential buyers' interest and explores value prior to entering into a definitive agreement.
  - Board, with its financial advisors, attempts to determine which buyers may be interested and capable of acquiring company.
    - Reasonableness of board's decision-making in defining the universe of potential bidders will be scrutinized, particularly if few bidders surface.
    - *In re Netsmart* (2007) – court enjoined acquisition because board failed to fully inform itself about all possible bidders in its market check (no strategic contacts, only financial).
  - Publicity and selective disclosure risks are heightened.

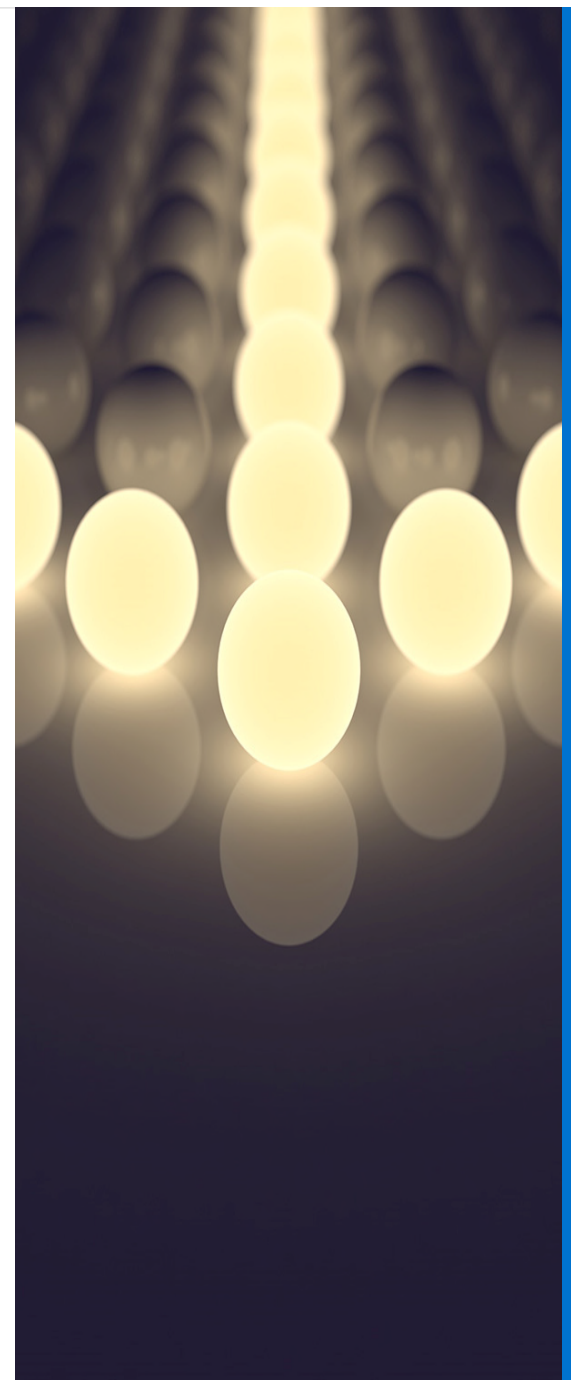


## Sale Process Types (2)

- Post-Signing Market Check / Go-Shop:
  - Go-shops remain an alternative in DE, but use has significantly declined.
  - Company signs a definitive agreement and then entertains competing bids.
  - Can be active (affirmatively seek alternatives) or passive (no outreach, but lower break-up fees during go-shop period).
  - Financial buyers seek go-shops because avoid auction risk and provide for a break-up fee if topped.
  - To be effective, potential bidders must have sufficient information and time to make a bid (typically 30-50 days).
  - Terms of deal protections (e.g., break-up fees and don't-ask-don't waive) significantly influence reasonableness of post-signing market check.
    - Potential bidders can't be unduly deterred.
  - Can be paired with limited pre-signing market checks.

# Best Practices

- Review and consider the stand-alone plan and all reasonably available alternatives.
- Disclose all personal or professional interests in any potential transaction.
- No negotiation of post-transaction arrangements between insiders and a bidder until after primary deal negotiated.
  - Review of arrangements to ensure no disguised value transfer.
- Assume that anything in writing (e.g., email, texts and notes) is discoverable in litigation.
  - Minimize notes – could be misunderstood out of context.
- Minutes are the primary record of the Board and should properly reflect considerations and deliberations.



## Best Practices (2)

- Be actively involved and remain in control:
  - Do not rush to a conclusion – company controls timing and process.
  - Consistent points of contact – senior management, lead director(s) or bankers.
  - Keep the team informed – if have direct communications, promptly communicate the substance of the discussions.
  - Promptly communicate any information obtained concerning a third party's thinking or plans.
  - Maintain confidentiality - limit to discrete group on a need-to-know basis.
    - General queries – “We don't respond to rumors.” “No comment.”
- Have a plan of communication if information leaks:
  - Board acting in an informed and deliberate manner, with a goal of maximizing shareholder value.
  - The reasons for considering this path and information considered.
  - The strengths and weaknesses of this direction versus stand-alone.

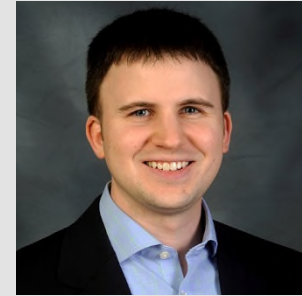
# Joseph Fore

Joseph Fore provides ongoing representation to private equity and venture capital firms, public issuers and private companies.

Joseph's experience ranges from representing Fortune 100 companies to startups. His transaction experience includes representing both strategic and financial buyers and sellers in mergers and acquisitions, joint ventures, equity syndication, secured debt financings, private securities offerings ranging from seed financings to pre-IPO financings, private placement of securities for public issuers, public registration of securities, corporate governance and SEC disclosure.

Joseph represents companies in the technology and software, transportation and logistics, oilfield services, employee benefits and payroll services, and healthcare sectors.

Joseph is a member of the Executive Committee of the Firm Wide Associates Committee.



## Joseph Fore

T: +1 512 457 7129

F: +1 512 721 2229

joseph.fore@dlapiper.com

## Education

University of Virginia School of Law  
(2010) J.D.

Dean's Scholar

University of Virginia (2007) B.A.

*Phi Beta Kappa*

Echols Scholar, Political and Social  
Thought, History

## Admissions

Texas

