



Tuesday, May 1
2:00–3:30 pm

**902 After the Closing: Practical Methods for
When the Real Legal Work Begins Post
Acquisition**
Legal Manager Track

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After the Closing: Practical Methods for When the Real Legal Work Begins Post Acquisition

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Agenda:

- General Concepts
 - Merger v. Acquisition
 - Figuring out “who survives” in the deal
 - Getting on the post-deal “A List”
 - Contingency Planning
- What to Figure Out Once the Deal is A “Go”
- Negotiating the Deal
- Post Transaction – Rollin’ up Your Sleeves
 - Post-Closing Checklist
 - Post-Closing Timelines
 - Integration of businesses

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“There’s going to be a merger...”

- Preliminary questions:
 - Merger
 - Direct
 - Forward/reverse triangular
 - Acquisition
 - Stock (assets & liabilities)
 - Assets (no liabilities)
 - “Who’s going to survive?”

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What will the new company look like?

- Post-closing company structure will drive who needs to stay
- Factors include:
 - Company’s needs
 - Company’s culture
 - Politics
 - Your abilities
 - “Do I Fit?”
- There are only two teams:
 - The “A Team”
 - The “Non-A Team”

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Make Sure You're On The "A Team"

- Self Assessment – Am I:
 - Making things happen?
 - Watching things happen?
 - Wondering what just happened?
- What's my role during the businesses integration process?
- What's my role after the businesses are fully integrated?
- The tough question: "Can my tasks be distributed among the remaining attorneys with minimal disruption to operations?"
- There are no assurances. Hope for the best. But plan for the worst.

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Planning for the Worst: Employment Agreements & Résumés

Employment Agreement

The rest of us...

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Due Diligence and Negotiating the Deal

- The Due Diligence Process and Negotiating the Agreements occur simultaneously.
- Results of due diligence will:
 - Pinpoint areas of greatest concern for post-closing matters
 - Develop leverage in agreement negotiations
- Get your feet firmly planted on both tracks

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Due Diligence Process

- What is the “Due Diligence” process?
 - Examination/evaluation of target
 - Teams of experts/specialists
 - Financial
 - Operations
 - Intellectual Property
 - Real Property
 - Contracts
 - Litigation
 - Securities
 - Employment & Labor
 - Compensation & ERISA
- Look for opportunities for the Legal Department to add relevant input and value to the transaction

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Due Diligence: Gather Data for Post-Closing Phase

- Generally, look for all Equity, Assets and Liabilities
- Equity:
 - Stocks, options, restricted stock grants, warrants, puts, calls, convertible securities, voting trusts, subscription agreements, stockholder agreements, other equity interests, etc.
 - If it's a stock deal, you want to own it all, not simply a portion (even if it is a majority)

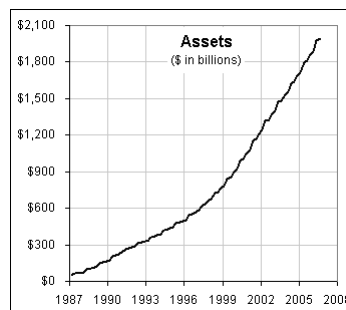
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Due Diligence: Gather Data for Post-Closing Phase

- Assets
 - Financial information
 - Accounts receivable
 - Operations
 - Inventory
 - Capital Equipment
 - Intellectual Property
 - Assignments
 - Leakage
 - Special Issues with Asset Deal
 - Contracts
 - Liquidated damages provisions
 - Real Estate
 - Employees
 - Non-disclosure agreements
 - Inventions assignment agreements



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Due Diligence: Gather Data for Post-Closing Phase

- Liabilities
 - Financial Information
 - Accounts Payable
 - Indebtedness and Contingent Liabilities
 - Compensation, Commissions & Bonus Plans
 - Deals rarely close precisely on the end date of the fiscal year or quarter, so pro-rating is necessary
 - Environmental
 - Benefits Plans and Programs
 - Contracts
 - Liquidated damages provisions
 - Warranties
 - Litigation
 - Employee problems (by department!)
 - Proceedings before any administrative or regulatory bodies
 - Environmental
 - HAZMAT
 - Investigations
 - Insurance
 - Claims history

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Negotiating the Deal

- Toughest Negotiating Points are Typically:
 - Indemnification
 - Escrow Arrangements
 - Purchase Price Adjustments
 - Earn-out and claw-back provisions
 - Exceptions to Representations, Warranties and Covenants
 - The thing you forgot about, discovered, or was revealed to you at the last minute
 - Exhibits and ancillary agreements

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Negotiating the Deal: Indemnification

- Indemnification provisions seek to balance the buyer's desire to keep the seller on the hook for breaches against the seller's desire to eliminate any continued responsibility for the business
 - Obligations
 - Amounts
 - Duration
 - Limitations
 - Minimum thresholds
 - Maximums/Caps
 - Procedures
 - Notice
 - Escrow Agents
- You must completely understand indemnification provisions to effectively identify and mitigate risk after closing.



Negotiating the Deal: Representations

- Three functions:
 - Obtaining disclosures about the target
 - Provide basis for rights to indemnification
 - Provide foundation for terminating the transaction entirely
- Recall your company's strategic goals. For instance:
 - If the acquirer is a publicly traded company, all of the target's representations and warranties in the acquisition documentation should be consistent with the SEC's disclosure requirements for public companies to permit simple reporting
 - If you plan on selling off portions of the target, consider what representations and warranties you will have to make as a seller in the future
- Strength of representations and warranties vary by industry:
 - Compliance with Laws; Permits – Crucial for highly-regulated industries
 - Intellectual Property – More important in high-tech and biomedical industries
 - No "Payola" – No Foreign Corrupt Practices Act violations or unlawful contingent fee payments in international area and government contracting. Check business practices, conflicts and ethics policies.
- The "MAC" and "MAE" clauses:
 - ...since [date], no material adverse change has occurred...
 - ...which is not reasonably expected to have a material adverse effect...



Negotiating the Deal: The importance of definitions

- **Definitions**
 - “Sellers” – Ensure target’s predecessors are included (especially true for environmental and product liability issues)
 - “Contracts” – Consider expanding definition to include agreements and understandings based on a course of dealing to expand disclosures
 - “Occupational Safety and Health” – Can include private programs required by insurers or recommended by trade associations
 - “Related Persons” – Dig deep to identify “sweetheart” deals benefiting the target or another party that artificially boost the target’s financial picture or are likely to evaporate after closing.
 - “Knowledge” – Officers & Directors only? Actual knowledge standard (avoid) versus “reasonably should know” standard (better).

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Negotiating the Deal: Other Considerations

- “Consistent with past practices” provisions – Consider defining past practices closely to put some collars around reasonable expectations and practices.
- Purchase Price Adjustments & Procedures – Very tricky. Each party has a financial incentive to continue dealing after the closing to maximize/minimize this adjustment driven by post-closing audits.
- Earn-Outs – Some say, “They never work.” Draft them carefully, and prepare for a battle.
- Qualifiers – “Knowledge” and “Reasonable”

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Post-Closing Checklist

The deal is closed.
Now you're now the "Contract Administrator."
Review the documents closely to identify:

- Specific Post-closing deliveries
- Collection of pre-closing items that were waived
- Notice information
- Required consents
- Every representation and warranty
- Every covenant
- On-going obligations
- Price adjustments and indemnifications

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Post-Closing Checklist

- Prepare an exhaustive list. It is easier to cross completed items off of this list early than to add items later in the game.
- Notice Information. Use e-mail as courtesy, but comply with the notice requirements to the letter.
- Investigations into Representations
 - "Trust. But Confirm." (Some say, "Assume fraud.")
 - Undisclosed Liabilities – Compare to exceptions listed in disclosure schedules.
 - Investigate FLSA compliance closely. Consider hiring a consultant.
 - Classification of Exempt/Non-exempt employees
 - Pay practices under wage & hour laws
 - Condition of Real & Personal Property. (There are no Lemon Laws.)
 - Inventory – Make sure the shelves weren't cleaned out...
 - Compliance with Laws – Especially where there are no knowledge qualifiers.
 - Absence of Certain Changes and Events (from last financial report or fixed date)
 - Contracts; No Defaults
 - Environmental
 - ERISA
 - Litigation matters not fully disclosed to protect A/C privileges.

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Post-Closing Checklist

- Specific intellectual property concerns
 - When buying assets or a business segment, carefully consider how you define the business being acquired.
 - Ensure that you have access to all IP required for use in that business (primarily v. exclusively used)
 - Consider licensing options if outright transfers don't work
 - License-back by buyer
 - Exclusive licenses by seller
 - Assignments & change of control provisions may weaken strength of IP.
 - "IP leakage" issues arise where buyer succeeds to the target's technology licensed to a third party, but the definitions imply that the licensed IP now includes buyer's IP either directly or as an affiliate.
 - Review license agreements to determine if buyer is affected by the license terms as a result of the merger and consider re-executing licenses.
 - Key terms to focus on are: Affiliates, Change of Control, Third Parties, and "now or hereafter" language

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Post-Closing Checklist

- Specific executive compensation concerns
 - IRS Code §409A governs non-qualified deferred compensation
 - Non-compliant employee taxed on value of compensation (once risk of forfeiture is mostly gone), plus 20% excise tax, plus interest
 - Employers must report taxable amounts and make appropriate income tax withholdings
 - Need representation that:
 - Plans have not undergone any material modifications
 - Plans comply with 409A
 - There is no reportable income under 409A
 - Payment of severance and other key employees may require six-month delay
 - Benefits continuation should not exceed 2 years plus the stub period
 - Be wary of separation or severance plans and look for exceptions
 - Target's options can be substituted with buyer's, but you must preserve the ratio of exercise price to FMV
 - Earn-out payments to optionees and other grantees of stock rights must be paid on the same schedule, terms and conditions as payment to other stockholders
 - Under recent Disney case, last minute compensation arrangements raise red flags with new focus on decisions made by the Board of Directors
 - New SEC Compensation Discussion & Analysis rules require full and detailed disclosure of all compensation arrangements
 - "This affects your bosses' compensation. Get it right."

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Post-Closing Checklist

- Investigations into Covenants
 - Performance of all obligations prior to closing
 - Conduct of business in ordinary course
 - Maintain good relations with customers, employees, landlords, vendors, etc.
 - Notice of any changes affecting representations, warranties or exceptions in the disclosure schedules
 - Payment of indebtedness to “related persons”
 - Identify all on-going obligations
 - Promissory Notes
 - Non-Competition Agreements
 - Employment/Consulting Agreements
 - Escrow Agreements
 - Incentive compensation plans for new key employees

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Post-Closing Checklist

- Some quick money-makers
 - UCC and tax lien search reports to verify no post-closing encumbrances on assets
 - Audit/Consolidation of outside legal counsel
 - Audit/Consolidation of insurance coverages
 - Audit/Consolidation of other vendors, especially telecom and office equipment
 - Eliminate/sublease redundant leaseholds
 - Push other departments to make these changes by offering to review all related documentation and provide legal guidance for possible options.

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Post-Closing Timeline

- Legal = Contract Administrator
- Time limitations on indemnification obligations
 - Keep all departments focused on these deadlines
 - Avoid last minute rush to find as many problems as possible to stretch to meet minimum indemnification thresholds
 - Prepare and update closing memorandums as a reminder
 - Consider including \$ amounts to indicate that numerous minor issues can accumulate quickly
 - Good faith, good faith, and good faith.

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Post-Closing Timeline (Cont'd)

- Time limitations on **ALL** escrow accounts
 - Usually coincide with indemnification obligations, but you should make every effort to give seller as much notice as possible to resolve discrepancies early.
 - Indemnification Escrow for Purchase Price Adjustment
 - Virtually NEVER an upward adjustment in purchase price.
 - Buyer has every incentive to drag heels on calculating any adjustment
 - The more time that buyer has to make subtractions, it will continue to try to locate them.
 - Indemnification for breach of representations or warranties
 - Sometimes broken down ratably into quarterly release periods
 - Escrow money can dribble out if no claims are made against the escrow.
 - Disclosing claims early can be perceived as demonstration of good faith, rather than 11th hour "indemnification surprise."

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Post-Closing Timeline (Cont'd)

- Notice of claims procedures – **CRITICAL**
 - Notice of claims only to the seller doesn't usually prohibit escrow agent from releasing funds to seller.
 - Escrow agreements are frequently crafted to permit the escrow agent to release monies to the seller from indemnification escrows if the escrow agent hasn't received notice of claims from the buyer consistent with the notice provisions of the escrow agreement.
 - Once escrow agent has received notice of claims, it can only release monies from the indemnification escrow after receiving written instructions signed by both the buyer and seller.

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Integration of businesses

- Organizational Charts
 - Corporate structure
 - Amount of stock/equity interests
 - Subsidiaries
 - Registrations as "foreign company"
- Integration of New Employees
 - Information
 - E-mail
 - Labor Matters
 - International or cultural issues

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Form of Post Closing “Internal Memo”

INTERNAL MEMORANDUM

FROM: General Counsel
 TO: Attached Distribution List
 DATE: May 1, 2007
 RE: Post-Closing Indemnification Obligations

- Congratulations to everyone on a superb effort in bringing this important transaction to a close. Thanks to your persistence and collective efforts during due diligence and preparation of the disclosure schedules, we were able to prepare an outstanding agreement. As we all settle into the integration phase, please keep the following points in mind.
- Section 7.6 of the Stock Purchase Agreement requires X, as the seller, to indemnify us for any breach of its representations, and for other specifically identified matters, for an aggregate amount of up to \$X,000,000. However, the seller's indemnification obligations are not triggered until the aggregate liabilities reach a minimum of \$Y00,000.
- These indemnification obligations expire on November 1, 2008. Therefore, if you discover any items during the next 18 months that you either did not identify or anticipate during the due diligence process, please contact the Legal Department so that we can promptly determine whether or not that item is a default under the agreement and whether the seller's indemnification obligations are triggered as a result.
- While our goal is not to have any unforeseen liabilities, we have anticipated that some unknowns may arise. Therefore, we need to position ourselves to regain any monies to which we're entitled under the agreements. Please note that small items can easily accumulate to exceed this minimum threshold. Even seemingly insignificant items should be reported so that we can quantify them and give notice to the seller in a timely fashion.
- If you have any questions regarding this transaction, including the closing documents and various disclosure schedules, please contact me.

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Simple Time-Line for Big Ticket Post Closing Deadlines:

Date	Event	Agreement	Section	Notes
August 1, 2007	Calculate Asset Value as of Closing Date	Asset Purchase	Section 2	Report due from Sellers showing all changes to due diligence report
September 1, 2007	Release of Purchase Price Escrow	Asset Purchase & Escrow Agreement	Section 2	
September 1, 2007	Earn-Out Calculations Due	Asset Purchase & Escrow Agreement	Section 3	
October 1, 2007	Earn-Out payments due	Asset Purchase & Escrow Agreement	Section 3	
May 1, 2008	Release of Claims Escrow	Asset Purchase & Escrow Agreement	Section 4	Joint Notice to Escrow Agent
May 1, 2008	Termination of Agreement	Non-Compete	Section 5	Moe Howard Larry Howard Curly Howard
May 1, 2008	Payment Due	Promissory Note	Para. 4	Balloon Payment
November 1, 2008	Termination of Agreement	Consulting Agreement		Lucille Ball

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- New England Chapter of Corporate Counsel, What's Behind Door #3? Avoiding Traps When Buying and Selling Companies, presented March 29, 2007
 - Intellectual Property:
 - Anne T. Warner, Inverness Medical Innovations, Inc.
 - Stephen G. Charkoudian, Goodwin Procter, LLP
 - Executive Compensation:
 - Ernest G. Cloutier, Digitas Inc.
 - Scott A. Webster, Goodwin Procter, LLP
- Womble Carlyle Sandridge & Rice, PLLC, ACC Sponsor for the New to In-House Committee 2007
- Michael Manning, Phillips Medical Systems