

ROBERT G. HUTCHINS – LEGAL ESSAYS

Buying Private Companies, Subsidiaries and Divisions Part III - Negotiating and Closing the Acquisition

Preliminary Note

This is the third of three Essays devoted to the acquisition, from the buyer's perspective, of privately owned business units. Part I explains when, and how, the buyer must obtain advance approval of an acquisition contract from its security holders and its secured creditors. Part I also touches upon threshold financing and management issues confronting buyers and it highlights some of the special problems associated with the acquisition of subsidiaries or divisions.

Part II urges would-be buyers to include both lenders and investment bankers in their acquisition planning. It stresses the importance of developing a realistic acquisition budget before encountering the pressures of actual negotiations. It also summarizes the structural alternatives and probable negotiating environment that should be considered by buyers when screening acquisition candidates. It anticipates the formal evaluation of a specific target by illustrating the questions that should be answered by the buyer's "Due Diligence" investigation.¹

Let us now assume that the buyer has identified a potentially attractive, but closely held, acquisition target. This Essay discusses the major objectives and contractual issues that will confront the buyer when negotiating with the target's corporate parent, managing executives or individual security holders all of whom I designate, indiscriminately, as the "seller." I do not presume to comment upon negotiating technique, or to suggest that negotiations in mergers or acquisitions are somehow the special province of lawyers.

Setting the Stage - Letters of Intent and other Preliminary Documents

The buyer's initial proposal to the seller will be designed to achieve four basic objectives:

¹ See this Website, Publications, Essays, *Buying Private Companies, Subsidiaries and Divisions – Part I – Launching the Acquisition Program, and Part II, Identifying, Investigating and Analyzing the Target.*

First, to "lock up" the transaction by obtaining the sellers' commitment to remove the target from the marketplace until the buyer can complete its investigation, formalize its offer and negotiate a final agreement;

Second, to acquire the right to investigate the target comprehensively by means the buyer can control;

Third, to obtain assurance, free from any reciprocal obligation, that the buyer can purchase the target on acceptable terms if satisfied with its investigation; and

Fourth, to gain adequate post-closing recourse against the seller if the sellers' representations about the target prove to be inaccurate or incomplete.

If the seller agreed, the buyer theoretically could achieve these objectives by purchasing an option to acquire the target on stated terms within a specified time period. The option agreement could cover the buyer's investigation and the related confidentiality undertakings. The option price could be credited against the purchase price if the transaction closed, but forfeited if the transaction collapsed. By forfeiting the option price the buyer could withdraw from the negotiations at any time, without explanation or further liability, if it determined not to proceed. The difficulty here is that option rights must be exercised in full or not at all. The buyer rarely knows enough about the target when an option is negotiated to state confidently the terms on which it later must be exercised. Sellers will not bind themselves to an option contract except at a seller's price. If that price is too high, the option is useless to the buyer. If the option is not exercised the buyer, in addition to losing the option price, will have no remaining contractual access to the seller or the target.

Accordingly, the buyer usually will forego a formal option and try to obtain a functional equivalent consisting of a plausible but non-binding undertaking to purchase the target on terms that the buyer can adjust or abandon after its investigation. To accomplish that tour de force, the buyer will submit a preliminary document that confirms the existence, purpose and maximum duration of the pending negotiations. The document will be called, variously, an "Agreement in Principle," a "Memorandum of Understanding," or a "Letter of Intent." I use the last of those terms. When the Letter of Intent is signed, the buyer's first two objectives, the "lock up" and the right to investigate the target, will be achieved automatically. The Letter will require that the seller withdraw the target from the marketplace and allow the buyer to conduct its investigation. The buyer's only obligations will be to hold the negotiations in confidence and neither to disclose nor exploit directly any proprietary information it discovers about the target unless the transaction is completed.

The buyer's third and fourth objectives, obtaining early assurance of completing the acquisition on acceptable terms and gaining post-closing recourse against the seller, are altogether different matters. The buyer will launch its campaign to achieve them by attaching an exhibit to the Letter of Intent that

describes or summarizes the buyer's proposed price, payment terms, conditions, warranties and remedies. The exhibit is called a "Term Sheet."

The Letter of Intent will contain precautionary language to the effect that the Term Sheet is not a binding contract and that neither party is bound to conclude a transaction until the buyer has pronounced itself satisfied with its investigation and the Term Sheet has been supplanted by mutually acceptable final, or "definitive," agreement. The precautionary language, however, can be misleading. If the buyer wishes to proceed when its investigation is complete, it will try to use the seller's implicit acceptance of the Term Sheet, which arguably can be inferred from the signing of the Letter, to *force* the seller to sign a conforming final agreement. The legal foundation for this tactic, which is not firm, can be summarized as follows:

The law imposes upon both parties an *implied* obligation, of judicial origin and uncertain scope, to negotiate the final agreement in "good faith" in light of the Letter of Intent and Term Sheet. The buyer, citing the implied obligation, will argue that the Letter of Intent was *conditionally* binding despite its contrary language and that the conditions were (a) the buyer's satisfaction with the investigation and (b) the preparation of a final agreement objectively giving effect to the Term Sheet. Simultaneously, the buyer will insist that the precautionary language permits it to withdraw from the transaction if its investigation is not satisfactory, thus disclaiming any premature obligation of its own.

Sellers who, having signed a Letter of Intent, refuse arbitrarily to execute a later agreement fairly reflecting the Term Sheet can indeed be held liable for acting in bad faith. That result is particularly likely when the refusal is shown to have been motivated by undisclosed self-interest, such as the sudden receipt of a better offer from a third party. On the other hand, the buyer's good faith can be challenged successfully if it purports not to be "satisfied" with an investigation that unearthed nothing significantly adverse about the target. Further, if the precautionary language in the Letter of Intent is too broad, no good faith obligation will arise at all, even by implication. Finally, astute sellers, fully aware of their legal position, will decline to execute any Letter of Intent unless they are completely satisfied with the Term Sheet. That can force the buyer to negotiate the essential terms of the transaction in advance of completing its investigation, a position associated with obvious risk.²

² The risk of incurring unintended "good faith" obligations can be hedged through binding provisions for the payment of "break up" fees compensating a party willing to proceed for the wasted time, substantial expense and opportunity costs arising from the other party's withdrawal. With those provisions in place, the parties can negotiate the transaction itself in a legal environment relatively free from ambiguity. Such fees can be difficult to negotiate when the target is a private company, however, because prior to its investigation the buyer lacks sufficient information to assess the probable cost of a breakup.

In the final analysis, no buyer can enter negotiations on the assumption that its preliminary evaluation of the target will remain intact and no seller can assume that its initial assessment of the market value of the target will be accurate. In most transactions, it is likely that both buyer and seller will want changes in the initial Term Sheet. If the Letter of Intent has been drafted ineptly, the parties will negotiate those changes in a context in which their reciprocal rights and obligations are unclear. Under all of the circumstances, the care with which the buyer should approach the preparation, negotiation and execution of the preliminary Letter of Intent cannot be emphasized too much.³

The buyer's Investigation - Gaining Access to Relevant Information

The acquisition will be closed only after the buyer has completed a comprehensive examination of the target undertaken with the cooperation of the seller and the target's management. The examination is called, in the jargon of mergers and acquisitions specialists, a "Due Diligence Investigation" or "Acquisition Review." I refer to it simply as the buyer's "investigation."

For a number of reasons, devising an agreed method by which the investigation may be conducted is never easy. First, buyers' investigations are necessarily collaborative, requiring input and guidance from the seller; yet they are detailed and intrusive which can make collaboration difficult. Second, these investigations reach confidential information the protection of which is imperative for the seller, at least until the acquisition is the subject of a binding contract. The seller's effort to control the buyer's preliminary access to such information can be an additional source of tension. Third, no matter how secretive the parties may have been initially, word that a "deal" is pending will spread quickly once the investigation begins. The resulting speculation, which is rarely accurate, will upset employees and may threaten relationships with lenders, major customers and suppliers while inspiring competitors to new efforts. Fourth and perhaps most importantly, the impact of the buyer's investigation upon the ultimate legal positions of all parties is profound. That proposition deserves special emphasis:

In the "definitive" acquisition agreement the seller will be required to warrant the accuracy and adequacy of all significant information it has disclosed about the target. The seller will also be required to warrant the absence of undisclosed adverse changes affecting the target or its business that occur between a negotiated cut off date (usually the date of the most recent financial statements for the target) and the closing date.

³ For an extended discussion of the perils of Letters of Intent and other preliminary documents see this Website, Publications, Essays, *Letters Of Intent and Press Releases In Business Acquisitions. Problems, Risks and a Mechanical Solution.*

The seller, having accepted its contract warranties with confidence and a clear conscience, can be undone later by the target's records. Those records will have been prepared, for the most part, by the target's employees. The records may not be consistent with the seller's general directives, or even with its specific instructions. In a surprisingly high number of cases, the records will be seriously misleading if not explained. The seller can also be confounded by careless verbal statements or assurances made during the investigation by the target's employees. Accordingly, the seller's stake in the investigation is by no means minimal.

The target's third party relationships and trade secrets may be compromised by the buyer's attempts to verify facts, observe products under development, or confirm research. That result, obviously, would work to the detriment of both seller and buyer. The parties thus have a mutual interest in avoiding a clumsy, makeshift and uncontrolled investigative effort.

The buyer itself, however, confronts the greatest risk. In the absence of sheer dumb luck, an acquisition will not be successful for the buyer unless its terms and structure are based upon a thorough understanding of the target. The buyer cannot assume that it always will have a remedy for undisclosed problems that become apparent only after the closing. To the contrary, post closing misrepresentation claims asserted by some buyers have been treated by courts as *waived* because they were based upon information the buyer lacked, but *should* have discovered. Such rulings have been issued notwithstanding contrary language in the "definitive" agreement.

In light of all this, I recommend that the Letter of Intent be accompanied by a separate and expressly binding agreement limited to the buyer's investigation, the seller's obligation to keep the target off the market while the investigation is pending, and basic warranties that are important inducements to both parties to pursue the transaction seriously (e.g. the seller's ownership of the target, the target's ownership of its assets, the buyer's financial capacity to pay the probable acquisition price and conclude the transaction etc.).

The investigation agreement should contain a clear description of the classes of information the buyer may examine (usually itemized in an attached checklist). It should impose mutually acceptable controls over the buyer's later use of that information if the transaction does *not* close.

The time of day during which the investigation may be conducted should be specified and, to accommodate the seller, will often be outside of normal business hours. The seller may also insist that its records be examined only in an off-premises "data room." In that event, a complete index of the documents to be examined should be prepared and approved in advance, accompanied by the seller's warranty that the examined documents include all documents that are significant to the target.

The personnel of the target whom the buyer may interview should be identified and responsibility for alerting them should be delegated to the seller. The

buyer, however, should retain the right to approve a written summary of the purpose and specific subject matter of any interview that is likely to be controversial or sensitive.

The agreement should take account of the fact that the investigation probably will be conducted in two phases. The first phase will be devoted to a business review and financial audit of the target. It will begin when the Letter of Intent is signed and will be carried out by the buyer's executives and accountants. It should be substantially complete when the final agreement is prepared. The prospect of follow up technical inquiries, however, prompted by incomplete or ambiguous records or interviews should be addressed.

The second phase of the investigation will be completed between the acquisition contract date and the closing date. It will consist of a legal audit, as opposed to a business review or a financial audit, and will thus be conducted by the buyer's counsel. During this phase, with a transaction at hand, the buyer will try to confirm the state of title to the target's assets, the legal good standing of the target and its affiliates, the binding effect of the target's major contracts and licenses, the degree of exposure of the target to asserted, threatened or probable third party claims and compliance by the target with laws affecting its business.

Throughout the investigation, the buyer's need to know must be balanced against the competing confidentiality requirements, planning objectives, schedules and general priorities of the seller, the target and the target's employees. The success of the investigation will depend upon coordinating effectively the separate activities of persons who are strangers to each other, having different backgrounds, motives, areas of expertise and points of view. An appropriate agreement covering these matters should always be signed contemporaneously with the Letter of Intent.

The Acquisition Contract -Putting the "Deal" Together

The "definitive agreement" or "acquisition contract" memorializes all significant terms of the final bargain, including any allocation between buyer and seller of the business, financial and legal risk associated with the target. The accurate assessment of acquisition risk is the most difficult task confronting any buyer. The shifting of that risk to the seller is the most difficult aspect of the acquisition contract for the buyer to negotiate satisfactorily.

The first draft of the contract is usually submitted by the buyer as a follow up to the Letter of Intent. Here is a summary of its essential provisions:

Parties and Structure. The parties and their roles will vary depending upon the structure of the transaction. The structure of most private company acquisitions is determined by federal income tax considerations beyond the scope of our current inquiry. Suffice it to state, for now, that the owners of the target will want to avoid double taxation on their gain from the sale. That will prompt them to offer the target's securities rather than its assets. The buyer will want to "step up"

the tax basis of depreciated property and will respond by offering to purchase only the target's assets. The opposed tax goals of the parties are usually resolved by adjusting the asking price. Our present inquiry is concerned with the effect of structural changes upon the parties' duties and their business and financial risk.

If the transaction is structured as a sale of the target's assets, the parties will consist of the target, the buyer and the target's owner(s), consisting of its corporate parent or the individual holders of its outstanding securities. The target will be identified by name, or as the "Company" or "Seller," depending upon the semantic preferences of the buyer's counsel. The owner(s) will be identified by name, or as the "Principal" or "Selling" Shareholder(s), Unitholder(s), etc.

The target's primary role in an asset transaction will be to convey the assets to the buyer at closing. To fulfill its role, the target will make comprehensive representations and warranties about those assets and about its financial, legal and business condition. The target will also be bound by various post-closing obligations including a covenant not to engage in business competition with the buyer. If the sale includes substantially all of the target's assets, the target may be required to complete proceedings for its dissolution by a specified date and to change its business name while the proceedings are pending.

The owners will join personally in the representations and warranties made by the target and will be bound personally by the covenant not to compete. The owners will also be obligated to insure that all legal formalities associated with or necessary for the binding effect of the target's conveyance of the assets are observed or waived.

If the transaction is structured as a sale of the target's outstanding securities, the same parties will participate, but their roles will change. The owner(s) will act as the seller and will transfer the securities, not the target's assets, to the buyer. The target will continue in existence after the closing, its ownership of its assets intact. It is commonly thought that a purchase of the target's securities will carry more risk for the buyer than a purchase of assets because the buyer will acquire the target as an intact legal entity. The buyer will thus inherit the target's undisclosed liabilities and latent problems as well as its business and assets. In practice, however, astute buyers view the risk associated with an acquisition as being essentially the same regardless of the form of the transaction. There are several reasons for this:

Many states, including Washington, have eliminated bulk transfer laws and with them any statutory procedure by which a buyer can obtain a list of the target's creditors, notify them of a pending asset sale, permit them to submit claims that are paid from an escrow of the purchase price and escape further liability. It is not yet clear to what extent, with the procedure eliminated, the courts will leave the target's unpaid creditors with recourse only against the target and the seller. Commercial loan documents, leases and major supply contracts routinely accelerate the target's indebtedness when assets are sold out of the normal course of business and many purport to obligate buyers as "successors" of the target. In any case, the major

indebtedness of a private target invariably will be secured by its assets. Tax statutes provide for successor liability in a number of instances, particularly at the state level. Employees and their unions have, on various theories, asserted liability against buyers as well as sellers for severance benefits and occasionally have attempted to block the transaction entirely. The courts have imposed liability for pre-closing injury claims based upon the target's defective products upon buyers who purchase the product line and continue the target's business. Accordingly, the typical buyer is well advised to insist upon substantially the same representations, warranties and indemnifications in an asset purchase as would be expected in a transaction structured as a purchase of securities.

Regardless of the form of the transaction, if the buyer is a newly formed or financially weak subsidiary and the purchase price is to be paid in installments, the seller may require that the buyer's parent join in the transaction, at least to the extent of guaranteeing the buyer's financial obligations.

The target's executives normally will not be parties to the acquisition contract except to the extent they hold equity securities of the target. The executives may, however, be required to sign certificates concerning the accuracy of factual matters falling within the areas of their responsibility. The certificates are used to support the target's representations respecting the absence of undisclosed claims or liens and the continuing validity of the target's major business contracts. The certificates are also used to support legal opinions given to the buyer on a variety of subjects by counsel to the seller. If the continued employment of key executives after the closing is a condition (or important inducement) for the transaction, the required approval by the executives of implementing agreements will be mentioned prominently in the acquisition contract. While not formally parties to that contract, the executives may be able to enforce it to the extent of protecting their rights and they may be accountable to both buyer and seller for material errors in their certificates. In most transactions, accordingly, the target's executives will be an important constituency whether or not they are named formally as parties.

Preliminary Recitals. To the surprise of many, most contracts do not stand or fall upon technical legal terminology or words of art. Unless its subject matter is so arcane that resort to technical terms is unavoidable, a contract will be enforceable if it satisfies a few elementary criteria: (a) its objective must be lawful; (b) it must have been entered by competent parties whose intent to contract has been communicated by objective means; (c) as a condition to entering it, the parties must have bargained for and received in exchange money, other property, rights, or promises; and (c) it must not have been procured by fraudulent means.⁴

⁴ To the extent that a contrary view persists, lawyers have no one but themselves to blame. "Legalese" is finally giving way to clarity, due largely to initiatives by the Securities and Exchange Commission respecting the use of "plain English" in registration

For enforcement to become a practical reality, however, it is necessary that the contract be understood, if only by a judge. In an acquisition contract, an important aid to understanding is found in a preliminary section describing the background for the transaction, the motives of the parties and any special features that explain the bargain and make the contract remedies appropriate.

Reciprocal Obligations To Sell And Buy. The basic obligations to sell and purchase the target are, of course, mutually dependent. They are stated in an early section of the acquisition contract and are expressly made subject to the performance of the parties' respective obligations and to the satisfaction of numerous external conditions (e.g. the receipt of necessary regulatory approval) that are set forth later in the text.

Purchase Price and Payment Terms. The section describing the price and terms of payment can range from a single sentence requiring that a lump sum be paid in cash at closing to multiple pages of extraordinary complexity describing a price to be paid over time in an amount that will vary depending on future events. Examples of such events include the post closing financial performance of the target, the outcome of pending litigation, the passage of proposed legislation and the election by one or both parties to pursue or decline various post-closing options.

If the price is to be paid in installments, the resulting obligation may be evidenced separately by the buyer's promissory note made payable to the seller. The note will be a commercial instrument that can be bought and sold. The seller may be willing to accept a market discount to convert the buyer's installment obligation to cash. If the note is "negotiable," the seller can transfer it to an innocent third party that can enforce the note against the buyer even if the seller is later shown to have breached the acquisition contract. For that reason, most notes given in acquisition transactions are made expressly non-negotiable by the buyer and in the hands of a third party will be subject to all defenses available against the original payee (i.e. against the seller). Most buyers will also negotiate for a specific right to *offset* (subtract) the amount of any post-closing claim against the seller from deferred installments of the purchase price. The right of offset will be set out in the acquisition contract and also in the text of any supplementary note. The right is a powerful tool that, in the event of a dispute, can shift the practical necessity and financial burden of initiating litigation from buyer to seller.

Accounting And Related Structural Issues. Generally accepted accounting principles in the United States used to recognize two basic methods of financial reporting for business combinations, "purchase" accounting and a "pooling of interests." When purchase accounting is used, assets and assumed liabilities of the target will be recorded by the buyer at fair market value. Any excess of the purchase price over market value will be allocated to *goodwill*. Any excess of the

statements and periodic reports by public companies. On the other hand, it is doubtful that legal subjects will ever make for light reading; witness these Essays.

purchase price over *book* value will result in a "*step up*" of assets to market value improving, to that extent, the target's post-closing balance sheet position. The operating results of the target are included in the financial reports of the buyer from the closing date forward. Purchase accounting provides relative flexibility in arranging earnouts or other variable price formulations, and in negotiating payment terms, price holdbacks, indemnification funds and escrows. These efforts can also increase the buyer's control over the time periods within which various events will be recognized for tax purposes.

The pooling of interest method is no longer permitted and is thus of significance only for completed transactions the accounting and tax attributes of which are still relevant. In brief, under the pooling method the assets and liabilities of buyer and target were added together and carried forward at their recorded amounts. The results of operations of the combining companies were also added together and included in the financial statements of the surviving entity for all periods presented both prior to and following the closing. The pooling method allowed the financial presentation, on a combined basis, of two or more ownership interests (of the target and of the buyer) that previously were independent. The method was used for acquisitions structured as mergers or exchanges of voting securities. The primary financial advantage was that neither ownership group contributed or withdrew funds or assets or incurred significant tax liability triggered by the closing. They merely exchanged securities in a ratio that reflected their bargained for interest in the combined entity.

The requirements for the pooling method were strict, numerous and detailed. If all of the requirements for pooling were present, the pooling method was required. If even one requirement was absent, purchase accounting was required. In unusual circumstances, purchase accounting could be imposed by regulatory authorities even after the fact.⁵

The pooling of interest requirements were impacted heavily by the prior history of the combining entities and by the manner in which the acquisition was structured and documented. The salient point here is that purchase accounting is now required for all acquisitions and the buyer must consult with its accountants about the underlying issues from the very beginning to minimize the risk of a serious and often irretrievable misstep.

⁵ An example I encountered involved a combination reported as a pooling of interests followed some time later by a divestiture of the acquired business. The surviving and reporting entity was publicly held. The SEC required that that the financial impact of the divestiture be disclosed as though the purchase method had been used to account for the original combination. The effect was to reduce substantially the reported gain on the divestiture.

Representations and Warranties. Unless the target is so attractive that the seller's bargaining power is overwhelming, the seller and the target will be required to make detailed factual representations, and warrant their truth, to protect the buyer against financial loss. The representations will cover the target's good standing, contractual authority, assets, liabilities, employees, financial history, current condition, freedom from adverse claims, regulatory compliance and business prospects. The representations will be supported by the warranties, which are contract promises to respond in damages if the representations are false.

In an asset sale, the representations and warranties of both the seller and the target will continue in effect after the closing, sometimes for a protracted period of time. Their duration can be the subject of intense negotiation. In a transaction structured as a sale of securities, the representations and warranties of the target will expire at closing, the buyer having little interest in protecting itself from its own subsidiary. The seller, however, will remain liable until all contract remedies have expired.

Indemnifications. “Indemnifications” are given *separately* from representations and warranties. Indemnifications are promises to respond in damages if specified conditions or events exist or occur. For example, in a typical acquisition the seller is required to indemnify the buyer against post-closing third party claims arising from pre-closing events that were known to or reasonably discoverable by the seller. The seller has already represented that no such events exist, and has warranted the truth of that representation. The related indemnification merely defines the precise remedy available to the buyer for breach of the warranty. Sometimes, however, an aggressive buyer will insist that the indemnification be given *whether or not the events were known, discoverable or disclosed and even if the seller disclaimed any representation or warranty concerning them*. The degree to which the seller must accede is determined by the relative bargaining power of the parties. A seller can control the risk associated with its *warranties* by making *full disclosure* of all known or anticipated problems thus eliminating any underlying *representation* that those problems did not exist. To the extent an outgunned seller provides *independent indemnification* if the problems arise, however, it is acting as an *insurer*.

At the risk of belaboring the point, I note that the risk of an inadvertent indemnification can be increased simply by the *format* of the acquisition contract. Representations and warranties usually appear in an early section of the text. Indemnifications, by contrast, are often buried in remedies sections that appear at the *end* of the document. They are written to impose a comprehensive duty to indemnify against a breach of warranty *and* against any “claim,” “liability,” or “loss” as defined fifty pages earlier in the section on representations. The use of the conjunctive “and” is a trap for the unwary. The failure of unsophisticated sellers to distinguish clearly between representations, warranties and indemnifications is a tendency that is universally exploited by buyers. The unwitting seller, having labored mightily to limit its representations and warranties, can find itself liable anyway when problems occur if it has agreed separately to indemnify against the underlying risk.

Conditions to Closing- Abandonment of Transaction - Other Consequences. The respective duties of the parties to close an acquisition will be subject to a number of conditions most of which will be stated expressly in the acquisition contract. One example is the completion by all other parties of their obligations to prepare for the closing, e.g. by obtaining necessary consents from shareholders or lenders. Another is the performance by such parties of their closing duties e.g. the buyer's tender of the purchase price, the target's transfer of its assets or the seller's transfer of a controlling interest in the target's outstanding securities. Other conditions are deemed legally to be inherent elements of the bargain, tacitly understood by the parties even if not expressly mentioned. The continued legality at closing of the target's business is an example. The absence of a natural catastrophe that destroys the target's manufacturing plant can be another, although the parties will usually manage that risk, and cover it in the contract, through an allocation of insurance proceeds and a discretionary right on the part of the buyer to close, accept the proceeds and rebuild.

The consequences of a failed condition will vary. In all cases, if a condition is not satisfied the party protected by it may, at its election, abandon the transaction without liability, or waive the condition and consummate the bargain. The more difficult question is whether a party entitled to exit may seek redress as well. A condition that a lender, landlord or regulatory agency approve the transaction, for example, cannot be satisfied by the actions of the parties themselves except to the extent they must take preliminary steps to bring it about (e.g. by making timely application for approval). When such a condition is not satisfied further performance is excused, but the excused party does not acquire a claim for additional relief. By contrast, if the condition rests upon a promise, a breach of the promise will excuse the performance of the party to whom the promise was made and will also confer an actionable claim. Correlatively, if an alleged failure of condition is *not* established, a party that refused to perform in reliance upon the allegation would *face* a claim for breach of contract.

The prudent buyer must distinguish conditions based upon promises from those based upon external events. It also must identify conditions the satisfaction of which may become apparent only over time. It must then obtain appropriate and explicit remedies for the failure of those conditions in the acquisition contract. For example, the truth of the seller's representation that the target's financial statements are accurate will invariably be a condition to closing and will be supported by a contract promise (i.e. the seller's underlying warranty). However, the falsity of the representation may not be discovered for some time after the closing. The buyer may sue for damages at that point only if the acquisition contract provided expressly that the warranty survived the closing and is still in force.

Pre-Closing Obligations. Between the contract date and the closing date both buyer and seller will be obliged to attend to a variety of matters that must be completed for closing to occur. Regulatory, director and shareholder approvals, third party consents, preliminary "spin offs" or "split offs" of unwanted assets, permitted distributions to the seller of the target's excess cash and the receipt of test results or

reports respecting the target's compliance with environmental laws are examples. The satisfactory performance of those obligations will be among the closing conditions.

Closing Procedures. A formal closing acts as a clearing event, providing an appointed time and designated place for the exchange of documents, the payment of money, the recording of deeds and releases, the transfer of securities or assets and the confirmation of external conditions that are necessary to vest ownership of the target in the buyer. In large transactions the closing process can require days to complete. In small ones a few minutes can suffice.

The closing date will be used to prorate normal course or assumed tax and other liabilities of the target. It will also be the date of the last financial statements, tax returns and other regulatory reports covering operations of the target while under the control of the seller. The "closing financial statements" will be used to calculate purchase price adjustments reflecting changes in the target's financial position and operating results occurring between the last audited statement date and the transfer of the target to the buyer. For administrative reasons, accordingly, most closings are scheduled on or immediately after the last day of the calendar month in which the conditions to closing are satisfied.

The closing participants will be the parties, their representatives, third persons with an interest in the proceedings such as unpaid lenders or lien holders and persons engaged to perform specific closing functions. Among the latter are escrow agents who will hold a portion of the closing payment made by the buyer pending computation of the adjusted purchase price and will also hold any additional sum established as an indemnification fund securing surviving warranties and indemnifications of the target and seller.

Unless the transaction is extraordinarily simple, the parties should sign a formal closing memorandum that identifies the participants, sets out the conditions that were satisfied or waived, confirms the actions taken and describes any post-closing actions yet to be completed. The latter would include the preparation of the closing financial statements, the computation of purchase price adjustments and the release to the seller (or withdrawal by the buyer) of appropriate sums from escrow.

Post Closing Obligations and Further Assurances. After the closing the parties will usually be confronted by a number of loose ends. There may be minor third party consents or routine regulatory approvals promised but not actually delivered at the closing date and these must still be obtained. Particularly in larger transactions there will be minor documentary oversights or technical errors that must be corrected and additional instruments of conveyance that must be executed, acknowledged and recorded. Inevitably there are practical operating questions and issues on which the buyer will require advice as it begins the process of assimilating the target's business. The buyer will have acquired ownership and possession of the target's business records, but the seller will require post-closing access to them for a variety of reasons, often for years after the closing date. For these reasons, the

acquisition contract will impose duties upon the parties to cooperate with each other on specified post-closing matters.⁶

Remedies. The parties to a contract are given wide latitude when establishing remedies appropriate for their situation. The buyer should begin its analysis of the subject by identifying those losses, liabilities, errors or omissions to which it is most vulnerable and the time period within which it is apt to discover them. A misrepresentation of the target's working capital position, for example, will likely become apparent within the first year after the closing, whereas undisclosed third party claims may not be asserted for years. Those timing differences will affect the negotiated duration of the buyer's remedies.

Most breaches of contract can be redressed by a payment of money and accordingly the appropriate remedy for them will be an action for damages. Breaches of obligations to convey specific assets or securities, to protect confidential information, or to refrain from competition, however, are another matter. A payment of money may not suffice to cure the resulting harm and the breach may be ongoing. Under these circumstances the remedy may take the form of a court order, enforceable through the contempt process, requiring that wrongful conduct cease, that conveyances be made, that confidential information be returned, etc. In appropriate circumstances, such affirmative "equitable" relief can be obtained in addition to a money judgment.

The forum in which relief will be sought is also important. States vary significantly in the manner in which their courts hear disputes and dispense justice. In Washington, for example, almost any relevant evidence will be admissible to explain an acquisition contract the meaning of which is disputed. In other states the evidentiary rules are relatively strict.

Arbitration is a form of alternate dispute resolution favored by many as being efficient and inexpensive to pursue when compared to litigation. In a consensual arbitration, however, the decision of the arbitrators is final. There is no opportunity to appeal to the courts unless the arbitrator's award was fraudulently procured or is patently incomplete. The rules of discovery are often limited in arbitration proceedings and that can frustrate a thorough investigation of the position to be taken by an opposing party.

⁶ Extensive post-closing consultation by the seller will be the subject of a separate agreement and will be purchased for additional consideration. In smaller transactions consulting agreements will be negotiated in a context in which the tax objectives of buyer and seller are directly opposed. Consulting compensation may be deducted by the payor if reasonable in amount. The recipient must report the compensation as ordinary income and pay the resulting tax.

Miscellaneous Provisions. Most acquisition contracts will have a section of varying length dealing with so called "miscellaneous" provisions. This section will identify the federal and/or state laws that will apply to the acquisition contract. It will provide for the manner by which notices must be given or permitted. It will determine whether the acquisition contract contains the exclusive arrangement for the transaction or is only one of several implementing documents. It will provide, if this is the case, that the contract may be executed in more than one counterpart. It will provide, if part of the bargain, that the prevailing party may recover attorney's fees in the event of a dispute; a critical right that will not exist unless contractually granted. It will state whether successors of the original parties will be bound by the contract and entitled to enforce it. It will state the extent, if any, to which the parties may transfer contract rights (e.g. to receive payments of the purchase price) or delegate duties (e.g. to honor the target's contracts) to affiliates or other third persons. The matters addressed by the "miscellaneous" section are thus important. Neither that section, nor any other part of an acquisition contract, should be dismissed as "boilerplate" undeserving of careful attention.

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