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Anatomy of a Purchase Agreement

Perspectives from Buyer's and Seller's Counsel

Presented by

Doug Griswold, Laura McKinney, and Jed Roebuck

Quick Reminder

- Stages of a Deal
 - Initial discussions/Structuring
 - Letter of intent
 - Due diligence
 - Purchase agreement
 - Closing
 - Post-closing



Deal Structure

- Assets vs. Stock vs. Merger
- Number of factors can influence structure:
 - Type of business
 - Operating history
 - Deal economics
 - Tax Issues
 - Seller's corporate structure
 - Third party consents/government approvals



The Anatomy of a Purchase Agreement

- Deal Mechanics
- Representations and Warranties
- Covenants
- Conditions to Closing
- Indemnification



Overview of What a Seller Wants

- Assurances as to actual closure of deal and receipt of purchase price
- Continuity of business
 - Operations
 - Employees
- Opportunities for additional post-closing consideration/compensation
- Limitation of post-closing liability and restrictions

But What About the Buyer! What Do They Want?

- Assurances that they "get what they paid for"
- No surprises arising out of pre-closing operations
- Everything in place necessary to continue operations of business
- Recourse for any liabilities arising out of pre-closing operations
- No competition from Seller (and possibly Seller's ongoing help in running business)

Deal Mechanics – How Much Are We Talking About?

- Description of Transaction
 - What's being purchased
 - What's not being purchased
 - What is being paid? Cash, debt, assumption of liabilities
 - How much is being paid and when
 - When and where is the closing



Deal Mechanics – Buyer's Interests

- Assumption of Liabilities
 - Buyers typically do not want to assume any of Seller's existing liabilities
 - But there may be pre-existing contracts, etc. that Buyer wants to assume
- Holdback of Purchase Price
 - Buyers often seek to retain (or place in third party escrow) some portion of purchase price to cover Seller's indemnification obligations
- Make Seller Earn It!
 - Buyers will negotiate earn-out provisions to incentivize Seller to assist in post-closing operations
- Sufficient Capital
 - Buyers want Seller to maintain sufficient working capital to ensure smooth transition of ongoing operations

Deal Mechanics – Seller's Interest

- Paid Up-Front
 - Sellers typically prefer to receive as much of purchase price as possible in cash at closing
- Favorable Conditions
 - If earnouts or working capital adjustments in place, ability to fairly participate in ongoing operations and/or review Buyer's financials with respect to target company
- Advantageous Tax Treatment
 - Sellers generally prefer purchase price to be allocated to capital gains (stock equity, personal goodwill, etc.) to limit tax liability

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Reps and Warranties – Time to Roll Up Our Sleeves!

- Legally binding statements by the parties regarding the business and related assets/operations inducing the other party to make the deal
- Tied closely to the indemnification obligations of each party
- Typically, burden is much greater on Seller (and thus Seller's counsel) given disposition of parties
- Common examples –
 - Organization/Capitalization
 - Accounting/Tax
 - Title to Assets
 - Undisclosed Liabilities
 - Material Contracts
 - Employment/Benefits
 - IP
 - Litigation
 - Regulatory/Environment
 - Compliance With Law



Reps and Warranties – Buyer's Interests

- Thorough – No Stone Unturned!
 - Buyer wants to know what it is paying for – do not want any surprises post-closing
- Joint and Several
 - If business is closely-held, Buyer will often want owners of business to "stand behind" representations of the company
- Special Interests
 - If due diligence has revealed any specific concerns, or there are certain industry-specific risks, Buyers will want Seller to make representations directly tied to these risks

Reps and Warranties – Seller's Interests

- Qualified
 - Seller's will seek to limit scope and breadth of its representations
 - Duration
 - Materiality
 - Knowledge
- Schedule It Out!
 - It's in Seller's best interest to disclose as much as possible on Disclosure Schedule related to specific representations (better to be "safe than sorry"!)
- Buyer Assertions
 - Seller may want some limited representations from Buyer regarding its ability to consummate the transaction (solvency, organizational authority, etc.)

Covenants - Wait, I Can't Go Work for a Competitor?!

- Express agreements between parties regarding their pre- and post-closing conduct
 - Regulatory approvals/third party consent
 - Business operations ("maintain the ordinary course")
 - Prohibit certain specific acts pending closing
 - Non-competes and non-solicits
 - Confidentiality
 - "No shop"
 - Public announcements
- Timing of Closing – "Sign and close" versus delayed closing



Covenants – Buyer's Interests

- Maintain the "Ordinary Course"
 - Buyers typically want to protect their investment by regulating Seller's conduct of business prior to closing
 - "Bring down" clauses
- No Competition!
 - Sellers restricted from shopping business to other parties prior to closing
 - Sellers restricted from competing in industry post-closing (and note most courts/statutes afford greater leniency when enforcing noncompetes in sale of business context)
- Control the Narrative
 - Buyers draft public announcements and prohibit Sellers or other third parties (brokers, agents, etc.) from disclosing "unapproved" deal terms

Covenants – Seller's Interests

- Getting Back In The Game
 - Sellers seek to limit non-competes and other post-closing restrictions, often attempting to carve out certain opportunities, locations
- Keep Things Running the Same
 - Sellers seek commitments from Buyer regarding certain post-closing aspects of business, including employment of staff
 - Particularly important if earn-outs or price adjustments have been negotiated
- Protect Business Reputation and Trade Secrets
 - Limit public notice until sale is consummated (protection from industry competitors)

Conditions to Closing – Let's Get Out Our Checklists!

- Outlines the conditions which must be satisfied before each party is obligated to close – common examples include:
 - Representations and warranties of each party were correct when made and remain correct as of closing
 - All pre-closing covenants have been satisfied
 - Receipt of all necessary regulatory approvals and third party consents and releases
 - Delivery of documents conveying assets or stock
- Closing deliverables – often a mini-"closing checklist"



Closing Conditions – Buyer's Interests

- No Surprises!
 - Absence of material adverse changes to Seller's business (in delayed closing)
- "Clean" Title
 - All regulatory, bank and contract approvals in hand
- Appropriate Authorization
 - Resolutions from Seller's owners and Board of Directors approving transaction
- Time to Walk Away
 - If closing is delayed, Buyers will often have right to terminate agreement if certain conditions are unmet

Closing Conditions – Seller's Interests

- No Surprises (Seller Version)
 - Financing has been lined up and/or Buyer has purchase price in hand
- Post-Closing Operations
 - Key commitments related to post-closing operation of business (e.g., staffing/ongoing employment, Benefits/PTO)
- Control Only the Controllable
 - Seller will want to limit its obligations with respect to third party events like government and lender approvals/consents

Indemnification – Who's Responsible?



- Powerful tool for allocating risk – often subject to extensive negotiation
- Most indemnification claims are typically brought by Buyer against Seller as Buyer is more likely to suffer loss after closing
- Indemnification clauses often reflect relative negotiating positions of Buyer and Seller
- Tied closely to the representations, warranties and covenants made by each party

Indemnification – Buyer's Interests

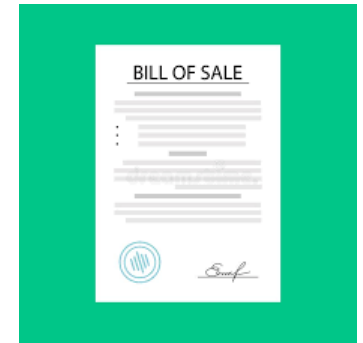
- Broad Indemnification Rights
 - Seller is to be responsible for all pre-closing liabilities of the business and also all of its representations, warranties and covenants
- Extended Survival Periods
 - Seller's representations should survive for extended (24-36 mos.) period with certain "fundamental" reps (title to stock/assets, taxes, fundamental corporate items) surviving indefinitely (or at least through applicable SOL)
- Unlimited Liability
 - No caps or other limitations on Seller's liability with respect to breaches of Seller's "fundamental" reps
- Control the Process
 - Ability to control defense of claims, or at least provide oversight of Seller's defense; Buyer wants final authority over settlement

Indemnification – Seller's Interest

- Limit Liability
 - Limiting both time periods when claims can be brought and scope of possible claims
 - Baskets – limit exposure until losses exceed a specific amount
 - Caps – limit maximum exposure (capped at percentage of purchase price)
 - Offset against any Buyer insurance recoveries
- Exclusivity
 - Seek indemnification as only remedy available to Buyer for breach
- Right to Participate
 - Seek to control defense of claims subject to Buyer's rights being harmed

Other Items

- Exhibits
 - Employment Agreements
 - Transition Agreements
 - Restrictive Covenant Agreements
- Disclosure Schedules (See Reps and Warranties)
- Bill of Sale
- Assignment and Assumption Agreements



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Contact Us

Douglas S. "Doug" Griswold

dgriswold@chamblisslaw.com

(423) 757-0262

Laura McKinney

lmckinney@chamblisslaw.com

(423) 757-0248

Jed Roebuck

jroebuck@chamblisslaw.com

(423) 757-0220

Doug Griswold



- Doug Griswold is a member of the firm's Health Care and Business Practice sections. He is Chair of the Health Care section. Doug focuses his practice on mergers and acquisitions and represents a number of healthcare providers in various business transactions, including asset and stock purchase transactions and joint venture arrangements. In addition, Doug regularly works with healthcare clients on physician employment and equity arrangements, professional service arrangements, state licensing and certification issues, billing and coding matters and compliance/regulatory guidance. In addition to healthcare matters, Doug advises clients in general corporate law and business matters, including entity formation and governance issues.
- Doug received his B.A., *cum laude*, from Harvard University, 2002, and his law degree from William & Mary Law School, 2007.

Laura McKinney



- Laura McKinney is a member of the firm's Business Section, focusing her practice on mergers and acquisitions, joint ventures, financial transactions, and general corporate matters. She works with clients on a variety of business matters, including asset and stock purchase transactions, preparation and negotiation of commercial contracts, entity formation, corporate governance, and regulatory matters.
- Laura received her B.A., *summa cum laude*, European Studies, Vanderbilt University, 1997, and her law degree from Harvard Law School, 2006.

Jed Roebuck



- Jed Roebuck is a member of the firm's Business, Health Care, and Startup Sections. He focuses his business and startup practice on private equity transactions, corporate restructurings, and other business combinations over a divergent field of industries. He also provides advice with respect to entity formation and ongoing corporate governance.
- In the health care sector, Jed has extensive experience in mergers, acquisitions, and joint ventures, representing buyers, sellers, and would-be partners. He is also involved in representing physician groups, revenue cycle management companies, and other health care entities regarding operations, regulatory compliance, contracts, and strategic planning.
- Jed received his B.A., English, University of Georgia, 2007, and his law degree, *cum laude*, The University of Mississippi School of Law, 2011.

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