International Business Law

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INTRODUCTION

Definition

Merger and Acquisition, also known with the acronym of M&A, is a big part of the corporate finance world.

Every day are arranged M&A transactions, which bring separate companies together to form larger ones.

The principle key behind buying a company is to create shareholder value over and above that of the sum of the two companies

Two companies together are more valuable than two separate companies - at least, that's the reasoning behind M&A.

WHY A M&A PROCEDURE MIGHT BE APPEALING?

Strong companies will act to buy other companies to create a more competitive, cost-efficient company.

Usually companies will come together hoping to gain a greater market share or to achieve greater efficiency.

Because of these potential benefits, target companies will often agree to be purchased when they know they cannot survive alone.

Although Merger and Acquisition are often uttered in the same breath and used as they were synonymous, these terms mean slightly different things.

DEFINITION OF ACQUISITION

what does ACQUISITION stand for?

When one company takes over another and clearly established itself as the new owner, **the purchase is called an acquisition.**

From a legal point of view, the target company ceases to exist, the buyer "swallows" the business and the buyer's stock continues to be traded.

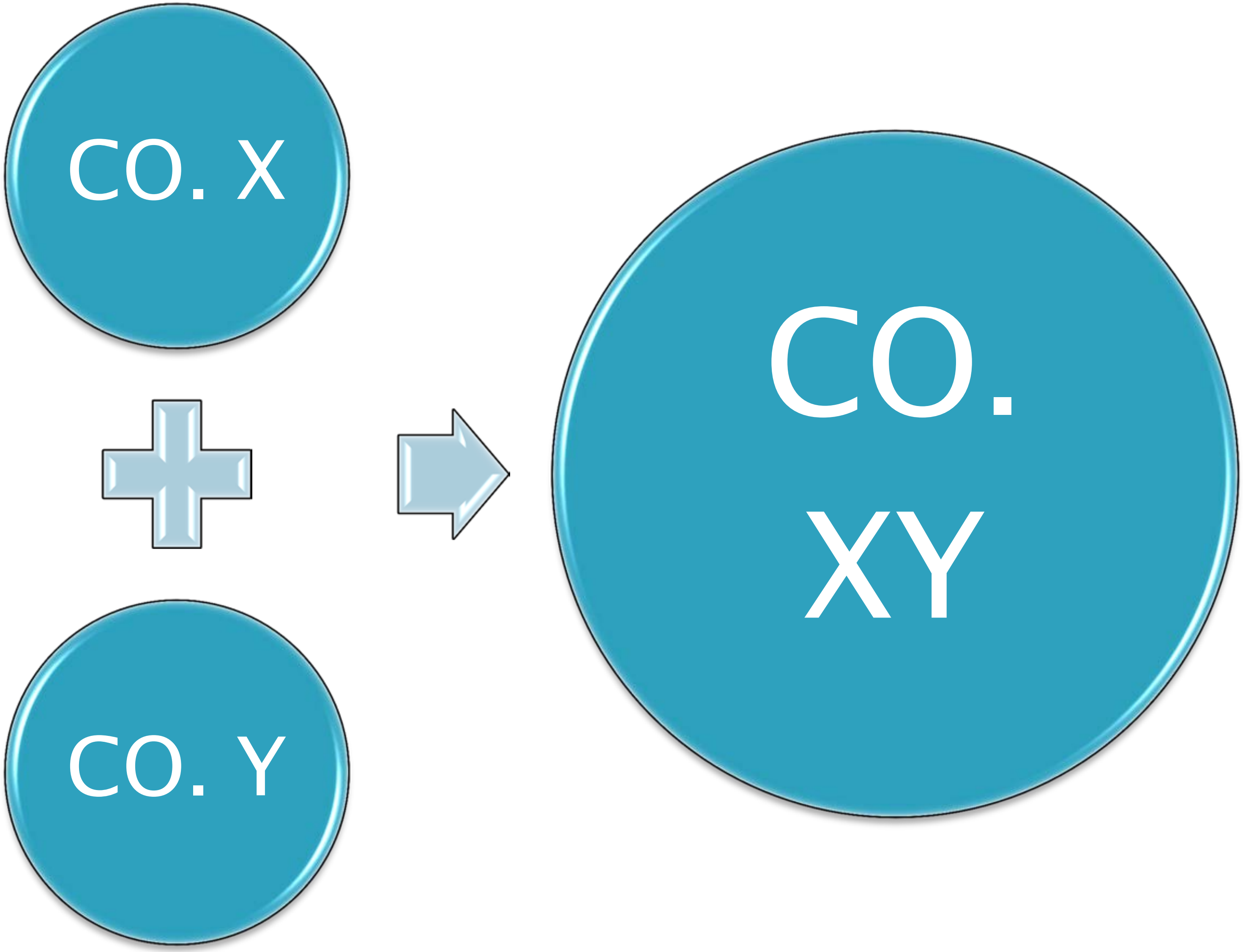
DEFINITION OF MERGER

WHAT DOES MERGER STAND FOR?

A merger happens when two firms, often of about the same size, **agree to go forward as a single new company rather than remain separately owned and operated.**

This kind of action is more precisely referred to as a "merger of equals."

For example, both Daimler-Benz and Chrysler ceased to exist when the two firms merged, and a new company, DaimlerChrysler, was created.


CO. X
CO. Y
CO. XY

Whether a purchase is considered a merger or an acquisition really depends on whether the purchase is friendly or hostile and how it is announced.

In other words, the real difference lies in how the purchase is communicated to and received by the target company's board of directors, employees and shareholders.

As a consequence a purchase deal will be called a merger when both CEO's agree that joining together is in the best interest of both of their companies.

But when the deal is unfriendly - that is, when the target company does not want to be purchased - it is always regarded as an acquisition.

Get the SYNERGY

By merging, the companies hope to benefit from the following:

STAFF REDUCTIONS –

As every employee knows, mergers tend to mean job losses.

Consider all the money saved from reducing the number of staff members from accounting, marketing and other departments.

Job cuts will also include the former CEO, who typically leaves with a compensation package.

ECONOMIES OF SCALE –

Yes, size matters.

Whether it's purchasing stationery or a new corporate IT system, a bigger company placing the orders can save more on costs.

Mergers also translate into improved purchasing power to buy equipment or office supplies - when placing larger orders, companies have a greater ability to negotiate prices with their suppliers.

and

ACQUIRING NEW TECHNOLOGY

To stay competitive, companies need to stay on top of technological developments and their business applications. By buying a smaller company with unique technologies, a large company can maintain or develop a competitive edge.

IMPROVED MARKET REACH AND INDUSTRY VISIBILITY

Companies buy companies to reach new markets and grow revenues and earnings.

A merge may expand two companies' marketing and distribution, giving them new sales opportunities.

A merger can also improve a company's standing in the investment community: bigger firms often have an easier time raising capital than smaller ones.

VARIETIES OF MERGERS

Horizontal merger - Two companies that are in direct competition and share the same product lines and markets.

Vertical merger - A customer and company or a supplier and company. Think of a cone supplier merging with an ice cream maker.

Market-extension merger - Two companies that sell the same products in different markets.

Product-extension merger - Two companies selling different but related products in the same market.

**Conglomeration - **Two companies that have no common business areas.

VARIETIES OF MERGERS

There are two types of mergers that are distinguished by how the merger is financed. Each has certain implications for the companies involved and for investors.

PURCHASE MERGER ≠ CONSOLIDATION MERGER

HOW THE MERGER IS FINANCED

PURCHASE MERGER

As the name suggests, this kind of merger occurs when one company purchases another.

The purchase is made with cash or through the issue of some kind of debt instrument; the sale is taxable.

Acquiring companies often prefer this type of merger because it can provide them with a tax benefit

Acquired assets can be written-up to the actual purchase price, and the difference between the book value and the purchase price of the assets can depreciate annually, reducing taxes payable by the acquiring company.

Consolidation Mergers

With this merger, a brand new company is formed and both companies are bought and combined under the new entity. The tax terms are the same as those of a purchase merger.

VARIETIES OF ACQUISITION

As you can see, an acquisition may be only slightly different from a merger.

In fact, taking into consideration what stated before, it may be different in name only.

<u>Like mergers</u>, acquisitions are actions through which companies seek economies of scale, efficiencies and enhanced market visibility.

VARIETIES OF ACQUISITION

In an acquisition, as in some of the merger deals we discuss above, a company can buy another company with cash, stock or a combination of the two.

Another possibility, which is common in smaller deals, is for one company to acquire all the assets of another company. Company X buys all of Company Y's assets for cash, which means that Company Y will have only cash (and debt, if they had debt before).

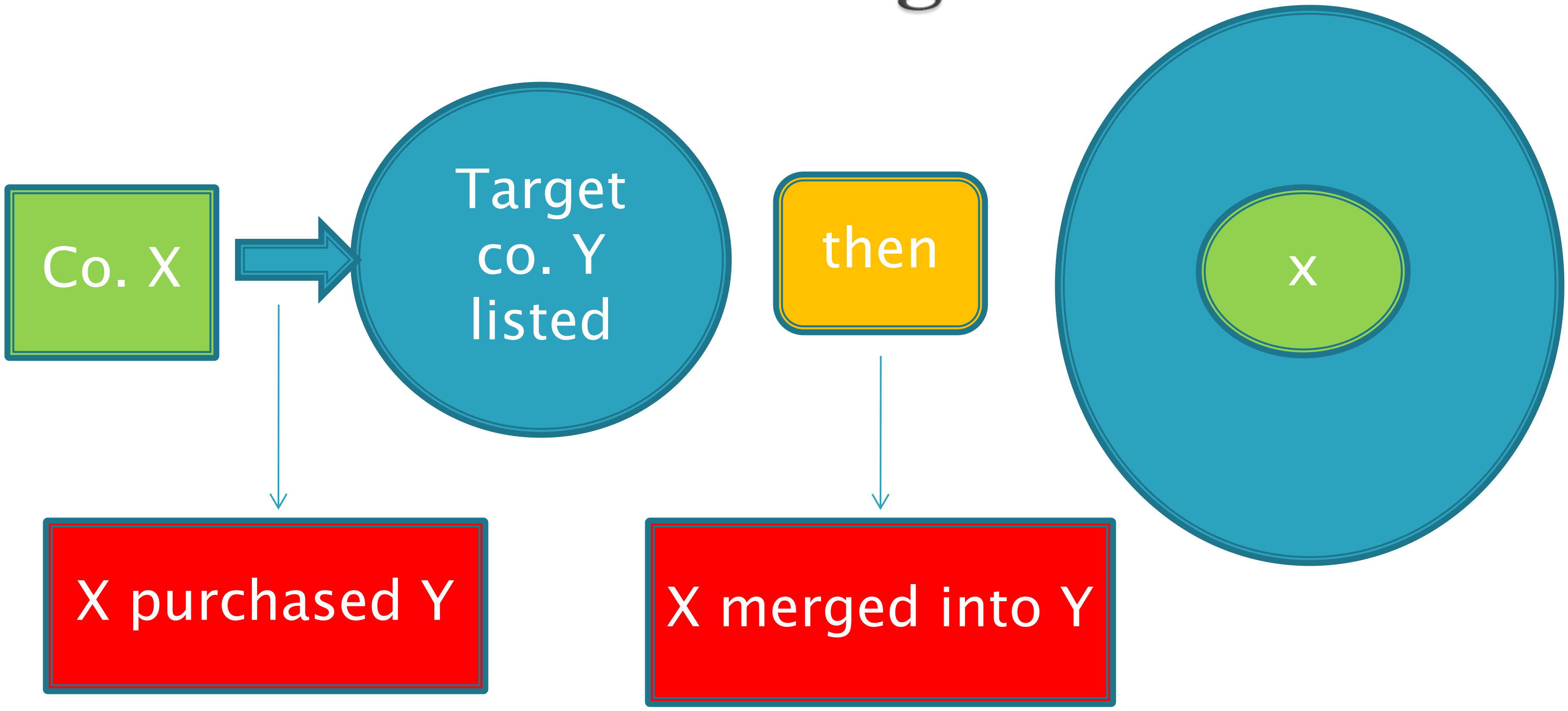
Of course, Company Y becomes merely a shell and will eventually liquidate or enter another area of business.

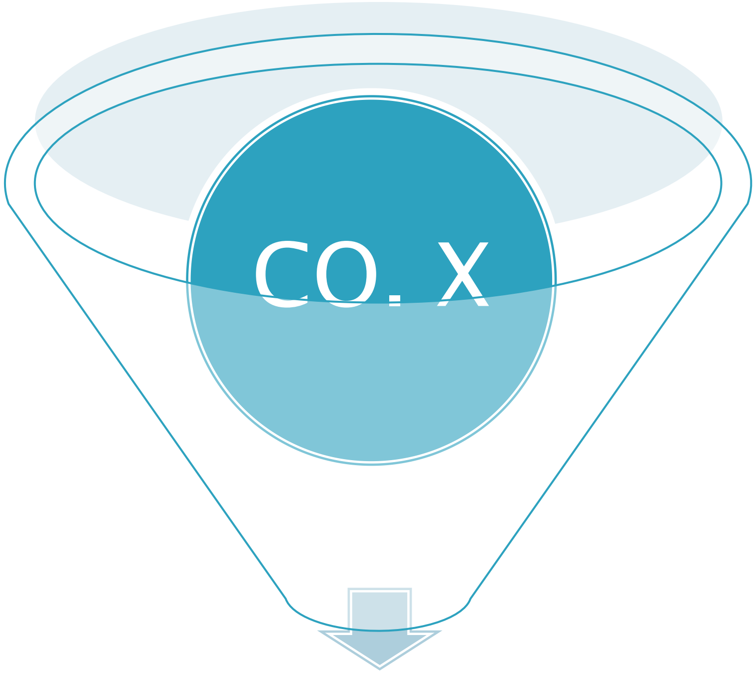
Another type of acquisition is a <u>reverse merger</u>, a deal that enables a private company to get publicly-listed in a relatively short time period

A reverse merger occurs when a private company, that has strong prospects and is eager to raise financing, buys a publicly-listed shell company.

The private company reverses merger into the public company, and together they become an entirely new public corporation with tradable shares.

Ex. Of a reverse merger





CO. Y = REVERSE MERGER

- **Reverse takeover (reverse IPO) is the acquisition of a public company by a private one to bypass the lengthy and complex process of going public. The transaction typically requires reorganization of capitalization of the acquiring company.**

- In a reverse takeover, shareholders of the private company purchase control of the public shell company and then merge it with the private company. The publicly traded corporation is called a "shell" since all that exists of the original company is its organizational structure.
- The private company shareholders receive a substantial majority of the shares of the public company and control of its board of directors.

NEGOTIATION

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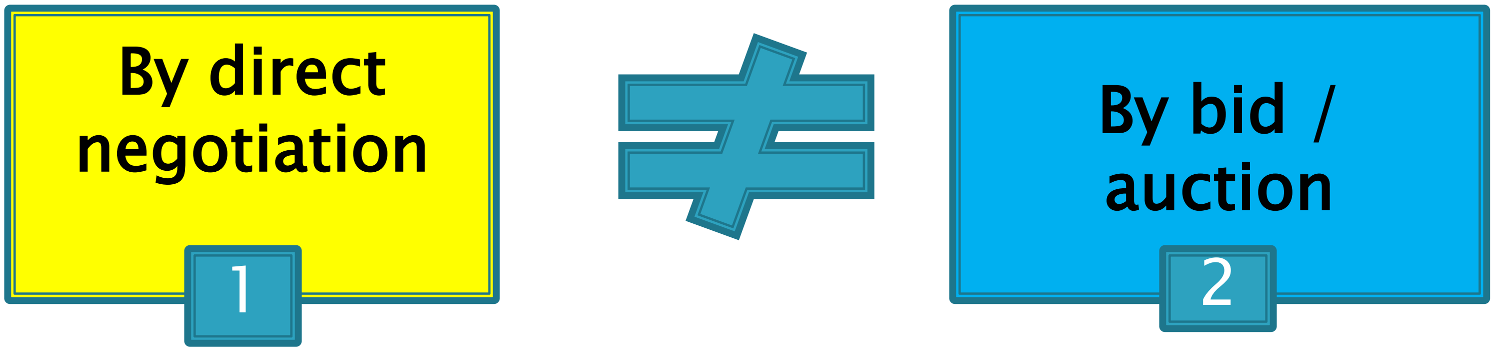
The M&A procedures can be conducted by means of two different approaches:



1 and 2 differ from the steps that have to be performed in order to get the M&A.

BY DIRECT NEGOTIATION

The seller negotiates with a specific buyer.

The parties negotiate directly, sometimes by means of a law firm. The parties generically bind themselves not to negotiate with third parties for a fixed period.

In order to accomplish the M&A procedures the parties shall have to go through the steps set out afterwards:

signing a confidentiality and non-disclosure agreement

Signing of an Information Memorandum.

Signing of a Letter of Intent

Due diligence

Signing of a Sale&Purchase agreement

By bid

- **This way is characterised by a more complexity, but it is indeed more used in the praxis.**

- The auction process will typically be used where the business in question is substantial one or one which is likely to attract a fair amount of interest from potential buyers, as seller are likely to conclude that **the competitive nature of the process is more likely to enable them to maximise the price which they receive than the negotiation with one particular buyer.**

- Sometimes the seller company decides to entrust a bank with the searching of the likely purchasers.

The foremost steps

1. **detecting the likely purchasers**;

2. signing of a confidentiality and non-disclosure agreement;

3. the likely purchasers issue a non-binding bid indicating the price for the purchase

4. the seller proceeds with the screening of the bids;

5. the bidders are invited to proceed with the due diligence procedures

6. the likely purchasers are invited to formulate a binding bid

7. the binding bid are formulated over a pattern of binding bid as prepared by the seller.

8. the bidders shall have to hold the bid for a fixed period of time;

9. the seller chooses the bid;

10. signing of the sales and purchase agreement.

Confidentiality Agreement – Non-disclosure agreement

In the common praxis the seller is likely to be required to provide certain amount of information about the business to any prospective buyer before detailed negotiations can begin.

However unless and until a binding sale and purchase agreement has been entered into, **a seller will almost certainly want to keep confidential the fact that the business is "for sale"** and the fact that discussions/negotiations are taking place with one or more interested buyers.

Ex.

The fact that the business is on sale may well unsettled its employees (who are likely to be distracted by concerns as to who the new owner might be and how a change of ownership may impact on them) and once the news (or even rumors) that business is up for sale reaches "the trade", relationships with customers and suppliers may suffer.

A **non-disclosure agreement** (NDA), also known as a **confidentiality agreement**, is a legal contract between at least two parties that outlines confidential material, knowledge, or information that the parties wish to share with one another for certain purposes, but wish to restrict access to by third parties.

It is a contract through which the parties agree not to disclose information covered by the agreement.

An NDA creates a confidential relationship between the parties to protect any type of confidential and proprietary information or trade secrets. As such, an NDA protects non-public business information.

Some common issues addressed in an NDA include:

1. **outlining the parties to the agreement**;

2. **the definition of what is confidential**, i.e. the information to be held confidential. Modern NDAs will typically include a list of types of items which are covered, including unpublished patent application, know-how, schema, financial information, verbal representations, customer lists, vendor lists, business practices/strategies, etc;

3.the **exclusions from what must be kept confidential**;

4.the **term (in years) of the confidentiality, i.e. the time period of confidentiality**;

5. **the term (in years) the agreement is binding**.

The NDA can be

mutual: when the parties undertake the non-disclosure duty one to another and vivce versa;

unilateral: when only one part undertakes the non-disclosure duty.

CONDIFENTIALITY AGREEMENT TEMPLATE

1. Except to the extent expressly authorised by this Agreement or otherwise agreed in writing, the Parties agree that, for the term of this Agreement and **for a three year period thereafter**, **the receiving Party shall keep confidential and shall not publish or otherwise disclose or use for any purpose other than as provided for in this Agreement any Know-How information and other information and materials furnished to it by the other Party pursuant to this Agreement** (collectively, "confidential information"), except to the extent that it can be established by the receiving Party that such confidential information:

a) was already known to the receiving Party, other than under an obligation of confidentiality, at the time of disclosure by the other Party;

b) was generally available to the public or otherwise part of the public domain at the time of its disclosure to the receiving Party;

2. Each Party may disclose confidential information hereunder to the extent such disclosure is reasonably necessary in filing or prosecuting patent applications, prosecuting or defending litigation, complying with applicable governmental regulations provided that if a Party is required by law or regulation to make any such disclosure of the other Party's confidential information it shall give reasonable advance notice to the other Party of such disclosure requirement and, except to the extent inappropriate in the case of patent applications, will use its reasonable efforts to secure confidential treatment of such confidential information required to be disclosed.

3. **This Article shall survive the termination or expiration of this Agreement for a further period of three years from the date of termination or expiration**

INFORMATION MEMORANDUM

Where the seller is negotiating individually with a specific buyer, it is likely to be the buyer who specifies the information that he requires, but **where a formal auction process is undertaken, the seller will need to make sure that the same information is given to all prospective buyers**

And

this is normally done by preparing an information memorandum relating to the business and distributing it to prospective buyers.

The information memorandum will normally be prepared by the seller's lead advisers, but on the basis of the information provided by the seller and, where relevant, by seller's solicitors and other professional advisers.

The information to be given can be as extinsive or as limited as the seller may choose.

The Information Memorandum will contain summary of the sale process and this is likely to include:

1. the proposed timetable;

2. required format and contents of bids;

3. the procedure for submitting bids.

The Information Memorandum will typically include the following information about the target company or business:

Executive summary, including key strenghts and future strategy;
Its history;
Its current ownership;
A description of the business;
Products and services;
Patents, trademarks and other intellettual property rights;
A summary of the market in which the business operates;
The business's position in the market;
Customers and suppliers;
Directors and senior management;
Organisational structure;
Employees;
Management information and IT systems;
Financial records;
Current tradings and future prospects.

DUE DILIGENCE

DEFINITION

- **Due diligence is the process by which the buyer and his professional and others advisers will investigate the target business and its assetts and liabilities before entering into a legally binding sale and purchase agreement**.

- The extent of the due diligence work to be carried out on any particular transaction will also depend on other cirmustances, such at the time available to the buyer for such work to be done and the importance of the transaction to the buyer.

The buyer, in this step, should regard warranties and indemnities as very much fallback position and should instead carry out as much investigation as possible into what he is buying before entering into a legally binding sale&purchase agreement:

in this way, if a major issue does come to light before then, the buyer will have the chance to negotiate a specific indemnity or retention to cover the issue, may be able to negotiate a price reduction which takes account of it or, as a last resort, may walk away from the deal altogether.

There are two MAIN different types of due diligence

Financial due diligence

Legal due diligence

Financial due diligence

Financial due diligence investigations typically provide an appraisal of financial matters (such as accounting policies and methodologies, trading results, assets and liabilities), as well as the provision of information on other areas such as employesss, management organisations and system

The main purposes of financial due diligence investigations include:

1. to identify any issues or areas of risk of which the buyer and any funders may not be already be aware and which may effect the purchase agreements;

2. to confirm the reasonableness of the key financial information presented by the seller;

3. to assist the buyer in determing the purchase consideration;

4. to identify matters in respect of which the buyer should seek warranties and indemnities from the seller;

5. to assess the level of ongoing working capital requirements for the target business.

Legal due diligence

Legal due diligence will normally consist of a number of different elements, such as:

- **enquiries of the seller**;

- **Searches and enquires of public registers** (such as the register of companies at Companies House and the Land Registry and other property rights);

- **A review of the information provided by the seller**.

Legal due diligence

Where the sale is taking place by way of competitive auction, rather than submitting enquiries, the buyer and his solicitors will normally review the "pre-packaged" due diligence information provided by the seller and carry out any additional legal due diligence which may be regarded as appropriate.

The legal due diligence will normally focus on the following aspects:

1. **Legal compliance**: the Buyer will want to be satisfied that the Seller has obtained all licenses, permits and other regulatory approvals which are required in order to enable the business to be carried on or which should ideally be obtained.

2. **Title to the assets of the business**: the Buyer and in his turn the Seller will need to make sure that the target company owns all of the assets which are needed to use the target company and in order to enable it to carry on its business. I.E.: if there is a valid lease, hire, rental or licence agreement.

- **3. Intellectual property rights:** a search can reveal details of both pending and granted trade marks and patents.

- **4. Employees:** as with other contracts, on a sale and purchase of shares the contracts of employment of the employes of the business will continue with the target company, notwithstanding the change of ownership of that company. **The buyer**, therefore, will need via the due diligence exercise, to identify the employees of the business, **obtains details of their contractual terms of employment and other employment – related agreements**.

DATA ROOM

The Data Rooms are part of the due diligence procedure.

It represents the place where phisically the legal and financial due diligence occurred.

The aim is to consent the Vendor, from one part, to disclose all the confidential documentation related to its business, and to consent the proposed bidders, from the other part, to analyse it.

DATA ROOM

The traditional data room are a physically secure room, continually monitored, normally in the vendor's offices (or those of his lawyers), **which the bidders and their advisers will visit in order to inspect and report on the various documents and other data made available**.

Often a normal due diligence procedure might take from 1/ 2 days up to weeks.

LETTER OF INTENT

▸ **The letter of intent term sheet establishes the framework for the entire transaction.**

What does a letter of intent set out?

It sets key commercial and possibly legal terms, it sets the timeline for the deal and establishes the legal back drop (and leverage) for later negotiations.

IN OTHER WORDS

A Letter of intent or LOI is a document outlining an agreement between two or more parties before the agreement is finalized.

The concept is similar to the so-called heads of agreement.

The primary purpose of a Letter of Intent or 'LOI' is to facilitate the start of a specific business deal or project between 2 or more entities, or for the prospective purchase of a company and/or their assets.

By identifying the key business and contractual understandings which will form the basis of the final contract, LOI's can provide the vital bridge between mere oral discussions/ understandings and a future binding written agreement.

WHICH ARE THE PURPOSES OF A LOI?

a. To clarify the key points of a complex transaction for the convenience of the parties.

b. To declare officially that the parties are currently negotiating.

c. To provide safeguards in case a deal collapses during negotiation.

A LOI may also be referred to as a ***memorandum of understanding*** **(MOU) or Letter of Understanding.**

The different terms reflect different styles, but do not indicate any difference under law.

Binding vs. Non-binding?

- LOI's practice to be non-binding except for certain protective provisions

typically exclusivity, confidentiality, payment of fees, etc

IN OTHER WORDS

LOIs resemble written contracts, but are usually not binding on the parties in their entirety.

Many LOIs, however, contain provisions that are binding, such as **non-disclosure agreement**, **a covenant to negotiate in good faith**, or a **"stand-still" or "no-shop"** provision promising exclusive rights to negotiate.

A LOI may also be interpreted as binding if it too closely resembles a formal contract.

Binding vs. Non-binding:

If the LOI is to be non-binding it must clearly express this intent. Usually this purpose is pursued by inserting within the LOI the wording:

"SUBJECT TO CONTRACT".

ACQUISITION AGREEMENT

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ACQUISITION AGREEMENT

The Acquisition Agreement

is the contract governing

the merger of two

or more companies.

The structure of the acquisition will be determined by a variety of accounting, business, legal, and tax considerations.

Pre-Closing Covenants

The second major feature of merger and acquisition agreements is the inclusion of various pre-closing covenants, or promises to do something, or not do something, during the period between the signing of the acquisition agreement and the closing

2 types covenants

positive

negative

Negative covenants restrict the seller from taking certain actions prior to the closing without the buyer's prior consent.

Negative covenants include:

not changing accounting methods or practices;

not entering into transactions or incurring liabilities outside the ordinary course of business or in excess of certain amounts;

not paying dividends or making other distributions to stockholders;

not amending or terminating contracts;

not making capital expenditures;

not transferring assets;

Affirmative covenants obligate the seller or the buyer to take certain actions prior to the closing.

Typical affirmative covenants include:

(a) **allowing the buyer full access to the seller's books, records, and other properties;**

(b) **obtaining the necessary board and stockholder approvals;**

(c) **obtaining the necessary third party consents; and**

(d) **making the required governmental filings and obtaining the required governmental approvals.**

Conditions to closing

Merger and acquisition agreements generally also contain several conditions to closing, which are certain obligations that must be fulfilled in order to legally require the other party to close the transaction.

Such as corporate approvals and
governmental filings and approvals,
compliance with a particular condition to closing
may be waived by the party that benefits from the condition.

All merger and acquisition agreements provide

that, **as a condition to closing**, **the representations and warranties of the parties must be true and correct at the closing,**

- **and that the pre-closing covenants have been performed or fulfilled prior to the closing.** <u>This is generally confirmed by each party delivering a written certificate to that effect to the other party.</u>

Other typical conditions to closing include:

(a) receipt of the necessary third party consents;

(b) receipt of the necessary governmental approvals;

(c) receipt of legal opinions and other closing documents;

(d) receipt of certain financial statements or the achievement of certain financial milestones;

(e) receipt of employment or non-competition agreements from key employees; and

(f) satisfactory completion of the buyer's due diligence of the seller's business.

Indemnification

Indemnification provisions protect the parties from certain matters that occur after the closing and allocate the risks and responsibilities for these occurrences between the buyer and the seller.

Indemnification provisions typically address breaches of covenants or representations and warranties that are discovered after the closing.

An example is pending litigation, the outcome and amount of damages of which cannot be predicted and reflected in the purchase price.

Therefore, the buyer may require the seller to remain responsible for the litigation after the closing. The buyer may also request separate indemnification for environmental and tax liabilities beyond the seller's representations and warranties.

Example

The Vendors hereby agree that they shall indemnify and keep indemnified the Purchaser against any loss incurred or liable to be incurred by reason of any claim for any taxation (to the extent that such claim exceeds the amount of any provision or reserve therefor in the Company's accounts) **made against the Company or any Subsidiary where such claim arises out of the conduct of business of the Company or such Subsidiary or out of any action or omission of the Company or such Subsidiary before Completion.**

INTRODUCTION
PURCHASE PRICE ADJUSTMENT

A business is a dynamic thing and a Merger and Acquisition ("M&A") transaction must account for this dynamism.

Unlike most any other asset that can be bought or sold, a business cannot be held in stasis while the parties work out the terms of the deal.

It must continue to operate and, inevitably, there will be some changes in the financial condition of the business before the transaction closes.

To account for these changes, the purchase price adjustment process ("PPA") is commonly used in M&A contracts.

Overview

Purchase price adjustments are used when there is a period of time between the signing and closing of the acquisition.

A target's value is usually determined on the basis of the most recent financial information available at the time of pricing.

Generally, the purpose of a purchase price adjustment provision is to reflect changes in certain values of the target between the signing of the acquisition agreement and the closing date.

The purchase price adjustment shall be reasonable under several points of views:

The length of the pre-closing period varies, but is often one to three months.

So **it bridges the gap between the financial condition of the seller at the time of signing the definitive purchase agreement and its condition as of the closing date.**

An additional rationale for use of a post-closing adjustment is that it effectively allocates the economic risks and profits of continued operations during the pre-closing period. The post-closing adjustment usually (but not always) allocates to the seller the economic risks and profits of continued operation of the target during this period.

BASIC STEPS

- 01 - PRE DEAL
- 02 - PRELIMINARY EVALUATION
- 03 - DUE DILIGENCE
- 04 - NEGOTIATION & SIGNING
- 05 - CLOSING
- 06 - INTEGRATION
- 07 - POST DEAL