
Legal Representation in Middle Market Mergers and Acquisitions

Investment banking services provided by Grand Avenue Capital will not include legal, accounting or tax advisory work and it is expected that Grand Avenue clients will employ separate team of legal, accounting and tax advisers in connection with engagements with the firm. Having competent legal representation is absolutely critical in managing the transaction when the "business people", the sellers and buyer of a business are serious about closing a transaction

The purpose of this guide is to provide an overview of the legal aspects of the M&A transaction, and possible save interested parties time, money and aggravation.

M&A and capital equity raising transactions are not "business as usual," for the business owner of a private middle market company, they are "extraordinary transactions." Obtaining legal representation appropriate to the transaction can make the difference between a success and an abject failure. Herein, you will find a summary of the role of a lawyer, some basic tips on selecting the right lawyer, and a summary description of the services that a lawyer typically performs in representing a client who is a party to an extraordinary transaction.

Lawyers, first and foremost, represent their clients' interests, and typically practice in areas of specialty. Lawyers whose practice is general business activities, or labor, or family law would not be the best choice in advising in an M&A transaction. Although all lawyers practicing in the United States are licensed by at least one state, there is a broad array of different types of law. In the context of M&A, the parties may require legal representation familiar with the legal aspects of taxes, securities, bankruptcy, corporate formalities and shareholder rights, antitrust, real estate, employee rights and benefits, environmental regulations, intellectual property, commercial contracts and any number of other specific areas.

In most transactions, involving the sale or finance of a company, there are at least two parties who have their own legal representation. Each lawyer will conduct diligence with respect to the company in question and will then advise their client of any risks attendant to the transaction or to their client's business following the transaction. Each party's lawyer will assist their client to negotiate and arrive at the most favorable structure and terms for the transaction and to document those terms. The lawyers also manage the process of obtaining third-party consents and government approvals, making required governmental filings, arranging for third-party services (like escrow agents and title insurance) and organizing and executing the closing of the transactions so that all of the documentation is properly executed and delivered to each party. Depending on the transaction, a party's lawyer may also provide a legal opinion as to certain aspects of the transaction.

What You Need to Know

The selection of legal representation with the appropriate specialization is critical to achieving your objectives. When selecting legal representation for the purchase or sale of a company or significant business unit, you should consider the following factors:

1. Seek extraordinary counsel for your extraordinary transaction. You may have a wonderful relationship with a lawyer who has served you as outside counsel and trusted adviser for as long as you can remember. Even so, before signing them on to represent you in an extraordinary transaction, be certain that they have the required expertise and resources.
 - (a) More often than not, the lawyer who has provided excellent counsel for all manner of general business issues, contract negotiation, litigation management, etc., has little or no experience with anything but the smallest of merger/acquisition transactions. No doubt, the institutional knowledge possessed by that trusted adviser will be very useful and there is a role for them in the transaction process. That should not, however, be in structuring and negotiation of the transaction.
 - (b) Similarly, you will need legal representation with resources (man power) appropriate to the transaction. For most middle market transactions, the legal team should be no less than an experienced partner and a reasonably senior associate, together with an experienced paralegal, each experienced in corporate and commercial transactions, and the constellation of legal subject matter experts (tax, environmental, real estate, etc).
2. Your company may not be ready. If you are selling a company, you will need to present every aspect of the company for all would-be buyers to evaluate. There are many technical legal matters that may or may not have made a difference to the company's operations that you must now address. Failure to address these items (or at least to recognize them) ahead of time can cost you time and money and potentially result in litigation. Even as a buyer, you need an understanding of how your existing organization's structure functions and how you want to fit in the new acquisition. Moreover, if you are planning on issuing securities to the sellers as consideration, unless you are a public company, you should expect that the sellers will want to take a close look at your company before they will close a transaction. The right legal representation will guide you through the right moves to make before you go looking for your transaction partner.

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3. Things that matter and things that don't. Just like any other service-based professionals, lawyers will pitch their own combination of expertise, price and brand name prestige in an attempt to earn your engagement. When selecting an attorney to represent you in the purchase or sale of a company, keep in mind the following:
 - a. Bigger may not mean better. There are plenty of giant, international law firms that will be happy to charge you top dollar to guide you through a transaction. If you are doing a transaction with over a billion dollars of enterprise value, your transaction involves purchase of operations in ten different countries, your transaction will undergo scrutiny under a somewhat esoteric set of regulatory guidelines (insurance, banking, mining, etc.), or your transaction requires a particularly complicated structure, then paying the big firm bill might be a good idea. For most middle market transactions, however, representation by smaller to mid-size firms will be far less expensive and may be of a higher quality as well.
 - b. The sector in which a company does business usually has little to no impact on the legal requirements of the transaction. Experienced merger and acquisition counsel can adapt to the basic legal requirements of most sectors and industries. Exceptions are industries with highly specific and complex regulatory compliance issues, and companies with products and services so technical as to require legal representation with a science background to understand the nuances of the company's product (and even that is not usually a problem for reasonably experienced attorneys with access to subject matter experts).
 4. Your lawyer is **not** your investment banker. Although some lawyers may use their connections to help you find a buyer or seller, most do not have their pulse on the current market conditions and valuations. Moreover, lawyers are almost never set up to conduct an auction process or a green field search for the right acquisition target. Middle market companies will almost always find that the investment banker will be a valuable member of the team. In actuality, the investment banker should be the "quarterback" for the transaction, coordinating legal, accounting and other advisers for their clients.
 5. Don't hire the "C" team if they pitched you the "A" team. This is a particular problem for the middle market business. Most of the larger law firms are built with a pyramid structure involving few partners at the top and lots of junior associates at the bottom. The bigger the firm, the bigger the fees generated by the transaction need to be in order to keep the attention of that top partner that you spoke to in the pitch meeting. Although the junior to mid-level associate who may lead your deal is very "smart," there is no substitute for experience. Your transaction may not go as smoothly as you hoped, and your fees may ultimately be significantly higher.

Process, Responsibilities, Deliverables

The legal services required for most transactions run a varied path from initial structure through post-closing matters. Typically, your counsel will perform the following services; in more or less the following order:

1. **Preparation for a transaction.** For a sell side transaction, or a buy side transaction in which securities will be included in the purchase consideration, a little attention at the start of the process can prevent big (and costly) problems later. The target/issuer should be clean for diligence and optimized for tax purposes. Counsel should verify that the company has taken reasonable actions to minimize potential issues relating to:
 - a. the company's governing documents and records;
 - b. litigation;
 - c. assignment of material contracts;
 - d. labor and employment issues that may arise in the context of a transaction;
 - e. ownership of intellectual property;
 - f. real property, including environmental matters; and
 - g. any other matters material to the company's operations, assets and liabilities.

2. Letter of Intent

A letter of intent ("LOI"), also called a memorandum of understanding, is usually (unless it is solely to start discussion) an agreement between the parties. An LOI usually does not bind the parties other than with respect to certain specified terms. Terms common to most LOIs in the merger and acquisition context include:

- a. **Structure of the transaction:** which may involve a merger (purchase of all of the target company's outstanding equity, a securities transactions), an acquisition (purchase of some or all of the target's assets/liabilities) or one of several combinations of the two. Creating a transaction structure also includes the choice of the most appropriate forms of organization (e.g. corporation, limited liability company, partnership, etc.). Transaction structure can be very complex and will depend in part on:
 - (i) desired tax effect;
 - (ii) level of difficulty in transferring material contracts, and governmental authorizations;
 - (iii) requirement and amount of difficulty of obtaining shareholder consents;

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- (iv) buyer's strategy for integrating the target into its organizational structure; and
 - (v) many other factors that may be unique to the transaction in question.
- b. **Consideration for the transaction:** which is the compensation that the buyer provides to the seller, may include:
- (i) cash;
 - (ii) equity of the buyer (including preferred equity, warrants and debt convertible to equity);
 - (iii) license(s) to use intellectual property; and
 - (iv) debt, which may be secured or not.
- c. **Procedure, timing of payments:** which may include:
- (i) an earn out;
 - (ii) payment in installments, which may be conditional;
 - (iii) and maybe a hold back in escrow to satisfy the seller's post transaction indemnity obligations.
- d. **Diligence procedures** according to which one or both of the parties may conduct diligence to ascertain if they actually want to complete the transaction described in the LOI.
- e. **Contingencies to closing the transaction,** which may include:
- (i) buyer's ability to obtain financing;
 - (ii) either or both parties' ability to obtain required authorization from shareholders and/or a board of directors;
 - (iii) obtaining necessary government approvals;
 - (iv) completion and satisfaction with due diligence investigations;
 - (v) agreement by seller's key personnel to not compete with, and/or continue working with the buyer for some time period following the closing of the transaction;
 - (vi) completion of other transactions (which may be with third parties);
 - (vii) other terms a party desires to include to avoid surprising the other party during the agreement negotiation process; and
 - (viii) other standard contingencies to be "negotiated in good faith by the parties."
- f. **Representations and warranties** of the parties often left to be "negotiated in good faith by the parties." These will be found in detail in the definitive agreements.

- g. **Terms of indemnification**, of the parties often left to be “negotiated in good faith by the parties.” These will be found in detail in the definitive agreements. which may include:
- (i) the specifics of which parties must indemnify which other parties
 - (ii) the conditions required to trigger indemnification obligations;
 - (iii) whether an indemnifying party may control the defense from a third-party claim;
 - (iv) the amount of any holdback of consideration; (v) the conditions required to trigger payment of the held-back consideration to a party (often a time schedule for payment to seller) and (vi) the amounts of any threshold or cap to the amount of funds subject to indemnification.
- h. **Period of Exclusivity**: To allow due diligence to be conducted the LOI will specify a "no shop" provision. However, a “go shop” provision may be a part of this that specifies a time period during which the seller may continue to market the company.
- i. **Confidentiality provision**: which may be unilateral or mutual, that obligates the parties to prevent the disclosure or improper use of each other’s “Confidential Information.” An nda most likely will have been executed between the parties prior to the LOI.

Generally, the terms of an LOI are non-binding (exceptions being the “no/go shop” and confidentiality provisions). Depending on the sophistication of the investment banker, an LOI may be drafted by competent legal counsel. The LOI is the blueprint for the transaction and gives guidance to the legal team drafting the definitive agreements. Once signed, the parties rightfully expect that the terms of the transaction will reflect the terms of the LOI.

However, counsel engaged *after execution* of the LOI may find that the terms of the LOI will:

- (i) increase transaction costs;
- (ii) create unexpected losses;
- (iii) result in missed opportunities; or that the terms in the LOI would result in an illegal or commercially impossible result.

3. Diligence.

Upon execution of the LOI, counsel for the Buyer will send counsel for the Seller a diligence request letter. These letters can be very long and are often overly broad. Each of Buyer's and Seller's counsel will review all of the available material information about the target's assets, liabilities, historical operations and near-term prospects. Buyer will use the information from the review to determine whether to pursue, renegotiate or abandon the transaction. Each counsel will rely on the information to negotiate the final terms of the transaction; and will also advise their client of any possible unintended consequences that may result from the transaction. Complete disclosure of all material information is the surest way to avoid post-transaction litigation between the parties.

Readers are directed to the **Due Diligence** section of the **Knowledge Base** of the Grand Avenue website for typical data required in due diligence.

4. The Purchase Agreement / Definitive Agreements

A completed purchase agreement will include:

- (i) a description of the target's equity or assets being purchased and the purchase consideration;
- (ii) mechanics for the exchange of consideration;
- (iii) representations, warranties and covenants;
- (iv) obligations of the parties' during the period between agreement execution and closing; (v) documents or conditions required prior to the closing;
- (v) post closing obligations of the parties; and
- (vi) tax elections, dispute resolution, and standard "boiler plate" items.

5. Drafting and continued negotiation

Using the LOI, the parties' respective counsels negotiate and draft the purchase agreement and other required documents. As part of the process, counsels address material matters discovered through the diligence process. Counsel will review the key documents with their client to obtain information and discuss the legal effect of the language in the documents. Counsel will also provide guidance as to sticking points in the negotiation, including matters discovered through the diligence process, and provide potential solutions.

6. Execution and closing.

Upon conclusion of the drafting process, the parties execute and become bound by the purchase agreement. Counsel now works with their client to satisfy any conditions precedent to the closing. Depending on the transaction, the parties may each need to:

- (i) take required organizational actions including obtaining approval from their equity holders and governing bodies; and
- (ii) obtain third-party and governmental consents and approvals;
- (iii) negotiate the terms of any ancillary agreements (e.g. shareholder agreements, employment/consulting agreements, license agreements, etc.);
- (iv) draft and review any number of ancillary closing documents (officer certificates, legal opinions, government filings, etc.). Additionally, if required, Buyer's counsel will also negotiate and draft documents required to accomplish Buyer's finance of the purchase consideration.

When all parties (buyer, seller, financiers and other third-parties) have approved the form of all of the documents applicable to them and all other conditions to the closing are completed or waived, the parties' counsels run the closing, overseeing the complete execution and delivery of documents in the correct sequence, the exchange of the company/assets for the purchase consideration.

7. Post closing matters.

Following closing, one of the parties' counsels will organize, bind and distribute full sets of executed closing documents. Counsel will also make any required government filings and assist in the drafting of any press release. After the immediate post closing matters are complete, counsel will continue to advise their client with respect to long term matters (e.g. release of held-back purchase consideration, calculation and payment of earn-outs, etc.) and application of the deal documents to real world circumstances (litigation avoidance).

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GRAND AVENUE CAPITAL LLC

INVESTMENT BANKERS

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Grand Avenue Capital Partners is a FINRA licensed broker/dealer authorized to manage security transactions and merger/acquisitions. Our firm's bio is attached which includes the backgrounds of our team and advisers.

Our firm focuses on sell- and buy-side investment banking assignments for domestic North American client companies with revenues \$10-200 million which are typically profitable and established. We are prepared to serve clients globally; approximately 25% of our practice is in Asia where we have been involved in substantially larger transactions with world-scale companies and investors. We have been engaged by private companies in China with up to \$2.6 billion in revenue, seeking growth capital private equity placements. We have managed investment banking assignments in Europe, Mexico and Asia and understand the complexities of cross border transactions.

Our principals and advisers have owned and operated companies of the type we seek as clients. We have manufactured and sold products, managed extensive work forces and as owners, generated profits and cash flows. Accordingly, we have great affinity with the business owners and entrepreneurs we work for.

We maintain a proprietary data base of institutional investors (over 1,300 such groups worldwide) wherein we have cataloged their investment/acquisition criteria. Matching these criteria with clients' needs is a routine activity for us in making a market for private companies. Our particular expertise is to similarly cultivate strategic investors/acquirers developing the specific operating synergies that match our clients' parameters.

We welcome your input and referrals regarding companies wishing to grow through acquisition, companies whose owners are interested in selling their businesses, and divestitures of divisions of public companies. We also welcome the opportunity to review business plans that would require capital via equity or debt placements. Currently, all our active engagements came from referrals.