ASSET AND SHARE PURCHASE AGREEMENTS

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Presentation to
Insight Information
Negotiating and Drafting Major Business Agreements **Toronto, February 2 - 3, 2009**

Purchaser Considerations

- **Strategic Analysis of the Transaction**
  - ❖ Multiple growth
  - ❖ EBITDA growth
- **Avoid Mistakes Regarding Expected Synergies**
  - ❖ Avoid overpaying
  - ❖ Unjustified Assumptions (the “Benny Hill Principle”)
  - ❖ Poor Financing
  - ❖ Poor Due Diligence
  - ❖ Mismanaging Post-Transaction Integration
- **Why M&A Succeeds**
  - ❖ Strong strategic fit
  - ❖ Price discipline, objective modeling and strategic risk analysis
  - ❖ Thorough due diligence including modeling tied to financing and GAAP adjustments (avoid *“Financial Shenanigans”)*
  - ❖ Post-deal integration well-conceived and rapidly implemented
  - ❖ Financing tied to strategy
  - ❖ Management resources and return on management (ROM)

Seller Considerations

- **Value Enhancement initiatives**
- **Stapled Financing**
- **Auctions**
- **Confidentiality of process**
- **Confidentiality of Data**
- **Employee retention**
- **Limiting Exposure for Reps/Warranties/Indemnities**
  - ❖ *See "Ludmer's Top 25"*
- **Securities Law Issues**
- **Investor relations**
- **Public relations**
- **Post deal consulting vs. rights under the Purchase Agreement and non-Competition Agreement**

Purchase Agreements

- **Lots of precedents <u>from a buyer's perspective</u>**
  - ❖ABA Section of Business law Committee on negotiated Acquisitions
  - ❖Sale of a Business 7th ed. Jennifer Babe, LexisNexis
  - ❖EDGAR; SEDAR; LIVEDGAR; Other commercial Co.
- **Ultimate Seller's Agreement – *"as is/where is"* purchases from a receiver or Trustee in Bankruptcy**
- **Purchase price formulations and adjustments**
- **Defining GAAP in the PA**
  - ❖A moving target
  - ❖IFRS – more principles based and not as much guidance yet
  - ❖Coordinate with credit agreements

2008 Canadian Private Target M & A Deal Points Study (ABA Section of Business Law)

- **63% had post-closing adjustments (of that working capital; other and debt were the most frequent)**
  - Only 1/3 had preliminary adjustment on closing and of those 2/3 had no right of buyer to approve the preliminary adjustment
  - 95% had no threshold for adjustment
  - Sometimes seller prepares, sometimes buyer
  - Methodology mostly "GAAP consistent with past practice" but lost silent
- **Earn outs in only 10% of deals (revenue/EBITDA/combination)**
  - Most frequently no covenant re how buyer to run the business or else consistent with past practices
  - 86% accelerate on a change of control
  - 71% have no offset provision re indemnities
- **Only 1/3 had "accurate and complete" financial rep**
- **Those with a "fair presentation" rep did not GAAP-qualify in 81% of deals**

2008 Canadian Private Target M & A Deal Points Study (ABA Section of Business Law)

- **No undisclosed liabilities**
  - 71% included as to “all liabilities
  - 23% no rep
  - 6% included but limited to GAAP
  - Where included: 84% did not qualify the rep by “knowledge”
  - Other qualifications: disclosure schedules(61%); ordinary course of business (60%); reflected or reserved on balance sheet (72%); immaterial (24%)
- **Compliance with law rep**
  - Included in 92% of deals; sometimes qualified by knowledge; usually past and present and includes notice of violation (but rarely notice of investigation)
  - 23% no materiality qualifier
- **Conditions re reps**
  - 79% have no express provision re “when made”
  - 98% of deals have a bring down certificate and condition
  - 49% of deals have no materiality condition on closing
  - 50% of deals have a “double materiality” problem

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2008 Canadian Private Target M & A Deal Points Study
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- **Buyer's Conditions**
  - 67% of deals have a MAC as a standalone condition
  - 70% have "any legal proceedings" (private and government)
    - Most including threatened proceedings and no materiality qualifier
  - Legal opinions required in 72% of deals
- **Indemnification (escrows in only 29% of deals and generally not exclusive)**
  - 11% silent/unspecified
  - 19% - 12 months
  - 19% - 18 months
  - 37% - 24 months
  - 11% - more than 24 months (3% - forever)
  - Often subsets for different reps (taxes, capitalization, due authorization, ownership of shares, fraud, title, sufficiency of assets)
  - Multiple indemnifiers: silent (41%); several (14%); joint and several (39%); mixed (6%)
  - Damages not limited to out-of-pocket (98%) and generally silent (86%) re diminution in value and lack of clarity (50% - 82% re "incidental", "consequential" and "punitive"

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- **Indemnification baskets**
  - No basket (34%)
  - Deductible (21%)
  - First dollar reversal once threshold exceeded (32%)
  - Combination threshold and deductible (13%)
  - Basket less than 0.5% of deal value 50% of the time; less than 2% of the deal value 92% of the time
  - Basket covers breach of covenants 85% of the time – A CLEAR ERROR
  - Basket carve outs (fraud, capitalization etc.)
  - No eligible claim threshold in 73% of deals
  - Caps as a % of transaction value: PP (52%); more than 50% of PP (17%); less than 10% of PP (14%)
    - Consider rephrasing to equity value, since often debt is non-recourse to buyer parent
    - Cap carve outs – similar to basket carve outs
  - Indemnification: 54% exclusive remedy (with carve outs for fraud, covenants and equitable remedies); 11% non-exclusive remedy; 35% silent

LESSONS FOR M&A AGREEMENTS FROM THE COURTS

- **Leading jurisprudence from 1980's – 2005 related to deal protection measures and take-over bid protection in competitive bidding scenarios**
  - ❖Break fees
  - ❖"fiduciary-outs" and post-agreement market checks
  - ❖"Revlon duties"
  - ❖"window shopping"
  - ❖Purchase options
  - ❖Lock-up and voting agreements
  - ❖Management conflict of interest
  - ❖Recent cases: *Omnicare; Toys R us; Netsmart; Schneider; Sunrise REIT; 2008 Delaware cases*

LESSONS FOR M&A AGREEMENTS FROM THE COURTS

- **Post 2004-mid 2007 M&A frenzy**
  - ❖No more financing driven unjustifiable valuations
    - Post-deal debt unable to be syndicated or if previously syndicated trading well below par
  - ❖Less leverage and harsher debt deal terms
  - ❖Equity sponsors concerned about exit and getting into a fight with their "friends, the financial institutions
  - ❖Instead of *"Let's Make a Deal"* - the new show is ***"Let's Break a Deal"***
  - ❖New acronyms: *"Holdups", LBO ("leveraged buyout remorse"), ADS (Alliance Data Systems – "another deal saga")*

LESSONS FOR M&A AGREEMENTS FROM THE COURTS

- **Unprecedented deal size, financing requirements and length of the "interim period" has lead to stresses from a legal perspective**
  - ❖The Business environment changes
  - ❖The financing environment changes
  - ❖Changes happen within the company's markets and competition
  - ❖Regulatory changes
- **Putting great stresses on drafting**
  - ❖Harman International Handout

LESSONS FOR M&A AGREEMENTS FROM THE COURTS

- **SLM Corp. (Sallie Mae) – J.C. Flowers (settled)**
  - ❖ Regulatory change
- **Harman – KKR and Goldman Sachs (settled)**
  - ❖ See Fortune Magazine Feb. 4, 2008 in depth
  - ❖ Interim period covenant
- **Genesco – Finish Line Inc.**
  - ❖ Seller won MAC dispute but bankers sued alleging insolvency
- **Alliance Data – Blackstone (settled)**
  - ❖ Conditions attached to regulatory approval
- **BCE – Teachers (terminated; target suing for break fee)**
  - ❖ Suit by debt holders re effect on rating
  - ❖ Lessons of the 1980's forgotten "event risk"
  - ❖ Mutual condition requiring solvency certificate not satisfied
  - ❖ See proposals from The Credit Roundtable for standard event risk covenants

LESSONS FOR M&A AGREEMENTS FROM THE COURTS

- **Apollo/Hexion – Huntsman (terminated for break fee)**
  - Buyer in merger alleged insolvency
  - Delaware court in October 2008 ordered buyer to specifically perform its covenants toward completing the transaction
  - Buyer (Hexion) is a subsidiary of private equity firm Apollo Management LP and won a bidding war in July 2007.
  - No financing condition
  - Positive covenant to use "commercially reasonable efforts" to consummate the financing on terms that it had negotiated with its banking syndicate and not to take any actions that "could reasonably be expected to materially impair, delay or prevent consummation" of the financing
  - Break fee of US$325million on a US$10.6 billion deal did not apply if buyer "had knowingly and intentionally" breached its covenants
  - Spring 2008 disappointing results lead to revised modeling
  - Court held: (I) no MAE; and (II) Hexion "knowingly and intentionally" breached its covenants and refused to rule on (II) solvency condition

LESSONS FOR M&A AGREEMENTS FROM THE COURTS

- **Jan. 2009: Dow Chemical faces suit for dodging US$15.3 billion deal for Rohm and Haas Co,**
- **So how do your draft to avoid litigation?**
  - Next to impossible in leveraged deals with long interim periods
  - United Rentals – Cerberus Partners
    - Dec. 2007 decision re interplay between Termination provisions and Specific Performance provision
  - SallieMae – the MAC clause specifically contemplated the legislation in question but was still likely ambiguous
  - Frontier Oil v. Holly Corp. (2005) and IBP v. Tyson (2001) interpreting "general" MAC language
  - Harman – company as a whole vs. by subsidiary gave buyer a negotiating position
  - "Best efforts"
  - "Commercially reasonable efforts"
- **Post-settlement SallieMae's general counsel resigned "for personal and family reasons"**

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