# M&A Spotlight: Demystifying the Process of Negotiated Acquisitions

COHEN & GRESSER

# **M&A Spotlight:** Demystifying the Process of Negotiated Acquisitions

Mergers and acquisitions (M&A), the transactional process by which a business is bought and sold, is an area about which many business executives and even their professional advisers know less than they would like, but do not always feel comfortable asking questions that might reveal gaps in their knowledge. No other area in corporate law and finance is as shrouded in obscure terminology by its practitioners and treated as specialized knowledge for which they alone can supply the answers. Most practice guides to M&A are either too dense to be accessible to non-specialists, or too superficial to convey practical and usable information. We are going to bridge that gap in this M&A Spotlight series, of which this is the first and introductory installment. Future editions in the series will drill down on topics including tax issues, which often are a principal driver of M&A transaction structures; preliminary documentation like letters of intent (LOIs); due diligence; transaction documents; securities law issues (particularly where public companies are involved); antitrust (competition) law; transaction financing; foreign investment review and technology export rules; employment and equity-based compensation; cross-border M&A (where the acquirer and target are domiciled in different countries); and industry-specific regulatory regimes.

## Basic Transaction Agreements

Negotiated M&A transactions, as opposed to unsolicited transactions or hostile takeovers, are fundamentally contractual agreements, falling into one of three basic forms: a stock purchase, in which a business is acquired by the purchaser (Acquiror) buying the equity securities of the seller (Seller or Target) business (Target); an asset purchase, by which an Acquiror buys a business by buying its assets (whether tangible, like manufacturing machinery, or intangible, like intellectual property); or a merger, a process governed by state corporate laws, by which one business merges into another, and the combined business carries on the business of its predecessors.

The principal transaction documents for each form routinely contain certain common elements. Among these are:

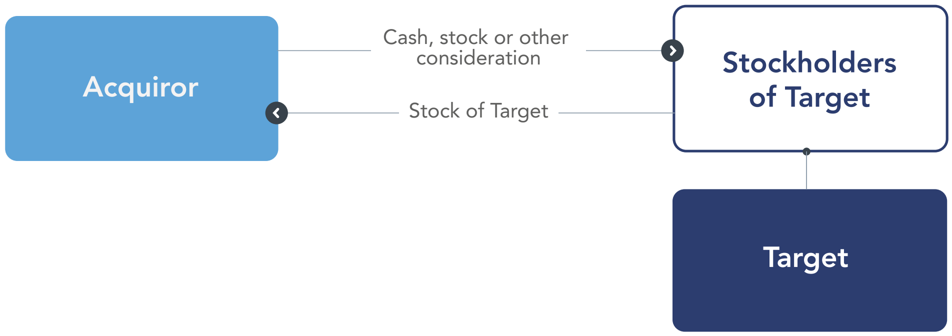
- a description of the basic transaction contemplated by the agreement;
- the purchase price, the form of payment (cash, stock, assumption of debt or some combination), and any adjustments for contingencies;
- conditions to closing, that one or both of the principal parties must satisfy after signing in order for the other to be obligated to consummate the transaction;
- detailed representations and warranties by the Target or its shareholders and the Acquiror about the business and their ability to carry out the transaction as of the date of the agreement's signing, and generally as of closing;
- affirmative and negative covenants, by either of the principal parties to either do something or refrain from doing something or to preserve a represented state of affairs until closing and possibly thereafter;
- termination provisions, which provide for when a transaction can be called off after signing but before closing;
- indemnification and liability provisions, most typically permitting the Acquiror to seek damages from the Target or Seller for breaches of representations or covenants, or possibly limiting or eliminating damages after closing; and
- other provisions, such as confidentiality, choice of governing law and dispute resolution provisions.

## M&A Transaction Structures

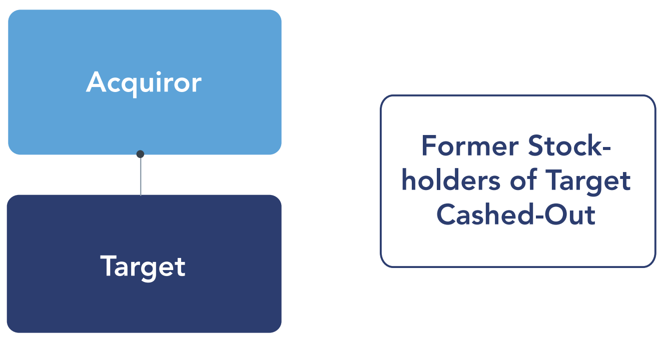
**Stock Purchase.** A stock purchase is ostensibly the simplest M&A structure. It may be accomplished by the Acquiror executing a stock purchase agreement with the Target's shareholders. The Target need not be a party to the agreement, but at closing, it becomes a subsidiary of the Acquiror. Because the Acquiror buys the Target's stock, it acquires the Target with all of its assets and liabilities.

### Direct Stock Purchase

Pre-Sale Diagram

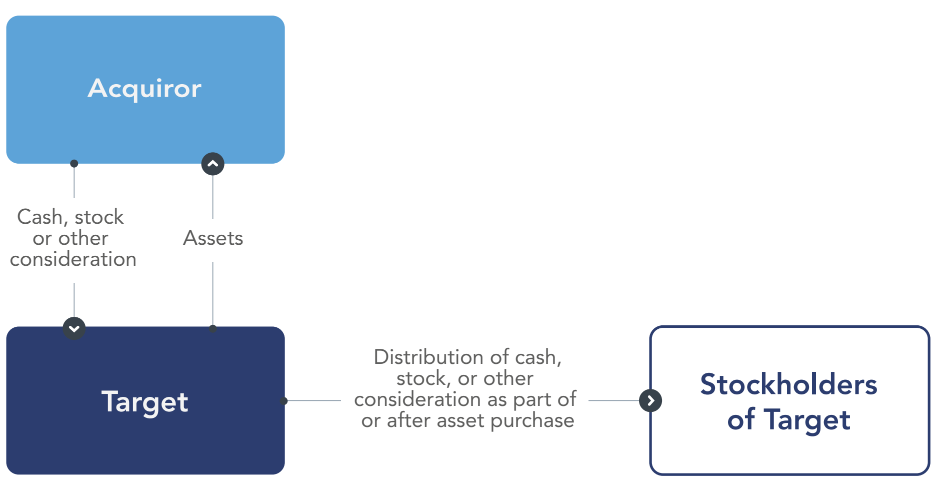



Post-Sale Diagram




**Asset Purchase.** In an asset purchase, the Target sells some or all of its assets, and assigns some or all of its liabilities, to the Acquiror. The Target does not become the Acquiror's subsidiary; it remains owned by its existing shareholders, who generally do not receive the acquisition consideration directly. All else being equal, an asset purchase is often preferred by Acquirors because it allows them to select the assets they want to acquire and avoid assuming liabilities or paying for assets they do not want, unlike in a stock purchase, in which all of Target's assets and liabilities are automatically conveyed with its stock.

### Asset Purchase



**Merger.** Mergers are a transaction form created and governed by state corporation statutes such as the Delaware General Corporation Law. The use of a statutory merger provides both ease and established legal certainty. When the certificate of merger is filed with the Secretary of State of the state of incorporation, one company (the Merging Entity) merges into the other (the Surviving Entity), the Merging Entity's legal existence ends, and title to its assets and liabilities transfers automatically to the Surviving Entity. There are several merger paradigms.

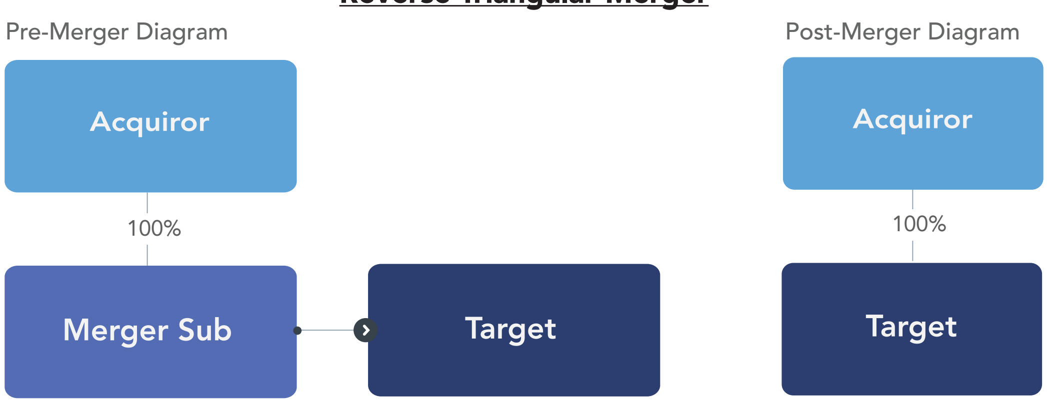
In a direct merger, the Target merges directly into the Acquiror, which is the Surviving Entity. In a reverse merger, the Acquiror is the Merging Entity that merges into the Target and it is the Acquiror that ceases legally to exist, while the Target is the Surviving Entity. In a forward triangular merger, the Acquiror forms a subsidiary (called the Merger Sub) (or uses a pre-existing subsidiary) to serve as a vehicle for the merger, the Target merges into Merger Sub, and Merger Sub is the Surviving Entity and subsidiary of Acquiror. In a reverse triangular merger, Merger Sub merges into Target, and Target is the Surviving Entity, becoming a subsidiary of Acquiror.

The reverse triangular merger format is popular, especially for larger deals and ones involving public companies, because it can allow the Acquiror to remain separate from, and structurally unaffected by, the core transaction, while permitting the Target to become an intact operating subsidiary of Acquiror. The reverse triangular merger structure also often enables Acquiror to take control of Target without triggering anti-assignment provisions in third-party contracts to which Target may be bound. The need to obtain third-party consents and the assignment clauses in agreements to which Target is a party can be a significant factor in driving transaction structuring. Some third-party agreements can represent so much of Target's enterprise value that a failure to obtain the third-party consent to assignment could derail the transaction.

## Direct Merger


## Forward Triangular Merger


## Reverse Triangular Merger



# Cohen & Gresser's **Corporate** Practice

Our Corporate Practice partners with clients to structure and execute a wide range of domestic and cross-border matters, including mergers and acquisitions, capital raising, fund formation, joint ventures and strategic alliances, corporate governance, and regulatory compliance. We have extensive experience working with public and private companies, private equity, venture capital and hedge funds and their managers, sovereigns, family offices, and investment banks.

**Bonnie J. Roe**
broe@cohengresser.com

Bonnie is a partner in Cohen & Gresser's New York office. She leads the Corporate Securities practice and has over 30 years of experience advising publicly and privately held companies and funds.

**Owen D. Kurtin**
okurtin@cohengresser.com

Owen is a partner in Cohen & Gresser's New York office. He advises companies, investors, and financial institutions on corporate, commercial, and regulatory matters across a range of technology-driven and highly regulated industries.

**Kwaku Andoh**
kandoh@cohengresser.com

Kwaku is a partner in Cohen & Gresser's New York office and head of the firm's M&A practice and its Africa practice. He regularly advises on domestic and international mergers and acquisitions, strategic investments, joint ventures and other corporate transactions, as well as general corporate counseling.

**Robert J. Gavigan**
rgavigan@cohengresser.com

Robert is a partner in Cohen & Gresser's New York office. His practice focuses on domestic and international mergers and acquisitions, supply and distribution arrangements, secured and unsecured loan financings, venture capital investments, private placements, complex commercial joint ventures and alliances, and general corporate counseling. He has substantial experience representing companies in the natural resources, life science, health care, and consumer products industries.

**Daniel H. Mathias**
dmathias@cohengresser.com

Daniel is Managing Partner of Cohen & Gresser's London office and a member of the firm's Corporate group. He advises private equity firms, founders, family offices, growth equity investors, alternative asset managers, and institutional investors on complex cross-border private capital and M&A transactions, with a particular focus on the United States and Europe.

**Olga Ponomarenko**
oponomarenko@cohengresser.com

Olga is a partner in Cohen & Gresser's London office, advising clients on complex cross-border mergers and acquisitions, equity capital markets transactions, and corporate matters. She brings deep experience representing private equity sponsors, sovereign wealth funds, multinational corporates, and financial institutions across a broad range of industries including technology, energy, financial services, retail, and infrastructure.