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presents

M&A Deal Dispute Resolution: Proactive Strategies

Evaluating ADR Alternatives and Crafting Merger Agreements that Minimize Post-Closing Litigation

A Live 90-Minute Teleconference/Webinar with Interactive Q&A

Today's panel features:

Kevin D. Krebs, Partner, **PricewaterhouseCoopers**, Chicago
Catherine B. Nelson, Senior Counsel, **Foley & Lardner, LLP**, Chicago
Vincent P. (Trace) Schmeltz III, Counsel, **Dewey & LeBoeuf**, Chicago

Thursday, October 21, 2010

The conference begins at:

1 pm Eastern

12 pm Central

11 am Mountain

10 am Pacific

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M&A Deal Dispute Resolution: Proactive Strategies

October 21, 2010

Today's Presenters

Kevin D. Krebs
PricewaterhouseCoopers



Vincent P. (Trace) Schmeltz III
Dewey & LeBoeuf



Catherine B. Nelson
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M&A Deal Dispute Resolution Proactive Strategies

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Agenda

- Overview of Provisions Giving Rise to Disputes
- Proactive Strategies for the Dispute Resolution Process
- Drafting Tips for Key Provisions

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Overview of M&A Provisions With Potential for Post-Closing Dispute

Overview of M&A Provisions Post-Closing Adjustments

- Net Working Capital / Net Assets
 - Strong preference for working capital test: “current assets less current liabilities”

 - Net asset value: net book value of the tangible assets less net book value of all the liabilities

- Common Areas of Dispute
 - How is it measured – what is GAAP?
 - “consistently applied”; “apples-to-apples”
 - Determination of baseline

Overview of M&A Provisions

Earn-Outs

- Deal structure delaying payment of the purchase price for some period, with the payments usually tied to a fundamental business metric.
 - More common in buyers' market
 - Variety of benchmarks and timeframes – EBITDA, sales or other balance sheet items
 - Proportionate or “cliff” to meeting milestones

- Common Areas of Dispute
 - Discretion in determination of milestones
 - Applicable accounting methods (same issues as purchase price adjustment)
 - Post-closing control of business

Overview of M&A Provisions

Indemnification Claims

- Indemnification by buyer or seller, as applicable, for breaches of representations and warranties, covenants or stand-alone indemnification (such as pre-closing matters, environmental, ERISA, etc.)
 - Generally subject to baskets, caps and specified time limits
- Common Areas of Dispute
 - Interpretation of the representation, warranty or covenant
 - Application of materiality or knowledge qualifiers
 - Quantification of baskets or caps
 - Overlap with purchase price adjustment (double-dipping)

Overview of M&A Provisions

Other Key Provisions

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- General Arbitration Provision
- Choice of Law
- Choice of Venue
- Waiver of Jury Trial
- Indemnification (caps/baskets/escrow)
- Survival Periods
- Specific Performance
- Exclusivity of Remedy

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Proactive Strategies for the Dispute Resolution Process

Dispute Resolution Process

Proactive Strategies

- Minimize Post-Closing Litigation
 - Note we are not saying “eliminate”!
 - These are ideas for streamlining the process
- Prior Planning Prevents Poor Performance
 - Tailor The Process To The Deal
 - Dual-Track or Sequenced Process
 - Choose Your Finder of Fact With Care
 - Manage Discovery & Written Submissions

Dispute Resolution Process

Proactive Strategies

- Tailor the Process to the Deal
 - Large deals may merit three-arbitrator panels, more discovery, litigation for breaches, etc.
 - Smaller deals may warrant a more measured, tailored approach.
- Think About the Money Likely to be at Issue
 - How much diligence has been done on accounting issues/standards?
 - Is there an earn-out?
 - How much care has been taken in drafting the purchase price adjustment provisions?

Dispute Resolution Process

Proactive Strategies

- Who, What, Where & When
 - Who handles – accountants or lawyers?
 - What disputes – purchase price vs. indemnification?
 - Where resolved – arbitration or litigation?
 - When resolved – simultaneously or seriatim?
- Common Concerns
 - Rulings in a purchase price adjustment proceeding can become binding in later proceedings!
 - Do you need consistency between proceedings?
 - Can findings in one be binding in another?

Dispute Resolution Process

Proactive Strategies

- Choose Your Accountants With Care
 - Accounting arbitration usually found in working capital adjustment and earn-out disputes
 - Legal issues may arise in these claims – or accounting issues may arise in indemnification claims
- Common Considerations
 - Potential conflicts – cannot necessarily be solved by advance home work
 - Specialized experience
 - Geography

Dispute Resolution Process

Proactive Strategies

- Choose Your Accountants With Care – Practical Tips
 - Joint contact to the potential firms is a best practice
 - Perform relationship check; identify individual neutral candidates
- Avoids any potential ex parte communications that may prejudice a party
- Agree upon a selection mechanism when choosing the individual
 - Obtain multiple resumes
 - Develop an agreed-upon ranking system to rank the individuals
 - Example: Each party ranks the 5 individuals in order of preference with their preferred candidate being assigned “1”, the next “2”, etc. Then add the two parties rankings together and pick the individual with the lowest combined ranking score.

Dispute Resolution Process

Proactive Strategies

- Choose Your Lawyer-Arbitrator With Care
 - Any industry groups with arbitrators?
 - Experience with accounting issues?
 - Will arbitrator need to hire an expert?
 - Should your panel be all lawyers?

Dispute Resolution Process

Proactive Strategies

Streamline the Process

- Discovery

- Documents, electronic records, access to people –
- Decide while you are still friends!

- Written Submissions

- Simultaneous
- Staggered
- Strategy vs. expediency

- Should there be a hearing? Is one necessary?

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Drafting Tips to Minimize Protracted Post-Closing Disputes

Drafting Tips

Purchase Price Adjustments

- **Common contractual shortcomings:**
 - Target/benchmark not well defined or documented in the agreement
 - Closing statement requirements ambiguous or in conflict with the target
- **Tailor the definition to the deal**
 - Catchall phrases like “current assets” and “current liabilities” are simple, but can increase the likelihood of dispute.
 - Take into account pre-closing cash sweeps.
 - Consider appropriate carve-outs or additions; such as transaction expenses, capital expenditures, taxes, prepaid items, etc.
- **Be clear in establishing the benchmark**
 - Rather than the “net working capital on the 12/31/09” balance sheet, set a numerical value and attach a schedule detailing how that value was derived.
 - Application of floor, cap or collar (not prevalent – only 20.7% of deals in a recent deal study).

Drafting Tips

Purchase Price Adjustments (cont.)

- Clarify the accounting standards; “consistently applied”.
 - What specifically does GAAP mean for this deal?
 - What if baseline wasn't GAAP?
 - If the calculation is to be based on GAAP, it is also important to have a GAAP representation on the baseline financials.
- Use audited financials whenever possible.

Drafting Tips

Purchase Price Adjustments (cont.)

- Clearly describe the dispute resolution process.
 - In a recent deal study, 84 out of 87 deals reviews selected an independent accountant to resolve disputes over purchase price adjustment.
 - Specify the arbitrator in the agreement or agree to agree? If the prior, be sure to check conflicts in advance.
 - Specify timeframes.
 - What happens if a party does not fulfill its obligation to deliver the calculation or timely respond, as applicable? Other party has right to prepare?
 - Scope of which disagreements/adjustments are required to be submitted to accounting arbitration? Don't want to go to court to determine what to arbitrate. For example, specify that if the agreement provides for both legal and financial arbitration, disputes as to where the dispute should be resolved to be determined by legal arbitrator (likely more expertise at contract interpretation).

Drafting Tips

Purchase Price Adjustments (cont.)

- Who pays? Generally three options:
 - Split the fees equally
 - Allocate in proportion to the amount by which each party's respective calculations varied from the final decision
 - The party the furthest from the final determination pays all fees and expenses.
- Options 2 and 3 increase the incentive to “be reasonable”.

Drafting Tips

Earn-Outs

Common Contractual Shortcomings

- Benchmarks typically well defined, but the measurement aspects? Perhaps not!

- How are certain expenses to be treated
 - Transaction costs
 - Integration expenses
 - Overhead allocations
 - Post closing capital investments/depreciation

Drafting Tips

Earn-Outs (cont.)

- As in purchase price adjustments, clearly define the accounting methodology; reference target's prior accounting practices or specific mutually agreed upon principles.
- Specify interaction with indemnification provisions (are earn-out payments to be subject to set-off beyond indemnification cap?)
- Describe parameters on control of business
 - implied duties
 - Whose fault is it if the milestone is not achieved?
- Bottom line – weigh the long-term risk of dispute against the importance of the earn-out in getting the deal done.

Drafting Tips

The “Boilerplate”

- Choice of law; jurisdiction
- Waiver of jury trial
- Arbitration clause
 - AAA standard clause or other specified procedure
- Overlap of multiple dispute resolution processes in a single agreement
- Joinder of all relevant parties (multiple shareholders; shareholder representative)

Drafting Tips

Ask the Experts

- When drafting provisions with accounting implications, seek the advice of an accountant.
- Get input from a litigator on various arbitration and litigation provisions.

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