

PART I

COMMON CORPORATE TRANSACTIONS

by Scott H. Rosenblatt, Edward G. Reitler and Eulalia M. Mack

A. Basic Steps of a Corporate Transaction

- (1) “Meeting of the Minds” among the business people
 - (a) Typically codified in a letter of intent or a term sheet.
 - (b) These “preliminary” documents are usually non-binding statements of the intention of the parties to enter into “definitive” documentation.
 - (c) Terms that are usually binding in such “preliminary” documents include confidentiality, exclusivity (“no shop”) and governing law.
- (2) Commencing Due Diligence
 - (a) Goals include uncovering material liabilities, any defects in ownership of assets and potential litigation claim.
 - (b) Due diligence allows a party to confirm the accuracy and adequacy of counter party’s disclosures in its representations and warranties.
 - (c) Conserve time and resources by uncovering material liabilities prior to finalizing definitive documents and therefore adjust the terms of during the negotiations based upon information uncovered.
 - (d) Allows a party to fashion reasonable indemnification protection relating to specific liabilities or concerns relating to the counter-party or its assets.
- (3) Preparation of Definitive Documentation
 - (a) Typically prepared by the party buying, lending or investing with an exception in the case of a sale by bid (an auction).
 - (b) Drafting usually proceeds while the due diligence process continues
- (4) “Signing” of Definitive Documentation
 - (a) In a simultaneous “sign” and “close” structure, the consummation of the transaction occurs upon signing of the definitive agreement(s).
 - (b) In all other structures, the parties enter into the definitive agreement(s) which will include conditions to be satisfied by one or more parties prior to the “closing” (as well as obtaining any required governmental consents and/or waivers).

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- (5) Satisfaction of Pre-Closing Conditions
 - (a) Both standard and deal-specific conditions that must be satisfied by a party, or waived by the counter party, as a condition to the obligation of the counter party to close the transaction.
 - (6) “Closing” of Transaction
 - (a) Effect the primary purpose of the definitive agreement.
 - (b) “Bring down” of all representations and warranties.
 - (c) Satisfaction or waiver of all closing conditions.
 - (7) Post-Closing Covenants and/or Performance
 - (a) Further assurances of performance.
 - (b) Deal-Specific obligations after the transaction such as non-competition, non-disclosure, non-solicitation, assistance in pending litigations, assistance in collecting receivables, etc.
- B. Acquisition Transaction
- (1) Asset Acquisition / Stock Acquisition / Merger
 - (a) Asset Acquisition
 - (i) Assignability of contracts, permits, etc.
 - (ii) Liabilities to be assumed.
 - (iii) Liabilities not intended to be assumed.
 - (iv) Successor liability.
 - (v) “Stepped up” basis in assets.
 - (vi) “Double taxation” to seller’s stockholders.
 - (b) Stock Acquisition
 - (i) Problem of assumption of unwanted, contingent and unexpected liabilities
 - (ii) Issues with a seller’s multiple stockholders.
 - (c) Mergers

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- (i) Forward Mergers
 - (ii) Reverse Mergers / Reverse Triangular Mergers
- (2) Elements of an Acquisition Agreement
- (a) Action Provisions
 - (i) Contain the heart of the transaction including the property to which title shall be transferred, consideration to be paid for such property, liabilities to be assumed (asset deal), ratio of shares to be issued upon closing (merger deal), post-closing adjustments to the price, date and time of closing and items to be delivered at closing.
 - (b) Representations and Warranties
 - (i) Basic “Housekeeping” – includes representations that the party is duly organized and existing, has authority to consummate the transaction, the transaction will not result in a breach of its organizational documents, other agreement or law and the agreement is binding upon such party.
 - (ii) Financial State / Liabilities / Assets – includes representations relating to the party’s financial statement, current liabilities, material changes to its business or assets, ownership of assets, material contracts, insurance coverage, accounts receivable and payable, tax liabilities, etc.
 - (iii) Litigation / Regulatory – typically includes representations regarding pending or threatened litigation, compliance with applicable laws, required permits or licensing, labor issues, environmental issues, etc.
 - (iv) Securities – capitalization, outstanding rights to acquire party’s stock, and if stock is to be issued, representations by the recipient to qualify the issuance as an offering exempt from registration under Section 5 of the Securities Act of 1933 and by issuer as to the securities being duly authorized, validly issued, fully paid and non-assessable.
 - (v) Affiliated Transactions / Brokers – representations regarding obligations or transactions involving affiliates or insiders of a party, broker’s and finder’s fees, etc.
 - (vi) Industry Specific – representations designed for the type of company or assets involved such as FDA approvals, intellectual property, etc.

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- (vii) Structure Specific – solvency (leveraged transactions),
 - (viii) Disclosure (or “10b-5 representation”)– the other representations or warranties do not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements herein not misleading.
- (c) Pre-Closing Covenants
- (i) Affirmative Covenants: Parties will agree to take certain actions or to permit certain activities to take place.
 - (I) Affirmative covenants include conduct of business in ordinary course, access to information and personnel, working in good faith to satisfy all conditions to closing, etc.
 - (ii) Negative Covenants: A party agrees that certain actions may not be taken during the period from signing to closing without the prior consent of the counter-party.
 - (I) Negative Covenants in an acquisition typically include: “no shopping” (exclusivity), incurrence of liabilities outside the ordinary course, disposition of assets, creation of liens in assets, damage or loss of assets, amendment or termination of existing contracts, changes to material licenses, permits, registrations, issuance or redemption of securities (stock or merger deal), changes to executive compensation, changes to business, affiliate transactions, etc.
- (d) Conditions to Closing
- (i) Standard closing conditions include obtaining all requisite consents, permits, approvals, waivers, etc., each parties representations and warranties must be true (subject to qualifiers), parties are not in breach of agreements and covenants contained in the definitive agreement, no injunction or other governmental impediment shall exist at the time of closing.
 - (ii) Deal-specific closing conditions may be included, such as financing is obtained, existing debt or equity is restructured, employment agreements are executed, liens against assets are released, etc.
- (e) Indemnification / Survival / Limitations of Liabilities (“Caps, Thresholds & Baskets”)

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- (i) Standard indemnification holds the indemnified party harmless for losses resulting from breach of covenants and misrepresentations.
 - (ii) Indemnified party typically contracts to recover reasonable legal expenses in connection with such losses (which, absent contractual agreement, are not otherwise recoverable) .
 - (iii) Specific indemnification may be included to address troublesome exceptions from indemnifying party's representations or other liabilities uncovered in due diligence.
 - (iv) Parties may determine that the indemnification is the sole and exclusive remedy of the parties for breach of representations, warranties and covenants in the definitive agreement.
 - (v) Parties may determine the length of time the representations, warranties and indemnification obligations survive the closing of the transaction or whether they survive at all and to whom each is applicable.
 - (vi) Parties may agree upon a "threshold" (losses must exceed specified amount and then indemnity starts from first dollar of loss) or "basket" (indemnity only applies to losses above a set amount).
 - (vii) Parties may cap all or certain indemnity obligations and may agree that indemnity obligations be paid in stock with a value equal to the loss rather than cash.
- (f) Termination Provisions
- (i) Parties may impose a "drop-dead" date for closing after which either party may terminate if not closed
 - (ii) Typically, a party will have the right to terminate if the other party has breached a pre-closing covenant and cannot cure such breach or if a closing condition cannot be satisfied.
 - (iii) Parties may agree to liquidated damages for a failure to close the deal due to the breach of the other party.
 - (iv) Parties may agree to a breakup fee payable if the deal fails to close due to a competing opportunity.
- (g) Miscellaneous Provisions
- (i) Important provisions include assignability, governing law, consent to jurisdiction, expense obligations, entire agreement, ability to

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amend the definitive agreement or supplement representations and warrants after signing but prior to closing.

(3) Practice Point:

- (a) When representing a purchaser in an “Asset” deal, be sure to obtain all requisite consents and approvals, acquire all assets “necessary” to conduct the “business”, and properly “exclude” all unassumed liabilities (a major advantage of the “asset” as opposed to “Stock” structure).
- (b) When representing a purchaser in a “Stock” deal, be sure to examine all potential liabilities and future claims as they will be assumed by the successor entity by operation of law, as well as the right to acquire capital of the counter party after the close of the transaction.
- (c) Other than tax structuring, an important element to consider when deciding on an “Asset” or “Stock” structure is the need to obtain consents to assignment of primary contracts as a condition to an “Asset” deal, as compared to the unknown liabilities to be automatically assumed if you choose the “Stock” deal.

C. Venture Capital / Minority Investment Transaction

(1) Differences from Acquisition Transactions

- (a) Typically acquiring a non-controlling interest in the issuer and acting as a non-manager, passive shareholder
- (b) Must protect against material actions being taken without investors consent that could materially impact the business or the investment
- (c) Documentation includes additional “definitive documents”:
 - (i) Securities Purchase Agreement
 - (I) Contains representation and warranties similar to acquisition agreement.
 - (II) Often structured as a “sign” and “close” transaction.
 - (III) Representations, warranties and indemnities survive the closings but few covenants survive (as most are contained in the related transaction agreements).
 - (ii) Amended and Restated Certificate of Incorporation or Certificate of Designations
 - (I) Defines the rights of all securities of the issuer.

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- (iii) Investor Rights Agreement
 - (I) Contains rights of investors to compel the registration of their shares for sale in the public market, rights to obtain financial and other information from the issuer, etc.
 - (iv) Stockholders Agreement
 - (I) Rights and obligations of the stockholders and the company focusing primarily on transfer restrictions .
 - (v) Voting Agreement
 - (I) Agreement to elect certain designees to the issuer's board of directors.
- (2) Typical Securities to be Purchased in a VC transaction
- (a) Common Stock
 - (i) Generally, same class as held by founders and employees
 - (ii) All additional rights of the investor must be based upon contractual rights as this security will be on par with other shares of common as to dividends and liquidation and will enjoy pro rata voting
 - (b) Preferred Stock
 - (i) Liquidation Preference – rights of security holder upon the liquidation of the issuer or, in some cases, a sale or merger.
 - (I) Standard – dividends and stated value
 - (II) Double Dip – dividends, a multiple of stated value
 - (III) Participating Preferred - participates with Common after receiving its preferred return
 - (ii) Dividends
 - (I) Cumulative
 - (II) Mandatory or As Declared
 - (III) Participating

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- (iii) Conversion to Common Stock
 - (I) Automatic
 - on qualified IPO
 - on a percentage of class choosing to convert (mechanism of cram down)
 - (II) Optional – at the option of the holder or group of holders

- (ii) Anti-Dilution Rights
 - (I) Adjustment - Full Ratchet or Weighted Average
 - (II) Triggers
 - Down Round
 - Fair Market Value
 - Mutually Agreed Value

- (iii) Voting
 - (I) Participating
 - (II) Board Seats upon Redemption or Default

- (iv) Redemption
 - (I) Fair Market Value
 - (II) Principal plus Accrued Dividends
 - (III) Cash Flow Repayments

- (b) Warrants
 - (i) Exercise Price
 - (ii) Term
 - (iii) Cashless exercise
 - (iv) Exploding warrants – can be used to effectively re-price the pre-investment valuation of the issuer

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- (c) Convertible Notes
 - (i) Priority over equity securities in liquidation
 - (ii) Discount conversion
 - (iii) Short Maturity
 - (iv) Security Interest

- (2) Stockholder Rights
 - (a) Preemptive Rights
 - (i) An investor's right to acquire additional shares of Common Stock or securities convertible, exchangeable or exercisable for Common Stock in order to maintain such investors percentage interest in the issuer.
 - (ii) Typical exceptions include employee compensation, strategic partners, vendor and lender relationships, existing options, warrant and convertible securities, mergers and acquisition activity and public offerings.
 - (iii) Usually terminates upon IPO.
 - (b) Tag Along Rights
 - (i) An investor's right to "tag along" or co-sell in the case of a sale of securities by other stockholders, such as a founding stockholders.
 - (ii) Typical exceptions include estate planning and affiliate transfers.
 - (c) Right of First Refusal / Right of First Offer
 - (i) Stockholder subject to right must offer the stock to be sold to the holder of this right prior to effecting a transfer of such stockholder's shares.
 - (ii) Generally, a right of first refusal requires the offering stockholder to first find a willing purchaser and, prior to a sale to such purchaser, offer the securities, on the same terms, to the holder of this right. If the offer is refused, the offering stockholder may sell the securities to a third party within an pre-agreed period of time but only on the terms presented to the holder of this right.

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- (iii) Generally, a right of first offer requires the offering stockholder to offer the securities to the holder of this right prior to offering such securities to a third party and if the holder of this right refuses, the offering stockholder may sell the securities to a third party within an pre-agreed period of time but on no more favorable terms than were offered to the holder of this right.
 - (d) Drag-Along Rights
 - (i) Certain stockholders holding this right may compel other stockholders to sell with securities at the time and upon the same terms as the stockholders holding this right.
 - (e) Board Seats or Observer Rights
- (3) Protective Provisions (Negative Covenants)
- (a) Without prior consent the issuer cannot effect certain actions. The required consent can be structured as:
 - (i) Investor Veto
 - (ii) Class Veto
 - (iii) All Preferred Classes Veto
 - (iv) Supermajority Vote
 - (b) Protective provisions (or veto rights) may require consent in order to:
 - (i) Create new series or classes of equity, pari passu or senior;
 - (ii) Pay dividends or repurchase securities;
 - (iii) Increase or decrease the class of stock being purchased;
 - (iv) Grant any additional registration rights with priority over investor stock;
 - (v) Alter or change the rights of the stock being purchased;
 - (vi) Reclassify stock to give a preference over the stock being purchased;
 - (vii) Amend the Certificate of Incorporation or bylaws at all or in a way that adversely affects the stock purchased;
 - (viii) Incur debt over certain amount;

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- (ix) Grant a security interest or suffer the incurrence of a lien;
 - (x) Merge, consolidate, lease, license or sell substantially all assets;
 - (xi) Engage in business not specified in business plan;
 - (xii) Purchase stock or make other investment in another entity;
 - (xiii) Grant awards or options to employees or other employee compensation;
 - (xiv) Enter into transactions over a dollar threshold;
 - (xv) Capital expenditure over a dollar threshold;
 - (xvi) Enter into related party transactions;
 - (xvii) File for bankruptcy, dissolve or liquidate;
 - (xviii) Change of accountants or auditors;
 - (xix) Accelerate or increase in any existing employee vesting schedule or compensation arrangement;
 - (xx) Create a subsidiary;
 - (xxi) Adopt a budget or variations from a existing budget;
 - (xxii) Increase or decrease size of Board of Director;
 - (xxiii) Settle pending litigation or commence litigation;
 - (xxiv) Hire or fire executive officers;
 - (xxv) Change any of the deal documents; or
 - (xxvi) Engage in any other material transaction.
- (4) Practice Points
- (a) Confirm that all intellectual property is properly owned by the issuer, not its founder, employees, consultants, vender or joint venture partners.
 - (b) Consult tax expert regarding the effect of use of warrants and bridge notes, as opposed to straight equity sale.
 - (c) Confirm that key employees are bound by covenants relating to non-competition, non-disclosure, non-solicit, assignment of intellectual property, etc.

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D. Credit Agreements

(1) Standard Types of Loans:

- (a) Term Loan – one-time loan with a fixed maturity – amounts cannot be re-borrowed – typically, all funds are advanced at once – used for acquisition financing.
- (b) Revolving Credit Facility – a credit line under which borrower can obtain advances as needed – amounts can be borrowed, repaid and re-borrowed – requires payment of a standby or commitment fee on the undrawn but committed amount (maximum that may be borrowed at any time).
- (c) Capital Expenditure Facility – a facility that is available for specific capital expenditure (i.e. equipment purchase).
- (d) Letter of Credit – credit support for obligations of a borrower to secure payment to a third party (often in international transactions) – acts as a guarantee of payment to third party by the lender.
- (e) Structured Loans – for example, loans to special purposes subsidiary that holds certain valuable assets used to secure the indebtedness (such as accounts receivables from account debtors with a better credit rating than the borrower) – proceeds of such loans are used by SPS to purchase additional assets from its parent to serve as collateral of the lenders.

(2) Standard Agreements

- (a) Credit Agreement
- (b) Parent / Subsidiary Guarantee
- (c) Security Agreement / Pledge Agreement
- (d) Syndication Documents
- (e) Collateral Agency Agreement

(3) Elements of an Acquisition Agreement

- (a) Principal Terms:
 - (i) Stated amount of loan (or each type of loan)
 - (ii) Portion to be furnished by each lender
 - (iii) Period for take-down of loan

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- (iv) Interest rate and payment schedule
 - (I) Payable monthly
 - (II) Payable with each installment of principal
 - (III) Balloon payment
- (v) Timing of Payment of principal (amortization)
 - (I) Number and amount of installments
 - (II) Date of first, subsequent payments and final payments
- (vi) Right of prepayment
 - (I) Without penalty or premium
 - (II) Premium if loan refinanced with other lenders
- (vii) Stand-by or Commitment Fees
 - (I) Percentage of loan not taken down from date of agreement to end of commitment period
 - (II) Borrower's right to reduce or release commitment
- (viii) Tax Make-Whole
 - (I) Accounts for events that alter the lender's cost of funds and therefore the interest rate applicable to the loan.
- (b) Borrower's Covenants - Borrower shall:
 - (i) Use loan proceeds for stated purpose only
 - (ii) Continue existence of corporation and business
 - (iii) Comply with all laws, regulations and ordinances
 - (iv) Not pay dividends, redeem shares, or change capitalization
 - (v) Not increase compensation of officers or stockholders
 - (vi) Not merge, reorganize, sell its major assets, or take other extraordinary actions
 - (vii) Not acquire other businesses

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- (viii) Maintain all corporate property in good condition (books, records, accounting procedures)
- (ix) Pay all debts and taxes when due
- (x) Maintain property free of encumbrances
 - (I) Mechanics and materialmen's liens
 - (II) Lien of current taxes not in default
 - (III) Pay in due course with right to contest in good faith
- (xi) Not sell or assign property other than in ordinary course of business
- (xii) Not mortgage or give other security interest in assets
- (xiii) Maintain insurance coverage for corporation
 - (I) Fire and extended coverage
 - (II) Public liability
 - (III) Worker's compensation
 - (IV) Fidelity bonds on officers
 - (V) Furnish banks with copies upon request
 - (VI) Advise lender of changes
 - (VII) Endorse insurance with loss payable to banks
- (xiv) Not incur other debts for borrowed money
- (xv) Maintain certain financial ratios:
 - (I) Interest coverage ratio
 - (II) Leverage ratio
 - (III) Fixed charge coverage ration
- (xvi) Not invest more than stated amount in fixed assets during term of loan
- (xvii) Notify banks of any litigation involving borrower

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- (xviii) Furnish financial statements to banks (both annually and quarterly)
- (xix) Pay banks' legal fees if rights under agreement enforced
- (c) Subordination of Other Obligations to Borrowings
 - (i) Express consent to subordinate (payment and lien subordination)
 - (ii) Form of Subordination Agreement
- (d) Collateral to Secure Obligations under Credit Agreement
 - (i) Form of Security Agreement
 - (ii) Form of Collateral Agency Agreement (multiple lenders)
- (e) Representations and Warranties of Borrower
 - (i) Similar to definitive agreement discussed above with certain additions
 - (I) Solvency
 - (II) Perfection of security interest in collateral
- (f) Events causing Acceleration of Loan Repayment
 - (i) Failure to make payment of principal or interest when due;
 - (ii) Failure to pay stand-by or commitment fee;
 - (iii) Default in borrower's obligations under agreement;
 - (iv) Breach of covenants (including financial covenants);
 - (v) Insolvency actions: assignment for benefit of creditors, bankruptcy, creditor's petition for reorganization, appointment of receiver, failure to pay debts when due
 - (vi) Cross default
 - (vii) Judgment or lien
 - (viii) Security interest granted to lender becomes unperfected
 - (ix) Default under any guarantee supporting the loan
 - (x) Change of control of the borrower

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Part II

DUE DILIGENCE AND NEGOTIATING REPRESENTATIONS AND WARRANTIES
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A. Function and Use of Representations and Warranties

- (1) In most definitive transaction documents, one or more parties will be required to provide detailed representations and warranties regarding itself and its property.
- (2) A “representation” is a party’s statement of fact as of a moment in time intended to induce reliance by the counter party and such reliance results in an action being taken by such counter party (such as entering into or closing a transaction).
- (3) A “warranty” is a promise by the party making the statement of fact that if the statement of fact is not true, then the party making such statement is liable for the damage incurred by the counter party that received such warranty.
- (4) Typically, representations and warranties are of a standard form that require the party providing them to affirmatively state a fact (a “flat” representation). For example:

“The Company is not a party to any, and there are no pending or threatened legal, administrative, arbitral or other proceedings, claims, actions or governmental investigations of any nature against the Company.”

- (5) The party providing representations and warranties may have to qualify a “flat” representation and warranty by reference to a particular item. For example:

“Other than the pending litigation between the Company and ABC Corp., the Company is not a party to any, and there are no pending or threatened legal, administrative, arbitral or other proceedings, claims, actions or governmental investigations of any nature against the Company.”

- (6) Often, a representation and warranty is qualified by reference to a disclosure schedule which will list all applicable exceptions to the “flat” representation and warranty. For example:

“Other than as set forth on the Schedule 3.14 to this Agreement, the Company is not a party to any, and there are no pending or threatened legal, administrative, arbitral or other proceedings, claims, actions or governmental investigations of any nature against the Company.”

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- (7) In addition to exceptions, representations and warranties can be qualified as to:
- (a) Materiality – Examples include:
 - (i) “The financial statements (including the notes thereto) present fairly in all material respects the financial condition of the Seller as of such dates and the results of operations of the Seller for such periods”
 - (ii) “Without the prior written consent of the Purchaser, the Seller shall not . . . effect any cancellation of any material indebtedness (individually or in the aggregate) or waive of any material claims or material rights owned by Seller or any of its subsidiaries”
 - (b) Knowledge – Limits the statement of fact to the knowledge of a certain party – Examples include:
 - (i) “to the knowledge of the Company”
 - (ii) “to the knowledge of the Company after due inquiry”
 - (iii) “to the Knowledge of the Company” with “Knowledge” defined as “the Company having actually inquired of its CEO, CFO, corporate secretary, vice president - operations, etc.”
 - (c) Ordinary Course of Business – Example:
 - (i) “Except as set forth in the Company’s financial statements, the Company has not incurred any liability, except in the ordinary course of business and consistent with past practice.”
 - (d) Material Adverse Change – Example:
 - (i) “The Company has complied with and is not in default under any applicable law, statute, order, rule, regulation, policy and/or guideline of any federal, state or local or foreign governmental authority relating to the Company, other than where such default or noncompliance will not result in a Material Adverse Effect.”
 - (ii) “Material Adverse Effect” means any change, event, violation, inaccuracy, circumstance, regulation’s decision or effect that is or is reasonably likely to be materially adverse to the business, assets (including intangible assets), capitalization, condition (financial or otherwise), operations or results of operations of the Company taken as a whole with its subsidiaries (if any).”
- (8) A representation and warranty with a noted exception is not breached if the act or omission stated in the exception occurs or exists. For example, in the case of the

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litigation between the Company and ABC Corp., damages to the post-transaction company relating to such litigation will not be recoverable on the theory of a breach of representation if the underlying litigation is disclosed and excepted from the litigation representation. There may be other contractual basis for a claim, such as breach of another representation or a specific indemnification provisions addressing this litigation.

B. Indemnification Provisions and Representations and Warranties

- (1) The breach of a representation and warranty by a party results in a cause of action by the recipient of such representation and warranty.
- (2) However, most definitive transaction documents also include indemnification provisions which provide that the party providing the representation and warranty will “indemnify and hold harmless” the party receiving such representation and warranty for damages to such recipient as a result of the breach of such representation and warranty.
- (3) While this may seem like overkill, the presence of the indemnification provisions provides important advantages to each party:
 - (a) the ability of the recipient to assert contractual claims for costs and expenses (i.e. legal fees) incurred by the recipient of the representation in connection with the breach (and – if drafted correctly – claims relating to the enforcement of the expense reimbursement obligation under the indemnity);
 - (b) the ability to address specific issues that have been excluded from the representations and warranties but as to which the recipient would like specific coverage from potential damage or liability;
 - (c) a convenient way to create caps (limits on liability for breach), baskets (a level below which losses that are not recoverable) and thresholds (a level above which losses must aggregate in order for indemnity to be sought); and
 - (d) the ability to limit type of action by the recipient of the representation and warranties in the agreement to the rights under the indemnity (exclusive remedy provision) and, thereby, limits the recipients use of other theories and causes of action.

C. Interaction of the Due Diligence Process and Representations and Warranties

- (1) If a party has knowledge of the specific “flat” representations that will be requested of the counter-party, the attorney for such party can fine tune the due diligence process to create model disclosure schedules responsive to such representations.

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- (2) Some of the benefits of the approach are:
 - (a) Ability to confirm the accuracy of the actual disclosure schedules provided by the counter party;
 - (b) Advance knowledge as to why the counter party may wish to modify the “flat” representation so as to avoid having to disclose an item that could impact the terms of the transaction; and
 - (c) Ability to plan for specific indemnity provisions to address issues that are likely to be excepted from the representations or will require additional protection.

D. Division of Responsibility for Due Diligence Review

- (1) It is important for counsel to coordinate the due diligence effort and utilize the appropriate person for each job.
- (2) Communication among professionals is critical to the success of the process – there is an interplay of business, accounting and legal due diligence in most transactions.
- (3) Common areas of focus and the party in charge:
 - (a) Financial information (client, accountants and investment bankers)
 - (b) Products and technology (client or outside experts)
 - (c) Seller’s internal policies and controls (client and accountants)
 - (d) Employment and consulting arrangements – option vesting schedules, effects of transaction on payment schedules and acceleration of option vesting, parachute payments (corporate attorneys)
 - (e) Contracts and organizational materials (corporate attorneys)
 - (f) Pending or threatened litigation or claims (litigation attorneys and specialists)
 - (g) Company-specific areas of interest (intellectual property counsel, real estate counsel, ERISA counsel, environmental expert, taxation specialist, etc.)
- (4) Staffing for legal due diligence:
 - (a) Junior attorneys to do leg work with adequate guidance and senior oversight and involvement

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- (b) Senior attorneys should prioritize overall project, make decisions as to what is, or likely to be, most important.

E. Components of Standard Legal Due Diligence Review

(1) Corporate Organization Documents and Stock Transfer Records.

- (a) review certificate of incorporation (as amended by any certificates of designations), by-laws and shareholders' agreements to determine the presence of provisions that would restrict or prohibit the proposed transaction or limit the rights of the successor entity in the future.
- (b) Verify that all of the issuer's outstanding stock was duly authorized and validly issued and is fully paid and nonassessable.

(2) Material Agreements – which may include:

- (a) indebtedness obligations (promissory notes, credit agreements, letters of credit, indemnity obligations under existing agreements)
- (b) primary supply and vendor contracts
- (c) asset acquisition agreements
- (d) leases
- (e) joint venture arrangements
- (f) primary intellectual property license agreements
- (g) voting agreements
- (h) registration rights agreements

(3) Title to Property

- (a) review results of UCC lien searches in applicable jurisdictions (under both the old and revised UCC Article 9)
- (b) review records for release of prior liens and security interests
- (c) determine the significant assets and focus the review around such assets

(4) Litigation

- (a) review pending and threatened litigation and settlement of prior litigation.
- (b) review type of business operations and likelihood of actions that could result in future liability claims.

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- (c) review coverage and deductibles under existing and former insurance policies.
 - (5) Compliance with Laws and Regulations
 - (a) determine potential exposure for non-compliance with laws .
 - (b) review administrative or regulatory warnings or actions resulting from non-compliance.
 - (c) complete searches of relevant databases.
 - (6) Crown Jewels
 - (a) determine the most crucial assets and focus additional due diligence
 - (b) If review determines shared ownership rights (or ownership by a third party), notify purchaser of the chance to acquire this crucial assets outside of the transaction
- F. Use of Due Diligence Results in Negotiation of Definitive Documents
- (1) Uses by party providing representations and warranties:
 - (a) Craft representation and warranty carve-outs and indemnification baskets and caps so as to exclude certain items uncovered in preparation of due diligence response.
 - (b) Seek to have counter party assume certain liabilities (asset acquisition).
 - (2) Uses by party receiving representations and warranties:
 - (a) Confirm information set forth on disclosure schedules.
 - (b) Confirm need for consents and waivers.
 - (i) Shareholder consents
 - (ii) Secured parties releasing liens and security interest
 - (iii) Landlord consents or waivers
 - (iv) Licensor consents or waivers
 - (v) Parties to material agreements
 - (vi) Release of Liens and/or Judgments
 - (vii) Employee and/or consultant accelerated benefits waivers
 - (c) Tailor representations and warranties to ferret out liabilities uncovered in due diligence process.

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- (d) Seek indemnification for certain liabilities (unassumed liabilities in the case of an asset acquisition).
- (e) Seek to adjust principal terms if the items uncovered affect the value of the property or business to be acquired or in which the investment is to be made.

G. Practice Points

(1) Asset Acquisitions

- (a) Restrictions or conditions upon assignment or transfer of specific assets (need for consents, waivers or approvals).
- (b) Successor liability such as environmental, liens, and intellectual property infringement claims.
- (c) Compliance with applicable state law bulk sale statutes, if applicable.

(2) Stock Acquisitions and Mergers

- (a) Change of control provisions (i.e., leases and licenses).
- (b) Prior securities law violations.
- (c) Ability of third parties to acquire additional equity.
- (d) Stock transfer records.

(3) Investment Transaction

- (a) Ownership of Intellectual Property needed to conduct the business
- (b) Extent of incentives to motivate founders (typically holding large blocks of equity)
- (c) Prior issuances in violation of securities laws (risk of rescission)

(4) Credit Transactions

- (a) Liens and other encumbrances on collateral
- (b) Solvency of borrower at time of grant of liens
- (c) Fraudulent conveyance issues in leveraged transactions

Part III

TEN THINGS TO KEEP IN MIND AS A TRANSACTIONAL ATTORNEY
by Scott H. Rosenblatt, Edward G. Reitler and Eulalia M. Mack

10. Term Sheet
9. Security for Indemnities
8. Precedents
7. Governing Law; Consent to Jurisdiction
6. Regulatory (Non-Securities) Clearance
5. Non-Competition Clauses / Restrictive Covenants
4. Assignment Clauses / Change of Control
3. Hart-Scott-Rodino / Other Anti-Trust
2. Federal Securities / Blue Sky
1. Tax