CHAPTER 1

Introduction to Deal-Making

Deal-Making in Practice

Looking back, I have come to realize that careful attention to transaction details played a critical role in the businesses I founded over the course of my career. Thinking strategically about potential outcomes—and setting the stage in the contract to navigate them in the future—was critical to my success.

—Dr. Henry G. Jarecki

My proposal turned the tables. I had conveyed it cautiously. Sound legal advice had been hard to come by. None of the lawyers I had hired could do more than follow technical instructions. As the clock was working against us, I followed my intuition on what our legal rights were. As desperate as things stood for our company, I figured that I could not possibly make things worse.

The effect was stunning. Triumphantly smug a moment before, the guys on the other side backed down. Perhaps they had known the weakness of their position all along and played hardball to get the better of us. After all, they were a large national player with a reputation for running over minor league players like us. Perchance I surprised them. Or had they not thought seriously about our side of the issue, let alone the business implications of their own legalese? At that moment, I realized how crucial legal knowledge was to running a business.

From that conference room, I took the shortest way to law school—only to find in my subsequent career that corporate practice is effective only if business judgment and legal expertise coincide.

That is the impetus of this book. It brings business, finance, and law together, showing how legal form configures the economic outlook, and how to support a business strategy with a legal framework. More specifically, it is designed as a tool for individuals in both business and law—in-house, in practice, or in training—to understand how merger and acquisition (M&A) deals are negotiated and how acquisition contract terms impact economic outcomes. It analyzes current techniques and mechanics used in acquisition agreements and shows how to design deal terms to meet the needs of your particular transaction.

In the larger scheme of things, this book may be a small step further down the road of commoditizing and quantifying legal advice. But I hope this book will also caution against overdoing it. As the review of actual deals will show, each is different. There is no "one size fits all" solution. Effectively combining different elements, applying the law to a specific situation, and calculating the economic effect of contract terms requires skill, intellect, and often a good dose of ingenuity that is not inherent in any commoditized form of legal advice.

Creativity (among other human faculties) does not come in a box. If, in that conference room, I had not been able to find a new perspective, to think outside and beyond the paradigm that the legal experts—including my own counsel—had presented me, the company I managed would have ended up like the other small fry. It is innovation that, more often than not, will give you an edge.

What makes M&A practice such a rich experience is that almost every deal is distinct in its facts, the business issues at stake, the economic trends in play, and the personalities and negotiating tactics involved. Given the number of variables, a deal can take on many different forms. It is crucial to understand that these different forms will invariably produce different legal and economic results. Structuring to solve business issues—and sorting out business issues resulting from the structure—is what M&A is all about.

The art of negotiating has been much dwelled on, but it is absolutely useless when the reasons for having a provision are not understood, when the follow-on implications of winning or not winning a point escape the players, or when they come to the negotiating table without any idea regarding their company's or client's backup positions. How will you know when a point is worth the fight, when to give in, and when to walk away? How will you know what to ask for in the first place? Before getting cute at the negotiating table,

you have to understand your business goals and your options—including the legal terms with which to achieve them. Otherwise, your art will backfire: "In my many business negotiations, I have always been amazed that the other side will ask for something that is less advantageous to them than the deal they already have," notes one of my clients.

This book starts by examining the various agreements that practitioners have to negotiate before actually sitting down to talk about the acquisition agreement. These include confidentiality agreements, standstill agreements, exclusivity agreements, and letters of intent or memoranda of understanding. These agreements protect the parties from economic disadvantage due to the deal process, set rules for the negotiations, and define preliminary objectives.

Separate chapters of this book show how the core elements of an acquisition agreement—that is, purchase price mechanics and adjustments, representations, covenants, conditions, material adverse effect clauses, financing contingencies and reverse breakup fees, fiduciary outs to top a public deal and indemnities—function within the context of a deal. Each chapter explains how a component is negotiated in real life with the purpose of creating value for and balancing risks between the parties. Comparing various strategies for solving business problems, some methods to provide for "rough justice" while other approaches are more refined. Transaction techniques often make a difference—and sometimes all the difference. The chapters include war stories to demonstrate potential pitfalls and bring out the relevance of certain techniques. In addition, statistics on how deal terms are negotiated in practice give an overview with regard to the prevalence of certain provisions and thus a sense for the market. Finally, sample provisions from actual contracts model the language that make a particular deal work.

This book next analyzes the overall framework of an acquisition agreement. It examines the different deal structures—that is, stock sales, mergers, asset sales, and complex structures—and lays out the criteria according to which practitioners choose (or should choose) between them.

War Stories

War stories from practice bring home the flavor of what is at stake in actual deals. Highlighting why drafting matters, the crux of each story elucidates the problems the parties grappled with, sidelined, or simply overlooked. Their successes and failures show the lessons learned. After all, to understand—and laugh at—the mistakes of others is the best way to appreciate why a point is important.

War Story

Thirty war stories reveal the workings of deal terms by way of example. The core issues at stake are conceptually "based on a true story," but they are all works of fiction.

Each mistake and problem described in those sections has happened in practice. The stories that go with them, however, bear no relationship to actual transactions. Any correlation to any real parties or lawyers—especially those who made mistakes or ended up on the wrong side of unexpected events—is purely coincidental.

The Market

Lawyers have been slow to quantify their expertise. But with the passage of time, and the continuously improving ease with which lawyers can gather and crunch the numbers on other deals, a more quantitative mind-set is filtering into practice.

This book uses quantitative analyses to see how deals fit into observable patterns of the marketplace, while, at the same time, cautioning against a simplifying, precedent-oriented approach to deal-making. After all, a weighted-average set of terms would, in fact, suit no one. And the examination of any one deal point in a vacuum can lead the parties to overlook the interactions among deal points or the specific needs of the parties at hand.

Nevertheless, as quantitative studies of transaction terms begin to proliferate, deal-makers will more frequently be pushed by the force of precedent into standardized provisions, paving the way for majority terms to become more and more dominant. As time goes by, the average may become the norm, whether or not the average fits the facts of a particular deal. Knowledge of what constitutes "market terms" (i.e., terms that have become commonplace in transactions) has become critical to arguing a position and can be a helpful tool for convincing the other side that a position is fair.

THE MARKET

Nearly 100 "The Market" sections are culled from studies of deals in which the author participated, as well as from a variety of other publicly available studies. As such, the data represent a generalized meta-analysis derived from numerous independent sources.

Quantitative analyses vary meaningfully from study to study. Different results are generated by:

- *Sample size.* The smaller the sample, the more they can be influenced by outlier deals.
- *Sample selection.* Rarely do studies consider all available data. How they pick and choose affects the results.
- *Period reviewed.* Trends change, by definition. The period studied matters.
- *Mix of deal types.* Different deal types constitute their own market. More or less of one type skews the results.

To help avoid the illusion that quantitative analysis of deal terms is a precise science, all results in this book have been rounded to the nearest 5 percent, or to thirds or halves, depending on the context.

Sample Provisions

Sample provisions illustrate model wording and key drafting choices. Frequently, these examples represent "form" language, or wording a practitioner would use as a starting point before changing it to fit a particular deal.

Sample Provision

Over 140 "Sample Provisions" are based on formulations used by the author as well as actual public deal precedents.

[Bracketed text] usually indicates a drafting choice. It shows an issue buyers and sellers may negotiate, or a provision that is more or less aggressive. Brackets are also used to summarize missing text, in order to focus an example on the primary topic.

Underlining is used to emphasize key words or phrases.

Litigation Endnotes

Good contracts are negotiated in the shadow of litigation. Rules of contract construction tell us that the court's primary job is to interpret the intent of the parties, who are relatively free to draft any provision they wish.

Courts do this by first giving a plain-English interpretation to the words on the page. In doing so, courts often assume the lawyers understand the underlying case law. Practitioners, in contrast, often draft as if the dictionary rather than case law provides the primary resource for giving meaning to the words they draft—and the topics they decide to avoid and be silent on. Case law provides the backdrop for lawyers to determine when silence works for them or against them, and when they should try to clarify ambiguity.

Some of the cases that elucidate these issues are interspersed throughout this book in approximately 100 litigation endnotes. They are not intended to provide a definitive statement of case law in any particular jurisdiction. Instead, they highlight the kinds of issues that must be dealt with in drafting, to avoid your client's falling into similar litigation.