CHAPTER 12

Business Acquisition Agreements

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Scope Note

This chapter provides a step-by-step analysis of how to draft and effectively negotiate business acquisitions agreements. The first half of the chapter describes each step in the acquisitions process in chronological order. The second half of the chapter focuses on practical negotiating strategies. Illustrative acquisitions documents are included as exhibits.

§ 12.1 THE ACQUISITION MATING DANCE

The sale of a business usually follows a predictable pattern, with appropriate variations in individual cases. This chapter describes this "acquisition mating dance," a phrase borrowed from the title of James C. Freund's *The Acquisition Mating Dance and Other Essays on Negotiating* (Prentice Hall 1987), and used here to include the complete business acquisition process, rather than preliminary negotiations culminating in a friendly or hostile takeover. The chapter provides practical guidance for dealing with problems encountered along the way.

The various steps in the dance are described below in chronological order. Section 12.2 identifies some of the factors which may influence a seller's decision to sell its business. Section 12.3 describes the preliminary steps which may be taken by a seller preparing to put its business on the market. Section 12.4 deals with the ways of finding potential strategic or financial buyers, the fiduciary duties implicated by a decision to sell, and the complications resulting from the seller's usual desire for secrecy. Section 12.5 describes the preliminary disclosure and negotiation with buyers and introduces the critical issue of deal structure. Section 12.6 discusses the nature and importance of nonbinding letters of intent. Section 12.7 describes the typical due diligence process and the importance of disclosure schedules. Section 12.8 provides an outline of a typical acquisition agreement and discusses the "four horsemen" of the agreement (representations, covenants, conditions, and indemnification) and how they interact. Section 12.9 describes various activities required during the period from the signing to the closing. Section 12.10 describes the mechanics of closing. After covering each step of the "dance" in detail, Sections 12.11 through 12.20 delve into the negotiating process.

§ 12.2 THE SELLER'S DECISION TO SELL ITS BUSINESS

This business decision may be prompted by numerous factors, including a desire to take advantage of favorable market conditions, external events such as the death or retirement of a founder, stockholders' need or desire to liquidate their investment, or the receipt of an indication of interest or offer from a prospective buyer. This decision is often reached without participation of the company's attorney.

§ 12.3 THE SELLER'S PREPARATIONS TO SELL

The seller's preparations to sell include consideration of the tax consequences of the sale of the business, which often turn on whether the business is organized as a C corporation or as an S corporation, LLC, or other "pass-through" entity. In some cases, decisions may include steps to assure retention of key management employees through incentives or other measures. The company should consider resolving troublesome problem areas, such as outstanding litigation or other disputes, prior to sale. Closely held companies should review their financial statements to eliminate or manage the typical management perks and benefits which reduce the company's earnings.

> **Practice Note**
> Most buyers employ business valuation models which use multiples of earnings, cash flow, or EBITDA (earnings before interest, taxes, depreciation, and amortization). Closely held companies frequently present buyers with adjusted or "normalized" financial statements to reflect the elimination of excess compensation, fringe benefits, and other nonrecurring or extraordinary expenses that a buyer will not incur.

Audited financial statements are required for most companies being acquired by publicly held buyers; consideration should be given to engaging accountants to audit the company's financial statements. The company should consider whether to obtain an appraisal of the value of the business or of particular assets, such as real estate. Where appropriate, an environmental assessment of the company's real estate may be obtained.

§ 12.4 LOCATING PROSPECTIVE BUYERS

The company should also consider whether to engage a business broker or investment banker to assist it in locating strategic buyers or financial buyers for the business.

> **Practice Note**
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> Strategic buyers are usually companies in the same or complementary businesses who are seeking to expand their business. Strategic buyers, unlike financial buyers, consider the synergistic value of a business combination and may be willing to pay a higher price for the business. Financial buyers, such as private equity funds, seek to purchase a company, expand its business by internal growth or acquisition, and resell it at a higher price. Financial buyers, unlike many strategic buyers, usually want to keep the seller's existing management in place.

A form of engagement letter with an investment banker is included as **Exhibit 12A**. The possibility of a management buyout may also be considered. A management buyout consists of one group of stockholders, usually consisting of or including management, funded by a financial buyer, purchasing the stock of the remaining stockholders.

There are two principal methods for soliciting offers to purchase a business:

- an open "auction" process in which multiple bidders are invited to review selected financial and business information regarding the company and to compete in a bidding process, and
- a more selective and private process in which the company or its representatives contact one or a few carefully chosen prospective buyers without public disclosure that the company is for sale.

There are, of course, many variations on these two methods. A 2010 book, *Negotiauctions*, by Professor Guhan Subramian, of Harvard Law School and Harvard Business School, contains an excellent discussion of strategies in mixed auction and negotiation deals.

§ 12.4.1 Fiduciary Duties

The fiduciary duties of the company's directors and stockholders may compel them toward an auction process. For Delaware corporations, the law is clear: in *Revlon v. McAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986), the

Delaware Supreme Court held that once a sale of control of a corporation has been approved by the board of directors or becomes "inevitable," the fiduciary duties of the board focus on one primary objective—securing the highest value for stockholders. The directors become, in the court's words, "auctioneers charged with getting the best price for the stockholders in the sale of the company." *Revlon v. McAndrews & Forbes Holdings, Inc.*, 506 A.2d at 182. Although the Delaware courts have held that a postsigning "market check" or similar process may be sufficient to satisfy the board's *Revlon* duties, it is clear that the directors of a Delaware corporation who deal with only one buyer without exploring competing offers are violating their fiduciary duties.

Massachusetts law is far less clear. There is no Massachusetts precedent confirming or rejecting the *Revlon* doctrine, and the Massachusetts corporate statute is not modeled on the Delaware General Corporation Law. *But see Gut v. McDonough*, 2007 WL 2410131 (Mass. Super. Ct. Aug. 14, 2007) (Superior Court judge ruled that the *Revlon* doctrine does not control in Massachusetts in view of the "other constituencies" provisions of G.L. c. 156D, § 8.20(a)(3), and instead applied the business purpose test of *Coggins v. N.E. Patriots Football Club*, 397 Mass. 525 (1986)). Nonetheless, many prudent corporate lawyers counsel the directors of Massachusetts corporations to avoid a closed sale process.

§ 12.4.2 The Seller's Desire for Secrecy

A practical issue of vital concern to the seller of a business is the impact of the sale process on the business. Business owners are often legitimately concerned that the process for the sale of the business be conducted in secret to avoid disruption of employees, suppliers, and vendors, to discourage trade rumors and disparagement by competitors, and to preserve the confidentiality of financial statements, trade secrets, customer lists, and other sensitive information.

This provides a powerful incentive to avoid the "auction" process in favor of secretive acquisition negotiations with a single buyer. As discussed above, this approach involves the risk of a violation of fiduciary duties and also forgoes the economic benefits of a competitive process. A potential solution to this dilemma is for the seller to negotiate a "go shop" clause in the acquisition agreement that enables the seller to test the market for superior acquisition proposals for a limited time following the signing of the acquisition agreement. Needless to say, this is not a popular position with potential buyers, who may well feel that they are being used as a "stalking horse" to obtain a better deal from others. It can, however, be accomplished.

Practice Note

Do not underestimate the difficulty of keeping acquisition plans secret or the resourcefulness of employees in ferreting out information relating to supposedly secret acquisition negotiations. After concluding "secret" acquisition negotiations for the sale of a client's business, we discovered much later that in spite of careful planning to disguise the negotiations, the seller's employees had identified the buyer and the purpose of its clandestine site visit within minutes of its representatives' appearance at the seller's offices.

§ 12.5 PRELIMINARY DISCLOSURE AND NEGOTIATIONS

Once a prospective buyer has been identified and has expressed interest in an acquisition, there is usually some preliminary disclosure of information such as financial statements of the seller. Prior to the delivery of any nonpublic information regarding the seller, the buyer will be requested to sign a confidentiality agreement, agreeing to keep such information confidential and to use it solely for the purpose of negotiating an acquisition. A common form of confidentiality agreement is included as **Exhibit 12B**.

The information disclosed at this preliminary stage is usually very basic: historical financial statements for the past several years, plus the most recent quarterly period, and a brief description of the seller's business. Often a seller or its advisors will prepare a confidential memorandum containing a prospectus-like outline of the seller's business, assets, management team, and financial data. This document usually omits detailed and sensitive information to limit the amount of disclosure. In any case, any disclosure materials should be labeled as confidential, should be carefully reviewed by counsel, and should be accompanied by written qualifications that they are incomplete and may not be relied upon as the basis for a decision to purchase the company.

Practice Note

When representing a seller, I usually insist that the confidentiality agreement be of unlimited duration, so long as the information remains in fact confidential. See **Exhibit 12B**. Many buyers' counsel resist this, insisting on a fixed term of, say, two or three years. Whether or not to accept this counteroffer depends largely on the expected degree of technological and other change in your client's business and whether the buyer is a competitor or a financial buyer. See § 12.4, below. I find that high tech clients feel that most confidential information loses its value within very few years; other clients may have different views. Once again, communication with your client is essential.

§ 12.5.1 The Importance of Deal Structure

> After three years of law school devoted to elevating substance over form, the realization that in acquisition transactions the form of the deal can have significant substantive impact may come as a rude shock to the beginning practitioner. On behalf of the merger and acquisitions bar, I apologize for this seemingly retrogressive tendency in the law. . . .

James C. Freund, *Anatomy of a Merger,* p. 77 (Law Journal Seminars Press 1975).

There are three basic ways in which one company may acquire another: a purchase of stock, a purchase of assets, or a merger. Each of these three basic forms has different tax, legal, and economic consequences to the parties. Indeed, differences among the three forms are so great that it is fair to say that agreeing upon the structure of a transaction is an essential prerequisite to agreeing on the price.

The following is a brief and simplified overview of the differences among the three forms, assuming a fully taxable transaction. A more detailed basic summary of the tax issues (including a discussion of tax-free reorganizations) is contained in Griffin and Lev, "Tax Aspects of Corporate Mergers and Acquisitions," appearing in *Representations, Warranties, Indemnification and Termination Clauses* (MCLE, Inc. 2008).

(a) *Sale of Stock*

In this transaction, the buyer acquires a controlling interest (normally 100 percent) of the company's outstanding stock from the company's stockholders. Other characteristics of this transaction are as follows:

- No stockholder vote is required; rather, stockholders must individually agree to sell.
- The company becomes a wholly-owned or, less frequently, a partially-owned, subsidiary of the buyer.
- The company remains liable on all of its presale debts and obligations to third parties, including unknown and contingent liabilities. The buyer, as the new owner of the company's stock, inherits the burden and risk of these liabilities.

- There is no transfer of the company's leases, contracts, or other assets, which typically avoids the necessity of obtaining consents from landlords and other third parties. (The exception to this rule is where a lease or contract expressly provides that a change of control of the company will constitute a breach or require consent.)

- For federal income tax purposes, the selling stockholders ordinarily will recognize capital gain or loss on the difference between the selling price and their tax basis for their shares; the buyer and the company will not recognize gain or loss; and the company's assets will retain their previous tax bases.

(b) *Sale of Assets*

In this transaction, the buyer acquires all or substantially all of the company's assets and assumes specific liabilities of the company. Other characteristics of this transaction are as follows:

- The sale requires a vote of the company's stockholders (two-thirds of the issued and outstanding shares in Massachusetts; a majority in Delaware).

- Dissenting stockholders may be entitled to appraisal rights.

- The buyer assumes only those liabilities of the company that are expressly assumed by agreement or imposed on the transferee by operation of law.

- Assignment of leases, contracts, or permits may require the consent of landlords and others.

- If the company is a C corporation, it will recognize gain or loss for federal income tax purposes on the sale of its assets; its stockholders will recognize a "double tax" (usually at capital gains rates) on the distribution of the net proceeds of sale from the corporation; and the tax basis of the assets of the company will be "stepped up" in the hands of the buyer to equal the purchase price (calculated as the amount of cash paid plus liabilities assumed). The stepped-up basis provides the buyer with larger depreciation deductions, including amortization of good will.

- If the company is an S corporation or other pass-through entity, no gain or loss will usually be recognized at the corporate or entity level, and the stockholders will instead incur a "single tax" (usually at capital gains rates); the buyer will obtain a stepped-up basis in the assets, as described above. An exception to this general rule is the so called "sting tax." Massachusetts imposes a corporate tax on large S corporations (i.e., those with revenues in excess of $6 million) on their net income (including gain on a sale of assets). For 2010 and thereafter, this tax is 2.3 percent for S corporations with revenues of at least $6 million, but less than $9 million, and 3.45 percent for S corporations with revenues of $9 million or more.

(c) *Merger*

In a classic forward merger transaction, the company merges with and into the buyer and goes out of existence; the buyer, as the surviving corporation, succeeds to all of the assets and liabilities of the company as a matter of law; and the shares of the company are automatically converted into the merger consideration (which may be stock in the buyer, cash, or other consideration). Other characteristics of a merger are as follows:

- Requires board of directors and shareholder approval of the company (two-thirds of the issued and outstanding stock in Massachusetts; a majority in Delaware).

- Dissenting stockholders may have appraisal rights.

- In a forward merger, the surviving company acquires all of the company's assets and assumes all of its liabilities as a matter of law. In a reverse merger, the company retains all of its assets and liabilities and becomes a wholly-owned subsidiary of the buyer.

- In a forward merger, the leases, contracts, and permits of the company are assigned as a matter of law to the surviving corporation; no consent of landlords or others is required unless the lease or contract specifically so provides. In a reverse merger, the company retains all of its assets and liabilities, so no assignment is involved.

- In general terms, the federal income tax consequences of a taxable forward merger are similar to those of a sale of assets, and the federal income tax consequences of a reverse subsidiary merger are similar to those of a sale of stock.

Practice Note

Mergers come in several flavors. In addition to the classic forward merger described above, the company may merge into a subsidiary of the buyer (a "forward subsidiary" merger), with the subsidiary as the surviving corporation, or a subsidiary of the buyer may merge into the company (a "reverse subsidiary" merger), with the company as the surviving corporation.

(d) *Choice of Deal Structure*

Where the company is a C corporation, the seller's and buyer's interests often conflict. A buyer usually prefers a sale of assets or forward merger, which assures it of a step-up in tax basis (resulting in larger depreciation deductions), as well as the avoidance of most undisclosed and unknown liabilities. However, a sale of assets may require obtaining consents to the transfer of certain assets or permits. In general, a seller prefers a sale of stock, which assures the seller of a single level of taxation at capital gains rates.

Where the company is an S corporation or other pass-through entity, the parties have the best of both worlds. The entity can sell assets to the buyer and pass through the gain to the owners at (primarily) capital gains rates. (The principal exception is recapture of depreciation under Sections 1245 and 1250 of the Internal Revenue Code.) The buyer can obtain the assets at a stepped-up basis and avoid the assumption of unknown or contingent liabilities. Under Section 338(h)(10) of the Internal Revenue Code, the parties can agree to treat a sale of stock of an S corporation as a sale of assets for federal income tax purposes, avoiding the necessity of consents to the transfer of leases and contracts. Organizing a company as an S corporation is thus an excellent way of facilitating an "exit strategy" via a sale of the business.

Practice Note

As the transaction will be a transfer of stock for state law purposes, the buyer still runs the risk of assuming the corporation's liabilities.

In the past, some tax advisors have recommended that a new company be organized as a C corporation, because the maximum federal income tax rate on corporations was slightly less than the maximum tax rate on individuals. (In 2012, the tax rates were identical.) This advice can be dangerously shortsighted, since the effect of the "double tax" on the later sale of assets of the C corporation will significantly exceed the slight tax savings on the differences in individual and corporate rates.

§ 12.6 THE LETTER OF INTENT

Once a buyer has been selected, the parties typically negotiate a letter of intent or term sheet setting forth the basic terms of the deal, including the price, the form of the transaction, and major business terms. Letters of intent should always contain a specific and unequivocal statement that the parties are *not* creating a binding legal contract and intend to be bound only by a later formal agreement to be prepared by counsel and signed by the parties. A sample letter of intent is included as **Exhibit 12C**.

The letter of intent may contain certain provisions that the parties desire to be binding legal obligations, such as confidentiality provisions (which may merely reconfirm the provisions of the confidentiality agreement), or "no shop" provisions requiring the seller to refrain from negotiations with other parties for a specified period of time. These provisions should clearly be identified as being legally binding on the parties and designated as exceptions to the rule that the letter of intent is nonbinding.

§ 12.6.1 Beware the Ties that Bind

In numerous cases (including the notorious *Pennzoil* case), letters of intent have been found by courts to constitute binding contractual obligations. *See McCarthy v. Tobin*, 429 Mass. 84 (1999); *Texaco, Inc. v. Pennzoil Co.*, 729 S.W.2d 768 (Tex. 1987) (finding Texaco liable to Pennzoil for interfering with Pennzoil's contract, set forth in a simple "memorandum of agreement," to acquire Getty Oil and awarding Pennzoil $7.5 billion in damages, plus $3 billion in punitive damages); *compare Schwanbeck v. Federal-Mogul Corp.*, 412 Mass. 703 (1992); *Goren v. Royal Investments, Inc.*, 25 Mass. App. Ct. 137 (1987); *Blomendale v. Imbrescia*, 25 Mass. App. Ct. 144 (1987); *Tull v. Mr. Donut Dev. Corp.*, 7 Mass. App. Ct. 626 (1979). For this reason, great care must be taken to explicitly and unequivocally state that the parties do not intend to create a binding contract. This is one instance where overkill in drafting is fully justified. Some lawyers recommend using an unsigned term sheet rather than a letter of intent to avoid a binding contract.

In *McCarthy v. Tobin*, the Supreme Judicial Court suggested, "If parties do not intend to be bound by a preliminary agreement until the execution of a more formal document, they should employ language such as that suggested by the Appeals Court." *McCarthy v. Tobin*, 429 Mass. at 88 n.3 (citations omitted). The language suggested by the Appeals Court was: "The purpose of this document is to memorialize certain business points. The parties mutually acknowledge that their agreement is qualified and that they, therefore, contemplate the drafting and execution of a more detailed agreement. They intend to be bound only by the execution of such an agreement and not by this preliminary document." *McCarthy v. Tobin*, 44 Mass. App. Ct. 274, 279 n.10 (1998).

§ 12.6.2 A Magic Moment

The letter of intent stage is usually a "magic moment" in the course of the transaction, when the buyer is most eager to make a deal. The negotiation of the formal business acquisition agreement is almost exclusively focused on providing protection for the buyer and is usually controlled by the buyer's attorneys, who tend to resist any relaxation of these protective provisions. For this reason, a seller should take advantage of this opportunity to include in the letter of intent any seller-favorable provisions which it finds particularly important. For example,

(Text continues on p. 12–11.)

employment agreements, noncompetition covenants, escrows and "baskets," and other exceptions to indemnification provisions are best negotiated at this time.

§ 12.6.3 Why Use Letters of Intent at All?

Although letters of intent are not legally binding, they are taken seriously by the parties and their attorneys for several reasons. First, they serve as a handy agenda and reminder to the parties regarding the principal terms of the deal. Second, there is a psychological aspect to a letter of intent: It is a symbolic handshake, something that the parties feel, as responsible business people, that they have a moral obligation to live up to. It is common for a buyer or seller to respond with outrage to a "new" provision in the acquisition agreement: "If you wanted a noncompetition covenant, why didn't you put it in the letter of intent?"

Finally, the seller usually experiences a substantial change of position as a result of signing a letter of intent and making of a public announcement of the fact that the business is being sold. It must deal with the reactions of its employees, customers, vendors, creditors, banks, and competitors. The seller is now psychologically committed to proceed with the deal because "if the deal doesn't go through, the suspicion will always exist (no matter what the actual or announced reason) that the purchaser found something wrong with the seller's business." Freund, *Anatomy of a Merger*, p. 66. Perhaps this is the reason why few acquisitions are terminated by sellers, as opposed to buyers.

§ 12.7 THE DUE DILIGENCE PROCESS

As discussed above, there is usually a period of preliminary information disclosure as a part of the vetting of prospective buyers and the negotiation of the letter of intent. Following the letter of intent, the buyer's due diligence effort begins in earnest.

> **Practice Note**
> In some auction transactions, the seller may give prospective buyers access to a "data room" or, more recently, a "virtual data room" containing a complete set of disclosure materials prepared by the seller. A virtual data room is an electronic compilation of due diligence materials, usually maintained by a financial printer or other intermediary, to which potential buyers are given password-protected access.

Typically, the buyer provides the seller and its counsel with a questionnaire outlining the specific information it seeks regarding the seller's business. Examples of due diligence questionnaires are included as **Exhibits 12D** and **12E**. Collecting the requested information is a major task, involving the seller, its counsel, accountants, and other consultants. Many boxes of documents are usually produced. Since this data forms the basis for the various representations and warranties made by the seller, it is important to keep careful records of the documents produced. You do not want to have a dispute after the closing over whether an important contract was or was not disclosed. Preparing and circulating among the parties a CD-ROM disk containing all of the information produced (indexed to the due diligence questionnaire) is an efficient way to keep track of this mass of data.

§ 12.7.1 The Timing of the Due Diligence Process

From the buyer's perspective, the due diligence process should be completed prior to the signing of the acquisition agreement, thus assuring that the seller's representations in the agreement and the related disclosure schedules are complete and accurate. Where the parties contemplate a simultaneous signing and closing, this goal is usually accomplished. In practice, however, particularly with a deferred closing, the due diligence process frequently creeps to a conclusion well after the agreement is signed. This can give rise to awkward problems when significant omissions are discovered in the disclosure schedules. See § 12.8.5 and § 12.9.1(a), below.

Sellers are often reluctant to make full and complete disclosure, particularly to competitors, during negotiations. This is always a bad idea in view of the likely consequences of nondisclosure: either termination of the agreement (if negative information comes to light prior to the closing) or indemnification claims (when it comes to light after the closing). Clients must be educated at this stage to suppress their instincts to act as salespersons and instead to focus on adequately protecting themselves against potential liabilities by full, complete, and accurate disclosure.

> I think the most important single thing a seller's lawyer can do at the outset is to keep his client from getting uptight about full disclosure. . . . The proper course is to . . . assure him that this is standard operating procedure in acquisitions; and point out to him that, although there is certainly room for negotiation on specific issues, in general the purchaser is entitled to full disclosure—even if that means a lot of work in dishing up the facts.

Freund, *Anatomy of a Merger*, p. 233.

A seller—particularly one who has never sold a business before—must also be educated that full disclosure is in its own best interest.

This is not to say that the disclosure of sensitive business information should not be carefully managed, but only that it should always be ultimately disclosed. It is sensible for a seller to candidly admit that it is not comfortable providing trade secrets or pricing information to a competitor until it is satisfied that the buyer is committed to the deal. Your client may also want to whet the buyer's appetite to close the deal before introducing certain negative information. But in order to protect itself, the seller must ultimately make the leap and completely "open the kimono," to use the vernacular of the trade.

§ 12.7.2 The Disclosure Schedules

Every acquisition agreement contains representations and warranties regarding the seller's business, supplemented by detailed disclosure schedules, which are either physically attached to the agreement or contained in a separate document. For example, a typical representation would state that the seller has no subsidiaries, "except as set forth in Schedule X." Schedule X would contain the names of any subsidiaries, their jurisdiction of incorporation, states in which each is qualified to do business, etc. Of course, if there are no subsidiaries, this particular disclosure schedule would not be needed.

> **Practice Note**
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> A separate document is often used where the acquisition agreement will become part of a proxy statement or other public document, with a view to avoiding public disclosure of sensitive details about the seller's business.

The preparation of disclosure schedules is usually delegated to more junior attorneys working on the project, who prepare the schedules based on the materials produced in the due diligence investigation. There is an unfortunate tendency on the part of clients to regard the preparation of disclosure schedules as purely technical "lawyer's work," like the drafting of the agreement. Because the disclosure schedules are the backbone of the due diligence process and the basis on which potential indemnification claims may be based, they are too important to be left solely to attorneys who may be unfamiliar with the client's business. The final disclosure schedules should be reviewed and approved by the senior attorney responsible for the matter, and most importantly, by the client's business and financial people who are, after all, those most knowledgeable about its business. The same observation applies to the senior attorney representing the buyer, and the buyer's business and financial people.

§ 12.8 THE ACQUISITION AGREEMENT

§ 12.8.1 The Unstated Assumptions of the Acquisition Agreement

The typical business acquisition agreement is based upon a number of unstated assumptions well understood by sophisticated clients and attorneys, but not always shared by those with less M&A experience. It is essential that the parties and their counsel understand these basic assumptions up front in order to minimize friction and controversy. Frequently, it will be necessary to educate the seller (who most often is the party with the least M&A experience) and its counsel—usually at the letter of intent stage—to avoid unpleasant surprises.

(a) *The Built-In Purchaser's Bias*

Once the letter of intent has been signed, the predominant purpose of the acquisition agreement is to protect the buyer from overpaying by providing it with assurances that it is actually receiving what it thinks it is purchasing. In Freund's words:

> In effect, the buyer is saying something along these lines: "I agree to buy your business at the price and upon the other terms we have agreed to, *provided* that: (i) you tell me everything there is to know about your business, because that state of affairs forms the basis on which I am willing pay this price; (ii) you promise not to do anything prior to the closing that would adversely disturb this state of affairs, and in fact everything is the same or better at the time that we actually close; (iii) you let me investigate you to my heart's content; (iv) you deliver me good title to what I am getting; and (v) you stand behind what you tell me in case something negative comes up later on."

Freund, *Anatomy of a Merger*, p. 173.

This point is clearest when the consideration is all cash. In that case, the seller needs only to be comfortable that the buyer is capable of paying the purchase price and is not going to back out of the agreement. The rest of the acquisition agreement will reflect the buyer's protections. The seller's interest here is essentially "defensive," i.e., in protecting itself against overreaching by the buyer.

Of course, when the consideration consists of the buyer's stock or securities, the seller's interests extend to assuring that it, too, will be receiving the consideration it bargained for, i.e., stock or securities of a certain quality. In that case, the seller will typically insist on warranties, representations, covenants, and conditions from the buyer similar to those given by the seller.

(b) *No Deposit Required*

Another unstated assumption is that the buyer does not typically provide a cash deposit to secure its undertaking. This is the reverse of the assumption underlying most real estate purchase and sale agreements, and is not always understood or acquiesced to by the seller.

The lack of a deposit is usually justified by the buyer's claim that it is investing many thousands of dollars in due diligence and transaction costs, which will not be reimbursed if the deal is unsuccessful.

In some transactions, particularly in the automobile dealership and restaurant businesses, deposits are typically required. In a transaction involving the simultaneous purchase of an operating business and a substantial amount of real estate, a deposit may be provided for the real estate purchase, but not for the purchase of the business.

> **Practice Note**
> The simplest contractual format for business acquisitions involving real estate is to avoid combining the purchase of the real estate and the corporate stock or assets in a single contract, but rather to draft two contracts—a "standard" real estate purchase agreement and a "standard" business acquisition agreement—and to make the performance of each agreement a condition to the performance of the other.

(c) *Buyer's Counsel Does the First Draft*

Business acquisition "etiquette" dictates that the buyer provides the initial draft of the agreement. This is sensible because, as discussed above, the principal purpose of the agreement is to protect the buyer's expectations as to the quality of the business it is buying. This idea is sometimes resisted, and sellers (particularly in "auction" transactions) sometimes have the leverage to provide a draft or template of the acquisition agreement.

> **Practice Note**
> Sellers in a strong bargaining position sometimes try to dictate a rigid format for the acquisition agreement. In a recent sports franchise

> deal, the seller provided a fifty-page agreement to bidders with instructions to merely fill in the name of the buyer and the purchase price and to leave the balance of the agreement unchanged. In this context money usually talks louder than words, so the bidder with the best price almost always has the opportunity to negotiate the terms and conditions of the agreement. In this sports franchise deal, the winning bidder ended up marking up nearly every page of the agreement with its comments and extensively negotiating the terms of the agreement.

If you are unable to do the first draft, you can still assert some control over the drafting by volunteering to draft some of the exhibits (say, the escrow agreement) or by responding to the first draft by extensively rewriting key sections of the agreement. Rewriting the agreement entirely from scratch is considered bad form, so be selective about which areas you rewrite.

§ 12.8.2 Outline of a Typical Acquisition Agreement

Although business acquisition agreements all vary in important details, the basic structure of acquisition agreements (whether for the sale of stock or assets or a merger) has remained remarkably consistent and durable over time. The following is a discussion of the various articles of a typical agreement.

(a) *Article I—Operative Terms of the Transaction*

This article will include the identification of the parties, the structure of the deal, a description of the stock or assets to be transferred, the consideration to be paid, and the mechanics of the transaction. It would typically include the formula for computing any contingent consideration or purchase price adjustment, the mechanics for the delivery of stock certificates, the establishment of escrows, and the like. If the purchase price is to be payable in stock or securities of the buyer, the seller's investment representations and any registration rights would also be included here. Many of these provisions in Article I and subsequent articles will refer to ancillary agreements, such as articles of merger, corporate charter amendments, escrow agreements and registration rights agreements attached as exhibits to the basic agreement.

(b) *Article II—Representations and Warranties of the Seller*

These representations typically include those relating to the corporate organization, good standing, foreign qualification, and capitalization of the seller and its subsidiaries, title to the shares of stock or assets being sold, and the taking of appropriate corporation action authorizing the transaction. These will be followed by representations regarding the financial statements of the seller, including representations that there have been no "material adverse changes" in the business and assets of the seller since the most recent balance sheet date. These representations will typically contain a "laundry list" of specific undesirable events (dividends, casualty losses, dispositions of assets, accounting changes, waivers of rights, etc.) warranted not to have occurred since the balance sheet date, and a generic representation that there has been "no material adverse change" in the operations, assets, liabilities, or prospects of the business since that date. Many agreements contain specific representations concerning liabilities of the seller (absolute, accrued, contingent, or otherwise), taxes, assets (often including specific representations regarding accounts receivable, inventory, machinery and equipment, contracts, real estate, leases, and intellectual property), litigation, insurance, employee relations, and compliance with laws and regulations. Agreements frequently include representations relating to environmental compliance, employee benefit plans (including ERISA compliance), protection of intellectual property, self-dealing transactions, and other matters relevant to the transaction.

(c) *Article III—Representations and Warranties of the Buyer*

In a cash transaction, these representations are usually limited to the corporate organization, good standing, and corporate authorization of the buyer. Where stock or securities of the buyer are used as consideration, the capitalization of the buyer and the authorization, validity, and nonassessability of any shares to be issued are always included. In such cases, the seller may insist upon additional representations regarding the buyer's business, with the result that the buyer's representations are largely a mirror image of the seller's. Where the issuer of stock or securities is a publicly held corporation, the seller typically requires representations regarding the buyer's compliance with the securities laws and often substitutes for more detailed representations, a representation that the issuer's current filings with the Securities and Exchange Commission are true, correct, and complete.

(d) *Article IV—Covenants of the Seller and Buyer*

Covenants of the seller (and in some cases, the buyer) between the signing of the agreement and the closing are always provided. The extent of these covenants usually depends on whether there is to be a closing simultaneously with or in close proximity to the execution of the agreement, or whether there will be a deferred closing. See § 12.8.3, below. Typical seller's covenants include agreements to conduct its business in the ordinary course, provide buyer with access to information, notify buyer of material developments, use best efforts to secure regulatory and other approvals, refrain from soliciting competing offers to purchase the seller, noncompetition covenants, and other appropriate provisions. (The topic of "deal protection" covenants is beyond the scope of this chapter.)

(e) *Article V—Conditions Precedent to Closing*

This article identifies the specific conditions to each party's obligation to close the transaction. Typical conditions to the buyer's obligation to close include a "bring-down" certificate to the effect that all of the seller's representations and warranties are true and correct at the closing date and that the seller has complied with all of its covenants. Other conditions may include the receipt of stockholder approvals, tax rulings, legal opinions, updated financial statements (and perhaps the achievement of certain earning goals), and the delivery of related contracts such as escrow agreements, employment agreements, and noncompetition agreements. Similar conditions apply to the seller's obligations, and include the payment of the consideration for the acquisition and related matters.

(f) *Article VI—Closing and Termination Procedures*

This article typically provides for termination of the agreement

- at any time, by mutual consent of the parties;
- prior to the closing, by either party if the other party has breached any representation or covenant in any material respect (and has not cured such breach within a specified period); and
- on the closing date, by either party if any of the conditions to that party's obligation to close are not satisfied (unless the failure results from that party's own breach).

Less frequently, the buyer may have the right to terminate within a specified period following the signing if it is not satisfied with the results of its continuing due diligence investigation. In some deals (usually involving a publicly held seller), the seller may have the right to terminate the agreement (often upon the payment of a "break-up" fee to the buyer) if it receives a superior offer from a third party.

(g) *Article VII—Indemnification*

This article sets forth provisions entitling the buyer (and less frequently, the seller) to claim damages postclosing for losses caused by the breach of a representation or covenant by the other party. These are among the most hotly contested provisions of the agreement and tend to be the most complicated.

Typical provisions include an agreement by the seller to indemnify the buyer for any losses resulting from any breach of its representations or covenants, upon receipt of a written demand by buyer. There is usually a time limitation for making indemnification claims, although certain claims (such as those involving taxes and environmental matters) may not have a time limit. The amount of the indemnification claim may be limited by a deductible, threshold, or ceiling (discussed below), or by the availability of insurance proceeds or offsetting tax benefits. Procedures for the defense of unresolved third party claims are usually provided. The indemnification rights may or may not be defined as the exclusive remedy under the agreement. The agreement may also provide for security for indemnification claims in the form of an escrow of cash or shares, or by set-off against any promissory note or future contingent payment payable by the buyer.

(h) *Article VIII—Miscellaneous Matters*

This is a catch-all article which typically deals with such boilerplate items as press releases and public announcements, third-party beneficiary rights, integration, succession and assignments, counterparts, the effect of headings and recitals, notice provisions, governing law, amendments and waivers, expenses, construction, incorporation by reference, dispute resolution, specific performance, and forum selection.

(i) *Article IX—Exhibits and Disclosure Schedules*

The acquisition agreement will contain various exhibits setting forth side agreements relevant to the deal, such as escrow agreements, registration rights agreements, consulting agreements, employment agreements, promissory notes, charter amendments, articles of merger, leases, and the like.

Disclosure schedules are discussed in § 12.7.2, above. Agreements frequently contain a buyer-favorable clause stating that matters disclosed in one schedule are not deemed to be contained in another schedule. This is intended to protect the buyer from the seller's claims that a contract listed in a schedule of "all contracts involving amounts in excess of $50,000" is automatically included in a schedule of "all contracts in which performance will result in a loss to seller." Compliance with this requirement is often burdensome and complicates the process of preparing the schedules.

A clever seller may find ways to finesse the effect of the seller's representations via drafting of the disclosure schedules. For example, a representation requiring a schedule showing "all contingent liabilities not reflected in the balance sheet" can be diluted by stating in the schedule that the buyer has liabilities for "product warranty claims incurred in the ordinary course of business." Buyer beware!

§ 12.8.3 Simultaneous or Deferred Closing

Frequently, an acquisition agreement between two closely held companies will be executed simultaneously with or in close proximity to the closing of the transaction. This permits the parties to dispense with a good many of the contractual provisions discussed above. For example, covenants pending the closing and conditions to the closing can be eliminated (or at least simplified) and only those representations that are intended to survive the closing need be retained.

In many cases, however, there will be a significant lapse of time between the signing and the closing, as when a stockholder vote or a tax ruling must be obtained, financing must be arranged, or the consents of third parties must be procured. Occasionally, the buyer requires the seller to complete an audit of its most recent fiscal year or interim period. In such cases, shortcut methods of dealing with the acquisition agreement are not available.

§ 12.8.4 The Four Horsemen (Representations, Covenants, Conditions, and Indemnification)

The representations, covenants, conditions, and indemnification provisions of an acquisition agreement each have different purposes and interact with each other in complex ways.

(a) *Representations*

The representations and warranties article of the acquisition agreement provides a static "snapshot" or "balance sheet" view of the seller's business at the time of signing of the agreement. Ordinarily, few representations are made regarding the *future* conduct of the seller's business—these are usually dealt with by the seller's covenants and the buyer's conditions to closing, which normally include a bring-down certificate certifying that the seller's representations are true and correct as of the closing date.

The seller's financial statements are usually warranted as of a certain "balance sheet date," which may be the end of the most recent fiscal year or a more recent fiscal quarter or some other "stub" period. The seller's representations ordinarily include a forward-looking statement to the effect that "since the balance sheet date, the seller has incurred no additional liabilities other than in the ordinary course of business." This makes the financial statement representations current as of the date of signing the agreement and avoids a gap period (from the balance sheet date to the signing date) for which the buyer would be unprotected.

(b) *Covenants*

In contrast to the seller's representations, the seller's covenants constitute an agreement on its part to behave in certain ways during the period from the date of signing to the closing. These provisions are future-oriented, as opposed to the representations, which are largely present- or past-oriented. The analogy here is to a "movie" rather than a "snapshot," or if you prefer an accounting analogy, to an income statement rather than a balance sheet.

The seller's representations usually include a statement that "since the balance sheet date," the seller has not taken certain specific actions deemed unfavorable to the buyer (e.g., paid a dividend, amended its charter, issued additional stock, incurred a casualty loss, etc.). This laundry list is usually repeated in a negative covenant to the effect that seller will not take any such actions pending the closing. Ordinarily, the seller's covenants are prefaced by a qualification such as "except with the written permission of the buyer," which gives the seller some flexibility in operating its business pending the closing.

(c) *Conditions*

The conditions article identifies the conditions precedent to each party's right to close, thus giving a party the right to walk away from the deal, or, in more practical terms, to renegotiate the deal, if the conditions are not met.

There are several ubiquitous closing conditions:

- all representations must be true and correct as of the closing date as if made on that date,
- all covenants have been performed by the relevant party by the closing date, and
- each party will provide an officer's certificate to that effect.

Legal opinions are another nearly ubiquitous condition. Other deal-specific conditions include the execution of certain contracts (employment agreements, covenants not to compete, dispositions of assets, etc.), and the receipt of stockholder approvals, tax rulings, and occasionally accountant's "comfort" letters.

(d) *Indemnification*

The indemnification article is always a hot-button issue for negotiation. Unlike the other "four horsemen," indemnification occurs *after* the closing. (In contrast, representations speak as of the signing of the agreement, covenants during the preclosing period, and conditions as of the closing date.) In short, this article states the conditions under which one party (usually the buyer) may recover damages or adjust the purchase price if one or more of the other party's representations or covenants are breached.

Indemnification provisions are often elaborately constructed and may include "caps," "baskets," or "deductibles," time limits on asserting indemnification claims, control of proceedings for third-party claims, and special provisions for insurance, taxes, and environmental claims.

> **Practice Note**
> A "cap" is a limit on the total amount of indemnification claims that may be asserted, usually a percentage of the purchase price. A "basket" is a threshold amount (say, $1 million) which aggregate indemnification claims must meet to be enforceable (in this example, claims totaling $999,000 would not be indemnifiable, but claims totaling $1.01 million would be indemnifiable in full). A "deductible" is similar to a basket but reduces the total amount of indemnification (in this example, with a $1 million deductible, a buyer with claims of $1.5 million, would be indemnified only for $500,000).

A curious feature of most indemnification clauses is that they usually fail to provide a formula for quantifying the indemnified loss. Sometimes, determining the loss is simple: An undisclosed $100,000 tax lien is discovered after the closing; the seller's indemnification obligation is $100,000, the amount by which the buyer must pay to discharge the lien. But suppose a business is purchased at a multiple of six times EBITDA. The buyer discovers a material misstatement of the historical financial statements resulting in a $100,000 reduction in EBITDA in the most recent financial statements. Can the buyer claim a $600,000 loss? Or only $100,000? One could argue that the multiplier only applies to *future* EBITDA and that the lower number should apply. In any case, the multiplier effect is rarely articulated in the agreement, perhaps due to "the fear that the seller will take umbrage at the concept and succeed in specifically negating it in the agreement—thereby foreclosing whatever argument purchaser's lawyer might have been able to make to the judge." Freund, *Anatomy of a Merger*, p. 369. This is a good example of "creative ambiguity," where a clause is deliberately left ambiguous to preserve a later argument which might be surrendered in negotiations.

Note that there are usually no indemnification provisions where the seller is a public company, usually attributed to the impracticability of pursuing claims against a large number of individual stockholders.

§ 12.8.5 The Interaction of the Four Horsemen

The interaction among representations, covenants, conditions, and indemnification provisions can be illustrated by an example.

Suppose an acquisition agreement is signed on January 2, containing the usual representation that there exists no material litigation against the seller. On February 1, a major lawsuit is commenced against the seller, well before the scheduled closing date of March 1.

Since the *representation* speaks as of the January 2 date of execution of the agreement, there is no breach of representation arising out of a later-filed lawsuit.

The seller may be obligated by a *covenant* in the agreement to update the disclosure schedules to reflect this event. Even absent this obligation, the seller will in any event have to comply with the *condition* that it provide a bring-down certificate at the closing to the effect that all representations are true and correct at and as of the closing.

If the seller makes the appropriate disclosure, the buyer will have the remedy under the conditions article of terminating the agreement since the “no litigation” representation was not true as of the closing date. Of course, if the seller does *not* make the disclosure and the deal closes, the buyer will be entitled to indemnification under the terms of the agreement (and may indeed have other remedies) because the bring-down certificate will be knowingly false.

If the seller does make appropriate disclosure at the closing, may the buyer *still* proceed with the closing and seek postclosing indemnification for the alleged breach? This is the problem of “sandbagging,” which should always be addressed in the acquisition agreement. A seller should always ask for a clause which makes the representations, *as supplemented by the officer’s closing certificate*, the basis for indemnification, in which case the buyer will bear the risk of an adverse outcome of the lawsuit if it proceeds with the closing. In the absence of a clear resolution of this issue in the agreement, the courts may find a waiver of the buyer’s right to indemnification.

It is worth noting that representations perform three different functions:

- they facilitate the disclosure of relevant facts relating to the seller’s business and thus complement the due diligence process;

- they allow the buyer to walk away from the transaction if they are not true and correct at the closing; and
- they provide the buyer with postclosing indemnification rights.

Nervous sellers sometimes worry that even a trivial breach of representation (e.g., a $1,000 lawsuit) may enable the buyer to walk away from the deal, and therefore insist that all representations be qualified by materiality. In such cases, there is usually an acceptable compromise position that requires a breach of representation to be "material" in order to justify a termination, but allows the buyer to seek indemnification (subject to any basket or deductible clause) regardless of materiality.

Typical issues which are subject to negotiation are the extent of the seller's representations, whether any of the representations or covenants will be qualified by materiality or the seller's knowledge (and if so, whose knowledge will be relevant), the extent to which representations or covenants will survive the closing, the extent to which indemnification obligations will be subject to a deductible, threshold, or ceiling, or limited by insurance or tax benefits, and the manner in which the buyer may recover damages for breaches of representations and covenants. When the seller is a publicly held corporation, its representations and covenants generally will not survive the closing or be subject to indemnification.

§ 12.9 FROM SIGNING TO CLOSING

As discussed in § 12.8.3, above, there often is no significant time period between the signing of the agreement to the closing. When the closing date is deferred, there are several activities important to attorneys that may be ongoing: completion of the due diligence investigation of the seller, monitoring the seller's ongoing activities, calling a stockholders' meeting, obtaining consents from third parties, and arranging acquisition financing. Of course, the parties will at this time be preparing for the business transition, which involves myriad details, from personnel issues to integrating computer systems.

§ 12.9.1 Completing the Investigation

In the final phase of the due diligence investigation, the buyer and its attorneys will review in detail the financial, legal, and business aspects of the seller's business. This serves as a check on the accuracy of the seller's representations and is a necessary part of the business transaction. Coordination and communication between the buyer's attorneys and business people is essential in this phase.

(a) *Unearthing a Skeleton*

What happens when the buyer's investigation turns up information inconsistent with or omitted from the seller's disclosure schedules? The first task is to assess the importance of the misrepresentation. Does the client consider this to be material to the business or an insignificant detail? It is important not to create a false crisis which may upset the deal.

If the misrepresentation is indeed material, was it inadvertent or intentional? Although the contractual consequences of either type of misrepresentation are probably identical, an intentional misrepresentation creates serious questions about the reliability of other information given by the seller and the seller's overall trustworthiness.

There are several alternatives available to a buyer in dealing with this situation. The first is to remain silent and to treat the misrepresentation as giving the buyer an "option" to terminate the agreement at or prior to the closing. Of course, if the seller discovers the misrepresentation, it may make disclosure to the buyer, which makes it more difficult for the buyer to invoke termination. The buyer may also choose to remain silent and rely on the indemnification provisions for a postclosing remedy, but this is a dangerous course unless the acquisition agreement is crystal clear on the buyer's right to do so. In any case, this form of "sandbagging" is often regarded as a breach of business ethics and does not make a favorable impression on the courts.

The second alternative, calling the misrepresentation promptly to the seller's attention, but then dropping the subject, is awkward, sends a confusing message to the seller, and runs the risk that the buyer will be deemed to have waived the misrepresentation.

The preferred alternative is usually to call the matter to the seller's attention, ask for an explanation, and forthrightly declare the buyer's intentions either to reserve its rights to terminate the agreement, to enforce its indemnification rights, or both. This frequently leads to a compromise involving some cash adjustment to the purchase price or other concession on the seller's part. Misrepresentations of this sort are often used as bargaining chips in resolving other outstanding business or legal issues between the parties.

§ 12.9.2 Monitoring the Business

The seller's personnel should, of course, be made aware of the various restrictions on the operation of its business contained in the covenants in the acquisition agreement. There is always a risk that an inattentive client will regard the covenants as mere lawyer's boilerplate and be unaware of their significance. The buyer's personnel, who will be in almost daily contact with the seller regarding transition matters, should be instructed to report on any problems in this area.

The seller may discover that some unexpected development makes it necessary or desirable to take action which technically violates the covenants. It should in such cases notify the buyer, seek its consent, and document the consent in a simple letter or other writing. The problems caused when some new adverse development (such as a lawsuit) arises between the signing and the closing are discussed in § 12.8.4, above.

§ 12.9.3 Stockholders Meetings

Where stockholder consent is required to approve a transaction, the parties may have to file a proxy statement with the Securities and Exchange Commission or prepare a similar disclosure document for the stockholders of a private company. The content of proxy statements filed with the SEC is prescribed by Regulation 14A under the Securities Exchange Act of 1934 and is beyond the scope of this chapter. Disclosure materials for companies not registered with the SEC are usually less formal and less complex, consisting of a description of the transaction, a copy of the acquisition agreement, and, in some cases, financial statements. Needless to say, early preparation and close cooperation between the parties are essential to making this process work efficiently.

§ 12.9.4 Third-Party Consents

Typical consents that may be required include those from seller's mortgagees, landlords, equipment lessors, licensors, contracting parties, and regulatory agencies. If the seller's existing bank financing is to be continued after a change of control, transfer of assets, or merger, the bank consent is almost always necessary. As a general rule, an assignment of contract rights is permitted unless the contract provides otherwise, and a change of control is not ipso facto considered an assignment. Nonetheless, the buyer must carefully analyze the terms of each of the seller's key contracts to ascertain whether the counterparty's consent is required.

Government contracts are a special case. The federal Assignment of Claims Acts, 31 U.S.C. § 203 and 41 U.S.C. § 15, prohibit assignment of government contracts without formal notification and consent. The government agency will usually require a "novation agreement" under which the seller remains liable as a guarantor of the buyer's performance. Since the process of assigning government contracts is incredibly slow-moving, it is common for the parties to consummate the acquisition without prior receipt of approval. The risks of doing so depend, of course, on the significance of the contract and the likelihood of government approval.

An assignment of a lease or contract to the buyer does not usually relieve the seller of its continuing obligations as a "quasi-surety," i.e., a guarantor of the buyer's performance, *even when consent to the assignment is not required*. Of course, a novation agreement releasing the assignor cures this problem for the seller, but the consenting party usually has little incentive to do so. For this reason, a careful seller may want to include provisions for indemnification by the buyer against obligations assumed by the buyer; although the seller should be entitled to subrogation rights against the buyer as a matter of law.

Third parties may use the consent process to extract some additional concessions from the parties (the burden of which would fall on the buyer). Where possible, try to avoid conveying to the third party the notion that its consent is vital to the deal. Some agreements provide for subcontracting-like arrangements between the buyer and the seller to preserve the benefits of the contract if the third party does not consent to its assignment. To my knowledge, the effectiveness of these arrangements is untested.

Assignment of government permits, licenses, and approvals ("permits") is frequently essential. There are a few generalizations that can be made about this subject: Some permits, such as zoning permits, "run with the land" and require no approval; others require only notification of assignment; others require notice and hearing before approval is granted; still others (liquor licenses are a good example) are expressly nonassignable and require the buyer to apply for a new permit in its own name. Be aware that government agencies do not always recognize the deal structure in the same way that corporate lawyers do. They may regard a merger as a "change of name" or a reverse merger or sale of stock as an assignment, rather than as a sale of control.

§ 12.9.5 Arranging for Buyer's Financing

Most large strategic buyers and private equity firms will have adequate prearranged debt or equity financing sufficient to finance the acquisition. The existence of prearranged financing gives those firms a major edge in the competition to acquire the company. Experience has shown that sellers tend to be risk-averse and may favor the "bird in the hand" who has its financing over a competitor that needs a financing contingency. It is always in the buyer's interest to have financing available prior to signing the agreement.

In appropriate cases, the seller may request a copy of the buyer's commitment letter from its lender and appropriate representations from the buyer that the commitment letter is in force and effect. Of course, commitment letters are notorious for containing numerous contingencies allowing the lender to terminate the transaction, so a seller should not expect more than a certain enhanced level of comfort from the existence of a commitment letter.

A buyer without prearranged financing may ask for a specific financing contingency in the acquisition agreement, or may choose to run the risk that it can obtain the financing. The number of deals with financing contingencies seem to vary with changes in the credit markets. A seller's decision to give the buyer a financing contingency requires a case-by-case analysis and may depend on the relative leverage of the parties. A seller in a strong bargaining position may seek a substantial "reverse termination fee" if the financing contingency is invoked, or may insist on the remedy of specific performance if there is no financing contingency.

§ 12.10 THE CLOSING

The best closings are anticlimactic. If all parties and their counsel have done their job and all surprises are identified and dealt with in advance, the closing should involve only the signing of papers and filing of relevant documents (and perhaps a toast or two). A form of closing agenda for a sale of stock is included as **Exhibit12F**.

In mergers and other transactions where the filing of articles of merger or other corporate documents with the secretary of state is required, you should arrange for prefiling approval by the secretary's office. This will avoid the embarrassment of having a technical defect delay the effectiveness of the entire transaction. The staff of the Corporations Division in the Office of the Secretary of the Commonwealth of Massachusetts is particularly helpful in coordinating filings.

Frequently, one or more of the closing documents is unavailable or not in proper form at the closing. Where the problem is entirely technical (a missing good standing certificate, for example), the parties usually waive the requirement against a promise to procure the document as soon as possible.

Where a document of much greater significance (a third-party consent, for example) may be unavailable at the closing, the parties usually find a way to close. The buyer may agree to waive the condition, delay the closing until the condition is satisfied, negotiate a financial or other concession by the seller, or escrow a portion of the purchase price.

I agree with the observation that when the parties reach the final stages of a business transaction, there arises a certain psychological gravitational force which pulls the parties together. With the finish line in sight, many clients tend to make concessions they would have rejected a few days earlier, if it gets the deal done. *See* Freund, *Anatomy of a Merger*, p. 441. For this reason, my strong personal preference is to conduct face-to-face closings whenever possible. The modern trend toward long-distance "e-mail" closings has eroded the importance of this psychological factor.

§ 12.11 ANATOMY OF A MERGER—NEGOTIATING BUSINESS ACQUISITION AGREEMENTS

The title of this section is an homage to James Freund's extraordinary *Anatomy of a Merger* (Law Journal Press 1975). Although dated in some respects (e.g., an extensive discussion of pooling versus purchase accounting), Freund's book remains the best practical guide for the lawyer engaged in negotiating business acquisitions, full of practical tips and brilliant insight into the strategy and tactics of negotiating business deals. Movie buffs and readers of a certain age will recognize the title of Freund's book as a pun on the celebrated 1959 motion picture, *Anatomy of a Murder*, a courtroom drama directed by Otto Preminger and starring Jimmy Stewart and George C. Scott.

The following sections provide the reader with practical advice based upon the author's forty years' experience in negotiating business acquisitions. I have tried to illustrate some of my observations with real-life examples. Some of these observations are truisms; others may be idiosyncratic or even iconoclastic. Oscar Wilde once said, "Experience is simply the name we give our mistakes." It is the author's hope that this portion of the chapter will help others avoid some of the mistakes which he has committed.

§ 12.12 THE LAWYER'S ROLE

§ 12.12.1 Lawyers and Business People

Lawyers and business people are quite different animals. Lawyers are by nature risk-averse, always imagining the worst-case scenario and capable of producing a parade of horribles at the drop of a hat. For these reasons, lawyers are often unfairly regarded as "deal killers," out to sabotage even the most simple and innocuous transactions.

Business people, in contrast, are inveterate risk takers; all but the most unsophisticated business people know that success in business comes only from taking calculated risks in search of potential rewards. "Nothing ventured, nothing gained" is their motto. Business people correctly see their jobs as making decisions in the absence of complete information, and are not afraid to do so.

> **Practice Note**
>
> I once had a law partner who seriously contended that he advised his clients *never* to sign a guaranty because "no good could ever come of it." He thus totally disregarded the "reward" portion of the risk-reward equation.

§ 12.12.2 The Lawyer's Role in Business Acquisitions

The proper role of the business lawyer in any business transaction is to help his or her client evaluate the legal risks involved in a business decision, and not for the lawyer to make the business decision himself or herself. This conclusion follows from the premise that lawyers are, by and large, not as well equipped by training or experience to make business decisions as those persons who are engaged in running their own businesses or are hired by stockholders to run their businesses for them.

The business lawyer must know how business people think, and how legal advice fits into the risk-reward calculation. The lawyer must, above all, *inform* his or her clients of the legal risks involved in making business decisions, including the likelihood and consequences of adverse outcomes. Once the client is fully informed about these legal risks, the lawyer's role is over, and the businessperson should be the one making the decision.

§ 12.12.3 Communicating with Clients

Business clients often complain that they cannot get a "straight answer" from their attorneys. They expect answers that are prompt, concise, correct, and to the point. They understand that not all legal questions have a black or white answer, but they are frustrated by responses that are verbose and fail to come to a conclusion. Inexperienced lawyers frequently respond to clients' questions by sending a long memorandum resembling a law review article, citing every case decided on a subject, discussing the different conclusions reached in different judicial circuits, and coming to a nonconclusion by listing a string of factors to be considered or giving an "on the one hand, on the other hand" analysis. They inevitably find that the client is unimpressed by their erudition and frustrated by their failure to give useful advice. Although the law or the facts may be in a gray area, it is best to give the client some idea of the outcome of his or her actions. Business people are comfortable with dealing with uncertainties; it is *complete uncertainty* they cannot stand. Tell them it is "highly likely," "likely," or "equally probable" that a court would act in a certain way, or, when possible, express the possibilities as a percentage. Business clients like percentages, but I personally dislike using them because they imply a precision that does not exist. I was once told by a labor lawyer that there was an "87.5 percent chance" that my client would prevail on appeal. I did not find that very believable.

§ 12.12.4 Three Special Cases

There are three cases in which the role of the legal advisor described above are put to the test: those involving the dishonest client, the unsophisticated client, and the irrational client.

(a) *The Dishonest Client*

An important part of assisting a client in reaching a business decision is advising him or her as to the *likelihood* of an adverse result (e.g., the practical probability that a stockholder would bring suit challenging an arguably self-dealing transaction), but you should *never* cross the line and advise a client to engage in clearly illegal or unethical conduct on the basis that he or she is unlikely to get caught. This is not only unethical, but may expose the attorney to civil or criminal liability.

Tax fraud is a good example. (A restaurateur once asked me how much cash he could pocket without the IRS getting wise. I answered truthfully that I didn't know and that it would be unethical to give such advice.) The likelihood of a tax audit of a business or individual return is extremely low, but this should never influence you to advise a client to take a chance in the "audit lottery" when there is no legitimate basis for his or her tax position.

(b) *The Unsophisticated Client*

Frequently, your client will have little business experience or familiarity with a particular business problem. (The sale of a small business, for instance, is usually a once-in-a-lifetime event for the seller.) In these circumstances, clients sometimes want their attorneys to make the business decisions for them. (We have all heard the statement "my lawyer won't let me do that.")

This is an often tempting but always risky situation. In such cases, the best course is for the attorney to try to *educate* the client as to the legal and business context and encourage him or her to make a decision based on good legal and business advice. A business advisor, frequently an accountant, can be engaged to help. Tell your client, "If the decision were up to me, I would (or would not) take the risk and do X; but it's your money and your decision. Whatever you decide to do, I'll help you achieve it."

(c) *The Irrational Client*

On rare occasions, you will encounter a client who is bound and determined to take a course of action (say, to buy a business) which will have predictably disastrous business consequences. Advising these clients is like talking lemmings out of going over a cliff. No amount of reason seems to prevail.

I once represented a client with a modest inheritance who dreamed of owning a particular country inn. When the inn came on the market, he jumped at the opportunity to buy it. Unfortunately, the price he agreed to pay was, in the opinion of all of his advisors, grossly excessive. (Curiously, his bank lender was suspicious that he was *underpaying*, and asked me whether there was some secret cash payment that was not being disclosed.) At my suggestion, he engaged a respected accounting firm to do a set of projections of the inn's future cash flow. Their calculations showed that he would run out of money in less than a year. Time and again, I tried to convince him of the folly of his actions. I only succeeded in angering him. Ultimately, the deal closed and, sure enough, the inn went out of business a year later and he lost his entire investment.

While I often reflect with sadness on this avoidable tragedy, my conscience is nonetheless clear: I did my duty as an attorney and advisor to dissuade my client from what I correctly thought was a ruinous course of action, but he made his own foolish decision in spite of my best efforts. (I sometimes wonder whether I should have resigned as counsel, but I realize that this would not have saved him from the consequences of his actions. He would simply have hired another attorney to do the job.)

On the other side of the ledger, my clients have over the years made many millions of dollars doing deals which I thought were too risky from a business standpoint. Perhaps they were all lucky; more likely, my business instincts were far too conservative, which confirms the wisdom of limiting my role to that of a legal, not a business, advisor.

§ 12.13 SOME GENERAL OBSERVATIONS ON NEGOTIATION

The business sections of the public library and larger bookstores are full of popular books on the art and science of negotiation. Harvard Law School, for example, has had a Program on Negotiation since 1983 (see http://www.pon.

harvard.edu), and the academic literature on negotiation (including the game theory branch of mathematics) is proliferating at an alarming rate.

Practice Note

Some of the better negotiating books are Fisher, Ury & Patton, *Getting to Yes* (Penguin Books, 2d ed. 1991); Nierenberg, *The Art of Negotiating* (1986); Hunt, *Structuring Mergers & Acquisitions*, ch. 25 (Wolters Kluwer, 3d ed. 2007); Harbaugh & Britzke, *Primer on Negotiating: Controlling Information and Making and Meeting Offers* (PLI 2006); Freund, *The Acquisition Mating Dance and Other Essays on Negotiation* (Prentice Hall 1987); *The Essentials of Negotiation* (Harvard Bus. School 2003); Subramian, *Negotiauctions* (W.W. Norton 2010).

There is a general consensus among the authorities that the best negotiator is one who can develop credibility, employ "principled" negotiation rather than take-it-or-leave-it positions, and find creative solutions that satisfy the interests of both parties.

§ 12.13.1 Positional Versus Principled Negotiations

The popular literature on negotiation consistently points out the advantages of "principled" negotiation based on the interests of the parties, over "positional" negotiation where the parties take a hard line on a take-it-or-leave-it basis. Positional negotiation is often referred to as "adversarial" or "zero-sum" bargaining; principled negotiation is often referred to as "problem-solving" bargaining. Dean Harbaugh describes the differences as follows:

> The classic form of bargaining, one that most people envision when they think about negotiating, is the adversarial model. Adversarial bargaining can be conceptualized as a zero-sum process in which the negotiators reduce each issue being negotiated to a finite fungible item, such as money or units to be bought or sold. In the adversarial model, negotiators attempt to get as much money or as many units on their side of the table as is possible. Each dollar or unit gained by one negotiator is taken away from and becomes an equally sized loss to the other negotiator. Adversarial negotiation gets its zero-sum label because the gains and losses of the parties balance off and equal zero.

> Problem solving negotiation is conceptualized as a non-zero-sum process in which the negotiators resist reducing the issues to a series of fungible items that can only be divided between the parties. Instead, problem solving negotiators attempt to identify the underlying needs, goals, values and interests of the parties. Once the parties' needs have been identified, problem solvers seek solutions that satisfy the essential and important needs of all parties without depriving any party of something that is highly valued. The parties in a problem solving negotiation tend to exchange items that each values according to different standards. In this model, the exchange sheet rarely balances out, and a non-zero-sum label can be applied.

Harbaugh & Britzke, *Primer on Negotiating: Controlling Information and Making and Meeting Offers*, p. 5.

A particularly good example of the distinction between positional and principled negotiations is the breakdown of the negotiations between the Kennedy Administration and the Soviet Union over the nuclear test ban treaty.

> A critical question arose: How many on-site inspections per year should the Soviet Union and the United States be permitted to make within the other's territory to investigate suspicious seismic events? The Soviet Union finally agreed to three inspections. The United States insisted on no less than ten. And there the talks broke down—over positions—despite the fact that no one understood whether an "inspection" would involve one person looking around for one day, or a hundred people prying indiscriminately for a month. The parties had made little attempt to design an inspection procedure that would reconcile the United States' interest in verification with the desire of both countries for minimal intrusion.

Fisher, Ury & Patton, *Getting to Yes*, p. 5.

Citing principles to justify a desired result is, of course, part of any lawyer's stock in trade as an advocate of his or her client's interests, and is one of the reasons why lawyers tend to be among the most skillful and effective negotiators.

§ 12.13.2 The Role of Leverage

I must admit my discomfort with the idea that principled negotiation is innately superior to positional negotiation. A successful business negotiator need not have superior debating skills if he or she has a thorough grasp of the parties' relative bargaining power and an ability to leverage that power. Let me illustrate with an example.

(a) *The Dog in the Manger*

(The term "dog in a manger" refers to Aesop's fable of that name, in which a vicious dog lies in a manger full of hay, refusing to allow the cattle to eat, even though the hay was useless to him.)

Early in my career, I assisted an experienced M&A lawyer in negotiating the sale of stock of a closely held automotive parts manufacturer to a large publicly held company. The agreed price for 100 percent of the company's stock was, say, $5 million. For reasons I have since forgotten, a sale of stock (as opposed to a sale of assets or a merger) was essential to the selling stockholders; the purchaser naturally would not accept less than 100 percent of the stock.

The problem to be solved was how to allocate the $5 million purchase price among the various groups of stockholders. Our client was the company's founder and owned a majority of the common stock; several professional investment firms owned a class of convertible preferred stock; and a small number of shares of common stock were held by a businessman who had extended the founder credit during the company's start-up phase.

The problem seemed simple: There were only two classes of stock and the value of the preferred stock on a "cashless" conversion basis was easily determined. The preferred would get X; the common, $5 million minus X.

The wrinkle was that the businessman wanted more than his percentage share of the business. The selling shareholders and their counsel met in Manhattan the day before the closing to iron out the details. A group of the best and the brightest Wall Street lawyers, investment bankers, and accountants hammered away at the recalcitrant businessman and his counsel (a suburban divorce lawyer) all day and far into the night, with no success. Finally, in the wee hours, the founder and the preferred shareholders relented and agreed to pay the businessman his price.

The stock purchase agreement was then signed and the businessman and his lawyer left. The minute the door closed, the Wall Street types began criticizing his accent, his clothing, and his obvious lack of education and financial sophistication. After this had gone on for a while, my senior partner interrupted and said: "I don't get it. This guy got 150 percent of the value of his stock, you got 95 percent of the value of your stock, and you're saying that he's the dumb one?"

The point of this example is not to disparage principled negotiation, but merely to demonstrate that all the principled negotiation in the world cannot trump a determined opponent who knows how to exercise his or her bargaining leverage. The mistake that the other selling shareholders made in this case was not the lack of a skillful presentation of a principled basis for allocating the purchase price, but rather, allowing the businessman to get into a position to veto the deal in the first place.

As a general rule, principled negotiation is most effective when the parties are (or believe themselves to be) in equal bargaining position; where one party has a clear bargaining advantage, he or she may use positional negotiation to his or her advantage. As a corollary, positional negotiation favors the party with the superior bargaining position; principled negotiation favors the party with inferior bargain positions.

(b) *The Myth of the Level Playing Field*

As Freund wisely observes, leverage enters into virtually every business acquisition transaction:

> Rereading today what I wrote years ago about negotiating acquisitions, I'm struck by the implicit assumption that the negotiations take place on a level playing field; *i.e.*, that each party approaches the conference room with the same degree of voluntariness and roughly the same quantum of desire to accomplish the transaction, and that each has a similar willingness, if the significant provisions cannot be worked out to its satisfaction, to walk away from the deal.
>
> Well, that's not a bad academic model to start from in assessing what can be accomplished through bargaining; but as an insight into today's real world of M&A negotiations, the premise is a bit naïve. The converse is possibly closer to the facts—namely, that in most deals nowadays, one or the other of the parties has arrived at the table in less voluntary fashion, possesses a stronger desire to achieve a negotiated outcome, and has a greater reluctance to terminate the negotiations unsuccessfully.

Freund, *The Acquisition Mating Dance*, p. 51.

Bear in mind that using positional or principled negotiation is not an either-or proposition. Finding the right mix is part of the art.

§ 12.13.3 Types of Leverage

What factors create positive or negative leverage in negotiating business acquisitions? A nonexclusive list would include compulsion, desire, competition, time, and personal career objectives. *See* Freund, *The Acquisition Mating Dance*, pp. 54–57.

(a) *Compulsion*

The first factor, which applies most often to sellers, is whether the party is forced by legal or practical necessity to enter into an acquisition transition. Underlying reasons may include the party's adverse (or desperate) financial condition; the death, incapacity, or retirement of a principal stockholder or key employee; the need to pay unexpected liabilities (e.g., estate taxes); or stockholder disagreements. Technological or industry competition may also compel a decision to buy or sell, as when a key patent expires or is found to be infringing, or when a competitor has developed new technology or some other competitive advantage over the company which it can overcome only by combining with another firm.

(b) *Desire*

A key factor in determining leverage is the answer to the question: Who wants the deal more? *See* Freund, *The Acquisition Mating Dance*, pp. 115–23. When the seller has a unique product, market niche, or asset, and is under no compulsion to sell, the playing field usually shifts in its favor. For purely personal or psychological reasons, a buyer may have a burning desire to buy a country inn, a sports team, or some other ego-gratifying business, or perhaps to become CEO of a public company. For similar reasons, a founder of a business may be reluctant to part with his or her "baby," or the seller's management may be loath to relinquish perks or prestige.

(c) *Competition*

There is a saying in the brokerage business that "one buyer is no buyer." The pressure on the buyer to make concessions rises dramatically when it is faced with an "auction" situation involving multiple contestants for an acquisition. In such situations, the buyer is forced to come quickly to his "best price" for fear that another bidder may acquire the company for a lower price. The opportunities for a seller to play bidders off against each other here is a powerful advantage. Contrast this situation with one in which there is only a single buyer and a single seller; there the buyer is much more inclined to test the seller's resistance to a price or terms which are less than the buyer's best offer. The same dynamics apply when the buyer has multiple acquisition opportunities, and there are few or no competing buyers.

(d) *Time*

Time is often a vital factor in determining leverage. A party faced with a deadline to complete an acquisition is at a great disadvantage to an adversary which can proceed on a more relaxed time schedule. Consider the bargaining position of a company which is about to lose its lease on a vital manufacturing facility or a key government contract, or is faced with an adverse change in the tax laws which takes place January 1 of the following year.

(e) *Personal Career Objectives*

In negotiating with large business organizations, the personal career motivations of individual officers may play a major role. The retiring CEO of a major company may be unwilling to cap a distinguished career by making a risky acquisition which would tarnish his or her reputation. A new CEO, on the other hand, may want to embellish his reputation by showing that he can make a major or important acquisition. The psychology of the individuals involved in acquisition negotiations should always be considered: Mr. Jones is usually thinking about whether this deal will advance him up the corporate ladder or result in his firing.

§ 12.13.4 Evaluating and Manipulating Leverage (The Concept of BATNA)

The factors affecting a party's leverage are usually external to the legal issues presented in negotiating a business acquisition, and are frequently unknown to the attorney. Yet ignorance or misperception of the parties' relative bargaining power will always complicate negotiations and may even doom them to failure.

A thorough analysis of the parties' bargaining power should be made at the earliest stages of acquisition planning. This requires, at a minimum, a meeting between the client and its attorneys in which a realistic assessment is made of the parties' strengths and weaknesses, and a decision is made as to the realistic outcome of the negotiation process. If your seller client is dealing with one buyer and is under time pressure or compulsion to sell, it should realize that it cannot realistically expect to get its top price or to get "all the meat off the bone" in negotiating the terms of the deal. If your client is in a stronger bargaining position, its realistic outcome would be more favorable. In either case, the success or failure of a business acquisition negotiation should be measured by the parties' success in obtaining the realistic outcome as opposed to some other standard.

(a) *The Importance of Perceptions*

Negotiation, like poker, is a psychological game: its outcome frequently depends on the parties' *perceptions* of their relative bargaining power, more so than their *actual* bargaining power. If your opponent believes you have pocket aces, you are in a strong negotiating position, even if you do not have them. It is important to be aware of the *actual* strengths and weaknesses of your opponent's position and that your opponent be aware of your client's actual strengths *but not its weaknesses*.

(b) *What Is the Bottom Line?*

Explore with your client in advance its bottom line—i.e., at what point does it make sense to walk away from the deal, rather than to keep on negotiating? This concept is most often used in price negotiations but also applies to key nonprice terms. Defining a bottom line in advance allows your client to resist the pressure and temptation to be too accommodating in an effort to bring the negotiations to a conclusion. There are, however, two things of which to beware: First, clients tend to be less than candid with their attorneys when it comes to disclosing a bottom line price, usually due to the fear that the attorney will too readily concede that price rather than negotiating for a better price. Second, focusing on a fixed-dollar bottom line limits your flexibility to negotiate alternative terms, and inhibits the exploration for creative solutions which can satisfy both parties.

(c) *Using BATNA*

The concept of BATNA (best alternative to a negotiated agreement) is often said to be preferable to a single bottom-line position. (Professor Roger Fisher is usually given credit for having developed this elegant concept and its hideous acronym.) A party's BATNA is the answer to the question, "What would you do if this deal did not go through?" Sometimes the alternative is simple: "We'd simply keep on operating the business at a profit," or "We'd buy another company with an equally strong foreign distribution network." Sometimes the alternatives are not so attractive: "We'd have to go out of business," or "We'd lose our competitive position in the marketplace." The benefit of doing a BATNA analysis is to give your client a realistic idea of its bargaining power so it can act accordingly.

(d) *An Illustrative Tale*

BATNA analysis does not imply passive acceptance of the status quo. Smart companies often *develop* alternatives which strengthen their bargaining position. The following example illustrates how thinking in terms of BATNA can lead to creative business strategies. It is noteworthy that none of the parties to this transaction had ever heard of the term "BATNA," and were led to an advantageous result by their application of common sense rather than academic concepts.

Several years ago, I represented a group of investors interested in developing a large parcel of land surrounding a golf course on Cape Cod. They secured an option to purchase the land and proceeded to apply for local zoning permits. Their development proposal met with furious community resistance and led to a proposal from the town to purchase the land for conservation purposes at a very attractive price. However, the town's proposal required town meeting approval, a process which could not be completed until several months after the clients' option to purchase the land was scheduled to expire.

Our clients first approached the landowner to negotiate an extension of the option. Since the town's proposal had been widely publicized, the landowner was aware of our client's precarious position and was ready to drive a very hard bargain. However, our clients were up to the challenge: Although no bank lender was then willing to make them a land acquisition loan, they located a private investor who agreed to lend them the full purchase price, albeit on terms that can only be described as usurious.

The clients then approached the landowner and offered him two alternatives: either extend the option period for three months in consideration of a percentage of our clients' profit on the resale to the town; or close on the sale upon the original option terms. The landowner initially attempted to call our clients' bluff, But after a day of furious negotiations on the option expiration date, it finally agreed to terms. Our clients went on to sell the property to the town at a handsome profit.

This tale also illustrates the importance of perception versus reality See § 12.13.4(a), above. When the negotiations with the landowner had reached an apparent impasse, I called his bluff and asked my client to call my office and tell my colleagues to close the mortgage and send over a check for the purchase price. The landowner quickly backed down and we promptly concluded the deal with him. Later that day, my client told me that my office had advised him that the private lender had backed out of the mortgage deal at the last minute! Astonished, I asked him why he had not told me this crucial fact before. He replied, "You were doing so well, I didn't want to stop you."

§ 12.13.5 Synthesizing the Two Approaches

The importance of understanding the concept of leverage is discussed above, but the successful deploying of leverage will accomplish only so much; even if your client has the bargaining advantage, a nonnegotiable demand can cause ill feelings and at best will force your opponent (and its counsel) to "lose face." It is far better to marshal a reasonable argument why your client needs a particular contract provision, and dig your heels in on that matter of principle. Your opponent can more easily concede to a reasoned argument than an ultimatum. The "fist in the velvet glove" approach is powerful because it combines both positional and principled negotiations.

One should always employ the principled method of negotiation, involving marshaling arguments and finding compromises, but be ever mindful of the parties' bargaining strengths and weakness.

(a) *Marshaling Arguments*

The ability to marshal an argument for or against a given proposition is the lawyer's stock-in-trade, but its execution requires thought and advance preparation. Approach any acquisition negotiation knowing the reasons for the particular contract provision you are advocating and the best arguments in support of that proposition. "I find that rarely is a negotiator able to win a point when he has no cogent argument to support his position, except where the bargaining strengths are unequal." Freund, *Anatomy of Merger*, p. 14.

(b) *The Creative Discovery of Common Ground*

Every successful negotiation involves finding compromises which both parties are willing to accept. When the parties cannot agree on a provision after giving principled arguments for or against, the resolution of the issue requires the finding of a creative solution which will satisfy both parties' interests. This involves exploring with your opponent the real reasons for his or her reluctance to accede to your position. A cooperative, problem-solving attitude on the part of both parties is essential. Sometimes a concession on another issue (particularly involving money) is sufficient to overcome the other party's resistance.

Freund believes, as I do, in the "ultimate solubility of most issues" through creative problem-solving. Freund, *Anatomy of a Merger*, p. 21. Here is an example.

I once negotiated a buy-out of a corporate stockholder where a large part of the consideration was paid in the form of a five-year consulting contract for, say, $100,000 per year. The selling stockholder insisted on the continuation of the payments even if he died within the consulting period. My client had no business objections to that arrangement but we were concerned that the postmortem continuation of payments would transform the contract from a tax-deductible service contract into a nondeductible payment for the purchase of stock. The solution we found was to provide the consultant (at the company's expense) with a five-year $500,000 declining term insurance policy, the face value of which declined by $100,000 per year. If he died within five years, the company would be spared the cost of paying the remaining consulting payments, and the stockholder's estate would receive the full value of the contract on an accelerated basis. Both sides would win.

(c) *Playing the Leverage Card*

When the parties have reached an insoluble impasse in negotiation and your client has the bargaining advantage, it is time to assert your client's leverage. This should be done in as diplomatic a manner as possible: "Look, I understand the importance of this issue to your client, but my client simply can't agree with it. If you can't concede on this point, let's call the deal off, shake hands, and remain friends."

When the other party plays its leverage card, it is the moment of truth for your client. You should, of course, persist in trying to find a creative solution to the impasse, but if you cannot, your client must decide whether its bottom line has been reached and whether it will either concede the issue or walk away from the deal and accept its BATNA.

Paradoxically, this is usually an opportunity for you to test your opponent's *real* leverage by calling its bluff. If your client is in fact willing to walk away from the deal, there is no risk in testing your opponent's threat to do so. On the other hand, if your client is willing to concede the issue, there is only a *little* risk to ignoring the opponent's ultimatum and provoking him or her to terminate negotiations, so long as the parties can revive the negotiations after a period of sulking in their tents. If your opponent is willing to accept your concession today, he or she will be equally willing to accept it a week later, when your client calls and says that after a week of soul searching, it sees the wisdom of the opponent's position and has now changed its mind.

Practice Note

The big exception to this rule is when the other party is about to irrevocably change its position after terminating negotiations, for example, by accepting an offer from a competing bidder.

Of course, this sort of brinksmanship should only be employed if you have the unqualified support of your client and have weighed the risks and rewards of the gambit.

§ 12.14 BE PREPARED—GATHERING AND PROTECTING INFORMATION

> Information is crucial to the outcome of bargaining. Indeed, research into negotiation outcomes suggests that there is a strong correlation between the control of critical information in negotiation and a successful outcome. The party that better controls the critical information in the negotiation does "better" no matter how that term is defined. This correlation between the control of information and outcome prevails without regard to the strategic approach of the negotiator. Thus, whether you decide to proceed as an adversarial negotiator or as a problem solving bargainer, controlling the critical information is a key to success.
>
> Without information, a negotiator cannot effectively determine bargaining ranges and rationales, cannot identify underlying needs or possible solutions, cannot know what arguments will persuade, what promises are valued, and what threats or warnings will be feared, and cannot measure the accuracy of an opponent's statements or decide when to accept an offer or press for more. Without information, a negotiator is handcuffed by his or her needs and position, [and] unable to recognize and appreciate the other party's goals, needs, values and concerns.

Harbaugh & Britze, *Primer on Negotiating: Controlling Information and Making and Meeting Offers*, pp. 15–16.

§ 12.14.1 Know the Law

Business acquisitions require at least a basic knowledge of corporate law, tax law, and securities law, as well as an understanding of any regulatory requirements to which the parties are subject. An understanding of basic accounting rules and principles and common business valuation methods is also essential. Negotiating a business acquisition also requires that you be able to deal with basic issues of employment law, real estate law, environmental law, ERISA, intellectual property law, commercial law, antitrust law (including the Hart-Scott-Rodino Act), and the laws of other states or countries. Although the lead attorney can and should rely on the expertise of other attorneys specializing in these areas, he or she must be able to spot the issues as they arise and converse intelligently with the experts regarding the specifics of a given transaction.

Freund—perhaps with tongue in cheek—identifies ten “nontraditional roles” that M&A lawyers are called upon to play: financial whiz, public relations expert, writer, psychologist, moralist, employee benefits consultant, stock market analyst, businessman, generalissimo, and seer. Freund, *The Acquisition Mating Dance*, pp. 110–14.

§ 12.14.2 Know the Facts

The type of information needed to negotiate intelligently and competently can be classified into “historical facts” and “motivations.” Harbaugh and Britzke refer to motivations as “intentional (or emotional) facts.” Harbaugh & Britzke, *Primer on Negotiating: Controlling Information and Making and Meeting Offers*, p. 16. (This terminology can be a bit confusing and counterintuitive; I favor the term “motivations,” which I use here.)

(a) *Historical Facts*

Historical facts include all publicly available information regarding the parties and, of course, all the information regarding the seller produced in the due diligence process.

The more you know about your client’s business, the better equipped you will be to understand, articulate, and protect its interests in the negotiations. If you are representing an existing client, you probably already know a lot about its business, legal structure, and corporate governance. If not, you need to get up to speed. What is your client’s financial condition? Ask for a copy of its financial statements.

What do you know and what can you learn about the opposing party? If it is a public company, read all of the available public information, including annual reports, 10-Ks, 10-Qs, proxy statements, and registration statements. Research the backgrounds of its management team and read the public documents containing the text of similar business acquisitions to which it has been a party.

(b) *Motivations*

Motivations are equally important. The "needs, goals, values, fears, hopes, resources, ambitions, interests, anger, guilt, greed, jealousy and anxiety" of the parties will to a great extent determine their behavior. Harbaugh & Britzke, *Primer on Negotiating: Controlling Information and Making and Meeting Offers*, pp. 16–17.

> Your client's motivations are ascertainable—but you have to ask the right questions. If your client is a seller, make sure you know the reasons for the sale. Is it under some compulsion to sell, such as the disability or death of the principal stockholder? Does the principal stockholder simply want to cash in his investment and retire? Are there pressing debts to be paid? Are there multiple potential buyers or just one? How will employees, customers, competitors or regulators react to the announcement of the deal?
>
> If your client is a buyer, what are its motivations for acquiring the seller? Is your client a financial buyer or a strategic buyer? Are other potential buyers for the seller likely to appear? Is this a geographic extension or product extension acquisition? How important is continuity of the seller's management or workforce to your client?
>
> The opposing party's motivations are always more of a matter of conjecture. The best one can hope for at the inception of the negotiation is to develop "confident expectations" of the opposing party's motivations. The challenge to the negotiator is to test these expectations by obtaining information in the course of bargaining and to adjust to new developments.

§ 12.14.3 Assessing Informational Needs

Harbaugh and Britze suggest that a lawyer and his or her client prepare for a negotiation by creating an "information assessment agenda," containing three columns of information: "[1] information that you *need* from the opponent to confirm or deny your confident expectations; [2] information that you want to *protect* from the other side because of its sensitive nature; and [3] information you want to *give* to the opposition to influence their perception of the situation." Harbaugh & Britzke, *Primer on Negotiating: Controlling Information and Making and Meeting Offers*, p. 17 (emphasis in original).

> **Practice Note**
>
> Of course, in the M&A context protected information would certainly *not* include historical facts required to be disclosed by a seller as a part of the due diligence process. This information must be disclosed for obvious legal and ethical reasons, as well the seller's self-interest in avoiding the consequences of misrepresentation. A seller's motivations, on the other hand, need not be disclosed.

Harbaugh and Britzke further recommend that the lawyer and his or her client prioritize the information in each column, anticipate the other party's information assessment agenda, and rehearse their responses to anticipated questions.

§ 12.14.4 Obtaining Needed Information

How does a negotiator go about obtaining information—particularly information regarding motivations—from an opponent? Simple: you ask for it. (And you thought all that shop talk between lawyers during negotiations was just idle chit-chat.)

Broad, general, and nonleading questions are best designed to elicit information: "What do you think a reasonable time schedule would be to close this deal?" Follow-up questions should be more specific. "That seems pretty short to me. Is there any reason why you couldn't extend the time schedule to x months?" A good negotiator must be a good listener. Don't dominate the conversation; let the other guy talk, and observe his non-verbal communication. You will be amazed at what people are willing to tell you.

§ 12.14.5 Protecting Sensitive Information

When your opponent probes for information about the "smoking gun" or the "skeleton in the closet," there are only three possible responses: Honesty, misrepresentation, and evasion. Honesty has an obvious downside. Misrepresentation is unethical and may expose you and your client to legal liability.

Practice Note

Supreme Judicial Court Rule 3:07 adopts the Massachusetts Rules of Professional Conduct. Rule 4.1, Truthfulness in Statements to Others, states that "[i]n the course of representing a client a lawyer shall not knowingly (a) make a false statement of material fact or law to a third person." There is some wiggle room, however. Comment [1] provides that "[a] lawyer . . . generally has no affirmative duty to inform an opposing party of relevant facts" and Comment [2] states that "[u]nder generally accepted conventions in negotiation, certain types of statements ordinarily are not taken as statements of material fact. Estimates of price or value placed on the subject of a transaction and a party's intentions as to an acceptable settlement of a claim are in this category."

Evasion is the only safe alternative: answer a question with a question, over- or under-answer a question, answer a different question, rule the question out-of-bounds, ignore the question, or (truthfully) deny knowledge.

§ 12.14.6 Setting the Table

Most acquisition negotiations these days are conducted *impersonally*: One attorney prepares a draft of a letter of intent or acquisition agreement and e-mails it to the other party's counsel, who marks up the draft or revises it and sends a redlined version back. The drafts volley back and forth until all but a few difficult issues have been resolved, and the attorneys then speak by phone to deal with these issues. This is an efficient way to clear the underbrush of trivial issues and language clarification, but it is a terrible way to obtain or communicate valuable information. Try to meet in person with opposing counsel or at least engage him or her in an open-ended discussion if you want to maximize your chances of discovering critical information.

§ 12.15 ESSENTIAL ATTRIBUTES OF A GOOD NEGOTIATOR

Most of the nonacademic works on negotiation acknowledge that they are an attempt to "organize common sense and common experience in a way that provides a usable framework for thinking and acting" and that negotiation skills cannot be taught from a book but must be acquired by practice. Fisher, Ury &

Patton, *Getting to Yes*, p. 147. I agree. The following ground rules for negotiation are not novel insights and should come as no surprise to any practicing attorney.

§ 12.15.1 Credibility

Establishing your credibility is an absolutely essential element of a successful negotiation. Bluffing and blustering may sometimes get results, but these are high-risk strategies which can poison the entire atmosphere of a deal. Consider your own reaction to discovering that the other party to a transaction is lying about a key element of the deal.

"Be yourself" is particularly good advice for establishing credibility.

> First point: everyone has his own negotiating style, and the worst thing you can do is to adopt a negotiating technique that does not feel comfortable, simply because a man in a book says that he uses it to advantage. In *my* book, credibility, based on an evident sincerity, is the most important single asset of a good negotiator.
>
> This applies both to form and substance. If you are using an uncomfortable negotiating style and not exuding credibility, you will probably get nowhere; if gambits are not your forte, and you are bumbling through one that somebody mentioned on page 81, it will boomerang. With respect to substance, you should only ask for what you feel you can reasonably support. Try for more and your arguments don't ring true; ultimately the hollowness in your approach will show up and get you in trouble. Some experienced negotiators go even further and ask only for what they actually think the other side *should* give them. Which brings us back to the same basic idea: you must feel comfortable in what you are doing.

Freund, *Anatomy of a Merger*, p. 10 (emphasis in original).

A good way to establish credibility is to demonstrate early in the negotiations that you are willing to concede an issue to opposing client if he or she makes a reasonable argument. Suppose, for example, that the letter of intent does not provide the seller with registration rights for the resale of the buyer's stock being issued in a merger. As buyer's counsel, you have discussed this issue with your client in advance, and you have confirmed that your client does not regard this as a serious matter. Graciously conceding this issue (without asking for something in return) establishes your credibility as a reasonable person who is not out to cheat the seller. This is an exception to the general rule against uncompensated concessions, which holds that you should always get a quid pro quo.

There may be times when you may even want to make a concession that has not even been requested, to establish a rapport which may stand you in good stead at a later time. Suppose while you are drafting the first draft of the acquisition agreement, you call the other party's attorney and say, "It just dawned on me that we didn't discuss registration rights in the letter of intent. I have spoken with my client and he has agreed that this is something that your client may want, and that we can provide your client with piggyback rights without serious cost." Not only will this ingratiate you with opposing counsel (whom you may have spared a certain amount of embarrassment), but it will also be difficult for him or her to look this gift-horse in the mouth and insist upon demand registration rights. This technique is particularly appropriate where you feel that it is only a matter of time before opposing counsel spots the problem and insists on these rights.

Practice Note

One of the many advantages to preparing the first draft of the agreement (see Volunteering for the Draft, § 12.16, below), is that you can build into the first draft a few unresolved, negotiable, "throw-away" points.

§ 12.15.2 Perspective

(a) *Know What Is Important*

In the give-and-take of negotiation, it is essential to understand that all issues are not of equal importance. Knowing which issues are truly important to your client (and which are not) will guide you in managing the negotiation process.

Avoid playing "Trivial Pursuit." Much of the time and money spent on negotiating business acquisitions is spent on "lawyer's issues" (i.e., those issues which the client delegates to his or her lawyers because the client either does not care about or understand them). Be aware that you are going to have to make concessions in order to do the deal, and do not make a molehill into a mountain.

Too frequently, law firms delegate the negotiation of the terms and conditions of acquisition agreements to associates who, though intelligent, thorough, and motivated, are not adequately briefed by a partner on the client's needs and motivations. As a result, negotiations often tend to focus on issues the client would regard as trivial or nonessential instead of the truly important issues that advance the client's interests.

(b) *Take a Long-Range View*

The negotiation of a business acquisition is often the first encounter in a long-term relationship between the principals of the seller and the buyer. If the seller's principals become part of the buyer's management team, they will have to develop a cooperative working relationship with the principals of the buyer. In any event, there may be postclosing agreements (for example, consulting contracts or supply contracts) between the parties that will require them to deal with each other over the long term.

Smart clients will often say to their attorneys, "Look, I'm going to have to live with this guy to run a key division of my company. I don't want to start off on the wrong foot by having him think he's been cheated or short-changed on some minor point in this deal." Smart lawyers will raise this relationship issue with their clients when the negotiations get sticky or contentious.

On the eve of a recent closing, I pointed out to my client (the buyer), that the seller had made an error in the calculation of the closing adjustment for vacation pay. The seller thought it owed my client $12,000, when it in fact was owed $36,000 *by my client*. At the closing, my client, with my encouragement, insisted that the amount be correctly recalculated, reasoning that passing up a $48,000 benefit in a $10 million acquisition was a small price to pay for the good will this gesture generated with the seller (or to avoid the potential ill will that would have been created if the mistake were discovered postclosing).

§ 12.15.3 Persistence

> It may well be that the most important ingredient for pursuing a difficult negotiation is a prior good night's sleep. As an exhaustive session draws to a close, all of us have given up on points that would not have been conceded in the early bargaining, when we were relatively fresh. The same incentive to drive a hard bargain just doesn't exist when you are physically and mentally tired. There is a tendency to want to 'wrap it up'; often the price for such finality is to forego secondary goals. All of which is to point up the obvious fact that, like the proverbial tortoise and

> hare, the persistent, unruffled, untiring lawyer will more often than not ultimately prevail over his flashy but early-wilting antagonist.

Freund, *Anatomy of a Merger*, p. 25.

Persistence is also essential to creative problem-solving. When an impasse arises, your efforts to find a solution should be relentless. Do not give up. *There is a solution*; it just takes time and dogged determination to find it. The best negotiators will find creative solutions not merely because they are creative thinkers, but also because they will not quit. Remember: Persistence trumps talent.

§ 12.15.4 Timing

(a) *Magic Moments*

Knowing when to raise an issue or seek a concession is an invaluable talent. There are certain "magic moments" in the course of acquisition negotiations when certain issues should be raised. One is at the letter-of-intent stage, when the buyer's appetite for the acquisition is usually at its highest point. A smart seller's counsel will press for important nonfinancial concessions at this stage (limitations on indemnification are a good example). Once the drafting of the acquisition agreement has been delegated to the buyer's attorneys, the buyer usually loses interest, while his or her attorneys ferociously defend the probuyer protections they inserted in the agreement.

Another magic moment is at or near the closing. As the parties approach the finish line, there is a psychological gravitational force which pulls them together. At this moment, the parties will often make concessions to get the deal done which they would never have made a few weeks earlier.

It is frequently useful to call attention to issues of vital importance ("dealbreakers") early in the negotiation process, often at the letter-of-intent stage. ("Look, the outside investors (or my ex-wife) are not going to personally guaranty the company's reps.") This has the advantage of emphasizing to the other party the seriousness of the issue to your client, getting the attention of the other principal, and avoiding a waste of time and money if the parties cannot agree on an essential deal point.

The problem with this strategy is that the other party may in fact *not* consider your client's issue to be of very great importance. But once you have signaled to the other party how important the issue is to your client, the other party may extract an appropriately large concession as a price for agreeing on the issue.

The better approach may be to raise the big issue more casually, in the context of a number of trade-offs.

Another occasion on which it is advisable to remain silent regarding a significant issue is when the issue would be resolved in your client's favor as a matter of law. For example, *Tobin v. Cody*, 343 Mass. 716 (1962), holds that the seller of a controlling stock interest in a corporation is subject to an implied covenant not to compete with the buyer. As buyer's counsel, you should consider whether to specifically provide for a noncompete covenant (which opposing counsel may try to dilute or negotiate away) or to take the bird in the hand offered by the case law.

(b) *Time Pressure*

External factors often impose time limits on completing a transaction which require the parties and their attorneys to negotiate under pressure. More often, the importance of one or both parties to get the deal done creates an artificial deadline. Time pressure can be used to your advantage. When the other party is anxious to act quickly, you should move deliberately; this will increase the likelihood that your opponent will make concessions.

Early in my career, I had the responsibility of negotiating on behalf of a tenant a series of lease amendments for a large industrial complex owned by a wily and parsimonious New York real estate investor with approximately fifty years more experience than I had. Our first negotiation session in Manhattan started at 10:00 a.m.; by late afternoon we had made virtually no progress. At about 4:00 p.m., however, the investor suddenly proposed a half dozen major concessions; I promptly counter-offered and fifteen minutes later, we had a deal. His secretary told me later that same day that the investor met his father for drinks every day at 5:00 p.m. at the Rainbow Room. Armed with that information, I scheduled every negotiating session thereafter to start no earlier than 3:00 p.m. See how it pays to chat?

§ 12.16 VOLUNTEERING FOR THE DRAFT

He who drafts the contract has the upper hand in the ensuing negotiations. There are so many opportunities in drafting a contract—"choices in the introduction and phrasing of concepts, the omission of certain language, the deliberate use of ambiguity and so on" (Freund, *Anatomy of a Merger*, pp. 26–27)—that the drafter is able to set the agenda for the negotiations. The recipient of the first draft is placed in a defensive position of responding to the drafter's choices rather than initiating the agreement on his or her own terms. Controlling the drafting of the agreement also allows you to control the timing of the negotiations, which will proceed as fast—or as slow—as you and your client choose.

For this reason, the astute attorney will always seize the opportunity to prepare the first draft. Because the prevailing etiquette is that the buyer's counsel drafts the acquisition agreement, the seller is more often at a disadvantage. Nonetheless, you should always try to take control of this assignment, or at least to draft significant portions of the agreement.

Penurious clients sometimes unwisely prefer that the other side do the drafting in order to economize on their legal bills. Point out to your client in advance that the benefits of drafting the agreement outweigh the burdens. Occasionally, you can persuade the other side that by taking on the burden of drafting the agreement you will be saving them money.

§ 12.16.1 The Unforgivable Sin

Transactional lawyers are inveterate copycats, preferring to mark up the version of an acquisition agreement used in the most recent deal. This is a terrible mistake. Not only is each deal different in significant ways (the last deal may not have involved significant real estate, intellectual property, or governmental approvals), but the last deal also reflects the results of negotiations that you may not want to concede in the current deal. As Freund points out,

> I want to call special attention to one cardinal sin that I find young (and often mature) lawyers commit time and again. The ABC deal comes in to the office. The partner evaluates it, calls in an associate, gives him the facts, and tells him to prepare a draft "modeled on the YXZ acquisition that we did in January." The associate goes to the shelf, pulls down the thick black binder on the XYZ deal, makes a photocopy of the agreement and proceeds to mark it up for the ABC deal. Fatal, fatal error. Do you know why?
>
> The reason is that the XYZ agreement which found its way into that binder was the final, executed, *negotiated* agreement. Using it as a model for a first draft bequeaths to the ABC lawyers, gratis, the work product of the XYZ lawyers. All of the provisions that you struggled so hard to resist and finally compromised—the additional purchaser's representations, the "materiality" limitations, the "knowledge" cave-

> ats—are fixed firmly in place. What the associate should have done, of course, was to go back to the *first draft* of the XYZ deal in the files, and mark that up. But believe me, this happens over and over, and you don't always catch it before the draft agreement is delivered to the other side.

Freund, *Anatomy of a Merger*, p. 142.

I recently negotiated for a client an agreement for the purchase of the business assets of a New England printing company. In my early discussions with the seller's counsel, he insisted on preparing the first draft. Despite my invoking the business "etiquette" rule that the buyer should prepare the first draft (see § 12.8.1(c), above), our discussions were inconclusive. I decided to pre-empt the process by preparing the first draft. As I was getting started, I received in the mail a first draft prepared by seller's counsel. My concerns were abated when I realized that he had committed the unforgiveable sin: his draft was modeled on the final agreement used in an unrelated deal which was overwhelmingly pro-buyer. Having received this unexpected gift, the negotiations were relatively easy to conclude.

§ 12.16.2 One Size Does Not Fit All

Word processing software is a wonderful invention. It allows us to draft in minutes documents which once took hours or days to create. But every stock purchase transaction is not like every other stock purchase transaction. Before marking up a standard office form, you must first understand the particular business context in which your client is operating. Is the seller under some compulsion to sell? Are there other buyers or other alternatives to selling the company? What is your client trying to accomplish by selling the company?

Knowing your client's business needs and motivations is essential to drafting and negotiating a deal that makes sense.

An example may help. My oldest client is a large multistate distributor of industrial supplies. It has made nearly 100 acquisitions during the past four decades, nearly all of which involve a cash purchase of another distribution company in a new geographic market. The basic structure of almost every deal is a purchase of the seller's inventory at book value and a purchase of the other fixed assets—usually including real estate—at their appraised fair market value; the client also agrees to collect the seller's accounts receivable and remit the proceeds. The client is indifferent to the financial condition of the seller, its customer base, its workforce, and its brand name, and usually assigns no additional value to good will. Why? Because my client is looking for one thing only: a new branch location from which it can deliver commodity products using its own well-developed skills in purchasing, pricing, and marketing. The form of asset purchase agreement used for these transactions is—and should be—quite different from the agreement you would draft for a financial buyer concerned with retaining existing management and assuring continuing future earnings and cash flow.

§ 12.16.3 Extremism Is No Virtue

The drafter may be tempted to draft a "perfect" probuyer (or proseller) document, which skews every clause in favor of his or her client. This strategy is occasionally successful when one is dealing with an inexperienced attorney on the other side. More often, however, it is a formula for complicating and slowing down the negotiation process, by inviting objections to provisions where a more balanced and "reasonable" solution would be perfectly satisfactory to your client. When representing a seller, observing that the negotiations will go more smoothly if the buyer's counsel gives you his or her "second draft" rather than an objectionable first draft, is an effective way of making this point, particularly with an experienced M&A attorney on the other side.

(Text continues on p. 12–55.)

§ 12.16.4 Riding the Coattails

Occasionally, a party—particularly a public company—will have made a number of similar acquisitions which are a matter of public record with the SEC or elsewhere.

This can be a treasure trove of information, showing the points the client was willing to concede in other transactions. You should always investigate the buyer's SEC filings to discover possible issues for negotiation. It is difficult for the buyer to insist upon language in an acquisition agreement when the seller points out that the buyer gave an entirely different clause to XYZ Corporation.

When representing a company with a public track record of this sort, be alert to this negotiating gambit and be prepared to distinguish the XYZ deal from the deal you are negotiating. On occasion, it is possible to turn this gambit on its head by arguing that giving the seller a certain concession would "open the floodgates" by compelling your client to give a similar concession in all its future acquisitions.

§ 12.17 DEALING WITH THIRD PARTIES

In a typical business acquisition, an attorney will interact with various players other than the buyer, the seller, and their attorneys. These may include investment bankers, business brokers, accountants, government agencies, and a host of other consultants and service providers. The following are observations on dealing with a few of the most common relationships.

§ 12.17.1 Investment Bankers and Business Brokers

These parties can add real value principally by locating potential financial and strategic buyers for the seller's business, advising on conditions in the M&A market, and acting as salespersons for the transaction. Investment bankers frequently advise publicly held buyers on issues of valuation and corporate strategy and often assist buyers in locating acquisition financing.

> **Practice Note**
> A special role is played by an investment banker engaged to provide a "fairness opinion" stating (usually to a seller's board of directors) that the transaction is "fair from a financial point of view." This can provide protection to the seller's board of directors against stockholder claims of breach of fiduciary duties, since the business judgment rule

allows the board to rely on the opinions of outside experts. The topic of fairness opinions is beyond the scope of this chapter.

Since these parties are usually compensated on a contingent fee basis and are compensated only if the transaction is consummated, they have an inherent conflict of interest. They have a natural bias toward encouraging the seller and buyer to make a deal, which can make their advice less than objective.

Some investment bankers tend to regard themselves as super lawyers, freely dispensing legal and tax advice to your client. This can lead to awkward situations when their advice conflicts with yours. My approach to this problem is usually to be respectful and grateful for any assistance in evaluating legal issues (particularly from experienced and sophisticated advisers), but to be firm about the role that the lawyer must play as the client's primary legal advisor.

§ 12.17.2 Accountants

A client's accountants play a vital role in performing financial due diligence and in providing tax and accounting advice to your clients. Transactions with publicly owned companies often raise SEC accounting issues such as proxy statement disclosure, the necessity for audited financial statements in certain cases, and the adequacy of internal controls of an acquired company under the Sarbanes-Oxley Act. These issues require top-notch accounting advice.

While a good M&A lawyer will always have a working knowledge of the accounting rules, it is usually folly to try to "play accountant," and your role should be properly deferential to the accountants. Occasionally, however, you will encounter an accountant for a private company (usually with a long history of providing services to the client) who is out of his or her depth. This presents a delicate problem of persuading the client to get sophisticated assistance for the accountant without appearing to advocate disloyalty. One thing you should never do in this situation is to assume the role of giving your client accounting advice; you will almost always make a mistake if you try.

I always try to copy my client's accountants on the various drafts of the acquisition agreement and exhibits. Although the accountants rarely respond, my intentions here (I confess) are defensive in nature. If there is a dispute over an accounting concept or accounting terminology, I do not want to be accused of a blunder because I exceeded the limits of my expertise.

Practice Note

This may be a case of "the generals always fighting the last war." Early in my career, I made the mistake of using the term "net earnings"

> as a measure of a bonus in an employment agreement. This phrase was arguably not a generally accepted accounting term ("net income" being the preferred terminology). When a dispute arose over the meaning of these words, I discovered to my chagrin that my client's accountants (whom I had not previously consulted) washed their hands of my transgression and were of no help in resolving the dispute.

§ 12.17.3 Government Agencies

You will frequently have to deal with government officials in securing permits, approvals, and certificates necessary to close the deal. The best advice I ever got on dealing with government agencies occurred in my first year practicing law. This is my "Mickey the Dunce" story.

I was assigned the simple task of obtaining an uncontested "voluntary conservatorship" from the Probate Court for an aged and infirm aunt of an important client, who was mentally competent but physically unable to attend to her business affairs. I dutifully researched the law and prepared the papers for filing with the court.

When I went to the court to file them, I was referred to an assistant registrar, who told me I needed a physician's certificate attesting to her mental competence. Preposterous, I replied, noting with irrefutable logic that if the woman was competent, she was entitled to a voluntary conservatorship; and if she was not, then she was entitled to an involuntary one. The assistant registrar refused to allow me to file the petition without the certificate and told me to come back with one before he would even consider scheduling a hearing.

I returned to the office in a foul mood and promptly related my experience with the uncooperative clerk to my senior partner in highly critical terms. My senior partner said:

> Look, the people who work as clerks in the court system get job satisfaction in two ways: Either they find some guy who thinks he's a know-it-all, and run him in circles to prove their superior knowledge; or they find somebody who needs help, and demonstrate their superior knowledge by guiding him through the maze of regulations. Go back tomorrow and say "Hi, I'm Mickey the Dunce. I don't know anything, but I need help." See how that works.

The next day I went to a different assistant registrar and took the recommended approach. I even mispronounced the word "conservatorship." To my amazement, the clerk told me that she would accept my filing, would schedule a prompt hearing, and allow me to file a physician's certificate before the hearing. She also promised that she would assign my case at the top of the list on the hearing date.

My senior partner's advice has proven over the years to be invaluable and nearly infallible. You will be astonished how cooperative government officials can be if you flatter rather than antagonize them. Mickey the Dunce can accomplish things far more effectively than the know-it-all.

A corollary to the Mickey the Dunce rule is that it is always easier to "dictate the terms of your surrender" to a government agency than it is to prevail in combat. Another corollary, which may surprise you, is that it is sometimes more effective to send a paralegal on a mission to an agency than a lawyer. A good paralegal with a working relationship with the agency is perceived as a person in need of help, rather than a know-it-all, and can be an invaluable resource.

§ 12.18 TRICKS OF THE TRADE

A good list of tips for successful negotiation of business acquisitions can be found in Hunt, *Structuring Mergers and Acquisitions* (Wolters Kluwer, 3d ed. 2007), § 25.03, and is excerpted with permission in **Exhibit 12G**. These points are tactical rather than strategic, but are good, common-sense reminders of the decisions that must be made during negotiations.

§ 12.19 SUMMARY

The following sections distill the most important points to bear in mind in any business acquisition negotiation.

§ 12.19.1 Importance of Client Communication

Let us start with the obvious: As an M&A lawyer, you are engaged by your client to accomplish an important business objective. Your efforts should be directed to achieving that ultimate goal by providing the client with an evaluation of the legal risks of each course of action and allowing him or her to make the business decision.

First you must clearly identify the objective. This requires you to think like a businessperson. Discuss the proposed transaction with your client at an early stage and learn his or her business goals. Prioritize these business goals, which are usually (1) do the deal, (2) at the best price, and (3) upon advantageous legal and business terms. You and your client should agree upon and prioritize the most important nonprice terms of the deal. Take this opportunity to learn your client's motivational facts—his or her needs, values, fears, hopes, resources, ambitions, and interests relating to the deal.

Explain to your client, as necessary, the nature of the business acquisition process and the various legal and business issues that will likely arise during its course. At this point you should be able to come to a conclusion as to which issues are more important than others, and to guide your negotiation and drafting accordingly.

It is equally important to engage your client in the negotiation process. To be sure, clients often abandon interest in the negotiations after agreeing upon the price and other central deal points, delegating to lawyers the minutia of the technical terms of a fifty-page acquisition agreement (not to mention the disclosure schedules) which are usually of no interest to the client. But there are important business issues that arise in the course of the negotiating the legal terms of the deal which your client, not you, should make. Make sure that you and your client are on the same page constantly during the course of negotiations.

§ 12.19.2 Be Cooperative

Avoid confrontational negotiation. The best approach is to set the tone of two parties cooperating in the mutual objective of finding business and legal terms with which they can both live. Ask for and share information, but be careful about revealing weaknesses. Always be aware of the restrictions imposed by Rule 4.1 of the Massachusetts Rules of Professional Conduct. See § 12.14.5, above. Marshal arguments for and against specific provisions and explore compromises and alternatives when impasses occur. Volunteer to draft the agreement and do not hesitate to redraft, in your own language, various provisions which you find unacceptable.

§ 12.19.3 Employ Leverage

Leverage is present in almost every business deal. Be aware of the factors (discussed in § 12.13.3, above) which give your client a bargaining advantage or disadvantage. Be subtle about deploying leverage; it is always better to allow the other party to save face by making some innocuous compromise rather than giving an ultimatum.

Be aware that leverage depends on the *perception* of the parties. Be aware of your client's bottom line and identify the client's BATNA (best alternative to negotiated agreement) and take steps where possible to improve your client's BATNA.

§ 12.19.4 Gather and Protect Information

Business acquisition negotiations provide many opportunities to gain information regarding the strengths and weaknesses of your opponent's bargaining position. Do not try to negotiate a deal by e-mail. Meet in person with your opposing counsel, or at least engage him or her in conversation regarding the background of the transaction. Use this opportunity to ask questions to elicit information on your opponent's motivations. Do not be afraid to be evasive when your opponent asks for sensitive information.

§ 12.19.5 The Essential Attributes of a Good Negotiator

Credibility is the one essential attribute of a good negotiator. If your opponents feel that you are trustworthy and reasonable, they will usually respond in kind. If not, you are unlikely to achieve much success.

Remember that persistence trumps talent; be relentless in advocating your client's interests, but have the perspective to know what is really important to your client and not to waste your time on trivia. Be aware that there are "magic moments" in a deal—at the letter-of-intent stage and at or near the closing—when concessions are most likely to be made. Use time pressure to your advantage when possible.

§ 12.19.6 Drafting

Seize the opportunity to draft the acquisition agreement whenever possible; it gives you a terrific advantage in the subsequent negotiations. When you cannot do the first draft, make sure to submit drafts of proposed modifications *in your words*, rather than allowing your opponent the opportunity to draft them. Beware of using a previously negotiated deal as your model and always tailor the draft to the particular facts and context of the seller's business. Do not skew the first draft of the agreement to excessively favor your client, at least when you have an experienced M&A attorney on the other side.

§ 12.19.7 Dealing with Third Parties

Be mindful of the limitations and resources of investment bankers and accountants, and tactfully resist their efforts to play lawyer. Take advantage of the "Mickey the Dunce" strategy in dealing with government agencies.

§ 12.20 A FINAL NOTE

Be flexible. Every negotiation is a unique event and every negotiator is a unique individual. Tactics that work in one context may not work in another.

Most of all, be yourself. Remember Freund's admonition that "everyone has his own negotiating style, and the worst thing you can do is adopt a negotiating technique that does not feel comfortable, simply because a man in a book says that he uses it to advantage." Freund, *Anatomy of a Merger*, p. 10.

EXHIBIT 12A—Sample Investment Banker Engagement Letters

SAMPLE INVESTMENT BANK ENGAGEMENT LETTER 1

___________, 20__

Mr. X. Y.
Chairman and Founder
of Company

Dear X:

This letter agreement (the "Agreement") is to confirm the engagement of Financial Advisor, LLC, ("Advisor") as your exclusive financial advisor in connection with the proposed sale of Company, Inc. (the "Company"). Advisor will act as the Company's exclusive financial advisor during the Engagement Period (as defined below) on all matters relating to the sale, merger or other business combination involving the Company and will provide financial advisory services on the terms and conditions presented below.

1. ***Financial Advisory Services:*** Advisor will work closely with you to:

    a. Develop and produce a Confidential Descriptive Memorandum (the "Memorandum") satisfactory to you for use in presenting the Company to potential acquirers;

    b. Develop, update from time to time and review with you a list of potential acquirers interested in pursuing a Transaction (as defined below) with the Company;

    c. Contact potential acquirers on the list as approved by you, obtain confidentiality agreements satisfactory to you from these parties, and, after execution of such confidentiality agreements, disclose to them the name of the Company and such other information about the Company as is necessary to determine their interest in a Transaction with the Company;

    d. Arrange introductions and meetings among the Company, potential acquirers and other relevant parties;

    e. Assist you in preparing and rehearsing management presentations to be used in presenting the Company to potential acquirers;

f. Assist you in managing the prospective acquirer's initial and formal due diligence investigations; and

g. Consult with and advise you concerning all matters relating to the strategy, timing, structure of and alternatives to the Transaction, and assist and advise you in negotiations concerning the Transaction.

2. ***Memorandum; Confidentiality:*** Advisor will not distribute any copies of the Memorandum other than to our employees and professional advisors directly involved in the Transaction nor shall we distribute any such copies to any potential acquirers without your prior approval and execution of a confidentiality agreement by such potential acquirer in a form satisfactory to you. We will number each copy of the Memorandum, keep strict control over the disposition of each copy of the Memorandum, and attempt to retrieve all copies of the Memorandum given to parties who decide not to pursue a Transaction.

3. ***Compensation Arrangements:*** As compensation for services described above, Advisor will be entitled to receive:

(i) retainer payments, payable in advance, of $10,000 per month with the first payment due upon execution of this Agreement. Fifty percent (50%) of the retainer payments shall be creditable against the Success Fee (defined below); and

(ii) a Success Fee of $450,000 plus:

- 1.0% of any Consideration (defined below) received in amounts between $20 million and $25 million; plus
- 3.0% of any Consideration received in amounts between $25 million and $30 million; plus
- 5.0% of any Consideration received in excess of $30 million.

Advisor shall be entitled to its Success Fee upon consummation of a Transaction during the Engagement Period. For purposes of this Agreement, a "Transaction" shall mean the sale of all or substantially all of the stock or assets of the Company, a merger or consolidation in which the Company is not the surviving entity or pursuant to which the majority of the stockholders immediately prior to such merger or consolidation are not a majority of the stockholders immediately after such merger or consolidation, or any series or combination of transactions whereby, directly or indirectly, control of the Company is transferred for consideration. Advisor shall be entitled to its Success Fee whether the prospective acquirer is introduced to the Company by Advisor, the Company or any other party. Advisor shall not be entitled to any Success Fee if a Transaction is not consummated. All fees due upon the sale of the Company shall become payable, and shall be paid together with all unpaid retainer amounts and unreimbursed out-of-pocket expenses at the time of the Closing (defined below).

The Consideration shall mean the sum of the following received in connection with the Transaction by the Company's shareholders and/or the Company: (i) cash; (ii) the fair market value of any stock or any other securities, including straight and convertible debt instruments; (iii) the fair market value of any assets or obligations, including contingent future payments; (iv) in connection with any major shareholder who is also an executive officer of the Company, non-compete, employment or consulting agreement payments in excess of the amount that such person would receive if he were paid at his current rate of compensation (base salary and bonus), plus; (v) if not already included above, the principal amount of all obligations for indebtedness for borrowed money remaining with the Company and assumed by the acquirer in connection with the Transaction. The fair market value of any securities, assets or obligations shall: (a) in the first instance, be determined in accordance with the valuation methods set forth in the definitive agreement pursuant to which the Transaction is consummated; and (b) in the second instance, be: (i) if it is of a class of security which is listed on a securities exchange, the average of the closing price of such security at the close of business for the five trading days immediately preceding the business date immediately preceding the date the Transaction is consummated; (ii) if it is a newly-issued security, the average of the closing price of such security for the twenty trading days following the fifth trading day after the date the Transaction is consummated; and (iii) if it is a security which is not listed on a securities exchange, the face value or principal amount of such security, if a debt security, or the fair market value on the date the Transaction is consummated as the Company and Advisor shall mutually agree, if an equity security.

The amount of Consideration involved in a Transaction, and the amount of the Success Fee due to Advisor, shall be determined at the time a Transaction is consummated (the "Closing"). If a portion of the Consideration is deferred or is structured as an earnout contingent upon future performance of the Company, then the portion of the fee that is deferred or relates to the earnout shall be payable when such deferred or contingent portion of the Consideration is actually received by the Company and/or its stockholders.

The Company agrees to provide to Advisor the names of all parties with which it or its stockholders has had contacts concerning a Transaction immediately upon entering into this Agreement and shall notify Advisor immediately of any additional such contact that occurs during this engagement. Regardless of the Company's compliance with the provisions of the preceding sentence, Advisor shall be entitled to the Success Fee if a Transaction occurs with any such party that has had contact with the Company.

4. ***Out of Pocket Expenses:*** In addition to any fees that may be payable to Advisor hereunder (and regardless of whether the Transaction occurs), the Company hereby agrees monthly to reimburse Advisor promptly for reasonable travel and other out-of-pocket expenses incurred in performing its services hereunder, not to exceed $2,000 per expense without the Company's prior written approval. Advisor shall notify the Company when total out-of-pocket expenses exceed $15,000 and for every $3,000 increment above this amount.

5. ***Indemnification Provisions:*** The Company agrees to indemnify Advisor and related persons in accordance with the Standard Form of Indemnification Agreement attached hereto as Exhibit A, the provisions of which are incorporated herein by this reference.

6. ***Reliance on Reports/Accuracy of Information:*** The Company agrees that Advisor shall be entitled to rely upon all reports of the Company and/or information supplied to Advisor by or on behalf of the Company (whether written or oral), and Advisor shall not in any respect be responsible for the accuracy or completeness of any such report or information or have any obligation to verify the same.

7. ***Communication and Advertisements:*** The Company agrees that, subsequent to the closing of a Transaction, Advisor has the right at its own expense to place customary advertisements in financial and other newspapers and journals and to make mailings to its current, former or prospective clients describing its services to the Company hereunder.

8. ***Confidential Use of Information or Advice:*** The Company agrees that any information or advice rendered by Advisor or its representatives in connection with this engagement is for the confidential use of the Company and its Board of Directors only in its evaluation of a Transaction and, except as otherwise required by law, the Company will not, and will not permit any third party to, disclose or otherwise refer to such advice or information in any manner without Advisor's prior written consent. The Company's Board of Directors and senior management will base their decisions concerning the Transaction on Advisor's advice as well as on the advice of their legal, tax, accounting and other business advisors and other factors which they consider appropriate, in any event at all times in accordance with their fiduciary duties to the Company and its shareholders. Accordingly, as an independent

contractor Advisor will not assume the responsibilities of a fiduciary to the Company or its shareholders in connection with the performance of Advisor's services.

9. ***Term of Engagement:*** The term of Advisor's engagement as financial advisor to the Company shall commence on the date hereof and continue until the earlier of the consummation of a Transaction or termination by either party upon thirty days' prior written notice (the Engagement Period"); *provided*, *however*, that no termination of this Agreement by the Company during the period ending six (6) months from the date hereof shall relieve the Company from its obligation to pay retainer payments for such full six-month period; and provided, further, that any termination of this Agreement will not affect the indemnification and contribution obligations of the Company, the confidentiality obligations of either party, any obligation of either party accrued through the date of termination or the right of Advisor to receive any unpaid amounts due hereunder as of the date of termination or pursuant to the following sentence. Advisor shall be entitled to its Success Fee in the event that, any time prior to the expiration of nine (9) months after the later to occur of (i) six (6) months from the date hereof or (ii) termination of this Agreement, a Transaction is consummated with any party (a) contacted by Advisor or the Company during the Engagement Period, (b) that has initiated contact with the Company during the Engagement Period, or (c) identified to Advisor by the Company pursuant to the provisions of the last paragraph of Section 3 herein. Upon termination of this Agreement, Advisor will provide to the Company a written list of all such parties that are included in the terms of clauses a, b and c of the immediately preceding sentence.

10. ***Sole Recourse:*** The Company's sole recourse with respect to this Agreement for any matter relating to this Agreement shall be to Advisor and in no event shall the Company have any recourse or assert any claim against or seek recovery from any other Indemnified Party as defined in the Standard Form of Indemnification Agreement.

11. ***Confidentiality:*** Advisor agrees to hold in confidence in accordance with procedures it applies generally to information of this kind and not disclose confidential information except as (a) may be required by law or as requested by any regulator having jurisdiction over Advisor and its affiliates, (b) to officers, directors and employees of Advisor and its affiliates and agents who have been informed of the confidential nature of the information and have a need to know such information to perform the services set forth herein, and (c) to potential acquirers consistent with the terms herein. Confidential Information includes any information about the Company or the Transaction furnished by the Company or its stockholders to Advisor but does not

include information (i) which was publicly known at the time of such disclosure, (ii) which becomes publicly known through no act or omission by Advisor, or (iii) which otherwise is known to Advisor other than through disclosure by the Company, its stockholders or a source known by Advisor to be bound by confidentiality obligations with respect to such information. In the event that Advisor is requested or required to disclose such Confidential Information in connection with any proceeding, Advisor will, unless prohibited by law, provide the Company with sufficient prior notice of such requirement or request so that the Company may seek a protective order or appropriate remedy, and cooperate with the Company to limit the extent of such disclosure by Advisor.

12. ***Governing Law/Miscellaneous:*** This Agreement (a) shall be governed by and construed in accordance with the laws of the Commonwealth of Massachusetts without regard to conflicts of law principles, (b) incorporates the entire understanding of the parties with respect to the subject matter hereof and supersedes all previous agreements should they exist with respect thereto, (c) may not be amended or modified except in a writing executed by the Company and Advisor and (d) shall be binding upon and inure to the benefit of the Company, Advisor, any indemnified parties and their respective heirs, personal representatives, successors and assigns. Except as otherwise contemplated by Exhibit A hereto, nothing in this agreement is intended to confer upon any other person other than the parties hereto any rights or remedies hereunder or by reason hereof.

This Agreement may be executed in two or more counterparts, each of which shall be deemed to be an original, but all of which shall constitute one and the same agreement. Please confirm that the foregoing is in accordance with your understanding by signing and returning to us a copy of this letter.

Very truly yours,

ADVISOR

____
Managing Director

Accepted and agreed to as of
the date set forth above:

COMPANY, INC.

By ____________________________________
Chairman and Founder

EXHIBIT A

ADVISOR

<u>Standard Form of Indemnification Agreement</u>

In connection with the services Advisor has agreed to render to the Company, the Company agrees to indemnify and hold harmless Advisor, its officers, directors, employees, agents, managers, members, affiliates and persons deemed to be in control of Advisor within the meaning of either Section 15 of the Securities Act of 1933, as amended, or Section 20 of the Securities Exchange Act of 1934, as amended (collectively, the "Indemnified Parties"), from and against any losses, claims, damages and liabilities, joint or several, related to or arising in any manner out of any transaction, proposal or any other matter (collectively the "Matters") contemplated by the engagement of Advisor hereunder. The Company also will promptly reimburse the Indemnified Parties for any expenses (including fees and expenses of legal counsel) as incurred in connection with the investigation of, preparation for or defense of any pending or threatened claim related to or arising in any manner out of any Matter contemplated by the engagement of Advisor hereunder, or any action or proceeding arising there from, whether or not resulting in liability (collectively, "Proceedings"). Notwithstanding the foregoing, the Company shall not be liable in respect of any losses, claims, damages, liabilities or expenses that a court of competent jurisdiction shall have determined by final judgment resulted solely from the gross negligence or willful misconduct of any Indemnified Party. Promptly after receipt by an Indemnified Party of notice of any claim or the commencement of any action or proceeding in respect of which indemnity may be sought against the Company, such Indemnified Party will notify the Company in writing of the receipt of commencement thereof, and the Company shall assume the defense of such action or proceeding (including the employment of counsel satisfactory to the Indemnified Party and the payment of the fees and expenses of such counsel), but the failure so to notify the Company will not relieve the Company from any liability which it may have to any Indemnified Party except to the extent of the Company's actual damages arising from the failure to so notify the Company. Notwithstanding the preceding sentence, the Indemnified Party will be entitled to employ its own counsel in such action if the Indemnified Party reasonably determines that a conflict of interest exists which makes representation by counsel chosen by the Company not possible. In such event, the fees and disbursements of such separate counsel will be paid by the Company.

If for any reason the foregoing indemnity is unavailable to Advisor or insufficient to hold Advisor harmless, then the Company shall contribute to the amount paid or payable by Advisor as a result of such claims, liabilities, losses, damages or expenses in such proportion as is appropriate to reflect not only the relative benefits received by the Company on the one hand and Advisor on the other but also the relative fault of the Company and Advisor, as well as any relevant equitable consideration. Notwithstanding the provisions of this agreement, the aggregate contribution of Advisor to all claims, liabilities, losses, damages and expenses shall not exceed the amount of fees actually received by Advisor pursuant to its engagement by the Company. It is hereby further agreed that the relative benefits to the Company on the one hand and Advisor on the other hand with respect to the transactions contemplated in this engagement letter shall be deemed to be in the same proportion as (i) the total value of the transaction bears to (ii) the fees paid to Advisor with respect to such transaction.

The indemnity, contribution and expense reimbursement agreements and obligations set forth herein shall apply whether or not an Indemnified Party is a formal party to any Proceeding, shall be in addition to any other rights, remedies or indemnification which any Indemnified Party may have or be entitled to at common law or otherwise, and shall remain operative and in full force and effect regardless of any investigation made by or on behalf of any Indemnified Party or any withdrawal, termination or consummation of or failure to initiate or consummate any Matter or any termination or completion or expiration of this letter or Advisor's engagement.

SAMPLE INVESTMENT BANK ENGAGEMENT LETTER 2

______________, 20__

Mr. X. Y. Z.
Chief Executive Officer
Company

Dear X:

This Letter Agreement confirms our mutual understanding regarding the retention of Financial Advisor L.L.C. ("Financial Advisor") by Company, Inc. (collectively with its subsidiaries and affiliates, the "Company") and the undersigned shareholder(s) thereof (the "Shareholders") to act as its exclusive investment banking representative in connection with the proposed sale of all or part of the Company.

Financial Advisor's Services and Role

1. Financial Advisor will assist the Company's management in: (a) identifying corporations, partnerships, individuals or other entities who might be interested in entering into a Transaction (as defined in paragraph two) with the Company; (b) preparing an information memorandum that describes the Company's operations, management, results of operations and financial condition and that incorporates current financial data and other information deemed relevant by the Company (as amended and supplemented from time to time, the "Information Memorandum"); (c) formulating and recommending a strategy for the sale of the Company; (d) contacting and eliciting interest from prospective purchasers; (e) conveying information desired by prospective purchasers not contained in the Information Memorandum (the "Supplemental Information"); (f) reviewing and evaluating prospective purchasers; (g) reviewing and analyzing all proposals, both preliminary and firm, that are received from prospective purchasers; and (h) negotiating, to the extent requested by the Company, with prospective purchasers.

2. As used in this Letter Agreement, the term "Transaction" shall mean: (a) the acquisition, directly or indirectly, by a person or group (as such terms are defined in Section 13(d) of the Securities Exchange Act of 1934, as amended) in a single transaction or a series of transactions, of (i) all or substantially all of the assets of the Company or (ii) all or substantially all of the outstanding stock of the Company; or (b) any merger, consolidation, reorganization, recapitalization, business combination, joint venture, lease, or other transaction pursuant to which the Company or substantially all of its assets are transferred to, acquired by, or combined with, another party.

3. In order that the Company and Financial Advisor best coordinate their efforts to effect a Transaction during the period of Financial Advisor's engagement, the Company, the Shareholders and Financial Advisor agree that: (a) Financial Advisor will be the sole and exclusive representative of the Company and the Shareholders in the sale of the Company; (b) in the event the Company continues or initiates any discussions relating to the possible sale of the Company other than through Financial Advisor, the Company and the Shareholders agrees to coordinate these discussions with Financial Advisor; (c) in the event the Company or the Shareholders receives an unsolicited inquiry concerning matters covered by this Letter Agreement, the Company and the Shareholders will refer any such inquiry to Financial Advisor; and (d) Financial Advisor will not contact any prospective purchaser, or provide an Information Memorandum, Supplemental Information or any other confidential information concerning the Company to a prospective purchaser, unless such prospective purchaser is approved in advance in writing by the Company (an "Approved Prospective Purchaser").

Information

4. In connection with Financial Advisor's activities on the Company's behalf, the Company and the Shareholders will furnish Financial Advisor with information and data concerning the Company (the "Information"). To the best of the Company's and the Shareholders' knowledge, all Information: (a) made available to Financial Advisor by the Company or the Shareholders; or (b) contained in any Information Memorandum or Supplemental Information will, at all times during the period of engagement of Financial Advisor hereunder, be complete and correct in all material respects and will not contain any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements therein not misleading in the light of the circumstances under which such statements are made. Further, any projections provided by the Company or the Shareholders to Financial Advisor contained in the Information Memorandum or Supplemental Information will be prepared in good faith and will be based upon assumptions which, in the light of the circumstances under which they are made, are reasonable. The Company and the Shareholders will promptly notify Financial Advisor if either learns of any material inaccuracy or misstatement in, or omission from, any Information previously delivered to Financial Advisor. The Information Memorandum and every item of Supplemental Information will be specifically approved in advance by the Company and the Shareholders. The Company and the Shareholders acknowledge and agree that Financial Advisor will be using and relying on the Information (and information available from public sources and other sources deemed reliable by Financial Advisor) without assuming any responsibility for independent

verification thereof or independent appraisal of any of the Company's assets. Financial Advisor does not assume responsibility for the accuracy or completeness of the Information or any other information regarding the Company.

5. In evaluating prospective purchasers, Financial Advisor will be using publicly available information; information contained in public reports provided by third party vendors (such as Dun & Bradstreet, Inc.); and other information furnished to Financial Advisor by such prospective purchasers. Financial Advisor does not assume responsibility for the accuracy or completeness of any information regarding a prospective purchaser contained in public sources or provided by a prospective purchaser.

6. The Company will provide Financial Advisor with access to the Company's employees, independent accountants and legal counsel and other third parties having a relationship with the Company to the extent Financial Advisor shall deem reasonably necessary in connection with the performance of its services hereunder.

Compensation and Reimbursement of Expenses

7. In consideration of Financial Advisor's services pursuant to this Letter Agreement, Financial Advisor shall be entitled to receive, and the Company agrees to pay Financial Advisor, the following compensation:

   a. An initial non-refundable cash retainer of $25,000 payable to Financial Advisor upon the execution of this Letter Agreement.

   b. A monthly non-refundable cash retainer of $7,500 payable to Financial Advisor in the amount of $22,500 upon the completion of every three months of this engagement.

   c. If a Transaction is consummated during the term hereof, there shall be paid to Financial Advisor a fee (the "Success Fee") equal to 2% of the Sale Price (as defined below) plus an incentive equal to 5.5% of the Sale Price in excess of $25,000,000. The minimum Success Fee shall be $350,000. The initial retainer of $25,000 paid to Financial Advisor pursuant to paragraph seven (a) and any monthly retainers paid to Financial Advisor pursuant to paragraph seven (b) will be credited against the Success Fee.

      The Success Fee shall be earned at the time of the closing of the Transaction and shall be paid to Financial Advisor at the time that the Sale Price, or portion thereof, is paid to the Company or its Shareholder. The

Success Fee shall be payable to Financial Advisor in the same form and manner as the Sale Price, or portion thereof, is paid to the Company or its Shareholders.

8. For the foregoing purposes the "Sale Price" shall be the aggregate consideration received by the Company and all equity owners in connection with the Transaction, including without limitation the sum of the following values:

   a. Cash and cash equivalents paid by the acquiring entity;

   b. Market value of any common or preferred stock issued by the acquiring entity, which shall be determined in a manner consistent with the definitive purchase agreement related to such Transaction;

   c. The face value of any notes or other evidence of indebtedness issued by the acquiring entity to the Company or its stockholders;

   d. The face value of any debt owed by the Company which is assumed or paid by or in connection with the entity acquiring the Company; and

   e. Consideration paid or payable under covenants not to compete, earn-outs, royalties, and management or consulting arrangements entered into in connection with the Transaction with senior executives of the Company but excluding all amounts that are consistent with the compensation paid to such senior executives by the Company immediately prior to such Transactions (on an annualized basis based upon salary and bonuses).

9. Notwithstanding termination of this Letter Agreement or Financial Advisor's engagement hereunder, in the event the Company or the Shareholders (i) consummate a Transaction pursuant to a definitive sale agreement or letter of intent entered into during the term hereof, or (ii) consummates a Transaction or enters into a definitive sale agreement or letter of intent regarding a Transaction with an Approved Potential Purchaser within nine months of the termination date of this Letter Agreement (which subsequently results in a Transaction), Financial Advisor shall be entitled to the Success Fee as set forth in paragraph seven above.

10. In addition to the fees described in paragraph seven above, the Company agrees to promptly reimburse Financial Advisor, upon request from time to time but not more than monthly, for all reasonable out-of-pocket expenses incurred by Financial Advisor in connection with the matters contemplated by this Letter Agreement, including without limitation, transportation, lodging, meals, communications, copying, printing, document services and legal

expenses. Financial Advisor will provide the Company with a reasonably itemized list of such out-of-pocket expenses for which reimbursement is required. Notwithstanding the foregoing, in order to obtain reimbursement hereunder, Financial Advisor shall first obtain the prior written approval of the Company for any expenditure in excess of $2,000 per calendar month.

Indemnification/Shareholders Responsibility in General

11. a. The Company hereby agrees to the indemnification and other provisions (the "Indemnification Provisions") attached to this Letter Agreement in Exhibit I, which Indemnification Provisions are incorporated herein and made a part hereof.

    b. The Shareholders shall be jointly and severally liable with the Company for all obligations of the Company pursuant to this Letter Agreement, including, without limitation, the obligations (i) to pay the compensation, fees and expenses owed by the Company, and (ii) under the Indemnification Provisions.

Other Terms

12. Either party hereto may terminate this Letter Agreement at any time but only upon written notice to the other party, without liability or continuing obligation except as set forth in this paragraph 12. Neither the termination of this Letter Agreement nor Financial Advisor's engagement hereunder shall affect: (a) any compensation earned by Financial Advisor up to the date of termination or completion, or after termination, as the case may be, pursuant to paragraph seven or paragraph nine; (b) the reimbursement of expenses incurred by Financial Advisor up to the date of termination or completion, as the case may be, pursuant to paragraph ten; (c) the attached Indemnification Provisions; and (d) the provisions of this paragraph and paragraphs 15 and 16 of this Letter Agreement, all of which shall remain operative and in full force and effect. This Letter Agreement shall inure to the sole and exclusive benefit of the parties hereto and their respective successors and, with respect to paragraph ten, the indemnified parties hereunder and their respective successors and representatives. This Letter Agreement constitutes the entire agreement between the parties and supersedes any and all prior or contemporaneous arrangements, understandings, written or oral, between them relating to the subject matter hereof. This Letter Agreement may not be amended or modified, nor may any provision be waived, except in writing signed by both parties. This Agreement shall be governed by and construed in accordance with the internal substantive laws of the State of Illinois.

13. Financial Advisor makes no representations, express or implied, that its efforts on behalf of the Company will result in a Transaction.

14. Financial Advisor agrees that there will be no obligation on the part of the Company or the Shareholders to negotiate with or accept any offer from any prospective purchaser unless, in the Company's sole discretion, the terms and conditions shall be acceptable to the Company or the Shareholders, as applicable.

15. Any advice rendered by Financial Advisor pursuant to this Letter Agreement may not be disclosed to any party other than the Company, its affiliates or their advisors without Financial Advisor's prior written consent.

16. Financial Advisor may publish, at its own expense, tombstone advertisements limited to announcing the completion of the Transaction (including the name of the Company) and Financial Advisor's role therein. Any other use of the Company's name or reference to the Transaction shall require the Company's prior written consent.

If the foregoing correctly sets forth our understanding, please sign the enclosed copy of this Letter Agreement in the space provided and return it to us.

Very truly yours,

Financial Advisor L.L.C.

By: ______________________
Managing Director

Accepted and agreed to this

___ day of ________, 20__

Company

By: ______________________________
Name
Title

Shareholder[s]

____

EXHIBIT 12B—Sample Short-Form Confidentiality Agreement

CONFIDENTIALITY AGREEMENT

This agreement is between Xyz, Inc., a Delaware corporation ("Xyz"), and the undersigned entity ("Company"). Xyz plans to disclose to Company certain Confidential Information, as defined below. Xyz is sometimes referred to as the "Disclosing Party," and Company is sometimes referred to as "Recipient."

1. Confidential Information; Exclusions.

   (a) "Confidential Information" shall mean all financial, technical, strategic and other information relating to the Disclosing Party or its actual or prospective business, products, or technology that may be furnished or disclosed to Recipient by, or acquired by Recipient directly or indirectly from, the Disclosing Party. Such term shall also include all copies and extracts of Confidential Information and all computer-generated studies and data containing Confidential Information. Information considered to be Confidential Information by the Disclosing Party may be disclosed orally or in writing.

   (b) For purposes of this Agreement, Confidential Information shall not include, and the obligations herein shall not apply to, information that: (a) is now or subsequently becomes generally available to the public through no fault of Recipient; (b) Recipient can demonstrate was rightfully in its possession prior to disclosure to Recipient by the Disclosing Party; (c) is independently developed by Recipient without the use of any Confidential Information provided by the Disclosing Party; or (d) Recipient rightfully obtains from a third party who, to Recipient's knowledge, has the right, without obligation to the Disclosing Party, to transfer or disclose such information.

2. Confidentiality Obligations.

   (a) Recipient shall use its best efforts to protect the confidentiality of the Confidential Information it receives from the Disclosing Party.

   (b) Recipient may use the Confidential Information only for the purpose of exploring an investment in or other business relationship with the Disclosing Party (the "Purpose") and may make no other use of the Confidential Information.

(c) Recipient may provide the Confidential Information it receives from the Disclosing Party only to those of its employees who (i) have a "need to know" such Confidential Information in order to enable Recipient to use such Confidential Information for the Purpose and (ii) are legally bound to use and disclose such Confidential Information for no other purpose.

(d) Recipient may, in addition, use or disclose, as applicable, the Confidential Information if: (a) required by any request or order of any government authority, provided that Recipient shall first attempt to notify the Disclosing Party of such requirement and, to the extent reasonable, permit the Disclosing Party to contest such requirement; (b) otherwise required by law; or (c) necessary to establish its rights under this Agreement.

(e) Recipient shall notify the Disclosing Party immediately in the event of loss or compromise of any Confidential Information.

3. Right to Disclose. The Disclosing Party warrants that it has the right to disclose the Confidential Information to Recipient. Except as otherwise provided, all information is provided "AS IS" and without any warranty, express, implied, or otherwise, regarding its accuracy or performance.

4. Return. Promptly upon the Disclosing Party's request, Recipient will either return or, if requested by the Disclosing Party, destroy all copies of any media or materials containing Confidential Information, including but not limited to all computer programs, documentation, notes, plans, drawings, and copies thereof to the extent that such contain Confidential Information.

5. Term. The term of this Agreement shall commence on the date of this Agreement and shall extend indefinitely.

6. No Implied License. No rights or licenses under copyright, patent, or trademark, or other intellectual property rights of the Disclosing Party are granted or implied by either a confidential or non-confidential disclosure.

7. Relief. Recipient agrees that, in the event of any breach of any provision hereof, the Disclosing Party may or will not have an adequate remedy in money or damages. Recipient therefore agrees that, in such event and without limiting any other remedies, the Disclosing Party shall be entitled to obtain injunctive relief against such breach in any court of competent jurisdiction. No failure or delay by a party hereto in enforcing any right, power or privilege created hereunder shall operate as an implied waiver thereof, nor shall any single or partial enforcement thereof preclude any other or further

enforcement thereof or the enforcement of any other right, power, or privilege.

8. Miscellaneous. This Agreement will be governed by and construed in accordance with the laws of Massachusetts.

Agreed:

Xyz, INC. Name of Company

____

By: ___________ By: ___________
(Signature) (Signature)

Date: ___________ Date: ___________
Printed Name and Title Printed Name and Title

EXHIBIT 12C—Form of Letter of Intent

___________, 20__

_____________Company, Inc.

____

_________, Massachusetts

Ladies and Gentlemen:

This letter is intended to set forth our mutual understanding and intention with respect to the proposed acquisition by _______________ Corp., a Delaware corporation (the "Purchaser"), of the assets of ______________ Company, Inc., a Massachusetts corporation (the "Seller"), pursuant to an Asset Purchase Agreement among the Purchaser and the Seller.

1. Purchaser will purchase from Seller all of the assets, properties and business of the Seller of every kind and description on the closing date, including without limitation the following:

   (a) all of Seller's accounts receivable, inventory, prepaid expenses and other current assets;

   (b) all machinery, equipment, furniture, fixtures, leasehold improvements, vehicles, office supplies and office equipment of Seller;

   (c) all of Seller's intellectual property rights, including patents, copyrights, trademarks, trade secrets and confidential information;

   (d) all of Seller's rights under existing equipment leases and executory contracts, including customer orders and purchase orders, and under any licenses or permits;

   (e) originals or copies of all sales records, customer lists, correspondence with customers, customer files and account histories, sales literature and promotional material, necessary or useful in the operation of Seller's business provided that Purchaser agrees to retain and make available to the Seller such documents for a period of three years from the closing date;

   (f) all real estate located at ___________ Avenue, Boston, Massachusetts, used by the Seller in its business (the "Real Estate"), which real estate is presently owned by ________Avenue Real Estate, Inc., an affiliate of the Seller (the "Real Estate Affiliate"), and leased to the Seller (the "Real Estate"); and

(g) all of Seller's rights to the trade name and mark "_____________", Seller's telephone number, and all goodwill of the Seller.

2. The consideration to be paid by Purchaser to Seller in full consideration for the aforesaid assets, properties and business shall be cash in an amount of $XX,000,000, plus the assumption of certain liabilities of the Seller pursuant to Section 4 below (the "Purchase Price"). The Purchase Price is based upon the Purchaser's analysis of the Seller's 20__ financial statements and is subject to further investigation and analysis.

3. The Purchase Price shall be paid as follows:

   a. a portion of the Purchase Price (to be agreed upon by the parties) shall be deposited in escrow and paid to Seller, with interest, on or before _______, 20__, subject only to claims by Purchaser for indemnification referred to in Section 8(iii) below; and

   b. the balance of the Purchase Price shall be paid by wire transfer of immediately available funds on the closing date.

4. Purchaser shall assume only those liabilities and obligations of Seller under the executory leases and contracts to be assumed by Purchaser pursuant to Section 1(d) above. Except as otherwise provided in the formal agreement, all of Seller's other liabilities and obligations will be satisfied, performed and discharged by Seller without any obligation on the part of Purchaser with respect thereto. The Purchaser may, but shall not be obligated to, offer employment to any of Seller's employees after the closing.

5. The payments referred to in Sections 3 and 4 hereof shall be guaranteed by the Purchaser's parent company, ____________, S. A.

6. On the closing date, Purchaser shall enter into employment and consulting agreements with each of the persons determined by Purchaser to be a key employee of Seller, pursuant to which each such person will agree, for a period of three years from the closing date (i) not to engage in competition with the Purchaser, whether as officer, director, agent, employee, consultant, stockholder, or in any other capacity, (ii) not to disclose any trade secrets or other confidential information of the Seller, and (iii) to serve as an employee of the Purchaser on the terms set forth therein. Prior to entering into the

Asset Purchase Agreement, Purchaser shall inform Seller of the identities of the persons deemed by Purchaser to be key employees.

7. A formal Asset Purchase Agreement and related documents, embodying the terms and conditions set forth herein and other customary terms and conditions, shall be prepared by __________________, counsel for the Purchaser, subject to the review and approval of __________________, LLP, a counsel for the Seller, as soon as possible. The Purchaser's obligations under the Asset Purchase Agreement shall not be subject to any financing conditions. The parties shall use their best efforts to complete the due diligence investigation, based upon preliminary unaudited 20__ financial statements, by January __, 20__, and to execute formal agreements on or before January __, 20__, which shall provide for a closing to take place as soon as possible thereafter, with an adjustment to the purchase price to the extent that the audited 20__ financial statements shall vary materially from the preliminary unaudited statements referred to above.

8. The formal Asset Purchase Agreement will contain certain customary representations and warranties relating to the business of the Seller and the assets to be acquired by Purchaser. The formal agreement shall contain among other things: (i) appropriate representations of Seller with respect to financial statements, properties, assets, liabilities and other items relevant to the value to Purchaser of the business and properties of Seller; (ii) appropriate conditions to Purchaser's obligations, including the receipt by Purchaser of financial statements of Seller as of _________, 20__; (iii) good title to Seller's assets and real estate, and absence of environmental liabilities, (iv) indemnification provisions whereby Seller shall hold Purchaser harmless from any misrepresentation or breach of warranty and any undisclosed or unassumed liabilities, including liabilities for taxes, environmental violations and patent infringement incurring prior to the closing date, which claims may be asserted against the amount held in escrow in accordance with Section 3(a) above; and (v) such other terms and conditions as are customary in transactions of this type. Purchaser shall have inspection rights to confirm the absence of any material and adverse financial effect upon Purchaser resulting from the inaccuracy of representations or warranties or failure of the Seller to comply with any covenant. It is intended that certain covenants of the parties will survive and be performed after the closing as to be detailed in the formal agreements.

9. Concurrently with the execution of the Asset Purchase Agreement, the Purchaser and Seller's Real Estate Affiliate shall enter into a real estate purchase and sale agreement (the "Real Estate Agreement"), providing for the purchase of the Real Estate by Purchaser for a cash consideration to be agreed upon by Seller and Purchaser, which consideration shall be credited

against the cash portion of the Purchase Price. The Real Estate Agreement shall provide for a deposit of $XX0,000 and shall contain customary terms and conditions, including those provided for in the Greater Boston Real Estate Board standard form, and the closing of the sale of the Real Estate under the Real Estate Agreement shall be a condition to the parties' obligations to close the sale of assets under the Asset Purchase Agreement. A formal Real Estate Agreement shall be prepared by __________, LLP, counsel for the Seller, subject to the review and approval of ________, counsel for the Purchaser.

10. In consideration of Purchaser's undertaking the substantial expenditure of time, effort and expense in connection with the various investigations and due diligence reviews necessary to effect the proposed transaction and in connection with the preparation of the Asset Purchase Agreement and the Real Estate Agreement, the Seller agrees that until ______ __, 20__ (and thereafter until either Seller shall advise Purchaser or Purchaser shall advise Seller in writing that it is terminating negotiations with respect to the proposed transaction) (a) neither Seller nor any of its stockholders will enter into or conduct any discussions with any prospective purchaser of the stock or assets of Seller; (b) Seller will use its best efforts to preserve intact the business organization and good will of Seller; and (c) Seller will refrain from taking any action not in the ordinary course of its business.

11. Seller shall give to Purchaser and its counsel, accountants and other representatives, with reasonable prior notice, full access during normal business hours to all of the properties, books and records of the Seller and shall furnish to Purchaser all information reasonably requested concerning Seller's business and finances and the Real Estate, including copies of all relevant contracts and other documents, provided that if the proposed transaction shall not be consummated, Purchaser shall return to Seller all documents and written information as Seller may request. Except as may be required by law or court order, all information so obtained, not otherwise already in the public domain, will be held by Purchaser in strict confidence and will be subject to the terms of a certain confidentiality agreement dated as of ________ __, 20__ between Seller and Purchaser.

12. The parties hereto shall agree with respect to the form, content and timing of any public announcements concerning the proposed transaction.

13. Purchaser and Seller shall each be responsible for and bear all of its own costs and expenses incurred in connection with the proposed transaction, including expenses of its representatives incurred at any time in connection with pursuing or consummating the proposed transaction.

14. This letter of intent is an expression of intention only and does not constitute a binding legal commitment on the part of Purchaser or, provided that the obligations set forth in Sections 10, 11, 12 and 13 of this letter shall be legally binding upon the respective parties when this letter is executed and delivered by all parties hereto. If the formal Asset Purchase Agreement or Real Estate Agreement is not executed and delivered for any reason, no party shall have any liability to any other party hereto based upon, arising from or relating to this letter, other than liability arising under paragraph 10, 11, 12 and 13 of this letter.

15. Except as and to the extent required by law, without the prior written consent of the other party, neither Purchaser nor Seller shall, and each shall direct its representatives not to, directly or indirectly, make any public comment, statement or communication with respect to, or otherwise disclose or permit the disclosure of the existence of discussions regarding, a possible transaction between the parties or any of the terms, conditions or other aspects of the transaction proposed in this letter.

If the foregoing accurately sets forth the terms of our understanding, kindly confirm this fact by executing the enclosed counterpart of this letter. Unless we receive a signed confirmation from you by 5:00 p.m., Boston time, on ______ __, 20__, this letter will be of no further force or effect.

Very truly yours,

______________________ CORP.

By: ______________________________

_________________, its attorney

_______________S. A.

By: ______________________________

_________________, its attorney

Confirmed:

____________________ COMPANY, INC.

By: ________________________________

__________ AVENUE REAL ESTATE. INC.

By: _________________________________

EXHIBIT 12D—Sample Due Diligence Request

ACQUISITION OF

____

First Request for Information

Please furnish for review copies of all of the following documents for ___________________ (the "Company") and for ______________ ("______"), as appropriate, or indicate to us that none exists. Please provide a written summary of each oral agreement or arrangement which is responsive to the requests set forth below.

Unless otherwise indicated, the requests are for any matters which are currently existing or in effect or which occurred within the last five years but which are not now existing or in effect.

Such documents should be furnished or made available to __________, Esquire, of [firm], [address], telephone: (___) ___-____, no later than ___________. Arrangements will be made to review materials which, because of their volume or utility for on-going operations, must be reviewed at the Company's offices.

I. Corporate Records.
II. Employee Benefits and Other Employment Matters.
III. Material Agreements and Financing Documents.
IV. Marketing, Sales and Operations.
V. Regulatory Matters.
VI. General Information.
VII. Accounting Matters.
VIII. Insurance Matters.
IX. Litigation, Claims and Related Matters

I. Corporate Records

1. Copies of charter documents of the Company, including all amendments, certified by Secretary of State of state of organization.

2. By-Laws, including all amendments and replacements, certified by Secretary of the Company.

3. Minutes of all meetings of the Company since the Company's organization, of the following (or written consents in lieu of meetings):

    a. Board of Directors;

    b. All committees of the Board of Directors; and

    c. Stockholders.

4. Management's reports to the Board of Directors, if any.

5. List of jurisdictions where the Company has substantial contacts; list of jurisdictions in which the Company is qualified to do business and evidence of such qualification; pending applications of the Company to register as a foreign corporation in any state in which the Company is not currently qualified to do business.

6. List of subsidiaries and affiliates and all of the above-described documentation with respect to each subsidiary and affiliate.

7. Stock ledger or register and copies of stock certificates, including reverse sides.

8. Warrants, warrant agreements, and other rights to subscribe for securities (see Item II(D) below regarding stock-option plans).

9. Voting agreements, voting trusts, proxies, etc., relating to the ownership and control of the Company.

10. Stock purchase and repurchase agreements.

11. Stock restriction agreements.

12. List of Officers and Directors/Members and Managers and Company Organization Chart.

II. Employee Benefits and Other Employment Matters

1. Employment, consulting, compensation, or other agreements or arrangements to which any Director, officer or employee of the Company is a party.

2. List of officers and other key personnel and their salaries, indicating the percentages of their time estimated to be devoted to the Company's business if they are less than full-time employees of the Company.

3. Pension plan documents, including trust instruments, plan summaries, reporting and disclosure documentation, IRS determination letters, financial statements and plan evaluations for most recent plan year, and most recent actuarial evaluation report.

4. Bonus plans.

5. Profit-sharing plans.

6. Stock-option plans.

7. Deferred-compensation plans.

8. Equity-participation plans.

9. Retirement plans.

10. Description of management loans, perquisites, or other similar arrangements.

11. Collective bargaining or other labor agreements, including any side letters.

12. Confidentiality and non-competition agreements between the Company and any officer, Director, employee, consultant, representative, supplier or customer.

13. Confidentiality or non-competition agreements to which employees and consultants are parties with their prior employers.

14. Other material employment-related agreements.

15. Documents relating to any transactions, agreements, or arrangements with any director, officer, trustee, or major stockholder (including their affiliates and relatives) of the Company.

16. A description of all material inter-company services provided to or on behalf of the Company by any of its affiliates, together with a list of all material assets, tangible and intangible, that are used by the Company but owned by any of its affiliates.

III. Material Agreements and Financing Documents

1. Leases with respect to real property (as lessee or lessor) to which the Company is a party or otherwise relating to its business.

2. Leases with respect to personal property (as lessee or lessor).

3. Laboratory and office equipment and machinery agreements.

4. Computer contracts (hardware, software, service bureau, etc.).

5. Contracts and agreements to which the Company is a party or otherwise relating to the Company's business.

6. Loan agreements (long-term and short-term), security agreements, financing statements, indentures, revolving credit agreements, note purchase agreements, notes, other evidences of indebtedness, and all related documents, including all amendments thereto, concerning any debt financing, etc.

7. Any agreements, in principle or otherwise, with respect to mergers, acquisitions, or sale of material assets of the Company, whether or not consummated.

8. Mortgages, pledges, other evidences of liens, or letters of credit securing the obligations described in response to Item 31 above and otherwise.

9. Corporate and personal guarantees of the obligations described in response to Item 31 above or other obligations.

10. Land purchase agreements.

11. Building or construction agreements for construction or alteration of property, plant, or equipment.

12. All documents evidencing title to real property, including deeds, title insurance policies, and title searches.

13. Copies of surveys, diagrams, and maps of real property owned.

14. All currently effective financing documents, such as sale and leasebacks and installment sales, and all liens and financing statements from all state, town, city, and county offices where such documents are filed.

15. All other documents relating to liabilities and obligations.

16. Correspondence and internal memoranda relating to any of the above.

17. All other agreements or understandings of any kind or nature relating to the Seller's plant business.

18. Agreements relating to ownership of or investments in any business, joint venture, or enterprise.

19. Any powers of attorney granted and other agency agreements.

IV. Marketing, Sales and Operations

1. Licensing agreements.

2. Schedule of patents, trademarks, copyrights, etc.

3. Schedule of fixed assets.

4. Distribution agreements, franchise agreements, or sales representative agreements.

5. Materials, sales and purchase contracts, and supply agreements.

6. Joint venture or partnership agreements.

7. Standard forms of purchase order, sales order, and other documents used in connection with purchases and sales.

8. List and description of major suppliers and ten major customers (for each of the last three years).

9. Records regarding backlog.

10. Company organization charts.

11. Agency or commission agreements.

12. Other material licenses, contracts, agreements, etc.

V. Regulatory Matters

1. All filings, reports, registration statements, correspondence, complaints, consent decrees, determinations, orders, etc., relating to federal regulatory agencies, and all state and local agencies performing similar functions, including:

   a. Environmental Protection Agency.

   b. Food and Drug Administration.

   c. Equal Employment Opportunity Commission.

   d. Occupational Safety and Health Administration.

   e. National Institutes of Health.

   f. Department of Defense.

   g. Internal Revenue Service, including all tax returns filed and results of most recently completed IRS audit.

   h. Other (e.g., Department of Justice, Federal Trade Commission, Department of Labor, Department of Commerce).

2. Schedule of all governmental licenses, permits, permissions, registrations, approvals and the like, including under the above-listed agencies and under state and local ordinances such as local zoning and other land-use regulations.

3. Any internal compliance audit, regulatory review or other investigation or report by the Company, or any other party relating to the Company's compliance with any law or regulation.

4. All documents submitted to governmental authorities or prepared pursuant to any community or worker right-to-know law or program or similar law or requirement.

5. All documents, including correspondence with governmental authorities, relating to air emissions and/or discharges into surface water or groundwater by the Company or relating to the treatment, storage, or disposal of waste materials (including any hazardous materials).

6. A list of each foreign jurisdiction to which the Company exports any products, equipment, services or technology, each foreign jurisdiction

from which the Company imports any of the foregoing (including raw materials), and each foreign jurisdiction (if any) to which any of the foregoing is re-exported.

VI. General Information

1. Brochures of products.

2. Press releases (last three years).

3. Press clippings (last three years).

4. Analysts' reports and industry surveys (by brokerage houses, technical experts, management consultants, etc.).

5. Budgets, forecasts, and projections (whether or not published), including any current or past business plans prepared by or at the request of any of the Companies, or relating to the proposed business of any of the Companies.

6. Appraisals of any fixed asset.

7. Texts of speeches by Company officers, if reprinted and distributed or released to media outlets.

VII. Accounting Matters

1. Accountants' reports and correspondence and management letters to the Company or the Seller (last three years).

2. Audited financial statements and any interim unaudited financial statements along with the name, address, and telephone number of the accountant or other person(s) who prepared each of the financial statements.

3. Audit Committee reports to Board of Directors.

4. Internal financial plans, budgets, and projections (last three years); review of or comparison with actual results for evaluation of current projections.

5. Any documents relating to material write-downs or write-offs to notes or accounts receivable other than in the ordinary course of business.

6. Tax returns for the Company for the latest closed year and all open years (federal, state, local, and foreign), the most recent IRS and state

tax audit reports and any other tax audit reports received within the past five years and any settlement documents entered into within the past five years.

VIII. Insurance Matters

1. Summary of the Company's insurance coverage.

    a. Property, including title, flood, etc.;

    b. Liability;

    c. Product liability;

    d. Life;

    e. Directors and officers indemnification;

    f. Accident, indemnity, casualty;

    g. Workers' compensation;

    h. Business interruption;

    i. Other.

2. Claims history.

IX. Litigation, Claims and Related Matters

1. Schedule of all existing or threatened pending litigation.

2. Litigation files, including pleadings, opinions of counsel, correspondence, and analysis of material litigation status; consent decrees, injunctions, etc.

3. All correspondence and documents relating to material contingent liabilities.

4. Counsel's letters to accountants with respect to litigation, contingent liabilities, etc.

5. All correspondence dealing with actual or alleged infringement of patents, trademarks, or copyrights.

6. Files regarding material claims settled or adjudicated, files relating to any past or current investigations or proceedings by any governmental agencies (including environmental and employee safety matters) with respect to the Company, and copies of and files relating to any outstanding orders, decrees or judgments, and files with respect to pending or threatened material labor disputes (including strikes, grievances, and arbitration proceedings).

7. Product warranty materials (including product return policies) and commitments and claims history.

8. A description of all material uninsured risks and self-insurance programs.

9. Any waivers or agreements canceling claims or rights of substantial value other than in the ordinary course of business.

EXHIBIT 12E—Environmental Due Diligence List

1. All audits, reports, site assessments, correspondence, notices, notes, government documents, and any other documentation regarding or relating to *any release or spill* at any facility or property *currently* or *formerly* owned, leased or operated by the Company or any of its subsidiaries.

2. All audits, reports, and site assessments, in the possession, custody, and control of the Company or any of its subsidiaries concerning environmental or health and safety matters regarding or relating to *current* or *former* property or facilities owned, operated, or leased by the Company or any of its subsidiaries.

3. Copies of any notices or correspondence from the Company or any of its subsidiaries to any federal, state, or local environmental, health or safety agency, or regulatory authority.

4. All notices of violation, liability or potential liability, complaints or suits to the Company or any of its subsidiaries by any federal, state, or local agency or regulatory authority overseeing environmental, health, or safety matters.

5. All correspondence or notices of violation, liability, or potential liability complaints or suits to the Company or any of its subsidiaries from any third parties regarding environmental, health, or safety matters.

6. Copies of any and all permits, registrations, licenses, or authorizations issued to the Company or any of its subsidiaries pursuant to any federal, state, or local environmental, health, or safety law or regulation.

7. Description of any processes or facilities currently or previously owned or operated by the Company or any of its subsidiaries that generate (or are suspected of generating), store, transport, or dispose any toxic or hazardous material or waste.

8. All hazardous waste manifests from the last five years from all facilities operated by the Company or any of its subsidiaries.

9. All EPCRA sec. 312 Tier II Reports from the last three years from all facilities operated by the Company or any of its subsidiaries.

10. All licenses or permits for the use and storage of radioactive materials for all facilities operated by the Company or any of its subsidiaries.

11. All MSDS (material data safety sheets) for all facilities operated by the Company or any of its subsidiaries.

12. Description of any processes currently or previously conducted by the Company or any of its subsidiaries at any facility (or by others on property currently or formerly owned by the Company or any subsidiary) that result in the generation of wastewaters or processwaters other than domestic sanitary sewage, and description of the method of treatment and disposal of such wastes.

13. Description of any processes currently or previously conducted by the Company or any of its subsidiaries at any facility (or by others on property currently or formerly owned by the Company or any subsidiary) that result in the generation of air emissions.

14. Identify the main SIC code for any facility owned or operated by the Company or any of its subsidiaries and provide a copy of any stormwater management plan or spill prevention control and countermeasure plan prepared for any such facility.

15. List all existing and former underground and aboveground storage tanks, whether active, inactive, or abandoned, now or formerly located on any property currently or formerly owned or operated by the Company or any of its subsidiaries. Please identify each tank by location, capacity, and substance now or previously stored. Please provide a copy of all documents relating to the existence, upgrade, abandonment, removal, closure, or compliance status of such tanks.

16. Please state for each facility currently operated by the Company or any of its subsidiaries whether it is serviced by a public sanitary sewer system or by an on-site sewage disposal system.

17. All documents relating to utility-owned or controlled equipment using PCBs, spills of PCBs, or worker exposure to PCBs.

18. All documents relating to the existence, condition, abatement, management, or removal of asbestos at all facilities owned or operated by the Company or any of its subsidiaries.

19. Copies of any discharge monitoring reports for any facility owned or operated by the Company or any of its subsidiaries.

20. All reports, notices, or correspondence from the Company or any of its subsidiaries to federal, state, or local environmental authorities notifying such authorities of instances of non-compliance with any environmental permits.

21. List of the names and addresses of companies or individuals that transport or have transported any hazardous waste or material of the Company or any of its subsidiaries.

22. List all properties formerly owned by the Company or any of its subsidiaries. Please provide any environmental site assessments that have been completed for any of these properties, as well as a description of the operations conducted at these properties.

23. List of all properties or facilities currently or formerly leased by the Company or any of its subsidiaries, as well as a description of the operations conducted at these properties. Provide copies of any such leases and any environmental site assessments that have been completed for any of these leased properties or facilities.

EXHIBIT 12F—Form of Closing Agenda

Newport

AGREEMENT AND PLAN OF MERGER
BY AND AMONG
NEWPORT CORPORATION,
MAGNESIUM ACQUISITION CORP.,
AND
MICRO ROBOTICS SYSTEMS, INC.

February 15, 2002

INTRODUCTION

On January 22, 2002, Newport Corporation, a Nevada corporation ("Newport"), Magnesium Acquisition Corp., a Massachusetts corporation and wholly owned subsidiary of Newport ("Merger Sub"), and Micro Robotics Systems, Inc., a Massachusetts corporation ("MRSI"), entered into an Agreement and Plan of Merger (the "Merger Agreement").

The Merger Agreement provided for the acquisition of MRSI by Newport by means of a reverse triangular merger of Merger Sub with and into MRSI, with MRSI surviving the merger as a wholly owned subsidiary of Newport (the "Merger"). The Merger was consummated (the "Closing") on February 15, 2002 (the "Closing Date"). Subsequent to the Merger, MRSI, as part of a single plan to which the Merger is a part, was merged with and into a newly formed and wholly owned Delaware subsidiary of Newport ("Newsub"), with Newsub surviving as a wholly owned subidiary of Newport (the "Sideways Merger"). The Sideways Merger was consummated on March 7, 2002.

This Closing Memorandum sets forth the various pre-closing, closing and post-closing actions taken and to be taken in connection with this transaction. Terms not defined herein shall have the meanings assigned to them in various transaction documents.

A. AGREEMENT AND PLAN OF MERGER AND RELATED DOCUMENTS

1. Agreement and Plan of Merger dated January 22, 2002, executed by each of the parties thereto.

2. MRSI Disclosure Schedules dated January 22, 2002, updated as of the Closing Date.

3. Newport Disclosure Schedule, dated January 22, 2002, updated as of the Closing Date.

4. Voting Agreement, dated January 22, 2002, as executed by Newport, Merger Sub, MRSI, _____________ and _____________.

5. Escrow Agreement, dated as of the Closing Date, as executed by Newport, _____________, as authorized representative of all shareholders of MRSI, and J.P Morgan Trust Company, as Escrow Agent.

6. Investment Representations and Joinder Agreement, as executed by each of the Shareholders of MRSI and delivered to Newport prior to the Closing Date [not included in this compliation].

7. Letter agreement dated the Closing Date regarding net worth adjustment.

B. DOCUMENTS RELATED TO ACTIONS TAKEN BY NEWPORT

8. Certified Resolutions adopted at a Meeting of the Board of Directors of Newport, regarding approval of the execution and delivery of the Merger Agreement, the related documents, and the consummation of the transactions contemplated thereby.

C. ORGANIZATION OF AND ACTIONS TAKEN BY MERGER SUB

9. Articles of Organization of Merger Sub, as filed with the Massachusetts Secretary of the Commonwealth on January 16, 2002 and as effective immediately prior to the Merger.

10. Consent of Incorporator in Lieu of Organizational Meeting, adopting bylaws and electing directors and officers, dated January 14, 2002.

11. Bylaws of Merger Sub, as effective immediately prior to the Merger.

12. Unanimous Written Consent in Lieu of First Meeting of the Board of Directors, dated January 16, 2002, ratifying adoption of bylaws and authorizing the issuance of stock to Newport.

13. Action by Written Consent of the Board of Directors of Merger Sub, dated January 16, 2002, authorizing and approving the execution and delivery of the Merger Agreement and the consummation of the transactions contemplated thereby.

14. Action by Written Consent of the Sole Stockholder of Merger Sub, dated January 16, 2002, authorizing and approving the execution and delivery of the Merger Agreement and the consummation of the transactions contemplated thereby.

D. ORGANIZATION OF AND ACTIONS TAKEN BY MRSI

15. Certificate of Clerk of MRSI, dated as of the Closing Date, certifying the following:

Exhibit A	Resolutions of the Board of Directors
Exhibit B	Resolutions of the Shareholders
Exhibit C	Articles of Organization
Exhibit D	Bylaws

16. Certificate of good standing of MRSI from the Secretary of the Commonwealth of Massachusetts

17. Certificate of good standing of Automation Unlimited, Inc. from the Secretary of the Commonwealth of Massachusetts

E. COMPLIANCE WITH CONDITIONS TO CLOSING

1. MRSI Stockholder Approval

18. Affidavit of Notice of Special Meeting of Stockholders and Proxy Statement, mailed on January 23, 2002 to all stockholders of record of MRSI as of January 11, 2002, together with schedule of stockholders.

19. Minutes of Meeting of Special Meeting of Stockholders of MRSI, held on February 13, 2002.

20. Voting Tabulation, reflecting dissenting shares, if any.

2. Compliance With Closing Conditions by MRSI

(a) Compliance Certificate

21. Certificate of CEO of MRSI, dated as of the Closing Date, regarding MRSI's representations and warranties and compliance with covenants in Merger Agreement.

(b) Employment Agreements

22. Employment Agreement dated as of the Closing Date between MRSI and _____________

23. Employment Agreement dated as of the Closing Date between MRSI and _____________

24. Employment Agreement dated as of the Closing Date between MRSI and _____________

25. Employment Agreement dated as of the Closing Date between MRSI and _____________

26. Employment Agreement dated as of the Closing Date between MRSI and _____________

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27. Employment Agreement dated as of the Closing Date between MRSI and _____________

28. Employment Agreement dated as of the Closing Date between MRSI and _____________

29. Employment Agreement dated as of the Closing Date between MRSI and _____________

(c) Non-Competition Agreements

30. Non-Competition Agreement dated as of the Closing Date between MRSI and _____________

31. Non-Competition Agreement dated as of the Closing Date between MRSI and _____________

32. Non-Competition Agreement dated as of the Closing Date between MRSI and _____________

33. Non-Competition Agreement dated as of the Closing Date between MRSI and _____________

34. Non-Competition Agreement dated as of the Closing Date between MRSI and _____________

35. Non-Competition Agreement dated as of the Closing Date between MRSI and _____________

36. Non-Competition Agreement dated as of the Closing Date between MRSI and _____________

37. Non-Competition Agreement dated as of the Closing Date between MRSI and _____________

(d) Sale of Vascular Technology Incorporated

38. Certificate No. 2 representing 1,000 shares of common stock of Vascular Technology, Incorporated ("VTI"), duly endorsed for transfer to _____________

39. Assumption and Assignment of Lease dated February 12, 2002 from MRSI to VTI

40. First Amendment of Lease dated February 12, 2002 between MRSI, VTI and _____________, LLC, as landlord.

41. Indemnification Agreement, dated as of the Closing Date, among VTI, _____________, Newport and MRSI, relating to indemnification of Newport and MRSI in connection with sale of VTI.

42. Check in the amount of $_____________, payable by ___________ to Newport.

(e) Other Closing Conditions

43. Legal Opinion of Davis Malm & D'Agostine P.C., dated as of the Closing Date.

44. Termination of Consulting Agreement with _____________

45. Termination of Consulting Agreement with _____________

46. Financial results of MRSI for quarter ended December 31, 2001

3. Compliance With Closing Conditions by Newport

47. Certificate of Officer of Newport, dated as of the Closing Date, regarding Newport's representations and warranties and compliance with covenants in Merger Agreement.

48. Financial results of Newport for the year ended December 31, 2001.

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F. OTHER CLOSING DOCUMENTS

49. Articles of Merger, merging Merger Sub with and into MRSI, filed with the Secretary of the Commonwealth of Massachusetts on February 15, 2002.

50. Resignations of Officers and Directors of MRSI and subsidiaries, effective as of the Closing Date.

G. EXCHANGE OF STOCK AND CASH CONSIDERATION

51. Schedule of MRSI Shareholders immediately prior to the Closing Date.

52. Conversion Schedule listing the number of shares and cash consideration to be issued and paid to MRSI Shareholders.

53. Form of Transmittal Letter, Instructions and Stock Powers, mailed to each of the MRSI Shareholders on March 4, 2002, regarding delivery of stock in exchange for the Merger Consideration and delivery of shares into escrow.

H. COMPLETION OF SIDEWAYS MERGER

54. Certificate of Incorporation of Newsub, as in effect immediately prior to Sideways Merger.

55. Certificate of legal existence of Newsub issued by the Delaware Secretary of State.

56. Articles of Merger, merging MRSI into Newsub, as filed with the Secretary of the Commonwealth of Massachusetts on March 7, 2002.

57. Certificate of Merger, merging MRSI into Newsub, and changing the name of Newsub to "Micro Robotics Systems, Inc.", as filed with the Delaware Secretary of State on March 6, 2002.

58. Foreign Corporation Certificate, qualifying Newsub to do business in Massachusetts, as filed with the Massachusetts Secretary of the Commonwealth on March 12, 2002.

I. REGULATORY FILINGS AND PUBLIC ANNOUNCEMENTS

59. Newport's Press Release, dated January 23, 2002, regarding execution of the Merger Agreement.

60. Newport's Press Release, dated February 19, 2002, regarding completion of the Merger.

61. Form S-3 Registration Statement, registering the shares of Newport common stock issued pursuant to the Merger Agreement, as filed with the Securities and Exchange Commission on April 15, 2002.

62. Form of prospectus filed with the Securities and Exchange Commission on April 25, 2002 under Rule 424.

63. Form S-8 registration statement registering the shares issuable to holders of MRSI stock options, as filed with the Securities and Exchange Commission on April 15, 2002.

64. Form of prospectus for resale of stock issued pursuant to MRSI stock options.

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EXHIBIT 12G—Tips for Successful Negotiation of Business Acquisitions*

A. Dos

1. Compromise

 The power of compromise is one of the most important lessons a negotiator can learn. Fundamentally, negotiation is all about compromise. Compromise comes in many forms. You can back away from an issue in order to move the process forward. You can trade an issue that is important to you for one that is important to the other side. Knowing your bottom line on an issue allows you to compromise in order to get the deal done, but not give away the entire deal.

2. Keep Notes

 Throughout the deal process, including the negotiations, keep a running list of the significant issues that rise. Make sure that you track issues that are of importance to you, and those that are important to the other side as well. In addition, keep a record of your conversations. You will learn that a lot of information is passed between the parties during negotiations, and it is easy to forget who's responsible for tracking down information or what the resolution of a certain issue was.

3. Keep Your Important Cards Close to Your Chest

 Focus on the issues that need to be addressed. Try not to add additional commentary on the deal, the people or tangential topics. If your counterparty is doing his job well, he is listening to everything you say, and could glean valuable information from you that could be used against you later. On the other hand, you should always subtly remind your opponent of the factors that enhance your bargaining leverage, such as the existence of other interested buyers or your client's alternatives if it does not do the deal.

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* Excerpted with permission from Hunt, *Structuring Mergers and Acquisitions* (Wolters Kluwer, 3d ed. 2007), § 25.03.

4. Be Consistent

   Be firm on those things that are important. Try not to go to battle on minor issues. Set the expectation with the other side that you are objective, fair and reasonable. Back up your statements with evidence or strong rationale. You should also be able to judge the overall temperament of the negotiations in order to know when to stick a stake in the ground on a certain issue.

5. Don't Give Away the Less Important Stuff Too Early

   If you come to terms too soon on all the simple points, you may not have something to trade later on. You should have a good enough understanding of all the issues in the deal that you learn which are important to the other side. While these points may not be important to your client, you are able to maintain a certain amount of leverage by not conceding these issues to the other side too soon. It is often good strategy to listen to *all* of your opponent's proposed changes before deciding which ones you will concede.

6. It's OK to Be a Jerk Every Once in a While

   Depending on the circumstances, it may be appropriate to get emotional during a negotiation. Reasons to make a bold statement would include if the other side is not hearing your concerns loud and clear, if they are veering off course, if their own behavior becomes intolerable, o[r] if you need to ensure than an issue of importance turns in your favor. This tactic is most effective if it contrasts with your usual cooperative demeanor.

7. Stop to Take the Temperature

   In every step of the negotiation, it is important to revisit the original objectives and expectations of the deal, and make sure that the direction of the discussions is consistent with those intentions. From a business perspective, you should be concerned that the evolving contract supports the valuation and financial analysis performed in the deal.

8. Track Progress

   At the end of each negotiation session, agree on the open items with the other side, what is required to resolve them, and what the next steps should be. Every step of the way you should be pushing the ball closer to the finish line.

9. Ask Questions

If you do not understand something, ask questions. One party may say something that is interpreted entirely different by the other side than was originally intended. If you think an issue is difficult to understand, it is all right to spell it out and ask the other side if they understand what you are saying. Misunderstandings do not move a deal forward.

10. Educate Your Opponent

A well-informed counterparty is more likely to see things your way. Spend time investing in your counterparty by providing him with information that educates him and is supportive of your position. Let him know why certain items are of importance to you; likewise, don't force issues that are not as important.

11. Decide on the Tough Issues

Many times, the difficult issues are not just price and structure. In fact, those points are often the easiest to tackle, since without agreement in these fundamental areas, there would be no basis for a deal. The tough issues are often those that don't appear until after the negotiation is already underway. It behooves you to try and preempt the process by ferreting out the difficult issues as soon as possible. You should then decide when you want those issues to be addressed. For example, there may be a lawsuit or regulatory issue that is pending, the premature resolution of which may scare away the other side. However, if left to the end of the negotiation, the counterparty may not perceive the issue to be quite as severe if they have made substantial progress on most other aspects of the deal.

B. Don'ts

1. Don't Get Hung Up on Issues

No transaction ever gets done unless both parties want to move the process forward. This means that neither side has the luxury of getting hung up on issues. If a particular point looks like it is not going to get resolved on a given day, agree to put it aside and revisit it later. You will be amazed at how quickly the list of unresolved issues dwindles.

2. Don't Keep Raising New Issues

You should get all the issues out on the table as quickly as possible in a negotiation, partly to understand the overall magnitude of the process, but also to prevent both sides from introducing new issues during the deal. New issues that are left too late in the process can negatively affect the entire process and damage your credibility, since these points may alter a party's viewpoint on issues already negotiated.

3. Be Careful when Trying to Bluff.

   People sometimes liken deal negotiation to a game of poker. This is a risky strategy, since in a transaction the whole deal is at stake rather than a single hand. While bluffing comes in different shades of gray and certainly can have its place in a negotiation, it is not for the faint of heart.

C. Tactics to Look Out For

1. Deceit

   In most cases, peoples' natural tendency is to give the other side the benefit of the doubt and to assume that they are acting in a forthright manner. While I'm not suggesting that you treat every counterparty as a criminal, you should be astute in your interactions with the other side and observe their approach to negotiations. Did he deliver on his promise? Has he provided the information you asked for? Does the term sheet or contract accurately reflect what you discussed and agreed to?

2. Calling on a Higher Authority

   A common strategy is for a lead negotiator to have the responsibility to negotiate certain issues but not others. "I'll have to check with my client on that issue" is a good way to buy time to think or to deflect responsibility for taking a hard line. While this strategy can work, the principal dealmaker runs the risk of undermining his credibility with the other side, because they become unsure over what issues the dealmaker has authority. They may become reluctant to resolve an outstanding point for fear that a "resolved" or "closed" issued may get reopened.

3. Good Guy/Bad Guy

   Much like the higher authority approach, a bad guy may play tough on issues in order to make as much progress as quickly as possible. To the extent the bad guy goes too far or fails in his efforts, the good guy then steps in and backtracks if necessary. However, if the bad guy's approach is successful, the good guy simply steps in to continue the deal. This high-risk approach can work under certain circumstances, but can damage credibility if used as an overriding strategy.

4. Intimidation

   Another tactic to be wary of is intimidation, where the negotiator tries to bully the other side into conceding on an issue. Intimidation may suggest a lack of leverage or a masking of issues that are not desired to be revealed. Common signs of intimidation are when a negotiator introduces personal attacks or tries to pull seniority over the negotiator for the other side.

5. Beware of the Trial Balloon

   Often, a party may float an idea or propose a solution to a problem. While in many circumstances, this is a legitimate means to exploring the other side's flexibility on an issue, you should be careful about giving too much away in responding to a proposal positioned as a "trial balloon."

6. Avoid Uncompensated Concessions

   Some negotiators employ the "slice the baloney" technique of asking for just one more little concession to seal the deal, and then repeating the process until the "slices" add up to most of the baloney. The surest way to thwart this tactic is to insist that every concession you make is offset by a concession on the part of the other party.

   All of these tactics may have their rightful use, place and time in a negotiation, and can be effective if not abused. However, misuse of any of these tactics is high risk and is certain to reveal weakness or damage credibility. So, just as you should be wary of using these approaches, you should be aware when others are using them on you.