

Tuesday, March 3, 2009

## Business and Finance Update

### Considerations When Buying or Selling a Business

By Renee Cain

Despite the general state of the economy, now may be a good time to buy or sell a business. The following is a summary of issues to consider prior to embarking on an acquisition or sale of a business.

Picking the Right Buyer. As a seller, you will want to look for a credible buyer – one that is willing to pay you the best price for your business; however, you need to balance that against the buyer's ability to stand behind the deal that it makes.

Performing Due Diligence. As a buyer, be thorough in asking questions and seeking out information regarding the business that you are proposing to acquire. Do your due diligence early in the process. If the deal involves the sale of real property, order any environmental assessments or title reports that you will need to properly evaluate the property. As a seller, be cooperative with providing information regarding your business. You will not benefit from "hiding the ball" from the buyer and after the closing, may face indemnification obligations for an issue that could have been addressed before the closing.

Agreeing to the Purchase Price. On both sides of a deal, you will need to determine the terms you are willing to pay or accept for the purchase price. Will the purchase price be payable with cash, stock, seller carry-back notes, or some combination? Are you willing to receive or pay an earn-out as part of the purchase price? What thresholds and conditions are acceptable for an earn-out? Does the seller have a loan that is assumable? Are you willing to step into that loan? Being creative in the structure of the purchase price can help you achieve a higher price and get a deal done.

Negotiating Key Terms. Whether you are buying or selling, negotiate the key terms up front. Will you buy or sell the assets or ownership interests of the company? How will the purchase price be paid? What are the terms for indemnification? Will you agree to a basket or cap on the indemnification obligations? What dollar amount are you comfortable with for a basket or cap? Will the founders or individual owners stand behind the representations and be responsible for the indemnification provision? Will the selling entity be continuing as an ongoing business? Is a revenue guaranty appropriate? Will there be a noncompetition and nonsolicitation agreement? What will be the area and term of such agreement? What conditions are necessary to be satisfied prior to closing? Are there any customers, vendors, suppliers, or landlords that require consent to assign an agreement? Do you need to get a lien released? Will there be an employment contract with any key employees or with the owners? If there is real property involved, are there any title exceptions that need to be cleared prior to closing?

Maintaining Perspective. In either case, as a seller or a buyer in this economic climate, you need to maintain perspective. Stay positive. Identify what is important to you about the transaction. Focus on the goals that you wish to accomplish with the transaction, whether it is adding value to an existing line, acquiring a competitor, or selling a line of business that has not been profitable to you. As issues arise throughout the process (which they inevitably will), do not react immediately, take a step back and consider these new issues as a part of the whole transaction.

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## Position Your Company for a Sale

By Susan M. Wissink and Renee Cain

If you are considering selling your business, you should take steps now that will help maximize the value and attract potential buyers. Many times, deals are delayed or sellers are discouraged if you have not taken these steps before you proceed with the sale.

- Prepare your books and records for a potential sale:
  - Clean up your corporate documents – make sure your bylaws or operating/partnership agreements reflect how you run your business and verify that you have complied with corporate requirements to have meetings, file annual reports, etc.
  - If you have major shareholders or owners in your company, discuss the potential sale with them to ensure you will have the support to proceed
  - Formalize shareholder or other ownership records and verify that all transactions are properly documented
  - Review your customer and supplier contracts, real estate leases, equipment leases, permits, and licenses to determine the impact of a sale
  - Verify that all your policies and procedures are documented properly
  - Evaluate and list the assets of your business
  - Consider disposing of obsolete equipment and inventory
  - Clean and organize your office or facility
  - Ensure that your financial records are complete and correct
- Remove potential deal breakers and correct any weaknesses in the business, such as those due to existing or threatened litigation, contractual disputes, or other outstanding legal, tax, banking or financial issues
- Consider having a third party appraiser value your company
- Determine your price range
- Consult with accountants or other tax advisor to understand tax consequences of the sale
- Write up a comprehensive summary of the business

## MAC Clauses: Make Sure Your Parachute is Packed Before You Jump!

By Sarah A. Strunk and Charles W. Ross

Recently, Jack Welch, the former Chairman and CEO of General Electric, was a special guest on a cable news program. The topic turned to Bank of America's recent acquisition of Merrill Lynch. Mr. Welch commented that had he been at the helm of Bank of America, he would have refused to close the deal with Merrill Lynch because of a material adverse change (MAC) in the financial results of Merrill Lynch. As discussed in this article, a recent decision by the Delaware Chancery court should give buyers pause before jumping head first into a MAC dispute.

Mr. Welch's suggestion that Merrill Lynch had suffered a MAC prior to the closing of the merger with Bank of America sounds reasonable given the recent financial downturn. In fact, you might wonder who would argue with that conclusion. However, the ultimate determination as to whether Merrill Lynch actually suffered a MAC would have depended on the definition of a MAC in the merger agreement and a court's interpretation of that definition.

MAC clauses describe the circumstances that allow a buyer to terminate a transaction, usually without penalty, prior to its closing. A MAC is often an event, or a series of events that have an adverse impact on the seller. A typical definition of a MAC might read, "any effect or change that would be materially adverse to the business of seller, taken as a whole, or to the ability of seller to consummate timely the transactions contemplated by this agreement." MAC clauses are heavily negotiated in most transactions. In many circumstances a seller will seek to include exceptions to the definition of a MAC for adverse changes related to general market conditions, political events, volatility in the stock market or changes in laws.

The notion that Merrill Lynch may have suffered a MAC prior to its acquisition by Bank of America is very real. According to Thompson Reuters, for the fourth quarter of 2008, the value of broken deals was equal to about 90% of the value of announced deals. In addition, since mid-2007, the number of terminated transactions has included some high profile acquisitions such as the Blackstone Group's failed acquisition of Alliance Data Services, Bain Capital and Huawei's failed acquisition of 3Com, and Hexion Specialty Chemicals failed acquisition of Huntsman Chemical.

Hexion's failed acquisition of Huntsman Chemical is particularly instructive because Hexion invoked the merger agreement's MAC clause in seeking to terminate the transaction. Hexion argued that Huntsman's business had suffered a MAC due to underperformance by two of its divisions, several consecutive quarters of poor financial performance, and an increase in net debt despite Huntsman's projections that debt would decrease.

Huntsman sued Hexion for terminating the merger agreement and the Delaware Chancery court sided with Huntsman. In finding for Huntsman, the court stated that "a buyer faces a heavy burden when it attempts to invoke a material adverse effect clause in order to avoid its obligation to close." The Court noted that "many commentators have noted that Delaware courts have never found a material adverse effect to have occurred in the context of a merger agreement. This is not a coincidence."

Given the *Huntsman* court's decision and its reaffirmation of the high standard a buyer must meet in order to prove the occurrence of a MAC, buyers should carefully consider whether to rely on a MAC clause to terminate a deal. We do not know all the reasons for Bank of America's decision to close the merger with Merrill Lynch instead of invoking the MAC clause. However, the Delaware court's decision in *Huntsman* should give any buyer pause for concern.

The Delaware court set a high bar for buyers in terms of proving a MAC and terminating a deal. Nonetheless, MAC clauses can still be a useful and important component of acquisition agreements to properly allocate risks of adverse events among the parties. Parties should determine what specific and quantifiable events (e.g. changes in earnings, loss of customers, increases in debt) would result in an adverse effect and seek to draft a MAC clause accordingly. In the current economic environment, we anticipate that MAC clauses will be more closely negotiated than ever so that the parties will have the right cord to pull if they need to get back on the ground safely.

## **Fiduciary Duties: Directors and Officers Managing Financially Distressed Businesses**

By Laura A. Lo Bianco and Christian M. Olson

Recent headlines have been filled with news of declining sales, bankruptcies, and corporate scandal. During these difficult economic times, businesses and charitable organizations will be looking to their officers and directors to provide strong leadership and innovative solutions. As they confront these challenges, officers and directors likely will encounter close scrutiny from shareholders, creditors, and government agencies. To protect themselves and their businesses from potential liability, officers and directors should ensure that they are familiar with and are fulfilling their fiduciary duties.

<sup>1</sup> Directors and officers generally owe three fiduciary duties to a corporation: (1) a duty to act in good faith, (2) a duty to act with the care an ordinarily prudent person in a like position would exercise under similar circumstances, and (3) a duty to act in a manner the director or officer reasonably believes to be in the best interests of the corporation. Directors and officers in a for-profit corporation also owe these duties to shareholders, as the owners of the corporation. Directors and officers in non-profit organizations also owe these duties to the organization's charitable mission and beneficiaries.

When a corporation approaches insolvency, the scope of persons to whom directors and officers owe fiduciary duties may expand to include creditors of the corporation.<sup>2</sup> These fiduciary duties are not owed to any single creditor but to all creditors as a class. Arizona follows the trust fund doctrine, which provides that upon becoming insolvent all of the assets of the corporation "exist for the benefit of all of its creditors and that thereafter no liens nor rights can be created either voluntarily or by operation of law whereby one creditor is given advantage over others."<sup>3</sup>

A corporation may be considered insolvent when (1) it is unable to pay its debts as they become due in the usual course of its business, or (2) its liabilities are greater than its assets. Both of these tests for insolvency are factually driven. Officers and directors should thus be familiar with the financial statements and general financial health of the corporations they serve. If officers or directors determine that the corporation is in or is approaching insolvency, they should re-evaluate their business plan to ensure that the interests of creditors are considered and not overridden by the interests of shareholders or charitable beneficiaries. Corporations should also review their articles, bylaws, and relevant insurance policies to determine if sufficient protection is in place for directors and officers. Businesses and charitable organizations with questions regarding the impact of insolvency on fiduciary duties, indemnification of corporate officers or directors, or other related matters are encouraged to consult with their legal counsel.

*A.R.S. §§ 10-830, 10-842, 10-3830, 10-3842.*

*Dawson v. Withcombe, 216 Ariz. 84, 107, 163 P.3d 1034, 1057 (App. 2008).*

*A.R. Teeters & Associates, Inc. v. Eastman Kodak Company, 172 Ariz. 324, 331, 836 P.2d 1034, 1041 (App. 1992).*



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# Our Clients. Their Success Stories.



Represented Allied Waste in several gas-to-energy transactions across the country, involving the sale of naturally produced biogas.



Represented USA Basketball in agreement with the City of Glendale to bring USA Basketball headquarters and training center to Glendale Sports and Entertainment District.



Represented Allied Waste in agreement with RecycleBank for national recycling incentive program launched in 2008.



Project financing for construction of cement plant in Arizona.



Multi-million dollar supply contract with Holcim (US) Inc. and St. Lawrence Cement Inc., and their North American subsidiaries.



Financing for the construction of a copper mine project located in southern Arizona.



Eleven preferred stock and convertible debt venture capital investments in clean-tech/energy companies located in the Southwest.



\$25 million construction, sale and leaseback of manufacturing facilities in Nogales, Sonora, Mexico.



Represented the City of Glendale, Arizona in an agreement that secured private funding for a \$25 million city-owned parking garage for Jobing.com Arena.



Multi-million dollar contract for the supply of commercial explosives and blasting related services to LaFarge North America, Inc. and its subsidiaries.



Purchase of ready-mix aggregate company located in Lake Havasu City, Arizona.



Represented PRN Medical Services, Inc. in acquisition by Mantucket Capital.



Agreements for distribution and sale in the United States of produce grown in Mexico.

### ***Bekam Development LLC***

Represented Bekam Development LLC in the purchase and sale of commercial property in Nevada in transactions totalling approximately \$40 million.



Represented John Staluppi, Jr. entities in the purchase of Nevada and Utah automobile dealerships in transactions totalling approximately \$68 million.



HOBO Arizona, LLC acquisition of Finley Distributing, Inc.

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