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EXIT PLANNING EXCHANGE

Chapter meeting: April 8, 2020
My Transaction Closed: Should I Worry?

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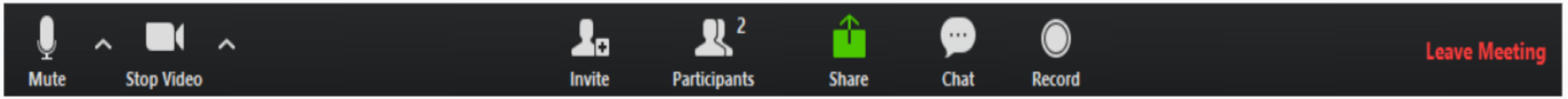
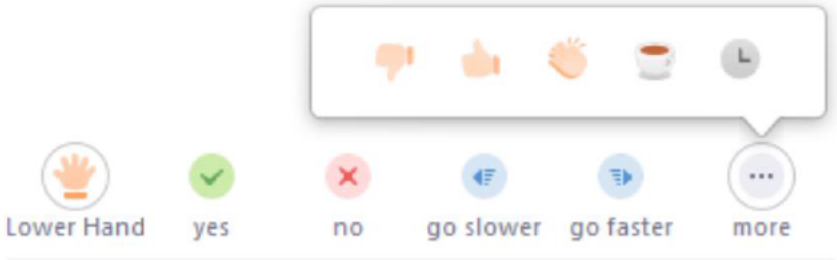
Use of Zoom – Platform Tips



- **Key controls are in the bottom of the Zoom window.**
- **Sound**: Microphone icon to mute/unmute – if you're on a phone *6 to mute/unmute.
- **Video** – Camera icon to turn camera on/off.
- **Open Chat**: We suggest opening chat and using it in the main meeting to share ideas, resource, questions.
- **Private Chat** – You can also reach out to someone individually to connect (we can also connect you later too).
- **Participants** – You can access buttons to raise your hand and more.



PLUNKETT LAW GROUP

CORPORATE & TRANSACTIONAL LEGAL SERVICES FOR BUSINESS

The COVID 19 PANDEMIC

MY TRANSACTION CLOSED BEFORE THE CRISIS, SHOULD I WORRY?

April 8, 2020

Disclaimer

This presentation is for information purposes only. The materials are not intended as, and do not constitute, legal advice and should not be used or acted upon as legal advice. Further, they are not the legal opinions of The Plunkett Law Group, LLC or any of its attorneys. Before you act or otherwise rely upon any materials or information in this presentation, you should obtain the advice of a qualified attorney.

What Will be Covered

- Acquisition transactions that closed before the start of the crisis in the US.

- Provisions Not Likely to be Implicated.
- Working Capital True-Up.
- Earnouts.
- Seller Financing.
- Bank Financing.
- Business Insurance.
- Representation and Warranty Insurance

Provisions Not Likely Implicated

Material Adverse Change / Effect

- Typically, only relevant prior to closing.
- Seller representation that there has been no MAC/MAE since a particular date.
- Condition to Buyer's obligation to close – no MAC.

"Material Adverse Change" means any event, occurrence, fact, condition or change that is, or could reasonably be expected to become, individually or in the aggregate, materially adverse to (a) the business, results of operations, condition (financial or otherwise) or assets of the Company, or (b) the ability of Seller to consummate the transactions contemplated hereby on a timely basis; provided, however, that "Material Adverse Change" shall not include any event, occurrence, fact, condition or change, directly or indirectly, arising out of or attributable to: (i) general economic or political conditions . . . provided further, however, that any event, occurrence, fact, condition or change referred to in clauses (i), (ii), (iii), (iv), (vi) and (viii) shall be taken into account in determining whether a Material Adverse Effect has occurred or could reasonably be expected to occur to the extent that such event, occurrence, fact, condition or change has a disproportionate effect on the Company . . . .

Provisions Not Likely Implicated

Force Majeure Clause

- Typically, excuses a party's nonperformance when extraordinary events prevent fulfillment of contractual obligation.
- Common in commercial agreements.
- Almost never included in a Purchase/Sale Agreement for M&A transactions.

Neither party shall be liable or responsible to the other, nor be deemed to have defaulted under or breached this Agreement, for any failure or delay in fulfilling or performing any term of this Agreement (except for any obligations to make payments to the other Party under this Agreement), when and to the extent such failure or delay is caused by or results from acts beyond the affected Party's reasonable control, including, without limitation: (a) acts of God; (b) flood, fire, earthquake or explosion; (c) war, invasion, hostilities (whether war is declared or not), terrorist threats or acts, riot, or other civil unrest; (d) Law; (e) actions, embargoes or blockades in effect on or after the date of this Agreement; (f) action by any Governmental Authority; (g) national or regional emergency; (h) strikes, labor stoppages, or slowdowns or other industrial disturbances; and (i) shortage of adequate power or transportation facilities.

Provisions Not Likely Implicated

Common Law – Impossibility of Performance

- Excuses non-performance where an unexpected intervening event has occurred, the parties assumed such an event would not occur, and the occurrence of the event made performance impossible or impracticable.
- If you rent a house, a basic assumption is that that house will exist.
- Very unlikely that it will be *impossible* to honor a Purchase/Sale Agreement.

Common Law – Frustration of Purpose

- Functions similarly to impossibility of performance, but does not require a supervening event that prevents performance.
- Did an unforeseeable event alter circumstances to such a degree that performance would no longer fulfill any aspect of the contracts original purpose.
- Classic example – rent apartment on parade route to see Queen and because of terroristic threats, parade route changed.

Working Capital True-Up

Challenges and Concerns

- Access to financial data, etc. may be a bit more challenging, but not too difficult.
- To the extent a physical inventory count is required, that could be very difficult.
- Dispute resolution procedures may take more time.
- Areas that may see additional scrutiny, especially if closing occurred after start of crisis
  - Bad debt reserve / allowance for doubtful accounts.
  - Litigation/contingent liabilities reserve.

What to do

- Be proactive – Reach out to counterparty to discuss any potential issues identified.
- Extend deadline for Buyer to provide Buyer's calculation of closing working capital and for Seller to review.
- Buyers - Consider dedicating additional resources to review of potentially problematic areas.
- Sellers – Consider proactively reviewing potentially problematic areas/preparing to respond to issues that may be raised by Buyer.

Earnouts

Components

- Financial Target for Acquired Business – EBITDA, revenue, and profit are common measures.
- Payment based on achieving target.
- Buyer protections - Subject to the terms of this Agreement, after Closing, Buyer shall have sole discretion with regard to all matters relating to the operation of the Business; provided, that Buyer shall not, directly or indirectly, take any actions in bad faith that would have the purpose of avoiding or reducing any of the earn-out payments. To the extent a physical inventory count is required, that could be very difficult.
- Seller Protections – Buyer required to
  - Provide adequate resources/funding, consistent with past practices; maintain appropriate level of working capital.
  - Operate the acquired business in substantially the same manner as operated prior to closing.
  - Use commercially reasonable efforts to achieve financial target.
  - Continued employment for executives/owners of Seller or other employment level requirements.

Earnouts

Risks to Seller

- Crisis negatively impacting EBITDA or other financial target.
- Acquired business being subject to claims arising out of crisis – breached contracts/tort claims; increased legal fees.
- Potential windfall to Buyer - Impact of crisis, while significant, is likely temporary.
- Subordination provisions / negative covenants in favor of lenders to Buyer.
- Bankruptcy.

Risks to Buyer

- Claim from Seller because earnout target not achieved. Claim, even if ultimately not successful can be costly.
- Violation of post-closing covenants – Highly dependent on whether Seller protections included.
- Implied covenant of good faith and fair dealing.
- Post-closing covenants restricting ability to respond to crisis.

Earnouts

What to do - Buyer

- While Buyer typically will be in a better position than Seller, protective actions should be considered.
- Document decision making process/considerations - how decisions are expected to benefit acquired business and, if applicable, how decisions comply with post-closing covenants.
- Communicate with Seller – Tell Seller what you are doing to protect business. Tell; don't ask for permission.
- Consider cooperating with Seller to address Seller concerns. Litigation is always a risk for earnouts and the crisis will only heighten that risk.

What to do - Seller

- Consider what you have to offer the Buyer - Lower maximum payout, waiving potential claims or loosen any post-closing covenants.
- Understand your rights to information and reports. Often, Seller's have rights to receive information and reports when there is an earnout.
- If owner remained with business as an executive officer and/or board member, be mindful of fiduciary duties to the company.

Earnouts

Common Ground for Buyer and Seller to Compromise

- Roll earnout period forward – allows Seller to mitigate risk of negative impact of crisis and Buyer to mitigate risk of claims/litigation.
- Reduce maximum payout in exchange for providing Seller some relief.
- Revise post-closing covenants to provide Buyer with additional flexibility to respond to crisis.
- To the extent owner exited the acquired business, owner could return to business to assist during crisis, especially in connection with customer, supplier and workforce relations.
- Buyer's need for flexibility to deal with Seller or third-party financing.

Seller Financing

Risks

- For Seller – Buyer does not have resources to pay or files for bankruptcy.
- For Buyer – Breach of payment requirements cause default under senior loan agreement and insufficient cash flow to make payments.

What to do

- Communicate early and often!
- Buyer and Seller should be fairly well aligned here.
- If there is Seller financing and an earnout, Seller can provide Buyer relief from payment requirements in exchange for changes to earnout.
- Again – If owner remained with business, be mindful of fiduciary duties to the company.

Bank Financing

Risks

- For Seller – Breach of financial covenants in loan documents by Buyer precludes payment of Seller financing or earnout; bank foreclosure or other drastic bank action.
- For Buyer – Breach of financial covenant in loan documents; inability to make payments.

What to do

- Buyer - Communicate early and often with bank. Banks likely to have many troubled loans and may be happy to revise loan terms to avoid having loan classified as nonperforming.
- Seller – Cooperate with Buyer where reasonable to preserve acquired business.
- Seller and Buyer – Understand that the bank probably has the most leverage, be thoughtful.

Business Insurance

Challenges

- Most business interruption policies require some sort of physical damage before a claim must be paid.
- After earlier epidemic, standard policy forms revised to exclude coverage for viruses, bacteria and the like.
- Likely to be an uphill battle for coverage.
- But don't give up!

- Situation is very fluid.
- Governmental intervention is possible – several states have introduced legislation to require coverage.
- Law developing – perhaps, ultimately, "physical damage" will be found to include virus.
- Some policies contain civil authority provisions.
- What to do now
  - Keep track of crisis-related losses and expenses; consider separate general ledger account.
  - Consider providing notice of loss/claim to insurer.
  - Workers compensation insurance may be available.
  - Read your policies – especially if you have a pollution policy.

Representation and Warranty Insurance

Expect Some Tightening of Claims Payment Practices

- Historically, rep and warranty insurers have been relatively quick to pay claims given concerns about reputation. The current environment may cause that to change.
- Once crisis started, many policies included broad COVID-19 exclusions. Impact remains to be seen.
- As business losses mount, Buyers may more closely scrutinize reps and warranties, looking for ways to recover.

Recap

- While focus has been on transactions that have not yet closed, there is likely much to be done on deals that already closed.
- Be proactive – both Buyers and Sellers have good reason to cooperate.
- Do not give up on business insurance.
- Talk to professional advisors.

Michael E. Plunkett

Michael E. Plunkett founded the Plunkett Law Group in 2016 after practicing law for 17 years with large, prestigious law firms in Philadelphia. Throughout his career, Michael has represented companies, investors and individuals in corporate and transactional matters, always with a focus on the client. With his own firm, Michael is able to use his formidable legal skills and knowledge, developed over the course of his 20+ year career, to provide small and medium-sized business, start-ups, investors and individuals, with real, practical solutions to their legal and business problems, all within an accessible cost structure.

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