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DEAL RELATED LEGAL ISSUES

BUYER AND SELLER PERSPECTIVES ON KEY PROVISIONS OF ACQUISITION AGREEMENTS

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BUYER AND SELLER PERSPECTIVES ON KEY PROVISIONS OF ACQUISITION AGREEMENTS

OVERVIEW

- Transaction structure – purchase of the company vs. assets
- Client consent requirements
- Earnest money, purchase price adjustments and holdbacks
- Indemnification provisions

TRANSACTION STRUCTURE – PURCHASE OF THE COMPANY VS. PURCHASE OF ASSETS

Seller Preference: Sale of the Company

- Sale of capital asset by owners – capital gains treatment
- Transfer all liabilities, except as agreed
- May not be possible if company is an S corp.
- Substantial tax cost if seller is a C corp.
- Potential to sell less than entire company

Buyer Preference: Purchase of Assets

- Acquired assets are listed and described
- Assumed liabilities are specifically identified
- Liabilities not assumed remain with seller
- If buyer already RIA, less complexity

DEAL RELATED LEGAL ISSUES

TRANSACTION STRUCTURE – PURCHASE OF THE COMPANY VS. PURCHASE OF ASSETS

- Which structure do you think makes more sense: equity deal or asset deal? Why?

TRANSACTION STRUCTURE – PURCHASE OF THE COMPANY VS. PURCHASE OF ASSETS

- Which structure do you think makes more sense: equity deal or asset deal? Why?

  70% asset deals

  30% equity deals

TRANSACTION STRUCTURE – PURCHASE OF THE COMPANY VS. PURCHASE OF ASSETS

- Planning Tips - Maximizing the Value of your Business:
  - Understand the implications of an asset sale vs. an equity sale on your business
  - Key employee agreements should be assignable
  - Employees should be subject to enforceable restrictive covenants
    - Confidentiality
    - Non-solicit of clients
    - Non-solicit of employees
    - Non-compete for key executives
  - Employees should be subject to arbitration agreements

CLIENT CONSENT REQUIREMENTS

- Why is client consent required?
- What constitutes client consent? Affirmative and negative consent
- What is affirmative consent?
  - When is affirmative consent required?
  - Client agreement requires affirmative consent
  - Purchaser requires affirmative consent
- What is negative consent?
  - When is negative consent permitted?
  - Client agreement does not specifically require affirmative consent
  - Purchaser does not require affirmative consent

DEAL RELATED LEGAL ISSUES

CLIENT CONSENT REQUIREMENTS

<u>Seller Preference: Negative Consent</u>

- No action required of clients to satisfy closing conditions
  - Increases probability of successful completion of transaction
  - Reduces client communication burden
  - Reduces paperwork

<u>Buyer Preference: Affirmative Consent</u>

- Increases probability of client retention
  - Client acknowledges awareness of transaction
  - Client affirmatively manifests consent to transaction
- Reduces risk of acquiring less AUM/run rate than anticipated

CLIENT CONSENT REQUIREMENTS

- What are the most typical client consent requirements?

CLIENT CONSENT REQUIREMENTS

Typical Deal Structures Includes Both Affirmative and Negative Consent Requirements

- Typical minimum client consent requirement is 80 – 90% of AUM

Typical Affirmative Consent Requirements

- Affirmative consents are required in more than 50% of transactions for at least some of the clients
- Specified clients and/or clients accounting for more than specified percentage of assets. For example:
  - Any client accounting for 5% or more of AUM
  - Specified number of large clients that together comprise a specified percentage of AUM (20 largest clients who together represent 35% of total AUM)
  - Clients comprising, in the aggregate, at least a specified percentage of AUM

DEAL RELATED LEGAL ISSUES

CLIENT CONSENT REQUIREMENTS

- Where affirmative consent not required, negative consent permitted if advisory agreement permits

- Client consent almost always a condition to closing

<u>Planning Tips:</u>

- Draft client agreements so they do not require affirmative consent

EARNEST MONEY, PURCHASE PRICE ADJUSTMENTS AND HOLDBACKS/EARNOUTS

- What are they?
  - Earnest money
  - Purchase price adjustments
  - Holdbacks or earnouts

EARNEST MONEY, PURCHASE PRICE ADJUSTMENTS AND HOLDBACKS/EARNOUTS

Seller's Preference:

- Non-refundable deposit paid upon signing purchase agreement
- No purchase price adjustment
- No holdback/earnout – entire purchase price paid at closing

Buyer's Preference:

- No deposit
- Purchase price adjusted based on run rate of consenting clients accounts
- Escrow holdback to secure indemnification obligations; earnout protects buyer's asset retention

EARNEST MONEY, PURCHASE PRICE ADJUSTMENTS AND HOLDBACKS/EARNOUTS

- What percentage of acquisition deals provide for purchase price adjustments?
  - Would you find that acceptable?

- What percentage of acquisition deals provide for holdbacks/earnouts?
  - Would you find that acceptable?

EARNEST MONEY, PURCHASE PRICE ADJUSTMENTS AND HOLDBACKS/EARNOUTS

- > 80% of acquisition deals provide for purchase price adjustments
- > 80% of acquisition deals provide for holdbacks/earnouts

INDEMNIFICATION

- Role of indemnification provisions in acquisition agreement
  - Typically sole remedy for breaches of representations and warranties
  - Typically sole remedy for breaches of covenants
  - May cap maximum liability of seller for certain breaches
  - May provide floor below which seller has no liability for certain breaches
  - May limit the period during which indemnity claims can be brought
  - Typically specify procedures for indemnity claims

DEAL RELATED LEGAL ISSUES

INDEMNIFICATION

Seller Preference:

- Sole remedy for all breaches of representations, warranties and covenants
- Liability capped at small percentage of purchase price (e.g. 25% or less)
- Deductible “basket”- indemnity only above basket amount – the higher the better
- Short period to assert indemnity claims (e.g. one year or less)

Buyer Preference:

- Retain remedies in addition to indemnification claim
- High cap or no cap on liability
- Threshold basket – indemnify from first dollar of loss – the lower the better
- Statute of limitations governs indemnity period (generally 4 years or less in CA)

INDEMNIFICATION

- Certain typical indemnification provisions:
  - Typically sole remedy except for fraud/intentional misrepresentation
  - Most deals include a cap as a percentage of purchase price – smaller deals higher %
  - Cap is usually not applicable to “fundamental” representations/warranties, breaches of covenants or fraud
  - Basket is typically a deductible
  - Baskets typically subject to same carve outs as caps
  - Indemnification rights typically survive 12- 24 months except for carve outs which are limited by statute of limitations

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SELF-ASSESSMENT

- Have you prepared for a potential acquisition?
- Have you taken steps to maximize the value of your business?

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