

Asset Acquisition Checklist

PLC Corporate & Securities

A Checklist outlining the steps in an asset acquisition of a private company, including process and structure considerations, preliminary agreements, due diligence, the asset purchase agreement and pre-closing, closing and post-closing matters.

PRELIMINARY STRUCTURAL AND PROCESS CONSIDERATIONS

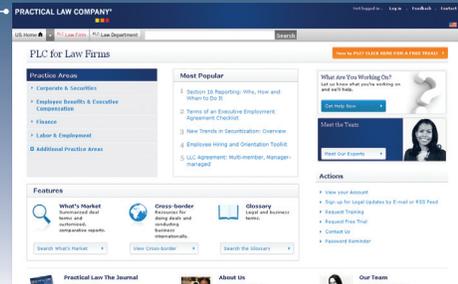
Once the parties agree to structure the acquisition as an asset purchase, there are certain threshold questions to answer. The answers to these questions impact:

- Due diligence.
- The negotiation of the asset purchase agreement and other ancillary agreements.
- The purchase price and transaction process.

For more information on the various ways to structure an acquisition, see *Practice Note, Private Acquisition Structures*.

- **How is the transaction process structured?** Is it an auction or a single buyer transaction? If it is an auction, has the seller decided to negotiate exclusively with the buyer or are there other competing bids remaining? For more information on the auction process, see *Practice Note, Auctions: From the Seller's Perspective* and *Auction Timeline*.
- **Is the acquisition structured as a taxable or tax-free transaction?** Most private company asset acquisitions are structured as taxable transactions for business reasons (such as the lack of a market for the stock of private companies (except in certain circumstances where the buyer or its affiliate is a public company)). For more information, see *Practice Note, Asset Acquisitions: Tax Overview*.
- **Which assets are the buyer purchasing?** Do they comprise substantially all of the assets of the company? Which liabilities will the buyer assume?
- **Are any assets subject to liens under the seller's financing arrangements?** If so, the parties must alert the lenders early in the transaction to determine how to release the assets.
- **How will the buyer finance the asset purchase?** If the consideration is cash, does the buyer need debt financing?

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For more information on financing an acquisition, see *Practice Note, Acquisition Finance: Overview*.

- **Who are the parties and who is representing them?** What law firm is the opposing party using? Are investment bankers engaged? What is the procedure for contacting the other party (for example, can the parties communicate directly or must they communicate through a representative)?
- **What is the relationship between the parties?** Is the buyer familiar with the seller's business? Is there any public information available about the seller or the assets?
- **Are there any antitrust issues?** If the buyer and the seller operate in the same industry, HSR antitrust (or other) clearance may be necessary for a transfer of substantial assets. If the buyer and the seller are competitors, the parties may want to restrict access to certain confidential information (see *Practice Note, Information Exchange and Integration Planning in M&A: Antitrust*).
- **Why is the buyer making the acquisition?** Does the buyer plan to integrate the assets into its current operations or is this a new line of business?
- **Are there any other issues affecting the timing of the transaction (such as necessary consents or approvals)?**
- **Have the parties entered into an exclusivity agreement which requires the seller to negotiate solely with the buyer?** If so, when does the exclusivity period expire?
- **Are any of the parties a foreign entity?** If so, do you need to engage local counsel?

PRELIMINARY AGREEMENTS

Parties often enter into preliminary agreements before they begin due diligence or negotiate the asset purchase agreement. The following are common preliminary agreements:

- **Term Sheet.** Sometimes called a letter of intent, a term sheet is a short, non-binding document containing material agreed terms. For example, the parties may agree to purchase price, certain allocations of liability or risk and other high-level deal issues. Sometimes the term sheet includes a legally binding exclusivity or confidentiality provision.
- **Confidentiality Agreement.** Before parties exchange confidential information, they typically enter into an agreement to safeguard that information.
- **Exclusivity Agreement.** Buyers may try to protect themselves from competing buyers by entering into an exclusivity agreement with the seller early in the process.

For more information on these agreements, refer to the following Practice Notes:

- *Term Sheets;*
- *Confidentiality Agreements: Mergers and Acquisitions;* and
- *Exclusivity Agreements.*

DUE DILIGENCE

Before agreeing to purchase assets or assume liabilities, the buyer must gather information (known as due diligence). Sometimes there is a preliminary period for the initial due diligence investigation (such as in an auction), but the buyer often conducts due diligence at the same time it negotiates the transaction documents. For more information on due diligence in an asset acquisition, see *Practice Note, Due Diligence for Private Mergers and Acquisitions and Private Mergers and Acquisitions Due Diligence Checklist.*

Generally, the buyer uses this due diligence phase to:

- Determine (or confirm) the value of the assets.
- Confirm that the seller has proper title to the assets.
- Fully understand any liabilities the buyer is assuming.
- Uncover any impediments to transfer of the assets or the transaction in general.
- Uncover any impediments to the future operation of the assets or line of business.
- Determine whether any portion of the assets or benefits will be disposed of or terminated before (or in connection with) the transaction.
- Plan how to integrate the assets into the buyer's business.
- Understand and confirm the information listed on the disclosure schedules.

DRAFTING AND NEGOTIATING THE ASSET PURCHASE AGREEMENT

While each deal has different issues, there are certain provisions in the asset purchase agreement that the buyer and seller typically negotiate. The following is a list of key questions to consider when drafting or reviewing the first draft of the asset purchase agreement. For more information on drafting

and negotiating an asset purchase agreement, see *Practice Note, Asset Purchase Agreement Commentary and Standard Document, Asset Purchase Agreement (Pro-Buyer Long Form).*

Preliminary Considerations and Business Issues

- Who should prepare the first draft? Except in an auction, the buyer typically produces the first draft of the asset purchase agreement.
- Is a long-form or short-form agreement more appropriate for the transaction? A short-form agreement typically does not include closing conditions or detailed representations and warranties or covenants. This decision depends on a variety of factors (such as the relationship among the parties, whether the signing and closing are simultaneous or separate and the size of the deal).
- Is there a term sheet? If so, what has already been agreed? Even though the term sheet is typically not legally binding, it is important to reflect the terms the parties agreed to or risk a loss of trust and possible break-down in negotiations.
- How much negotiating leverage does the particular party have? For example, if there are competing bidders, the buyer may want to take a less aggressive approach.
- Are there any important business arrangements or concerns to provide for? For example, a particular liability to protect against or consent that must be obtained?
- Are there any particular specialist concerns (for example, tax, employee benefits, intellectual property or environmental)? It is important to get specialists involved early on in the process and have them review the applicable representations, warranties, covenants and other provisions.
- Are any employees being transferred in the acquisition?
- If so, are there any special arrangements with management in connection with the transaction (such as retention bonuses, severance arrangements or change of control payments)?
- Who needs to review the agreement before the party can deliver it to the other side?

Each party should also consider the items listed in *Preliminary Structural and Process Considerations.*

Parties

- Who is the buyer? Is the buyer a financial buyer or a strategic buyer? Financial buyers and strategic buyers often have different objectives. Does the buyer have any assets of its own or is it a shell company formed for the purpose of the acquisition?
- Who is the seller? Will the seller have continuing operations after the acquisition?
- Is either party asking for a third-party guaranty of the obligations of the other? For example, the buyer may want a guaranty of seller's indemnification obligations from the seller's parent company. Likewise, if the buyer is paying a portion of the purchase price after the closing (for example, if there are purchase price



adjustments which may be due or earn-out payments) or if the buyer is a shell company, the seller may want a guaranty of the buyer's obligation from the buyer's parent company.

Purchase and Sale

- What assets are being purchased and what liabilities are being assumed? Do the assets comprise substantially all of the assets of the business? If not, how are the parties determining which assets are included in the purchase and which liabilities will be assumed?
- What is the consideration (cash, shares, promissory notes or a combination of the three)?
- How is the purchase price calculated? Are any adjustments necessary at closing?
- If the purchase price is subject to purchase price adjustments, how should such adjustments be structured? What should the adjustments be based on (for example, balance sheet, inventory counts or valuation of specific assets)? What should the procedure and timing be for delivery and review of the final financial statements and for dispute resolutions? How should the costs of preparing the final financial statements and any dispute resolution be allocated among the parties?
- Should a portion of the purchase price be held in an escrow account to secure purchase price adjustments or indemnification obligations?
- How should the purchase price be allocated among the assets?

Closing Mechanics

- Where will the closing be held? Most often closings are held remotely by phone, fax and e-mail, so the agreement should be drafted broadly enough to accommodate such arrangements.
- What is the process for delivery of the consideration?

Representations and Warranties

- What type of assets are being purchased (for example, real property, employees, intellectual property, customers or a line of business)? Are any specialist, business or industry specific representations and warranties necessary?
- What is the scope of the representations and warranties? Should any of the representations be qualified by materiality, material adverse effect, knowledge or the disclosure schedules?
- Were any issues uncovered in due diligence that should be addressed in the representations and warranties?
- Was the buyer able to conduct a thorough due diligence review of the assets and liabilities? If not, the buyer has to rely on the representations and warranties from the seller.

Closing Conditions

- What conditions to closing does a party need? For example, the ability of the buyer to obtain financing or the requirement of the seller to obtain a third party consent.

- What transfer documents are necessary? For example, a bill of sale, assignment of specific assets or real property deed.
- Are the representations and warranties made at signing and then made again on the closing date (known as a bring down)? What is the standard for this bring down? (see *Practice Note, Asset Purchase Agreement Commentary: Bring down*).
- Are any material third party (governmental or otherwise) consents required?
- Is stockholder consent required? If the assets constitute substantially all of the assets of the seller, its stockholders typically must approve the transaction (see *Practice Note, Asset Acquisitions: Overview: Corporate Approvals*).
- Are any of the closing conditions contingent on the actions of a third party?
- Do any of the closing conditions give a party the ability to unilaterally refuse to close the transaction?
- What standard must each party use to ensure that the closing conditions are satisfied (for example, best efforts, reasonable best efforts or commercially reasonable efforts)? Should the parties define what constitutes whichever standard they choose (for example, by setting a cap on how much a party is required to spend in order to satisfy a condition)?

Covenants

- What must the seller do in the period between signing and closing? What actions are prohibited? For example, the buyer wants to prevent the seller from doing anything to diminish the value of the assets or increase the size of any assumed liabilities. If the purchase price is subject to an adjustment at closing, the buyer should also include covenants that prevent the seller from distorting the relevant financials in its favor.
- Is the seller restricted from talking to other potential buyers (known as a no-shop)?
- Are any covenants necessary regarding the transferred assets (such as relating to employees or their benefit plans)?
- Are any post-closing covenants appropriate? For example, a covenant not to compete for a specified period of time.

Termination

- What rights do the parties have to terminate the agreement?
- Can a party terminate if a material adverse effect occurs? If so, how is material adverse effect defined?
- Is there a drop dead date in the event the closing conditions are not satisfied?
- What if the transaction does not close? What should the result be? Should the parties have any liabilities that continue after the termination of the agreement?
- Is there a reverse break-up fee? If so, what is the appropriate amount?

Indemnification

- Are there any liabilities requiring specific indemnification (for example, an environmental clean-up)?
- Is there an escrow or guaranty to back-up any future payments?
- Is there a cap? If so, what is the size?
- Is there a basket? If so, how does it work (threshold or deductible) and what is the amount? Is there a mini-basket and if so, what is the amount?
- What are the procedures for a third-party indemnification claim?
- Does the indemnified party have any obligation to set-off against or subrogate its claim to another party?
- Does either party have any obligation to mitigate damages?
- What kinds of damages are permitted? For example, is a party indemnified for consequential damages (such as business interruption)?

Miscellaneous

- What is the appropriate location for jurisdiction and venue? What is the governing law?
- Do the parties want to waive a jury trial?
- Is alternative dispute resolution required (for example, an obligation to submit to arbitration)? Is the outcome binding? Do the parties need to jointly select the arbitrator(s)? Who pays the fees and expenses?
- How are transaction expenses allocated? Typically each party is responsible for its own expenses, but parties may sometimes agree to share particular expenses (such as the HSR filing fee or the cost of an escrow agent).
- Is specific performance of the agreement permitted?

DISCLOSURE SCHEDULES

Disclosure schedules (typically in list form) are attached to the asset purchase agreement. They are drafted by the seller and the seller's counsel. The disclosure schedules have two main functions:

- To provide information to the buyer about the assets and liabilities.
- To provide exceptions to the representations and warranties.

The parties should consider if the seller should be allowed to update the disclosure schedules before closing. If updates are allowed, what effect do updates have on the seller's representations and warranties and the buyer's indemnification rights?

For more information on the drafting, review and negotiation of disclosure schedules, see *Practice Note, Disclosure Schedules: Mergers and Acquisitions*.

TRANSFER DOCUMENTS

Transfer documents are usually required to perfect the transfer of assets and assume liabilities. These ancillary documents are

usually negotiated and attached as exhibits to the asset purchase agreement. Common ancillary documents related to transfer are:

- Bills of sale for the transfer of tangible assets (see *Standard Document, Bill of Sale*).
- Assignment and assumption agreements for the transfer of contracts (see *Standard Document, Assignment and Assumption Agreement*).
- Deeds for the transfer of real property.

For more information on the transfer of assets, see *Practice Note, Asset Purchase Agreement Commentary: Transfer of Certain Assets*.

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