



Litigation Issues Arising from M&A Transactions

Don't Cut Corners: How Legal Shortcuts May Come Back to Haunt You

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Why does this happen?

- Fast-paced, high-stakes and high-pressure early-stage environment
- Legal needs may seem a nuisance
- Reasons for neglect of legal matters vary but may include:
 - lack of awareness of legal requirements
 - failing to sufficiently prioritize legal matters
 - not knowing where to turn for assistance
 - compelling need to minimize legal costs

Why is this important?

- Inattention and missteps can cause problems later when the company pursues a sale transaction
- Adverse and impactful consequences may include
 - negative impact on company value and management credibility
 - adverse effect on auditor's willingness or ability to audit
 - nightmarish due diligence with potential buyers
 - required indemnification of buyer following a sale
 - transactional delays or cancellations
 - hefty legal costs



Ten *Examples* of Legal Shortcuts that May Haunt a Company Later in a Sale Transaction

1. Failing to properly and completely document investments in the company

- May result in:
 - uncertainty and disputes regarding ownership rights in the company
 - not understanding the practical effect of terms relating to matters such as investor liquidation preferences and investor veto rights
 - issues arising from stock option and equity compensation programs
 - no record of compliance with federal and state securities laws

2. Inadequately protecting IP and/or not taking steps to avoid infringing third party IP

- May result in:
 - restrictions on the company's conduct of its business
 - liability to third parties whose IP is infringed, including the payment of licensing fees for use of the IP
 - lack of critical agreements covering assignments of IP to the company by founders, employees and consultants

3. Tasking untrained non-legal personnel with handling legal matters

- May result in:
 - wide-ranging exposure to liability and adverse consequences (for example, to contract counterparties and regulators)
 - failure to comply with applicable law
 - regulatory concerns if company is operating in regulated areas (e.g., pharmaceuticals)
 - disadvantageous and costly contract terms, including, for example, (1) unintended “most favored customer” pricing commitments and (2) poor positioning in any battle of the forms

4. Inadequate document control and retention procedures

- May result in:
 - disorganized or even nonexistent filing systems
 - undocumented transactions with rights and obligations that are unclear
 - unsigned documents where, as a result, enforceability is questionable
 - required commitment of time and financial resources to document past transactions, if that is even possible

5. Inattention to governance requirements

- May result in:
 - inadequate agreements among founders and investors (e.g., shareholder agreements and LLC operating agreements)
 - ineffective corporate actions (e.g., invalid appointment of directors and officers)
 - failure to obtain necessary shareholder approvals
 - non-compliance with charter documents such as articles of incorporation and bylaws
 - obstacles to obtaining required legal opinions from outside counsel in a sale transaction

6. Paying insufficient attention to employment matters

- Such as failing to:
 - enter into employment and employee confidentiality and assignment of invention agreements
 - adopt employment policies
 - comply with local employment law
 - understand enforceability of restrictive covenants in employment relationships
- May result in:
 - liability to employees and regulators
 - fractured relationships with employees and volatile workforce

7. Not monitoring whether an entity is required to qualify or register in foreign jurisdictions

- Also, neglecting foreign qualifications and registrations that have been put in place
- May result in:
 - liability to regulators, including penalties and fines
 - inability to conduct business in the applicable jurisdiction
 - potential invalidity of transactions

8. Allowing unresolved claims against the company to remain hanging

- May result in:
 - when resolution becomes critical, those with knowledge of the facts may be long gone
 - relevant records may not have been preserved or cannot be located
 - other parties may use the company's urgent need to resolve the matter to their advantage

9. Failing to create form and model contracts or to tailor form contracts to specific transactions

- May result in:
 - confusion regarding the company's contractual obligations
 - business contracts with wildly differing provisions that are difficult to administer and unattractive to a buyer
 - contracts that do not reflect the underlying transactions
 - a need to approach counterparties to amend contracts

10. Overlooking the need to negotiate company-friendly assignment and change of control provisions in the company's contracts

- In the event of a change of control (e.g., a sale transaction), may result in:
 - monetary penalties
 - untimely termination of contracts
 - unduly burdensome and expensive third party consent requirements

Common Adverse Consequences Include:

- Costly and protracted litigation
- Expenditure of time and money to address issues
- Transactional delays
- Raises concern on the part of a potential buyer

What should early-stage company do?

- Commit a minimum of time and financial resources to legal needs
- Manage resources effectively and efficiently
- This may include hiring qualified internal legal personnel and/or partnering with outside counsel
- Any outside counsel should be selected carefully and have:
 - experience working with companies from inception through later stages of the business life cycle
 - a broad range of subject matter expertise
 - knowledge of the company's industry and of applicable law
 - ideally, offices or relationships in jurisdictions in which the company's business has or is likely to have substantial operations



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