JUNE 2022 NEWSLETTER

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THE SCIENCE OF CLOSING A MERGER AND ACQUISITION (M&A) TRANSACTION AND AVOIDING THE STUMBLING BLOCKS

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1. AWARDS:

Pozzuolo Rodden Pozzuolo is pleased to announce that Joseph R. Pozzuolo has been awarded the 2022 Martindale-Hubbel AV Preeminent rating for the Highest Level of Professional Excellence – the highest Peer Review Rating achievable; recognizing lawyers for their strong legal ability and high ethical standards. These rating are used to identify, evaluate and select the most appropriate lawyers by attorneys seeking to refer colleagues as well as individuals looking for legal counsel. This designation is trusted worldwide by seekers of legal services and held only 10 percent of all attorneys.

2. SEMINARS:

Jeffrey S. Pozzuolo, Esquire recently presented a CPE seminar titled "Business Succession Planning and Buy-Sell Agreements" to the Montgomery County Society of Certified Public Accountants.

Speakers are available upon request to Joseph R. Pozzuolo at Joe@Pozzuolo.com

2. BLOGS:

The following are a few of the business, tax, employment, estate planning and business litigation blogs posted on our main website www.pozzuolo.com:

a. Choosing A Retirement Plan;
b. Living Wills and Power of Attorney; and,
c. The Use Of A Will In An Estate Plan.

Please visit our website www.pozzuolo.com for more information on these and other relevant business, tax, estate, business litigation and employment topics.

THE SCIENCE OF CLOSING A MERGER AND ACQUISITION (M&A) TRANSACTION AND AVOIDING THE STUMBLING BLOCKS

By: Jeffrey S. Pozzuolo, JD/MBA, LLM Tax, BS, BA

Buying and selling a business can be a stressful time for both parties. The buyer is nervous whether he is getting a good deal and acquiring what was promised; the seller is usually morose about moving on from a major chapter of his life where the business has been his second family and worrying if he is getting an adequate amount for his business; and both parties are worrying whether they are negotiating for naught spending thousands of dollars on due diligence and professional fees trying to iron out a deal that may never materialize. Most business deals have emotions running high and, as a result, sometimes deals which are otherwise good business for both parties will break down due to such emotions. This newsletter discusses the science and art of negotiating a M&A transaction, the many pitfalls caused by such emotions which may destroy an otherwise good deal and why it is important to use an experienced attorney and CPA who knows how to navigate these situations.

1. **Getting lost in the trees and not seeing the forest** – With emotions running high, sometimes people get fixated on a detail or principle where they miss the big picture. Sometimes it is worth taking a small loss to secure a larger overall gain. For instance, let's assume you are negotiating to purchase your next door neighbor's real property with a fair market value of $5 MM (including improvements) because you need to expand your business. Many times the neighbor will hold out and ask for a premium, let's say of 50%, realizing you need his specific property as it would be more costly, impractical or overwhelming to expand your business elsewhere. If you get stuck in the trees, you would cancel the negotiations on the principle that your neighbor is charging you an exorbitant premium. However, by cancelling the deal, you may be costing yourself $2 MM a year in additional net profits and an increased business valuation by forgoing the expansion project based on principle. While the fair market value of the property itself to a third person may only be $5 MM and the premium may be maddening, you need to take a step back and see how it fits into your expansion project. As a whole the increase may increase your business valuation by $8 MM plus you will own the $5 MM property, so you are still only paying $7.5 MM for $13 MM of value (the business valuation increase plus the underlying property). It is important to not get fixated on a smaller issue or the principle of a situation as many times it is best to just move past it for the net monetary gain of the transaction.

2. **Taking someone's attitude too personally** – As stated, emotions in a normal M&A run high, especially for some sellers who are selling their life's work and for some serial buyers who get frustrated because you are not the usual dead fish seller. The buyer simply wants you to sign a one sided agreement prepared by buyer's counsel because the buyer opened a briefcase of cash under your nose. Further, some more temperamental counterparties get really upset when you tell them "no" as they are the owner; they are boss; and they are not used to people telling them "no." As a result, you can run into some highly charged emotional moments where you may want to walk from a highly workable and profitable deal because the other side is insulting, offensive and disrespectful.

   Again, it is important to take a step back and look at the big picture. Sometimes, the really difficult counterparties end up leaving a lot of value on the table because others do not want to deal with their abusive, condescending, volatile and erratic behavior. Their temperamental personality will cause them to pay higher when buying and sell lower when selling because many business persons do not want to contend with them. Therefore, by taking their attitude and mannerism too personally you may leave a lot of money on the table for someone else to ultimately take. While you would not want them in your personal circle of friends, you are simply doing "business" with them and need to survive a couple of months with them. Do not let their emotional outbursts ruin an otherwise highly profitable and attainable deal which has perfect synergies for your business. Also, remember, if you are selling your business at a premium or buying a business at a discount due to their negative attitude and behavior, you are ultimately getting the last laugh to more than compensate you for all the abuse they put you through.

   By way of example, we have closed a number of deals where the sellers were miserable people and very difficult to deal with. They curse you out on Friday and apologize on Monday and many of these closings ultimately became a highly profitable deal because our clients reaped the value others left on the table. Sometimes you can use their emotional, abusive outbursts to your advantage by asking for concessions whenever they come back to earth.

3. **Not using timing properly** – One of the biggest tools a negotiator has, but many do not use properly, is timing. Sometimes it is necessary to strike while the iron is hot and sometimes it is necessary to take your time to not seem too eager or to make a party internalize their unreasonable behavior. If you are receiving a great deal, sometimes you need to act now, especially if it is easy for someone else to move in. However, in other situations you need to balance not letting the deal slip through your hands while not acting too eager making the other party think they are leaving too much on the table.

   If urgency is not an issue and the parties are tied to one another business wise, then slow playing sometimes works to your advantage. By responding too quickly and jumping too quickly to accept, it makes the other party think he is leaving money on the table. For instance, if you would pay up to $100/unit, but they offer you $50/unit; if you jump too quickly they will wonder if they are charging you too low. It might be best to counter with $40/unit and settling on $50/unit (or possibly lower) as then they feel like it was a hard fought fair price.

   Additionally, if counterparty is being difficult, unreasonable, or emotionally/provocative, it may be best to slow your response. One trick horror movies play is they will not show the violence and put it off screen realizing your imagination and anxiety will imagine something worse than what would have been actually shown. For this, the slowed response allows their

mind/thoughts to imagine whether their unreasonable behavior ruined the deal, and also conditions them that reasonable behavior gets quicker responses and unreasonable behavior gets delayed responses. Sometimes you should wait a day or two, or until they follow up to show their eagerness and worrying.

Also, if the counterparty's attorney is behind the hard lined responses, slow playing will neutralize the attorney, especially if it is a large law firm attorney charging close to a 4 figure hourly rate. Usually, after a bill or after some time passes, the counterparty thinks 'I am (going to be) charged all this money and I have gotten nothing out of it.' As a result, they will give their attorney marching orders to quit the games and close the deal because they don't want the attorney to bill anymore. They want to close.

There is no hard and fast rule on timing, but it is an art of reading the situation and simply knowing what is appropriate based on experience of ironing deals out.

4. **Not keeping business matters between the parties** – When documents are negotiated, there are two types of issues, business issues and legal issues. Business issues are the rote business terms such as price, what is being sold, timing, closing date, and so on. Legal issues are the more nuanced issues most business parties would not think of when ironing out a deal. These would be indemnification, representations and warranties including time limits and a floor, basket and cap on breach damages, an escrow for breach damages, assignability, jurisdiction, venue, mediation/ arbitration clauses, restrictive covenants, etc.

   To smoothly run through the negotiations, business issues should be ultimately discussed by business parties and legal issues should be decided by the attorneys. Too many times attorneys unilaterally try to change the business terms or the business nature of the deal, and will try to push an otherwise reasonable and workable M&A into a one sided deal. This will upset the party on the other side, cause emotions to run higher, and will threaten to ruin the deal if not immediately and correctly remedied. The business parties should consult their attorneys or have an all hands on call/in person meeting with attorneys and business parties while discussing/deciding the business issues, but ultimately the business parties are best to iron out business issues as they know their business the best, especially if the parties will have an ongoing relationship, The business clients simply want something which is fair to everyone instead of negotiating a one sided agreement at a horse trade.

5. **Not realizing in the end, every term is a business issue** – As a corollary to keeping business matters between the parties, eventually, every issue is a business issues. Legal issues are usually best initially discussed by the attorneys as many times the business parties do not appreciate the full significance of such legal matters since they do not have legal training and experience. The vast majority of legal issues are quickly worked out by "experienced" M&A attorneys; however, there are always one or two legal issues where attorneys end up butting their heads. Eventually those issues turn into a business issue. Usually, if experienced attorneys are butting heads, there are strong legal arguments on both sides. They are in a stalemate and the deal will not be finalized until that stalemate is broken. If the parties want the deal completed and completed timely, then once the attorneys realize they are in a stalemate, it is best for the attorneys to explain the significance of the legal issues to the client and let the business parties make an informed decision of what they see as fair or what should stand. Many times the party with the greater bargaining power will win this.

   A common example would be if one attorney wants Pennsylvania law and venue and the other attorney, whose party is from California, wants California law and venue. Both

attorneys have good reason for their choices. Eventually, if they cannot convince one another, it needs to be brought up to the parties and let the clients decide one, the other, or a neutral law/venue in the middle such as Delaware law and a major city for binding mediation/arbitration.

Another example is a confession of judgment clause for a bank loan. No one in their right mind would voluntarily agree to a confession of judgment clause in isolation. However, if you do not, the bank may not lend the client the money you need. Therefore, the confession of judgment clause becomes a necessary risk for the benefit of using the bank's money if reasonable and practical safeguards are built inside the agreement to protect the borrower. Once again, experienced attorneys are necessary to find what is necessary to achieve fairness and protection to both parties to close the transaction.

Conclusion – This is by far not an exhaustive list of pitfalls that should be avoided to keep a business sale/purchase on task, and being aware of them is half of the battle to successfully and smoothly navigating a M&A transaction. The other half is actually putting them into practice. This is why it is important to have an experienced attorney and CPA review every step of business purchases/sales from the letter of intent to the closing documents as they do these deals on a daily basis and can guide you through difficult owners and potentially emotional transactions. We can help you see through the noise of the emotions to keep both you and the counterparty on task to ensure you end up getting the value that others left on the table.

This newsletter is courtesy of Pozzuolo Rodden Pozzuolo, P.C.

To subscribe, unsubscribe, or for any questions, please contact us at INFO@POZZUOLO.COM.