

Selling a Repair Station

The Legal Dimension – What to Worry About in Twelve Areas

Al Givray

-Law Partner, Davis Graham & Stubbs, Denver CO

-General Counsel, The NORDAM Group, Tulsa OK

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"If it flies and it's not a bird, we can do the legal work."

- **Area 1: Preparing To Sell**

- If you're like most owners, you'll have a lot of work to do when the decision is made to sell your repair business.
- This is because you keep your info documented (or not) to run your business, not sell it.
- But the buyer will want to see all your company's info documented so it will tell him if your company is worth buying, and how he can get it at the cheapest price if it is.

- **Area 1: Preparing To Sell**

- So a key legal theme throughout the sale process is you can't get credit for things you can't **document**.
- You of course will want to cast your info in a way that tells your company's story best, shows how much your company is truly worth, and why the buyer should pay your asking price (when you figure out what it is).
- And so the tension in the drama begins ...
- But before you start your documentation quest, there are three steps you have to take right after you've pulled the trigger to "sell."

- **Area 2: Assembling Your Team of Experts**

- **First**, assemble your team of experts, in-house and outside:
 - Your inner circle from your senior management team.
 - Your outside financial advisor (if you have one) and an aviation investment banker, to arrive at a value of what your MRO business is worth in dollars.
 - An aviation M&A lawyer to advise on what's worth worrying about legally, and what's not worth the bother.
 - An FAA regulatory lawyer to assess the “health” of your chief asset – regulatory approvals – and how to rehabilitate them for “sale” – (rehabilitation is always needed).
 - An aviation tax accountant to optimize tax treatment.
 - Foreign local experts if you operate outside the USA.

- **Area 2: Assembling Your Team of Experts**
 - ***Second***, pin down who else from your senior and middle management teams should be “read in” to the process.
 - Determine who should/will go with the business when it’s sold, and who shouldn’t/won’t.
 - Fashion a “success bonus” for the team you’ve “read in” to incent them to work what will be a second job in making the sale happen, and to comfort their insecurity at the uncertainty that will ebb and flow throughout the entire process.

- **Area 2: Assembling Your Team of Experts**
 - ***Third***, make everyone sign an short oath of secrecy and acknowledge that they will probably be fired if they violate the oath.
 - May sound offensive, childish even, but nothing impairs the value of a company faster than a premature leak that it's up for sale.
 - And if you ultimately don't sell (it happens), you risk losing your key people as they bail when they don't see their future with you (since you've already signaled that you're ready to bail).

- **Area 3: Setting Up Your Data Room**
 - What's next? You need a "data room."
 - In the old world, that used to be an office or a conference room near the CEO's office.
 - Today, it's a VDR – a Virtual Data Room. Many third-party providers offer them for a price, and there are many to choose from online.
 - For now, though, you just need a secure place on your IT network that can accommodate 20 or 30 "folders" and secure access by those who signed the secrecy oath.

- **Area 3: Setting Up Your Data Room**

Two more tips on your internal “data room”:

1. Your IT chief should ensure that whatever is fashioned on your IT network as the temporary/internal “data room,” its content must be easy to migrate when the VDR is adopted for potential buyers to access.
2. Adopt a “confidential” way to refer to the emails and calendar notices that will be circulated during the sale process, so secretaries and assistants who have access to Inboxes and Calendars don’t accidentally stumble across what’s going on.

- **Area 4: “Teaser,” “CIM,” and Bridge to DD**
 - You’re finally ready to begin plowing through a long list of informational items that you’ll have to collect and organize in your “Teaser” and “CIM,” which will do two things:
 - Bring out the maximum monetary value of your repair business, and
 - Tell your story so that it will entice the buyer who will pay top dollar after he hears the story.
 - For most sellers, this will be a mind-numbing and frustrating exercise, because much known info will need to be recast for buyer’s viewing.
 - But good will come of it if it’s done right, because it will build the bridge to the “due diligence” that the buyer will insist on completing before agreeing to buy.

- **Area 5: Finding Right Buyer – Legal Worries**
 - Brian will walk us through how to find the right buyer. Some things to worry about from the legal end.
 - **Should you auction or not?** Wisdom says auction brings best price. But auctions take longer and increase risks of leaks about your business being for sale, not to mention deal fatigue due to prolonged uncertainty. So think about having your investment banker find you discrete buyer who will want exclusive negotiation period.

- **Area 5: Finding Right Buyer – Legal Worries**

- ***What if your best buyer is a competitor?***
- You'll have to worry about disclosing info that the antitrust laws will not want you to disclose, like product-level pricing, profit margins, and costs.
- Even if antitrust is not a consideration, you have to worry about giving your competitor a better means of competing against you if you don't consummate the sale with him.

- **Area 5: Finding Right Buyer – Legal Worries**

- *When your best buyer is a “strategic” . . .*

- He’ll be looking at you for synergies like:
 - Vertical integration on key inputs.
 - Improve economy of scale.
 - Reach customers you’ve got that he doesn’t have.
 - Acquire IP that he doesn’t have.
 - Eliminating you a competitor.

- **Area 5: Finding Right Buyer – Legal Worries**
 - All this means a “strategic” may be willing to pay a higher price than a “financial” buyer.
 - But is your IP shored up?
 - Do you have non-compete agreements with your management?
 - How important is it that the buyer keep your key employees? Many “strategics” will eliminate.

- **Area 5: Finding Right Buyer – Legal Worries**
 - *When dealing with a “financial” buyer . . .*
 - These are VCs, PE firms, and some hedge funds.
 - They won’t pay premium in price like “strategics,” because they’re more worried about hitting their investment metrics than getting synergies.
 - So a “financial” buyer will have exit strategy versus indefinite horizon of a “strategic,” and the “financial” buyer will worry more about your reps & warranties, esp. IP gaps and false or misleading DD statements.

- **Area 6: The NDA(s)**

- M&A NDAs come in many varieties. Focus on **twelve** things from legal end for Confidential Information:
 - 1—Don't open the kimono until NDA is signed.
 - 2—Make sure recipient is responsible for his Reps.
 - 3—Be esp. careful of third-party CI you disclose.
 - 4—Delete “knowledge” exception for TP crooks.
 - 5—Make sure there is parity between who will see your CI and who will be barred from soliciting/hiring your people (so exclude investment bankers or not).
 - 6—Destroy CI versus archival copy.

- **Area 6: The NDA(s)**

7—Make sure there is no calendar sunset for what is CI.

8—Get injunctive relief w/o damages or bond.

9—No contact with your shareholders and privies.

10—No solicitation/hiring of your people.

11—No reliance; buyer to make own judgments via DD.

12—Ask for destruct certificate from all who exited race.

What if your prospective buyer is a competitor? You may need a special NDA to make info available to only Specified Individuals who are buyer's outside team and one or two very senior officials within buyer's organization.

- **Area 7: Management Presentation / DD / VDR**

- With signature of the NDA(s) will come the management presentations.
- Some investment bankers will tell you to skate to the edge of what may be false or misleading.
- Legal advice: Don't do it.
- Make sure nothing you say is false in a literal sense or true but misleading in a material way.
- Reason: your reps & warranties as well as whole DD effort will be excruciatingly painful the closer you skate to the edge, and there will be hell to pay during post-closing fight over escrowed funds earn-out, and indemnities.

- **Area 7: Management Presentation / DD / VDR**
 - Following management presentation, deep-dive DD will continue.
 - Focus will be on detailed info about every aspect of your company that you migrated from your internal data room to a true Virtual Data Room (VDR).
 - Most sellers will use a third-party commercial VDR so they don't have to give prospective buyers access across the seller's firewall.
 - There are several VDR options in the marketplace. Your IT expert can help secure the right choice for you, based on cost and breadth of services needed.

- **Area 7: Management Presentation / DD / VDR**

- Three things from legal end to focus on with VDR:
 1. Fashion your click-accept Ts & Cs for access to your VDR so the Ts & Cs match your NDA. Most commercial third-party VDR Ts & Cs don't do that. This legal step is critical if any dispute arises about violations. You don't want a set of poor Ts & Cs to trump your well-crafted NDA.
 2. Mark everything you upload with a clear watermark (include footers and headers) so that every copy that is downloaded is "branded" in a way that is not possible to remove. Here, things have not changed much since cattle were branded with a hot iron for their long journey on the Santa Fe Trail.

- **Area 7: Management Presentation / DD / VDR**
 - Three things from legal end to focus on with VDR (cont'd):
 3. Plan to make a copy of your entire VDR at closing so you have a snapshot of contents and who accessed what, when. This is key for future disputes.

- **Area 7: Management Presentation / DD / VDR**

- For the deep-dive DD, each prospective buyer will bombard you with questions and requests for additional information:
 - Regulatory approvals that Sarah walked us through.
 - Pay special attention to “related party” debts and dealings.
 - Don’t do IP DD via VDR; do it offline at your premises.
 - For IP DD, beware of your fingers in OEM cookie jars.
 - Focus on contract breaches from your customers.
 - Focus on contract-breach claims you have against suppliers.

- **Area 7: Management Presentation / DD / VDR**
 - Questions and requests for additional information (cont'd):
 - investigations by FAA or other governmental agencies?
 - ADs?
 - SBs?
 - “Quality escapes”?
 - Previous offers to buy your company?
 - Any other warts that you can think of?
 - Employee claims or promised bonuses to them?

- **Area 7: Management Presentation / DD / VDR**

- Questions and requests for additional information (cont'd):
 - Footnotes in your audited financials?
 - What cap ex will be needed to realize projections?
 - Are there improperly allocated overheads?
 - Real estate lease recently re-negotiated?
 - CoC clauses in your customer agreements?
 - Anti-assignment clause in your contracts (cust or supp)?
 - All involve price haircuts and how reps, warrs, indemnities, and escrow are negotiated, and if will close on time.

- **Area 7: Management Presentation / DD / VDR**
 - What if prospective buyer is a competitor of yours?
 - Think about staging DD in defined phases and requiring agreement on each phase before proceeding to next phase.
 - E.G., do DD only on regulatory approvals, and sign agreement that buyer is done (with any haircut in price agreed) before proceeding to next phase (contracts & liabilities).

- **Area 8: The LOI**
 - LOI is prepared in parallel with management presentation and DD in earnest.
 - LOI won't be binding, but make it "stick" with key particulars of structure for your deal.
 - Use LOI to tell what deal will be struck (or if no deal will be possible) by mapping out each major deal point.

- **Area 8: The LOI**
 - **Stock versus asset deal**
 - Seller wants stock deal so that seller's shareholders only pay capital gains taxes.
 - Buyer wants asset deal to get a step-up in basis.
 - Buyer also wants to minimize assumed liabilities.
 - So seller and buyer can agree to bridge gap by:
 - Agreeing to the transaction structure that minimizes taxes, and
 - Then adjusting purchase price to share advantage.

- **Area 8: The LOI**
 - **Stock versus asset deal** (cont'd)
 - “Personal goodwill” : buyer acquires assets from company and “personal goodwill” of equity owners directly from owners.
 - Other structures with S-Corps and LLC conversions.

- **Area 8: The LOI**
 - **Company attributes at closing**
 - Stock deal:
 - Will buyer acquire the company cash-free, debt-free?
 - Will seller be permitted to do a cash sweep? Declare a dividend? Will the company have a threshold amount of working capital at closing (Working Capital Peg)?
 - asset deal:
 - Parties list each of the assets transferred in the sale, and the seller needs to make representations and warranties about each of the assets.
 - Which debts/obligations will buyer assume?

- **Area 8: The LOI**
 - **Employee retention & non-competes:**
 - Are there key individuals who must stay with the company?
 - Does seller require buyer to keep certain individuals for a period of time or offer certain terms of employment to the retained employees?
 - What non-competes bind people who will exit at closing?
 - **Reps, warranties, indemnities:**
 - Will there be a “knowledge” qualifier?

- **Area 8: The LOI**
 - **Earn-out:**
 - Use revenue-based
 - Huge source of litigation
 - **Escrow:**
 - How long will funds be escrowed?
 - Plan tight/objective rules for money release.
 - Sunset for claims except title/fraud/non-compete.

- **Area 9: Definitive Agreement & Deal Docs**
 - If you've done a detailed LOI, the main body of the definitive agreement should not be difficult for the lawyer on your team of experts to draft.
 - Much negotiation, but pressure points are well known. Key here is **speed**: Frame open item, decided it, and move on. Longer it takes, more chance there is of deal fatigue and deal bust.
 - Focus efforts on Schedule preparation which should be easy if DD done correctly. Tie Schedules to VDR info.

- **Area 9: Definitive Agreement & Deal Docs**

- Overriding tension during negotiation of deal docs:
 - Buyer will push seller to “represent and warrant” that seller has told buyer everything that a reasonable buyer would want to know about the company or business being bought and that seller should indemnify buyer for anything suffered by buyer post-closing if he learns something that seller should have disclosed but didn’t.
 - Seller will push for a rule saying that buyer is a sophisticated investor and that he needs to make his own decision on whether or not to buy.
 - Find happy medium.

- **Area 10: Between Signature and Closing**
 - **Business must proceed**: Company still has to operate, but you should notify buyer of any major decision that your instinct tells you buyer would want to know after signing the definitive agreement and before the closing. Obtain buyer's agreement or at least his non-objection.
 - **Customer meetings**: Prepare minutes of all meetings.
 - **Regulatory filings**: Submit HSR & regulatory filings.
 - **Dividends?** Declare and pay permitted dividends.

- **Area 11: Closing the Deal**

- Sweetest part of the drama.
- Use closing checklist you started when you signed LOI to choreograph everything -- who, what, when, where – and think of all closing documents as props on the stage for the drama:
 - Money wire transfers esp. when foreign banks are involved.
 - Stock transfers on books of corporation.
 - Cancel old stock certificates & issue new ones.
 - Asset sale – contract assignments & third-party consents.
 - Sign & deliver all docs, esp. regulatory approval docs.

- **Area 11: Closing the Deal**

- Closing checklist to choreograph everything (cont'd):
 - Loan payoffs.
 - Bank account closings.
 - Director resignations.
 - Indemnity for departing directors.
 - Deliverables at closing.
 - Test and retest all reps & warranties.
 - Capture snapshot of all records you'll need for post-closing adjustment of price.

- **Area 12: Post-Closing**

- Complete audit through closing date so you can do true-up of metrics for post-closing price adjustments.
- Complete transfers/transitions on regulatory approvals.
- Carry out earn-out.
- be ready with your team of experts to address workings of how you'll pull money out of escrow by meeting conditions of release.
- this is where good escrow agreement and “rocket docket” arbitration will pay off.

READY FOR QUESTIONS