

VC M&A Checklist: Post-Close Drafting Considerations

Purchase Agreement

- ✓ **Working Capital**
 - Watch for non-accounting issues in working capital (e.g., tax compliance, reserves for litigation, capitalization). These require legal analysis to resolve. Accounting arbitrators only know how to address accounting issues.
 - Watch for overlap in definitions, circular definitions, or reference to documents outside the four corners of the agreement.
 - Ask the Shareholder Representative to review draft language (they will be the ones who need to implement/enforce it).
- ✓ **Shareholder Liability**
 - Review the limit of shareholder liability deriving from post-closing matters, including joint and/or several liability, whether there are caps on liability in the absence of fraud, and the order of liability (i.e., who pays for what, and in what order?)
- ✓ **Baskets and Caps**
 - Review the language around baskets (e.g., overbroad exclusions, does it allow for potential damages?).
- ✓ **Post-Closing Dispute Mechanics**
 - Ensure at least a 30-day response period for claims and ability to control third-party claims.
 - If possible, be sure that if the Sellers have the right to control third-party disputes, they can do so without having to admit indemnification.
 - Require that the Shareholder Representative must provide written consent to any settlement.
 - Require that a claim notice be sufficiently specific to identify a claim. This prevents “claim creep” where the Buyer may start articulating new theories after the survival period has ended.
 - Determine if a cap on specifically indemnified matters is appropriate.
 - Watch for damage calculations based on diminution of value. This kind of provision gives the Buyer a free pass to inflate claims by the multiple they calculated for the deal. That is a substantial advantage to the Buyer and makes damages nearly impossible to agree upon for purposes of claim resolution.
- ✓ **Assignment**
 - Review assignment provisions, particularly if investment is made by a late-stage fund that may be winding-up during the active post-closing period. Ensure that the fund could easily assign interest in post-closing economics (escrows, milestones, expense funds) if the fund needs to wind-down before all potential distributions have been made.

- ✓ **Privilege**
 - Expressly address ownership of the selling company’s attorney-client privilege*.
 - Include pre-emptive conflict waiver so that seller’s counsel can continue to represent the shareholders.

Earnouts

- ✓ **Diligence**
 - Review Buyer obligations to achieve earnouts/milestones (ideal minimum obligation of commercially reasonable efforts).
 - Consider approaches that are intended to minimize post-closing friction between the Buyer and Seller.
- ✓ **Milestone Structures**
 - Any milestone structure that gives the Buyer incentive to miss it, or that may result in a profitable outcome for the Buyer but no milestones for the Sellers, should be avoided. Examples include milestone “cliffs” after a certain date, overly specific milestone definitions which may become irrelevant if development changes direction.
- ✓ **Reporting and Opportunities for Meetings**
 - Review the reporting obligations for deals with milestones (require meaningful substance in reports, opportunity for meetings, etc.).

Cap Table

- ✓ **Pro Rata Calculation**
 - Review your firm’s pro rata on the allocation spreadsheet and ensure it is calculated as set forth in the definitive agreement. This is particularly important if there are liquidation preferences that may impact the share to be received by different classes of stock, or exercise prices that may be erroneously factored into the pro rata calculation.

Paying Agent

- ✓ **Non Standard Items**
 - Understand post-closing distribution mechanics, particularly for non-standard items such as tax refunds, the Shareholder Representative expense fund, and earnouts that may be achieved long after closing. Verify with company counsel that the paying agent is retained to handle these potential distributions (or if another arrangement has been made). Note the risks of having an inexperienced Shareholder Representative be directly responsible for distributing funds of any kind (regulatory, financial and administrative risks).

* See SRS v. RSI Holdco, LLC, CA No. 2018-0517-KSIM (Del. Ch. May 29, 2019).

(continued on next page)

VC M&A Checklist: Post-Close Drafting Considerations *(continued)*



Employee Payroll Taxes

- Determine who is responsible for funding the employer portion of payroll taxes for post-closing payments to optionholders and other compensatory payees. This is especially important on deals with potentially large earnout payments where the payroll tax amount could be significant.

Escrow



Distribution Logistics

- Have the distributions from escrow be made to the payment instructions used at closing. Some escrow agents 'throw away' payment instructions received at closing, and default to a paper check for distributing the escrow. Be sure the escrow agreement provides for the distribution to be made to the account identified at closing, unless updated.
- The escrow distributions should be made by the paying agent used at closing.

Post-Closing Matters



Consider Hiring a Shareholder Representative

- Consider retaining a professional Shareholder Representative and establishing an Advisory Committee to direct those post-closing matters that impact all shareholders.



Expense Fund

- Establish an appropriate expense fund—preferably at least \$250,000. Higher amounts are appropriate when there are known issues to deal with post-closing or when there are long-term and/or complex deferred consideration components (e.g., earnouts).
- Arrange for the Shareholder Representative to hold the expense fund rather than the escrow agent. This makes it easier for the Representative to act quickly (no instruction letters to a bank), avoid funds being locked up if there is a dispute, and avoid fees.
- Allow the Shareholder Representative (as directed by the Advisory Committee) to control/decide when to release the expense fund to shareholders (do not hard-wire a date in the purchase agreement).



Confidentiality Obligations of Shareholder Representative

- Ensure that confidentiality obligations imposed on the Shareholder Representative are flexible enough to permit the Shareholder Representative to communicate with (at a minimum) the Advisory Committee. Without this, it can be very difficult to address post-closing claims.



No Shareholder Representative

- Make sure to address what happens if there is no Shareholder Representative (e.g., majority vote can act until a successor is appointed).



Indemnification

- Ensure appropriate indemnification of the Shareholder Representative by the selling shareholders (typically joint and several). If there is an Advisory Committee, extend indemnification to include this group.



Authority

- Ensure scope of authority covers the full set of payees (e.g., warrant holders, option holders).
- Avoid express restrictions on the Shareholder Representative's authority in the merger agreement. If needed, address such matters in a side letter where they are governed by the Advisory Committee.



Obligations of Shareholders

- Make sure that any confidentiality provisions imposed on the shareholders allow for sharing information with any parties of whom the fund will need to share information (e.g., advisors, LPs).
- Review restrictive covenants closely, adhering to your own policies regarding non-compete/non-solicitation agreements and confidentiality.

Contact:



SRS Acquiom

303.648.4085 | sales@srsacquiom.com

A Comprehensive Suite of Solutions

SRS Acquiom delivers a smarter way to run deals, with solutions that reduce the administrative burden.

Tax & Accounting Advisory

Pre-closing prep for a smoother post-closing. Experienced, in-house tax and accounting professionals address potential issues during diligence.

Enhanced Stockholder Solicitation

A digital, efficient and secure process for collecting consents, joinders, 280G elections, and more—helping to facilitate a timely close.

Payments

We continue to set the standard for tech-enabled disbursement of merger consideration. Most shareholders are paid in less than 24 hours.

Escrows

A better M&A escrow experience, period. Simple, fast engagement, streamlined KYC, online Deal Dashboard™, and a dedicated team.

Shareholder Representation

The most experienced team in the industry. We proactively solve post-closing issues to reduce potential risks and protect shareholder interests.

Loan Agency

Unbiased third-party loan agency services for syndicated and bilateral loans. Gain a team with an unparalleled depth and breadth of experience.