SEEKING A US EXIT? GET ON THE RIGHT TRACK!

MORRISON FOERSTER

With tech M&A activity continuing to increase, cash rich US corporates and VC/ PE funds with capital to deploy are looking to invest in promising European technology companies. We explore some of the differences Sellers/ Management may encounter when seeking a US exit.

	US	UK
Deal certainty/ Financing conditions	US purchase agreements tend to include a number of conditions. US sellers prefer offers that are not conditioned on financing, however, some Buyers (mostly financial sponsors) are able to include financing conditions. In those cases, the Buyer must pay to the Seller a reverse termination fee if at the time for closing the Buyer does not have financing.	Deal certainty is key and UK agreements contain fewer conditions to closing. These typically only relate to specific legal or regulatory requirements such as anti-trust clearances. In the UK, the Buyer takes the risk that its third-party financing is not in place at closing.
Bring-down of reps/ warranties	US purchase agreements will often contain a condition that, where closing is not simultaneous with signing, the reps/warranties remain true and accurate up to closing, with all reps/warranties repeated at closing (usually with allowance of some degree of materiality). Material breach often entitles the Buyer to terminate.	It is more unusual in the UK than the US, particularly where there are institutional/ private equity Sellers, for reps and warranties to be repeated at closing, except perhaps for fundamental warranties.
Locked Box/ Completion Accounts	Purchase price adjustments based on working capital or other specified criteria at closing are more common than "locked box" structures. Economic risk remains with the Sellers until closing, but the Buyer could end up paying more if the relevant amounts increase before closing.	Often, exits are structured on a 'locked box' basis, in an attempt to fix the purchase price and easily distribute proceeds. On a locked box deal, the economic risk and benefit in the company passes at an agreed date. The price is effectively 'locked' from that date with all distributions and leakage of value from the company prohibited (save for permitted leakage, which is priced in). If any leakage does occur, it will be indemnified by the Sellers.

	US	UK
Material adverse change	Material adverse change conditions are relatively common, though under court rulings the threshold for showing a material adverse change is typically quite high.	Although these provisions were regaining popularity (often structured as warranties) purchase agreements do not usually contain them.
Financial limitations	In both the US and UK, liability for breach of fundamental reps/ warranties is often capped at the aggregate consideration paid (with few other limitations). For other claims, individual de-minimis thresholds apply to avoid trivial claims and a basket threshold (deductible) is often set. Prior to reaching this threshold, Sellers often have no liability for claims, save for fraud. Once the basket threshold is met (by claims above the de-minimis level) the parties also must agree whether the basket will tip, so that all liability is recoverable (subject to other limitations), or will serve as a deductible, so that only the excess above the basket threshold is recoverable.	

	US	UK
De-minimis	Circa 0.1% of consideration	Circa 0.1% of consideration
Basket	Circa 1-2% of consideration	Circa 1-2% of consideration (usually tipping basket)
Cap (non-fundamental warranties)	Usually under 15% (often 10% - 15%) of consideration.	Usually 25% or more of consideration.

	US	UK
Escrows	The Buyer typically retains up to 10% -15% of the equity value of the company from the Sellers, for payment into escrow (in proportion to their respective shareholdings) to settle claims against the Sellers.	Escrows are not common. Sometimes retentions are used (often without third party escrow agents), but it is less common for amounts to be withheld from the Sellers on closing than in the US.

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	US	UK
Reps and Warranty / W&I Insurance	Reps and warranty insurance (providing cover for losses arising from a breach of representation or warranty) is less common than in the UK but is becoming more popular in deals with financial buyers and sellers (and certain active strategic buyers).	There has been a shift away from the use of escrows to warranty and indemnity insurance. This has been fueled by market practice for UK private equity transactions and the desire of a PE sellers to achieve a clean break and distribute all sale proceeds to investors in one go.
Liability Cover	Generally, the scope of reps/ warranties provided by Sellers is more extensive than in the UK. In part, the more extensive reps/ warranties are off-set against lower caps on Sellers' liability.	Institutional Sellers will generally only warrant as to their title and capacity. Management Sellers will give the business warranties and their liability will be capped.
Disclosure	Sellers generally cannot avoid breach of rep/warranty claims by making general disclosures, but disclosures made for a specific rep/warranty typically are deemed to apply to all reps/warranties to which they appear to be relevant. It is not common for Sellers to disclose the entire data room.	General disclosures are commonplace. Disclosure of the entire data room is very common in the UK and disclosures often qualify every warranty to which they appear to be relevant.
Buyer's Knowledge	Whether a Buyer may "sandbag" a seller by claiming damages for a breach the Buyer knew about depends on (i) the language of the agreement, with more supporting a buyer's right to do so, and (ii) governing law, the results of which may vary between the states. Pro sandbagging clauses are more common than the converse.	In the UK, where a Buyer has actual knowledge of a fact or circumstance that may constitute a breach of warranty, it is usually able to bring a claim but the courts may award only nominal damages. Even with a pro-sandbagging clause, specific indemnity cover should be sought for known issues.
Recovery	US agreements typically provide that damages for breach of reps/ warranties are calculated on a dollar-for-dollar indemnity basis.	In the UK, generally, the Buyer would have to bring a claim for damages and prove loss for a breach of warranty.

Typically, rep and warranty/ W&I insurance policies cover between 10 and 20% of the enterprise value of a target company with net premiums of between 1 and 2.5% (3% in the US, if used) of the policy value. Insurers usually require the insured to bear an excess of between 0.5 and 1% of the enterprise value before the insurance policy attaches.

OTHER CONSIDERATIONS

- Other considerations include negotiating who pays the stamp duty (typically split between the Buyer and Sellers on US deals).
- Each US state will have its own legislation, which may also come into play on an exit.
- Strategic Buyers based in the US will often want to replace the directors of the company with their own group directors (in contrast to the continued company director role most retained managers might expect in the UK).
- Sellers in US deals often seek to eliminate liability for fraud for matters not covered by the reps/warranties, but may not be able to do so for fraud related to matters covered by the reps/warranties.
- Finally, it is worth remembering that whilst this is what we typically see, everything is to some degree deal dependent.

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There is a lot to do in preparing for an exit. We can help you prepare your business for sale to achieve the best possible outcome. Speak to us – We would love to help you navigate the process quickly and efficiently to achieve an exit on the right terms.

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