

Considerations for successful merger and acquisition negotiations

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The recent news on a large merger and acquisition (M&A) deal involving a prominent business leader and a powerful media brand going awry has highlighted how challenging it can be to successfully conclude negotiations.

Research shows that most M&A deals tend to fail due to a variety of reasons. While deeper issues such as cultural synergies can be challenging to address in an M&A deal, there are other aspects that can be better addressed in the initial stages itself, thereby improving the chances of success.

Below are a few key aspects to consider during the due diligence phase.

Due diligence checklist for pre-merger negotiations

1. **Ensure adequate and relevant legal documentation is available** – Legal documentation during pre-merger negotiation is a two-step process that involves drafting a Term Sheet/MoU and the due diligence process to guide negotiations. The legal framework lays down the foundation of the negotiation process and helps both parties to frame a detailed business understanding and clearly define the ramifications for each party upon the violation of the agreement. The process is an imperative risk allocation in the subsequent process of drafting definitive contracts.
2. **Draft an appropriately tailored term sheet** – Any potential M&A transaction includes signing a non-binding agreement that stipulates the key terms of the intended merger or acquisition between the parties involved. A well-defined term sheet enables stakeholders to identify major deal breakers early in the process before deploying significant resources in the deal. Some of the indispensable components of a term sheet include value or purchase price, indicative structure of the M&A transaction, key responsibilities of the outgoing founders, employee matters, exclusivity (only binding clause), confidentiality and break-fees (if any).
3. **Consider key issues** – Often, matters such as transition of the employees of the target business tend to take a backseat during negotiations and the focus remains on the financial parameters of the deal. However, in our experience, it is important to prioritise such issues. Most of the time, cultural incompatibilities can render even the most financially sound deals unsuccessful. Therefore, the term sheet should ideally contain provisions on handling employees post the transition. Questions like how the acquirer plans to retain employees and ensure they stay motivated, and how the company will deal with stock options often assigned to employees should be proactively addressed.
4. **Due diligence is key to identifying the right negotiation strategy** – To ensure a clear picture of the company that is being acquired, thorough due diligence must be undertaken. This can include legal, financial, tax, and reputational due diligence. Often in small deals, the reputational due diligence tends to focus on the promoters and their vision for the future. But there is a need to dig deeper. The information gathered in the due diligence can help ascertain the counterparty's claims and identify the right negotiation strategy.
5. **Leverage expertise of M&A counsel** – Seasoned M&A attorneys can navigate through complex, multi-faceted agreements and deal structures. During high-stakes agreements, their practical experience of business realities in M&A deals and the inner workings of the

acquisitions can be useful in improving the odds of deal closure. Essential qualities to look for in an M&A counsel include command of the applicable substantive law, and the capability to be a skilled advisor, effective negotiator, and draftsman.

Tackling adverse scenarios

Often, despite the best efforts of parties, M&A transactions fall through. This could happen either during the discussions of the term sheet or during the course of the due diligence, negotiation of the definitive documents or before consummation of the deal. Some of the primary reasons for this include:

- (a) disagreements on valuation, transaction structure and sharing of business risks;
- (b) adverse discoveries during the due diligence process, such as inaccuracy of financial records, disputes/litigation impacting the business; or
- (c) new events, impacting the buyer and/or the seller that impact their respective appetites for the deal - such as COVID-19.

1. In the event that a party chooses to walk away from a deal before signing definitive documents - the other party's ability to force the former to either close the deal or compensate the latter for the deal breakdown is extremely weak. The notable exceptions here include:

- (a) if the parties have pre-agreed to a break-fee in the event a party walks away and the conditions for the break-fee are satisfied; or
- (b) if the parties, by their conduct, have elevated a non-binding term sheet for the M&A transaction into a binding deal document.

Both scenarios (a) and (b) presume that the parties have entered into some form of arrangement to explore the deal together (whether in the form of a term sheet, LOI, or otherwise).

2. In the event that a party may seek to walk away after signing definitive documents - in this scenario, the other party will have the ability to pursue the former for performance of the agreement and/or monetary remedies unless the former party has exercised an agreed termination right. Examples of this include:

- (a) buyer terminates the deal because the seller's warranties on compliance with law are false;
- (b) buyer terminates the deal because the seller has not been able to get third-party consent that is a pre-requisite for the deal; and
- (c) seller terminates the deal because the buyer was not able to arrange cash for the purchase price.

3. Dispute resolution – often, written arrangements (whether in the form of term sheets, LOIs, or definitive documents) will include express provisions for dispute resolution between the parties. Typically, this will provide for arbitration, relying on institutional arbitration rules in a defined location. Arbitrators typically have the ability to provide interim relief to either party pending the final determination of the dispute. Where this is not viable, parties usually have recourse to the courts for interim relief.

4. **In view of the potential risk of adverse outcomes** - parties exploring an M&A transaction focus on ensuring that confidentiality of both diligence information and the potential transaction is maintained by both parties and that any announcements/communications of the deal (at any stage) are approved by both sides.
5. **Many M&A deals are undertaken through a bidding process** - This often ensures that:
 - (a) parties must demonstrate a high level of seriousness to proceed with the deal in order to progress (including through a form of pay-to-play);
 - (b) the sharing of confidential information is staggered such that only the very serious bidders have access to all information; and
 - (c) in the event the deal with the selected bidder falls through, there are alternative bidders available. This process is increasingly becoming the norm for large ticket M&A.

Conclusion

The merger and acquisition industry is [predicted to grow](#) in the coming years, presenting dealmakers with the scope to leverage business opportunities in the sector. While the bustling sector is bound to attract investors, there's no denying that non-compliance and repudiated contracts in *M&A transactions* can have a far-reaching *impact* on stakeholders, including directors, shareholders, employees, and customers. Hence, due diligence in managing risks in the beginning can prevent financial and reputational ramifications in the later stages.

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