

# Mergers & Acquisitions in the Hospitality Industry

## A Roadmap to Successful Deals

Ray W. King, Esq.  
Elizabeth J. Atkinson, Esq.  
Jeffery K. Mitchell, Esq.  
LeClairRyan

February 2012

# Presenters



## **Ray W. King, Esq.**

- Experience in purchase, sale, financing and defeasance of high rise office buildings, office parks, shopping centers and apartment complexes in the eastern United States
- Represents borrowers in the closing of securitized or "CMBS" loans secured by commercial real estate
- Commercial real estate, real estate litigation and commercial foreclosures



## **Elizabeth J. Atkinson, Esq.**

- Focuses her practice on federal, state, local and international taxation matters with emphasis on tax controversy
- Extensive experience in tax planning and tax litigation.
- Counsel in administrative and judicial controversies, which have included favorable resolution of numerous audits, appeals and collections matters



## **Jeffery K. Mitchell, Esq.**

- Lead counsel on numerous venture capital financings, private equity raises, mergers, acquisitions, joint ventures, strategic alliances and complex limited liability operating agreements.
- Focuses his practice on corporate transactions working with emerging and established businesses to provide strategic, growth-oriented legal advice
- Member of the leadership team for the American Bar Association Middle Market and Small Business Committee

# The Initial Steps

---

- Non-disclosure Agreement
- Letter of Intent
- Due Diligence
- Merger Agreement/Buy-Sell Agreement
- Other Contractual Documents

# CONFIDENTIALITY AGREEMENTS

---

- Only way to keep confidential is not to disclose at all.
- As a practical matter, necessary to disclose information in a deal transaction.
- Timing of sharing of information is important—the more proprietary, the later it should be shared.
- Remedies for breach

# Confidentiality Agreement Provisions

---

- Who are the parties?
- Is disclosure mutual or unilateral?
- Definition of confidential information.
- Scope and purpose of disclosure.
- Term
- What to do upon termination
- Remedies
- Governing law and venue

# Exclusivity

---

- Buyer wants to be only potential buyer.
- Seller might want to make sure it is sole potential target.
- Time period for exclusivity.
- No shop provision
- Fees for exclusivity/fees for breakup of deal
- Agreement to negotiate in good faith.

# Due Diligence (where deals go bad)

---

- Corporate records
- Shareholder issues
- Financing terms/creditor issues
- Financial data and taxes
- Contractual relationships
- Employees/Managers
- Intellectual Property

# Key Concerns in Due Diligence: Assets

---

- Can the seller convey clear title to the assets in the deal?
- Will the contractual agreements, often the source of most revenue transfer seamlessly?
- Will the company infrastructure function in key areas post-merger and integration: Sales, marketing, IT, cultural/HR issues



# Key Concerns in Due Diligence: Liabilities

---

- Full disclosure of all liabilities
- Contingent liabilities
- Taxes—is seller compliant in all tax jurisdictions (there are over 7,000 tax jurisdictions in U.S)
- Environmental
- Intellectual Property
- Franchise and License agreements
- Governmental regulation
- Insurance coverage

# The Purchase Agreement

---

- Article I: Definitions
- Article II: Purchase and Sale
- Article III: Representations & Warranties of Seller
- Article IV: Representations of Buyer
- Article V: Covenants
- Article VI: Conditions to Closing
- Article VII: Closing
- Article VIII: Indemnification
- Article IX: Termination
- Article X: Miscellaneous Provisions

## Some Pitfalls in Representations & Warranties

---

- What is a “Material Adverse Effect?” or (MAE)
- MAE is a common provision in a Purchase Agreement. If Buyer asserts an MAE and walks away, then Seller is often in the position of having to settle and take less to bring the Buyer back to the table after the deal is done and Seller has sold.

# Case # 1: Innkeepers v Cerebus

---

- Innkeepers in bankruptcy and sold multiple hotel units to Cerebus in \$1.12 Bill deal.
- Buyer claimed MAE and parties renegotiated and lowered deal price by \$180 mil.

# Case # 2: IBP v Tyson Foods

---

- 2001 case: 789 A. 2d 14 (2001)
- Seller sued Buyer for specific performance
- Tyson had walked away based on MAE
- Court held for Seller
- A “short term blip” was not material

# Case # 3: Hexion v Huntsman

---

- Hexion signed merger agreement to acquire Huntsman
- Hexion walked away and claimed MAE
- Suit filed: 964 A. 2d 715(2008)
- Ct said stand is what would long term acquirer expect—burden rests on Buyer to show poor results expected to persist indefinitely into the future

# Case # 4: Genesco v Finish Line

---

- 2007 Tennessee Ct found there was an MAE
- Looked at length of time, size of change, frustration of buyer's purpose

# Lessons learned on MAE

---

- Be specific
- If possible, use specific economic benchmarks such as earnings per share
- Define period of longevity for MAE
- State intentions of parties
- Use carve outs to eliminate applicability of MAE to general economic downturns or other foreseeable events



# Hypothetical Case Study

- Little Security agrees to buy Bigger Security in a merger transaction.
  - Purpose was to allow Little to expand into other states where Bigger was already licensed.
  - Post-merger problems ensued.
1. Bigger did not have the required Homeland security certifications needed to perform under the contracts it had.
  2. Books and records for Bigger were missing, allegedly due to a stolen laptop
  3. There were tax liabilities for tax returns that were not filed.
  4. Contracts did not produce the gross revenue represented in the merger agreement.

# Lessons from Case Study

---

- Due diligence before the closing is of critical importance.
- Always consider whether an asset sale is less risky and can accomplish the goals.
- Always think about remedies you may have post-closing if the transaction goes bad. Unless Seller is a major company, you may have difficulty with actually recovering anything.
- On the Seller's side, consider contingency planning if Buyer walks away.

# Conclusion

---

- Go beyond the boilerplate.
- We are so used to “standard deal terms” that we often don’t think through what might happen and how we might prevent issues by better drafting.
- In the current economy, deals are more tenuous and due diligence is very important.
- With increased governmental regulation in the hospitality industry, it is important to be able to spot industry specific issues that can arise in a deal: remember the times when we did not worry about bedbugs, fat content of food, or Homeland Security?

# Questions & Contact Info

---

- Ray King

[ray.king@leclairryan.com](mailto:ray.king@leclairryan.com)

- Liz Atkinson

[elizabeth.atkinson@leclairryan.com](mailto:elizabeth.atkinson@leclairryan.com)

- Jeff Mitchell

[jeffery.mitchell@leclairryan.com](mailto:jeffery.mitchell@leclairryan.com)

# Session Evaluation

---



Scan or Visit [TheHLC.co](https://TheHLC.co)