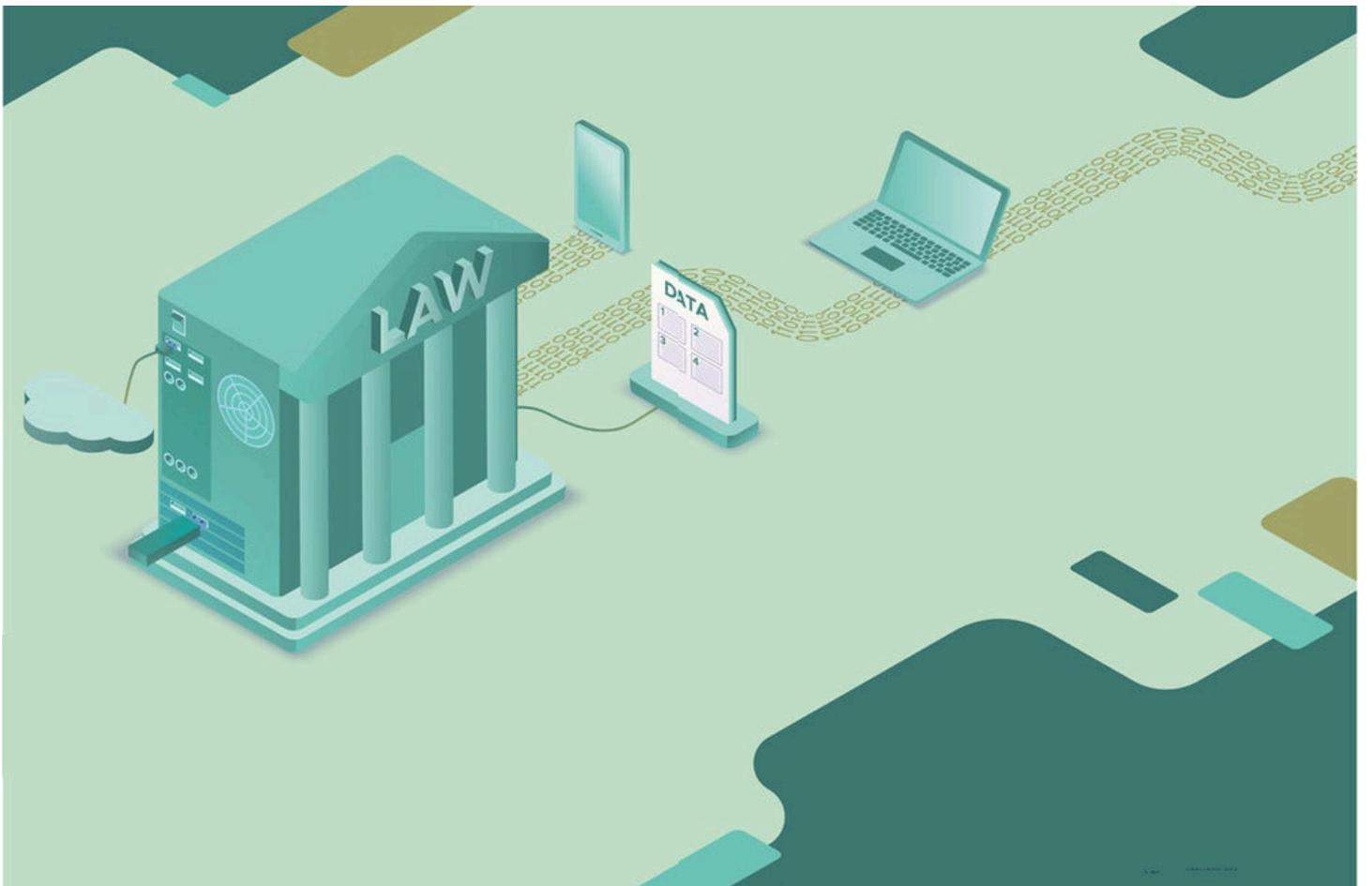




Using Legal Technology and Creative Structuring to Get Deals Done

Technology, Privacy, and eCommerce



CHEAT SHEET

- **Due diligence tech.** Use evolving technology like artificial intelligence and virtual data rooms to maximize efficiency, organization, and precision during due diligence.
- **Transaction docs.** New technology can also be applied during the transaction process, like automated document templates and proofing, e-signatures, and electronic closing books.
- **Creative deal structuring.** Adjust purchase agreement provisions that would be implicated during events like COVID-19. Consider material adverse effects, earn-outs and deferred payment structures, and interim covenants.
- **RWI.** Representations and warranties insurance (RWI) in transactions can help bridge gaps by allocating risk to a third-party insurer so both buyer and seller can reach their goal of closing the deal.

Spoiler alert: Transactions and investments often do not unfold exactly as planned and the deal-making landscape is constantly evolving. Transactional lawyers — and mergers and acquisitions (M&A) lawyers in particular — must be nimble, creative, business-minded, and equipped to get the deal done. Now more than ever, in the wake of COVID-19, technology and service delivery resources play a key role in a lawyer's ability to close a transaction and also meet client expectations for increased efficiency, improved communication, and, when possible, meaningful reductions of overall legal costs.

In today's deal environment, it is critical for transactional attorneys to have a deep understanding of the following areas to drive client value:

- Dynamic use of technology in due diligence and the transaction process;
- Bridging gaps in an uncertain economy through creative deal structuring; and
- Increasing use of representations and warranties insurance in transactions.

Dynamic use of technology in due diligence and the transaction process

In a time of unprecedented economic uncertainty, clients expect increased fiscal responsibility from lawyers when planning for potential transactions. What can lawyers do to successfully deliver on this expectation?

Due diligence

Conducting accurate and expansive legal due diligence is one of the most important ways that lawyers can uncover issues and mitigate risk for clients. However, this can account for a large portion of time and legal fees associated with transactions, as long hours are often spent reviewing hundreds or even thousands of contracts and other business and legal documents for rights, risks, liabilities,

obligations, and other relevant provisions. Leveraging evolving technology, such as due diligence technology powered by artificial intelligence (AI) and virtual data rooms, can maximize efficiency, organization, and precision in document review.

Use of AI technology in diligence

Diligence platforms that use AI technology are trained to identify, analyze, and extract key provisions, such as change of control, assignment, termination, exclusivity, non-competition, non-solicitation, or most favored customer treatment, in contracts and other diligence documents. These platforms are not only able to highlight these provisions in contracts, but can also generate preliminary reports outlining relevant information in the reviewed documents. This gives lawyers a major head start in completing diligence contract reviews and can materially reduce the amount of “lawyer time” spent reviewing a contract for key terms.

In the face of COVID-19, buyers should pay particular attention to whether the effects of the COVID-19 pandemic could constitute a default, basis for termination or non-performance (such as a force majeure event), or result in material liabilities of the target or an interruption in the target’s supply chain. Reviewing relevant force majeure provisions from a large batch of contracts becomes much easier when a lawyer using automated AI diligence technology can easily extract the relevant information with a few clicks of the mouse.

Benefits of AI diligence technology

- Upload documents either directly from certain virtual data room (VDR) providers or locally saved folders.
- Reduce time needed to review contracts by highlighting key provisions.
- Safeguard against human error through initial review and report process.
- Mechanism to compare individualized documents against standard forms of such documents.
- Facilitate searching of documents, including by searching any relevant text within the document. This is especially helpful when documents in a VDR are not clearly labeled or organized.
- Summary reports and compilations are usually readily created using AI technology products.

Virtual data rooms

With an increase in the number of documents exchanged between parties in an M&A transaction and the number of parties needing access to the relevant documents, VDRs have largely replaced physical data rooms in modern M&A transactions. A VDR is a secure online platform for document storage and distribution that allows multiple parties to simultaneously access relevant documents.

Initial considerations and benefits of VDR

- Request a list of buyer team members and other outside parties to be invited as authorized users to access the VDR and restrict access to certain documents in the VDR to ensure that access to confidential information in the VDR is properly restricted based on data sensitivity and necessity of review.
- Ensure that buyers sign a confidentiality agreement or non-disclosure agreement for purposes of limiting access to and use of confidential business information prior to obtaining access to the VDR. In addition, a VDR may contain a customizable click wrap agreement form of nondisclosure and confidentiality agreement by which the user of the VDR accepts the

restrictive terms of access and use upon login to the VDR.

- Delegate tasks related to the maintenance of the VDR, such as which individuals are responsible for adding new users or uploading new documents to ensure that content is current and timely updated based on requests for additional information. To streamline the Q&A process, many VDRs also include Q&A trackers by which buyers can directly ask and prioritize questions and sellers can directly provide responses or automatically route questions to relevant subject matter experts.
- Sellers should test the VDR prior to sharing it with the buyer by running their own diligence process to become familiar with any issues or deficiencies that the buyer may encounter. The sellers should attempt to resolve any deficiencies prior to allowing the buyer access.
- Use of a VDR provides a far more organized method of delivering diligence information when compared to traditional piecemeal physical delivery because all the documents are indexed and labeled in one place. Further, VDRs automatically generate an index of available documents, which facilitates the division of diligence review, monitoring of updated information, and creation of disclosure schedules for the definitive purchase agreement.

After the deal has crossed the finish line, closing and deleting the VDR to prevent continued access to information is an important step. Prior to deletion, sellers should create electronic backups of the VDR, as agreements often require sellers to provide electronic copies of the VDR to buyers and underwriters, if a representations and warranties insurance policy is in place. Many buyers will request an electronic copy of the VDR as well, to be provided promptly upon closing a transaction.

Transaction documents

Technology is available and can be applied to facilitate and minimize fees associated with the preparation of ancillary deal documents.

Document automation

While transactional lawyers are no strangers to using precedents from prior deals, document automation software can make this process much more efficient by creating templates for certain deal documents, such as third-party consent letters, escrow agreements, bills of sale, non-disclosure agreements, and other form ancillary documents. To prepare new documents, preparers will simply need to complete a questionnaire and the document will be generated based on the answers provided. Such questionnaires will not only ask the preparer for factual information such as names, dates, and figures, but also permit preparers to easily control whether more specific provisions are included.

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Document proofing

Evolving technology is also changing how lawyers proof documents. Reviewing large documents for defined terms, cross-references, and other grammatical errors may take a great deal of time and the slightest error could have significant consequences on future interpretations of the agreement.

Document proofing software (AI) helps analyze documents to confirm that all defined terms, cross-references, numbering, and general formatting are consistent. It also identifies and corrects errors that may be hard to spot with human review. By increasing the efficiency and accuracy of document proofing, transactional lawyers are better able to reduce client costs and minimize risk.

Signing/closing

For many transactions, in-person signings and closings are no longer feasible, causing the electronic signing and closing process to become standard.

Electronic signatures

Electronic signature software enables signatories to be easily designated for certain documents, keeps track of when documents are received and executed, and allows clients to sign and submit an executed document without ever picking up a pen or using a printer. However, lawyers must be aware of circumstances in which an electronic signature does not comply with legal requirements. For example, original signatures may be required in a real estate transaction or issuance of stock certificates. It is important to consider transaction documents that require original execution and notarization early on so that the requirements will not hold up closing the transaction.

In response to COVID-19, at least 23 states have adopted remote online notarization statutes that permit notarization via videoconferencing technology.

Electronic closing books

Once a transaction has closed, clients generally want a final bill for legal fees and copies of the closing documents as soon as practicable. In large transactions with many closing documents, the preparation of and delivery of hardcopy closing books is no easy feat, adding legal fees and delay to a closed transaction. Electronic closing books, which often include a PDF closing index with embedded links to copies of the closing documents, provide a cost-effective and environmentally friendly alternative to voluminous hardcopy closing binders.

Benefits of electronic closing books

- Consolidate location of closing documents with linked closing index.
- Reduce client costs related to duplication and delivery of closing documents.
- Integration of closing documents with internal document management systems.
- Facilitate review of closing documents for specific information.
- Store hundreds or thousands of documents electronically and reduce the need for physical storage space, while also preventing the misplacement of original documents or delays in accessing transaction files.

Bridging gaps in an uncertain economy through creative deal structuring

The impact of COVID-19 has created unprecedented economic uncertainty for businesses around the world. At this point, it is still difficult to predict when and how businesses will re-open and whether and to what extent consumers will resume buying their goods and services. This uncertainty has created business valuation issues as now, more than ever before, past results may not be a reliable

indicator of future performance. Accordingly, creative deal structuring to appropriately allocate valuation risks and adjustments to purchase agreement provisions that would be implicated in the case of events like COVID-19 are necessary.

Defining a material adverse effect

COVID-19 has changed mindsets. Buyers and sellers now know that an unforeseeable event can really happen at any time. The world economy can turn on its head in a few short months.

Customary definitions of a material adverse effect (MAE) focus on what it is not, with sellers carving out certain events and buyers using disproportionate effect qualifiers to neutralize those carve-outs. So, with everyone thinking about COVID-19, sellers may simply seek to carve-out pandemics and public health events from the definition of the MAE to make it completely clear that such events cannot be used as an “out” for buyers via the MAE — and a buyer will apply a disproportionate effect qualifier and call it day.

Agreeing on the amount of financial loss that must be suffered, or by using another objective test to determine that a MAE has occurred, would not only provide greater certainty to buyers and sellers but would also reduce the extensive negotiations that go into defining an MAE under the most often used construct of that definition.

However, this approach is likely short-sighted, as the next major disaster may not be included in the carve-outs, and then the parties are left wrangling over whether a “material adverse effect” has really occurred. Accordingly, for greater certainty, parties should consider setting materiality thresholds using quantifiable financial metrics in the definition of MAE.

This way buyers and sellers can definitively allocate the risk of an event like COVID-19 in terms of whether the buyer would be obligated to close. Agreeing on the amount of financial loss that must be suffered, or by using another objective test to determine that an MAE has occurred, would not only provide greater certainty to buyers and sellers but would also reduce the extensive negotiations that go into defining an MAE under the most often used construct of that definition.

Earn-outs and deferred payment structures

Due to economic volatility and negative effects on a target company’s financial projections caused by COVID-19, it may be more difficult for buyers and sellers to agree on the target’s true value. Earn-outs and deferred payment structures permit buyers and sellers to bridge valuation gaps by structuring payment based on milestones to be met by the acquired business. In the current climate, lawyers for buyers may seek longer earn-out periods so that the target valuations are not compromised by short-term COVID-19-related financial losses. In response to buyers seeking longer earn-out periods, sellers may seek partial payment of the earn-out payment for milestones at intervals during the earn-out period. Parties also should consider limiting post-closing net working capital purchase price adjustments to account for potential fluctuations due to COVID-19.

Another potential deferred payment structure to consider is known as a hybrid rollover structure. In this type of structure, the buyer would purchase less than 100 percent of the target company’s equity at the initial closing and subsequently purchase the balance of the target’s equity at a later date, based on a mutually agreed formula to determine the balance of the purchase price based upon the future financial performance of the target. The hybrid rollover structure provides sellers with some

liquidity at the initial closing and potential upside if the seller improves operations to pre-COVID-19 levels within a reasonable time.

Further, the structure provides buyers with some downside protection in the event that the financial performance of the target business is permanently impaired or takes an extended time to improve due to the impact of COVID-19.

Interim covenants

For M&A deals with an interim period between signing and closing, agreements typically include covenants which, during the interim period, require sellers to conduct their business in the ordinary course consistent with past practice and prohibit various actions without first obtaining buyer's approval. However, given the uncertainty and volatility caused by COVID-19 and the prospect that a similar unforeseeable event could occur, lawyers for sellers should seek maximum flexibility and rights with respect to the operation of the seller's business in the interim period if an unforeseeable event occurs. For example, in the face of a crisis such as COVID-19, many businesses needed to take urgent and immediate action, such as obtaining additional credit, laying off staff, or closing business facilities, in order to preserve the target business. Short of express rights to take action outside of the ordinary course, sellers should, at least, seek to enhance their interim operating obligations with "in all material respects," "in compliance with applicable laws and governmental orders," or "commercially reasonable efforts" qualifiers to give them some wiggle room in complying with these obligations. If expanded rights to operate in response to certain events occurring between signing and closing are provided to sellers, at minimum, buyers should seek to be consulted, kept apprised of, and otherwise be part of the process between signing and closing.

Enhanced diligence and narrowing exclusions to representations and warranties insurance (RWI) policies in response to COVID-19

In conducting due diligence and negotiating representations and warranties, the impact of COVID-19, or other negative impacts that could be caused by a similar event, should be top of mind for buyers to ensure they are being provided with sufficient information to make informed decisions in valuing the transaction and providing for proper downside protection in the purchase agreement. For example, buyers should conduct more expansive diligence and seek additional representations regarding the target's:

- Business interruption insurance coverage or lack thereof;
- Policies and practices related to health and safety, including compliance with the Occupational Safety and Health Act (OSHA), and any potential related liabilities;
- Material contracts, including in particular a review of force majeure provisions and any indications from the counterparties to such contracts regarding potential non-performance or termination; and
- Contingency plans, business continuity practices, programs, and policies, as well as the protections in place with respect to privacy and cybersecurity in the event of potential long-term need for remote working arrangements.

However, given the uncertainty and volatility caused by COVID-19 and the prospect that a similar unforeseeable event could occur, lawyers for sellers should seek maximum flexibility and rights with respect to the operation of seller's business in the interim period if an unforeseeable event occurs.

Further, some underwriters of RWI policies are seeking full or partial exclusions from coverage for COVID-19-related losses and liabilities. Buyers should negotiate with insurers to narrow the scope of the exclusions to the greatest extent possible and at the very least, for the exclusions to apply only to losses actually resulting from COVID-19. As previously indicated, heightened scrutiny should take place in the diligence process on potential losses and liabilities associated with the impact of COVID-19 on the target business. Buyers also should consider supplements to RWI coverage, such as direct seller indemnification arrangements and holdbacks, to provide protection for buyers against COVID-19-related losses for which it may not be protected under the RWI policy.

Increasing use of RWI in transactions

As dealmakers face considerable economic and geopolitical uncertainty, transactional lawyers must continue to adapt their M&A strategy and find solutions to manage their clients' transactional risk. RWI is not new to M&A (it has been around for more than 20 years, starting initially with private equity buyers), but has emerged as a critical tool in the broader M&A marketplace due in large part to decreased costs, streamlined process, and documentation, increased speed in policy issuance, expanded coverage and claims, increased evidence of claims being paid and overall comfort level among practitioners in using RWI.

RWI is almost always considered in any M&A transaction (much like title insurance in a real estate transaction), even for deals with a purchase price as small as US\$5 million. In fact, according to the 7th edition of Seyfarth Shaw's Middle Market M&A SurveyBook released earlier this year (which analyzed key transaction terms from more than 100 middle market private target acquisition agreements signed in 2019), approximately 55 percent of the transactions reviewed for the survey included RWI, compared to approximately 40 percent of the transactions surveyed in 2018.

Allocation of risk is a key component of every M&A deal. Since conflicting motivations of a buyer and seller can result in contentious and difficult negotiations, RWI can bridge the gap by allocating risk to a third-party insurer and allow the parties to reach their mutual goal of getting to closing. RWI has significant benefits (for both a buyer and seller), as well as important costs and other considerations.

Benefits of RWI

Risk management benefits

- Protects against unanticipated, unknown losses that result from breaches of representations and warranties made by a seller or target company contained in a purchase agreement, and shifts risk of loss (subject to retention amount and policy limits) to the insurance carrier at a fixed cost.
- Allows sellers to put more money in their pockets at closing as opposed to an indemnity escrow.
- Enhances the indemnification package (both increased monetary coverage and longer survival periods) available to a buyer beyond the terms negotiated with a seller.
- Provides recourse when a seller is unwilling (e.g., in seller's market and/or when a seller has significant leverage) or unable to provide indemnity (e.g., bankruptcy or distressed situations or public company sales).
- Mitigates post-closing collection risk (e.g., insolvent or "shell" sellers, multiple sellers (in the absence of joint and several liability, especially for minority or passive sellers), or foreign

sellers).

Tactical benefits

- Distinguishes a buyer's bid in an auction process as potentially being more attractive to a seller (or, increasingly, to keep pace with other bids), especially if a buyer is willing to bear the RWI fees and costs and/or offer a "no survival" deal without any holdback or escrow provided by the seller.
- Reduces certain complexities of negotiating indemnification provisions between a buyer and seller.
- Reduces negotiation of and provides a more robust representation and warranty section, as a seller is generally more willing to provide more expansive representations and warranties if the RWI policy is buyer's sole or primary recourse.
- Protects key post-closing relationships (e.g., management or rollover holders that will shift from being the pre-closing "seller" to the post-closing "employee" or "partner" of buyer).

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Costs and other considerations of RWI

- Involves not insignificant fees, especially in the context of a lower-middle market deal (e.g., a non-refundable underwriting fee (US\$25,000 to US\$50,000), a total premium (two to three percent of the policy limit, including broker fees and taxes), and a retention/deductible amount (one to two percent of enterprise value, often stepping down to half a percent after 12 months from closing as the likelihood of claims decreases)).

Pre-COVID-19, the uptick in claims notices and losses paid under RWI policies were expected to result in an increase in premium charged over the course of 2020. However, the drop-off in M&A deal volume post-COVID-19 and the resulting stiffer competition for deals within the insurance market has largely been a counterbalance to any increased premium rates.

- Increases buyer's scope and documentation of diligence in order to satisfy the requirements of the RWI underwriter and its counsel.
- Does not cover "known" matters and loss contingencies (i.e., issues discovered through due diligence or disclosed in schedules to the purchase agreement).
- Can contain blanket exclusions of certain "high risk" matters from coverage (e.g., uninsurable fines and penalties, pension underfunding, certain environmental or pollution cleanup, value of deferred tax assets, collectability of accounts receivable, and forecasts and forward looking statements), and does not provide coverage for payments pursuant to purchase price adjustments or breach of covenants.
- Contains exclusions of certain "heightened risk" matters that require enhanced due diligence before an RWI carrier determines whether to impose a blanket exclusion, narrow exclusion, or no exclusion at all (e.g., wage and hour matters, cybersecurity/privacy, transfer pricing, foreign corrupt practices, products liability, and condition of assets).

At the outset of the COVID-19 outbreak and in the months that followed, most carriers required a broad or blanket COVID-19 exclusion across all deals. However, as the United States begins to

reopen and dealmakers begin to assess COVID-19 impacts, carriers have begun shifting to a more narrow exclusion for deals, tailored to address the risk of compliance with measures designed to protect employees, clients, suppliers, and other third parties.

Looking ahead, the use of RWI is almost certainly going to expand and further establish itself as an essential deal-making tool to protect buyers from potential risk, while also allowing them to provide sellers with more attractive terms.

Prepare today for tomorrow's transaction

Being practical, efficient, and business-oriented is table stakes for a transactional lawyer, especially in today's deal environment. It is now essential to implement technology and creative problem-solving at each step of the transaction process in order to get the deal done, successfully meet client expectations, and be prepared for the next transaction that is just around the corner.

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[Legal Tech Roadmap: Where to Start Your Technology Journey](#) (July 2019)

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[Craig Rosenthal](#)



Senior Vice President and General Counsel

BellRing Brands, Inc.

Craig Rosenthal is the senior vice president and general counsel of BellRing Brands, Inc. He is responsible for all legal and regulatory affairs and strategies for the company. craig.rosenthal@bellringbrands.com

[Andrew Lucano](#)



Partner

Seyfarth

Andrew Lucano is a partner at Seyfarth where he is vice chair of the firm's Mergers & Acquisitions practice. alucano@seyfarth.com

[Suzanne L. Saxman](#)



Partner

Seyfarth

Suzanne L. Saxman is a partner at Seyfarth where she counsels clients through every phase of growth, using her three decades of experience as a corporate lawyer.

[Aaron M. Gillett](#)



Associate

Seyfarth

Aaron M. Gillett is an associate at Seyfarth. From startup to sale, he represents clients in all aspects of their businesses, providing practical legal advice at every stage.

[Matthew Wiener](#)



Associate

Seyfarth

Matthew Wiener is an associate at Seyfarth. He partners with clients on structuring their businesses, running their day-to-day operations, and engaging in acquisitions and dispositions.