

Sell-Side M&A: Navigating Continuing Entanglements After the Deal Closes

November 7, 2024
By Michael N. Mercurio



Sell-side mergers and acquisitions (M&A) can be transformative events for companies, shareholders, and stakeholders alike. For the seller, this often means a significant payout and the culmination of years or even decades of hard work. However, post-closing sellers often remain connected to the business in various ways through what are known as "continuing entanglements." These post-transaction obligations can have legal, financial, and operational implications for the seller.

Earnouts and Contingent Payments

An earnout is a mechanism where the seller receives additional compensation based on the post-closing performance of the business. Earnouts are common in deals where the buyer and seller cannot agree on the valuation or where future business growth is uncertain. However, earnouts can be complex and can be areas of dispute post-closing. Sellers should negotiate clear terms that are tied to objective financial indicators, especially as Sellers may have little control over the business post-sale.

Escrow and Holdback Provisions

Buyers often require a portion of the sale price to be held in escrow or retained as a "holdback" for a period after closing as means to cover post-closing items such as undisclosed liabilities and indemnifications. Sellers need to negotiate protections and structure into these escrows including the terms of release and limitations against escrow claims.

Representations, Warranties, and Indemnifications

In M&A transactions, Sellers provide representations and warranties about the state of the business at the time of sale. If these representations turn out to be inaccurate or incomplete, the buyer may seek indemnification. Sellers should limit the duration and scope of their representations and warranties. At times, representation and warranty insurance may be an option to protect sellers from such claims.

Non-Compete and Non-Solicitation Agreements

Buyers often require sellers to sign non-compete and non-solicitation agreements as part of the M&A transaction. Sellers should also evaluate how these restrictions will affect their future business ventures and negotiate reasonable carve-outs when possible.

Consulting or Employment Agreements

In many cases, the buyer may require the seller to stay involved with a consulting or employment agreement, especially for transition and integration. Sellers should be careful about clarifying their role and expectations post-closing, including a

seller's ability to terminate the arrangement.

Tax Implications

Taxes drive transactions and M&A transactions can trigger significant tax liabilities for sellers. Sellers should work closely with tax advisors to structure the deal in the most tax-efficient way as well as be mindful of tax treatment for contingent payments like earnouts.

Operational Matters

Sellers should be careful to account for day-to-day potential entanglements with buyers post-closing. Such items include bank account transfers, leases, licenses, etc. Having a clear understanding with the buyer as to what will be the disposition of these items post-closing is important.

Conclusion

For sellers, it is important to be mindful of the continuing entanglements that can persist long after the deal is done. Legal, financial, and operational obligations may continue to bind the seller to the business for years to come. Sellers should work closely with experienced legal counsel to navigate these complexities and minimize their post-closing risk.