

Getting Your Deal Done – Considerations For Selling And Buying Small Systems – Part II

*By Kurt Mueller and Chris Cinnamon
Cinnamon Mueller Attorneys*

This is the second in a series on considerations in selling and buying a small cable system. In last month's issue of ICN, we discussed the first two steps that occur after you and your broker have found a potential buyer or seller – the letter of intent and due diligence. Here we focus on the purchase agreement.

Key Aspects Of Purchase Agreements

Parties to a cable transaction often enter into a letter of intent outlining the material terms of the deal. A properly drafted letter of intent does not obligate the parties to actually close the deal. Rather, it serves as a roadmap for the parties as they negotiate a binding purchase agreement.

The purchase agreement incorporates and expands upon material terms from the letter of intent. The purchase agreement then goes much further and addresses a range of terms and conditions, rights, remedies, and obligations relating to before, during, and after the deal closes.

First, we take a look at some purchase agreement terms that are typically also addressed in the letter of intent. These terms go to the very heart of the deal – what is being sold and for how much.

- **Form of transaction – assets or stock.** In an asset deal, the buyer is buying the assets of the cable system – the physical plant, subscriber goodwill, and the rights under the franchise. In stock deals, the buyer purchases all of the stock of the seller, thus buying the company as a whole. This means that the liabilities of the seller come along with the assets. In both asset and stock deals, the buyer will want a detailed schedule showing all of the assets and liabilities of the business. Often times in asset deals, specified assets and liabilities will be excluded. For example, if the buyer already has its own satellite programming lined-up, the rights and liabilities under the seller's programming contracts may be excluded.

- **Purchase price.** The purchase price, and any major adjustments to that price must be specified. Most cable transaction today will reduce the purchase price if the basic subscriber count falls below an established threshold. The form of the purchase price also needs to be spelled out. Will it be paid in all cash, stock of the buyer, a promissory note? Finally, often a portion of the purchase price will be held back by the buyer until some time after the closing. Known as a "holdback", this type of provision puts money behind the seller's representations and warranties and is discussed below in more detail.

The buyer's lawyer typically prepares the first draft of the purchase agreement. A number of important terms are often put in play for the first time when the purchase agreement lands with a thud on the seller's (and, hopefully, his lawyer's) desk. These include:

- **Seller's representations and warranties.** The buyer wants the seller to say "you are buying what you think you are buying" and wants it in writing. This is the

purpose of the seller's representations and warranties. Often running to several pages, the seller "reps" are often heavily negotiated. In the course of evaluating the business, the buyer receives lots of data: asset descriptions, subscriber counts, technical specifications, and financial and other data regarding the business. The buyer will not want to sign the purchase agreement unless the seller reps that: the seller owns the assets, the business really does have 1,500 subscribers, the system is at least 450 MHz and passes 2,100 homes, the financial statements are accurate, FCC regulations have been complied with, and a host of other reps.

- **Conditions to closing.** One of the most important assets a buyer acquires is the seller's franchise. The franchise will often provide that the franchising authority must consent prior to any assignment of the franchise or prior to a change in control of the seller. Thus, in both asset and stock deals, the seller often times must obtain the consent of the franchising authority prior to closing the deal. The buyer is not obligated to buy the system until that consent is in hand. If the buyer's relationship with the franchising authority is less than stellar, we sometimes advise the parties to closely follow formal FCC procedures that, if invoked, provide certain rules for the franchise transfer process.
- **Indemnification.** The indemnification section provides the rules for alleged breaches of the purchase agreement that are discovered after the deal closes. For example, if the buyer believes the seller breached a rep, the parties will look to the indemnification section for guidance as to resolving the dispute. A well-negotiated indemnification section contains several key provisions. First, there will often be a time limit as to how long after the deal has closed the buyer may attempt to recover damages. Next, assuming the buyer is within this "survival period", the buyer will be required to provide the seller with a written notice detailing the claim. Finally, there may be upper and lower limits on the size of the indemnification claims.
- **Holdback.** Often a portion of the purchase price is held back by the buyer until the expiration of the survival period in order to back up the seller's reps. In this case, the purchase agreement needs to specify when and to whom these funds will be disbursed. Generally, the funds will be used by the buyer to satisfy valid indemnification claims. Then, any funds remaining after the expiration of the survival period are paid to the seller.
- **Dispute resolution.** Related to indemnification are provisions regarding dispute resolution. In the purchase agreement, the parties may specify what state's laws will apply and in what court a suit on the agreement may be brought. Or they can agree that instead of resolving disputes in court, disputes will be resolved through mediation or arbitration. If properly drafted, an arbitration clause can provide for the equitable resolution of disputes in an expeditious and orderly fashion.

In a coming issue of the Independent Cable News, we will discuss closing and post-closing issues.