Cable and Telecom Deals – Lawyers' Perspective

By Jake Baldwin and Bruce Beard

While the Comcast-Time Warner Cable and AT&T-DirecTV mega-deals garner all the press, we've seen a recent surge in deal activity among small and mid-sized operators too.

Some parts of a cable or telecom deal are like any other transaction, but many aspects are unique. For both buyers and sellers, a key step to ensuring a successful transaction is starting with a big picture understanding of the deal process. This article breaks the process into key phases that begin after you find a potential buyer or seller: the letter of intent, due diligence, the purchase agreement, and closing.

Letter of Intent. In many cases, parties show that they are serious about a transaction by negotiating and signing a letter of intent. The letter of intent summarizes the key terms of a proposed deal and serves as a roadmap for the purchase agreement. Letters of intent are generally not binding, but they may contain certain binding terms, such as a confidentiality provision or a "no-shop" clause. Important provisions in a letter of intent include:

Purchase price. The letter of intent typically specifies the amount and form of purchase price and any major adjustments to that price.

Form of transaction. A letter of intent generally specifies whether the parties will structure the transaction as an asset or a stock deal. In an asset deal, the buyer acquires the company's assets—the physical plant, subscriber goodwill, licenses, and rights under franchises and other contracts. In a stock deal, the buyer acquires the seller's stock, buying the company as a whole. The form of transaction can have significant tax implications, and the prudent seller involves tax advisors early in the process.

"No-shop" clause. One reason buyers often want a letter of intent is for the "no-shop" clause, which includes the seller's promise that it will not try to find or negotiate with other potential buyers for a specified time.

Confidentiality. Before sharing any confidential information, the parties often execute a confidentiality or non-disclosure agreement. This sometimes happens before the execution of a letter of intent. If the parties have not entered into a separate confidentiality or non-disclosure agreement, a seller may insist that the letter of intent include confidentiality provisions.

Due Diligence. The next important step in the process is conducting "due diligence." During due diligence, a potential buyer gathers and evaluates information about the seller's business. In addition, many sellers conduct "sell-side" due diligence before a buyer begins its review. This helps sellers identify and, if necessary, remedy or disclose any problem areas before the buyer begins its due diligence. Due diligence generally focuses on three key areas: financial, physical, and legal and regulatory.

Financial due diligence includes a detailed review of the seller's financial records and projections. Physical due diligence typically includes an inspection of headends, central offices, and other key facilities. Legal and regulatory due diligence involves a detailed review of the company's contracts and regulatory filings.

Purchase Agreements. The purchase agreement incorporates and expands on terms from the letter of intent. It 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.

Transaction structure. We outlined key differences in asset and stock deals above. In both asset and stock deals, the buyer will want a detailed schedule showing all of the assets and liabilities of the business. In asset deals, the purchase agreement will also specify certain assets and liabilities that the buyer will not buy in the deal.

Purchase price. The purchase agreement will specify the purchase price and any major adjustments to that price. For example, most purchase agreements provide for a reduction in the purchase price if the subscriber count falls below an established threshold before closing. The purchase agreement also specifies the form of payment. For example, a buyer may pay in all cash, stock of the buyer, a promissory note, or some combination of these.

Seller's representations and warranties. In the course of evaluating the business, the buyer receives lots of data: asset descriptions, subscriber counts, technical specifications, financial records, and other data about the business. The buyer will not want to sign the purchase agreement unless the seller "reps" that it: owns the assets, accurately reported subscriber counts, financial statements, and other information, and complies with applicable FCC regulations, among other reps.

Conditions to closing. Many franchises require the franchising authority's consent to any assignment of the franchise or to a change in control of the grantee. Retransmission consent and other important contracts may contain similar requirements. And FCC rules require companies holding FCC licenses to apply for any license assignment or change in control of a licensee. The purchase agreement usually requires the seller to obtain these consents to trigger the buyer's obligation to close.

Indemnification. The indemnification section sets the rules for alleged breaches of the purchase agreement that a party discovers after the deal closes. A well-negotiated indemnification section sets a "survival period" during which parties may make indemnification claims, requires a party seeking indemnification

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to provide a detailed, written notice of any claim, and imposes upper and lower limits on the size of claims.

Holdback. Often the buyer holds back a portion of the purchase price during the survival period to "back up" the seller's reps. the buyer may hold those funds back in its accounts, or the parties may decide to use an escrow agent for this purpose. The purchase agreement specifies when and how parties or their escrow agent will disburse these funds. Generally, the buyer will use the funds to satisfy valid indemnification claims. Then, any funds remaining after the survival period are paid to the seller.

Closing and Post-Closing. Once the parties sign the purchase agreement, they start working towards closing. Generally, this involves obtaining required consents and satisfying other closing conditions. Once the parties satisfy the closing conditions, they schedule the closing.

Closing. The closing involves signing several documents to consummate the transactions. The seller will formally transfer ownership of the seller's assets or stock to the buyer. And the buyer will pay the seller, either through a wire transfer, execution of a promissory note, or other arrangement, and take over operation of the business. Most closings today occur remotely, with the buyer and seller exchanging signature pages via email or fax.

Post-closing. After closing, the parties will make regulatory filings or provide notices that may be made after the transaction closes. Many purchase agreements also provide for post-closing adjustments to the purchase price. For example, parties often agree to use purchase price adjustments to "true up" expenses incurred while the seller owned the company but paid by the buyer after the closing. The parties also track the holdback and release it according to the purchase agreement.

Conclusion. No transaction will go exactly as planned. But, in our experience, successful transactions start with the buyer and seller knowing what to expect in the deal process. ❑

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