Chapter 17

Anatomy of an Acquisition Agreement

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§ 17.01

Introduction.

The acquisition of an active business operation is a challenging transaction for lawyers, business persons and accountants. Whether the acquirer purchases the “business” by purchasing all of the assets of the target company (an “asset” transaction), or by purchasing all of the ownership interests held by owners of the target (a “stock” transaction), there are a myriad of operational, legal and practical matters that should be addressed in order to consummate a transaction with minimal interruption to operations and minimal adverse consequences. Despite the extreme complexity involved in evaluating (a) the value of a target, (b) the assets of the target, (c) the procedures for closing the transaction without adverse consequences and (d) the legal risks applicable to the target (and equally important, allocation of liability for such risks) the ability to consummate acquisition transactions is critical to an efficient capitalist market because it enables the allocation of resources to the most efficient users thereof in an efficient, lump sum transaction. Therefore, mergers and acquisitions lawyers play a vital role in greasing the gears of the free market by helping business folks consummate whole-company acquisitions.

2 Of course, mergers are also a form of acquisition, but the issues are essentially the same as with a stock acquisition.
Unlike leases, coal sales agreements, and contract mining agreements, to name a few examples, acquisition agreements are not documents that most clients become familiar with through their daily business activities. For many clients, an acquisition or disposition of a company will occur very rarely throughout their career, making the job of counsel all the more important when it comes to advice regarding what is reasonable from a business perspective, not just a legal perspective.

Further, an acquisition agreement cannot be pulled off the shelf without a great deal of risk that the provisions will not provide the language and protection necessary for the deal and assets at hand. There is simply no generic agreement that works.

To exhaustively cover all of the legal issues that need to be considered when acquiring a coal business, one would need to draft a chapter that touches on every legal issue covered by every white paper submitted to the Energy and Mineral Law Foundation since its inception, and then some, because all of those issues may come up and be of concern to a purchaser, especially in a stock transaction. This chapter does not do that, but what it does is describe the master agreement that governs the acquisition: the Asset Purchase Agreement, Stock Purchase Agreement or Merger Agreement, as applicable. A customary acquisition agreement is long and complicated, but as with a coal lease or a coal purchase agreement, or any other commonly utilized form of agreement, the standard terms all serve an essential purpose. It is also essential for buyer’s and seller’s counsel to master every provision in the agreement in order to adequately represent their clients in an acquisition transaction. As the chapter discusses various provisions of an acquisition agreement, it briefly touches on substantive issues of the law as it relates to a coal acquisition, including tax, real estate, environmental issues, the contract law of consents, and human resources matters.

This chapter discusses the acquisition agreement from the purchaser’s perspective, focusing on key provisions specific to our industry and completely ignoring certain provisions that are applicable to all transactions and that were deemed less important or interesting than the items covered in detail. Covering the acquisition agreement mostly from the purchaser’s perspective is reasonable because the initial draft of an acquisition agreement is generally
prepared by the purchaser and the purchaser is, generally speaking, the party most interested in having a complex, comprehensive agreement. After all, when a company is selling all of its assets or shareholders are selling all of their stock, their only real concern — absent release of personal liability in the event of reclamation liability, personal guarantees or other liabilities that pierce the veil of limited liability — is receiving the consideration they are owed, which is cash in the vast majority of transactions. Throughout this chapter, drafting recommendations and examples are provided.

After a very brief discussion of the pre-signing activities related to an acquisition, this chapter discusses a selection of the most important provisions in an acquisition agreement for an active mining company and the overall layout and goals of an acquisition agreement. Finally, this chapter discusses tools that can be used to argue over what “market” terms are for various provisions in the agreement.

§ 17.02. Pre-signing Documents.


Because of the importance of the standard documents that precede the execution of an acquisition agreement, the following briefly describes the Confidentiality Agreement, Letter of Intent and Due Diligence Checklist, which are executed or provided (in the case of the checklist) in the order listed. A full chapter could be devoted to each of the following, but for current purposes a few important points regarding each are worth discussing.


Confidential information is essential to the success of mining companies. The location of a target’s owned or leased property, the royalties they pay to their landlords, and the prices they are paid for their coal (and by whom) are three of the most obvious types of information that are very valuable to a target and become less valuable once disclosed to competitors. As such, before any action is taken to discuss terms of a deal, and especially before a target discloses information that the purchaser will need to value the going concern, a confidentiality agreement will be proffered by the target. Such an agreement, as its name suggests, creates a contractual obligation to keep
information secure and confidential. In a cash transaction, the confidentiality obligations are usually just obligations of the purchaser to not disclose target’s information. However, where the purchaser is public, or where stock consideration is involved, the purchaser may want a covenant by the target not to discuss the transaction or any confidential information it provides to the target concerning its stock value. Further, Confidentiality Agreements will usually require that a purchaser not use the confidential information to the target’s detriment, which is most important when the target controls a mining area, but may not have formalized leases or purchases with all property owners in the vicinity. The terms of a confidentiality agreement are very similar across forms, but counsel should never discount their importance.

Further, even after obtaining a confidentiality obligation, many targets will want to protect very sensitive confidential information, such as coal contracts and certain leases, until purchaser is pretty far down the road to closing a transaction. This is partly because a target could feel like it has struck a particularly good economic deal with a landlord or buyer, and will want to protect that information because they do not want third parties discovering it. The other reason for extra protection of certain confidential information is that many contracts restrict disclosure of their terms. This is a particularly troublesome issue as purchasers and targets often do not want third parties to know of the existence of a potential transaction until well into the process, but sharing of agreements is often done much earlier, usually before the pricing stage, and well before execution of a definitive acquisition agreement. This conundrum is one that is not easily dealt with, but one option is simply not to provide such restricted contractual information until well down the road to closing, and potentially obtain consent to share the information immediately prior to obtaining consent to assign such agreements. This process may work well because, invariably, if a contract has a confidentiality provision, it probably also has a restriction on assignment, so the third party will have to be approached to consummate the transaction. A purchaser will insist on a diligence closing condition if it has not yet been able to review certain contracts — which harms the target, which wants to push for very minimal closing conditions — but this seems to be the only reasonable solution in the absence of strong leverage on the target’s side to
not allow a diligence contingency and not share copies of all contracts to be assumed until well into the post-signing, pre-closing process. One other option that arguably prevents breach of a confidentiality provision is to heavily redact the agreements (including the counter-parties identities) and/or provide summaries of such restricted contracts. This is a partial disclosure, but it shows a good faith effort to comply with the covenant of confidentiality and hopefully would avoid a breach to the extent that the contract could be terminated by the third party or that the third party would have a damages claim, which are the issues of concern with respect to these provisions. Of course, the main takeaway from this discussion of confidentiality covenants is twofold: (1) lawyers should strongly consider carveouts to confidentiality provisions to permit sharing such restricted contracts in conjunction with a material transaction such as a sale of substantially all assets, and (2) lawyers should make sure they think about this issue and discuss it with their client so that they do not ignorantly create a new issue. Many times, a client will be much less concerned about the issue than their counsel, and it is certainly within the client’s prerogative to ignore the fears and worries of their counsel. What is not good is for the lawyer to fail to raise the issue for their client to decide.


A letter of intent sets forth the material terms that the parties each believe are vital in order to be willing to consummate an acquisition. As its name suggests, the letter of intent (LOI) is prepared in letter format and describes the parties desire to consummate a transaction, states that most its provisions are non-binding, describes contemplated timing, details certain binding provisions, and lays out, either in the letter or in an exhibit, a list of material terms. These material terms always including the following: purchase price, form of payment, specifics on assets to be conveyed, specifics on liability assumption, discussion of indemnification provisions and limitations on same (deductibles, escrow of purchase price). There are no rules for an LOI other than to make sure it is clearly non-binding with respect to the deal terms and obligation to close, as neither party will truly want to be forced to close without standard, definitive agreements and diligence. The letter of intent
is binding with respect to certain, specific provisions such as the no-shop, choice of law, and an agreement to move forward with good faith dealings and negotiation towards reaching a definitive agreement.\textsuperscript{3}

The best reason to require a letter of intent is to make sure the parties are in agreement on these most substantive business and legal terms before a great deal of time is spent drafting documents. If the parties come to blows over the amount of the indemnity cap or the amount of a deferred purchase price, it is much better for almost everyone involved to find that out early on as opposed to discovering it after thousands of dollars have been spent drafting an agreement that will fail to move forward because of a business term.

Finally, a purchaser will also want a letter of intent because of the no-shop that is usually granted in a letter of intent, requiring that target not solicit, or entertain, any material transaction with third parties for a period of time. This allows purchaser and target breathing room to reach a deal without other buyers breathing over their shoulders. A target may, at times, require a deposit towards the purchase price to establish the purchaser as bona fide and serious about completing a transaction and also to compensate target for the time it is losing by taking itself off of the market for a period of time.

\textbf{[4] — Due Diligence Checklist.}

As its name suggests, a due diligence checklist is a list of items purchaser asks target to provide so purchaser’s counsel, accountants, insurance brokers and others can determine the value of the target and whether any issues exist that need to be specifically dealt with in the acquisition agreements, such as consents to assignment of material agreements, confidentiality provisions, bad economic terms in contracts, a history of employee issues, or litigation for which purchaser will require specific indemnity from target.

Due diligence checklists are all fairly similar in content and scope, but will need to be modified to cover the specific issues that face mining companies. Specific questions about MSHA violation history, title disputes

between co-tenants, necessity for 404 permits to continue per the Mine Plan, and other industry-specific items should be requested in the checklist.

The checklist requires that existing documents be provided, such as contracts and permit information, but also may require de novo documents such as a list of material suppliers, customers or employees.

The request, to the uninitiated, may seem extremely onerous. It is not unheard of for a request list to be 20 pages long. The standard response by purchaser counsel is that many of the requested items are hopefully non-existent, such that responding to them will only take a few minutes, and that providing this information now will save time later in the transaction when it comes time to prepare schedules. Commonly, a purchaser will set up an electronic data room organized in the same manner as the due diligence checklist so that target’s employees and counsel can easily upload responsive information. This cuts down on cost and also provides the purchaser with a strong record of the target’s response in case it turns out any of the responses were less than complete. Purchaser’s counsel should be prepared to deal with some backlash when a lengthy due diligence checklist is sent, but it is better to ask the necessary questions in writing than to not do so in fear of facing some consternation from a client who gets grief from target’s business folks for all of the work they have to perform.

§ 17.03. The Acquisition Agreement.


Acquisition agreements deal with the following major areas of agreement, usually in substantially the following order:

1. Recitals
2. Definitions
3. Sale and Transfer of Assets; Closing
   a. Description of Assets Assumed and Retained
   b. Description of Assumed and Retained Liabilities
   c. Description of Purchase Price
   i. Discussion of any Earnout or Deferred Consideration
   d. Closing Deliverables
4. Representations and Warranties of Seller
5. Representations and Warranties of Buyer
6. Pre-closing Covenants
7. Conditions Precedent to Obligation to Close
8. Termination
9. Post-closing Covenants
10. Indemnification
11. Miscellaneous (boilerplate)

§ 17.04. Definitions Section.


The definitions section of an acquisition agreement is not a light read, but the devil is in the details and these definitions can be very important and heavily negotiated. Defined terms are utilized, ostensibly, to make the acquisition agreement more readable and shorten the body of the agreement. Definitions used in acquisition agreements are often long lists of items that are defined down to one or two words, such as “Permitted Encumbrances,” in order to provide all of the nuance and detail that attorneys require without making for an unreadable document. One might argue that many commonly defined terms, such as Accounts Receivable, do not necessitate a detailed explanation, because the word itself is unambiguous and need not be defined. However, the custom is to carefully define any material term to avoid the risk of ambiguity and argument over what is and is not included. Just as soon as an attorney chooses the path less chosen and leaves a commonly defined term undefined, a dispute will surely arise as to its meaning. Ergo, it is safest to utilize definitions for commonly defined terms and carefully parse through what goes into such definitions. Of course, there can be ambiguity in a lengthy definition, but theoretically less so. There are a multitude of standard defined terms in an acquisition agreement ranging from the definition of environmental laws to the definition of knowledge.

As a matter of “optics,” it is worth considering moving the definitions section to an exhibit or to the end of the agreement instead of being up front as is usually the case. A business person reviewing ten pages of definitions may have a predilection to balk at the length and complexity of the agreement and provide negative feedback to the drafter. Further, they may never read
past the first few pages of definitions, a result that is not ideal. An attorney reading the agreement will find the definitions wherever they appear, so putting them up front is not essential and is likely detrimental. That being said, this chapter addresses them up front, ignoring the author’s suggestion.

As a matter of self-preservation and in order to retain as many readers as possible, this chapter does not discuss every defined term, as most are the same in a non-mineral acquisition as in a mineral acquisition. The following terms are of distinct interest in the mining context.


One of the heavily negotiated provisions is the definition of knowledge. This term is an important qualifier to many representations and warranties. This qualifier means that a warranty will only be breached if the party making it had knowledge of facts that make the warranty incorrect, instead of a breach solely based upon the truth of the warranty. The definition in the footnote is a fairly standard, and purchaser-favorable, knowledge definition. That being said, a knowledge qualifier is always to the benefit of the target. A so-called “flat” rep is the best form of warranty for a purchaser because it is breached if false, whereas a knowledge-qualified warranty could be “breached” in that the matter covered by it (for example, that a lease has not been complied with) may be inaccurate; but the target may still not be liable because to target’s “knowledge” the operations were in compliance with the lease.

As a practical matter, a knowledge qualifier will make proving a claim for breach of such a qualified warranty extremely difficult for the party seeking indemnification because of the vagaries and difficulties of proving knowledge, an arguably subjective standard. However, a definition such as

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4 For brevity’s sake, this chapter refers to representations and warranties simply as warranties.
5 It would be very useful for the reader to have access to examples of a few asset purchase agreements while reading through this chapter. The Securities and Exchange Commission’s EDGAR system provides access to dozens of coal industry purchase agreements, but most involve public companies on one or both sides, so many of the provisions could vary due to the public disclosure of information about the seller and the widely dispersed share holdings. Further, the American Bar Association’s ABA Model Asset Purchase Agreement with Commentary provides useful examples of provisions in an acquisition agreement.
in the footnote, due to the deemed knowledge and reasonable investigation requirements in it, greatly curtails the knowledge qualifier and move it back towards a “flat rep” several notches. This seems fair; if a target reasonably should have known, then they should not be able to rely on a knowledge qualifier unless the deal is priced as an “as is, where is” transaction (which is not generally the case).

In the mining context, a target will want knowledge qualifiers on warranties covering permit breaches, title issues, trespass, compliance with leases and compliance with coal contracts. Whether a purchaser will consent should depend upon the purchaser’s determination that the purchase price is low enough to “compensate” it for some of these issues coming to fruition, its comfort level with the target’s veracity, and its tolerance for risk. Many times a purchaser is willing to take a deal with some “hair” on it because

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The phrase “to the knowledge of” and similar phrases relating to knowledge of (i) the Sellers shall mean the actual knowledge of those persons listed on Schedule 1.2(d)(i) of the Company Disclosure Schedule and what each such individual would reasonably be expected to have known after reasonable inquiry and after specific inquiry with respect to investigation regarding the accuracy of any representation or warranty contained in this Agreement, including being aware of facts, circumstances or events that would lead a reasonable Person to conclude that any representation or warranty in this Agreement is not correct, and (ii) the Company shall mean the actual knowledge of those persons listed on Schedule 1.2(d)(ii) of the Company Disclosure Schedule and what each such individual would reasonably be expected to have known after reasonable inquiry and after specific inquiry with respect to investigation regarding the accuracy of any representation or warranty contained in this Agreement, including being aware of facts, circumstances or events that would lead a reasonable Person to conclude that any representation or warranty in this Agreement is not correct.

A person (other than an individual) will be deemed to have knowledge of a particular fact or other matter if any individual who is serving, or who has at any time served, as a director, officer, employee, shareholder, partner, executor or trustee of that Person (or in any similar capacity) has, or at any time had, knowledge of that fact or other matter (as set forth in section (d) above), and any such individual (and any individual party to this Agreement) will be deemed to have conducted a reasonably comprehensive investigation regarding the accuracy of the representations and warranties made herein by that person or individual.
it feels the price is so good that any risk will be absorbed in the windfall profits they expect to receive from striking a deal at a bargain price. Many purchasers understand that they are taking a gamble, to some extent, because they have no one to blame if certain issues arise in the absence of knowledge or fraud on the target’s behalf.


The definition of Permitted Encumbrances arises with respect to warranties covering real estate and personal property of the target. All property is subject to some level of encumbrance but a purchaser will want a warranty that the acquired real property is free and clear of all encumbrances other than specifically described encumbrances. Because the nature of mineral property in a business acquisition is such that it often constitutes a vast acreage of property comprised of hundreds of deeds and leases, and such property is not highly valuable on a per acre basis, title work on each parcel of property is not typically performed by the purchaser before closing. However, purchaser will want a representation that there are not “material” encumbrances on the property such as mortgages, *lis pendens* and other voluntary or material liens. A target, on the other hand, will want a list of permitted encumbrances that is somewhat generic with the general concept being that certain technical encumbrances are not material to the use and benefit of the coal property. There is a great deal of tension in negotiating this definition as there is a big gray area as to what encumbrances are not material and should be included in the permissible section.

Further, this definition is closely related to, and an extension of, the title warranties that a target and purchaser have priced into a transaction. Title to real property really involves two analyses. The first is what is owned of any particular acre. This requires determining what interest target acquired and what it has divested after acquiring it. This is the traditional concept of title in which a purchaser is concerned with previous outconveyances of mineral

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7 This could be as minimal as an inchoate lien for taxes not yet due or easements or rights of way along road frontage – both clearly immaterial items.
or surface interests, multiple co-tenants, previous out-leases, easements, and other sticks in the proverbial bundle of real property rights that may be held by others. The second analysis is what obligations or encumbrances bind or encumber the sticks in the bundle that target does own. These are the mortgages, mechanics liens, tax liens and *lis pendens* issues. These could be thought of as additional sticks in the bundle, but it is easier for the author to think of encumbrances not as separate sticks but as mud on the sticks that impacts their usefulness, to complete the metaphor.

With respect to certain highly improved real property parcels, such as loadouts, preparation plants, offices and mine entries, warranties and diligence may be more like a traditional real property acquisition. This is discussed further in the section discussing real property warranties, but it bears mentioning here that there should potentially be a more narrow Permitted Encumbrances definition (one more akin to that in a commercial real estate agreement) applicable to those improved sites that have a high value per acre.

[4] — **Mining Title.**

Many targets are unwilling to give a general warranty, but a purchaser will want some warranty as to the nature and quality of title possessed by the target beyond a mere special warranty. A general warranty simply means that the target is stating, with respect to any particular tract or parcel of land, that it owns such described interest (whether it be a fee interest or, *e.g.*, a 1/16th interest in the Lower Kittanning seam) with no reservations, issues or encumbrances. One relatively common compromise is to have the target represent that it has Mining Title to the mining property.\(^8\) This provides a warranty beyond a special warranty, but short of a general warranty, and gives

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\(^8\) A common definition is as follows: “Mining Title” means fee simple title to surface and/or coal or an undivided interest in fee simple title thereto or a leasehold interest in all or an undivided interest in surface and/or coal together with no less than those real property, easements, licenses, privileges, rights, and appurtenances as are necessary to mine, remove, process and transport coal in the manner presently operated and as contemplated to be operated by Buyer in a reasonably prudent manner consistent with the coal mining industry in Central Appalachia and pursuant to the Mine Plan.
a fair amount of comfort that mining should be relatively unobstructed by title or correlative rights conflicts. Keep in mind that the existence of owners of other interests in any one acre and the necessity for access to public roads (and more importantly to public roads that permit heavy coal trucks to traverse same) is just as important as the title to the particular coal land to be mined.

A mining title definition such as the one described in footnote 8 is not directly analogous to general or special warranties, as it contemplates and warrants certain necessary appurtenant rights such as access. It also clearly does not warrant the ability to mine 100% of all the coal in whatever manner the purchaser sees fit. It can be thought of as a warranty that the property will not fail in its essential purpose, which is to be a source of coal.

Finally, it should be considered that a coal company may have three vastly different types of real property: (1) improved facilities, (2) raw, undeveloped mineral resources and (3) active surface or underground mining operations. It is reasonable to consider having different levels of warranties covering each type of property being acquired, with the first receiving the most robust title and encumbrance warranties (or purchaser having the right to obtain full title insurance as a condition to closing), the second receiving very little in the way of warranty, and the third falling somewhere in the middle.


It is often claimed in business that past performance is a good predictor of future returns. The modifier “good” is highly suspect in all situations, but the entire statement is highly suspect in the context of valuing a mining company. Future returns have almost no relationship to what the mining company has done in the past. The reason for this is simple: no two acres of coal seam are alike. Therefore, even if the equipment, the management and the employees are the same, one contour area or section of an underground mine can produce a million tons of coal at a highly competitive cost per ton and the very next contour or underground section can be a total disaster due only to seam variations or geologic issues. So valuing a coal company based on prior years’ earnings is risky business indeed. The only accurate way to value the operating portion of a target as a going concern is to determine the net present value of the expected future cash flows. For coal in place that is
merely a reserve, and not under permit or part of foreseeable operations, it is reasonable to set some per ton value for the property if reasonably decent geologic data exists as to the seams and conditions. In order to determine future cash flows for an operating mine or mines about to go under permit, or about to begin operations, a pro forma profit and loss statement needs to be constructed to try to determine as closely as possible what the future cash flows will be for the following five to ten years, so a net present value calculation can be prepared.

Of course, there are many valuation methods, including liquidation value and the aforementioned multiples of previous earnings. The methodologies that contemplate liquidation or per asset value will almost never provide as high a valuation as a net present value calculation, so the previous earnings or net present value calculations are the only viable options. Of course, there are many coal operators who have an instinctive knack for valuing a business and who can gamble that their hunch is correct as long as they are gambling their own money, but whenever outside financing is required, the basis for the purchase price will need to be grounded in strong financial analysis that supports such coal baron’s hunches. Because preparing a net present value calculation model requires a mining plan, purchasers should try to obtain a warranty regarding the mining plan — and thus the mining plan must be defined.\footnote{Typical provision: “Mining Plan” means the economic model and production plan as set forth in Exhibit [____] relating to the projected 10-year performance and production of the mines and operations owned or controlled by the Company and the Company Subsidiaries which contains detailed mine plans containing good faith, reasonable and complete estimates (by principal components) of production volume and location of mine works and improvements and direct operating, capital expenditure and other costs, including reclamation costs, with respect to each mine, set forth on a quarterly basis for each mine covered in the Mining Plan.} As discussed in the section on the Mining Plan warranty, the warranty cannot reasonably be very robust, but it should exist especially if the target has marketed their assets based on future projections. Also, a Mining Plan is important because it is usually reasonable to have stronger warranties with respect to property in the mining plan and weaker warranties for properties outside of the Mining Plan.
§ 17.05.  Asset v. Stock Sales and Backdoor Liability Assumption in Asset Sales.


The differences between an asset sale and a stock sale are extremely important to consider. This chapter outlines an asset acquisition agreement, as it is generally the more complicated transaction document, but stock acquisitions are a very important component of mergers and acquisitions that also bear discussing.

In an asset sale, every asset of the target is being sold to the purchaser. Documenting and consummating legal transfer of those many assets is tedious and expensive. With respect to real property, omnibus or separate deeds of conveyance or assignments of lease (or easement) must be recorded to transfer the assets. The taxes involved in transferring a large number of deeded properties can quickly become expensive. Transfer of equipment, permits and other assets involves dozens, if not hundreds, of certificates of title, permit transfer applications, and other documentation. For many personal property assets, there is no additional paperwork except for a bill of sale that covers the items generally or with particularity, with the latter being the obvious choice for any asset of material value. For many other personal property assets, such as on-the-road trucks, a great deal of paperwork is added to the transaction because of the need to transfer ownership on the certificate of title. Sale of permits requires a mountain of paperwork and follow up with the regulatory body responsible for issuance. Finally, contracts must be specifically assigned in an asset sale, and the issue of anti-assignment restrictions becomes a major hurdle.

That being said, asset sales are generally the preferred route because of the ability to avoid unwanted liabilities. The conventional wisdom is that the additional legal tedium in an asset deal is more than offset by the ability to only take certain liabilities of the target, an option that is technically impossible in a stock acquisition. The purchaser can leave behind certain liabilities in an asset sale, whereas in a stock sale the assets remain encumbered by all known and unknown liabilities created while the target was operated by the previous owners and management simply because the purchaser is buying the entire company by buying its stock. That being said,
it bears discussing briefly whether the difference is all that great due to a few legal concepts that can be used by certain creditors to tag a purchaser with liabilities of a target.


The legal action for fraudulent conveyance, both in and out of the bankruptcy context, can unwind a transaction and leave the purchaser with nothing more than an unsecured claim to its purchase price, even though liabilities are expressly retained by the target. To avoid getting hopelessly bogged down in another article entirely, the basic rule for fraudulent conveyance is that a purchaser that gives less than “fair” consideration while a seller is “insolvent” risks having to give back the assets. Even though these criteria may not be met, if a seller rather quickly files bankruptcy or is pushed into bankruptcy, a purchaser will have to fight the fraudulent conveyance claims of a trustee or creditors at great expense even if the purchaser paid a reasonably large sum for the assets. This is why several of the provisions discussed below are so important for a purchaser to include, even if the “deal” is not to take liabilities (see the Solvency representation and the covenant to not dissolve within a period of time).


Another legal theory, that of the business continuation doctrine, can hook an unwary purchaser with liability for an asset seller’s retained liabilities regardless of the terms of the acquisition agreement. Courts, of course, hold that “[i]t is generally accepted . . . that a corporation which purchases another corporation does not assume the payment of any debts or liabilities of the corporation which it has purchased.” Unfortunately for purchasers, almost as well established are the exceptions to the general rule. A Kentucky court will hold a successor corporation liable in the following four situations:

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10 See generally Section 548 of the Bankruptcy Code, as well as the Uniform Fraudulent Transfer Act.
12 See American Ry. Express Co. v. Commonwealth, 228 S.W. 433 (Ky. 1921).
(1) where the purchaser expressly or impliedly agrees to assume such debts or other liabilities;
(2) where the transaction amounts to a consolidation or merger of the seller and purchaser;
(3) where the purchasing corporation is merely a continuation of the selling corporation; or
(4) where the transaction is entered into fraudulently in order to escape liability for such debts.\textsuperscript{13}

With respect to the second and third categories above, the following factors guide courts in their determination whether to apply the de facto merger doctrine: (1) continuity of management, personnel, location, assets, and general business operations; (2) continuity of shareholders which results from the purchasing corporations paying for the acquired assets with shares of its own stock; (3) whether the seller corporation ceases business operation and liquidates or dissolves as soon as is legally or practically possible; (4) whether the purchasing corporation assumes the obligations of the sellers which are ordinarily necessary for the continuation of the seller’s normal business; and (5) adequacy of the consideration received by the selling corporation.\textsuperscript{14}

These two hooks for the unwary purchaser (fraudulent conveyance and the business continuation doctrine) are why, even in an asset deal in which the target is retaining most liabilities related to the business, warranties about

\textsuperscript{13} Parker v. Henry Petter Supply Co., 165 S.W. 3d 474, 479 (Ky. App. 2005), citing American Ry. Express Co. See also Payne-Baber Coal Co. v. Butler, 123 S.W.2d 273(Ky. 1938).

\textsuperscript{14} Wallace v. Midwest Fin. & Mortg. Serv., Inc., 2010 WL 2835753 at *16 (E.D. Ky. 2010)(citations omitted). See also Dixstar v. Gentec Equip., 2004 WL 3362501 at *4 (W.D. Ky. 2004)(“The cases discussing this doctrine have evaluated several common elements in determining whether the “mere continuation” exception applies: (1) continuity of shareholders and ownership, management, personnel, physical location and business operations; (2) whether sufficient consideration was given, particularly whether stock was given in exchange; (3) whether the predecessor ceased business operations and was dissolved shortly after the new company was formed; (4) whether the successor company paid any outstanding debts on behalf of the previous company in order to continue the business without interruption; (5) the buyer’s intent or purpose when the new company was formed; and (6) whether the successor held itself out to the public as a continuation of the previous company.” (citations omitted).
litigation, accidents and other matters that are clearly stated to be “retained” are important from the perspective of trying to unearth liabilities that may permit recovery or at least cause litigation costs for the purchaser. If the liabilities retained are massive or if it appears the seller is deeply insolvent, these risks become material and a purchaser should consider extra protection from creditors of seller, including obtaining an independent appraisal, cutting all ties with the seller’s management and owners, and potentially purchasing the assets out of bankruptcy such that creditors’ claims are cleansed.

Further, it should be remembered that those creditors that a seller fails to pay are probably the same vendors and suppliers that a purchaser will need to use in its business operations, so there is a very practical reason to make sure a target, even in an asset deal, pays all of its debts.

Also, keep in mind that in any transaction where the target is distressed or the purchaser is getting an “unbelievable” deal, there are likely to be “scorched earth” litigators representing creditors of a seller who will assuredly go after the purchaser if they do not get paid at the closing of the transaction, regardless of the finer points of the transaction structure. There is a big difference between technically not being liable and not being sued by someone making a colorable claim that a purchaser is liable.


In a stock transaction, the only protections against liabilities that a purchaser does not want to assume arise from (1) uncovering all liabilities through diligence and disclosure, (2) obtaining or confirming the possession of insurance to compensate for losses arising out of such liabilities where possible, and (3) indemnity from the equity owners selling the target, along with comfort that the equity owners can make good on their indemnity obligation — either because they clearly have sufficient funds and a disincentive to ignore a judgment against them, or through retaining a portion of the purchase price to provide a pot of money from which to obtain indemnity payments.

We will discuss indemnity later in this chapter, but we should briefly discuss insurance and diligence matters now. With respect to diligence, it bears mentioning that diligence needs to go beyond the target, and include
lien searches and other investigation with respect to the shareholders selling their equity, as two levels of lien issues in a stock transaction exist (liens on the stock itself and liens on the assets of the company whose stock is being purchased). Not only could the company whose stock is being purchased have major liabilities, the sellers of the stock could also. After all, a stock transaction is really an asset deal where the one asset is extremely complicated to value and to perform diligence on (namely, the stock of the active company).

Making sure adequate and enforceable insurance exists to cover many of the types of liability that could come to light post-closing is yet another topic that requires its own chapter. In brief, insurance counsel must carefully review the insurance to determine whether it is claims-made or occurrence basis and what to do about change of control restrictions that are ever-present in insurance policies. The types of liabilities that could be covered by insurance range from environmental, to harassment claims, to personal injury; so experienced insurance counsel is a mandatory component of any stock transaction.


A perceived advantage to a stock acquisition that should be briefly discussed is that of the consent problem that is largely avoided in a stock transaction. Because many contracts that restrict assignment do not restrict change of control, a stock acquisition can be seen as streamlining a transaction and shortening the time from the first discussions to a closing. However, not advising key suppliers and other contract parties of a major transaction can lead to consternation that would come to light in the process of obtaining consents to assignment, so the consent solicitation process can serve the important purpose of uncovering festering issues within the relationship as well as issues that the contracting party may have with the transactions occurrence. In a stock acquisition, the purchaser will not have an opportunity for most contracting parties to chime in on the transaction, thus creating the possibility that a blindsided supplier’s pent up anger over the mining operation bites the purchaser, or that the same supplier simply does not want to deal with anyone except the target’s management.
§ 17.06. Sale and Transfer of Assets; Closing.  

After the aside into the important considerations in choosing a deal structure, we now delve back into examining a typical acquisition agreement’s structure. The “Sale and Transfer of Assets; Closing” section of the acquisition agreement sets forth what is being transferred (stock, assets, liabilities), what is not being transferred, how much is being paid for it, when and where the closing will be, and other matters related to the purchase price such as any earn out or working capital adjustment. This is essentially the part of the agreement that has to exist to consummate the transaction. The rest of the agreement consists of additional warranties and covenants not technically necessary to reach an agreement to transfer assets in exchange for cash.


When structuring the acquisition, it is customary to have two purchaser entities: one to acquire the real property assets, and one to acquire the permits and equipment and to hire the retained employees. There are liability and tax benefits to this structure. From a liability perspective, separating the reclamation liability incumbent upon the permittee from the ownership in the land protects the most valuable asset in a mining company, namely, the real property rights that entitle it to access mineral resources. While coal contracts can of course be extremely valuable depending on their term and pricing, they are short-lived assets that are always at risk of being lost due to default by the supplier, default by the purchaser or the vagaries of the market price of coal. Equipment, of course, quickly loses its value. Permits have great value while they cover unmined coal, but quickly flip from the asset column to the liability column once all of the permitted coal is extracted. Employees, as the saying goes, are the greatest resource of most companies. While this is true, they are not an asset that can be protected, and are only as valuable as their last paycheck was to them, meaning that they are an asset only as long as they choose to be. Unlike the contracts, equipment, permits and employees described above, owned real property is not subject to being lost or devalued, so keeping the real property interests in their own entity is an extremely smart and legal way to protect assets, much like commercial
products companies or franchises place their intellectual property in a separate entity for liability shield reasons (see what Coca-Cola and others do with their intellectual property).


It goes without saying that a detailed and inclusive list of the assets being purchased is very important to the purchaser. In a mineral transaction, the greatest value will often be in the real property, followed by the equipment and the permits that cover unmined coal. The permits held by the target that are of no future value are discussed in the liabilities section. While not exhaustive, the discussion below describes how some of the more important assets are generally dealt with in this section of the acquisition agreement.

The typical acquisition agreement specifically lists every permit of every nature related to the business, with the schedule usually being provided in the warranties section and that schedule being cross-referenced in the description of assets in this chapter of the acquisition agreement. Each SMCRA permit and the related water, air, 404 and other permits will need to be specifically enumerated with as much detail as reasonably possible in the schedules. Preparing such a list should involve the engineers at the target and should be carefully vetted by purchaser’s mining consultant to ensure adequacy.

As with permits, real estate should be specifically described by each deed or lease conveying the property to the target and should mention each outlease encumbering such owned property. Again, this is most efficiently done by cross-referencing the schedule provided in the warranty section of the acquisition agreement.

Equipment should be specifically listed along with a generic catch-all for all equipment related to the operations being purchased.

Insurance is usually not assignable, but the benefit of the insurance can be assigned and sold to the purchaser, so it may make sense to be specific regarding insurance policies under which benefits are being assigned.

Depending on how important inventory was toward the valuation of the target, and depending on how many active coal contracts are being assumed that will require prompt deliveries, inventory can be a very important asset to deal with in the acquisition agreement. A standard definition of inventory
will be as specific as possible as to location, will include inventory in transit, and will cover non-coal inventory (such as spare parts for equipment). Further, the acquisition agreement may call for a specific tonnage of inventory or a general statement that enough inventory will be present to fulfill outstanding orders, assuming production of new inventory continues on pace with prior production. This obligation is to ensure that a purchaser does not run out of coal in the short term and default under its newly acquired supply contracts.

Quite often, receivables are not sold in an asset deal, but a transfer is inevitable in a stock deal without assigning the receivables to a separate entity prior to closing in order to not transfer their value to the buyer. Receivables should be specifically described, and it is worth considering whether target should be required to provide an aging detail report immediately prior to closing, if accounts receivable are to be conveyed.

Cash is often excluded because it is a fungible asset; it really makes no sense to pay cash for cash, which is akin to the proverbial robbing Peter to pay Paul. That being said, the author has seen situations where a purchaser buying a turnkey operation does not want to have to fund short-term cash needs and thus requires that a seller in an asset sale leaves enough cash in the company to provide liquidity, so that there are no short-term cash crunches due to lags between payables and receivables.


While it may seem logical that all assets not specifically mentioned in the section of the acquisition agreement previously described are excluded, it is convention to include a section on excluded assets for the avoidance of doubt. Of course, this means that there must be language in either the “included assets” or “excluded assets” section stating whether miscellaneous assets not specifically described are to be assigned, or excluded and retained.

The following are some of the more material excluded assets categories:

[a] — Benefit Plans.

While the author is not an expert in benefit plans, it is safe to say that the ERISA and benefits experts he has dealt with always lobby vociferously
against assuming any plans or even assets of plans. The main reason is one of successor liability.

[b] — Certain Contracts.
Sometimes, it is just as important to leave out certain contracts that are not valuable as to purchase good contracts, but keep in mind the risk of fraudulent conveyance concerns and hindering creditors if there is intent to leave behind a horrible, executory contract in an insolvent company. The buyer should strongly consider using a large holdback to cover any liability for non-performance of that contract by the target, or obtaining an amendment or termination of the contract.

[c] — Permit Collateral.
Many times, the target will want to retain the collateral securing its reclamation obligations under its mining permits. Often this collateral takes the form of cash posted with the state or certificates of deposit securing bank issued letters of credit. In either case, this cash asset needs to be explicitly dealt with. Also, keep in mind that the collateral securing the target’s reclamation obligations under its mining permits could be in the form of related party or affiliate-owned bonds, letters of credit backed by affiliate owned collateral accounts, or cash posted directly to the permitting authorities by an affiliate of the target instead of the target itself. Therefore a purchaser always needs to fully understand what reclamation collateral is, if it is to be purchased instead of excluded, as it is often the case that the target does not hold title to the reclamation collateral, but rather an affiliate does. The target and purchaser should determine what form of collateral secures the reclamation obligations under the permits and ownership of same and explicitly cover it, whether excluded or included.

[d] — Insurance.
Insurance is rarely, if ever, assignable in an asset deal. It requires consent to a change of control, so insurance policies are always on the list of retained assets or, in a stock deal, assets to be spun out of the target.

[a] – Assumed.

The most important difference between an asset acquisition and a stock acquisition is that a purchaser of assets does not, generally, assume any liability for the actions or contracts of the seller other than liabilities inherent in the assets purchased. However, the acquisition agreement often contractually binds purchaser to assume liabilities beyond those inherent in the assets. Normally the assumed liabilities section is very short, as the essential purpose of an asset deal is to exclude the taking of most liabilities. Generally, a target will insist upon including a specific reference to reclamation liabilities and performance under contracts (both payment to suppliers and delivery of coal to purchasers) as liabilities to be assumed.

[b] — Retained.

Most liabilities not inherent in the assets purchased will be retained by the target. These include liabilities related to tort litigation, breach of contract claims, trespass claims and (usually) contractual debt obligations. Generally, acquisition agreements state that any liabilities not expressly assumed are retained, but lawyers cannot help themselves from creating a non-exclusive list of retained liabilities. It can be important to enumerate certain types of liabilities because a target covenants to pay all of its retained liabilities; breaches of covenants are often not subject to a deductible, whereas breaches of a warranty are. Thus making a claim for breach of a covenant with respect to an employee harassment claim (which would almost always fall under a category of retained liabilities), for example, is better for the purchaser than making a claim for breach of a warranty that would cover the same legal issue, because it is not subject to the deductible on indemnification in most situations.

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15 By inherently assumed liabilities, I mean performance obligations under purchased contracts, obligations to pay taxes on real property, reclamation obligations under assumed permits and other obligations that are part and parcel with the asset acquired.
[6] — Consideration

[a] — Payment Terms.

In the majority of transactions, a large part of the consideration for the assets is cash payable at closing. However, the balance of the consideration often gets paid out over time and is potentially subject to certain formulas and factors for payment.

[b] — Valuation.

As discussed in the definition of Mining Plan, the proper valuation methodology for a going concern business is the discounted cash flows method based on strong pro forma calculations that take into account (as well as possible) seam conditions, expected costs and expected revenues. Of course, a purchaser does not want to base the price fully on the value they believe they will add through better management, better methods of mining, synergies such as cost consolidation, or the combination of contiguous coal properties or other advantages, as that will eliminate their profit in acquiring the company at a lower value based upon its perceived untapped potential. Having said that, deals are priced based on a certain price per ton for in place proven and probable reserves. This method, like rough justice, may get the job done, but it is hard to justify to a third party if you need them to provide funds. The first part of a discounted cash flow analysis is determining the expected future net cash flows (cash available to distribute to the investor as a return). The second part is determining the beta (or discount rate) that the future returns should be divided by to reach the net present value of the future stream of cash. This is where the real art and science of net present value calculations come into play. While guessing as to future cash flows requires a great deal of research and compilation of costs, revenues, and production schedules, determining how likely it is that such cash flows will be reached is extremely subjective. Looking at market returns for large coal companies can help, but ultimately a purchaser must keep in mind that a riskier investment will have a lower net present value because the likelihood of those cash flows being met is slimmer. The author must stop now to avoid devolving this chapter into one on finance, but it is worth pointing out that the risk factor should take into account title and permitting risk, if the deal
is structured as an “as is, where is” transaction with respect to title to the property. This will lower the purchase price that is justified and therefore account for the fact that the assets are subject to title risk and are not worth face value.

[c] — Wire Transfers.

Of course, the purchase price will have been agreed to, hopefully, long before the drafting of the definitive agreement. What the purchaser’s counsel will be worried about in drafting the purchase price section is how the purchase price is to be paid. The purchase price is almost always wired partially to secured creditors pursuant to payoff letters such that the assets that are subject to liens are unencumbered at the closing by the act of paying off amounts due per the instructions in the payoff letters. Typically, the creditor will authorize purchaser’s counsel to release liens upon payment of the balance due per the payoff letter (taking into account any per diem). Also, in any situation where there is a sale of the entire business, a purchaser should also strongly consider requiring payment of the purchase price directly to any known, unsecured creditors. There is no good reason for a target to resist allowing the purchase price to be paid directly to the creditors whose liabilities are not being assumed by the purchaser.

[d] — Non-cash Consideration.

Partial seller financing is a fact of life in the post-2008 economy of frozen-up lenders. As a result, targets are often asked to take payment on part of the purchase price at a later time. This creates double the work for target’s counsel because now they are negotiating a sale and a loan transaction, hopefully with a collateral position in the assets. If a seller will be asked to take a large portion of the purchase price on credit, it is worth considering whether the target should lease or sublease the real property as opposed to selling it in order to keep a strong “lien” position in it. If this is not a tenable proposition for the purchaser, target will simply need to insist on mortgages on the property and liens on the assets to secure the payment obligation. Of course, the ability to repossess contracts and permits is hampered by their nature (both require consent to assign often, and may be so damaged by
purchaser that they are not worth taking back), so fully perfecting a security interest in the intangible personal property is an impossibility.

If purchaser is proffering stock for the assets, the target has an entirely different issue to consider. Target will need to assess the value of the stock and will want warranties about the stock and the business underlying the stock, and covenants to avoid dilution of the stock it is receiving. This form of consideration, like seller financing, adds an entirely new dimension to the transaction and should be thought of as a standalone transaction (investment in a company) when considering what agreements need to be set in place to reasonably consummate the sub-transaction.

[e] — Earnout.

In situations where a target is selling undeveloped property without a great deal of diligence or studies to back up its value, but is insisting on a value that assumes the expectations about profit pan out, a relatively small fixed purchase price, with a per ton royalty as a kicker makes a good deal of sense. The purchaser has an incentive to mine the coal, so the target can get comfortable that the purchaser will not intentionally deflate production, as that would harm it as much as the target, assuming the earn out is properly drafted to fill any loopholes. This way, a seller can argue against much in the way of indemnification liability related to title or coal adequacy, and will likely only get paid for what profitable coal actually exists. A target will have to be comfortable with purchaser’s mining ability and practices or else this earnout will introduce a risk of litigation over whether the property is being adequately exploited. Generally, a target will want the earnout to run with the land being sold to avoid any risk of a transaction circumventing the obligation, so deeds of overriding royalty are generally put to record.


In the sale of an entire business, the purchaser will assume short term receivables and payables. A component of the purchase price is often the working capital as of a date prior to the closing. Working capital is simply the amount by which short term assets (cash, inventory, receivables) exceed short term liabilities (payroll, payables (including short term portion of
long term debt), fees and taxes). So, an acquisition agreement may include a mechanism whereby the purchase price is trued up after closing to reflect what the actual working capital was at the closing. A great deal of negotiation will go into what balance sheet items go into the working capital calculation, how they are determined and what happens if the parties disagree over the validity of the numbers.

[g] — Inventory Purchase Price Adjustment.

A typical, although daunting, inventory purchase price calculation will require a third party appraiser. Inventory of a large target could easily run

16 Typical provision: The Coal Inventory Purchase Price Adjustment.
(a) The Apportioned Unadjusted Purchase Price shall be increased by the Estimated Coal Inventory Value. The Apportioned Unadjusted Purchase Price, as increased by the amount of the Estimated Coal Inventory Value, will be the “Cash Purchase Price.” The Cash Purchase Price plus the principal amount of the Note will be the “Purchase Price.”
(b) Intentionally omitted.
(c) Sellers and Purchasers shall jointly engage Marshall Miller & Associates (“MMA”) to calculate the amount (based on volume and density) of raw and clean tons of coal located at each inventory location on or after the fifth (5th) Business Day prior to, but not after, the Closing Date (such amount referred to as the “Pre-Closing Date Coal Inventory”). The Pre-Closing Date Coal Inventory shall be final and binding on the parties unless the parties mutually agree on an adjustment thereto due to an error in its calculation that appears on the face of such calculation. Sellers and Purchasers agree to execute, if requested by MMA, a reasonable engagement letter. Sellers, collectively, and Purchasers, collectively, shall each pay one-half (1/2) of the fees and expenses of MMA. The Pre-Closing Date Coal Inventory shall be adjusted to the Closing Date to reflect changes in such Pre-Closing Date Coal Inventory from the date of the MMA calculation through the Closing based on the operating records of Sellers. At least two (2) Business Days prior to the Closing Date, Sellers shall provide Purchasers with an estimate of the Closing Date Coal Inventory after taking into account the estimated or, if available from MMA, the actual, Pre-Closing Date Coal Inventory and setting forth the actual and estimated coal activity at the Mines during the period from the date of the MMA calculation through Closing and such estimate of the Closing Date Coal Inventory shall be the “Estimated Closing Date Coal Inventory”. The parties will close the Transactions based on such estimate. The Estimated Closing Date Coal Inventory shall thereafter be deemed to be the Closing Date Coal Inventory and the Estimated Coal Inventory Value shall thereafter be deemed to be the Coal Inventory Value and each of such determinations shall be final and binding on the parties unless, within thirty (30) days after the delivery of the final calculation of the raw and clean tons of coal from MMA, notice is given by Purchasers or Sellers of their objection, which notice shall be limited to the adjustments from the Pre-Closing Date Coal Inventory to the Estimated Closing Date Coal Inventory. If notice of objection is timely given, the parties shall consult with each other.
into the millions of dollars, so it is often a distinct component of the company’s valuation and it makes sense to have a true up calculation to ensure that the purchaser is not overpaying because of changes in the inventory stockpile between the initial determination date and closing. Of course, in transactions where the receivables are being transferred, a reduction in inventory should lead to a commensurate increase in receivables or cash, but it is often not the case that receivables or cash are transferred.

[h] — Holdback/Escrow.

In almost every transaction, a portion of the total purchase price will be held back or placed into escrow to provide for a ready and available pot of

with respect to the objection. If the parties are unable to reach agreement within fifteen (15) days after the notice of objection has been given, the dispute shall be submitted, as promptly as practicable, into binding arbitration for resolution to an independent accounting firm of nationally recognized standing mutually selected by Sellers and Purchasers (the “Inventory Accountants”), who shall act as the arbitrator. Each party agrees to execute, if requested by the Inventory Accountants, a reasonable engagement letter. If Sellers and Purchasers do not promptly agree on the selection of the Inventory Accountants, which shall occur no later than five (5) days after the end of the 15-day period referred to above, then each shall select an independent accounting firm of nationally recognized standing and such two independent accounting firms shall joint select the Inventory Accountants pursuant to this Section 2.4.4(c). The Inventory Accountants will make a determination, based solely on presentations by Sellers and Purchasers and not by independent review, as to (and only as to) each of the items in dispute, which determination will be (i) in writing, (ii) furnished to each of the parties hereto as promptly as practicable after the items in dispute have been referred to the Inventory Accountants, (iii) made in accordance with this Agreement and (iv) conclusive and binding upon each of the parties hereto. In connection with its determination of the disputed items, the Inventory Accountants will be entitled to rely on the accounting records and similar materials prepared in connection with the calculation of the Estimated Closing Date Coal Inventory and the fees and expenses of the Inventory Accountants shall be borne equally by Purchasers and Sellers. Each Purchaser and Seller will use reasonable efforts to cause the Inventory Accountants to render their decisions as soon as reasonably practicable, including by promptly complying with all reasonable requests by the Inventory Accountants for information, books, records and similar items. If the final and binding Coal Inventory Value, as determined by the Inventory Accountants, is less than the Estimated Coal Inventory Value, such deficiency shall be paid in cash by Sellers to Purchasers as a reduction of the Purchase Price. If the final and binding Coal Inventory Value, as determined by the Inventory Accountants, is more than the Estimated Coal Inventory Value, such excess shall be paid in cash by Purchasers to Sellers as additional Purchase Price. Obtained from private transaction on file with author.
cash to satisfy purchaser’s indemnity claims for a period of months or years. If the purchaser is paying part of the purchase price through a note, it will want to simply have the right to set off against the note payments. A target may want to insist on the cash going into escrow because that provides greater protection that the escrowed funds will not go back to purchaser unless a truly valid claim for indemnification has been adjudicated. Escrow agents typically charge a small percentage to administer the escrow account and will not distribute the funds absent a court order, a jointly signed authorization to release the funds, or if a firm expiration date is reached.

[i] — A Note on Complicated Consideration Provisions.

As lawyers, we thrive on complexity. If things were simple, our jobs would be less important and we would have less to do. That being said, this author generally abhors complicated purchase price calculations and deferred purchase prices. In addition to those mentioned above, there are often purchase price adjustments for tax payments arising out of the sale depending on who bears the incidence of payment and how the parties have allocated such taxes triggered by the transaction. This abhorrence is simply because working capital adjustments and inventory adjustments have often led to contentious litigation, and because the true necessity of such a calculation is suspect in the first place. Counsel needs to be ready, however, to provide functional language to cover these various types of purchase price adjustments and deferred purchase price scenarios, while at the same time reminding the client of the added risk of litigation whenever a sum certain at closing is not provided.


A sale of assets constitutes hundreds or thousands (depending on the number of assets) of individual sales for income tax purposes. As such, purchaser will have to allocate the purchase price to each asset, as will seller. Each party may have wildly different incentives. A seller will want to allocate as much as possible to assets with high basis to avoid gain; and to assets that are capital assets, to obtain a better tax rate. Purchasers will want
to allocate more to assets with quick depreciation and potentially allocate less to property with high *ad valorem* tax rates. If each party uses a different allocation, it is almost a surety that if the IRS ever reviews the transaction, it will whipsaw each party and use the other’s allocation against them. As such, the parties should always agree to use the same allocation.

In a stock transaction, a purchaser carries forward the low, depreciated basis of the company whose stock is being purchased. However, it is important to always investigate whether a 338(h)(10) election is amenable to both parties. When such an election is made, the parties can treat the stock sale as an asset sale and step up the basis in the assets, permitting purchaser to re-depreciate the assets.

In conjunction with allocation of the purchase price, it is important that the accounts factor in the goodwill value and the value of any non-competes.

**[8] — Closing and Closing Obligations.**

This section simply recites all of the documents and agreements to be exchanged between target (and sometimes its owners) and purchaser at the closing date. These items do not include items such as consents or payoffs from third parties, just the various title documents and ancillary agreements (such as bills of sale, assignments of contract, transition services, deferred purchase price notes and non-competes). There are three sections of the acquisition agreement that deal with the mass of paper to be traded to get both parties to the closing table. The first is this section which recites the documents among the parties (and transfer of purchase price). The second is the pre-closing covenants section that will detail the payoff letters to be obtained, transfer applications to be drawn up, and other documentation to be prepared for a closing (along with covenants unrelated to the closing table or closing documents). Third are the documents that serve as conditions precedent to closing that have to be provided at or prior to the closing to trigger one or the other party’s obligation to deliver the closing documents and funds. To complicate matters somewhat, one of the documents is usually a certificate of each party certifying that the pre-closing covenants and conditions precedent have been complied with and met, respectively.
§ 17.07. Representations and Warranties.


It is important to keep in mind that the representations and warranties should be tailored based upon the reasonable expectations of the purchaser in light of the valuation of the target. For example, is it reasonable for the purchaser to require an ironclad title warranty from the seller for a thousand acre mineral lease that is not currently being mined on and was valued at well under a dollar per ton for in place, mineable and merchantable tons? This author would posit that it is not reasonable. On the other side, is it reasonable for a purchaser to require a very strong title warranty regarding leasehold interests in the surface and mineral leases for an active mine site that was valued based on the net present value of the future cash flows based on a well developed mine plan for that site? I would posit that such a warranty is reasonable because the purchaser is paying an amount for that mine that does not contemplate a loss in surface or mineral acreage. The point here is that each warranty that is negotiated should provide recourse in situations where the purchaser’s reasonable expectations would not be met. Many times, a purchaser will simply throw extremely strong warranties at a target on their first draft. This is common, if not always advisable. It is on the second and subsequent drafts, if the target has not been scared off, that counsel needs to understand what the client’s reasonable expectations are and tailor the warranties to provide recourse if those expectations are not met.

Assuming a purchaser is being reasonable, anything and everything that could impact the value of the assets is fair game for a warranty. Whether it is a “flat” warranty or qualified by knowledge or materiality is the real question.


The definition of knowledge and the severe impact it has on the ability of a purchaser to prove breach of such a warranty was discussed above. However, severe the impact, there are simply some warranties that almost always have a knowledge qualifier, such as warranties covering pre-existing environmental conditions and warranties covering breach of contract claims available to third parties. Another common qualifier is materiality. The target’s reasoning for such a qualifier to a warranty is that neither party should be tied up with
nickel and dime breaches and with respect to a warranty (e.g., that there are no breaches under target’s contracts); it is practically impossible that there do not exist immaterial breaches. Many targets are simply averse to making a warranty they know is not entirely true, so they want the comfort of having that materiality qualifier. Further, a scorched earth litigator could always make a claim for fraud where a non-materiality-qualified warranty is made if it is clearly false (such as a case where a warranty is made that there are no defaults under contracts instead of no material defaults). However, the most direct way to protect a target from the risk of dealing with or paying for legal fees arising out of the many immaterial issues that may exist with contracts, permits and real property title is to have a deductible apply to a target’s indemnification obligations to prevent some of the penny-ante claims. Of course, if enough “immaterial” claims exist that they aggregate to something material, recourse should be available to the purchaser, which may not be the case if materiality qualifiers are in the warranties, along with a deductible in the indemnity provisions. As such, a materiality qualifier is not generally the best solution even though it is one that, through inertia, is included in at least a few warranties in most acquisition agreements. Further, the existence of a materiality qualifier complicates the purchaser’s closing condition related to material or total accuracy of target’s warranties. For these reasons it is fair for a purchaser to resist materiality qualifications in the warranties, because target’s concerns are more delicately handled by a deductible — and potentially a mini-deductible on a per claim basis, as discussed further below.


[a] — Introduction.

Many of the warranties given by a seller are standard regardless of the type of business conducted. Warranties that the company is not enjoined from consummating the transaction, warranties that it has taken all steps necessary to properly consummate the transaction per its governing documents and warranties regarding the absence or presence of litigation all apply just as much in any transaction and are thus not discussed here. The following
discusses some of the warranties that require special consideration or different language because of certain specifics of the coal industry.

**[b] — Financial Statements.**

The warranty regarding accuracy of financial statements may want to expressly include a warranty that the reclamation liabilities are adequately represented. Further, a separate warranty may be reasonable requiring the target to opine that the reclamation costs and liabilities are accurate estimations.

**[c] — Inventory.**

The purchaser may want a specific warranty stating that the coal inventory has quality characteristics compliant to the delivery obligations it has under the contracts being assumed, so that purchaser will not have a rejected or price-adjusted delivery because of target’s inventory.

**[d] — Accounts Receivable.**

Coal contracts are generally extremely complicated. There are price adjustments for out-of-specification quality characteristics, price adjustments for delays in delivery, rights to reject, rights to reject based on a certain number of previous violations, and many other provisions that can impact what a customer is obligated to pay. As such, the accounts receivable warranty is important and there may be a lot of negotiation as to whether the exact amount is warranted. Further, because certain contracts contain a punitive provision that a certain number of “strikes” can lead to future penalties, a purchaser should include warranties specifically tailored to cover situations where the contract is teetering on the brink of major issues. Counsel will need to carefully review material coal contracts and also strongly argue for obtaining estoppel letters from material customers in conjunction with consents or otherwise.

**[4] — Permits.**

The warranties regarding permits should probably be fairly extensive. A purchaser will not only want to know what permits exist, but will also
want warranties regarding the status of permits and related violations. While much of this information is publicly available, a purchaser may want to require target to warrant the information. Certainly a warranty that sufficient permitted tonnage capacity exists to comply with the Mine Plan — or at least for deliveries under coal supply contracts in the near term — is a reasonable warranty, even if it may need a schedule to list exceptions to the warranty. Also, warranties regarding the type of reclamation collateral are essential so the purchaser knows what needs to be replaced. Finally, a permit warranty should include language covering necessary renewals, and the absence of any conditions that would lead to a permit violation if uncovered.

[f] — Real Property.

Most acquisitions of coal mining companies are based predominantly on the value of the real property rights held by the target. Unsevered coal is a real property asset and the ownership of the right to extract that coal is a crucial matter to be warranted by the target.

Of course, there are a plethora of matters related to ownership of the coal for which purchaser will reasonably want warranty coverage from the target. From the purchaser’s perspective, the extent of warranties should be extensive if the mineral valuation on which the purchaser has based its purchase price places a significant value on the coal ownership. Effectively advocating a purchaser’s position with respect to real property warranties requires that counsel understand the purchaser’s expectations, valuation and plans. On the other side of the transaction, a target’s counsel can do more harm than good by pushing too hard against providing warranties that target would be comfortable providing, because such a hard line stance will cause the purchaser to perform more diligence and potentially second guess the transaction due to fear of the unknown. The way a target gains comfort with respect to its level of warranties on mineral title is both through the obvious route of knowing what it knows and does not know about its ownership rights, but also by negotiating appropriate terms with respect to indemnification for title issues.

Before delving too deeply into specific title warranties, it is important to point out that the sort of warranties given in a business acquisition that
involves commercial or industrial real estate are vastly different. The issues to be addressed with respect to coal title bear almost no resemblance to those that come up when commercial real estate is being transferred. In Kentucky, large portions of West Virginia, and other parts of the Central Appalachian coal region, title insurance for mineral interests is typically unobtainable or at least not obtainable within a reasonable time frame. As a result, the parties cannot place the risk of a title issue on an insurer, so one party or the other will necessarily bear the cost of a title issue.

When one discusses necessary real property rights for mining, a lot depends on the mining to be performed. Without getting into the finer points of the matter, coal that is to be surface mined requires real property rights from mineral and surface owners, which may be held by two or more entities. If coal that is being purchased is to be underground mined, very little in the way of surface rights is needed beyond the mine mouth area, so an ownership interest (by lease or deed) to the applicable mineral seams is all that is needed. There will be, however, surface rights that are needed even where an underground mine is miles from its portal, so consultation with the mining engineers of target and purchaser will be necessary to ascertain any material surface rights needed for underground mining.

With respect to the right to mine, a target can control such rights by ownership of the property or by way of a leasehold interest. Generally speaking, if the real property rights are owned, the issues to consider are (1) the state of title granted to the target and (2) what encumbrances or outconveyances the target or predecessors have caused with respect to the property. Concerning the first item, it is not uncommon to find that there are other entities that own the mineral seams, that cotenants may own an undivided interest in the same seam target owns, that other parties own other seams above or below the seams that target owns, or that there are oil and gas rights held by others — all items that could impact the utilization of the coal ownership. Concerning the second type of title issue (encumbrances and outconveyances), the target could have caused a myriad of events to occur that encumber the right to mine the mineral. These encumbrances range from leases to third parties for mining, which effectively transfer the rights to mine the coal until exhaustion, in some cases; to liens held by contractors,
taxing authorities, and lenders, all of which would survive a transfer of the property (assuming property perfected), and could force a sale of the asset by the purchaser, with only the surplus value of the property accruing to the benefit of the purchaser.

Again, it is important to remember that the state of title in most industries is quite well buttoned up, and a third party, the title insurer, takes the risk that some non-recorded issue arises. In the coal industry there is no such luxury, and many times the property is so vast, and worth so little per acre, that title searches and title opinions are not even available for all property to protect and provide information to the purchaser.

Another way in which the mining title paradigm is drastically different than commercial real estate is with respect to boundaries and surveys. The exact boundaries of a severed mineral interest are not surveyed as a closing condition to an acquisition, as would be the case with an ALTA survey on a commercial tract. Very infrequently, surface properties may be surveyed to determine boundaries, easements and encroachments, but not very often. One reason for this is the generally rural nature of surface coal properties. Another is that coal properties, unlike commercial properties, have not been subdivided and platted of record, so the only legal description is often over one hundred years old and not capable of being accurately surveyed without extremely costly and painstaking survey work. Even then there is no guaranty a surveyor can locate all landmarks in a one hundred year old legal description that has been incorporated by reference into subsequent deeds.

As a result of the uncertain nature of boundaries with respect to surface and mineral interests, boundary disputes often arise in surface mining and are not unheard of with respect to deep mining. With respect to a reasonable warranty regarding location of mineral and surface interests, it seems reasonable to a target to at least represent that an exhibit map accurately depicts the general location and approximate boundaries of the properties being conveyed.

Reserve studies, which generally form the basis of a large bulk of the deal’s valuation, assume that there are no title defects that reduce the amount of coal mined. As such, if a deal is priced based on full recovery of
mineable and merchantable coal stated in a reserve report, it seems only fair that the target be liable for title issues that would make the reserve report assumptions false. That being said, many times a target will have more leverage in negotiations on title issues. One of the reasons for this is that mineral acquisitions by mining concerns during their life cycle are often completed without fully developed title searches, opinions, or insurance, and without strong grantor warranties and as a result a target will be unwilling to make warranties that it has not received from its source of title. That being the case, it is important to keep in mind that a deal without strong title warranties and strong indemnification for breach of those warranties will need to be priced to take into account the risk of title issues and the cost to resolve those issues.

In many geographic areas of significant mining activity, the corollary rights of the oil and gas estate’s owners can have a material impact on mining, especially surface mining. Where wells or transmission lines may be located in hollow fill locations, for example, the existence of such equipment and the cost for relocating same can impose a material cost and impact on mining plans. As such, it is reasonable to require a representation as to locations of oil and gas operations and potentially a representation as to what rights exist.

The level of warranty protection, and potentially title insurance and survey closing conditions, could reasonably differ for different types of real property conveyed by the target. A large preparation plant and loadout facility, especially if it is coupled with a mine portal, could reasonably be the subject of very strong title warranties and potentially a requirement that target obtain title insurance with the survey exception removed, regardless of the fact that this would buck the normal trend in coal transactions. On the flip side, some property owned by a target could really be akin to an appendix — totally useless, but along for the ride. It makes sense to consider a more complicated and nuanced approach to title warranties and closing conditions in coal industry transactions than is often the case.

Specific warranties will need to be included regarding compliance with the terms of in-leases (where target is lessee) and out-leases (where target is lessor or sublessor). Even though these leases would be covered by the
contract’s warranties elsewhere in an acquisition agreement, more nuanced and specific warranties are advisable for this special subset of contracts.\textsuperscript{17}

\begin{footnotesize}
\begin{enumerate}
\item The following are representative warranties: (a) The Company and the Company Subsidiary each have good and indefeasible title to or valid leasehold interests in their respective personal properties and assets (other than the Real Property and the Leased Real Property), and no such personal property, asset or leasehold interest is subject to any Lien, other than Permitted Liens. The Company and the Company Subsidiary, as applicable, have good, marketable title to all Real Property and Leased Real Property, and no such property is subject to any Lien, other than Permitted Liens. Except as set forth on Schedule 4.14(a) to the Company Disclosure Schedule, there are no outstanding options or rights to purchase any Real Property or Leased Real Property owned by the Company or the Company Subsidiary, or any interest therein. Neither the Company nor the Company Subsidiary has any contractual obligation to purchase any real property. There is no pending, or to the Knowledge of the Company, the Sellers and the Company Subsidiary, threatened dispute relating to boundary lines, ingress and egress, adverse possession, trespass, lack of mining rights or mining related rights, breach of the terms of the applicable agreements, or similar issues with respect to the Real Property or Leased Real Property. There are no pending condemnation, eminent domain or similar proceedings, or, to the Knowledge of the Company, the Sellers or the Company Subsidiary, any threatened condemnation, eminent domain or similar proceedings that affect any Real Property or the Leased Real Property.

(b) Schedule 4.14(b) of the Company Disclosure Schedule sets forth a true, correct, and complete list, as of the date of this Agreement, of, and specifies, as applicable (i) all real property owned, in whole or in part, by the Company or the Company Subsidiary (“Real Property”); (ii) all real property leased, subleased, or controlled by easement, license or other agreement in whole or in part, by the Company or the Company Subsidiary (“Leased Real Property”); (iii) all leases, licenses and other agreements wherein the Company or the Company Subsidiary is a lessor, sublessor, licensor or otherwise a grantor of real property rights (collectively, “Outleases”); (iv) a description for each parcel as to whether the Company controls surface, mineral, partial mineral or fee; (v) all Leased Real Property with respect to which all co-tenants are not subject to a lease with the Company or the Company Subsidiary; and (vi) all royalties payable with respect to the Real Property and such schedule also describes all escrow arrangements currently in place with respect to co-tenants of Leased Real Property. The Company has made available to the Purchaser true, correct and complete copies of all documents (including deeds, leases and amendments thereto) conveying Real Property and Leased Real Property to or by the Company and the Company Subsidiary. Each deed, lease or other title document listed on Schedule 4.14(b) of the Company Disclosure Schedule (other than Outleases) has been validly recorded (or a valid memorandum thereof has been properly recorded in the case of Real Property Leases) in the records of Somerset County, Pennsylvania. Schedule 4.14(b) of the Company Disclosure Schedule includes the expiration date of each of the Real Property Leases.
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\end{footnotesize}
(c) To the Knowledge of the Company, the Sellers and the Company Subsidiary, there exists no material default under any Real Property Lease or Outlease.

(d) The maps and schedules attached hereto as Schedule 4.14(d) of the Company Disclosure Schedule depict the location, boundaries and interest (whether surface or mineral, including a notation if control of mineral is limited by seam) of the Real Property, Leased Real Property and Outleases. Except as set forth on Schedule 4.14(d) of the Company Disclosure Schedule, there are no improvements on the Real Property or Leased Real Property.

(e) Except as set forth on Schedule 4.14(e) of the Company Disclosure Schedule, the lessors and sublessors, as applicable, under each Real Property Lease granting Leased Real Property interests to the Company or the Company Subsidiary have good and marketable title to such property.

(f) Schedule 4.14(f) of the Company Disclosure Schedule sets forth a true, correct and complete list of all consents required pursuant to the terms of the Real Property Leases or Outleases in order to effect the transactions contemplated by the Agreement without triggering a default, event of default, termination right or penalty under such agreements.

(g) Schedule 4.14(g) of the Company Disclosure Schedule sets forth a true, correct and complete list of all Real Property Leases which expire in the next five (5) years, without provision for further renewal or extension.

(h) Except as set forth on Schedule 4.14(h) of the Company Disclosure Schedule, the Company, the Company Subsidiary and their lessees have not mined any coal to which they had no legal right.

(i) With respect to all Leased Real Property surface rights, the Company and the Company Subsidiary have the right, notwithstanding the termination of any lease, to enter upon the Leased Real Property covered by such lease for the purpose of complying with all reclamation obligations of the Company, the Company Subsidiary, or their lessees arising under or pursuant to any law.

(j) Schedule 4.14(j) of the Company Disclosure Schedule sets forth a true and complete list of all royalty payments made by the Company or the Company Subsidiary that have not been cashed or have been returned or rejected by the lessor, other than payments made within the last thirty (30) days.

(k) Except as set forth on Schedule 4.14(k) of the Company Disclosure Schedule, the Company has received no notice of claims by or disputes between Company and any Persons (including any Persons owning or occupying lands or realty adjoining or near any of the Real Property or Leased Real Property) pending or threatened in writing regarding mining activities, title, location of boundary lines, encroachments, mineral rights, royalties, subsidence, water quantity or quality, blasting damage, transportation of coal or other materials, nuisances or any other similar matter.

(l) To the Company’s Knowledge, use of the Real Property for the various purposes for which it is presently being used by the Company and the Company Subsidiary is permitted under all applicable zoning legal requirements. The Real Property and Leased Real Property, taken as a whole, abuts on and has direct vehicular access to public roads or has access to public roads via permanent, irrevocable, appurtenant easements benefiting it and comprising a part of the Real Property or Leased Real Property.
Further, because coal properties are often saddled with overriding royalties, lease agent royalties and other interests in the coal, a warranty specifically requiring disclosure of all royalties payable is advisable.

[g] — Reserves.
This author has never seen a warranty guaranteeing that the amount of proven and probable reserves claimed in target’s marketing materials actually are there and are mineable. No one can truly warrant that because it is based on extrapolation, and whether the number ever pans out also has a lot to do with how mining is conducted. Finally, the accuracy of the number will not be known for years if not decades with respect to multiple, large reserves. That being said, it may make some sense to have a target warrant that the methods, data and processes used to calculate the reserve data complied with reasonable industry practice. Ultimately, a purchaser needs to get comfortable with the reserve numbers and class of reserve (whether it is mineable or not, and how verified the reserve is based on the proximity and number of bore hole samples) — not through warranties but through use of its own experts internally and with independent contractors hired from one of the many fine mining engineering companies that offer such services to perform adequate due diligence.

[h] — Mining Plan.
As discussed above, many targets market and sell their assets based partially on a mining plan showing future production and profit expectations. This usually complex mining plan amounts to a great deal of assumptions put together, often taking the rosiest of all possible outcomes. Any sort of strong warranty for the Mining Plan is unlikely, but some warranty at least representing that the Mining Plan was compiled in good faith, using reasonable estimations and methodology, seems reasonable in any transaction where the mining plan was a major component of the marketing materials.

[i] — Affiliate Agreements.

A recurring theme with some coal companies is that affiliates of the ownership or management may provide services on contracts that may or may not be on arm’s length terms. It is not uncommon to have a warranty specifically calling for disclosure of agreements among affiliates to help the purchaser hone in on where they need to apply “enhanced interrogation” tactics in their diligence efforts.

[j] — Solvency.

A warranty of somewhat questionable value, but which should be easy for a target to give, is that the target is not insolvent and will not be made insolvent after completion of the transaction. This could provide some benefit to a purchaser if target’s creditors come after the purchaser using a fraudulent conveyance theory.


The warranties that a Buyer makes in a normal cash-for-assets deal should be fairly limited. The target’s only real concern is avoiding an unwinding of the transaction, so warranties regarding the authority and approval process for the transaction are common. Any form purchase agreement will provide the standard warranties for a purchaser in this sort of simple transaction. However, the one mining-specific warranty to always include is that the purchaser is not permit-blocked on the Applicant Violators System such that they will be unable to take transfer of the permits. As discussed elsewhere in this chapter, permits are not transferred upon closing, but instead take months to fully transfer. A target runs risk during this pre-transfer time if the purchaser, as is usually the case, is permitted to operate on the permits. If

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18 Typical provision: Permit Blocking. Neither Buyer, any Person “owned or controlled” by Buyer or any Person which “owns or controls” Buyer has been notified by the OSM or the agency of any state administering SMCRA or any comparable state Law, that it is: (i) ineligible to receive additional surface mining permits; or (ii) under investigation to determine whether their eligibility to receive such permits should be revoked, i.e., “permit blocked.” As used in this Agreement, the terms “owns or controls” or “owned or controlled” shall be defined as set forth in 30 C.F.R. §773.5. Obtained from private transaction on file with author.
§ 17.08  Covenants.


In conjunction with selling an entire business’ worth of assets or the stock of an active business, there are a great many “i”s to be dotted and “t”s to be crossed prior to closing, as well as some obligations that purchaser will want target to have after closing to help ensure the benefit of the bargain. As a result, an acquisition agreement contains several pre-closing and post-closing covenants that bind both the target and the purchaser to take certain actions. In the mining context, several of these covenants are very important and are different from other industries.

Probably the most important reason why acquisition agreements are set up such that there is a signing with a delayed closing is that many third party consents generally are required, and the target does not want to solicit those consents until its management feels fairly confident that a transaction will be consummated — with that level of comfort resulting from signing of a purchase agreement with few conditions precedent to purchaser’s obligation to close.

Also, a target will want to have a deal “locked up” via a signed acquisition agreement that includes a no shop covenant by the target, if it needs to raise debt or equity to finance the acquisition. As a matter of marketing, it is much easier to raise capital for an acquisition if the target is bound to close, subject to a few conditions precedent.

Generally, the pre-closing covenants fall into two categories: (1) preserving the assets and the “business” and (2) taking acts necessary to fulfill the conditions precedent to a closing.

the purchaser is prevented from taking the permits, the permits could stay in seller’s hands indefinitely and create a major risk of liability to seller and its affiliates and officers should purchaser commit multiple, serious violations with respect to the permits.

When purchaser is offering non-cash consideration, or even deferred cash, additional warranties are customary. Simply put, if a non-public purchaser is offering stock, target’s counsel will want warranties and covenants similar to those typically found in a private equity purchase agreement.
With respect to post-closing covenants, the main objective is to bind each party to take actions necessary to ensure the deal is carried out and is treated as the parties intended, based upon the terms of the acquisition agreement.


[a] — Access and Investigation.

A purchaser always insists on the right to kick the tires throughout the post-signing, pre-closing period, so a covenant is included obligating the target to allow the necessary access to properties, certain employees, and records. A purchaser should have every right to learn as much as possible about the target, while maintaining as much secrecy as may be necessary to not cause adverse consequences for the target or purchaser due to the transaction becoming discovered.

[b] — Operation of Business.

A target will be obligated to run “business as usual” and not materially alter the acquired business without consent from the purchaser. Specific mention should be considered regarding entrance into any long term coal supply agreements or re-pricing negotiations with respect to existing contracts. Also, any permit amendments should be made with the involvement and consent of purchaser.

[c] — Delivery of Interim Financials.

This is a covenant to provide periodic financial statements to the purchaser on a timely basis. When purchasing an active operation and where there is a significant lag between signing and closing due to Hart-Scott-Rodino approval, obtaining consents, obtaining financing, or other reasons, it can be very illuminating to track financial statements to see trends in revenue and expenses. Financial performance could suffer enough to provide for a material adverse change closing condition to become applicable, and permit the purchaser to walk under the terms of the agreement, or re-negotiate the purchase price.
[d] — Approvals and Consents.

Probably the most important pre-closing covenant in a mining deal, along with the exclusivity language, is the covenant requiring target, and purchaser to some extent, to use a certain level of effort to obtain the many consents that are probably needed to properly assign leases and contracts.

Obtaining third party consents is one of the most critical and sensitive portions of a transaction. After the painstaking process of determining what contracts, permits, leases or other agreements require consent to assign (which determination will require careful analysis of the applicable state law, and federal law in the case of Bureau of Land Management leases), a strategy has to be laid out with respect to obtaining each consent. Some consenting parties, such as large land holding companies, will require a much more hands-on and negotiated approach to obtaining consent, whereas so-called “Mom and Pop” landlords will generally require a much different approach.

Further, a target has to determine whether or not they desire to obtain a release as part of the assignment (sometimes referred to as a novation). In many states, an assignor is not relieved of liability under a contract simply by assigning the obligations and benefits thereunder. Most courts hold that “the assignor of a contract remains liable for performance of the obligations which he assumed therein, even after it is assigned.”\(^\text{19}\) An agreement between the parties that a contract may be assigned, moreover, will not of itself release a party assigning it, unless it expressly states so, or it can be inferred from the circumstances surrounding the agreement that such a release was intended, and extrinsic evidence is permitted.\(^\text{20}\) This release will make obtaining a consent more difficult, so the parties should agree upon the form of consent


prior to signing an agreement, as the form will dictate whether a release of liability on the part of the assignor is part of the consent.

[e] — No Shop.

One of the most heavily negotiated pre-closing covenants is the exclusivity or “no shop” covenant that a target is generally required to provide. In essence, a target agrees to not talk to any other potential purchasers about buying what purchaser intends to buy. When the transaction is a stock sale, obviously the shareholders are required to be bound to this covenant, except in the context of a publicly traded target in a share exchange or merger. When the target is a public company, a huge layer of additional negotiation and hair pulling is required in negotiating this covenant, due to the wealth of Delaware case law stating that a board of directors must be very careful not to violate their fiduciary duty when agreeing to a covenant to not accept or entertain higher and better offers.21 This is a topic for an entire chapter, and many have been written, so for purposes of this chapter it is sufficient to say that the exclusivity provision often contains a fiduciary out and very little in break up fees.

In a seller’s market, a seller will want to curtail the exclusivity provision by allowing for a break-up fee that they can simply pay and walk away from the transaction, and will want a large, potentially non-refundable deposit, in exchange for the value of the time purchaser is locking up.

[f] — Payment of Liabilities.

At the closing, the purchaser will want all but current (non-delinquent) accounts payable to be paid off by direct transfer of the applicable portion of the purchase price to all such creditors. Clearly, this is vital with respect to secured creditors where the purchasers is not assuming such secured debt, but it is also important with respect to unsecured creditors. Unsecured creditors, while not possessing a lien on the assets, may be able to recover amounts due from the purchaser under the previously described theories of

fraudulent conveyance or the business continuation doctrine. Further, for those unlucky enough to have to deal with the Bulk Sales Act, Article 6 of the Uniform Commercial Code (UCC) requires notice to creditors of a seller in a transaction wherein the company is essentially sold in whole. While the statute of limitations for bringing a claim is short, the creditors can go after the buyer for such liabilities if the proceeds are not used to pay the creditors as per the terms of the Bulk Sales Act. Where purchaser is not assuming accounts payable, it will want all creditors to be paid off at closing. Where there are situations in which there may be a dispute about the amount owed by target to a creditor, the parties may consider putting the disputed amount in an escrow account for the benefit of the creditor or target — whoever prevails on the merits — in exchange for a release for the benefit of the purchaser.

Generally, the mechanism for this covenant is for target to provide payoff letters from all secured creditors, and potentially some unsecured creditors, and to provide a list of payables certified by an officer. The closing funds flow memorandum will then direct payments directly to such persons for the account of target. The secured creditor payoff letters should grant the purchaser the right to release UCC filings, and the necessary mortgage releases will need to be prepared and ready to be filed immediately prior to the transfer documents (be they deeds or assignments of lease).

[g] — Estoppels, Ratifications, and Amendments.

There may be certain key contracts that do not require consent to assign, but for which purchaser will want some comfort with respect to the absence of defaults in the form of affirmation from the counterparty. Such estoppels and ratifications should be requested sparingly because of the added time, expense and issues that can be caused by bringing a third party into play without an absolute need to do so. Also, certain contracts may need to be amended prior to purchaser taking assignment because of some unfavorable term in them.

[h] — Recordation.

Many times, an operating coal company will acquire leases without putting their interest to record immediately, or ever. While this opens the
door for a subsequent lessee to trump the title of the target in states that are race-notice with respect to superiority of title, it is still a common occurrence for leases to be recorded years after execution, if at all. Often a purchaser will want as many of these unrecorded leases as possible to be put to record. Sometimes, this will require a new lease memorandum if the original lease is not fit for recording due to lack of acknowledgements or some other failure to include the necessary items for valid recordation. This can be a time- and labor-intensive project, and as much as lawyers dislike the uncertainty of not buttoning up title as much as possible, often these recording issues are swept aside in the interest of time.

[i] — Evidence of Title.

In a normal commercial transaction, a target would often be required to provide a title insurance commitment with only immaterial exceptions noted, and an ALTA survey for the real property, such that purchaser is essentially taking no risk with respect to the value and ownership of the real property. In a mineral transaction, this is almost never a covenant or a condition precedent. There is some logic in having such a requirement with respect to highly improved properties (such as preparation plants and loadouts), but this author has not seen that as a common covenant.

[j] — Employees.

The pre-closing covenant dealing with employees is pretty much the same as those covenants in a purchase agreement related to any labor-intensive company. Obligations to allow interviews, transition employee information, make employees available for hiring, and deal with collective bargaining are all potentially key issues to deal with. When and how employees are informed of the transaction is also a very important covenant to set forth.

[k] — Tax Compliance Certificates.

In jurisdictions where it is available, it is worth considering a requirement that a target provide tax compliance certificates as a protection against certain state tax liens.
[I] — Closing Deliverables.

While not generally reiterated in this section of the acquisition agreement, the closing deliverables such as deeds, resolutions, certificates, bills of sale, assignments and other closing documents are the subject of a closing covenant to deliver such documents in a form agreed to either by attaching an exhibit at signing or as mutually agreed to prior to signing.

[m] — Utilities.

Utilities contracts are generally not assignable. In the coal industry, electric utility arrangements are very important because of the large usage at underground mines and preparation plant facilities. The parties should carefully consider whether there are any agreements that can be assigned to avoid re-pricing by the utility. These contracts can get overlooked because business persons often do not think of them as contracts, like they would think of a coal supply agreement or a contract mining agreement, but they can be vitally important.


[a] — Payment of Retained Liabilities; No Distribution.

This covenant acts as the suspenders to the belt that is the retained liabilities section of the acquisition agreement, with both serving the purpose of protecting purchaser against liabilities of the target that it does not expressly assume. If a retained liability creditor pursues purchaser, the purchaser can efficiently point to a direct covenant (as opposed to the statement of retained liabilities) that target will pay such retained liabilities within a certain period of time when making an indemnity claim. Hopefully (if you are purchaser’s counsel) such indemnity claim can be made against a deferred purchase price holdback or an escrow fund. After all, without a protected pot of funds for recourse, if creditors are desperate enough to pursue a purchaser, the target probably is insolvent and the purchaser will recover nothing on a judgment against seller because the vultures are already circling what is left of the rotting carcass of the seller. In addition to the covenant to pay all liabilities, the covenant typically should include a related restriction on distributing
assets (including cash) to the shareholders for a period of time to make sure the seller is solvent if unknown claims crop up.

[b] — Noncompetition, Nonsolicitation and Nondisparagement.

Many times, restricting the activities of the target’s owners or key employees is nearly as important as acquiring the assets of the target. Certain beneficiaries of the acquisition (namely the parent company, or shareholders if the target is closely held) may have a great deal of untapped value through their experience, contacts and knowledge of the industry which they used and acquired in building up the target. Some of these individuals and entities may not want or be offered employment by the purchaser, so the purchaser will want to ensure that they do not interfere or cause diminution in the value of the acquired assets.

In mining, sometimes that property that is just beyond what you own is as important as the property you own, and a purchaser will want to ensure that any beneficiaries of the purchase price from the purchase of target will be bound to aid purchaser in picking up additional property, or at least not obstruct or interfere with such acquisitions. As such, a noncompetition covenant usually is included which requires that the target owners or other key individuals or entities agree to not compete for land — but also, in some instances, for purchasers, suppliers and contractors. With respect to key employees of the target, the purchaser will often have a closing condition stating that they obtain employment agreements with such employees that will contain this same covenant. But with respect to owners who are planning to ride off into the sunset or, for personal or personality reasons, will not agree to employment, a purchaser needs to ensure inaction since it cannot obtain action.

Defining the scope of the noncompetition with respect to real property acquisitions is straightforward (you simply create a map with clearly labeled boundaries), but agreeing to the boundaries can often be bitter and bloody. At a minimum, it seems reasonable that a purchaser should have protection for the entire area to which current mines could reasonably expand, and within areas that the target had reserves but which reserves have holes.
where additional property must be acquired to construct a reasonably sized mineable block of coal.

Defining the scope of the noncompetition/nonsolicitation clause with respect to suppliers, contractors and purchasers is a much more difficult task if the parties to be bound desire to have any dealings in the coal industry during the term of the non-compete. While suppliers and contractors are often tied to a certain geographic location, purchasers of coal are not. A great deal of time and energy could be expended in negotiating a non-compete related to competition with coal purchasers, and getting such a covenant may be a bridge too far in some cases. That being said, it is a material issue that counsel should always discuss with their client.

The second of the triad of “N”s that make up this covenant, the nonsolicitation clause, simply bolsters the non-competition clause by restricting certain parties from poaching the employees who are being hired or brought on board by purchaser as part of the transaction.

Finally, the nondisparagement covenant simply restricts the same set of entities and individuals from harming the reputation of the acquired target or the purchaser.

It is important to remember that restraints on competition are very narrowly construed and vary from state to state and circumstance to circumstance. As with other areas touched upon in this chapter, there are many useful treatises that go into excruciating detail on the legal bounds of these covenants. The most important advice for counsel preparing this provision is to consult with experts, make oneself an expert, and always including a savings clause in case any portion of the covenant is found unenforceable.

[c] — Mining Permit Matters.

One of the most important assets to a mining company is the Surface Mining Control and Reclamation Act-mandated surface disturbance permit. For the initiated, it goes without saying that without that permit and the myriad water, air, corps of engineers 404 stream disturbance (e.g. Hollowfill) and other related permits that may be required to obtain a SMCRA permit — the alphabet soup needed for any particular mining operation varies
depending on the mining, operations and disturbances contemplated — the act of mining, even underground mining, will lead to severe penalties for the purchaser. As such, no mining acquisition that involves active operations would be complete without covering transfer of the permits. And, as is often the case, one of the most important assets cannot simply be transferred by a bill of sale or an assignment, but instead requires a long process of transfer approval in an asset context (and also in a stock context, although less so).

In the context of a stock transaction the permits are obviously not transferred — only the ownership of the permittee changes — but the change of control requires filings with the various permitting authorities. However, in the more common asset transaction, a rather lengthy application and transfer process must be carried out to finally transfer the permits, and the process is never completed prior to the consummation of the transaction and the transfer of the purchase price. However, because of the nature of the asset, both sides are incentivized to complete the transfer in the normal situation so the delayed nature of the transfer is less troubling than might be thought.

In a typical asset transaction, the purchaser will be required within a few days of the closing to file the necessary transfer applications for all permits. The permits that “underlie” issuance of the SMCRA permit, such as water, air and 404 permits, are generally more straightforward to obtain transfer on the records of the permitting authority, but the mining permit can take months to obtain full transfer due to the review that takes place in the applicable office of surface mining or permitting. At closing an assignment of permits will be executed by seller and purchaser, but the assignment is only effective as between the parties. Because the purchaser does not purchase the collateral securing the various types of reclamation “bonds” that are required for issuance of an SMCRA permit, the seller is usually incentivized to help complete the transfer expeditiously. Also, because the purchaser is in the somewhat tenuous position of operating on a permit that, in the eyes of the issuer, is still held by the seller, it is incentivized to finish the transfer quickly or risk seller pulling its “designated operator” status and thus preventing purchaser from operating on the permit.

Also, as discomforting as it is to a target and its counsel, the typically large bonds, letters of credit or cash collateral that secure the mining
reclamation obligations (commonly referred to generically as “reclamation bonds” or simply “bonds”) under the SMCRA permit do not get released by the permitting authorities until transfer is complete. This creates a situation where, if things go wildly wrong with respect to purchaser’s permit compliance prior to transfer completion, the sellers could lose their cash held as reclamation collateral, or their cash backing letters of credit or bonds that the permitting authorities hold in lieu of cash. A common way to protect the asset seller against this is to require the purchaser to “double bond” or post their own cash, bonds or letters of credit with the permitting authorities immediately on the closing. However, this method does not protect the sellers’ reclamation “bonds” from being taken by the regulators in a doomsday scenario.  

During this time between closing the transaction and obtaining full transfer of the permits to the purchaser, the target and its ownership and control group are still liable for, or at least heavily impacted by, permit violations on the yet-to-be-fully transferred permits. In practice, while the permit is being transferred, the target designates the purchaser as “operator,” which allows them to use the permit as a licensee. Another concern that really cannot be helped or prevented is that if purchaser makes a big enough mess, the permit could be revoked and the seller’s ownership and control group could receive the black flag of being “permit blocked” — meaning upstream managers and companies, and potentially even sister companies, could face a major roadblock upon permit renewals and applying for new permits (in all 50 states, and potentially for permits other than mining permits, and potentially forever). As a result, the acquisition agreement generally covers in great detail indemnity and provisions for halting operations on the permit during the pre-transfer phase.

Finally, it is worth mentioning that some permits are assets and some are liabilities. The old adage works well for permits: With great power comes great responsibility. A permit allows someone to extract minerals

22 A seller can require purchaser to post replacement bonds and substitute seller’s bonds, but this is uncommon and eliminates part of the leverage purchaser has to force seller to keep the ball rolling.
and hopefully sell them at great profit. The same permit requires that entity to restore or reclaim the disturbed area at very high cost and to rather demanding standards. Without getting into a great deal of detail that many wonderful EMLF chapters have provided over the years, the permit holder must generally (1) return the disturbed property to its approximate original contour (subject to obtaining authority to do otherwise), (2) re-vegetate the property with grass and usually trees, (3) mitigate any run off issues (including potentially treating acid mine drainage caused by groundwater leaching through coal works for as many years as the problem persists), and (4) take various other actions to essentially cover up the existence of prior mining activities. So when a permit is for an active mine with millions of tons left under permit, it is fairly easy to get the purchaser to quickly complete the transfer process. However, when the permit is about to run out of coal, or has long since run out, getting the transfer complete — or even getting the purchaser to take the permit — can be a tough row to hoe. A purchaser has to be somewhat worried about leaving behind a massive liability in a seller that may or may not make good on its responsibilities to the regulators.

[d] — Transition Services.

In the situation where a purchaser is purchasing a mining division (e.g., the XYZ Mine or all mines in Central Appalachia), they will generally hire all of the operations employees, but often the purchaser will not be able to cause the seller to make available for hiring the administrative and managerial folks that are vital to the back office functions necessary to keeping a business afloat. Historically, many buyers in mineral acquisitions are new to the industry or to the region. In such instances, retaining the consulting and bookkeeping services of the seller can be critical. In the case where the purchaser is new to the industry or region, the purchaser often will require that the seller or target provide back office services for a period of time at cost or at some pre-determined fee per hour, week or month. While this type of outsourcing is not necessarily fraught with peril when performed by a company whose expertise is handling back office functions for third parties, this type of transaction is fraught with peril when a seller is asked to perform this back office work for a purchaser. That being said, the folks
who will provide the services are adept and knowledgeable in the particular operation for which they will provide accounting services. Usually, this post-closing covenant to provide transition and back office services stands alone in a separate transition services agreement that contains excruciating detail on performance standards, indemnity, payment terms, authority for making payments, and a myriad of other issues.

[e] — Transfer and Property Taxes.

Closing always occur in the middle of a tax period for property taxes. As such, the parties generally allocate tax liability for such straddle period. Also, some coal-producing states have unmined mineral taxes that will be due with respect to produced coal that the parties may want to allocate responsibility for. Finally, it is important to take into consideration the transfer taxes and recording fees for real property transfers, and potentially sales tax on personal property, if an occasional sale exemption cannot be used. Each state varies wildly on this point, and it is important to consider whether the states (e.g., Pennsylvania) potentially tax a stock sale as if an asset sale actually occurred for purposes of real estate transfer taxes.

[f] — Further Assurances.

This covenant might as well be called the “oops” covenant or the “bail out the lawyer” covenant. In a transaction as complicated as the sale of hundreds, maybe thousands, of assets, including contracts, equipment, coal, property and receivables, something is likely not going to be fully and adequately documented prior to, or at, the closing. As a result, each party makes a covenant to the other to sign what documents may be needed to clean up any loose ends. This may be as simple as signing certificates of title (if not handled at closing) to preparing a deed for a tract that was left off of a schedule inadvertently. Regardless, such a provision is only fair and reasonable. The only point to really negotiate is how costs, if any, related to such further assurances should be allocated.

§ 17.09. **Conditions Precedent.**

[1] — General Description.

As the saying goes: “Stuff happens.” Between the time a deal is struck and the acquisition agreement is signed, and the time that the parties are ready to close, many events could occur, or not occur, that would make the deal no longer palatable for one or both parties. As a result, acquisition agreements contain a section that provides conditions precedent to the obligation of one or both parties to consummate the transaction contemplated thereby. Of course, in a simultaneous sign-and-close transaction this is a non-issue.

There are two categories of conditions precedent: (1) documents that must be delivered or time periods and filings that must be made, and (2) events that arise that alter the nature or value of the transaction. The first category is a list of actions that must occur that cannot fairly be made covenants for which a breach of contract claim can be brought, because these deliverables require the input of a third party whom neither party can control. The second is really the “stuff happens” category.

It is important to also understand that there is no liability to either party for failure of a condition precedent, unless such failure is due to breach of a covenant elsewhere in the acquisition agreement. For example, the most common condition precedent is the receipt of necessary consents to assignment. Seller does not have the ability, short of unwise threats of violence, to cause a third party to consent to an assignment. As such, it would be unfair and unreasonable to hold a seller liable for failure to obtain the consent. However, there is usually a covenant elsewhere in the acquisition agreement that requires the seller to use commercially reasonable efforts to obtain those consents. So if the consents are not obtained because seller twiddled its thumbs and made no attempt to obtain such consents, there will likely be a breach of that covenant — but it is the failure to use commercially reasonable efforts, not the failure of the condition, that is the breach.


Other than the “consents” closing condition mentioned above, some other common closing conditions tied to third party deliverables, or actions of third parties, are: settlement of litigation; receipt of payoff letters; amendments
to contracts to extend terms, amend provisions or terminate; and estoppels from landlords or coal purchasers. There are also common closing conditions related to regulatory approvals such as Hart-Scott-Rodino approval and WARN Act notice periods.

[a] — Real Property Comfort.

Often, especially where seller has negotiated minimal title warranties, a purchaser will insist on a closing condition that they are able to obtain title opinions or title insurance commitments with an acceptably low level of title exceptions. Also, where reserves were heavily hyped in seller’s marketing efforts, a purchaser may insist on receiving certified reserve numbers from a mining consultant, such as John T. Boyd, with the cost for such certification to be shared or even allocated to seller. Also, where the seller has unrecorded leases, a purchaser may well insist that such unrecorded leases be put to record prior to closing, and title work performed, to ensure another lease, mortgage or outconveyance does not affect their validity or priority.

[b] — Financing.

Depending on the coal market and the relative leverage of seller and purchaser, a purchaser may be able to obtain a closing condition that they are able to obtain sufficient financing, either through debt or equity, on terms that they find acceptable. Usually this condition would expire before the ultimate closing “drop dead date.”

[c] — Diligence.

Often times, a purchaser will want a deal inked even before they have completed their diligence and fully vetted the purchase. From time to time, a purchaser is able to obtain the right to walk away from the deal for a certain period after signing if they are not reasonable satisfied with their diligence results. A prudent seller would want to strongly consider a non-refundable deposit if they are going to grant such a right to a purchaser, since a seller will have invested a reasonably large amount of money in legal fees to get to a signing of a definitive acquisition agreement, just to see the purchaser walk. It is reasonable to consider a compromise wherein the purchaser’s diligence
right to walk after closing is tied only to uncovering certain types of issues, such as issues that come up through a Phase 1 or title search.

[d] — Adverse Facts Closing Conditions.

The other category of closing conditions is related to changes in circumstances. The two main items in this category are (1) breaches of warranties and (2) the existence of an event that gives rise to a material adverse effect.

[e] — Breach of Warranty Closing Condition.

It is important to carefully consider whether there are materiality qualifiers in any warranties, and how that materiality qualifier may interact with any materiality qualifier in the closing condition regarding the accuracy of warranties. Usually, a closing condition tied to accuracy of warranties will be materiality qualified, such that a breach will not permit the non-breaching party to avoid closing if the breach is immaterial. Because such a qualifier exists in the closing conditions section, one must be careful to consider the interplay with the qualifiers in the warranties themselves. Simply put, if the closing condition states that all warranties are materially accurate, and some warranties have materiality qualifiers, there is a risk to the purchaser that there is a double materiality qualifier on those warranties. The effect of that double materiality qualifier could be that a seller could argue that the closing condition has been fulfilled even if there is arguably a material breach of a warranty because there are two materiality thresholds to overcome, thus making a double material, or extra material, breach required to cause the failure of a closing condition. Of course, it is not unfair to have a materiality qualifier on the accuracy of warranties closing condition as this will not preclude a remedy, since an indemnity claim for breach of such warranty will still exist, so long as the indemnity provision is properly drafted regarding materiality, and the claim exceeds the deductible. In fact, it seems most fair for the transaction to still close as long as the breach is immaterial, because it does not materially alter the benefit of the bargain. However, since an indemnity claim should exist, there is a remedy commensurate with the breach. This issue ultimately comes down to party preference and whether a purchaser
would rather be obligated to close — but have an indemnity claim, because
a warranty breach is arguably not material — or whether a purchaser would
simply want to walk away from the transaction because of any warranty
breach. The latter position would seem unreasonable especially because
the target has likely already put the world on notice of the transaction, and
could lose a lot of face if the transaction fails to close and it comes out that
the reason was a warranty breach. The seller will likely want the purchaser
bound to close, but with the right to an indemnity claim.

[f] — Supplements to Disclosure Schedules.

Note that supplements to disclosure letters have no effect for purposes
of closing conditions (meaning that the newly disclosed item will give the
purchaser grounds on which to not close if the item is material enough to
cause a closing condition to not be met), but do have effect to protect seller
against indemnity claims. This seems fair. If the purchaser doesn’t like the
newly disclosed item, it can choose to not close, but if it chooses to proceed
it can not bring an indemnity claim

[g] — Material Adverse Effect.

The other closing condition tied to changes in facts is the condition
stating that no event has arisen that gives rise to a material adverse effect on
the assets or business being sold. Because a significant amount of time may
elapse between signing and closing, there is some risk that some significant
event could occur that would drastically change the value of the assets or
company being acquired. Where such an event occurs, it is arguably fair for
the purchaser to be permitted to have the right to not close. This condition
is different than that of warranty breaches (although there may be overlap)
because an event that gives rise to a material adverse effect may not be due to
breach of a warranty, but merely bad luck between signing and closing. The
common definition of a material adverse effect usually carves out matters
that impact all companies equally, but will often not have such a carveout in
purchaser’s first draft. The seller’s point is that it cannot help that the world
has changed around them, and that risk should fall on the purchaser. This
can be hotly contested.

Seller’s will often have their own closing conditions, albeit more limited. These often including shareholder approval where the seller is not closely held and the absence of an MAE affecting purchaser where stock or seller financing is part of the consideration.

§ 17.10. Termination.

Because most acquisition agreements provide for a delayed closing, meaning that the agreement is signed and then a time period elapses before the parties must close, there must be a way to terminate the already valid agreement should certain events arise that make closing not tenable to one party or the other. The Termination section in an acquisition agreement contains provisions that permit either the target, the purchaser or both to avoid consummation of the transaction. Because the right to terminate means that a great amount of effort and cost will be washed down the proverbial drain, termination provisions are narrowly tailored in scope.


The previous section of this chapter discusses the many conditions precedent that one or both parties will want to be fulfilled prior to closing. However, those conditions precedent do not terminate the transaction; they merely delay it. This section provides the language that terminates the agreement if the conditions precedent are not fulfilled by a certain “drop dead” date. It is important to keep in mind that conditions precedent are split up between purchasers and targets, so one party cannot take advantage of the other’s closing conditions to terminate the agreement.


Generally, because of the expense and effort that goes into negotiating and consummating an acquisition agreement, the breach by one party of a warranty or covenant has to be material for the other to be permitted to completely walk away. If a breach is not material (of course this is a very ambiguous, but common, standard), the non-breaching party is obligated to close and then pursue remedies for breach, most likely money damages.
[3] — Drop Dead Date.

The parties can’t go on forever in the limbo created by signing a purchase agreement. In fact, the seller will want this period to be very short, just long enough to obtain any necessary consents. Usually, a drop dead date is placed in the termination section just to keep the parties moving forward and working under a deadline.


The effect of termination is quite varied. If the termination is because of a material breach, generally the non-breaching party is expressly permitted to pursue a cause of action, and the indemnification provisions survive termination. If the failure to close is due to a condition precedent and failure of such condition to be met is not the result of a party’s failure to use reasonable efforts (or whatever the covenant standard is) to fulfill such condition, there is generally no liability to the parties. If purchaser has a financing or diligence closing condition, generally there is no liability to purchaser if such conditions are not met (again, disregarding any argument that a covenant to use commercially reasonable efforts or to act in good faith was breached), so query whether it is reasonable for the target to demand some amount of deposit before executing the acquisition agreement, which they would be entitled to retain if either of the aforementioned closing conditions gives rise to termination by purchaser. Of course, the risk with respect to a large non-refundable deposit (large enough to make litigation a reasonable expense) is that a purchaser that wants its deposit back can often claim that the reason they did not obtain financing, or that diligence was unsatisfactory, was because of a breach of warranty or misrepresentation by the target — so both parties may face the unsavory risk of litigation over the deposit.

§ 17.11. Indemnification.


This section of the acquisition agreement sets forth the remedy for breaches of the acquisition agreement by both target (and its shareholders) and purchaser, and also often sets forth specific known liabilities which the parties negotiated such that the risk falls completely on one side or the other,
or is to be allocated in a specific way. Even without an indemnity section, breach of a warranty or breach of a covenant would entitle the non-breaching party to recover its damages pursuant to the terms of common law, or the UCC, depending on the nature of the warranty. However, it is common practice to explicitly set forth that the breaching party indemnify and hold harmless the non-breaching party for all costs, including attorney fees and other items that may not be recoverable in the absence of express language in a contract. Further, an indemnity section can clarify whether certain damages are not recoverable (e.g., consequential damages), and also provide various important provisions such as the length of time that warranties survive and the allocation of specific liabilities that are known and disclosed, and as such are not liabilities arising out of the breach of a warranty.

[a] — Why So Important?

The indemnity section is extremely important and is often utilized by a purchaser to recover or withhold funds that would be due to the target absent an indemnity right. The fact that indemnity claims are prevalent does not mean that targets lie often, or that purchasers are looking to save money on the “deal” price; it is simply a result of the massive amount of actions and assets involved in a business acquisition. Because there are so many contracts and activities, and because of the fallible nature of man, it is close to a certainty that mistakes will be made — and thus some breaches of warranty are almost inevitable. For example, a target will generally warrant that they have not breached the contracts they are assigning. After closing, however, it may very well come to light that they delivered a non-conforming shipment under an assigned coal contract and such shipment constituted a breach which entitled the counter-party to deduct damages from the receivable. Assuming the target did not retain the receivable, the reduction in receivable is a cost for which purchaser would have a claim for recovery under an indemnity provision. Another example would be a complete failure of title to a surface parcel on which sits a material improvement, such as a preparation plant. A target will usually give a strong warranty of title to material surface parcels, so a breach would exist in this case. In both of these examples, an indemnity claim is foreseeable because mistakes and breaches happen all the time, even with
the best of intentions. Many warranties allocate risk that the seller cannot possibly fully understand, because mistakes and accidents just happen. As a result, it is extremely important to have a very clearcut remedy and course of action for resolving a claim, and setting parameters, and usually sources of funds for satisfying claims.

[b] — Public Company Stock Sale.

It is important to briefly note that indemnity is almost entirely unheard of in a stock sale if the target is a public company. The many inactive shareholders will not be responsible for paying back a portion of the proceeds given them. This additional risk to purchaser should simply be priced into the transaction.

[c] — Standard Indemnity Section Outline.

a) Survival periods
b) Indemnification by Seller
c) Detail of what Seller indemnifies for and what indemnity covers.
d) Indemnification by Buyer

e) Limitations on amounts of liability
f) Minimum threshold to bring claim, maximum amount of indemnity allowed.
g) Right of set off; escrow
h) Treatment of Third Party Claims
i) Treatment of Direct Claims that do not involve Third Parties
j) Sole Remedy

[d] — Why Warrant?

It is fair to consider whether a target should have to warrant that which it is selling. After all, the purchaser is often given time to review contracts, run title on property and check litigation records. A target could argue that the purchaser needs to take the whole deal “as is, where is.” This makes some sense, but generally the pricing of a deal does not assume the assets are
sold “as is, where is,” but instead is calculated based upon an assumption of value that does not take into account hits to cash flow arising out of breached contracts, failure of title and tax liabilities that follow on to the successor. Thus a great deal of the risk that there are unknown liabilities under contracts, or that the assets are not as valuable as everyone assumes, should be allocated to the target, which is getting a price based on the no-issues assumptions made in discounted cash flows analysis. Also, many issues for which indemnity is given, such as potential employee claims that were not properly documented, are not susceptible to being uncovered during diligence by their very nature.

[e] — Shareholders Liable.

Generally, even in an asset sale, the owners of the company provide indemnity even though they are not selling the assets. This is simply because the actual seller is often left as a shell after the transaction and, as such, an indemnity claim solely against it would not be recoverable. The shareholders of a seller may push back against this personal liability, but if so they must then face the prospect of a larger holdback or escrow of purchase price, or face losing the transaction due to taking a non-market position.

[f] — Note on Importance of Insurance.

At this point, it bears discussing the importance of insurance to both the target and the purchaser. A great many liabilities can be insured such that neither party bears the risk of cash outlay with respect to a third party claim. Of course, the insurance had to have existed prior to knowledge of the specific claim at issue, so having adequate diligence performed on litigation and contemplated litigation and on the type and adequacy of insurance coverage, is crucial. Certain of target’s insurance policies may very well be claims-made policies, instead of occurrence-based coverage, so the purchaser may need to require tail coverage or a reasonable retroactive date on its coverage.

To provide one hypothetical, assume a target in a stock acquisition discloses the threat of a sexual harassment claim by an employee who resigns claiming a hostile work environment. The purchaser will want to ensure that the target had a liability policy that covers employee claims liability, that notice has been sent to the insurer, and that the insurer has not reserved rights
— or if it has, that the indemnity risk lies on the shareholders of the target, this being a stock deal. Many forms of liability can be protected against by insurance, so it makes a lot of sense to ensure that all reasonable insurance is in place and is purchased prior to closing, to lessen the need for indemnity to only non-insurable issues. Also, title insurance can serve the exact same purpose of eliminating a fight between the seller and purchaser and laying the cost for unknown issues on the title insurer.

[g] — Survival Periods.

While it is customary for a seller to make warranties about what is being sold, those warranties (and the liability they may give rise to) usually only last for a period of time after closing. Warranties with respect to status and condition of equipment are necessarily rather short-lived because equipment is in constant use, wears out, and changes. Any warranty beyond a month after closing would be very risky for seller. As such, it is only reasonable that any equipment warranty should only survive for a matter of days or months post-closing. Warranties with respect to matters that are not subject to change (e.g., as a matter of fact, warranties about title to assets are either breached or not breached at closing), however, generally have longer survival periods and the term of such survival period is usually based solely on whether the target or purchaser has more bargaining leverage, and on what custom is. Certain warranties customarily survive closing until the applicable statute of limitations runs out, which can be many years. A general survival period of eighteen to twenty-four months for most of the warranties is standard.


A matter that lawyers love to wrangle over, which is of some importance, deals with the effect of knowledge by purchaser of the existence of a breach of a warranty by seller. An example of this would be where a purchaser uncovers the existence of a prior outconveyance of a mineral seam by seller’s predecessor in title, which such seam is material to the mining plan or is already being mined. At first blush, one would think purchaser should tell seller immediately of this issue. However, this could slow down the deal, and purchaser has no legal duty to take such action. Without specific language
in the acquisition agreement, the purchaser could say nothing, stop mining immediately after it took control of the operations to avoid any risk that it trespasses, and bring a claim against seller — assuming seller warranted its title in such seam — for the value of the lost seam.

This result may seem unfair, but it is not. Purchaser has no duty to seller, and seller is a sophisticated party and ostensibly understands its risks. As a result of the standard rule, sellers often try to incorporate an anti-sandbagging provision that requires purchaser to notify seller of any breach that it has knowledge of, and requires that such breach cannot, in some cases, be the basis for indemnification. (“Sandbagging” refers to a purchaser not telling seller of a breach; this term of art comes from poker parlance and may have its origins in medieval warfare, where sandbags were used as fortifications.) The author feels fairly strongly that an anti-sandbagging provision should be resisted by a purchaser. For one, a seller could claim that purchaser had knowledge even when it did not, if a purchaser attempts to make an indemnity claim. A purchaser could have lawyers pore over documents for hundreds of hours and miss a breach, but a seller could use such facts to convince a the trier of fact that the purchaser clearly knew of the breach, but sat on it until after closing. Since knowledge is a question of fact, a purchaser will be assured of a long trial without settlement as summary judgment would not be a probable result.


This section states the grounds for indemnification by seller and shareholders for the benefit of purchaser. The obvious grounds for indemnification are breaches of warranties. Also, indemnification applies to breaches of covenants, such as the non-compete covenant and covenants regarding efforts required to obtain consents. Further, it is often the case that both parties are aware of some liability, such as a tort liability related

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24 CBS Inc. v. Ziff-Davis Publ’g Co., 553 N.E.2d 997 (N.Y. 1990) (knowledge of breach does not matter absent contractual language because it is part of the contract).

to wrongful death or employment practices, such that there is no warranty that such claim does not exist, but the parties still want to allocate the risk to seller or equally to seller and buyer. These claims have to be covered specifically in the laundry list of items for which seller indemnifies purchaser. One example of this is a situation in which the parties both know that a disturbance may arguably be “off permit.” The parties will want to allocate that risk specifically if seller scheduled it as a condition to its compliance with permits, such that the existence of such issue will not be a breach of warranty. A question often exists as to whether a supplement to the disclosure letter cleanses the breach for indemnity purposes. Normally it does not. The purchaser should have a full right to indemnity based on the warranties made as of signing, as that is when the deal was priced. Further, materiality qualifiers on warranties should be stripped for indemnity purposes if there is any deductible or minimum threshold on a per-claim or all-claims basis, so that purchaser is not faced with a double materiality qualifier (a materiality threshold, plus a dollar amount threshold) that could inflate the threshold for making a claim beyond the deductible amount. Seller also indemnifies purchaser for any costs related to retained liabilities, which is the suspenders to the belt of the covenant to pay all retained liabilities.


As mentioned in various places in this chapter, indemnification is usually subject to a minimum threshold of some sort in order to eliminate nickel and dime claims. This threshold can take many forms, but is often called a deductible. The basic mechanics of this provision are such that purchaser is not permitted to bring a claim unless such claim exceeds a certain estimated dollar amount in total damages (including legal fees and other costs). After the claim exceeds such a limit, the parties have to agree on whether the claim is payable to purchaser by seller on a first dollar basis (the parlance in this case being that the deductible basket tips over and the full claim pours out to the liability of seller) or whether just the claim amount that overflows the deductible basket must be paid out by seller (a true deductible). Also, many times the deductible will be quite large such that no one claim will reach such an amount, so the parties have to determine whether the small claims
that do not reach such amount can aggregate to fill the deductible basket. Many times, to further complicate matters, mini-deductibles will apply to these small claims. Purchaser’s counsel must be careful to avoid the risk of a target “double dipping” and claiming that the breach only exists to the extent that it is material, and that the material breach is subjected to the deduction of the basket. This double dip arises any time there is both a deductible and materiality language in the warranty at issue. One issue that should be dealt with directly is who bears the burden for costs related to third party claims that end up being without merit, or at least unsuccessful. Generally, it makes sense for the seller to bear the cost, but agreements often do not adequately deal with invalid or meritless claims specifically, so one should be careful to clarify this issue. With respect to meritless claims that are not related to third party claims or litigation, it seems reasonable that the purchaser, if it brings a meritless claim, should not receive indemnity for its legal fees and costs.

Keep in mind that typically breaches of covenants are not subject to deductibles, nor are breaches of certain warranties such as payment of taxes. This means that if purchaser is sued for payment of a debt that arose during seller’s operation of the business, and was clearly a retained liability, purchaser will be able to recover its entire loss and damages, without the limitation of a deductible.


One of the most important concepts in the law of breach of contract is the inability to squeeze blood from a turnip. The seller in an “all assets” sale is, by definition, selling all of its assets in exchange for cash, which will most likely be distributed to its shareholders very quickly. As such, an indemnity claim against it will be valueless because of the inability to recover on a claim against a shell. As mentioned before, usually shareholders in a closely held seller will be joint and several indemnitors, but bringing a claim against individuals is an unsavory proposition. As such, the best course for all involved is to have a sufficient pot of money available for purchaser to have recourse against. This pot of money often takes the form of purchase price paid into escrow as opposed to paid out to the seller at closing. On other occasions, the pot of money is in the form of deferred purchase price
or recourse against purchaser’s obligation under a purchase price note in seller-financed transactions.

Whatever the form of purchase price holdback, the parties will heavily negotiate the amount, whether interest is payable, and when the holdback is released. Escrowed funds are the most typical form of holdback. An escrow agent will hold the funds, pay interest to the seller and release the funds at the end of the escrow term, which often runs the same length as the survival period for the bulk of the warranties. The escrow agent is typically a bank, such as JP Morgan Chase, which has a department dedicated to holding escrow funds arising out of purchase agreements. A three-party escrow agreement will be executed at closing, which basically states the terms upon which escrow agent will release funds. The terms are essentially that funds are released upon expiration (unless notice of a dispute has been given, in which case then only the non-disputed funds are released), upon a final non-appealable court order, or upon joint direction by seller and purchaser. While this is not a perfect remedy to ensure damage claims are recoverable, it is the best of many options.

A deferred purchase price can be set off against by purchaser, but this provides a great deal more power to the purchaser than does the escrow of funds, and will often be resisted by seller.

[6] — Separate Title or Reclamation Indemnity.

Something that is not often done, but is worth considering, is having a separate deductible and cap on liability for certain types of warranty breaches. Two that come to mind as reasonable are title warranty breaches and breaches related to reclamation costs, if such warranties exists.


Generally, acquisition agreements hold that indemnification is the sole remedy for breaches of warranties and covenants. However, fraud is almost always carved out, which allows for claims that are not subject to the time limitations and the baskets and caps that apply to indemnity claims. A seller will want to be careful about the definition of fraud because reckless misrepresentations can sometimes be considered fraud under case law
interpretations, which may not be the true intent of the parties when using the term “fraud.” Other than fraud claims, typically indemnity, along with the restrictions that apply to it, applies to all claims and is the sole remedy for breach of a warranty or covenant.26

While such clauses may be extremely tedious to draft and comprehend, acquisition agreements generally provide a great deal of detail about the course of events and obligations of the parties when a third party brings a claim that is subject to indemnification. The example provision provided in the footnotes is typical. Because the ultimate liability is on seller’s dime, the seller will want to control the litigation. On the other hand, the purchaser has a stake in the outcome if the litigation can in some way affect its operations going forward. These issues must be dealt with, and the method is fairly well established by customary language.

Not much needs to be said about direct claims. If one party believes the other party breached the agreement, and if the other party disagrees that a breach exists, one party will file suit or pursue arbitration, depending on what the agreement says. The indemnified party will want to make it clear than they may withhold or tie up the deferred purchaser price, or escrow, in an amount equal to their estimate of the total claim.

By the time a drafter gets to the final portion of the acquisition agreement, exhaustion will likely have set in. However, many of the so-called “boilerplate” provisions at the end of the agreement are of vital importance. Provisions related to selection of venue, arbitration, public announcements and time being of the essence can all be vitally important if the parties come to loggerheads over an issue. With respect to arbitration, for example, the

26 Fina, Inc. v. ARCO, 200 F.3d 266 (5th Cir. 2002) (regarding pitfalls surrounding indemnification for negligence in environmental liability context where purchaser arguably has partial liability for the actions leading to the liability).
devil is in the details; it is highly recommended that someone very adept at arbitration assist in drafting the agreement, as provisions with respect to the amount of discovery, rules of evidence and rules related to the proceeding can be very important in obtaining the quick and affordable dispute resolution mechanism that parties generally intend with an arbitration provision.


Determining the material deal points in most contracts is fairly easy for the business folks to handle. For example, they generally know what the market royalty is for coal or surface leases; they know how they want to price coal under sales contracts; and they know the market rate for a contract miner. However, when it comes to pricing a coal deal and determining the prevailing holdback, indemnity cap, or indemnity deductible, just to name a few, the business folks are usually reliant upon their counsel. Nothing dictates that the parties look at other deals to see what is “market,” but it is usually a valuable use of time, as it may help you argue your point on any one deal point. There are several sources for information as to prevailing “market” deal point outcomes.


The Mergers and Acquisitions Market Trends Subcommittee, Mergers and Acquisitions Committee of the American Bar Association Business Law Section publishes multiple annual studies that are extremely valuable for statistical analysis of deal points. The volunteers in this group summarize and provide charts on lots of “hot topic” deal points, such as deductible amount, survival period, materiality qualifiers and so on. All deal lawyers should arm themselves with this information.


J.P. Morgan handles escrow accounts in many M&A transactions and compiles an annual report that provides helpful statistics related to the amount of holdback and the frequency of indemnity and other claims against the escrowed funds. It is important to keep in mind, as this study points out, that
there are many instances in which there is an adjustment to the purchase price that is paid out of escrow which is not based on an indemnity obligation, but is instead related to working capital adjustments or potentially inventory adjustments to the purchase price.

[a] — Electronic Data Gathering, Analysis and Retrieval (EDGAR).

Not your wife’s weird uncle; rather, the SEC’s Electronic Data Gathering, Analysis and Retrieval (affectionately known as EDGAR) is another great source for information. Every material agreement entered into by every company required to provide public disclosures under the Exchange Act of 1934 must be uploaded to this system. This is a wellspring of information. There are also many pay-for-use services that digest and provide information on EDGAR-filed acquisition agreements in a more usable and comparable format.


As the end of one of the author’s favorite movies asks: “You’re still here? It’s over.” All kidding aside, I hope this chapter has provided some insight and food for thought to folks who ply their trade in the world of mergers and acquisitions. Our role is a noble one. Theoretically, our skills help the gears of the entire economy to be well-greased by helping to efficiently consummate complicated transactions that place valuable assets in the hands of the highest bidder (and therefore in the hands of the party that is in the best position to maximize the value of those assets and provide the most value for shareholders). The value gets turned around and used to buy services and goods, which thereby employs more Americans and increases the greater good by increasing gross domestic product. This in turn increases the standard of living and (theoretically) increases the total wealth and happiness of our people. So, take pride in your work and enjoy it.