

SPA Skeleton

Stock Purchase Agreement Skeleton

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DEVELOPED IN PARTNERSHIP WITH KATTEN MUCHIN ROSENMAN LLP:

This document was prepared with help from **Katten Muchin Rosenman LLP** (“Katten”). The founder of ASimpleModel.com has worked on control-equity, non-control equity and preferred equity investments with partners who are now at Katten for 10+ years. They have always been excellent to work with.

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The purpose of this document is to provide an outline of the stock purchase agreement with some context to make the document easier to digest.

On the pages that follow, each primary section of the purchase agreement (referred to as an article) will be introduced with simple language (no legalese). **More information is available as part of a mini course titled *Stock Purchase Agreement on the ASM+ PRO tier*.**

This approach facilitates an introduction to this document in as few as five pages. It also provides a framework that can be revisited when a particular topic or concept requires review without having to navigate a dense legal document.

Purpose of the Stock Purchase Agreement:

A stock purchase agreement is the primary transaction document for a stock acquisition. The purpose of the stock purchase agreement is to confirm the price paid for the securities sought, to control risk to the degree possible and to provide a roadmap for the hold period.

The two most important variables in any investment are price and risk. It is said that the best way to control risk is through price, but that assumes you know precisely what you are buying and how you are protected in the event that there is a misrepresentation about the assets acquired or liabilities assumed.

For this reason, the bulk of this document deals with identifying variables that could put the investment at risk and detailing how the parties can protect themselves in the event that they are exposed to loss. Beyond price, parties should be aware of three primary concepts:

1. Representations and Warranties
2. Covenants
3. Indemnification

As the text that follows will explain, these three items focus on the assurances and promises made so that the parties can comfortably enter into a transaction, and the protections available to them in the event of a breach.

WHAT FOLLOWS IS A HYPOTHETICAL EXAMPLE PROVIDED SOLEY FOR GENERAL INFORMATION PURPOSES.

STOCK PURCHASE AGREEMENT

EXPLANATION: Following the table of contents, the first text you will typically see is a paragraph identifying the parties by name and defining each party by the role they will play in the transaction. Most concisely, this preamble will identify the Buyer and Seller.

RECITALS

EXPLANATION: The Recitals may provide background on the transaction, identify the target company and the securities to be sold, and state the Seller's desire to sell and the Buyer's desire to purchase the securities.

**Article I
DEFINITIONS**

EXPLANATION: The purpose of Article I is to group many of the defined terms into one section so that definitions do not need to be repeated throughout the document. It is not uncommon for a purchase agreement to include 10 pages of definitions.

**Article II
PURCHASE & SALE**

EXPLANATION: This section of the purchase agreement will focus largely on purchase price and purchase price adjustments. If the transaction includes an earnout, or escrow agreement, such concepts will likely be included here as well. This section will also cover the closing mechanics of the transaction and describe what items the parties must deliver at the closing.

**Article III
REPRESENTATIONS AND WARRANTIES OF SELLER**

EXPLANATION: This section of the purchase agreement contains statements of fact and assurances made by the Seller that must be true and correct as of the closing date. In an aggressively summarized format, the Buyer is looking to have the following confirmed:

1. That the Seller has the authority to enter into the purchase agreement and sell the securities described, and that the share count and capitalization represented are accurate.
2. That the Company is duly organized, validly existing and in good standing.
3. That the financial statements provided are complete and correct and fairly present the financial condition of the Company.
4. That there are no undisclosed liabilities.

5. That the company has all required permits and operates within the boundaries of the law.
6. That taxes have been paid and returns have been filed.
7. That Seller has provided information regarding the Company's litigation matters, employee matters, as well as the material contracts of the Company.

Article IV
REPRESENTATIONS AND WARRANTIES OF BUYER

EXPLANATION: In similar fashion to the prior section, the Seller is looking to have the following confirmed:

1. That the Buyer has the authority to enter into the purchase agreement and make the acquisition.
2. That the Buyer is duly organized, validly existing and in good standing.
3. That there are not additional brokers that will benefit from the transaction beyond what is stated in the purchase agreement.
4. That the Buyer has sufficient knowledge of the Company and is acquiring the securities of the Company for its own account.
5. That the Buyer has sufficient funds to complete the transaction.

Article V
COVENANTS

EXPLANATION: In contrast to representations and warranties, a covenant is a promise to take an action (or refrain from taking an action) that must be true for the period described in the purchase agreement. In the event that the purchase agreement does not contemplate a simultaneous "sign and close," Article V will address the period of time between the execution of the purchase agreement and the closing. Beyond that, most covenants will address the period of time commencing with the closing with various survival periods based on the covenant. Some examples follow:

Should the purchase agreement be executed prior to the closing:

- **Conduct of Business Prior to the Closing:** The Buyer will want to know that the business is run in the ordinary course consistent with past practices.
- **Access to Information:** The Buyer will want to maintain full access to the Company's information and leadership, including its books and records.
- **No Solicitation of Other Bids:** The Seller will not be allowed to solicit or entertain any new bids for the Company.
- **Notice of Certain Events:** The Buyer will require the Seller to provide notice prior to the taking of certain actions, including: issuance of additional shares; incurrence of additional indebtedness; hiring or firing of employees of the Company; and entering into any long-term or material contracts.

Purchase agreements will also include certain covenants that apply from the time of the closing:

- **Confidentiality:** For a period of [5] years following the closing, the Seller cannot disclose any confidential information, whether written or oral, concerning the Company (unless publicly disclosed or lawfully acquired through no fault of the Seller).
- **Non-Solicitation:** Defines restrictions placed on the hiring and solicitation of employees of the Company by the Seller.
- **Non-Competition:** Defines restrictions placed on competing with the company after the closing. For this clause definitions such as Company Business and Territory are critical.

Article VI TAX MATTERS

EXPLANATION: When you close a transaction, there are typically tax periods for which tax returns have not been filed, tax periods that end on the closing date (and for which a return will need to be filed) and tax periods that include periods both before and after the closing (e.g., property taxes). This section is intended to address the responsibility for filing any of these tax returns, the responsibility for paying taxes and the allocation of the tax liabilities for these periods.

Article VII INDEMNIFICATION

EXPLANATION: The purpose of this Article VII is to describe the ways in which the Buyer and Seller may be indemnified. An indemnity is simply protection against loss. Indemnification protects a party from losses due to broken “promises” (i.e., breaches of representations and warranties or covenants), and requires that the breaching party make the other party whole for losses realized.

The representations and warranties and covenants describe what must be true and what must remain true. Article VII describes what takes place in the event that the representations and warranties are not true, or in the event that a covenant is breached. **In other words, Article VII describes how a party will be compensated in the event that they did not receive what had been negotiated.**

Indemnification Procedure: This provision will also detail the indemnification procedure, which describes the rules that the party seeking indemnity (or protection against loss) must follow to bring a claim. This will be detailed for both third-party claims and for claims made directly by the Buyer or the Seller.

Limits on Claims Period: This provision will also establish the time horizon over which the parties are indemnified. Indemnification will vary substantially based on the type of claim. Within this description you will always find **Fundamental Representations**, which are viewed as so basic and fundamental that the indemnified party is generally protected for an indefinite period.

Liability Limits: As it relates to liability limits, the parties should consider two critical concepts: (1) “Basket” and (2) “Cap.” A Basket is a dollar amount (measured as an aggregate sum of all claims) that must be exceeded before an indemnified party can seek indemnification. Baskets may be structured as a threshold (i.e., a “tipping basket”) where the indemnifying party is liable for the total amount of losses, or as a deductible where the indemnifying party is only liable for the amount of losses in excess of the agreed amount. The “Cap” is the absolute total dollar sum of exposure for either party in the event of loss. These terms typically would not apply to the fundamental reps or any obligations or representations concerning tax matters.

Article VIII MISCELLANEOUS

EXPLANATION: Article VIII may cover a wide variety of issues but will typically address delivery of notices between parties, the significance of the purchase agreement and the associated schedules and exhibits, governing law and dispute resolution, and specific performance.

The **notices** portion of Article VIII is straight forward. It will include the means of delivery and the correct contact information for such notice.

As it relates to the **purchase agreement and the schedules and exhibits**, Article VIII primarily addresses four items:

1. **Entire Agreement:** The purchase agreement and the associated schedules and exhibits are the sole agreement of the parties. It will supersede any other negotiation or understanding whether written or oral.
2. **Severability:** If any term or provision of the purchase agreement is found to be invalid, illegal or unenforceable, it will have no impact on the other terms of provisions of the purchase agreement.
3. **Waiver:** The purchase agreement can only be modified by an agreement in writing executed by each party named in the agreement.
4. **Counterparts:** The agreement may be executed in “counterparts.” This means that the same piece of paper is not required to collect all signatures. Instead the signatures can be individually collected and transmitted electronically.

The parties must also agree on **governing law** for any dispute that arises. Because both Delaware and New York have a comprehensive and well-known body of corporate law, one of these two will typically be selected.

As an additional means of limiting risk, Article VIII may also include a section for **specific performance**.