



WOOLLY WAYS NEGOTIATION

Attorney for WiseWool

General Information

WiseWool, Inc., is a large privately held company that manufactures and sells wool and wool blend clothing products to health conscious and environmentally concerned consumers. While their target customers have long been affluent outdoorsy types, they would like to expand their sales to younger urban buyers with disposable income. WiseWool is aware that those buyers demand “on trend” styling and at present WiseWool struggles to get major upscale retailers to feature anything but their socks. WiseWool management is also painfully aware many customers customer browse on their retailers’ sites but go to Amazon or discounters to purchase. Still, brands sold by pricy retailers gain status from being featured there.

WiseWool decided to purchase AllSheep, a company that hit the market a decade ago with high style and high-priced wool-based shoes that were immediately popular among young urban buyers – exactly WiseWool’s target customers. Since then, AllSheep has also created a small but moderately successful line of “base layer” undergarments and athletic wear. Originally in Australia, AllSheep moved some of its sheep farms and all of its manufacturing and design operations to the U.S. during the Obama years. The four AllSheep founders recently became open to selling the company.

After some negotiations, WiseWool agreed to purchase AllSheep at a price of \$36 million. Two of the four AllSheep founders agreed to stay on during a transition period. As part of the deal, WiseWool is permitted but not required keep the AllSheep brand name. WiseWool has stated its intent to retain most AllSheep employees and properties, at least for a transition period, and plans to expand its sales and product lines.

Once the businesspeople had outlined the deal, attorneys for the two companies began negotiating and drafting contract documents. They were able to reach tentative and reasonable agreements on most of the usual terms. However, before completing the negotiations, WiseWool’s senior attorney was called to an emergency assignment at the DOJ and AllSheep’s senior attorney was forced to leave to deal with a family emergency. Both law firms are confident, however, that their highly competent associates can handle the outstanding issues.

The only items left to negotiate now are the amount of the purchase price to be held in escrow and a possible purchase price adjustment (PPA). The proposal for a hold-back was agreed upon in principle, but the amount was not. The parties have not determined whether there should be a purchase price adjustment at all, but both accept that any PPA would be based on changes in cash balances, quarterly revenues, and debt incurred since the date of the letter of intent.

Confidential Information

You are an experienced associate representing WiseWool in their purchase of AllSheep. Together with the partner on the deal, you provided advice to the client's executives even as they were putting together the basic deal terms. You also did quite a bit of behind-the-scenes drafting, research, due diligence, and number crunching with the client for much of the contract language. It's safe to say that you are very familiar with parameters of the WiseWool-AllSheep deal.

The only items for negotiation now are the escrow amount and a possible purchase price adjustment (PPA). In a preparatory Zoom call WiseWool's CEO made it clear that escrows and PPAs are just not that important. Frankly, WiseWool strongly believes the \$36 million purchase price was a bargain and they do not want legal matters to hold up the closing.

Regarding the escrow: you know escrow amounts can vary from zero to as high as 30% of deal price. As a bottom line, you wouldn't recommend an escrow amount in this matter that is lower than \$1 million, and your client has confirmed that \$1 million is all they need. If AllSheep won't agree to such a small amount that itself would be a cause for suspicion.

If AllSheep won't agree to at least \$3 million for the escrow, you would recommend requiring that it obtain Representation and Warranties Insurance – "RWI" – typically priced at 2-4% of purchase price. You are confident they could find an RWI for about \$1 million. But you would like to negotiate for an escrow at the high end to protect WiseWool without need for insurance and to lower the chance of uncompensated "surprises."

WiseWool sees the PPA issue as an entirely separate matter. When the deal was struck AllSheep's cash balances were \$5 million and inventory values between livestock, raw and spun wool, and finished product were \$10 million. Its debt was \$3 million and monthly gross revenues had averaged \$2 million over the past year or so.

WiseWool's CEO is aware of the risks attached to fluctuation in wool prices, damage to stored raw wool inventory, and various sheep blights, particularly since AllSheep's does purchase some of its raw wool. Thus, WiseWool would value PPA reductions if AllSheep's cash balances or inventory values dip significantly, or if it takes on significant additional debt (some sellers will take on debt to beef up cash balances or take out excess cash.) WiseWool anticipates, however, that AllSheep may resist a PPA reduction for what it would characterize as temporary market conditions.

WiseWool doesn't have great concerns about a PPA reduction if AllSheep's monthly revenues dip because it is confident of future AllSheep sales under its management. While it wouldn't be a deal breaker, WiseWool's management would be happiest if there were provision for a significant PPA reduction, linked to AllSheep cash balances and inventory values and debt as of the closing date.