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Acquiring a Business in the U.S.:
10 Ways Attention to the "Legal Terms" Can Enhance the Economic Value of Your Deal

Pointers from the perspective of the Scandinavian, European or other Non-U.S. Buyer, which are also applicable to U.S. Buyers

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As tentative news of incipient financial recovery begins to unthaw stock markets and credit markets, there are reports of increasing interest in IPO's in Europe and India and we see early signs of a re-awakening of interest in mergers & acquisitions activity in the U.S. This early prospecting for acquisition targets is fueled by the availability of bargains presented by a plethora of troubled companies left by the Great Recession which we are struggling to overcome. Favorable exchange rates, relatively favorable macro-economic economic indicators just reported by the U.S. Government for the second quarter this year, and federal Stimulus monies (particularly for the renewable energy and medical IT sectors) available under President Obama's American Recovery and Reinvestment Act of 2009, all combine to provide incentives for acquisition investments in the U.S. over the next several months and next year.

We currently are seeing increasing interest among our Scandinavian and European clients in investing in U.S. assets, acquiring or partnering with U.S. companies, or entering the U.S. market to raise money or start up operations to tap U.S. markets --- particularly in the renewable energy and information and communications technology sectors.

Following are ten tips or pointers on how attention to "legal terms" can enhance the economic value to the Buyer of a deal acquiring a business in the U.S. Based on our more than 30 years of experience in this area, we believe that consideration of these points may be helpful to Scandinavian, European or other Non-U.S. – as well as to U.S. – companies contemplating the acquisition of a business in the U.S. in the near future.

1. **Avoid Costly "Financial Advisor" Terms from Unqualified Finders.** Find your deal through a reputable, licensed investment banker who gives you full value for what you pay for. Avoid wasting money on unregistered "finders" or "financial consultants," who too often take your money and do nothing. Many claim to have contacts, experience and ability to help you that they do not have. And, worse, unfortunately, in the U.S. legions of these unregistered "financial advisors" or "consultants" that purport to be able to help you raise money or help sell your company are operating illegally by conducting money-raising or other activities involving the purchase or sale of stock, which they are not legally qualified to conduct in the U.S. without being a registered "broker/dealer" with the National Association of Securities Dealers and meeting all of the minimum capital requirements and other qualifications that go along with broker/dealer registration and U.S. securities laws compliance. Paying attention to the "legal terms" offered to you in any agreement proposed by a transactional financial advisor, as well as checking into the legality of his operations, can save you very substantial amounts of money and grief, and save you from derailing your deal before you get started.

2. **Except with Advice of Competent Counsel, Avoid So-Called "Non-binding" Letters of Intent; They Might Bind You.** Avoid signing a letter of intent or memorandum of understanding, without competent counsel. Under the common law of several U.S. States, you may find yourself bound where you did not so intend. Years ago Texaco was nearly bankrupted by a Texas jury's $10 billion punitive damage award for "tortious interference with a business relationship," because Texaco had entered into a definitive agreement to

acquire Getty Oil from certain of its shareholders, disregarding a letter of intent previously signed by the Getty Oil shareholders to have Getty be acquired by Pennzoil. Both the Getty shareholders and Texaco assumed the letter of intent with Pennzoil was non-binding because it contained language specifically stating that it was non-binding and was subject to negotiation and signing of a definitive agreement. Nevertheless, Pennzoil sued to enforce the letter of intent and to hold Texaco liable for damages for interfering in a binding business relationship between Getty's shareholders and Pennzoil. Based on legal instructions under Texas law, the jury found that the letter of intent constituted a binding agreement between the Getty shareholders and Pennzoil. It looked to other language in the letter of intent and outside facts to determine that it was the intent of the Getty shareholders and Pennzoil to be bound, a finding which under Texas law trumped the express non-binding language in the letter of intent, even in the context of a multi-million dollar transaction. Seeking the advice of competent counsel before you sign a "letter of intent" or "memorandum of understanding," even if you think it is not binding, could save you a lot of money and pain later.

3. The Legal Structure of the Deal Can Save You Taxes and Liability. While every situation is different, consider first purchasing assets (rather than stock) of the Target company where possible, in order (a) to assume only specified liabilities and avoid assuming undisclosed liabilities of the Target company and (b) to obtain a stepped up tax basis in the assets purchased (minimizing future tax liability on sale of the assets). Shareholders of a Target company, however, are likely to prefer a stock sale or tax-deferred merger transaction, in order to (a) transfer the entire business with all liabilities to the buyer and (b) avoid incurring tax in the target corporation (which they will continue to own after the asset sale) on any gain upon a sale of assets by the target.

If your counsel and tax advisor affirm that an asset purchase makes sense for you, then look for a rationale for doing an asset purchase from the seller's point of view. This may help you negotiate for an asset purchase without increasing the purchase price to compensate the seller(s) for their tax liability. For example, situations such as the following may provide good reasons to argue that the seller(s) should consider an asset sale:

a. The Target's shareholder/ capital structure makes a share purchase impractical (E.g. where the Target, whether public or privately held, has a huge number of shareholders). In this situation, it may be that no buyer is likely to want to incur the additional costs of doing a tender offer or merger acquisition for this business; or

b. The value of the business being acquired (and hence the purchase price payable to the Target and its shareholders) is enhanced if only selected assets are sold (E.g. where significant contingent liabilities of the Target depress the value of the business, if sold in its entirety as a stock sale). But, in this context, be sure to negotiate for adequate indemnification against potential "fraudulent conveyance" claims by creditors of the Target.

c. Key contracts of the Target to be acquired, by their terms, require consent of the other party, not only to an assignment of the contract, but also upon a change of control (via a stock sale or merger) of the Target. In this case, the cost and expense of obtaining third-party consents would not be avoided by a stock sale transaction.

4. Representations, Warranties, Covenants, and Indemnities in the Acquisition Agreement are not just "Legal Terms;" They are Worth Money. In the course of negotiations with the Seller(s), if you make concessions in the extent of representations, warranties, covenants or indemnities required from the Sellers, you may be able to trade these off for a reduction in purchase price. In the U.S. environment, very extensive contractual protections of the Buyer in the form of lengthy representations and warranties about the business and indemnities against breaches and undisclosed liabilities given by the Seller(s), are the norm in acquisitions by strategic, corporate buyers.[1] These provisions are generally more important to the Buyer of a business in the

[1] This is less the case in controlled auction acquisitions or competitive acquisitions by private equity firms or other financial buyers.

United States than in other countries which have Code Law legal systems, as opposed to the Common Law system that prevails in the U.S. Unlike the buyer protections provided by law in many Code Law countries, the protections of the Buyer contained in detailed representations, warranties, covenants, and indemnities in the typical U.S. acquisition agreement are not generally implied by law in the U.S. They must be stated in the acquisition agreement or you don't have the protections and may be subject to unexpected liabilities of the Target business. Be aware that these provisions are worth money to you. They are not just "legal terms" to be negotiated by the lawyers.

5. **Cash Consideration Can Save You Money if Spread Over Time.** In a cash transaction, negotiate to pay as much as possible of the purchase price over time. Then you can also negotiate to make the note evidencing your deferred payment obligation subject to set-off for any damages or indemnification liability arising out of breaches of the Seller's representations and warranties or undisclosed liabilities of the Target business. You may be able to point out that the Seller may have a tax incentive to accept payment in installments over more than one year. If structured correctly, such an installment payment plan may save the Seller taxes by spreading the Seller's realization of gain over more than one tax year, and consequently reducing the effective tax rate at which the seller would otherwise be taxed on his ordinary income during the year of acquisition.

6. **Structure an "Earn Out" Transaction, Defining the Purchase Price in Terms of the Actual Performance of the Business Post-Closing.** Consider negotiating for an "earn out" transaction, where a substantial contingent portion of the purchase price is to be paid in the future, conditioned upon actual performance of the business after you acquire it. This will significantly reduce your risk of loss from undisclosed problems of the business. This structure may be most appropriate and acceptable to the Seller where the Seller is an individual (or individuals) who will remain with the business and continue to run it after you acquire it.

7. **Buy the Target without Paying Cash.** Where appropriate, acquire the business without paying cash – such as by issuing shares of stock of your company or your subsidiary to the Seller(s) as the consideration for the business you are acquiring. However, be aware that issuance of stock to Sellers in the U.S. will require compliance with registration requirements under the U.S. Securities Act of 1933, or qualification for an available exemption therefrom, as well as compliance with the State securities laws in every State where the Sellers are located. These requirements may be very extensive, costly, and time-consuming – especially where stock is to be issued to a large number of Target shareholders, potentially requiring registration as a public offering with the U.S. Securities Exchange Commission and several State securities authorities. Where registration is required, this process can take up to several months.

8. **Some Non-U.S. Stock May be More Liquid, and Therefore worth More as Consideration, in the Hands of the U.S. Seller than would the "Restricted Stock" Issued by Other U.S. Buyers.** Where your stock is to be used as the currency, negotiate for a lower purchase price of the business (or a higher per share valuation of your stock) if your stock will be liquid (can be traded easily outside of the U.S.) in the hands of the Seller(s). Note that in the U.S., stock that is issued pursuant to an exemption from public registration, even if issued by a public company, is treated as "restricted stock" under U.S. securities laws. Such privately placed restricted stock (as opposed to registered and publicly issued stock) generally cannot be traded in the U.S. and is highly illiquid under U.S. securities laws. If you are incorporated and do business outside of the U.S., the status of your stock in the hands of the U.S. Seller(s) needs to be analyzed by U.S. securities lawyers and securities lawyers in your country. If your stock can be publicly traded (or at least more freely traded than U.S. "restricted securities") outside of the U.S. by the U.S. Seller, then it should be worth considerably more to the U.S. Seller than the typical U.S. restricted stock that the Seller would receive from a U.S. Buyer.

9. **Require that the U.S. Seller(s) Enter a Shareholders Agreement Upon Issuing Them Stock or Securities in Your Company.** If your company is closely held, and you are to issue stock in your company or Notes or debt instruments convertible into stock, to the U.S. Seller(s) of the business you are acquiring, then be sure to have your local counsel and U.S. lawyers negotiate and put in place appropriate shareholders agreements

with your new U.S. shareholders. Such U.S. Seller(s) may be accustomed to provisions typically contained in shareholders agreements for U.S. companies, and you may be able to negotiate for similar restrictions, even if not customary in your country. In U.S. companies, such shareholders agreements may include call rights on the stock at a stated price (exercisable, for example, in the event of breaches of the acquisition agreement for the Target business), a pledge of the stock to secure indemnity obligations of the Seller(s) under the acquisition agreement respecting the Target business (which would be implemented by a separate Pledge and Security Agreement and perfected by delivering physical possession of the stock to the Seller or its escrow agent) , and other terms contingent on performance of the business, as well as buy-sell provisions, rights of first refusal, drag-along rights, tag-along rights, registration rights (hinged on meeting certain performance criteria of the acquired business), put and call provisions, and other provisions. Your local counsel, working with your U.S. lawyer, may be able to craft special protections for you in the form of contractual restrictions on your stock in the hands of the Seller(s) that may be crucial protections for your interests as Buyer and thereby be worth substantial money to you in the future.

10. Leverage the Target Company's Assets to Finance the Acquisition. Take advantage of LBO forms of acquisition that are permitted in the U.S. to acquire a business with primarily borrowed money, non-recourse to the Buyer. While laws of many countries prohibit these kinds of acquisitions, it is permitted and quite common in the U.S. for a Buyer to create a newly formed subsidiary and use this new company ("Newco") as an acquisitio½n vehicle to purchase a target company using a very small amount of equity capital invested in Newco and a large amount of borrowed money. In this "leveraged buyout" form of acquisition, the acquisition debt may be non-recourse to the Buyer, and upon merger of Newco with the Target, the debt will be secured only by the assets of the Target. Often an LBO can be accomplished in alliance with a financing entity, such as a private equity, venture capital or LBO firm, which may take an equity interest in Newco along with the strategic Buyer.

The above are just 10 examples of the myriad ways in which the legal considerations in choosing a proper investment banker or advisor to find and facilitate your deal, the legal structure of your deal, and the "legal" terms of your acquisition agreement are worth real money to both the Buyer and Seller of a business. If you have questions or comments on this article, please feel free to contact the author at CBarnhart@BarnhartLawPLC.com, or by telephone at +1-954-545-4994 or mobile at +1-954-232-5378.

Constance R. Barnhart is the founder and Managing Member of Barnhart Law PLC, a niche law firm that handles all business and corporate law matters, cross-border and U.S. mergers & acquisitions, international commercial transactions, contracts of all kinds, and venture capital and financial transactions. The firm currently represents Scandinavian, European, Latin American and U.S. business clients in the technology and information industries (including computer software, SMS/MMS text messaging, e-commerce, media, and information and communications technology), alternative and renewable energy (wind and solar), and product manufacturing and distribution, among others, in both cross-border and U.S. matters.

After 12½ years as a Partner in the law firm of Holland & Knight LLP, and more than 30 years of law practice at large law firms, Ms. Barnhart founded Barnhart Law PLC in March, 2009, in order to continue serving her U.S. and international corporate clients with the same high quality competence and service they have been receiving from her at large law firms, while passing on to clients the cost savings of lower overhead permitted by practicing at a niche law firm, along with the greater flexibility to provide partner level individualized service from this platform.   For specialized assistance in complementary areas, such as tax, regulatory advice, and other areas, when required in the transactions we handle, we bring in and continue to work with Ms. Barnhart's colleagues of many years.

In over 30 years of practice, Ms. Barnhart has handled as lead attorney many substantial cross-border and U.S. mergers & acquisitions, and other commercial, securities, and financial transactions for U.S. and international clients in several industries. For the last 12½ years, she was a Partner at Holland & Knight LLP, a 1250 lawyer national and international law firm, where she practiced in the Business Law Section and the Corporate/ International & Cross-Border Transactions Practice Group of the firm, and was a Co-Chair and member of the firm's Nordic/ Scandinavia Practice Team, as well as a member of its Renewable and Alternative Energy Team. Ms. Barnhart is fluent in English, Norwegian, and Spanish, and conversant in Swedish and Danish. She is admitted and licensed to practice law in four U.S. States – New York, Florida, Texas, and Minnesota. **Ms. Barnhart may be reached at CBarnhart@BarnhartLawPLC.com or by telephone at +1-945-545-4994 (Office) or +1-954-232-5378 (Mobile).**