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10 COMMON MISTAKES THAT CAN DOOM AN ACQUISITION BUYER'S PROSPECTIVE

BY PHIL W. JAEGER, ESQUIRE

During my 25 years as a mergers & acquisitions (M&A) lawyer, I am frequently asked to identify the most common mistakes that cause an M&A transaction to fail. Honestly, I continue to be amazed at the frequency with which transactions fail because of fundamental and repeated mistakes, many of which could be avoided. Most experienced business lawyers have their own list of common mistakes. My list is very meaningful to me and my clients, because I believe the success rate of completing transactions would rise substantially if these mistakes did not occur.

1. Failure to Make a Commitment and to Dedicate Needed Financial and Manpower Resources

The initial mistake made by most buyers is believing that suitable acquisition candidates can be identified without much difficulty. Acquisition candidates usually do not fall from the sky. Identifying acquisition candidates requires commitment, planning and dedication of resources.

The commitment must be made at the top of the company to pursue growth by acquisition. Financial and manpower resources should then be allocated to the project. Certain people, either inside or outside the organization, must be dedicated to implementing the acquisition search process in order for the process to begin. Failure to preliminarily dedicate resources to the acquisition process sometimes indicates a deeper reluctance on behalf of the buyer to develop and pursue an acquisition strategy.

2. Failure to Develop a Sound Strategy Based Upon an Understanding of the Marketplace

If you want to identify suitable acquisition candidates, you must have an acquisition strategy based upon clearly defined objectives within a marketplace that you understand. Defining objectives requires you to focus on how your company's value can be enhanced through strategic acquisitions.

A profile of an ideal acquisition candidate should be developed. A buyer without a strategy and clearly defined objectives, might be overwhelmed with so many prospects and offerings that it will not even have enough time to review all the prospects. Even worse, you may miss entirely the one candidate out of many that may be a good acquisition fit.

3. Paying Too Much for Target Companies

Overpaying for a target company is a huge problem. If you have identified a real prospect and you intend to make an offer, an experienced financial advisor should be consulted to assist in analyzing the value of the target company to the acquirer's business. The use of an outside professional to value the target company should be strongly considered in order to eliminate bias in the valuation and to help value

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the target from several perspectives.

4. Failure to Employ Experienced M & A Legal Counsel

Before any offer is actually made, engage counsel experienced in mergers and acquisitions. All lawyers are not experienced in the very complicated mergers and acquisitions field. Experienced deals lawyers not only know the rules and practices of the M & A road, but they can also bring a wealth of experience to the table to resolve and compromise difficult deal points that could become problematic. Furthermore, an experienced deals counsel can save you money in the long run because he or she will not have to reinvent the wheel in structuring and papering the transaction.

5. Complete the Due Diligence Process Before Reaching Agreement On Terms

The due diligence process should begin as soon as the letter of intent is executed. Certain due diligence tasks with long lead times, such as environmental audits, should commence immediately. These long lead time tasks are costly, frustrating and time-consuming, but are an absolutely critical part of the due diligence process. Examining the books, records and "people" in the company can also be time-consuming. The seller will pressure the buyer to complete the process as soon as possible since the buyer's offer will almost always be contingent upon the successful completion of the due diligence process. The buyer should always use experienced deals people in conducting due diligence including attorneys, financial professionals, and business people who are knowledgeable with the seller's business.

6. Failure to Develop and Follow a Negotiation Plan

A negotiation plan should be developed and followed by the acquisition team. The first step in developing a negotiation plan is to rank the issues to be negotiated in your order of importance. As a general rule, the material issues should be negotiated to near conclusion before the non-material issues, sometimes treated as an entire separate category, are negotiated. Remember, what may be material to you may not be material to the other party. You might be able to trade off concessions on what you consider non-material issues to get concessions on the material issues.

The leaders of the acquisition team should be kept informed on all issues and provide strategic guidance to their professional advisors on negotiating these issues. They should never "go-around" their acquisition team by negotiating directly with the opposing party, unless these negotiations are part of the negotiating plan. Back door negotiations undercut the credibility of your professional advisors and undermine any apparent authority that the seller's team believes your professional advisors possess. The buyer should always be able to walk away from a deal that does not seem to make sense. Never allow yourself to be put in a situation that creates momentum to close a deal when a final decision has not been reached.

7. Assuming Parties Will Do What They Say

During the negotiation process, you may receive assurances "off the book." While you may not want to appear suspicious, if the assurances are important to you, you should insist they be memorialized in writing. The other side should not object unless their reasons are less than candid. If the assurances cannot stand the light of day, you should be concerned with the value of the assurances or with the credibility of the other side, or both.

Sometimes your own position needs to change during a transaction, and your credibility will be challenged accordingly. Modifying your position during a transaction is not uncommon as you learn new facts during the due diligence phase that materially affect the value of the transaction. Never deny what you have done. Admit you have changed the "deal" and state the reasons why. Being forthright may not save you from being strongly criticized by the other side (you would do the same), but at least you can avoid being labeled "dishonest" (or worse) and proceed with the transaction.

8. Permitting a Transaction to Drag and Become Stale

A deal has only so much life. Momentum is critical. If a deal sits, momentum is lost and the parties are allowed to review their positions, their attention span will dissipate, and the chances of the deal closing will greatly decrease. Be decisive. Never let a deal sit too long.

9. Failure to Pursue a Deal Diligently Through Closing

If the deal has moved to closing, never assume the deal is done until it has finally closed. Keep up the momentum through closing even if you believe the deal is done.

10. Always Be Able to Walk Away From The Deal

The acquisition process is not for the fainthearted. Expect the unexpected and the unexpected will then become normal. Always be able to walk away from a deal if it is not right. Deals that were closed at the last minute with cold feet usually end up being deals that never work.

Final Word

How many of you have made these mistakes before? If so, it is all right because everyone else has made these mistakes before. The only people who have not made mistakes are those people who have never done a deal. Learn from the mistakes made before you to greatly increase your chances of closing the deal.

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TAX LAW: ENGAGING APPRAISERS FOR CLOSELY-HELD BUSINESS INTERESTS

BY RONALD A. FEUERSTEIN, ESQUIRE

Frequently, we will tell clients that their business must be appraised or valued. Sometimes, clients will ask us about the need to do so.

The need for valuations arises in numerous contexts under tax law. While the most obvious need for valuations occurs in business sales and acquisitions, tax law requires valuations for non-publicly traded stock given outright as compensation, in the form of options (qualified or non-qualified) or in the form of "restricted stock" under Internal Revenue Code ("IRC") section 83 compensation.

IRC section 409A, which governs non-qualified deferred compensation, requires valuations for non-qualified stock options with more onerous rules than were in place prior to its enactment in 2004.

Another area where tax law requires appraisals is employee stock ownership plans ("ESOPs"). Specialized appraisers need to value ESOP stock at formation and each year thereafter, in addition to when a participant's stock is purchased.

Yet another area where valuation is a necessity is charitable gift giving.

The above transactions are, by no means, exhaustive but provide some examples of the broad application of valuation requirements under tax law.

In determining the value of closely-held business interests, the entity's net worth, earning power and, in the case of C corporations, dividend-paying capacity, are taken into account. Moreover, after these factors are taken into account, the interests may be discounted (i.e., its value for tax purposes is reduced) for a number of reasons, such as lack of marketability or lack of control ("minority discount"), which is a hotly contested and litigious area of tax law.

In the context of buying or selling a business, hiring a qualified appraiser can help you assess the validity of your own determination of investment value (i.e., the return on your investment in the closely-held business), and help you structure an offer and convince the seller of a negotiating price range.

Clients may also need an independent appraisal to obtain financing or to provide documentation to support any valuation. Where the valuation of a closely-held business is relevant to the correctness of a tax return, the taxpayer must submit with the return complete financial data on which the valuation is based, including copies of reports of any examination made by accountants, engineers or technical experts, as of or near, the valuation date.

Thus, the appraiser's report can provide both financial and tax substantiation. Should the valuation issue become the subject of litigation with the IRS, the appraiser's expert testimony can be the best way of presenting the factors used to value closely-held business interests. In fact, it would appear that the taxpayer can even shift the burden of proof to the IRS on the valuation issue if the appraiser's testimony provides credible evidence.

Caution is appropriate in reviewing an expert's qualifications. In the event of tax litigation, the general standard applied to the admissibility of an expert's opinion is whether that testimony would assist the trier of fact in deciding the case. If an appraiser's techniques, experience or qualifications are found unreliable and irrelevant, a Federal court or United States Tax Court judge may find that the expert's testimony does not meet the admissibility standards of Federal Rule of Evidence 702 and, thus, the testimony will not be evidence in the case.

To save time and money, it may make sense to find an appraiser who can provide both asset appraisals and business valuation. In any case, you should check the appraiser's references, experience and credentials. In that regard, you need to determine whether the appraiser has been certified or accredited by the American Society of Appraisers (ASA), the Institute of Business Appraisers (IBA), the National Association of Certified Valuation Analysts (NACVA) or the American Institute of Certified Public Accountants (AICPA).

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The client should also ask whether the appraiser is familiar with the widely recognized professional standards for appraisers. The Uniform Standards of Professional Appraisal Practice (USPAP) and the Principles of Appraisal Practice and Code of Ethics (PAPCE) establish authoritative principles and a code of professional ethics for appraisers. In addition, the Business Valuation Standards (BVS) of the American Society of Appraisers supplements and clarifies the USPAP and the PAPCE with respect to the valuation of businesses, business ownership interests and securities.

One should also select an appraiser who has actual practical experience in buying or selling businesses or valuing specialized assets (such as intellectual property), as the case may be. Moreover, it would be a good idea to inquire whether the appraiser has experience testifying as an expert witness to establish valuation and whether the appraiser has represented both taxpayers and IRS. The fact that an appraiser has provided expert testimony on behalf of taxpayers and IRS can add to the appraiser's credibility should you someday need his or her testimony to establish valuation.

For each of the foregoing reasons, it is essential that you select an appraiser whose qualifications, experience and analysis are beyond reproach whenever possible.

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