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Forewarned is Forearmed

Legal due diligence in M&A transactions

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Due diligence should play a vital role in any merger or acquisition. Not only do buyers need to engage in *financial* due diligence, but they also need to engage in *legal* due diligence that considers the target company's contracts, litigation and potential liabilities, and property, including intellectual property.

Contracts

A large chunk of the *legal* due-diligence process should be devoted to reviewing the target company's existing contracts. They will likely encompass a wide range of subject matter, including leases, employment agreements and contracts to provide services. For example, the buyer's attorney may begin by examining the target company's labor and supply contracts with third parties. Will the buyer want to continue the contracts after the merger? If so, do the contract terms permit an uninterrupted continuance?

Other contracts related to the company's operations also warrant attention. These contracts are particularly significant when the merger turns on the proposition that the buyer can improve the company's productivity and profitability. The attorney will determine which, if any, contracts will require a third party's consent and assignability. These provisions can heavily affect the transaction's timing and purchase price. Without consent, closing the deal and then continuing daily operations may be difficult, if not impossible.

The attorney will also want to look for transaction-triggered contractual obligations such as anti-assignment, re-pricing and retention, or severance provisions. Non-compete agreements that current employees entered into with former employers could affect the transaction too; losing key employees who are barred from working for the buyer might undermine the purchase's value.

Additional relevant contracts include those related to benefit plans, employment and confidentiality.

Litigation

Before closing, the buyer's attorney should also review all pending or threatened litigation involving the target company. Will the buyer expose itself to liability arising from conduct that occurred before the merger? The attorney will want to consider all of the pleadings from any threatened and pending litigation,

including any involving affiliates or subsidiaries.

Equally important is compliance with governmental licensure issues and regulatory investigations or notifications. Tax counsel is also necessary to properly structure the transaction.

Property

The buyer's attorney will need to request a comprehensive list of the target company's real estate holdings. Title research should confirm that ownership of all real estate holdings can pass free and clear to the buyer after merger.

Intellectual property can prove even more important to a company's value than its real property. In fact, the value of intellectual property may well drive negotiations over the purchase price. Due diligence involving intellectual property requires a complete listing of the target company's patents, trademarks, trade names, trade secrets and copyrights. The buyer's attorney will also review any intellectual property-related agreements with employees, independent contractors, suppliers, vendors, partners or others.

Information technology

A merger can run into trouble if the companies' hardware and software systems aren't compatible. In this case, buying new systems and technology may substantially add to the overall cost of the purchase. So, the buyer must investigate the details of the target's computer systems — including lease provisions and software contracts.

Do the contracts lock the company into a specific operating system and updates? These obligations could reduce some of the transaction's expected efficiencies.

Premerger scrutiny

The *legal* due diligence process' scope, duration, and cost will depend on several factors, including the target company's size and industry. However, regardless of how much time, money, and headache are involved, some level of *legal* due diligence before a merger or acquisition is a must.

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