Between The Lines

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M&A Transactions — Understanding Unique Circumstances and Issues

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Every year in the US a huge volume of merger and acquisition transactions occur. Despite the vast number, every M&A transaction presents unique issues and circumstances. Experienced M&A parties are generally well versed in recurring and heavily negotiated legal issues such as indemnity; working capital and other purchase price adjustments; escrowed amounts; representations and warranties; treating stock purchases as asset acquisitions for federal income tax purposes under Section 338(h)(10) of the Internal Revenue Code; etc. Other legal issues appear less frequently, however, and may not receive the same attention. This article focuses on a selection of those M&A issues that are less frequently encountered and less discussed, especially in asset transactions, which could present significant problems if left unattended to.

Bulk Sales/Successor Liability. This issue can be confusing because there are (at least historically) two types of bulk sales laws. A bulk sales law generally applies if a seller transfers all, or substantially all, of its assets in bulk to a buyer. One type of bulk sales law existed under Article 6 of the Uniform Commercial Code (UCC). This type of bulk sales law was intended to protect creditors who were at risk when a merchant sold all of its inventory in bulk and could abscond with the proceeds, leaving the creditor with no recourse. Article 6 has been repealed in Colorado and in most other states. With the passage of the Uniform Fraudulent Transfers Act — which provides adequate and often better remedies and protections for creditors — the repeal of Article 6 made sense. However, that does not mean a buyer in an asset transaction should ignore bulk sales issues. Most states maintain separate successor liability statutes for tax purposes triggered by bulk sales. These bulk sales laws typically protect the state to ensure that any unpaid taxes (usually sales taxes) owed by seller will be paid in connection with the sale to the buyer. States know that a buyer of a business is generally in a better financial position to collect or pay taxes from the sales price than the seller who is quitting the business. Thus, states usually extend the successor liability to asset sales even if the parties have agreed that buyer is not assuming this liability. Buyer should therefore carefully review and

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G. Brent Coan, Willis V. Carpenter and Andrew S. Klatskin have been recognized as 2017 Colorado Super Lawyers, and Michael C. Payne and R. Clay Bartlett have been recognized as 2017 Colorado Rising Stars. The 2017 Colorado Super Lawyers and Rising Stars' lists are credible, comprehensive and diverse honors reserved for lawyers who exhibit excellence in their practice. Each year, no more than five percent of Colorado lawyers are selected to receive the Super Lawyers listing, and no more than 2.5 percent of Colorado lawyers are selected for the Rising Stars list.

CP2 Welcomes New Attorney Elizabeth Cypers

Elizabeth Cypers
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Elizabeth Cypers' legal practice is focused on estate planning, wills & trusts, probate & estate administration, elder law, business succession planning, real estate, and small and family-owned businesses in Denver, Colorado.

Prior to establishing her Denver-based legal practice, Ms. Cypers served the United States Department of Housing and Urban Development, where she provided advice and handled the closings of FHA insured transactions for multifamily projects, hospitals and assisted living facilities. She also advised the Single Family Insured Mortgage Division, Procurement/Government Contracting, and FOIA.

Ms. Cypers received her Bachelor of Arts degree from Emory University, majoring in Psychology. She then earned her Juris Doctorate from Loyola Law School in Los Angeles where she focused her coursework on trusts and estates, business, elder law, and real estate. Ms. Cypers is licensed to practice in Colorado and California.

determine whether any successor liability bulk sales law will apply. This should occur early, as some states require substantial advance notice to the tax department prior to the closing. While the exact procedure to avoid successor liability will depend on the state, a few common principles usually apply. The law will generally require providing notice of the impending sale within a certain time limitation and establish limitations on consummating the transaction until the tax department has either (i) not responded within a certain time or (ii) "cleared" the seller. If tax liability exists, some states may require that a certain sum be withheld or placed in escrow by buyer. The obligation to comply with the process may be on the seller or the buyer. In Colorado, for example, the responsibility is imposed on a seller, yet the buyer can also be liable for the seller's unpaid state tax obligations if the buyer does not withhold sufficient funds to cover the amount of unpaid taxes until the seller has either produced a receipt from the department of revenue showing taxes have been paid, or provided a certificate that shows no taxes are due. Sometimes, parties seek to avoid the time consuming process to notify and transact with the tax department. In these instances, the buyer can accept a seller's contractual indemnity for any seller's tax liabilities (usually with an escrow to assure availability of funds). However, the drawback is the time and effort to process the claim for any indemnification, and, if tax liability exists, the time and attention the buyer will be required to invest to satisfy the same. Proper advance planning regarding bulk sales issues will generally benefit both parties and ensure a smoother closing.

Foreign Corrupt Practices Act Issues. As a result of increased global trade, international business and legal issues are ever expanding. Now, even smaller M&A transactions frequently contain an international angle. A relatively small target company in Colorado may contract with foreign sales representatives, consultants, and/or distributors in connection with its business. A lower middle market company may have one or more foreign subsidiaries. As such, all buyers should be mindful of Foreign Corrupt Practices Act ("FCPA") requirements in connection with a seller's business. This is not limited to stock transactions. The DOJ and the SEC, which enforce FCPA violations, take the position that, although the focus in an investigation is generally on the offending target company, successor liability may extend to the buyer in asset transactions. The probability of successor liability can usually be managed by proper due diligence and other mitigating factors. While a buyer does not need to be an expert on the FCPA, buyers should have a basic understanding thereof. The FCPA was enacted to make it unlawful for certain persons and entities to make payments to foreign government officials to assist in obtaining or retaining a business in the foreign market. Payments to foreign officials in a foreign country that are part of "doing business" there may be prohibited under the FCPA. Any target company who contracts with foreign sales representatives, consultants, or distributors may, depending on the country and nature of business, be susceptible to FCPA violations. In fact, the majority of enforcement proceedings by the DOJ or SEC involve third parties. At a minimum, buyers should include a basic

CP2 Welcomes New Legal Assistant Sherri Case

Ms. Case comes to CP2 with experience as an estate and trust administration paralegal and assists our Denver team with real estate matters, corporate transactions, and estate administration. Before transitioning into the legal field, Ms. Case had a successful career as a special education and elementary education teacher.

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CP2 Promotes Katie Beargie to Assistant Firm Administrator & Marketing Coordinator

Katie Beargie
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Ms. Beargie has been with CP2 for over two years as a Paralegal. She now assists the Firm Administrator with the administrative and business functions of the firm in addition to coordinating all marketing projects. She has a strong accounting and legal background and is currently pursuing a Master's in Business Administration from the University of Colorado Denver.

review of the target company's international business in its due diligence to determine if FCPA violations may become an issue. If violations are uncovered, buyer should take appropriate steps (which is beyond the scope of this article). While a buyer may be tempted to rely on an indemnity from seller for FCPA violations in lieu of due diligence, a seller may not agree to an escrow to assure buyer can be satisfied, and dealing with DOJ or SEC post-closing will take considerable time and effort. Consideration of this issue will allow buyers to make an informed decision before closing.

Transitional Services Agreement. It is common for a buyer to want the principal or key personnel of seller to provide consulting services for a period of time, post-closing, to assist in the transfer of assets, maintain customer relationships and provide other consulting services. On occasion, such consulting services may be insufficient and the buyer may wish that the seller itself be contractually responsible for systemic transition services relating to the business, such as back office support, training, customer service procedures, and other key aspects of the target company's business. In those instances, the parties should consider drafting a transition services agreement (as a stand-alone agreement or as part of the purchase agreement). The parties should confront potential issues in connection with the transition services agreement early. For example, the seller will have less motivation to assist buyer if consideration has already been paid and/or if few obligations to perform remain post-closing. In addition, the cost of transition services will likely impact the purchase price. The parties need also consider the conflicting interests. From the buyer's perspective, it will want to ensure that the transition is seamless and that day-to-day operations are not disrupted. From the seller's perspective, it will want to define scope, compensation, and time commitment so it can plan accordingly. A properly drafted transitional services agreement should generally include scope, the length of time, the seller's compensation, acceptance criteria, and any allocation of risk.

Gift Cards/Gift Certificates. In any M&A asset transaction involving the retail industry, buyer should devote some attention to previously issued gift cards and/or gift certificates (together "Gift Cards"). While Gift Card liability may be difficult to accurately pinpoint, since it may be hard to determine how much is likely to be redeemed post-closing, buyer should not assume that declining to assume those liabilities is the end of the matter. While a buyer is within its rights to reject the assumption of Gift Card liabilities, it may be undesirable to turn away existing customers who wish to redeem Gift Cards issued pre-closing. Doing so may harm the relationship with valued customers and the goodwill of the business. Most buyers will instead elect to assume at least some Gift Card liability and negotiate terms in the APA to reflect the bargain. Usually, a buyer will conduct appropriate due diligence with regard to Gift Card liability to project the percentage of outstanding Gift Card liability

CP2 Welcomes New Attorney Jeremy Rose

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Jeremy Rose's legal practice focuses on all areas of business, technology, and special district matters, including corporate transactions, special district formation, elections, IT governance and risk management, and associated litigation.

Before joining CP2, Mr. Rose was a solo practitioner in the Northern Colorado community for seven years while also completing 18 years of service in the Army National Guard as a Judge Advocate, including serving as the sole attorney for a Special Operations command deployed to the Arabian Peninsula.

Mr. Rose received his Bachelor of Science degree from Doane University, majoring in biology and music and minoring in chemistry. He worked for several years in the banking and finance industries before graduating law school at Creighton University School of Law in Omaha, Nebraska. While in law school, Mr. Rose focused his coursework on business law, receiving his Juris Doctorate with a concentration in business.

which is likely to be redeemed. The Buyer will usually want the APA to reflect that the face value of the Gift Cards (subject to any caps or limitations) is being assigned to Buyer, provide Buyer with an appropriate credit against the purchase price, and provide language as to any post-closing adjustments. The failure to deal with this issue may surprise the buyer and could lead to post-closing conflict between the parties.

Transfer of Trademarks. It is very common for target companies to own registered trademarks. For that reason, registered trademarks are commonly an asset to be acquired by a buyer. Because the value in proportion to the other assets may be less significant, a buyer in an asset deal may neglect material trademark issues, such as how to properly assign and transfer registered trademarks. While the parties will generally draft a bill of sale to transfer title to the assets, buyer should make sure that they enter into a separate, recordable, trademark assignment with the seller prior to or at closing of the transaction. The typical bill of sale will not allow the buyer to properly record the transfer of ownership of the trademark with the USPTO. To be a valid assignment, it must contain language that the registered trademark is being assigned together with the goodwill of the business to which the mark pertains. 15 U.S.C. § 1060(a). Under 15 USC 1060(a), the failure to record the assignment with the USPTO within three months after date of the assignment, or prior to a subsequent purchase, means the assignment is void against a subsequent bonafide purchaser without notice. The failure to draft a separate and sufficiently worded trademark assignment, and record the same with the USPTO, could render the applicable trademarks abandoned, or otherwise negatively affect the right of buyer to use the trademark post-closing.

Even experienced parties to M&A transactions may overlook issues which do not arise frequently. While overlooking an issue may sometimes be of no consequence — a buyer unaware of potential bulk sales successor liability suffers no loss because there is none — other times a failure to perceive such an issue may result in expensive and time consuming consequences for the buyer and the seller. This article has highlighted a few of those M&A issues that sometimes get overlooked. While they usually involve less risk than more prominent material issues, sufficient attention should be afforded to all potential legal risk to reduce the risk of potential loss and properly protect the parties.

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