# Article

# A List Of Common M&A Transaction Showstoppers

The following is a list of typical “showstoppers” that can derail an M&A transaction or result in a reduction of the purchase price. If you have any questions, contact Rob Kibby.

**Stock/equity ownership issues.** If the buyer is acquiring the stock/equity of the seller, the buyer’s counsel will do a thorough investigation of the seller’s capital structure to attempt to spot any of the following:

- Commitments to grant equity that haven’t been recorded in the ownership records
- Equity ownership records that aren’t clear or are inconsistent with other company records
- Agreements to issue equity interests with unusual antidilution or other rights
- Agreements or obligations to issue securities haven’t been complied with
- Equity ownership records that conflict with information in Secretary of State filings
- Stock certificates that are lost or misplaced
- Undocumented stock transfers; multiple claims for same ownership interest
- Owners who can’t be located
- Company repurchases of equity where state laws haven’t been followed
- Owners who are uncooperative
- Issuances of equity in transactions that are not clearly exempt from securities registration requirements
- Use of unregistered broker to conduct private securities offerings

**Issues with financial statements or accounting records.**

- Financial statements don’t reflect all financial transactions
- Because buyers typically analyze the performance of a business based on the seller’s financial statements, exceptions from generally accepted accounting principles (GAAP) need to be identified. Revenue recognition and inventory valuation are commonly recurring issues.
- Personal financial transactions are run through the business and mingled with business transactions.

**Intellectual property (IP) ownership issues.** These types of issues commonly arise from the following:

- Employees haven’t signed confidentiality agreements that protect customer lists, trade secrets, technology, etc.
- Independent contractors have developed software or other technology but haven’t assigned their rights to the company, which could create joint ownership of the IP.
- Company uses IP that appears to infringe upon another’s IP rights.

**Key employees aren’t bound by non-competition/non-solicitation agreements,** which could enable them to leave and raid customers or employees or set up a competing business.

**Contracts with terms that a buyer won’t want to assume.** Examples include:

- Exclusivity is granted with respect to specified territories, customers, or lines of business.
- Pricing is substantially below market and can’t be modified; there are substantial limitations on the ability to raise prices; or “most favored nations” clauses require seller to give specified customers the best deal offered to any customer.
- Contract provides for substantial future payments when no future benefits will be realized to the buyer. One example of this is a referral fee agreement that provides for “perpetual” payments to the referral source, far beyond the initial customer introduction.

- Contracts contain “no assignment” clauses or require consent of the contract counterparties to assign, which makes an asset sale difficult to consummate.

Tax risks. There are many tax issues that can derail a transaction, and buyers will typically conduct substantial tax due diligence. One way a seller can anticipate these issues and solve issues before they occur is to have its accounting firm weigh in on substantial tax issues as they are encountered instead of waiting until an M&A transaction is in view.

Customer issues. Because buyers will want to talk to your key customers, you’ll need to make sure that your relationships with them are good and that any outstanding issues have been addressed. It’s best not to have any surprises here.

Employee claims. This can be a particular problem with recently terminated employees who smell an opportunity to make a claim and get a quick settlement. Substantial liabilities can also result if the company doesn’t comply with OSHA requirements or facilities do not comply with access requirements for the disabled.

Immigration matters. Potential issues often arise with companies that use a significant number of unskilled workers. Buyers will often ask to review copies of Social Security “no match” letters the seller has received. This review will help potential buyers assess whether the company has a substantial risk of government raids or fines.

Regulatory issues. The particular issue depends on the industry in which seller operates and could include failure to possess the necessary licenses or the failure to comply with regulatory requirements that would expose the company to fines or penalties.

Issues with key creditors. If the seller’s business is substantially dependent upon its relationships with key creditors, the buyer will be interested in the quality of those relationships. If the seller is experiencing financial difficulties, the buyer will want to assess whether the seller’s lender will continue to advance funds until the closing.

Litigation, claims and contingent liabilities. Buyer’s counsel will do substantial due diligence to find and assess potential problems, and a buyer will typically expect the seller to continue to be responsible for claims that aren’t insured. Claims often come out of the woodwork when a transaction is in view, and it often pays to try to resolve any claims and potential claims before a transaction arises.

Environmental conditions or liabilities. Buyers typically don’t want to assume environmental liabilities, so it’s often best to have a game plan to address environmental liabilities and risks if the seller’s business lends itself to those types of risks.

Joint ventures/strategic partner relationships. Although sellers might view joint venture and similar agreements as being similar to other types of business contracts, they do present special risks and will require the buyer to do substantial due diligence. Buyers will pay special attention to ongoing capital contribution requirements, tax issues, potential liabilities, and the reputation and competitive position of the other venture party.

ERISA/Employee Benefits. Issues often arise in the following areas:

- Failure of compensation plans and benefit plans (including qualified plans, option plans, etc.) or their operation to comply with legal requirements
- Underfunded pension plan liabilities
- Employment or severance contracts provide for substantial payments or obligations to terminated employees, including golden parachute payments, health benefits, perks, etc.

## Primary Contacts

Robert Kibby
Dallas
214.855.7504
rkibby@munsch.com

## Related Practices

Corporate & Securities
Mergers & Acquisitions