ENTERPRISE IRELAND

# Ask U$

ADVICE, STRATEGY AND KNOW-HOW
ON DOING BUSINESS IN THE U.S.

## A GUIDE TO ESTABLISHING OR ACQUIRING A BUSINESS IN THE U.S.

# Table of Contents



Success in export markets is crucial to the long-term growth of Irish business and the Irish economy. Support for companies who are focused on rapid growth is a corporate priority for Enterprise Ireland. Through its network of 33 offices worldwide, Enterprise Ireland works in partnership with Irish industry to develop its business internationally.

'A Guide to Establishing or Acquiring a Business in the U.S.' is part of Enterprise Ireland's *AskUS* campaign that aims to provide a framework for Irish industry to focus successfully on the U.S. market.

*Ask U$* is an information suite broken out into a series of easy to read Guides that address the key areas you need to consider when doing business in the world's most powerful market. Each individual guide has been written by professionals in their field who have provided advice and insight on the most crucial elements you need to keep in mind to create a compliant, effective and successful presence in the U.S.. In addition to this Guide, there are five other guides in the series that cover:

- Marketing in the U.S.
- Tax and Finance
- Immigration
- People, Patents and Partners
- Public Relations

To learn more about the U.S. and to build your business in this land of opportunity, consider Enterprise Ireland as your strategic partner. With a network of 33 offices worldwide including five in the U.S., Enterprise Ireland is serious about global business.

Regardless of your industry background, stage of development or market focus we have qualified people on hand to help you. Call us now and speak to us about your ambitions.

*By Margaret Rowe of Rayner Rowe LLP*

# RAYNER ROWE LLP
## ATTORNEYS AT LAW

*Rayner Rowe LLP was established almost seven years ago as a New York law firm by Daniel Rayner. Daniel is an Englishman who has practiced law in both London and New York and his idea was to develop a practice advising English companies with U.S. interests or to act as New York counsel to the law firms representing those companies. Margaret Rowe is Irish and admitted to practice there as well as in England and in New York. She has practiced corporate law in New York for many years. She joined Rayner Rowe in 2003 as a partner and has developed a similar practice involving the Irish and U.K. business and legal communities. Margaret is currently based at the firm's London office.*

*Rayner Rowe, is a boutique practice, specializing in corporate transactional work and has offices in New York and London. It prides itself on having a user-friendly and cost conscious approach to the provision of legal services for its clients, and its partners have over 40 years of experience working in big firm environments. While a small firm, it has, through its affiliation with Interleges, access to lawyers throughout the world. Rayner Rowe's corporate clients include U.S. corporations as well as U.K. and Irish companies. Because of our European background we are more aware of the cost-consciousness of European clients and to distinguish ourselves from other New York lawyers, our policy is to discuss the fee structure at the outset with our clients and charge on an hourly rate or quote a flat fee for the transaction, depending on the client's wishes.*

*Rayner Rowe LLP would be happy to advise you on any questions on U.S. law relating to this guide. Please contact the writer, Margaret Rowe at the address below or phone her directly at (1) 212-497-8061 if in the U.S. or at (44) 207-833-9671 if in Europe.*

*Margaret Rowe (margaret@raynerrowe.com); Daniel Rayner (daniel@raynerrowe.com).*

Raynor Rowe LLP
10 East 40th Street, 26th Floor, New York, NY 10016 • Tel: 212-497-8065 • Fax: 212-213-0540
www.raynerrowe.com

## INTRODUCTION

This Guide is designed to give non-U.S. investors and operating companies an overview of the issues involved in establishing and/or acquiring a U.S. business.

**Advantages of Entity:** Corporations and LLCs are formed to enable persons to transact business without having personal liability for the debts incurred by the business. Incorporating a business is relatively easy but nonetheless requires specialist help.

**Planning Stage:** There are important considerations that should be discussed at length both with your financial advisors and your lawyers before you decide to do business in the U.S.. In addition, it is important to carefully decide **where** to organize your entity and to choose the **type** of entity that is best suited to your needs. The initial considerations and preparatory work should include, at a minimum, the following:

- Articulating clear reasons for establishing a company in the U.S.; should you simply continue to do business in the US from your home base or should you establish a business entity within the U.S.?
- Deciding what type of entity best suits your purpose and where to organize that entity;
- Considering the tax ramifications both from a personal and entity perspective;
- Preparing a good business plan;
- Choosing the name of the new entity and deciding on a physical location;
- Planning the ancillary steps to be taken and their timing, e.g. finding office space, executing a lease, establishing phone and Internet access, advertising and developing a website and registering a domain name;
- Choosing a bank with which to develop a relationship;
- Dealing with all relevant immigration issues;
- Analyzing the costs involved.

**Why Bother?:** A lot of non-U.S. companies transact business in the U.S. but never establish a U.S. base. However, if you have a large volume of business in the country, you should incorporate. Having a U.S. base is also advisable for the following reasons:

- it is a strong selling point with U.S. customers;
- Americans are often reluctant to make overseas phone calls to contact you if there is a local alternative;
- they are also reluctant to buy products unless assured that problems can be solved quickly and at a local level;
- if your activities come to the attention of the regulatory authorities:

– you may be fined;

– it could complicate subsequent efforts to incorporate;

– it would be foolish to come to the attention of the IRS for the wrong reason[1];

– your employees working without proper visas may be asked to leave the country and re-admission would be difficult;

– if you need to pursue a customer over an unpaid bill or any other reason, the courts would be unlikely to allow you to initiate proceedings.

**Location:** Most U.S. companies are organized in a different State from the one in which they are head-quartered. When you decide you want to incorporate a business in the U.S., location is one of the important business considerations and it is equally important in the legal arena. **Delaware (DE) is the common choice and has a very favorable business environment from a legislative and judicial perspective but may not be the best location for the sales team. The majority of U.S. companies are formed under the laws of Delaware; in fact over 60% of Fortune 500 companies and 50% of companies listed on the New York Stock Exchange are incorporated there and almost none of them has a real presence in that State.** Incorporating in Delaware is popular because it has a highly developed body of law, including case law relating to corporations; it affords directors and officers greater protection against liability and it gives a corporation's management more independence from shareholder interference. In addition, both its courts and the various departments of the State that deal with businesses are efficient and friendly.

*Incorporating in Delaware is popular because it has a highly developed body of law, including case law relating to corporations; it affords directors and officers greater protection against liability and it gives a corporation's management more independence from shareholder interference.*

Most U.S. business lawyers are well versed in the corporate laws of Delaware even if admitted elsewhere and can usually advise on Delaware corporate law. Delaware gets over 30% of its revenues from the franchise and other taxes paid by corporations so it is very unlikely to change the rules and regulations in an adverse manner.

Insofar as your company needs a presence in a State other than Delaware, we usually suggest that you incorporate in Delaware and then seek "authorization to do business" in that other state. (See page 6)[2]

There are a number of non-profit and state-sponsored organizations that offer advice and practical help to new businesses, including the NYC Department of Business Services, the Small Business Development Center and the New York Business Development Corporation, all based in NYC. In addition, the Small Business Administration will provide loans to qualified entities.

[1]If a company is doing substantial business in the U.S., the Internal Revenue Service may become curious and attempt to claim taxes on profits.

[2]California has become so concerned about the propensity of companies to incorporate in Delaware that it now treats foreign corporations (those incorporated in other states) very aggressively, and if more than 50% of the publicly traded entity's voting securities are owned by Californians, then California law will supercede the laws of the jurisdiction in which the company is incorporated.

## CHOOSING THE FORM OF BUSINESS ENTITY

One of the most important decisions when starting a business is what entity to choose. All of the options discussed in this Guide have advantages and disadvantages. Usually the most important considerations are (i) avoiding personal liability for business debts and obligations; (ii) decision-making and control of the business; and (iii) the impact of tax laws.

When a foreign entity decides to organize in the U.S., the decision needs to be analyzed from a tax perspective. The use of a branch of a foreign corporation to operate a business in the U.S. presents significant complexity primarily as a result of the way deductible interest expense is computed and the application of the "branch profits tax", which is used in connection with the taxation of foreign corporations[3], in addition to which there are no significant cost savings. Sole-proprietorships and general partnerships are also legitimate forms of business enterprises and usually inexpensive to establish but they leave the owner personally liable for business debts and are rarely advisable. A foreign entity will usually form a Corporation[4] or a Limited Liability Company. Both offer limited liability for the entity's debts and obligations.

*Most corporations are C corporations and this type of entity has one major disadvantage; the corporation pays taxes on its profits and if dividends are paid to shareholders, they too must pay taxes.*

**The most common forms of business entities are:**

**(a) Corporations:** "C corporations" are the more common, but "S corporations" are also used. In both cases, a Certificate of Incorporation is filed with the relevant Secretary of State which should include a description of the corporation's purpose or state that it is being incorporated for "any legal purpose";

**(b) Limited liability companies:** ("LLC"), where one or more persons form an entity by filing Articles of Organization (Certificate of Formation in DE) with the relevant Secretary of State and agreeing other matters relating to the management of the LLC in an Operating Agreement;

**(c) Partnerships with unlimited personal liability and limited partnerships:** a hybrid partnership where liability is capped at the amount of capital invested and which has at least one general partner whose assets are not protected;

**(d) Limited liability partnerships:** which is a general partnership that provides professional services (e.g. law firms) and is registered as an LLP.

**This Guide focuses on C corporations and LLCs, as the choice of entity usually involves an election between the two.**

### Corporations:

A corporation is a business entity where the entity formed is completely separate from the shareholders forming the entity and becomes an artificial legal entity that carries on business through its officers on behalf of the shareholders. The shareholders appoint a Board of Directors and the Board designates officers to manage the corporation; the shareholders are not involved in the day-to-day management of the corporation. The shareholders receive stock certificates representing the amount of their invested capital[5] and ownership is transferred by the sale of stock of the corporation. It is possible to have a corporation with a sole shareholder. Most corporations are C corporations and this type of entity has one major disadvantage; the corporation pays taxes on its profits and if dividends are paid to shareholders, they too must pay taxes. Recent enactments, however, have eased this double-tax burden and if the corporation is not paying dividends, the concern about double-taxation is not an issue. Notwithstanding the foregoing, if the IRS decides that there is an unreasonable accumulation of income in the corporation it may force the corporation to pay over the taxes ("accumulated earnings tax").

An S corporation is the same as a C but with a special tax status. An S corporation arises where an existing C corporation files Internal Revenue Service ("IRS") Form No. 2553 electing to have all profits taxed to the shareholders directly rather than the S corporation, which pays no federal or state taxes. The disadvantage of an S Corporation is that even in situations where it determines that the profits will not be distributed to the shareholders, the IRS will treat the profits as taxable income of the individual shareholders in that year. However, the impact of this is lessened, as a shareholder could offset corporate losses against his income tax liability. Certain criteria must be met before a C corporation can become an S corporation and it is essential to get up to date tax and legal advice on the subject. **Non-resident aliens may not be shareholders of S corporations.**

### Limited Liability Companies:

The concept of an LLC is relatively new, but has become very popular and statutes on the subject have been adopted into legislation in all 50 states and in the District of Columbia. While the law relating to LLCs is very similar in all the states, the tax treatment of LLCs does vary, e.g. Texas treats an LLC as a corporation. In both DE and New York, LLCs can be organized for most lawful purpose, but banking and insurance are excluded. Single member LLCs are permitted and there is no upper limit on the number of owners.

[3] It is important to get tax advice before establishing a branch operation. For further information, please refer to the *AskUS* guide 'Tax and Financial Considerations on Doing Business in the U.S.'

[4] Any reference in this Guide to "Corporation" is unless otherwise stated a reference to a C Corporation.

[5] Pursuant to the 2004 amendments to the Delaware General Corporation Law, it is now possible to have shares issued for entirely non-monetary, intangible consideration (Section 152). However, Section 153 remains intact, so that shares with a par value still cannot be issued for consideration less than such par value (although such consideration may be in any of the forms now authorized by Section 152).

The formation of LLCs as opposed to C Corporations is becoming more common. Owners of an LLC are called members. The members may directly manage the LLC or may delegate all or part of that task to "managers". As a hybrid of the C corporation and a partnership, it has some of the advantages of both - limited liability and the owners, not the entity itself, are taxed. The management of an LLC is governed by a combination of statute and the terms of its Operating Agreement (which is similar to a corporation's bylaws). The charter document, which is filed with the Secretary of State is a very simple document which gives the name of the LLC, the address of the registered office and other basic details.

As in a corporation, the members contribute capital in cash, property, services or other obligation to contribute cash, etc[6]. As a "pass-through" entity, its income, deductions, gains and losses flow through and are reported on the individual members' tax returns and the LLC does not itself file tax returns or pay taxes. Profits and losses are allocated amongst the members in accordance with the terms of the Operating Agreement or if not specified, in accordance with their capital contributions.

**The costs involved in the initial formation of an LLC vary from State to State with Delaware usually being the lowest. The out-of-pocket expenses in DE are approximately $500 - $700, which would include the filing fee, the cost of getting a certified copy of the Articles of Organization and a Good Standing from the Secretary of State, a Minute Book, the costs of using a corporate search company to do the filing plus the annual fee to that corporate search company for acting as agent in the State. Insofar as the newly formed entity needs "authorization to do business" the out-of-pocket expenses will increase accordingly, e.g. in Massachusetts the filing fee alone is $500 and total costs will amount to approximately $800 – $1,200.[7] The annual filing fee for LLCs was recently increased to $500 from $325 in NYS and the fee per member was increased by $50 to $100. In addition those fees must be paid earlier - January 30th of each year and out-of-pocket expenses typically apply.**

### C Corporation versus LLC:

The main advantages of a C corporation over an LLC are:

- its ownership liquidity; it is very easy to develop a market in, and trade shares of, a corporation so if you want to raise capital from the U.S. markets you will need a C corporation;
- the fact that corporation tax rates are often lower than personal income tax rates.

In addition, the laws relating to corporations are more developed and as a result there is more predictability. Some argue that there is less formality and expense relating to the formation of an LLC than to a corporation but that point can be debated. Corporations require a formally elected board, statutory officers, stockholders meetings and proper records. While one can neglect the mandated formalities, there are risks involved and the Board could be found to be in breach of its fiduciary duties. In addition, taxes are payable on the number of shares authorized both at the time of incorporation and on an annual basis. One advantage of the LLC is its tax flexibility; the members of the LLC are allowed to choose how the entity will be taxed. Most LLCs select to be taxed as a partnership and the LLC is treated as a "pass-through" entity, paying no separate entity level tax and therefore there is no double taxation. If an entity intends to pass a substantial portion of its income to its members, an LLC is probably the best choice. In addition to the single level of taxation and the resultant simplified tax returns, the LLC provides limited liability and maximum flexibility in relation to the division of profits and losses. However, it is important to note that non-U.S. equity holders in a business operating as an LLC may be required to file U.S. federal and state tax returns and pay U.S. tax on the operating income of the business, where they would not have such an obligation if the business was operating as a corporation. This is a key area of concern, so the issue of the structure of the business should be considered carefully with experienced counsel.

*It is important to note that non-U.S. equity holders in a business operating as an LLC may be required to file U.S. federal and state tax returns and pay U.S. tax on the operating income of the business, where they would not have such an obligation if the business was operating as a corporation.*

### Authorized to do Business:

As previously mentioned, organizations (including corporations and LLCs) formed outside the state where they intend to conduct business, called "foreign" corporations (whether formed in another state of the U.S. or in another country), generally may not do business in the relevant state unless authorized to do so. For example, if you incorporate in Delaware you can only "transact" business in another state if you are authorized by that state to do so.

In New York, for example, the terms "doing business" and "transact business" are not defined by statute, but relevant law does provide a nonexclusive list of what does not constitute "doing business" in NYS. Other States may have slightly different guidelines. It is clear that conducting an isolated transaction does not qualify as "doing business" nor does soliciting orders via email or internet. If regular business is carried out, however, proper authorization is required. Generally, a state would view each case on its particular facts but would consider the following factors:

[6] A recent amendment to the Delaware General Corporation Law (August 2004) addressed the type of consideration for which a Delaware corporation may issue stock. There is now no restriction on the types of consideration that may be paid for the issuance of stock and stock may be issued for any consideration the Board deems appropriate – including services to be rendered in the future. However, case law indicates that there could be a challenge to the directors' judgment on the value of the non-cash consideration, if excessive.

[7] Example: if you want to form a Delaware LLC and seek authorization in Massachusetts, the out-of-pocket expenses today will be approximately $1,500. In addition you must factor in the costs of hiring a lawyer to prepare the organizational documents, the tax forms and to ensure that the filings are made correctly, etc.

- Whether the Corporation has a physical presence in the state;
- Whether the Corporation has employees in the state;
- Whether the Corporation accepts orders in the state and has a bank account located there.

The "authorization" requirement exists mainly to protect domestic corporations from unfair competition and it has the advantage of placing the domestic and the foreign corporation on a similar legal footing in the State. A corporation doing business "without authority" is at a disadvantage. For instance, in most states it will be prohibited from initiating a lawsuit in the courts of that state and may face tax fines and penalties. The authorization process is relatively straightforward and usually requires the filing of an "application for authority" with the Secretary of State which gives the name, jurisdiction of incorporation, the purpose, and other basic information about the entity. Each State has its own filing requirements and charges.

*A corporation doing business "without authority" is at a disadvantage; for instance, in most states it will be prohibited from initiating a lawsuit in the courts of that state and may face tax fines and penalties.*

## FORMATION FORMALITIES

When you have discussed your plans with your accountants and lawyers and decided whether to establish a corporation or an LLC and where to organize, there are certain administrative matters that should then be dealt with:

### Corporate Name:

It is important to first check if your chosen entity name is available and, if so, to reserve it, particularly if the chosen name is peculiar or special to the business being incorporated. The name of the corporation or LLC must include one of the following words, as appropriate: incorporated, Inc, corporation, corp., limited, limited liability company or LLC. Once you know the name is available, you can reserve it, during which time no other person will be allowed incorporate using that name, giving you time to complete the incorporation procedures.

*The EIN number is a nine-digit number assigned to all businesses for tax filing and reporting purposes and must be obtained whether or not your company has employees.*

### Organizational Documents:

Depending on whether you plan to establish a corporation or an LLC you will need to prepare either a Certificate of Incorporation and Bylaws or, in the case of an LLC, the organizational document and an Operating Agreement. While it is easy to download precedent forms from the many websites that exist, it is important not to blindly follow any form. You or your lawyer should draft such documents that conform to current law, your requirements and the long-term needs of the corporation or LLC.

### Registrations:

In addition to the preparation of the relevant organizational documents, you will need to file an application for a Federal Employer Identification Number (EIN number) on Form SS-4. An EIN number is similar to an individual's Social Security number. Form SS-4 should be filed as soon as the entity is incorporated and can be downloaded from the IRS's website, www.irs.gov. One can apply on-line or over the phone by following the instructions on the form and if you have all relevant information it can be done very quickly. The EIN number is a nine-digit number assigned to all businesses for tax filing and reporting purposes and must be obtained whether or not your company has employees. It is used to establish the entity's business tax account and is often required information on other official registrations and applications regardless of the State, e.g. opening bank accounts, seeking authorization to do business in certain states and for all tax filings.

**If a foreigner is an EIN applicant and does not have a Social Security Number, then that applicant must apply for an Individual Taxpayer Identification Number.** The form is simple enough and can be downloaded from the IRS website. When completed, it must be submitted along with a certified copy of the applicant's passport and other supporting documents. It can take up to 6 weeks for the form to be processed, though efforts are being made to speed it up.

## ACQUIRING A U.S. COMPANY

**General:** If you are contemplating the acquisition of a U.S. corporation, you should first discuss the tax implications with your financial advisors. *(For further information please refer to the AskUS guide 'Tax and Financial Considerations on Doing Business in the U.S.')* This 'Establishing Your Business' guide discusses the acquisition of private companies only, as the acquisition of a publicly quoted company in the U.S. is an entirely different and more complicated affair. Between 1980 and 2003 there were almost 17,000 acquisitions of privately held companies against 7,300 acquisitions of publicly traded companies in America.

**Reference Sources:** The Baker Library which is affiliated with Harvard Business School (http://library.hbs.edu) is an excellent place to start your research for a suitably sized company in your industry but there are lots of others. The library will identify companies within industry classifications and provides overviews, financial data and analysis of the companies listed. Of course, you can also go to an investment banker or broker but in this internet age it is advisable and also less expensive to do the initial research yourself. You can get advice from Enterprise Ireland, friends and other business people in the U.S. when seeking out such advisors and then interview them carefully.

**Issues to Consider:** The procedures for acquiring a private company are very straightforward and are based largely on the laws of contract. It is not that difficult to understand, and if you have done an acquisition in Ireland or the U.K. you will know roughly what to expect in the U.S..

Once you have decided to purchase a company, identified a potential target ("Target") and have done your initial research, you should discuss with your lawyers and tax advisors the best way to structure the acquisition and whether you want a merger, stock or asset transaction. If you purchase the stock of the Target, you purchase all liabilities of the business along with the assets. However, for you, as the acquirer, it is generally advisable to purchase the assets and avoid the liabilities. The assets you want can then be cherry-picked and can include the name of the Target.

*If you purchase the stock of the Target, you purchase all liabilities of the business along with the assets. However, for you, as the acquirer, it is generally advisable to purchase the assets and avoid the liabilities. The assets you want can then be cherry-picked and can include the name of the Target.*

Finally and most importantly you need to value the Target. This is a business decision for you and your accountants and should be based on the Target's audited financials, cash-flow, strategic fit, etc. There is no standard method of valuation and the price is usually agreed on with Target's management.

**Letter of Intent:** You then prepare an offer letter (called a Letter of Intent) outlining the main terms - the estimated price, whether stock or assets are being acquired and if the latter, it should list the actual assets, etc. The Letter of Intent is always stated to be subject to negotiation of relevant agreements, signing of final documentation and satisfactory Due Diligence. The courts in the U.S. have fairly consistently held that Letters of Intent are not binding, but is it important to state this on the face of the Letter.

The offer price contained in the Letter of Intent is often tentative until the Due Diligence is satisfactorily completed. It is important that the Letter of Intent states that you require generous access to the Target's accountants and other advisors and that you also need full disclosure of all matters relating to the business, finances and prospects of the Target on an ongoing basis. Your lawyer needs to draft the Letter of Intent carefully while leaving plenty of "wiggle" room for additional and standard clauses but as it forms the basis for the Acquisition Agreement it is important that all the major items be included. It should also include a "no-shop" clause, which prohibits the Target from talking to other potential suitors for a defined period to enable you complete the transaction. If the Target signs the Letter of Intent (usually after some negotiation) it will usually insist on having a signed Confidentiality Agreement before providing any financial or proprietary information.

*The Due Diligence Checklist should be prepared by your lawyer with input from your other advisors and should cover the business, financial and legal aspects of the Target.*

**Due Diligence Phase:** The problem with acquiring a private company is that there is little information available to the public so the Due Diligence must be thorough. It is generally advisable to prepare a Due Diligence Checklist which lists all the documents needed from the Target.

Once the Letter of Intent is signed you should present the Due Diligence Checklist to the Target; the review of the relevant documents can take place on or off-site but a partial on-site review is recommended as it will give your advisors an opportunity to talk to the Target's employees on an informal basis. The Due Diligence Checklist should be prepared by your lawyer with input from your other advisors and should cover the business, financial and legal aspects of the Target. The List is usually extensive but should, at a minimum, include **(i) financials:** both current and historical audited and unaudited financials, valuation of assets, health and pension benefit costs, letters from accountants, loans, leases, and an explanation of the accounting principles used by Target; **(ii) business:** including product lists, list of all assets and all liabilities, customer lists, suppliers, industry competition, staff information including turnover, rights to intellectual property, management resumes, list of shareholders and backgrounds, status of operations and facilities (actual or potential) and **(iii) legal:** all corporate documents, charter documents, copies of minutes, copies of all agreements, including software licenses, etc, list of insurances, information on litigation (including threatened litigation), title deeds to and/or leases of properties and facilities, and copies of environmental reports.

The Due Diligence process is tedious but essential and you and your senior management team should be heavily involved in meeting with and interviewing Target's senior management. Also, if Target was on the block in advance of your offer, the reasons why and the lack of other interested suitors should be explored. Your accountants and lawyers will do most of the due diligence but you must be actively involved. If there are environmental issues, they need to be fully explored. Law firms are inclined to have a junior person conduct the bulk of the Due Diligence and you should decide if that practice is appropriate. Once complete, the lawyers should prepare a report of their findings for your approval. In the meantime the accountants should review the financial information, paying particular attention to the footnotes to the audited reports and do whatever ratio and comparative analyses you require. All parties should talk to staff of Target and get their feedback.

**Drafting Acquisition Agreement:** While the due diligence is in progress, your lawyers (traditionally the acquirer's lawyers) should draft the Acquisition Agreement. The Agreement usually has 5 main sections but is nonetheless a lot longer than the typical form used in Ireland:

(i) the type of transaction – merger, asset or stock and, if an asset purchase, a list of the included and excluded items;

(ii) the conditions precedent to the consummation of the acquisition, e.g. satisfactory Due Diligence, payment of purchase price, consent of necessary third parties, approving resolutions of Target and acquirer and a representation that there has been no recent material adverse change in Target's business, finances or prospects;

(iii) the terms – price, how the price will be paid and in what format, e.g. all cash, all stock or a combination of stock and cash and whether there will be holdbacks, etc. It should also include sections relating to retained management and employees, if any;

(iv) the fourth section contains the representations and warranties of the Target and limited representations and warranties of the acquirer;[8]

(v) the covenants.

In a case where assets only are being bought, you need to incorporate the acquisition vehicle. You may also need to have employment agreements, non-compete agreements,* assignments of leases and licenses prepared, but your lawyer should be able to handle most of this. You need to review the important documents carefully and ensure that there are no unnecessary delays. Before fixing the offer price and signing-off on the draft Purchase Agreement, you should carefully review the final Due Diligence Reports with all your advisors and ensure that you have lined up the necessary financing.

**Bank Financing:** If you are borrowing to complete the acquisition you need to ensure that the banking lawyers are working in tandem with the corporate people. The Loan Agreement is one of the most important documents for you and your CFO to review, as the financial covenants are usually heavily negotiated and must allow you the flexibility to run the business, especially in the early phases. Different banks have different financial tests/ratios and before choosing the lender it is often useful to look at that institution's typical lending document and decide if it is reasonable. Your U.S. lawyers and advisors should have some suggestions but you do need to shop around for a suitable bank with which to develop a relationship. Also remember that in the U.S. you pay the bank's fees and costs. The lending criteria of banks are sometimes so stringent that it is difficult to get a loan, but whatever you do, you must avoid giving a personal guarantee.

*The Loan Agreement is one of the most important documents for you and your CFO to review, as the financial covenants are usually heavily negotiated and must allow you the flexibility to run the business, especially in the early phases.*

**Closing:** Once the Due Diligence is satisfactorily completed and the Acquisition Agreement and all ancillary documentation has been negotiated, all that remains is to sign the agreements and hand over the money.

**Problems:**

(a) The potential acquirer must retain his objectivity throughout and know when to walk away from a deal. It is very important to spend time and effort on comprehensive Due Diligence and objectively analyze any problems discovered.

(b) Sometimes one sees 'the tail wagging the dog' with lawyers quibbling over non-essential details and accountants arguing about the tax treatment of some minor asset. You need to ensure that your advisors are cost conscious.

(c) If you are hoping to retain employees ensure that, to the extent possible, they are informed of developments at an appropriate point in the process.

(d) Ensure, in conjunction with Target, that the relationships with key customers and suppliers are maintained.

(e) Discuss the allocation of the purchase price with your tax advisors in advance of the acquisition and take advantage of any provisions of the tax code that are applicable to you. The Target will have a preferred method of structuring the acquisition in terms of tax liabilities but you need to be well advised from the outset and you may need to seek the advice of a tax lawyer with cross-border experience as well as your accountants.

(f) If the owner or any senior management members of the Target are not invited to join your new team, you need to ensure that carefully drafted non-compete and non-solicitation agreements are in place preventing them from setting up a competing business and poaching your staff. This is an issue that should be raised early in the negotiations or included in the Letter of Intent.

(g) Ensure that the business and the assets are insured during the negotiations and that the insurance continues under your ownership.

(h) Beware of talk of "synergy"- KPMG in a recent study of global acquisitions concluded that almost 80% failed and the combined group did not do as well as their peer group. The evidence is that cost-saving mergers have better success than growth synergy mergers.

(i) Sometimes "fairness" opinions are sought from an investment bank at considerable cost, but they are worth the effort. When deal makers (even with "Chinese Walls" in place) also pass judgment on whether the deal makes sense, you may have a conflict of interest.

(j) The few empirical studies on private acquisitions unanimously show that short-term market reaction around announcements seems to favor acquisitions of private companies – mainly because when both companies are publicly traded, the acquirer normally pays a premium whereas the owners of private companies are often willing to accept a discounted offer and the return is greater when the bidder offers stock[9]. Also it is sobering to remember that of the top 10 serial acquirers of the 1990s (including Tyco, Cendant, GE, and WorldCom), 8 reported serious accounting problems in the recent past.

[8]If the consideration being paid is not all cash, a representation that the information provided by Target is complete and accurate is common and should include language to the effect that nothing has been omitted which would make any of the information provided false or misleading.

[9]Extrapolated from Journal of Finance, Vol LVII. No 4 August 2002, page 1763.

*For further information on recruitment, please refer to the *AskUS* guide 'People, Patents and Partners: Protecting and Developing in the U.S., Your Company's Most Valuable Assets'.

## CONCLUSION

Whether acquiring an existing U.S. company or incorporating a new entity the following advice is useful:

(a) Spend time preparing a business plan. Make sure it gives a clear picture of where your start-up and ongoing funds come from, the financial prospects (complete with pro forma accounts for at least 3 years), critical marketing information, business goals, customer lists and a chapter on prospects and potential growth. When the business plan is being given to a bank or potential investor it may be advisable to have it prepared by a professional.

(b) Choose lawyers and accountants with whom you can work well and who will be responsive. Always interview them and speak to references before making your choices. Also, if you need to find premises, your lawyers/accountants should be able to provide referrals to real estate brokers.

(c) When the entity is formed/acquired ensure that all initial and ongoing corporate formalities are complied with, e.g. call an organizational meeting to elect directors, adopt bylaws, appoint the officers, issue shares, call regular meetings and keep proper minutes, etc.

(d) The large money-center banks can be very useful for foreign companies as they often make it easier and usually quicker to transfer funds between your home country and the U.S.. However, they can be dismissive of small businesses, so it is important to develop a relationship with the individual branch manager or find a user-friendly bank. Regardless of the bank, resist any pressure to provide a personal guarantee for a loan, as it will destroy the main advantage that the corporation or LLC has bestowed (i.e. limited liability).

*The lending criteria of banks are sometimes so stringent that it is difficult to get a loan, but whatever you do, you must avoid giving a personal guarantee.*

(e) If you need to raise capital for your new business or acquisition there are several sources available, including bank loans and loans from the Small Business Administration (SBA). The SBA does not fund the loan but guarantees it through a bank; there are of course certain criteria which must be met to determine whether your company would be eligible for an SBA loan. Alternatively, if you have insufficient assets to act as security for a bank loan and don't want to give a personal guaranty to a bank, consider whether a family friend is interested in becoming an investor or whether an "angel" investor or venture capitalist is available.

*If the owner or any senior management members of the Target are not invited to join your new team, you need to ensure that carefully drafted non-compete and non-solicitation agreements are in place preventing them from setting up a competing business and poaching your staff.*

(f) Insurance is a costly but necessary business expense. You need to evaluate your needs and discuss them with a reputable insurance broker or agent (again referrals from your lawyers/ accountants should be helpful). You need to consider property and/or casualty insurance, workers' compensation, liability insurance and business interruption.

(g) Make sure that you are in compliance with INS (immigration matters) and IRS (tax matters) rules and regulations.

ENTERPRISE IRELAND

## ENTERPRISE IRELAND OFFICES

---

**NEW YORK**
345 Park Avenue, 17th Floor, New York, NY 10154
Phone: 212-371-3600 • Fax: 212-371-6398

**BOSTON**
50 Milk Street, 20th Floor, Boston, MA 02109
Phone: 617-292-3001• Fax: 617-292-3002

**WASHINGTON, D.C.**
Embassy of Ireland, 2234 Massachusetts Avenue NW, Washington, D.C. 20008
Phone: 202-462-3939 • Fax: 202-232-5993

**SILICON VALLEY**
100 Hamilton Avenue, Suite 130, Palo Alto, CA 94301
Phone: 650-329-1414 • Fax: 650-329-1818

**LOS ANGELES**
5900 Wilshire Blvd., Suite 408, Los Angeles, CA 90036
Phone: 323-936-3623 • Fax: 323-936-3629

---

**www.enterprise-ireland.com**

Enterprise Ireland is funded by the
Irish Government and part-financed
by the European Union under the
National Development Plan, 2000-2006.

NDP
NATIONAL DEVELOPMENT PLAN

EUROPEAN UNION
STRUCTURAL FUNDS

Designed by James, McGrath & Young, NY, NY • January 2006