

Construction

EXECUTIVE

THE MAGAZINE FOR THE BUSINESS OF CONSTRUCTION

Executive Insights

In the current economy, contractors are considering all their options. *Construction Executive* asked leaders in construction law for their advice on an array of legal issues, including the decision to sell, buy or merge a construction business; how to minimize the potential for contract document disputes; and what contractors should know before responding to a federal RFP.

"Contractors faced with an uncertain future may be considering buying a rival, selling the business or merging with another firm. What are the key factors to consider when making this decision?"



MICHAEL X. MCBRIDE
Managing Partner

Connell Foley LLP

The decision to buy, sell or merge a construction company is a difficult one and depends entirely on the objectives for the future of the business. If your company has a strong balance sheet and wants to expand into a different and growing market, consider buying a competitor in that market to gain a foothold. In large part, the decision to sell is driven by business conditions, family succession plans or tolerance for risk. The decision to merge is usually driven by the desire to cash out, yet remain active in the business with a larger and better capitalized company providing greater opportunity for growth.

BUYING A CONSTRUCTION COMPANY

My advice is to buy the assets of the company and not the stock. Pre-existing liabilities on environmental, tax and labor issues would remain with the former company. Significant due diligence of ongoing projects, including a close analysis of the costs to complete current jobs, should be carefully undertaken. In anticipation of a sale, sellers will sometimes book work at or below cost in order to create a backlog and increase the book value of the company.

Buyers also should review the in-house estimates on larger projects. Many purchasers encounter significant financial difficulties in completing ongoing projects from recently acquired companies.

I would also recommend extending the duration of the representations and warranties regarding taxes, insurance reconciliations and environmental issues. These issues inevitably surface three or four years down the road, by which time the seller no longer has the capacity, the funds or the commitment to deal with these issues

COUNSEL AND ADVICE

FROM LEADERS IN CONSTRUCTION LAW

BY DONALD BERRY

appropriately.

Finally, all accounts receivables over 60 days should be written down to zero as part of the valuation process.

SELLING THE COMPANY

From a seller's perspective, I would recommend a stock sale so the liabilities belong to the buyer. We counsel clients to limit the duration of representations and warranties on environmental, tax and insurance reconciliations and litigation. In public transactions, we recommend our clients take cash rather than stock unless the company is a large, well-capitalized public company.

JWP, formerly the Jamaica Water Power Company, purchased numerous construction companies in the 1980s and 1990s with stock and eventually filed for Chapter 11. Numerous owners not only lost their respective companies; they never received full consideration from the sale.

With respect to accounts receivable, the seller should make every effort to reconcile



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them before closing, otherwise they will be written down to zero by the buyer’s accountants.

Selling a company is always a difficult decision. It is usually driven by family members who have a low aversion for risk, are not interested in the business, or no longer want to sign indemnity agreements on the bonds or personal guarantees on the lines of credit. In most situations, it is better for the family members operating the business to buy out existing members and to stay in the business on their own. In addition, senior owners of the firm can sell the company to the senior employees in lieu of selling to a third party. In that way, the senior members can keep their hand in the business with the relationships they have established through their years in the industry.

MERGER

Companies usually merge in order to cash out their stock and to stay in business. Sometimes, a merger provides a better

opportunity to expand the business into other markets and to help grow the company utilizing the expertise, assets and/or marketing exposure of a larger company. It is critical to maintain control of your own operation and the key people who understand the intricacies of your business and its business relationships. Employment agreements should be provided for your key personnel to help them compete and succeed within a large organization.

Many times, the managers and officers of the larger company simply do not understand the business operations of the merged company, but they attempt to run the new business anyway. Your employees may become dissatisfied and leave. The opportunity to expand and succeed is lost.

There needs to be a clear understand-

ing, before the merger, of who is going to run your business and the time period during which your key employees will continue to be able to make critical business decisions. This may be particularly important if you have received stock in the new company rather than cash.

Further, you should understand the business and strategic goals of the company with which you are merging. What are their officers and managers like? Are they handshake people, and do they understand your business? Will they work with you to grow your business or grow the business on their terms? Remember, it will be difficult to “unscramble” the egg if the competitive advantages do not materialize or are lost due to inexperienced or improper decision-making by others in the company.

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