Mergers and Acquisitions in the Grocery World

ISSUES TO CONSIDER WHEN BUYING OR SELLING

When considering buying or selling a business, the parties almost always consider the business terms first. Does the deal make fiscal sense? Will I make money buying or selling? What are the profits and losses, operating history and income, or value of assets?

While these business terms will dictate whether or not a deal should go forward, many buyers and sellers fail to recognize the legal and tax issues that can have drastic impacts on the business deal and its eventual success or failure. And, the earlier that these legal and tax issues are considered, the greater the chances for success, both for the deal and the operation afterwards.

Across all different types of businesses, deals will have a number of common legal and tax considerations beyond the business terms; namely deal structure, types and condition of assets, and contracts, licenses and approvals. But, a few types of businesses combine not only the common general considerations, but highly unique issues and circumstances as well, and retail grocery stores are among them.

Buying or selling a retail grocery store (or a number of them) requires knowledge of common acquisition issues together with an understanding of the specific and critical items that are unique to the industry.

Getting Started: Do Your Due Diligence!

Every purchase, whether a retail grocery store or other business, should begin with a thorough investigation of the business, its finances and operations and its assets.

- *Business and Financial Records:* Audited or reviewed financial statements are always a great place to start. These contain a wealth of information on the business, its past practices and potential liabilities and issues. But, remember that financial statements that are prepared internally could be inaccurate; the safest financials to review are prepared by a certified public accountant that audits or reviews the books of the company, and cleans up incorrect entries. Additionally, it's critical to review the organizational documents and, at a certain point, the tax returns and books and records used to prepare the financial statements. If anything looks awry here, it's not a good sign of things to come.
- *Condition of Assets and Liens:* A physical inspection of the assets and business will begin to tell the story of how the business was run, how maintenance was performed and whether there will be any potential capital outlays after the deal closes; but, a comprehensive lien search (and title report if owned real property is involved) will give you the rest of the picture. What assets are owned outright? What are the liens and who are the lienholders? Are there capital leases? Is there consignment inventory? A lien search starts to clarify the answers to these important questions.
- *Contracts:* Every business relies (or should rely!) on written contracts for its operations. For a grocery store, the major ones will likely be leases (real property and equipment), and vendor and supplier contracts. There should be effectively written contracts in place that spell out the parties' rights clearly, with hopefully no active or likely defaults under any of them!

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General Considerations: Work Through Your Structure and Its Implications!

Once there's a general sense of the business and the shape that it's in, the parties can really start discussing structure. Although, there are a number of ways to structure a deal, each being appropriate under different circumstances and each having drastically different tax implications, most grocery transactions are structured as either a stock purchase or an asset purchase.

A stock purchase allows a buyer to walk into the business as is. The buyer becomes the new owner of the entity that operates the business and, through the entity, inherits all of the assets and liabilities (whether known or unknown, truly ALL liabilities in the business) of the seller. An asset purchase allows a buyer to pick and choose the assets that it wants to purchase and the liabilities that it wants to assume. For a retail business, especially one with a variety of inventory and asset, an asset purchase generally allows the parties to craft a specific deal for certain assets, contracts or lines of business without overly complicating the structure.

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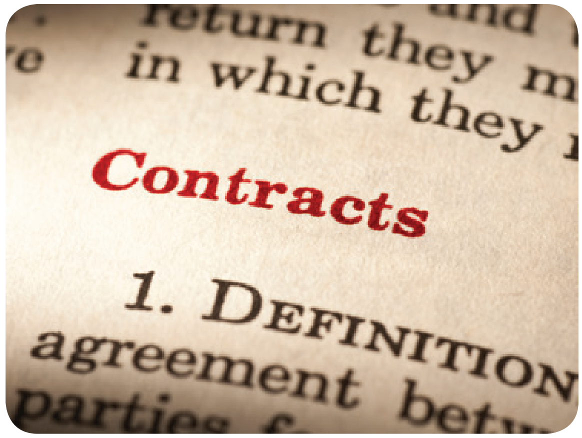
Depending on your role in the transaction, a stock sale or asset sale (or any other structure) will have significantly different impacts on the parties. Generally, a stock purchase is more beneficial to the seller as they are taxed at capital gains rates and a buyer is unable to further depreciate assets. On the other hand, an asset purchase penalizes the seller as they pay tax (generally at ordinary income rates) on the profit on each asset (remember that depreciation reduces your basis), and a buyer takes a basis in the assets in the amount they paid and can then depreciate them.

Grocery Specific Considerations: [Know Your Business and Think About What's Important]

Once you're generally comfortable with the business and have decided on a structure, it's time to dig into the details for grocery stores that can have significant impacts.

- *Bulk Sales Law and Successor Liability.* If a large portion of the assets are sold, there are notice requirements and other items that must be met or the buyer may get stuck being liable to the creditors of the seller. Additional liabilities, taxes and other amounts due to governmental authorities may remain with the business or assets. None of these should be a surprise after a closing, so it's critical to understand these liabilities, amounts due or past due and when they remain payable by a successor upfront.



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- *Contracts.* Many contracts will require notice to or consent of the other party if the business is sold, otherwise the other party to the contract may be able to terminate. If the contract is an important part of the deal, like a lease, supply or vendor contract, make sure that any notice/consent requirements are strictly complied with. Also, if the contract is not part of the deal, make sure that is clear and that the seller takes care of properly terminating it.
- *Licensing.* The permits and licenses needed to conduct the business, including business licenses, environmental and health permits, liquor licenses, pharmacy licenses, PACA licenses, WIC and SNAP licenses may not all transfer to the new owner.

  It is important to understand the required licenses, whether they are transferrable and how they transfer, and how long the process will take to transfer a license or obtain a new one at the relevant location.
- *Regulated Assets.* Some types of inventory are heavily regulated and require special procedures or precautions to transfer. Liquor, pharmacy stock and patient profiles and information all require specific handling.

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- *Employee and Union Issues.* Buyers should be mindful of how they intend to address existing employees and, in January 2016, the implications of AB 359, which will affect those decisions and be addressed in more detail in a separate article in *California Grocer*. If employees are terminated, the parties may also need to comply with requirements to notify the employees of terminations or they can be held liable for amounts due under federal or state law. Also, how will the parties handle benefit and welfare plans or accrued PTO or vacation time? Depending on the size of the business, these can be significant liabilities. And, if the business being acquired has a union, or employs people that belong to a union, there will be implications related to the collective bargaining agreement.

Purchasing a business obviously requires careful consideration of numerous factors, and those factors are often dependent on many variables. This article is meant to provide a cursory overview of some key issues to consider, and is not a comprehensive list of all of the important considerations a party should contemplate when selling or acquiring a business. Although some transactions may seem too small to justify engaging an attorney experienced in negotiating and documenting commercial transactions, doing so will always allow a party to better protect its interests while at the same time provide a more comprehensive understanding of the transaction and potential issues. Moreover, the initial investment in an attorney may save a purchaser tens (even hundreds) of thousands of dollars in taxes, fines or litigation expenses in the future. ■

Brian Pick is a partner and Brian Schusterman is counsel in the Corporate, M&A and Finance group of Downey Brand LLP. Both practice primarily in the areas of business organizations, mergers and acquisitions and finance and commercial transactions.