LEGAL UPDATES

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Selling the Business: Five Priorities Every Construction and Electrical Engineering Company Should Address Before Going to Market

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Construction and electrical engineering contractors considering the sale of their business face a deal environment that is more complicated than a typical private company transaction. These businesses are frequently organized as S corporations that might never have had a sale in mind. They often operate under collective bargaining agreements and contribute to multiemployer benefit plans, and their workforce and bonding relationships make strategic buyers hypersensitive to labor and benefits risk.

Getting ahead of these issues before a letter of intent is signed can be the difference between a smooth closing and a deal that stalls, is repriced, or falls apart in diligence.

Husch Blackwell has recently represented a seller in connection with its sale to a strategic, public company buyer. Below are five priorities we counsel construction and electrical engineering clients to address when planning a sale of the business, assuming a stock sale structured to be treated as an asset sale for tax purposes through an F reorganization completed in connection with closing.

1. Plan for the F Reorganization to Be Completed in Connection with Closing

Many closely held construction and electrical engineering companies are organized as S corporations. A buyer, particularly a private equity-backed platform or strategic acquirer using a corporate or partnership acquisition vehicle, will typically want to purchase the target in a transaction that is

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structured for tax purposes as an asset purchase. The buyer obtains a stepped-up basis in the target's assets, while the sellers still convey the target in the legal form of an equity sale for state law, contract assignment, licensing, and bonding continuity reasons.

The mechanism commonly used to reconcile these two objectives is an F reorganization under the Internal Revenue Code, which is typically implemented as one of the last steps taken immediately before the closing of the equity sale. In simplified terms, before closing the transaction, the S corporation shareholders form a new holding corporation and contribute their stock in the operating company to that holding company in exchange for holding company stock. The operating company then converts to a limited liability company that is disregarded or treated as a partnership for tax purposes, after which the holding company sells its interests in the newly converted entity to the buyer at closing.

Properly executed, this restructuring is treated as a qualifying reorganization under the Internal Revenue Code and does not itself trigger tax to the shareholders, while positioning the business so that the buyer can acquire the operating assets with a stepped-up basis and the transaction can be treated as an asset sale for tax purposes even though it is documented as a sale of equity.

Because the F reorganization steps are executed right before closing, sellers should nonetheless begin planning for the mechanics well in advance, so everything is ready to be signed and implemented immediately prior to the closing date without delay.

Key action items include:

1) Confirming the company's S election has been valid and unbroken since inception (a defect here can unwind the entire structure);

2) Coordinating in advance with state authorities and other third parties on the entity conversion mechanics that will take effect at closing, since construction and electrical contractor licenses, surety bonding, prequalification status, and government contracts are frequently issued to a specific legal entity and may require novation, reissuance, or consent to assignment when the operating entity converts to an LLC at closing;

3) Confirming that key contracts, including bonded projects, joint venture agreements, and union agreements, contain change-of-control or assignment provisions that will be triggered by the restructuring steps taken at closing, separate and apart from the sale itself;

4) Engaging legal counsel and accountants well in advance of closing to prepare the reorganization documents, valuations, and shareholder consents so they are ready to be executed as part of the closing mechanics, since buyers will expect to review the entire reorganization structure as part of their own diligence before agreeing to the structure.

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2. Get in Front of Union Relationships

Construction and electrical engineering contractors frequently operate under one or more collective bargaining agreements with building trades unions, and this is often the single issue that most concerns a prospective buyer, particularly a buyer without existing unionized operations. Sellers should proactively assemble and review the following, well before marketing the business:

All collective bargaining agreements currently in force, including expiration dates, successor clauses, and any evergreen or automatic renewal provisions;

Any letters of assent binding the company to area-wide or national agreements, which can create obligations broader than the local agreement itself;

Withdrawal liability exposure under any multiemployer pension plans to which the company contributes, discussed further below;

The successorship and assumption provisions in each agreement, since many building trades agreements require a purchaser to assume the agreement, recognize the union, or face successor bargaining obligations regardless of how the transaction is structured.

Sellers should also consider, in consultation with labor counsel, how the transaction structure interacts with successorship doctrine generally applicable to asset and stock transactions, and whether the buyer intends to operate the workforce on a union or open-shop basis after closing, since that decision materially affects deal structure, price, and the level of union involvement required before signing.

3. Audit ERISA and Benefit Plan Compliance, Including Multiemployer Plan Exposure

Benefits and retirement plan compliance is consistently one of the most heavily scrutinized areas in a construction industry sale, both because of the complexity of multiemployer plan participation and because errors are expensive to unwind after closing. Sellers should undertake a benefits compliance audit that covers:

1) Current withdrawal liability estimates from every multiemployer pension plan to which the company contributes, obtained directly from the plan administrators, since a sale structured as an asset sale for tax purposes (even where documented as a stock sale) can trigger a complete or partial withdrawal from a multiemployer plan depending on how the transaction is structured and whether the buyer continues covered operations;

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2) The funded status and any outstanding minimum funding contributions for any single-employer defined benefit plans; compliance testing history and plan document compliance for 401(k) and other defined contribution plans, including timely deposit of employee deferrals, proper eligibility and vesting administration, and required plan amendments;

3) Health and welfare plan compliance, including ACA employer mandate reporting and compliance, COBRA administration, and, where applicable, prevailing wage and fringe benefit compliance, since construction contractors performing public work must properly credit bona fide fringe benefit contributions and errors here surface quickly in buyer diligence;

4) Any outstanding filing deficiencies, plan document restatement gaps, or uncorrected operational failures that could be addressed through IRS or Department of Labor voluntary correction programs before the plans are presented to a buyer.

Sellers should also evaluate, with benefits counsel, whether the transaction structure allows the buyer to avoid assuming multiemployer plan liabilities outright, whether a withdrawal liability payment or bond will be required at or before closing, and how purchase agreement indemnification and escrow provisions should be structured to address benefit plan risk that cannot be fully resolved before signing. Addressing plan compliance gaps proactively, rather than allowing a buyer to discover them, typically preserves both deal value and negotiating leverage.

4. Confirm Licensing, Bonding, and Contract Assignability Survive the Restructuring and the Sale

Because both the F reorganization and the eventual sale can trigger change-of-control or assignment issues, sellers should inventory, early in the process, every contractor license, professional engineering license, electrical license, surety bond and General Indemnity Agreement (GIA), letter of credit, and material customer or subcontract agreement held by the operating entity. For each, sellers should confirm whether the license is held by an individual qualifying party rather than the entity itself, and if so, what transition plan is needed if that individual will not continue in that role after closing; whether change-of-control, assignment, or consent provisions in customer contracts, joint venture agreements, teaming agreements, or subcontracts will be triggered by either the internal restructuring or the ultimate sale; and whether the company's surety is aware of, and will consent to, the anticipated restructuring and sale, since sureties often require advance notice and updated indemnity agreements before a change in ownership and can otherwise decline to bond in-process or future work. If the seller's principals individually signed GIA's, they must affirmatively cancel their obligation, or they will remain exposed to defaults after the buyer completes the purchase.

Addressing these items early avoids a scenario where the steps taken at closing inadvertently breach a bonding or contract requirement at the moment the sale is meant to close.

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5. Organize Financial, Tax, and Operational Diligence Materials in Advance

Sale processes move faster, and generate less friction, when the seller has assembled a complete diligence package before going to market rather than reacting to buyer requests. For a construction and electrical engineering business, this typically includes:

Historical and current work-in-progress schedules, job costing detail, and backlog reports, since buyers will scrutinize percentage-of-completion accounting and the accuracy of estimated costs to complete;

Safety records, including OSHA logs, experience modification rating history, and any open safety citations or investigations;

A complete history of warranty, defect, and litigation claims, including any ongoing or threatened construction defect claims;

Equipment and fleet schedules, including owned versus leased assets and any liens;

A clean summary of related-party transactions, including any real estate, equipment leases, or intercompany arrangements with entities owned by the selling shareholders, which will need to be addressed, terminated, or restructured as part of closing.

Assembling this diligence package well in advance of closing, in parallel with preparing the F reorganization mechanics that will be executed at closing, allows sellers to run a more competitive process, reduces the risk of price chips late in negotiations, and shortens the time between signing and closing, which matters in an industry where bonded projects, union relationships, and key personnel retention are all sensitive to prolonged uncertainty.

Conclusion

A sale of a construction or electrical engineering business is rarely a simple transaction, and the combination of an S corporation ownership structure, union workforce, and benefit plan obligations means the issues above should be addressed as part of pre-sale planning, rather than left to be discovered during buyer diligence. Companies that begin this planning well before engaging an investment banker or signing a letter of intent are consistently better positioned to preserve value, maintain labor stability, and close on schedule.

Contact Us

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If you have questions about preparing your construction or electrical engineering company for a sale or managing other transaction-related considerations discussed in this alert, please contact Steven Levine or your Husch Blackwell attorney.

This client alert is provided for general informational purposes only and does not constitute legal advice. The application of the concepts discussed above depends on the specific facts, applicable collective bargaining agreements, benefit plan documents, corporate structure, tax elections, and the laws of the relevant jurisdictions, and should be discussed with counsel before taking action.

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