// TRANSACTIONS AND TRIALS

BERMAN AND SABLE NEWSLETTER

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TRANSACTIONS AND TRIALS

As our firm enters its third decade, and the world enters a new century (the exact start of which is the subject of many a nerd convention), we at Berman and Sable have decided to launch this Newsletter. Until it reaches critical acclaim, this journalistic marvel is yours, free, in grateful appreciation of your patronage and friendship. The intent is to furnish you with commentary and up-to-date information in the areas of law we hold near and dear to us. These include financing, mergers and acquisitions, mortgages, recovery and liquidation, lender liability, bankruptcy, construction, leasing and most everything else in commercial and business law. Our aim is to make the text simple and the font large for easy reading. (Some might be inclined to label it good "leisure" reading, if you get our drift.) We will attempt to keep the quality somewhere between "Ulysses" and People Magazine. And now, our first offering.

"Business Records" . . . Is It Evidence?

By Michael P. Berman

One thing we all have is "business records" … or do we? Many times in the course of a commercial trial, a party finds it necessary to introduce certain of its business records into evidence in order to prove the existence or other aspect of a transaction. A simple concept. Yes? No! Business records are made from ordinary dealings which often occur long before anyone knows a lawsuit is going to be brought. Since these business records are made outside of a courtroom, they are considered "Hearsay", and, therefore, inadmissible into evidence. Yet, they must come into evidence to be considered by the judge or jury in deciding the case. Typical business records are: account ledgers, reports, records of receipts and payments, inventories, and so on.

To respond to this need, State and Federal Courts have laws and procedures to admit business records into evidence as an exception to the Hearsay exclusion. These laws and procedures are all pretty similar, and state that, so long as the record is kept in the ordinary course of business, reflects transactions at or about the time they occur, and so long as it is the regular course of the party's business to maintain such a record (that is, the record wasn't newly created just for the trial), it is considered to be sufficiently reliable to be allowed as a document in evidence even though, technically, inadmissible Hearsay. (The fact that a business record becomes a piece of evidence doesn't mean it can't be shown to contain inaccurate information, mistakes or errors.)

The party offering the record must produce a witness on the stand, usually an employee, who can testify that all the requirements are satisfied and, therefore, the document can become evidence. If all the requirements can't be shown to the satisfaction of the judge, then the document cannot be considered, or even looked at by the judge or jury. Many a case has been lost on just this point.

With the advent of computer record keeping, the situation gets more complicated because the printout document is not the business record, but merely a copy of the record. It is the data that is

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stored in the "memory" that is the business record.

But, how do you introduce a bank of data stored in memory? Well, Courts have allowed the printout of the data (the "hardcopy") that's stored in memory if a witness can testify not only about the "regular business" requirements mentioned before, but also that the procedure for data entry, and the software program, produce reliable results. So, when it comes to computer records we need more than just a bookkeeper to get the printout into evidence. Our Connecticut Appellate Court has held that an affidavit of reliability is no good. (FDIC v. Keating, 44 Conn. App. 556 (1997).) Likewise, a credit specialist without personal knowledge of the reliability of the computer system does not suffice to admit the computer record. (Central Bank v. Colonial Romanelli Assoc., et al, 38 Conn. App. 575 (1995).) But, where an asset analyst was able to testify to the "regular course of business" requirements and, further, to his independent verification of the accuracy of the results, as well as his familiarity with the procedures to obtain the report, and had used such records on a daily basis, the printout was allowed into evidence. (SKW Real Estate L.P. v. Gallicchio, et al, 49 Conn. App. 563 (1998).) Similarly, when a loan officer testified that he was personally familiar with the loan relationship with the customer and the bank's computer records in connection with the loans to this customer as well as the procedures used by the bank to enter data into the computer system, and described those procedures, and, further that he found the procedures reliable, the computer record was allowed. (Shawmut Bank Conn. v. Conn. Limousine Service, Inc., 40 Conn. App. 268 (1996).)

The computer business record issue becomes slightly more involved when the party trying to introduce the record was not the original party to the transaction (for example, a subsequent note holder). In this situation, the records have to be transposed onto the new bank's software system. The current state of the law in Connecticut is that a witness familiar with the originator's record keeping system, a witness familiar with the procedures used for the transition of the data to the new bank's system, and a witness familiar with the new bank's system may all be required to testify to satisfy the Court as to the continuing reliability and accuracy of the data, in order to get the record into evidence. (A case just decided by the Connecticut Supreme Court appears to have relaxed, somewhat, the additional issues of record authentication and document custody which may confront the subsequent note holder. New England Savings Bank v. Bedford Realty Corp., et al, 246 Conn. 594 (Sept., 1998).) So, remember, when buying commercial paper, the deal doesn't end with the endorsement or assignment. You still may have to prove the debt, and this may require use of the old bank's and new bank's computer system.

Attention Contractors: Beware of the 89th Day Filing Trap! (Mechanic's Lien Law)

By Alena C. Gfeller

Mechanic's liens are a great way to help to ensure that contractors and subcontractors are paid for work performed. However, care must be taken to protect these lien rights in the event of non-payment.

The statute which creates the Mechanic's lien (Conn. Gen. Stat. Section 49-33, *et seq.*), provides that any such lien must be filed and served within ninety (90) days of the last "lienable work." This means that ninety (90) days after substantially all of the work is completed, the lien must be filed and served, to ensure its validity.

The majority of Mechanic's liens that are found to be invalid are the result of untimely service. It is common for contractors and subcontractors to wait until the 89th day to turn the matter over to an attorney. The attorney must then prepare, file and serve the lien before the 90th day. This delay is viewed as an "89th day filing trap" as errors and omissions are common when an attorney has only one day to ensure that your rights are protected. This "89th day filing trap" can be avoided by simply taking care to note the date when the work is "substantially completed" and getting the lien process started early to protect your lien rights.

Even if the lien is not truly served until the 89th day, allowing an attorney the opportunity to properly prepare the lien and to research any unique issues will help to ensure a valid lien and will ultimately serve to protect your right to payment.

Financing Purchase of the Closely Held Business

By Steven A. Berman

These are the times that try men's souls! Especially if you are trying to buy a business. Generally, these days the "pickins" are slim and fall into two categories: First is the business that is booming with the times; the owners are making more than they ever had and they want to cash out at a handsome premium and retire. Second is the business that got left in the wake and is on the brink of failure.

When a buyer seeks to purchase the failing business, the task is somewhat easier as usually he can purchase it for a percentage of the value of the assets. If the buyer has a realistic plan for turning the business around, the assets provide adequate collateral to justify a depressed purchase price. In that case, the buyer must either know the industry well, so that he can infuse new ideas to alter the path of the failing business, or is a general turnaround specialist who specializes in such business turnarounds.

On the other hand, purchasing the successful business involves many more issues. These days, many aging "baby boom" owners are looking to cash in on the present business boom. Sales of businesses at multiples of earnings of five times or more are creating instant multi-millionaires. But, unless a publicly held company with a huge bank account is the buyer, these acquisitions can be difficult to finance. The biggest problem is that the purchase price is not derived by the asset values but by a multiple of the target company's earnings over recent years. In such situations the purchase price can represent three or more times the value of assets being purchased which represent borrowable collateral.

These days, a typical transaction might involve a business with sales of $10,000,000, earnings of $1,000,000 and borrowable collateral of $2,000,000. Simply put, a business with these characteristics might be offered at $4,000,000 to $5,000,000. The first $2,000,000 might be fairly easy to arrange. This is the "senior secured" layer of debt which most banks would be willing to entertain. First, it is often fully secured by the assets of the business. Second, it is usually the senior level of secured debt which means it will get paid first if there is a liquidation. Third, in the ordinary course, this senior lender will require that payments of this level of debt have priority over payments of any other debt.

The remaining $2,000,000 to $3,000,000 of the purchase price presents the real problem. As there is not collateral to support debt in this amount this part has come to be known as the "air ball". Most entrepreneurial buyers are unable or unwilling to tie up very much of their own cash in this investment. In a transaction like this, it would be unusual for such an entrepreneurial/owner investor to offer more than 10% of the entire purchase price in cash. In our hypothetical transaction, this would leave a "hole" in the purchase price of anywhere between approximately $1,500,000 and $2,500,000. The question is how do we pay for this?

This layer of finance is usually a combination of "mezzanine debt" and equity. Mezzanine debt is a loan provided by a lender

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Glossary of Words and Phrases

Juris diction	*The careful and proper enunciation of legal phrases.*
Writ	*Past tense of: write (alt. form), "He writ an interesting essay."*
Fore bear	*What Canadian Rocky Mountain trappers hunt.*
Work-out	*See: YMCA*
Eligible Receivables	*Those people who may potentially be allowed to catch a football.*

(We invite you to submit your own words and definitions. We will try to include some in our next issue.)

(who usually specializes in these types of loans) who loans on a subordinated basis (to the senior secured debt) and, usually, on an unsecured or partially unsecured basis. Sometimes the expense of this layer of debt can make the deal impractical. It is not unusual for lenders at this level to be looking for aggregate returns of between 25% and 45% per annum, although usually, not all of this is paid currently. The "paid" interest rate is usually around 15%. Sometimes, there can also be an accrued but unpaid add-on to this. Finally, there is usually what is called an "equity kicker". This takes the form of a warrant for the purchase of shares or could be in the form of shares themselves which the lender can require the company to redeem (i.e. the lender has a "put"). This redemption is usually at the higher of a multiple of book value or a multiple of earnings, times the percentage of shares that the warrant represents. The formula is negotiated at the closing and the better the company does, the more expensive the warrant is to redeem. Even if this mezzanine debt is prepaid, the warrant remains outstanding unless its redemption is part of the negotiations relating to prepayment.

If a mezzanine lender is unwilling to lend the entire amount of the "air ball" the next turn is to the equity markets. These investors are taking the highest risk and their money is priced accordingly. They will not get paid unless all of the senior secured and mezzanine debt is paid yet they do not have the same control over the future of the business as the entrepreneur/owner does. Consequently, these funds can be extremely expensive. It is not unusual for the person providing these funds to demand the right (but not the present obligation) to control the company from the time of their investment. These investors will usually have the right, as part of their original understanding, to take the company public. A successful public offering is the "home run" for this investor. Alternatively, they will have the right to "put" their shares back to the company at an effective interest rate which is usually between 33% and 50% per annum, compounded. This is the typical venture capital model. This is a high risk source of funds for the entrepreneur/owner as the requirement to repurchase the shares may even force the sale of the company in order to meet the purchase price. If the public offering is successful, the entrepreneur/owner is unlikely to retain control. There may be other sources of equity which are much more "user friendly". These are usually private groups, a relative or an "angel".

One source of funding that can be very effective to fill this gap, that should never be ignored, is the various state agencies and authorities. The Connecticut Development Authority and the Department of Economic and Community Development provide financing at the layer of mezzanine financing but at extremely reasonable rates and terms. Typically, the key issue is the creation or retention of jobs as well as the commitment to remain in the State of Connecticut. The amount available will typically depend on the number of employees and jobs to be created.

The bottom line is that almost any business can be bought. It takes much tenacity and creativity in order to assemble the various pieces of the puzzle and to make