

## SELLING YOUR COMPANY? A PRELIMINARY CHECKLIST TO PREVENT DELAYS AND SURPRISES

Two of the most common deal killers in selling a company are delays and surprises. The purchase and sale of a company can be time-consuming and tedious for both the buyer and the seller, and unnecessary delays can wear down and frustrate the parties and make them less willing to compromise. A buyer who encounters unexpected issues regarding the seller will become more cautious. A seller should take steps early in the sale process to eliminate potential surprises and causes of delay. Here is a partial list of legal issues for sellers to consider.

### Employment Matters

- Make sure you have an updated employee handbook and all employees have acknowledged receiving a copy. Employee handbooks can reduce the risk of employment-related liability, which is comforting to a buyer and may minimize your potential liability for breach of employee-related representations and warranties. Among other things, an employee handbook should provide support for a seller's representation, if required, that its employees are employed on an at-will basis.
- Your employee immigration records should be up to date. You will need to have a completed Form I-9 and related documentation for each employee.
- Review your employee classifications. Are employees who are classified as exempt for overtime and other purposes in fact exempt under applicable laws and regulations? If you use independent contractors, you should ensure they qualify as such and are not required to be classified as employees.
- Make sure your benefit plan documents are complete and that you have made all necessary filings and provided employees with required information such as summary plan descriptions.

### Real Property and Environmental Matters

- If the seller is a business entity (e.g., corporation, limited liability company or partnership) that occupies business premises owned by one or more individual owners of the company, be sure the leases between the owner(s) and the company are in writing and signed.
- If the seller occupies real property owned by a third party, consider the adequacy of the remaining lease term. It may be desirable to attempt to negotiate an option to extend the term. You should review the lease to see if the landlord has the right to approve an assignment of the lease or a change in control.

- If your business involves the use of hazardous materials, obtain a Phase 1 environmental study. That will enable you to address, or at least disclose to a potential buyer, any suspected contamination.

## **Material Contracts and Leases**

Make sure your material contracts, such as loan documents, equipment leases and important vendor and customer contracts, are readily available for delivery to a potential buyer. You should review each such contract to determine whether the other party has the right to approve an assignment of the contract or a change in control.

## **Litigation and Potential Claims**

Be prepared to provide the buyer with the details of legal proceedings involving the company. In addition to pending and recently concluded matters, are there potential claims, such as an unhappy customer or supplier, an employee who left under adverse circumstances or a law, such as OSHA or the ADA, with which the company may not have fully complied. If actual or potential litigation exists, consider trying to settle it before undertaking discussions about selling your business.

## **Insurance**

Review your insurance policies and request a history of claims, if applicable, from your insurer(s). Consider the adequacy of the types and amounts of your coverage and deductibles. Determine whether your coverage is claims-made or occurrence based. If the former, you may want to procure tail coverage. Some insurance companies also sell policies covering potential liability for breached representations and warranties.

## **Corporate Governance**

- Make sure your board and shareholder minutes are up to date. At a minimum, you will need to demonstrate that the persons who purport to be the officers and directors of the company have been duly elected. The buyer will likely want to confirm that important matters such as loans, leases, material contracts, officer and director compensation, stock options, transactions involving officers, directors and/or significant shareholders and dividends have been approved by the board of directors.
- Confirm that securities filings have been made for all issuances of securities and, if possible, correct any omissions.
- Make sure original stock certificates are readily available. If stock certificates have been lost or damaged, replace them.
- Consider whether you have qualified to do business in all jurisdictions where you are required to qualify. In general, qualification is required in states and countries where you have employees, facilities or operations.

## **Permits**

Make sure the company has all required permits and licenses for its business and apply for any that may have been overlooked.

## **Intellectual Property**

- Make sure all employees have signed nondisclosure agreements. If your business involves inventions or processes, such as manufacturing processes, your employees should also sign invention assignment agreements.
- If your trademarks and service marks are registrable, either at the state or federal level, register them. The registration process may bring to light third party infringement, which you should address early in the sale process.
- If your company owns patents, you may want to prepay patent maintenance fees that are likely to come due during the sale process or immediately after the sale. Dealing with patent maintenance fees during the sale process can be distracting, and it would not be comforting to a buyer to learn late in the process that maintenance fees for one or more patents are due immediately following the closing.
- Make sure you have licenses for all copies of software being used in your business, make them available to the buyer and determine whether they are transferable or subject to change of control restrictions.
- If you are a software developer, you must be able to demonstrate that you have licenses for any third party software incorporated into your products, and you should be able to identify and disclose to a buyer any open source components of your products.

## **Financial Matters**

- You will typically need to provide a potential buyer with your financial statements for the three most recent years and year-to-date financials for the current year. They may not need to be audited or reviewed, but they must be complete and accurate and comply with generally accepted accounting principles (although a lesser standard may be acceptable depending on the size and nature of your business).
- You must have filed all required federal, state, local and foreign tax returns and be prepared to deliver copies of recent returns to the buyer.
- Make sure your financial statements reflect accrued vacation pay and sick pay obligations (if applicable) and that your allowance for bad debts is adequate.

## **Title to Assets**

You should obtain a lien search report from the Secretary of State and from the recorder's office in each county where you have a facility and clear any invalid liens and liens related to fully paid obligations.

## **Conclusion**

Addressing the foregoing matters early in the sale process will help avoid delays and surprises that could adversely affect the sale price or cause the sale to be lost. Consulting with an intermediary (such as a business broker or investment banker), attorney, accountant and insurance agent prior to sale discussions can facilitate the transaction and often ultimately reduce a seller's professional fees.

Consulting with an attorney early prior to sale discussions can facilitate the transaction and often ultimately reduce a seller's professional fees. For advice regarding this topic, please contact Karl D. Chandler, Peter D. Feinberg or another member of our team.

This Corporate Insight is provided as an educational service by Hoge Fenton's Corporate Group for clients and friends of the firm. This communiqué is an overview only, and should not be construed as legal advice or advice to take any specific action.

## Related Attorneys

- Karl D. Chandler