

# **PREVENTING LEGAL DEAL KILLERS**

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## PREVENTING LEGAL DEAL KILLERS

A legal deal killer is a legal issue that causes a purchaser to walk away from a deal. A business owner can take steps in advance of a transaction to prevent a legal deal killer from occurring.

### Employee Issues

Having key employees is a critical value driver for a business. But what happens when the key employee says that he won't work for the prospective purchaser and that if the business is sold to the prospective purchaser that he will quit and start a competing business? I once saw this exact situation derail a \$1,500,000 transaction. So, what could the seller have done to prevent this from occurring?

Business owners should consider having their key employees enter into non-competition and non-solicitation agreements. Many business owners think that such agreements are unenforceable, but in Colorado a company may enter into enforceable non-compete agreements with key employees. In order to be enforceable, a non-compete agreement must be reasonable as to geographical area and time period. Also, a non-compete agreement should be provided to a key employee either when the employee is initially hired, or, if a non-compete agreement is provided to an existing employee, it should be provided in conjunction with the company providing the employee with additional compensation or some other benefit. Further, the non-compete agreement should state that the company may assign it to a purchaser of the business.

If a key employee quits prior to a closing, that could negatively affect the value of the business and decrease the likelihood of the business owner being able to sell the business. Business owners should consider providing their key employees with a financial incentive to remain employees of the business through the closing date. One way to do this is to enter into a phantom stock agreement with an employee. Phantom stock is not actually stock, but a contractual agreement between the company and the employee that provides the employee with certain financial benefits that are similar to the financial benefits that the employee would have received if he were an owner of the company.

### Trade Secrets and Intellectual Property

A business's trade secrets and intellectual property can be significant value drivers for the business. It's important that business owners take steps to protect these assets and make sure that they can be transferred to a purchaser. A business owner should have his employees sign confidentiality agreements and take other steps to protect the confidentiality of the company's important information.

A business owner should take steps to protect his business's intellectual property. Business owners should determine if they have any patent, copyright, or trademark rights worth protecting, and, if so, they should consider filing patent, copyright, or trademark applications (copyright and trademark applications are not expensive and are within the budget of most business owners; patents, although much more expensive, may become significant value drivers for a business). If a business has had a software developer develop proprietary software on behalf of the business, or if other intellectual property has been developed on behalf of the business, such as trademarks,

taglines, or designs, the business owner should confirm that these intellectual property rights have been assigned by the company which developed such intellectual property to the business, or else the creator may be considered to be the owner of these intellectual property rights, notwithstanding that the business owner fully paid the creator for the development of such intellectual property.

A business owner should also confirm that the business has purchased all necessary software licenses.

### Lease Issues

A business's lease may be an important asset. When negotiating a lease or a lease extension, a business owner should make sure that the lease provides the business with the right to exercise renewal options, and that a purchaser of the business will be able to exercise these renewal options. Many leases state that the assignee of a lease (such as a purchaser of the business) may not take advantage of any renewal options, and that if a business owner requests that the lease be assigned, then the landlord has the option to terminate the lease; these provisions could be deal killers. Also, a business owner should make sure that his lease guaranty does not continue in effect during a renewal period if the purchaser of the business exercises the renewal option after the business is sold.

### Corporate Issues

A business owner should assure that his corporate records are up to date and that there are no open issues in regard to who are the owners, directors, and officers of the business. If there are any options to acquire the stock or membership interests of the business, these options should be in writing. Also, any "phantom" stock or membership interests should be in writing.

### Liens

A business owner should do a lien search to determine whether there are any liens filed against the business's assets. If the business has outstanding loans or other financing secured by liens against the business's assets, these will need to be paid off at closing or immediately following the closing out of closing proceeds. Sometimes, business owners will find that although they have fully paid off a loan or other financing, the creditor has failed to release the applicable lien. The business owner should contact the creditor to release this lien well before closing so that this lien does not create a problem at closing. A business owner should also make sure that the business is current as to liabilities that would create an inchoate or statutory lien against the assets of the business, such as state employee withholding, sales taxes, unemployment compensation, and worker's compensation.

### Contractual Relationships

A business owner should evaluate his business's important relationships with its customers, vendors, and other third parties. Are these agreements oral or in a written contract? Can the business assign these relationships to a purchaser of its business?

By taking these steps, a business owner can greatly increase his odds of avoiding deal killers and enabling his business to be sold.