Preparing Your Clients for the Sale of a Business

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Representing a client who is selling a business can be among the most rewarding projects for a transactional attorney, at least in part because of the satisfaction that comes with the fruition of a long-term project. Yet, too often attorneys fall into the trap of attending to their client's immediate legal tasks, failing to give their clients sufficient advance notice for business "to-do" items before a big sale. Advanced preparation is essential to maximizing the value of a client's business, not only by facilitating a smoother transaction, but also, when performed properly, leading to a greater sale price and fewer legal issues associated with the sale.

This article discusses the steps corporate attorneys should take to prepare clients for the sale of a business *before* the sale is even contemplated. By planning ahead with your client well before an eventual sale, many of the would-be-buyer's potential issues can be resolved in advance of the sale process.

You should, at a minimum, take the following steps to position your clients for a future sale:

1. Conduct due diligence on your client's business
2. Engage in corporate clean-up
3. Assist your client in putting together an acquisition team

Conducting Due Diligence

Conducting due diligence is an essential first step to preparing clients for a future sale, as it allows you to identify issues a potential buyer might inherit and in turn gives your client the ability to resolve those issues before a prospective buyer is involved.

Some of the key questions to ask your client during the due diligence process include:

- Does your company have supporting documentation for its current capitalization (i.e., do you know who owns the company and can you prove it)?
- Is your corporate record book in order and have you followed all necessary corporate formalities?
- Do you have up-to-date shareholder and board/manager meeting minutes?
- Have your previous significant actions been properly authorized and recorded in the board/manager/member meeting minutes?
- Are your financial records in order? Have your financials been audited?
- Have you properly documented your relationships with key customers and suppliers? If so, have you reviewed these agreements for potential issues upon a change in control?
- Have your key employees signed non-competition, confidentiality, and trade secret agreements?
- Do you have sufficient documentation supporting your intellectual property, including for any copyrights, trademarks, trade names, or patents owned by your company?
- Do you have any ongoing disputes involving your business? What steps have been taken to mitigate or negotiate these issues?
- Are you qualified to do business and in good standing in the necessary jurisdictions?
- Does your company hold all necessary licenses, permits or authorizations?

The ability to say "yes" to these questions should be a business priority for more than just the comfort of knowing your client has dotted its i's and crossed its t's. Your client must understand that a prudent buyer will be asking these questions as part of its own due diligence review of the business. The answers to these questions are often an essential first step to uncovering areas of your client's business that require further action, a step that this article will refer to as "corporate clean-up."

Engaging in Corporate Clean-Up

Undoubtedly, one of the least glamorous, but easiest ways for you to position your client for the sale of its business is to be sure the business is as "clean" as possible beforehand. This means, in addition to helping your client answer the above questions affirmatively, establishing processes your client can implement to ensure the answer to these questions remains a "yes" five years down the road.

Emerging companies often focus their time and resources on product development, attraction and retention of talent, and commitment to selling their products and services. Yet these companies often fail to understand the importance of simple record keeping. While this is understandable, you would like to see your client undertake corporate clean-up so that when the client's business efforts generate an ideal exit opportunity, your client is well-positioned to capitalize on it.

Observing Corporate Formalities. A client's casual treatment of corporate formalities can lead to far worse outcomes than being unable to sell his or her business. In addition to inactive corporate status or ineffective corporate actions, failure to adhere to these rules is essential to avoid the dreaded "piercing of the corporate veil." If a client has failed to hold shareholder meetings, hold director meetings, prepare meeting minutes, or formally approve significant company actions, then adopting a corporate governance policy and establishing a formal corporate record book are musts.

Financial Statements. Depending on the size of the deal, prospective purchasers may or may not require audited financial statements in connection with the purchase of a business. However, your client would be wise to obtain audited, or at the very least reviewed, financial statements that look back two to three years. This will give prospective buyers additional comfort with respect to the fundamentals of your client's business.

Key Agreements. Attorneys should review their clients' leases, contracts and other agreements that a potential buyer might eventually inherit. As a threshold matter, relationships with key customers and suppliers should be supported by signed, written agreements. If customers and suppliers are not bound by long-term contracts, encourage the development of those contractual relationships and negotiate forms of agreements for the most significant facets of your client's operations.

Securing Key Employees. As the often-cited adage goes, "your people are your greatest asset." Yet equally notable, "you are only as strong as your weakest link." Analyze whether your clients have appropriate confidentiality, non-competition, non-solicitation, and trade secret agreements that bind their key employees.

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Resolving Ongoing Disputes. For the litigators still reading, disputes can be one of the easiest items to spot in the due diligence process, even before a complaint is filed. Based on your client's industry, the type and severity of these disputes may vary. Take the time to discuss any areas that may continue to pose litigation risks and ensure preventative measures are in place. To the extent possible, prevent existing disputes from dragging on, though that is perhaps easier said than done.

The "cleaner" your client's business, the more attractive the company will be to a prospective buyer. Conversely, even a company with a superior product or service will be less attractive if there is significant need for corporate clean-up. Performing appropriate corporate clean-up will make the company an easier sell for your client and will also make the transition an easier process for the seller.

Assembling an Acquisition Team

Once you have conducted due diligence and completed any necessary clean-up, you should determine what type of transaction your client might be seeking (i.e., a stock sale, asset sale, etc.) and what your client's timeframe might be. The final step in pre-sale preparation is to assist your client in assembling an acquisition team.

The value of having a team of experts and specialists to facilitate the sale and assist you through the process cannot be understated. Careful consideration must be given to choosing members that specialize in the sale of businesses. Although members of an acquisition team typically include at least an accountant and an attorney, you should help your client determine whether a business broker or investment banker would also be beneficial. At this stage, it is important to consider whether you have the appropriate expertise to facilitate the sale and assist your client through the sale. A valuable team presents the business in its most favorable light. By shining the spotlight on the company's assets, structuring the transaction, and timing the market, a great acquisition team can maximize the purchase price the business will command while also minimizing the pitfalls and headaches for owners and buyers.

Conclusion

It is never too early to start preparing your clients for the sale of their businesses. Even if your client doesn't expect to sell his or her business for several years, protecting your client's business also means protecting future opportunities. Ensuring that the business is prepared for the probing eye of potential purchasers means not only that your client's legal bases are covered, but also that they can focus on what matters most to them and future buyers: running a great business.

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