



Closing a Sale When the Unexpected Strikes

A creative and experienced team can get you through a crisis.

by William S. Hanneman

The journey between the decision to sell a private business and closing the sale can be a winding road. Despite declarations by our clients that their businesses were ready to be sold, twenty-five years and \$5 billion worth of transactions have taught us to expect the unexpected.

Most of the issues likely to arise in the sale of a business can be anticipated and the effects mitigated if identified in advance. In the rush to get to market, issues can be overlooked and some things are unknowable. During the sale process, the emergence of an unexpected event can cause the probability of closing to decline precipitously. The worst situation is when, after entering into an exclusive arrangement, a buyer discovers an undisclosed piece of information that they deem material. Unless dealt with, the buyer's concern often extends beyond the single issue, possibly leading to a belief that the seller has not been forthcoming in its disclosures. Equally bad, the buyer can conclude the buyer didn't know, and should have, which can raise questions about what else is unknown. In either case, the trust between buyer and seller that is so important to get a deal done rapidly deteriorates and either or both sides can become righteously entrenched. Without the involvement of an experienced, creative transaction advisor, one or both parties are likely to throw up their hands as the deal grinds to a halt. It's not a pretty affair.

Despite thorough pre-transaction planning, we have experienced our share of unexpected bumps in the road, which have required a level head and a large dose of creativity to overcome a potential calamity. Consider what would happen in the sale of your company if during the sale process a buyer discovered that...

1 Products sold overseas for many years are found not in compliance with foreign regulatory directives.

Our client's business had been selling product in the European Community for many years, and these products had come to contribute a significant portion of the company's earnings.

During routine due diligence, the buyer inquired about conformity with CE (Conformite Europeenne) designation, a requirement for certain (electrical) products that are sold in Europe.

The designation had not been applied for nor obtained. The buyer's concern was that if not in compliance, products could be returned at great cost (regardless of defect or warranty). Our client did not believe there would be any liability (no products had ever been returned), but the buyer refused to close until the products were in full compliance. The solution was to im-

.....

Most of the issues likely to arise in the sale of a business can be anticipated and the effects mitigated if identified in advance. In the rush to get to market, issues can be overlooked and some things are unknowable.

.....

mediately pursue compliance on an (expensive) expedited basis to protect future sales. Products already in the market were addressed by establishing a special declining escrow, calibrated based on product longevity, volumes, and customer relationships. Although delayed from the original closing date, the transaction was completed without other changes to price or terms.

2 The non-owner members of the management team decide to resign and start a competing business.

Our client, who founded the business, had long since turned over the reins to an at-will management team. Once engaged, we advised the owner to negotiate employment agreements with managers that would both protect and reward them in an ownership change, but would also ensure continuity for a buyer. His judgment was that the buyer should negotiate its own arrangements with management. A week prior to the scheduled closing, the CEO,

CFO, and Sales Manager quit to form a competing business rather than enter into the employment agreements offered by the buyer.

The sale was delayed as we assisted the buyer to recruit a new management team. Ultimately, the transaction was completed as the seller agreed to a small reduction in the price (to cover the cost of recruiting a new team) and conversion of a portion of the consideration to a contingent earn-out.

3 In interviews immediately prior to closing, a significant customer discloses a concern about the stability of the supply relationship.

Our client's managers had insisted that the strength of the company's customer relationships was one of the key assets of the business. As a final step in its due diligence, the buyer insisted on talking to key customers. In that process, the buyer heard concerns about the relationship directly from one of the customers, which caused it to conclude that the expected financial performance might be compromised.

By converting a small portion of the purchase price to a short contingent arrangement, payable if the customer remained for a period after the sale, we were able to close the transaction without a reduction in the overall purchase price.

4 A real property lessor elects not to approve transfer of the contract to a new tenant and release the seller from his personal guaranty, despite the fact that the buyer is a national business with a sterling credit record.

Although the lease contained an unconditional right to approve a new tenant, assurances had been given that the landlord would fully cooperate with the transfer. Once in the power position (closing was contingent on assignment), the lessor elected to try and extract higher rents, which would have changed the economics of the business and the price of the transaction.

Ultimately, the transaction was restructured by dropping the business assets into an LLC,

with membership interests sold to the buyer, leaving the lease behind as the only liability of the old company. The seller's company continued to be a party of the lease and the seller remained a guarantor, but we were able to obtain indemnification from the buyer for any damages as a result of a lease default. At a later date, the lease was renegotiated and the seller

was released.

These are only a very few of the variety of obstacles we have faced in assisting our clients to sell their businesses. These experiences have taught us that the need for planning and investigation cannot be understated even though some things remain undiscovered and others are unknowable. Surviving a traumatic event

during the course of a transaction requires detailed knowledge of the issue and its economic effect, both the buyer's and seller's transaction goals, objectivity, a reserve of patience, and, above all, a creative mind to search for win-win solutions. **zs**



Zachary Scott

INVESTMENT BANKERS

1200 Fifth Avenue, Suite 1500
Seattle, Washington 98101
www.ZacharyScott.com

ABOUT ZACHARY SCOTT

Zachary Scott is an investment banking and financial advisory firm founded in 1991 to serve the needs of privately held, middle-market companies. The firm offers a unique combination of in-depth knowledge of the capital markets and industry competitive dynamics, sophisticated analytical capabilities, and proven expertise in structuring and negotiating complex transactions. For more information on Zachary Scott, please go to ZacharyScott.com.

Mark D. Working

206.224.7382
mworking@zacharyscott.com

William S. Hanneman

206.224.7381
bhanneman@zacharyscott.com

Frank S. Buhler

206.224.7383
fbuhler@zacharyscott.com

Michael T. Newsome

206.224.7387
mnewsome@zacharyscott.com

Ray D. Rezab

206.224.7386
rrezab@zacharyscott.com

Doug Cooper

206.224.7388
dcooper@zacharyscott.com

Jay Schembs

206.838.5524
jschembs@zacharyscott.com

Michael J. Black

206.838.5526
mblack@zacharyscott.com

David Working

206.838.5527
dworking@zacharyscott.com