



The Ticking Time Bomb: Third Party Consents

Uncertainties and transferability issues can blow up the sale.

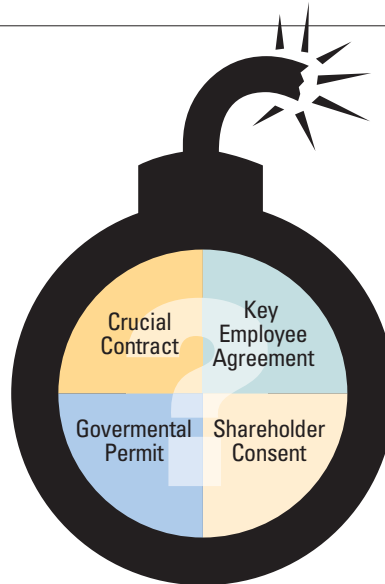
by Mark D. Working

Even a meticulously planned sale of a business can stumble if it comes down to a requirement for approval or consent that is beyond the control of both buyer and seller - the assignment of a crucial contract or lease, the agreement of a key employee, the issuance of a governmental consent or permit, or gaining information from a non-controlled source. Problems can arise when the consenting parties lack the buyer's and seller's sense of urgency, resist the risk dynamics of the new proposition, or simply view the situation as an opportunity to improve their position. Because the success of a sale transaction often depends upon following the shortest path between an agreement-in-principle and closing, eliminating the uncertainties associated with third-party consents typically improves both the value and probability of closing.

Maximizing the value of a business in a sale depends on the seller's ability to transfer to the buyer all critical elements of the business that contribute to its future performance. The worst time to identify those elements is when a transaction is imminent. Instead of addressing a buyer's concerns in the heat of a deal, there is significant value to be gained by anticipating transferability issues and addressing them in the normal course of business. Your corporate counsel is an important resource for systemically reducing dependence on third parties by identifying and addressing potential transaction bottlenecks long before a transaction is even contemplated. Our experience has yielded a few rules that should be incorporated into standard business practices.

MINIMIZE THE NUMBER OF PARTIES WHO CAN "VETO" THE DEAL.

If shareholder consent is required for the contemplated transaction, get them in the loop early with regard to the general direction and concept, and deal with any concerns in advance. Coming forward with a fully negotiated deal with no forewarning is a recipe for problems, where some may be tempted to stall the transaction in an effort to gain special treatment.



A Ticking Time Bomb

Before selling your company, make sure you have the ability to transfer all critical elements of your business to the buyer.

The same concept applies to key managers. Buyers often want assurance that key people will be retained and will require the comfort of employment agreements. Rather

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than wait for this situation to occur, it is wise to negotiate "stay and perform" bonus agreements that include a non-compete provision in order to align the interests of both the employee and the business in the event of an ownership change.

Contractual agreements with customers, suppliers, and landlords are important elements of value that are regularly subject to

change of control or anti-assignment clauses. These provisions are easy to ignore, but can turn into costly and time-consuming headaches that have derailed some transactions. Wherever possible, avoid such provisions altogether or, as a fallback, make sure contracts require that consent cannot be unreasonably withheld or delayed.

CONSISTENT HOUSEKEEPING PRACTICES CAN MINIMIZE CLOSING CONTINGENCIES.

There is real value in a disciplined approach to handling business details, such as documenting and protecting intellectual property, employment policies, environmental exposures, or product warranties. Complete records of such rights and investigations minimize uncertainty with regard to the assets owned by the business and potential liabilities not reflected in the firm's books. Invariably, there is a significant price to be paid if issues that are cloaked in uncertainty have to be resolved under the pressure of a pending transaction.

Environmental matters deserve special attention. They can take considerable time to investigate and the conclusions drawn from the analysis may be very subjective. Drifting off into a battle of experts can bog down a process for months. We recommend engaging a nationally recognized environmental firm to conduct all phase-one investigations and provide these results during the due diligence phase of the transaction. In that way, material concerns will be on the table before transaction negotiations are underway.

Employee compensation, option, or phantom stock plans may need to be terminated at closing. By taking care of amendments to these agreements prior to initiation of a transaction, it may be possible to avoid employee consent under the pressure of a closing.

It is not uncommon for small business owners to provide personal guaranties for a host of purposes. These guaranties are a perennial stumbling block in business transfers. Avoid them whenever possible; otherwise negotiate specific criteria for their release. At the end of the day, other than for financing arrangements that will be replaced by

the buyer, removing guaranties at the time of a sale can offer an unwanted challenge. Sophisticated buyers are likely to treat guarantee requirements as an increase in purchase price. That implies less value to the seller. Even if otherwise willing, some buyers, such as private equity funds, often have prohibitions against replacement guaranties in their charters.

BE ORGANIZED WHEN SEEKING THIRD PARTY APPROVALS.

The key to minimizing the impact of third

party consents is discipline as to when and how constraints are placed on the flexibility of the business and shareholders in a change-of-control transaction. Realistically, privately held businesses do not have the negotiating leverage to avoid consents in all circumstances. It is important to have a handle early in the sale process on all the consents that will be required, who will make the decisions to grant the consents, the process and timing specified in the contracts, and what the consenters' reasonable concerns might be. Each consent

request should be managed like any other important aspect of the project, with a plan, someone with specific responsibility for carrying it out, and an ability to monitor progress.

While it may not be possible to eliminate the requirement for third party consents, contemplating the need for releases or assignments at the time the agreements are put in place is one of those time tested business practices that enhances both value and the probability of closing the sale of a business. ♦



Zachary Scott

INVESTMENT BANKERS

1200 Fifth Avenue, Suite 1500
Seattle, Washington 98101

www.ZacharyScott.com

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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

Brian J. Kremen
206.838.5526
bkremen@zacharyscott.com