

# Employment and Employee-Related Issues in the Sale of Small Businesses

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# Overview

- Workforce issues = W-9 and 1099 Workforce
- Break employee and employee-related Issues into phases:
  - Letter of Intent
  - Due Diligence and Agreement Drafting
  - Closing
  - Post-Closing
- Role of the legal advisor



# Letter of Intent

- Determine if workforce is an asset or a liability
- Functions versus people
- Goals of Buyer
  - Is the Seller an owner-operator and how crucial is the Seller and his/her knowledge to value of the business going forward
  - Going Concern or a Strategic Purchase
  - Need for seller-owner operator and other key employees to stay with the business for the buyer to obtain the value
- Goals of the Seller
  - Does the Seller want (or need) his or her employees to stay with the business post-closing
    - To earn value as part of an earnout
    - To make sure workforce continues to have a job



# Letter of Intent (con't)

- Structure of transaction – asset or stock deal – dictates options available with the work force
- Functions versus people
- Stock Transaction:
  - Buyer steps into shoes of Selling Shareholder(s); workforce comes with unless parties do something otherwise
  - Who terminates the workforce and when.
- Asset Transaction:
  - Workforce is terminated effective immediately prior to closing and then re-hired by Buyer immediately after closing
- Workforce issues (and needs) may impact structure in the LOI



# Due Diligence and Drafting

## How it Works

- Buyer prepares and sends to Seller a Due Diligence Request
- Buyer (or its representatives and agents) start the due diligence process typically before the first cut of the purchase agreement is provided by Buyer to Seller
- The Due Diligence Process and the drafting of the Purchase Agreement actually tend to be done at the same time
- What the Buyer is buying?
- Where the risks are with respect to what is being purchased (these risks impact the value that is being paid for the business)
  - Too many risks may equal a purchase price reduction; or
  - Is reflected in the indemnification provisions
- Workforce is reviewed like any other asset or liability



# Due Diligence and Agreement Drafting

- Consider the following issues as part of due diligence Process:
  - Pre and Post Closing Liabilities
  - Value of the Selling Company and its assets
  - Pre and Post Closing Logistics
  - Post-Closing Protection of Business and Assets that were Acquired
  - Post-Closing Transactions and Operation of the Business



# Pre and Post Closing Liabilities

- Does the Seller has issues with its workforce today that may cause problems in the future once this Buyer “owns” the workforce and these problems
  - Existing relationships, claims, etc.
  - Employment agreements and Independent Contractor Agreements
    - Survive or new ones
  - Mis-classification issues
  - Employee Benefits
  - Collective Bargaining or other Union or labor issues or concerns
- Whose problem is it if issues are discovered? Definitive Purchase Agreement will address who takes and who keeps the various problems that are discovered



# Value of the Selling Company and its assets

- Has the selling company properly obtained from its workforce full rights in the assets of its business
  - Invention Assignments
  - Confidentiality Agreements
    - Consider the nature of the business and its goodwill; trade secrets versus patent portfolio
  - Non-compete Agreements
- Is the workforce the asset? If so, how does this impact the value of the business – cannot make a workforce continue on with a buyer
- Are there issues – litigation, benefit or tax issues related to a workforce that impacts the value and the structure of the transaction



# Pre and Post Closing Logistics

- Who is coming and who is going?
- With respect to the workforce that is coming, how will they be engaged in the future
  - Buyer has an existing workforce, how does the “purchase” workforce fit into the Buyer’s existing workforce
    - Compensation, Benefits, PTO, Severance, Retirement
- Dealing with logistics when the Seller’s workforce does not know a deal is in the works is difficult
- Deal structure dictates level of logistics. Regardless
  - New consideration is required to support a noncompete, confidentiality and invention assignment agreements (old or new)



# Post-Closing Protection of Business and Assets that were Acquired

- Workforce of selling company holds a lot of information
- If need to “protect” that information in order to obtain the full value of the purchase, a buyer needs to know that agreements that are in place pre-closing will hold up post-closing, especially if a workforce is not retained
- May not terminate a person in order to protect information even though there is no further need for that person
- Owner-Operator Post-Closing Employment or Consulting Agreement
- Confidentiality and Noncompete Agreements with Seller(s) and key employees



# Post-Closing Transactions and Operation of the Business

- Who and what is needed to operate the business short and long-term post closing is determined in the due diligence phase and is then incorporated into the Purchase Agreement
- C-Suite Employee retention:
  - how much and for how long
  - what will it cost –
    - these tend to be individually negotiated agreements that allow a non-selling party to control the transaction
- Any Earnouts will impact the workforce question since a seller with a portion of consideration to earned post-closing will want his or her team in place to earn the earnout



# Closing

- Communication
- Firing and hiring – it takes a village and a plan
- Key-Employee Agreements
  - Severance Arrangements
  - Noncompete Agreements
- New “employee” agreements for rank and file workforce
  - Same documents needed to on-board a workforce organically – is new consideration required?
  - How do I get paid and what are my benefits?
  - Workforces need answers to these questions
  - HR professionals and lawyers work together



# Post-Closing

- You bought it – now what?
- Simple rules to remember
  - Some employees will transition over but will not stay, regardless.
  - A bad transition can impact the value of the business that was purchased. A bad post-closing integration plan can deplete even more value from the business purchased
- Seller-Owners who work for the buyer are almost never happy – its hard to make a boss and employee
- The non-competes and severance agreements negotiated in earlier phases are now tested (and tested)



# Conclusions

- Deal lawyer and employment and benefit lawyers work together – bring in the real experts when needed
- One bad employee missed in due diligence can cause a real mess post-closing
- Seller-Owners who work for the buyer are almost never happy – its hard to make a boss and employee
- The non-competes and severance agreements negotiated in earlier phases are now tested (and tested)





Questions?

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