



# LET'S MAKE A DEAL

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## *Identifying and Solving People Problems When Buying or Selling a Business*

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We are employment lawyers, so let's face it . . .  
Commercial lawyers don't really care about us.

*But they should . . .*

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## Executive Employment Agreements

Buyer will need to focus on:

- Obligations in Current Agreements
- Drafting New Agreements

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## *Who Wants To Be A Millionaire:* Current Employment Contracts

- Change in Control Payments
  - Single or double trigger
  - Typically 1x to 3 x salary, plus bonus(es)
  - Accelerated vesting of equity awards
- Golden Parachute Excise Taxes
  - Payments exceed 3x of 5 year average compensation
  - Public v. non-public companies
- Severance Provisions
  - No change-in-control
  - Executive is terminating

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## *Who Wants To Be A Millionaire:* Current Employment Contracts

**Lesson:** Understand the financial terms of target's executive employment agreements so you can:

- Contract around adverse consequences; or
- Account for financial consequences in purchase price

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## *The Dating Game:* Drafting New Executive Employment Agreements

- Compensation
- Term
- Termination Rights/Severance Obligations
- Title/Assigned Responsibilities
- Other Important “Boilerplate” Terms
- Confidentiality/Trade Secret Protection/Restrictive Covenants

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## *The Dating Game:* Drafting New Executive Employment Agreements

- Compensation
- Term
  - Demonstrates commitment
  - Renewal provisions are key
    - Automatic renewal
    - Renewal on written agreement
    - Conversion to at-will employment

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## *The Dating Game:* Drafting New Executive Employment Agreements

- Termination Rights/Severance Obligations
  - Expiration of term
  - Death or disability
  - By Company for cause
  - By Executive for good reason
  - By Company without cause
  - By Executive for no reason

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## *The Dating Game:* Drafting New Executive Employment Agreements

- By Company For Cause
  - Breach or material breach
  - Failure to perform duties/insubordination
  - Fraud, theft or embezzlement
  - Guilty or 'no contest' plea to felony
  - Serious/gross misconduct
  - Persistent unsatisfactory performance

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## *The Dating Game:* Drafting New Executive Employment Agreements

- By Executive For Good Reason
  - Reduction in salary
  - Material reduction in position/authority
  - Forced relocation
  - Failure to pay salary or bonus
  - Change in leadership

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## *The Dating Game:* Drafting New Executive Employment Agreements

- Title/Assigned Responsibilities
  - Careful delineation of title & duties Limit outside duties
  - Full business time required
- Important “Boilerplate” Terms
  - Assignability
  - Effective Date
  - Cooperation (Transition / Litigation)
- Choice of Law

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## *The Dating Game:* Drafting New Executive Employment Agreements

**Lesson:** Structure New Executive Employment Agreements to Maximize Company's Objectives:

- Maintain flexibility, by having short term & easy termination or non-renewal  
or
- Recruit and retain critical executive, with higher compensation package, longer term, less flexible termination provisions.

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## *The Weakest Link: Trade Secret Protection / Restrictive Covenants*

ABC Corp. makes an offer for XYZ Partners, a small technology company that markets integrated file management software and hard copy file management and storage equipment. The software side of the business is what has piqued ABC's interest. ABC and XYZ agree on a purchase price of \$30 million.

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## *The Weakest Link: Trade Secret Protection / Restrictive Covenants*

XYZ has two key personnel:

- Founder/president, who has the key client relationships
- CTO, who wrote the software and is the only person who can customize for sale

ABC offers employment and Executive VP title.

Both reject the offers.

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## *The Weakest Link:* Trade Secret Protection / Restrictive Covenants

After the sale:

- Founder/president sets up competing company
- CTO takes copy of software and accepts position with ABC's chief competitor

Well, they can't do that . . .

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## *The Weakest Link: Trade Secret Protection / Restrictive Covenants*

- Did either person execute a restrictive covenant?
- Did either person execute non-disclosure agreement?
- Did XYZ actually own the software at the time of sale?

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## *The Weakest Link: Trade Secret Protection / Restrictive Covenants*

Both executed restrictive covenants:

*During and for four years after employment, Employee will not become employed by a competitor anywhere in the United States.*

Enforceable in these circumstances?

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## *The Weakest Link: Trade Secret Protection / Restrictive Covenants*

### Probably not . . .

- Term of years too long
- Capacity restriction too broad
- U.S. geography problematic
- Self-employment creates ambiguity in VA
- Blue penciling / modification rules offer no help

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## *The Weakest Link: Trade Secret Protection / Restrictive Covenants*

Both executed boilerplate confidentiality agreement in which they promised not to disclose the trade secrets of XYZ Partners?

Does that offer protection in this case?

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## *The Weakest Link: Trade Secret Protection / Restrictive Covenants*

### Probably not . . .

- “Trade secret” is remarkably narrow concept
- Client lists and goodwill are generally not trade secrets
- ABC must show use / threatened use contrary to obligation
- ABC must show that it owns the software source code

And on that point. . .

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## *The Weakest Link: Trade Secret Protection / Restrictive Covenants*

Three months and \$150,000 into litigation, your lawyers discover:

CTO designed and wrote the source code of the program at home while he was getting his PhD in computer science. Founder/President convinced CTO to join XYZ and use the program to open a new division of XYZ, which prior to that had sold hard copy file management equipment. CTO provided XYZ a non-exclusive license to use the software.

How does that affect ABC's rights vis-à-vis CTO?

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## *The Weakest Link: Trade Secret Protection / Restrictive Covenants*

### How to Avoid this Scenario:

Effective due diligence on restrictive covenants

- Do the right people have them?
- Do they protect the right property and interests?
  - “trade secrets” v. broader “confidential information”
- Are they enforceable?
  - Protectable interest
  - Limit to “competition”
  - Limits on capacity / geography / time
  - “Boilerplate” matters

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## *The Weakest Link: Trade Secret Protection / Restrictive Covenants*

### How to Avoid this Scenario:

- Use “deal-related” restrictive covenants
- Effective reps/warranties re itemized IP
  - Seller warrants ownership free and clear
  - Look for formal assignments, or provide them in deal
  - Do not rely on “work for hire” doctrine
- Use earn-out/escrow to keep key personnel employed
- Enter new employment agreements

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## *Fear Factor: Collective Bargaining Agreements*

ABC set to acquire hotel management company, HMC, and its management contract with a major resort hotel. The hotels housekeepers, restaurant employees and maintenance employees are unionized by the Hotel Workers Union.

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## ***Fear Factor: Collective Bargaining Agreements***

HMC collective bargaining agreement states:

*This Agreement shall be binding on HMC, its successors and assigns.*

What does this mean for ABC?

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## *Fear Factor: Collective Bargaining Agreements*

Is ABC a successor?

It depends.

- Majority of ABC hotel employees must have been employed by HMC under contract.
- Basic nature of the business must be the same.

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## *Fear Factor: Collective Bargaining Agreements*

If ABC is a successor, is it bound by the existing collective bargaining agreement?

No. But,

- ABC may become bound by operation of law if it impliedly adopts the agreement by conduct. *E.g.*, if ABC continues applying terms without seeking to bargain new agreement.
- ABC will be bound if it acquires HMC through stock transaction.

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## *Fear Factor: Collective Bargaining Agreements*

Does that mean the successors and assigns clause is meaningless?

No. But,

- HMC may be liable to union.
- Employees may get damages for differences in compensation.
- Union may have grounds to enjoin the sale.
- Sellers often try to force Buyer to accept the CBA as part of deal, but often back off that demand.

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## *Fear Factor: Collective Bargaining Agreements*

What obligations does ABC have as a “successor”?

ABC is obligated to bargain with the union over a new collective bargaining agreement.

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## *Fear Factor: Collective Bargaining Agreements*

Can ABC avoid “successor” status by hiring new employees?

Yes. But,

- Section 8(a)(3) makes it unlawful to discriminate in employment on the basis of union membership, so proceed with caution.
- NLRB remedy = order to bargain.

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## *Fear Factor: Collective Bargaining Agreements*

### Strategies:

- Review CBAs in detail for economic terms. Assume if favorable.
- Be careful with clauses requiring Buyer to hire all Seller employees.
- Go through hiring process; consider outside candidates as well as existing employees.
- Meet with union before closing to try to secure favorable deal.

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## *Family Feud:* Evaluating and Blending Different Cultures

- Evaluating the Target Company
- Blending the “Families”

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## *Family Feud:* Evaluating and Blending Different Cultures

- Pay practices
  - Classifications
  - Vacation balances
  - Severance practices
- Benefits plans
- Other fringe benefits & lifestyle issues
  - Flexible work schedules
  - Expense allowances
- Leadership
  - Identify critical leaders
  - Style of successful leadership
  - Promotion paths

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## *Family Feud:* Evaluating and Blending Different Cultures

- Restructuring the organization
  - Selecting leadership / Creating teams
  - Refocusing business groups
- Retaining key employees
  - Retention bonuses / Relocation assistance
- Maintaining and Integrating vital culture elements
  - Identifying and preserving critical cultural elements
  - Obtain input from target employees
- Transition management
  - Communication re: changed organization/anticipated layoffs
  - Transferring personnel files

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## *The Gong Show:* Terminating Employees Not Making the Transition

WARN liability:

- Will it be triggered by transaction?
  - Number of people terminated
  - Floating period of time
- Who is responsible?
- What to include in deal documents?
  - Representation by seller regarding prior terminations
  - Representation by buyer regarding post-closing behavior
  - Indemnification clauses

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## *The Gong Show:* Terminating Employees Not Making the Transition

### Separation Agreements

- Severance pay (beyond any already due)
- Transition period
- OWBPA compliant releases and disclosures
- Confidentiality/Restrictive Covenants
- Non-disparagement clauses

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## *Jeopardy:* Evaluating Pending Litigation

Successor theory prevails in most litigation contexts.

Even acquisition of assets can result in transfer of liability under pending employment related litigation.

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## *Jeopardy:* Evaluating Pending Litigation

Inadvertent acquisition of litigation:

- Potential financial impact
- Potential disruption of operations
- Public relations issues

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## *Jeopardy:* Evaluating Pending Litigation

Due diligence is key:

- Get list and description of pending litigation
- Understand what the information means, or could mean

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## *Jeopardy:* Evaluating Pending Litigation

Broaden your understanding of 'litigation':

- Federal and state employment litigation
- EEOC Charges
- Investigations by EEOC / OSHA / DOL
- Arbitrations
- Unfair Labor Practices / NLRB Proceedings

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## *Jeopardy:* Evaluating Pending Litigation

Ensure that definition of “Knowledge” accounts for employment context:

- Buyer: Do not accept definition that limits “Knowledge” to actual knowledge of a few top officers.
- Seller: Ensure that you cannot be held responsible for making representations regarding government investigations you know nothing about.



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***THE END***