

THE ART OF DOING DEALS

by
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The process of selling a company can be a daunting task even for seasoned professionals. For first-time sellers, it can be absolutely overwhelming. Consequently, if you decide to sell your business, assemble an experienced team of professionals to advise you. That's the only way you will be able to focus your attention on "the deal." And remember, after all is said and done, selling your company is a deal between two parties. Never lose sight of the deal, even though at times you may feel you are buried beneath a mountain of financial, accounting, tax, and legal details. Keep in mind that the process of selling a company is more of an art than a science. It is full of nuance, subtlety, contradiction, and paradox. This article has two goals: to explain why the process of selling a business is an art and to provide some practical tips for dealing with what can be an extremely perplexing process.

Bargaining Leverage. Continually evaluate what bargaining leverage you have relative to the buyer on a particular issue. Your leverage will change over time and will vary depending on the issue at hand.

The stage of the negotiations has a profound effect on bargaining leverage. Generally speaking, you should negotiate as many significant deal points as you can early in the

process, before an announcement of the deal is made and before the definitive documents are drafted. Nail down the key provisions early, because your bargaining leverage will normally be the greatest at this point.

After a public announcement of the deal is made, your bargaining leverage will change dramatically. The company's creditors, employees, suppliers, customers, and competitors will all learn of the transaction, and thereafter, if the transaction fails to close (regardless of the stated reasons), there is a good chance that many of them will assume that it was because the buyer discovered something bad about your business.

Sophisticated buyers are aware of this shift in bargaining leverage and will often take the approach of agreeing on the purchase price and "leaving the details to the lawyers." Don't be persuaded to adopt this approach: it could put you at a considerable disadvantage.

Other factors could affect the relative bargaining leverage of the parties and cause a potential buyer to adopt a different approach. For example, if the buyer is concerned that another bidder for the company might approach you, the buyer might try to secure your agreement that, for a period of time, you will deal only with the buyer. Such provisions are often found in letters of intent and are referred to as "lock up" provisions. Be careful if you decide to agree to such a provision, for they will dramatically affect your bargaining leverage.

One of the most important sources of bargaining leverage in a transaction involving the sale of a business is to draft the documents. If you have the opportunity to draft one or more of the documents, seize it. The provisions of the documents set the agenda for the negotiations, which provides a tremendous advantage. Although the buyer will object to many of the provisions in your first draft, and concessions will have to be made, the final document will be closer to its original form than anything the buyer would have offered.

Getting to draft the documents as the seller is rare, however. Expect that the buyer's lawyer will draft most of the documents. It's an example of the "golden rule" of mergers and acquisitions: he who has the gold rules.

Developing a Blueprint. Before you spend the time and money associated with having your lawyer negotiate the terms of the definitive documents, you and the buyer should prepare a written summary of the transaction. It will help you determine whether there is truly a meeting of the minds between you and the buyer and will provide the lawyers with important guidance for drafting the documents.

Sometimes, such a summary is done in the form of a non-binding letter of intent that sets forth the basic terms of the deal. Other times, the summary is a list of "bullet points." I prefer letters of intent. Although letters of intent are typically non-binding, they are extremely important in establishing the agenda of the negotiations, and they can have significant persuasive value. They also often include binding provisions, such as confidentiality provisions, which are very important.

Dealing with Risk. A fundamental aspect of any deal is how the parties deal with risk. As the seller of the business, you will know a lot more about the business than will a prospective buyer. A potential buyer will try to reduce the risk of the unknown by learning as much as possible about your business. You, on the other hand, will try to disclose enough about your business to preclude the buyer from claiming fraud or the breach of a representation following the closing, but not so much that the buyer decides to walk away from the deal, having learned valuable information from you.

In dealing with the risk of the unknown, a buyer will seek two distinct types of protection:

- the ability to **walk away** from the deal, because, on closer examination, the company proved to be different from what the buyer thought it was and
- the ability to **seek compensation** from you following the closing, if the buyer learns that the company is not what you said it was.

The first type of protection is found in a section of the acquisition agreement called the “conditions to closing.” Problems with conditions could mean that you wind up with no deal at all. The second type of protection is provided pursuant to the “indemnification” provision, which generally allows a buyer to recover from you personally if any of the representations that the company or you made in the acquisition agreement proves to be false. Problems with the representations could mean that you still have a deal, but what you receive in exchange for selling your company is a lot less than you expected. Accordingly, scrutinize each of these provisions carefully.

Deal Makers, Deal Breakers, and Other Negotiating Difficulties. Transactional lawyers often describe each other as either “deal makers” or “deal breakers.” Unfortunately, many are in the latter category. The problem stems from the way lawyers are educated and, in some instances, the client’s expectations. Law school prepares future lawyers for the **adversarial process** of the courtroom, and clients often think they should ask for the “meanest, toughest lawyer you’ve got.”

Adopting an extremely tough negotiating posture when selling a business simply doesn’t work, however. Negotiating the sale of a business is different from negotiating a settlement agreement in litigation, where each side has decided to negotiate and compromise in order to remove the uncertainty of the outcome of a lawsuit. In a transaction

involving the sale of a business, there is usually another target company for the buyer to pursue. Consequently, coming on too strong may end a deal before it starts.

Most of the terms of a transaction involving the sale of a business are found in the acquisition agreement, which is normally heavily negotiated by the lawyers for the parties.

When negotiating these deal points, you and your lawyer should:

- Remember that the transaction is a ***business deal*** between business people, not an intellectual jousting match between lawyers;
- Continuously ***evaluate your bargaining leverage*** vis à vis that of the buyer and try to position yourself to maximize your bargaining leverage; and
- Solve problems that arise through the art of ***compromise***.

Lawyers, especially those with less experience, can get their egos tied up in a transaction. If that happens, legal expenses will skyrocket. Stay involved in the negotiations to prevent your lawyer from haggling over provisions that are unlikely to matter in the final analysis. Inexperienced lawyers are often reluctant to deviate from their “firm form document” and wind up arguing over language that has little relevance to the transaction at hand.

Ensure that your lawyer understands that you expect him or her to come to you if the negotiations bog down. Sometimes, after listening to the lawyer’s explanation of a particular issue and the risks involved, you may be able to break the impasse by discussing the matter with your counterpart on the buyer’s team, especially if you can legitimately claim that the buyer’s lawyer is behaving like a “deal breaker.”

Nevertheless, negotiation difficulties are not always the product of a lawyer’s ego or inexperience. Lawyers are occasionally unfairly labeled as “deal breakers,” because of the

lawyer's role. After the business people negotiate the purchase price and a rough outline of the transaction, their lawyers are asked to "flesh out" the deal. Lawyers often ask tough questions about issues that the parties might have failed to consider, such as covenants not to compete, escrows, indemnity provisions, and collateral to secure future payments. The manner in which such provisions are drafted can mean the difference between a great deal and a disastrous one. Don't confuse a lawyer's tough questions with being an impediment to getting the deal done. There are questions that need to be asked (and answered) before the deal documents are completed. Accordingly, it might be a good idea to involve your lawyers early in the negotiating process, when the letter of intent or term sheet is being prepared, so that these issues can be addressed then.

Because transactional lawyers are paid to worry about what can go wrong in the future, they sometimes appear to be overly negative. Stay involved in the negotiations to modulate that negativism. If the lawyer's negativism gets out of hand, it can destroy the transaction. Learn to distinguish between a lawyer who acts constructively and one who simply nitpicks. A lawyer who acts constructively will apprise you of problems and issues that arise during the negotiations and offer suggestions and ideas for solving them. Lawyers who nitpick will usually dump problems in your lap without any suggestion on how to solve them. Never tolerate such behavior.

Lawyers are not the only parties who can get the transaction off track. For example, don't expect a mid-level manager employed by a large prospective buyer to understand the perspective and feelings of one who is selling a business that has been his or her life's work. Most such managers have never been entrepreneurs, and many of them are young and lack real-world business experience. They have no appreciation of what you have gone through to

build your business or what it and your employees mean to you. Don't allow their lack of perspective to get you off track. Be prepared to explain why you are taking the positions you are taking, even if you think they should be obvious to the buyer's representatives.

Negotiating Tips. The following tips will further show why I believe that the process of selling a business is an art. This list is by no means exhaustive.

Ensure you always know who the real decision maker is for the buyer. Don't waste energy or arguments on someone who is not in a position to make the final decision. Never make a concession in the interest of achieving a compromise, unless the person with whom you are negotiating has the authority to bind the buyer.

Remember that overreaching provisions in a document rarely survive and asking for them could cause the negotiations to be unnecessarily bitter and protracted. The real art of drafting is to accomplish your objective in a manner that is so subtle that the other party doesn't even realize it. That is not to say, however, that duplicitous conduct is advisable. On the contrary, because the parties will have to deal with each other long after the closing, it is important that each side believes it has been treated fairly and honestly. Otherwise, you are merely planting seeds that could grow into huge conflicts.

Avoid labeling a position as "non-negotiable." Everything is negotiable—at some price. If you are later forced to compromise your "non-negotiable" position, you will lose credibility. Nevertheless, you must also stand firm on positions that are important to you. It doesn't require yelling or histrionics, it simply requires being resolute. And don't let the buyer know which issues are most important to you. You may be able to get a concession from the buyer by agreeing to concede on an issue that really doesn't matter to you.

Know when to concede a point. You will lose credibility and destroy the spirit of cooperation in the negotiations by holding fast to a position that lacks any apparent justification. Alternatively, if your position has merit, but is one you are prepared to concede, don't give it away for nothing.

Avoid compromising issues one by one. Big issues are usually resolved as part of a "package deal," with give and take on each side. Ensure there is a final resolution of **all** the big issues before you agree to a compromise on any one of them.

Beware of how the time factor can affect your bargaining leverage. If you have a deadline and the buyer is aware of it, then few, if any, concessions will occur prior to that deadline. Convey to the buyer that you have all the time in the world to do the transaction. Never show up at an out-of-town negotiating session with your luggage in hand and your return ticket in your breast pocket.

If in fact you are facing a deadline, and need to develop a sense of urgency in the negotiations, then you must convey to the buyer that you have other options, including not doing the deal at all. At the same time, keep the negotiations in perspective and make appropriate compromises on issues of lesser importance to you. This is the essence of the art of compromise. As the gambler said, "You've got to know when to hold them, know when to fold them, know when to walk away, and know when to run."

The Art of Compromise: Looking for the Win-Win Solution. In negotiating a particular issue in a transaction, the needs of the parties are often not in opposition. If you can cause the focus of the negotiations to shift from defeating each other to defeating the issue at hand, then you can usually achieve what is commonly called a "win-win solution."

I have negotiated with many people who view negotiations as a win-lose proposition. They believe that if I win, then they lose, and so they need to make me lose so that they can win. Besides making it extremely difficult to reach a consensus on any issue, such a philosophy merely plants the seeds for future conflict. The old saying, “What goes around comes around” is definitely true in business dealings. If a party is deceived or forced to accept truly egregious terms, then following the closing, he’ll spend a lot of energy trying to find ways to even the score. Alternatively, a party who participated in fair and open negotiations will be more likely to accept his fate, even if the transaction failed to turn out the way he expected. He’ll be more likely to admit to himself and others: “Well, that’s what I agreed to.”

When seeking compromise, you must distinguish between the buyer’s stated position on an issue and the buyer’s real needs, which are often very different. Ask questions and listen carefully to what the buyer says and doesn’t say for clues concerning the buyer’s true needs. Fashioning a solution that addresses the real needs of both parties is the key to reaching a compromise. If possible, use the buyer’s ideas and “piggyback” on them, adding what you need to something the buyer suggested. This technique can turn adversarial negotiations into collaborations.

The matters discussed in this paper involve a complex area of the law. Despite the length of the paper, it is not an all-inclusive discussion of the issues presented and does not represent legal advice. Accordingly, it should not be relied upon without consulting with a qualified attorney.