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LEGAL UPDATE

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JUST WALK AWAY

By Andrew Apfelberg

Sometimes, you need to walk away from a transaction. The best way to save yourself from a failed transaction (or at least needless expense) is to be on the alert for the warning signs of a bad deal and to trust your instincts in reacting to what you see. Getting caught up in the momentum of a negotiation or the adrenaline rush of trying to close your deal is a very good way to wind up with either a transaction that does not deliver the opportunity or benefits that you sought or a big bill for the costs related to a deal that you have to abort at the last minute.

Every deal has its own pacing and timing that develops. This is true whether the deal is an acquisition, a lease or a contract with a vendor. It is important to maintain the pace in order effectively to take the transaction from concept to signed agreement. However, when the parties to the deal focus almost exclusively on maintaining momentum, they tend to ignore the red flags that pop up from time to time as well as their own inherent reaction to what is uncovered. Let me give you a recent example.

A client wanted to acquire substantially all of the assets of a business and the real property on which the business was located. The price was fantastic and the business broker assured my client that this was a rare opportunity. The seller delivered a skimpy purchase agreement and put significant pressure on my client to review and sign the document within 24 hours of receipt. After a late-night and rather frank conversation with me, my client did not sign the document and asked for a short no-shop period within which she could conduct additional due diligence. The seller refused the no-shop restriction but, nonetheless, my client decided to proceed to negotiate the transaction.

A day or two into the due diligence period it came to light that one of the seller's key employees did not hold a necessary license and had, instead, worked out a side-deal with the seller. My client instructed me to draft around the problem by inserting an indemnification provision into the purchase agreement. The seller then provided some self-prepared financial statements but would not give my client access to the back-up data or the seller's previously filed tax returns. My client felt she could trust the seller and took him and his financials at his word. In the meantime, I revised the purchase agreement and prepared the balance of the missing documents that are typically associated with this type of transaction. The seller refused to accept any of my proposed changes to the language of his purchase agreement and was hesitant to agree to the terms of the other documents. He insisted that the sale was "as-is" and that if my client did not like it, there was another eager buyer waiting in the wings who had offered more money. My client requested that I trim-down the documents to appease the seller.

The transaction wound up not closing at the 11th hour. After all the documents were laboriously negotiated and revised, one of the members of the management team of the seller refused to sign his non-competition agreement. My client was livid. She had incurred significant legal, accounting and other fees and invested over eight weeks into the deal. She felt cheated and looked for someone to blame. My client ultimately concluded that the blame fell squarely on her own shoulders because she was so eager to close the deal that she had ignored some obvious warning signs, failed to investigate when red flags popped up

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and refused to be guided by her "gut" instinct which told her that this deal did not feel right.

Some of the warning signs and red flags that my client ignored (but that I hope you never do) were:

- ✔ The deal seems too good to be true.
- ✔ The insistence on an overly quick closing or execution of the transaction documents.
- ✔ There is hesitancy or delay in providing requested due diligence items or to deliver or respond to transaction documents.
- ✔ The records or documents reviewed in the due diligence process are incomplete or materially disorganized.
- ✔ Unwillingness or lack of ability by the other side to develop a transition plan for post-closing of the transaction.
- ✔ The other side insists on preparing the transaction documents when the custom is for your side to prepare them.
- ✔ Refusal to negotiate the business terms or language of the agreements.
- ✔ Insistence on an "as-is" sale or license and the refusal to give any material representations or warranties.
- ✔ The other side or a broker/finder exerts significant pressure to close despite the existence of open items or outstanding questions.
- ✔ Discovery of instances (even if they seem minor) where the other side was less than honest with others or failed to follow corporate formalities or the applicable rules and regulations.
- ✔ Questionable reputation of the other side within the community.
- ✔ Receipt of communications from your professional advisors pointing out issues and highlighting that you have instructed them to take a certain course of action in the face of such issues (i.e., a "CYA letter").

These warning signs and red flags apply to almost any type of transaction. However, the existence of one or more of those items does not mean that a potential deal is not a good one. Instead, it means that you should take some time to gather more information and carefully analyze it before proceeding. Often times, though, the best indicator of the significance of one of those items is your own word choice. My client in the example given here told me things like "I do not trust the seller, but ..."; "that does not seem right to me, but . . ."; "those are legitimate issues, but . . ."; and "that is a huge risk, but . . ." Each of those statements wound up being 100% correct, though it took my client many weeks to realize how right she was.

My best advice is to listen to yourself. The words you use unintentionally are the best indicators of your gut level reaction to the warning signs and red flags that you observe. If you do not pick up on your word choice on your own, your professional advisors should point it out to you. You are likely to be less guarded when talking with them and they should be more than yes-men/women who are willing to follow your instructions and keep billing the file so long as they send you a CYA letter. To get the full value for the hourly rates you are paying, your professionals should carefully observe you and be candid about what they see. You are paying for another set of eyes and deserve to receive the results of clear vision.

By continuously looking out for warning signs and red flags, you will inherently slow the momentum of a deal down just enough to analyze carefully the information and issues presented without jeopardizing the pacing of the negotiations. By listening to your instincts, you are much more likely to avoid a bad deal and to make better decisions because you inherently know what is right and what is wrong and what makes sense and what does not. Do not be afraid to walk away from a deal that does not feel right. There is almost always another opportunity just around the corner. When asked what his most profitable transactions were, a highly successful real estate developer that I admire answered without hesitation, "the ones that I didn't do."

Andrew Apfelberg was selected as a "Super Lawyer" in the Business Law practice area by the publishers of Law & Politics magazine (which was included in the February 2005 issue of Los Angeles magazine). "Super Lawyers" are the top five percent of attorneys in each state, as chosen by their peers and through independent research.

He serves as primary outside counsel to middle-market companies and entrepreneurs, advising on entity formation, finance, licensing of intellectual property, critical agreements with employees and third parties and mergers and acquisitions. Andrew can be reached at (310) 286-1700, or by e-mail at Aapfelberg@rutterhobbs.com.

DEAL MAKERS, NOT DEAL BREAKERS

Transactions closed by Rutter Hobbs & Davidoff in 2005

MERGERS & ACQUISITIONS

- Represented the foreign and domestic entities that were sellers of assets and securities of an international bottled water brand to a Southern California conglomerate.
- Represented one of the nation's leading suppliers of ferrous wire and bars for aerospace, automotive, commercial and industrial applications in its acquisition of the assets and real property of an Ohio entity that specializes in the manufacturing and processing of specialty high quality rod, wire, and bar products.
- Represented a healthcare service provider in a stock for stock exchange with a publicly-traded company.

MANAGEMENT BUY-OUT

- Represented senior management in a buy-out of one of the nation's leading suppliers of ferrous wire and bars for aerospace, automotive, commercial and industrial applications and the associated recapitalization required to finance the transaction.

FINANCING AND RECAPITALIZATION

- Represented a prominent transportation services provider in California, Nevada and Arizona in multi-million dollar recapitalization involving a Los Angeles based private equity group.
- Represented a local investment company in a multi-million dollar equity investment in an outdoor advertising company.
- Represented international record company in negotiations and documentation of joint venture with record producer.

SECURITIES & SARBANES-OXLEY COMPLIANCE

- Represented a publicly traded local biotechnology company in connection with its private placement of convertible notes.
- Represented the Audit Committee of a publicly-traded media company in connection with an internal investigation.
- Represented several regional investment banks in the negotiation of their engagement letters with clients, and related equity warrant matters.

LICENSING

- Represented a nationwide provider of golf instruction to children in the licensing of its intellectual property to a division of the PGA and to the Golf Range Association of America.
- Represented an inventor in the license of his patent portfolio to a leading national exercise equipment manufacturer to be utilized to create the next generation of exercise equipment.

DISTRIBUTOR & SUPPLY AGREEMENTS

- Represented a manufacturer of a grinding, sanding and polishing device used in the jewelry, woodworking and medical devices industries in obtaining an exclusive supply arrangement from 3M that included the right to utilize certain of 3M's trademarks in connection with the marketing and promotion of the product.
- Represented a prominent clothing and shoeware designer and manufacturer in the entry into distribution agreements with entities throughout Europe and the Middle East.

EMPLOYMENT ARRANGEMENTS

- Represented a Southern California based distributor of food products and restaurant supplies in the negotiation of employment agreements with the president and the chief executive officer of the company that included grants of phantom stock and comprehensive severance packages.

EQUITY INCENTIVE PLAN

- Represented the manufacturer of screenwriting software in the negotiation and implementation of a stock option plan for key management.

The Firm Welcomes...

Wendy C. Freedman – *Intellectual Property, Employment and Business Litigation*. The focus of Wendy's practice includes intellectual property, employment and business litigation. She has worked on matters involving Fortune 500 corporations, small start-ups, financial institutions, non-profit and governmental agencies, as well as family businesses.

Frank E. Melton – *Labor and Employment*. Frank is a labor and employment lawyer who advises employers and litigates discrimination, wage and hour, trade secret, wrongful termination, and other employment-related cases in state and federal court, arbitration, and administrative forums. He assists employers in drafting employee handbooks and personnel policies and in negotiating collective bargaining agreements. Frank also negotiates employment agreements and separation agreements involving executives and professionals.

Mark M. Scott – *Business Litigation*. Mark is a trial lawyer offering the insight of three decades of experience in complex business and real estate litigation, including property damage, construction defect, inverse condemnation, and insurance coverage. He has litigated cases in California state and federal courts, including multi-district litigation and appeals.

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