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## BUYING AND SELLING A BUSINESS

# Employment issues overlooked when buying a business

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When buying or selling a business, the buyer always remembers to review assets, liabilities and traditional balance sheets.

When a buyer invests in an equipment-rich business, valuing assets is straightforward. Formulas are used to adjust purchase prices and depreciation schedules, and the costs of things are established. However, buyers often forget to review the issues relating to the business' human capital, which can have a profound impact on determining whether the business is a good investment.

Buyers often forget to review the issues relating to the business' human capital, which can have a **profound impact** on determining whether the business is a good investment.

The valuation of knowledge and the services provided by employees are complicated, but due diligence should include an audit-style review of human resources practices and documentation to show the true value of a company.

Consider the following five employment issues most often overlooked when buying a business:

• **Hidden liability** — Pretty handbooks, well-formatted forms and numerous employee files may be evidence of a well-run human resources department. Or they could unlock some frightening employment liability.

Employment claims can be brought anywhere from 300 days to three years, depending on the type of claim. A savvy buyer will look under the hood, conduct an HR audit and be aware of potential employment law issues before signing on the dotted line.

Buyers should review whether policies are accurate and up to date; whether there are any pending claims of discrimination, harassment or retaliation; whether past complaints were handled appropriately; whether Form I-9s and Colorado Affirmations have been accurately completed and maintained; whether there are independent contractors routinely used by the business who could be classified as employees; whether personnel files have been appropriately



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maintained; and whether benefits administration has been properly handled.

Also, consider if positions are appropriately classified under the Fair Labor Standards Act. Workers misclassified as exempt when they should be paid overtime as non-exempt employees can lead to significant time and energy resolving and defending such errors. If changes to employee classification are required, consider how this could affect the bottom line.

Sloppy administration in any of these areas can create exposure for the company and the new owner if not addressed. If

issues are revealed, consider reducing the value of the business by an amount equal to a weighted estimate of the cost of potential claims, or adding an indemnification provision to the purchase agreement.

This is also the time to consider whether employment practices liability insurance or other additional insurance is necessary, and whether this should become part of the negotiations.

• **Turnover** — During a transition, some employees will quit and others may be fired. Take the time to consider all essential employees — not just those with a key to the now-mythical executive washroom — and take necessary steps to ensure a smooth transition.

Combining two cultures, or creating a new culture out of whole cloth, is tough work. More than once, an acquisition has caused valued employees to jump ship. Include the cost of a transition plan or consultant into the acquisition price, or determine what other incentives you may be able to offer to essential employees in order to create the team you need to continue the business and thrive.

• **Noncompetition and nondisclosure agreements** — It's common for buyers to ask to see employment contracts, handbooks, noncompetition and confidentiality agreements, and other documents to confirm the steps taken to protect

trade secrets as well as the restraints on executive employees. However, evaluation of the enforceability of those documents is another important step.

Were employees considered "executive" or "management" when they signed the documents? Were the contracts supported by financial or other recognized consideration? Do the agreements allow for enforcement by a successor in interest? If the answer is no, consider requiring key employees to sign new agreements, and budget for the appropriate financial consideration that may be required upon execution of any such new agreements.

• **Cost to create or revise employee documents and processes** — Consider the additional costs involved in revising and/or drafting employment-related documents.

Are there any employment agreements in force that should be reviewed? What promises were made in offer letters? Have commission agreements been executed? Is there potential liability for commission payments to employees who leave or are terminated as part of the transition? Does the employee handbook, related policies or standard operating procedures require updating? What benefits have been offered, and are there hidden costs?

Consider whether some of these items may create significant costs, and consider that as you decide on the purchase price.

• **Human resources personnel** — Consider whether the owner of the business you plan to purchase handles human resources in a sufficient manner, or whether you may require additional personnel or a third-party administrator. A new business owner quickly can become overwhelmed in handling unforeseen personnel matters when the focus should be on growing the business.

A prospective buyer would be remiss in not considering these employment law issues prior to purchasing a business. Often, identification of these issues and their impact on assets, liabilities and the bottom line are key to determining how smoothly a transition will occur. A savvy buyer knows that early identification and consideration will reap significant benefits in the end.

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