

advisory

THE IMPORTANCE OF FIRST IMPRESSIONS — GETTING A COMPANY READY FOR A FINANCING OR SALE

If you are considering applying for a substantial bank loan, seeking capital from equity investors or a possible sale of your company, the very first step in the process should be a thorough review of the company by its own management. According to the old cliché, “You only get one chance to make a first impression.” While that is certainly true in a social context, it is also true in the business world, where the stakes are usually much higher.



Any well advised lender, investor or potential buyer will undertake a thorough “due diligence” review of your company before they make a final decision to lend, invest or buy the company. Most often, this starts with a due diligence checklist, to which you will be expected to respond with both information and documentation. The initial impressions created by your response to this due diligence checklist can have a profound impact on the terms, price and sometimes, whether the transaction closes at all. If your company will be applying for a substantial bank loan, seeking equity investors or considering a possible sale of the company in the near term, you should conduct your own due diligence review, correct any deficiencies and assemble the materials that you will likely be asked to produce by a potential lender, investor or buyer.

It is also important to keep in mind that two things shape the impression you make in responding to a due diligence request. The first is the quality and completeness of the information and documentation you provide. The second is how long it takes you to respond. A complete and well organized response is expected, but even a thorough response can create a negative impression if it takes too long to pull together the requested information and

documentation. Conversely, a thorough and timely response to a due diligence request can create a positive first impression that may help to temper at least some types of negative issues that might be raised by the substance of your response.

What needs to be done to get ready for a financing or sale will vary depending on your company and industry. However, the following areas have universal application and are frequently among the most overlooked.

- **Signed Copies of All Important Agreements.** Every company has agreements that are critical or at least material to its operation and financial success. These often include real estate and equipment leases, documentation of existing credit facilities, distribution agreements, licenses and employment related agreements. Be sure that you have complete copies of all current agreements, that they are signed by all the parties and that any attachments or exhibits referred to in the agreements are attached.

- **Who Owns the Company?** There is rarely a doubt in the minds of the owners regarding the answer to this question. However, in a surprising number of cases, producing the legal documents to substantiate ownership can be a problem. The issuance of stock must be approved by a vote the Board of Directors. Once stock is issued, the original owner and all stock transferred by the original owner should be documented in the company's stock transfer records. If there are restrictions on transfer in the charter, bylaws or a stockholders agreement, a waiver of transfer restrictions should be on file. If stock has been issued without the proper approvals or there are gaps in the stock records, this could be an indicator of a potentially expensive dispute or litigation in the future. Getting your corporate house in order is very important.
- **Employment Matters.** Are the company's service providers properly classified as employees or independent contractors? Improperly classifying service providers can lead to expensive problems, including civil fines and liability for failure to pay withholding taxes, penalties and interest. Also, if your company has intellectual property that is material to its operation and success, all service providers should be required to sign confidentiality agreements and, in some cases, assignment of developments agreements.
- **Qualification to Do Business.** Virtually all companies are required to file annual reports in the state in which they are organized. If they do business in other states or foreign countries, they also may be required to qualify to do business in those other jurisdictions. Failure to file annual reports in the state where you are organized can result in administrative dissolution of your company. Although there is a procedure for reinstatement, being administratively dissolved for failure to file your annual reports makes a profoundly negative statement about how the company is run. Failure to qualify in another state or foreign country can also give rise to civil penalties and disqualification from use of the courts in that jurisdiction. That could be important if a major customer fails to pay you and your company decides to sue to recover what is owed.

The information set forth above is a brief summary of common problems that come up in due diligence reviews. It is not an exclusive listing of areas that need to be addressed.

If it would be helpful to see a due diligence checklist of the type you might expect to receive in an equity financing or an acquisition, please contact us your regular PLDO lawyer and we will be happy to send you a complimentary due diligence checklist.



William F. Miller

Partner

William F. Miller is a Partner with Pannone Lopes Devereaux & O'Gara LLC and a member of the Corporate & Business Law Team. He is a highly skilled attorney with more than 30 years of experience who focuses his practice on corporate and business law matters, including mergers and acquisitions, angel, venture capital and private equity financing, commercial contract matters, intellectual property protection and licensing, and entity and investment fund formation. Mr. Miller frequently advises early stage technology companies, manufacturers, service and distribution companies as well as investors in such companies.

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DEVEREAUX & O'GARA LLC
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