

CORPORATE AND SECURITIES LAW

Alert

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Lessons For Acquirors: Protecting Acquisitions from Defecting Target Employees

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Companies view their key executives and employees as assets to be preserved and maintained, recognizing that these individuals add value to the organization. In an attempt to keep those assets in place and out of the hands of competitors, companies often utilize employment and non-competition agreements. When companies are acquired, however, uncertainty arises as to whether or not the acquiring company will be able to benefit from the existing agreements. Often, acquirors seek new employment and non-competition agreements as a condition to closing the acquisition. The recent Delaware Court decision in *Ivize of Milwaukee, LLC v. Compex Litigation Support, LLC*¹ illustrates the importance to acquirors of structuring acquisitions to keep key target employees in the fold and to protect the value of the acquired business from the effects of any departures.

The Case

In early 2007, Ivize, LLC, a provider of nationwide litigation support services, sought to acquire the Milwaukee and Kansas City facilities of Compex Legal Services, also a litigation support service provider. During the negotiations, Pete Cobb, the manager of the Compex Milwaukee facility, was informed that he would not be retained beyond the transitional period of the acquisition. The prospective buyer, however, failed to have Cobb sign any agreement requiring him to stay with Ivize during the transitional period or to refrain from competing with or soliciting customers of the business.

Cobb secretly began taking steps to create a competing business that would provide similar services to those of Compex and Ivize. Cobb discussed the confidential transaction with key salespeople who, collectively, accounted for approximately 90% of Compex's sales. Cobb and the key salespeople, in violation of existing non-competition agreements with Compex, formed a rival entity, met multiple times during business hours to discuss the rival's business, diverted Compex funds and business to the rival, solicited key Compex employees, and stole company records and equipment for use at the rival. The morning after the acquisition closed, Ivize representatives arrived at the Milwaukee facility to find it looted and virtually abandoned, with only a handful of employees present.

¹ No. 3158-VCL and 3406-VCL (consolidated) (Del. Ch., April 27, 2009).

Ivize filed suit against Compex alleging that Compex breached the Asset Purchase Agreement's representation that the Milwaukee facility had "operated only in the usual and ordinary course" and that there existed "no . . . event or condition which . . . [was] likely to have a material adverse effect on the Business of the Facility." According to Ivize, the adverse actions of Cobb and other Compex employees prior to termination were not in the usual and ordinary course and were likely to have a materially adverse effect on the business of the Milwaukee facility.

The court nominally sided with Ivize and found that a company cannot be considered to have operated in the ordinary course when managers and employees of the company were taking actions so detrimental to the business and its operations. The court therefore held that Compex's untrue representation constituted a breach of the Asset Purchase Agreement. However, despite expert testimony for Ivize that it had suffered over \$800,000 in damages for the loss of the business's goodwill, the court awarded Ivize only nominal damages after finding that Ivize had no reasonable expectation to the retention of Compex employees following the closing. Specifically, the court noted that Ivize's assumption that it was contractually entitled to Compex's goodwill, including the continued value of its human capital, was false. Because Ivize had failed to structure the transaction in a manner that would secure the services of key employees or protect against defecting employees, the court concluded that Ivize's reasonable expectation included only a "fair chance" at retaining Compex employees and, therefore, the court awarded Ivize only one dollar for the loss resulting from its lost opportunity.

The Lessons

The *Compex* decision is significant for acquirors who seek to acquire a company that has a significant portion of its success hinging on the efforts of several key employees or their relationships with customers. One of the prime objectives of an acquiror when structuring a transaction with a target company is to preserve goodwill by ensuring that, among other things, key employees are retained. *Compex* makes clear that relying on general representations and warranties will not always prove sufficient to protect the acquiror against the diminished value of an acquired business resulting from defecting employees. Rather, an acquiror should take care to structure acquisition transactions in a manner that ensures the retention of key employees through the use of non-compete agreements, employment agreements, targeted representations and warranties, earnouts and other devices.

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Kevin H. Douglas
Scott W. Bell
Brandi L. Holland

(615) 742-7767
(615) 742-7942
(615) 742-7744

kdouglas@bassberry.com
sbell@bassberry.com
bholland@bassberry.com

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315 Deaderick Street • Suite 2700 • Nashville, TN 37238-3001 • (615) 742-6200
The Tower at Peabody Place • 100 Peabody Place, Suite 900 • Memphis, TN 38103-3672 • (901) 543-5900
1700 Riverview Tower • 900 S. Gay Street • Knoxville, TN 37902 • (865) 521-6200