Legal Aspects of Selling Your Business

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The Obligatory Disclaimer.

This article is a primer on the legal process of selling your limited liability company ("LLC"), S Corporation, partnership or other business entity. While this article might appear to be lengthy, it really is just a summary, a very short summary, of the legal framework for selling your business. And there are many issues not identified, let alone discussed. You must understand that before proceeding with any transaction to sell your business, you should not rely on the following discussion. You must instead engage counsel to assist you in addressing the many unique legal variables and intricacies to be considered and negotiated when you sell your business.

Summary

An obvious point: before you sell your business, you will have to provide information to a prospective purchaser. The buyer of your business will present a confidentiality agreement that "they use all the time". It will appear reasonable, but it will not provide you adequate protection. You should seek protections not mentioned in their form of agreement.

After executing appropriate protective agreements, information will be shared to permit the buyer to evaluate seller's prospects and to negotiate a letter of intent or memorandum of understanding. Again, the buyer will have their form of letter of intent. Again, it will appear reasonable. Also, it should be, and no doubt will be, non-binding. So seller may conclude that there is no down side to signing.

But the letter of intent, even though non-binding, will govern the entire process of selling seller's business. If seller later raises new points or negotiates new issues, buyer may assert that seller is "changing the deal". From seller's perspective, buyer's reasonable letter of intent may suddenly seem unreasonable as seller negotiates the sales agreement (unless, with the aid of seller's attorney, seller has carefully considered and inserted provisions friendly to seller into the letter of intent).

After the protective agreements and the letter of intent are signed, seller will provide information and negotiate the sales agreement. In the agreement seller will make comprehensive representations and warranties. Seller will also prepare a disclosure schedule which will list exceptions to seller's representations (e.g., Seller represents and warrants that Seller owns all of the outstanding capital stock of the Company), and which will provide detailed information about seller's business (e.g. Schedule 3.17 lists all agreements in excess of $25,000).

The representations and the disclosure schedule will contractually describe seller's business. Seller must make every effort to prepare an accurate disclosure schedule. But

what happens if seller violates a representation or violates a provision of the agreement. There are potentially many consequences. But Seller can add provisions to the sales agreement which help keep a problem from ever becoming a problem (utilizing baskets, along with knowledge and materiality qualifiers, and so forth). Also, seller can add provisions to help minimize or manage seller's risks after the problem is identified (making adequate disclosures, utilizing caps, inserting time limits within which to assert claims, and so forth). This is a very complicated process which will be the subject of much negotiation.

Buyer will conduct a very thorough due diligence review of seller's business. They will ask many questions and review many documents. Some of their requests might appear unreasonable. But buyer absolutely must complete this process to make certain that buyer understands your business. And while frustrating, seller will be called upon to provide significant assistance while continuing to run seller's day to day operations.

Then if all goes as planned, seller will sell seller' business, seller will probably continue his or her employment for some transition period, seller will comply with seller's non-competition and other post-closing agreements and then seller will wait for his or her representations and warranties to expire.

Exit Strategy; Getting Ready.

Exit Strategy. Some clients focus on their exit strategy from the date the business is formed. Others no doubt consider exit strategies but do not take affirmative steps to structure their company for an eventual disposition. It is an issue they will address later. The exit strategy may be as simple as carefully considering and then adopting a succession plan to leave the company to one or more children while making other provisions for children not involved in the business. Or selling the business to key employees. Others will attempt to maximize growth and enhance their company's "curb appeal" by recruiting key management with attractive equity kickers to incentivize management to help grow the company and to provide continuity of quality management for a prospective purchaser.

This article does not focus on exit strategies or succession plans, but it is appropriate to point out the need to at least consider exit strategies long before a Seller decides it's time to sell his or her business. Those who have considered and adopted a good exit strategy or succession plan stand the best chance to maximize their return when selling their business.

Getting Ready to Sell Your Business. Once you decide to sell your business, there are certain preliminary steps which you should consider.

Before discussing the following details, one point. When getting ready, you may uncover issues or potential problems which you will eventually need to bring to the attention of the buyer. As discussed below, voluntary and full disclosure is a key element when selling your business. But there is always the question of when should you make such disclosure. Generally, it is best to make the disclosure when all the facts are known and corrective approaches to resolve the issue are identified. But even then you probably will not shake your purchaser's hand when first meeting and then promptly air your dirty laundry. As a business person you already know timing is critical.

Also, you should not disclose or give any material information to any prospective buyer until the buyer has signed a good

confidentiality and non-solicitation agreement. The buyer will normally have its own form of agreement which will appear reasonable. However, as discussed below, it will be drafted to protect the buyer's interests. I have seen some agreements which appear at first blush to be reasonable, but in fact leave the seller with inadequate protection.

You will naturally be prepared to discuss the prospects of your business, potential expansion plans, customer base, competition, competitive advantages and so forth. You will naturally think about how best to present these matters to a prospective purchaser. Essentially, why should they purchase your business?

You will also automatically consider how best to identify a purchaser of your business. Should you use a business broker? How should you approach a prospective purchaser? With a little help could key employees purchase your business? How should you respond to potential inquiries? What approach should you take if a competitor contacts you (obviously, this is a very tricky situation). And so forth.

You will naturally consider these matters as you contemplate selling your business. The following are additional, more detailed matters for you to address when getting ready to sell your business.

First, any purchaser of your business will focus extensively on your financial statements and income tax returns to understand the financial state of your business. If you are serious, you may consider involving your CPA to prepare your business for a detailed financial due diligence investigation. Also, you should consider your financial position from the purchaser's perspective and prepare to answer questions regarding problem areas. At some point you will be required to explain financial issues and trends before the sales transaction will close.

Second, the prospective purchaser of your business will be very interested in the quality of your business relationships. The buyer will eventually need to review your key contracts with your customers, your vendors, your landlord, your employees, possibly your banking relationships, and so forth. You should make certain that those agreements are organized and readily available. If possible, it would be best to prepare a summary of your major agreements showing the parties, the term, the subject matter, and so forth and then cross reference that summary to the actual agreements. You should also be prepared to discuss any problems and opportunities which may exist.

In two recent deals, the seller set up and controlled an electronic data room. All of the agreements and documents which the buyer needed to review were previously scanned and made available through a secure internet connection. This sped up the buyer's review of the seller's business.

Third, you need to carefully consider your employee relationships. Which key employees are critical to your business once you sell the business to the new buyer? Can those key employees leave and then compete against you? Or do you have good non-competition, non-solicitation and confidentiality agreements with these employees Do you have employment agreements with questionable employees? Will the buyer of your business have the ability to let some employees go?

You may need to retain key employees just in case the deal does not close, or to help you sell your company, but the buyer might not need certain key employees after the transition period. How should you handle this situation?

Finally, are you personally concerned about the continued employment of your employees after you sell your company? Are there safeguards which you want to try and negotiate? These are very difficult issues because the buyer will want complete freedom to structure its employment force as buyer sees fit.

Forth, also give careful consideration to unusual facts or circumstances surrounding your business. Do you have an old environmental issue which you have previously addressed (or which needs to be addressed)? Think about your litigation history. Do you have the proper permits to operate the business which you want to sell? Are you properly licensed and qualified to do business in other states or foreign locations? Do you have open tax issues? If applicable, how efficient is your international tax structure? In each case, consider how to approach the above and any other prospective issues which will arise when the purchaser conducts its due diligence investigations.

Essentially, as discussed in greater detail below, before purchasing your business you will be asked to represent and warrant that the business is in good shape, except for those matters which you specifically disclose. And the purchaser will carefully review your business operations, records, contracts, business relationships, and so forth before closing the deal. If you have problems, do not plan on hiding them. Rather, you should eventually bring them to the attention of buyer, hopefully along with an approach to resolve the issues (perhaps with an explanation why the issue is not all that important or with a proposed holdback to address the issue after closing, etc.).

Initial Contact and Negotiations.

The following are some of the legal issues and concerns you should consider in your initial contact and negotiations.

Normally, the buyer will have more experience in these matters and will take the lead. But remember that they will proceed with their best interest in mind. And the agreements and approaches they propose to follow will always be to their benefit

The ultimate objective of this phase of the negotiations is to enter into a nonbinding letter of intent or memorandum of understanding. However, before the buyer of your business can have any meaningful discussions they need access to some (not all) information regarding your company. How do you impart sufficient information to the potential purchaser of your business while protecting your company before you sell it?

Confidentiality Agreement. This first one is simple, and appears to be straightforward. You should insist on executing a confidentiality agreement. When selling your business you will not want to provide much information until you have certain contractual protections.

As you would guess the proposed purchaser of your business will have a form of confidentiality agreement which buyer always uses and which on its face will appear reasonable. However, the agreement will favor buyer. Some of the issues you will want to address include, but are not limited to, the duration of the confidentiality agreement, who can review the confidential information, for what purposes can the confidential information be used, what happens to the confidential information if you do not sell your business, and so forth. To further illustrate, normally, the buyer's form will require the buyer of your business to maintain confidences for, say, two years. The

implication is that after the two-year period they are free to use your confidential information. Why should that be? Why should buyer ever have the right to use your confidential information? Buyer will normally agree to extend the confidentiality provisions in perpetuity.

Other Issues. But your concerns are not limited to confidentiality matters. You will also want provisions to protect you from the purchaser raiding your customer base or hiring key employees. You will also want to make certain that the purchaser of your business does not notify your customers or vendors of the potential sale of your company. In one deal, before I was engaged, my client's customers started calling him regarding the transaction while the parties were still negotiating.

You should also consider how your key employees will react to indications that you are selling your business. Will they stay until your business is sold? Or might they start looking for employment elsewhere? What type of contractual protections or comfort can you give your key employees? As discussed above, the buyer of your business might need assurances that your key employees will continue after you have sold your business. Or the buyer might need the ability to shed employees and consolidate functions with their personnel.

Sometimes, the buyer will also attempt to contractually prevent seller from entering into discussions with other potential purchasers of his or her business. At some point a standstill agreement may be appropriate when the purchaser is prepared to commence its detailed review of your business. During that process, the purchaser normally will be expending significant funds to engage outside and internal professionals to conduct the investigation. However, you will also be expending significant time and resources with no assurances of closing the deal, which will also impact the negotiations of a potential standstill agreement.

At this stage, you are trying to build contractual protections so that you can make targeted disclosures to your prospective purchaser. The above list of issues is not exhaustive. Each situation is unique. But when you are selling your business it's best to carefully consider issues which can arise during the initial negotiation phase and then address your exposure with strong agreements. Then, as the purchaser acquires additional information the parties can progress to discussing more specific terms and conditions of selling your business.

Generally, you will not start the process of making full disclosures until the Letter of Intent is signed, and, as discussed below, under some structures full disclosures are not made until the sales agreement is also signed.

The Letter of Intent.

At some point, if the negotiations progress, the buyer normally will propose a term sheet, letter of intent, memorandum of understanding, or some other form of summary of the potential deal. I will call this summary a Letter of Intent. Again, the buyer of your business will prepare the Letter of Intent. Again, as expected, it will be drafted to protect their interest. There are a number of issues which should possibly be addressed from the seller's perspective which the buyer will completely ignore. It will be up to you and your attorney to raise these issues. Also, the provisions included in the Letter of Intent might appear reasonable, that they accurately reflect your proposed deal, but as you would expect, the buyer's "reasonable" form of Letter of Intent will normally have a strong built-in bias favoring buyer.

While the Letter of Intent is generally a nonbinding agreement, it sets the general parameters for the comprehensive sales agreement to be negotiated and signed. If you later want to "change the deal" the buyer may object. The buyer may argue that you should have negotiated the point before you signed the Letter of Intent. But, if the purchaser wants to change the deal, they will argue circumstances have changed, the business is not as represented, so they have the right to change the deal.

Also, it is generally believed that the seller of a business is in a stronger position to negotiate before the Letter of Intent and the buyer is in a stronger position after the Letter of Intent is signed. It has been my experience that most, if not all, purchasers of businesses are serious when they enter into a Letter of Intent and they intend to work hard to get to a closing. But the buyer understands that from a psychological perspective once the seller has committed to the deal it becomes more difficult for the seller to walk away. Sellers start taking personal and business steps or changes in attitude in preparation for their new life. So after the Letter of Intent is signed, and the deal is "reached," internal pressures start to push the seller into selling his or her business.

Obviously, as the purchaser of your business expands more money and effort on the project the purchaser also is subject to momentum to close the deal. Buyer is generally incurring significant costs. And reputations are somewhat on the line. However, most believe that the dynamics after the Letter of Intent is signed favor the purchaser rather than the seller of a business

Unfortunately, I am not normally brought into the negotiations until after the Letter of Intent is signed. Then, a CPA or other professional will bring me in and we will get started. But, as stated, the overall parameters of the deal will then be "morally" set with a bias favoring buyer. Obviously, the Letter of Intent cannot contain all of the detailed provisions which the sales agreement will include but it's to the seller's advantage to get an attorney involved who is knowledgeable of the process as soon as possible. If you are not prepared to engage an attorney until you know you got a deal, one strategy is to negotiate a preliminary Letter of Intent. Then once it is acceptable, tell the buyer that you are not familiar with the legal process of selling your business, that you are concerned that you have not considered all issues, and that you are prepared to sign if your attorney does not have any comments. But, again, the best practice is to engage counsel early in the process.

Price. There is no magic formula for determining the price at which you should sell your business. Many factors will come into play. The purchaser will tend to focus on the quality of your cash flow, the value of your assets and the opportunities and savings which they can enjoy after buying your business. Obviously, they will pay more if they share your optimistic view of your company's future. They will pay more if your company has a history of steady and increasing cash flow. Essentially, when pricing your company, the purchaser will project the impact of your current business on their operations and then project the additional value they can squeeze out of your company once they have purchased it.

Sometimes, you will hear references regarding a multiple of some form of earnings. But how do you determine the appropriate multiple. It will differ from company to company and industry to industry. There is no magic number.

The client of one of the CPA firms I work with was a seller who had secured a good appraisal of his company. The seller decided that the company was worth more to the anticipated purchaser than the appraisal indicated. That client went through the same analytical process as the purchaser and realized that after the acquisition this purchaser would be in position to greatly increase the business of his company. The final purchase price was 3 to 4 times more than the initial appraised value. The appraisal was not wrong . The seller simply recognized the strategic value of his company to the purchaser, and then increased his price to capture a portion of that upside.

Again, there's no magic formula for determining the purchase price. The price will be determined based upon the many facts and circumstances surrounding the business, the negotiating capabilities and positions of the parties and how motivated each party is to close the deal.

Earn Out. I have been involved in more than one deal were the parties could not agree upon the price. The seller believes that significant growth was imminent. The buyer was optimistic and believed that significant growth would be enjoyed, but the buyer was not prepared to pay for "blue sky".

To compromise, the parties negotiated an earn out where the seller participated in a portion of a defined upside. Obviously, this structure is very complicated. How do you measure performance? Should there be multiple levels of participation? How do you prevent manipulation? Should the performance income bear the cost of the purchaser's overhead? How do you reach management decisions? And so forth. But in appropriate circumstance implementing an earn out has closed the gap when the parties could not otherwise agree on the sales price of the business to be sold.

Structure of the Deal. There are numerous issues and options to consider when structuring a deal. There are tax issues. Should you sell the assets of your business or sell the stock, LLC Membership Interests or other ownership interest in your business? Should there be a post-closing adjustment for working capital or should the parties adopt a closed working capital model? There are the pricing issues discussed above. There are payment issues, issues concerning securing the purchaser's obligation to pay the purchase price if there is a deferred purchase price to be paid. Should a portion of the purchase price be held in escrow in case the seller breaches a representation or warranty (discussed further below)? And so forth. Again, it is normally to the seller's advantage to negotiate the broader framework of these issues when negotiating the letter of intent.

Definitive Purchase and Sale Agreement.

There are two basic approaches to negotiating and executing the definitive purchase and sales agreement (I will refer to this agreement as the “sales agreement”). First, the parties can negotiate and execute the sales agreement and then the purchaser can carefully and methodically review the books, records, operations, legal issues, employee issues, environmental issues, vendor issues, customer issues, and so forth. This review process is referred to as "due diligence". I will refer to this first approach as the "sign, due diligence, then close structure". In the second approach, the parties simultaneously sign the sales agreement and close the deal. Under this structure, buyer conducts its due diligence as it negotiates the sales agreement. I will refer to this second approach as the “due diligence then sign and close structure.”

Sign, Due Diligence, Then Close Structure. In this first approach, the buyer and the seller obviously negotiate a sales agreement. However, while the purchaser has some view of the company, it has not conducted its detailed due diligence. Rather, based upon buyer's preliminary view, the agreement is negotiated and signed with the seller making representations and warranties upon which the buyer relies. For example, the seller will represent that there is no litigation other than as disclosed on Schedule 3.12.

As discussed in greater detail below, the sales agreement also includes a disclosure schedule which sets forth the agreed upon exceptions to the representations and warranties made by seller and other information pertaining to the company which the seller represents and warrants is true and correct in all material respects. In our example, Schedule 3.12 is part of this disclosure schedule.

But, and this is the point to be made, the buyer will sign the sales agreement based upon the representations and warranties made, as modified by the identified exceptions noted on the disclosure schedule, before the seller has been given the opportunity to fully and carefully consider all matters pertaining to the business.

After the sales agreement is signed the purchaser then conducts its due diligence. If the company is not as represented then certain consequences follow. For example, if certain representations are not met then perhaps the buyer can simply walk away from the deal. Or perhaps the buyer is entitled to other relief as negotiated by the parties in the sales agreement.

Also, because the purchaser is required to buy the business if all goes as planned, the sales agreement will contain provisions which requires buyer's consent for certain transactions following the execution of the sales agreement but before the date the sales transaction closes (before closing seller cannot hire any new key employees without the prior consent of buyer).

The essential concept is as follows. The seller, through the sales agreement and the schedules, describes the business to be sold, the liabilities and claims associated with that business, the nature of the vendor and customer contracts, the absence or existence of litigation or other problems, and so forth. The purchaser, through its due diligence efforts, evaluates the business to be purchased and if the results of that evaluation are satisfactory then the purchaser is contractually obligated to buy the business. If instead problems exist, then different consequences follow. Until closing, the seller continues to operate the business with oversight from the purchaser on certain agreed-upon major matters. And if all goes as planned, and all conditions are satisfied, the deal closes.

Or if the deal fails to close because the seller failed to identify a material exception to a representation or warranty (for example failed to identify an existing significant lawsuit) or if the deal failed to close because the seller materially violated the provisions governing the operations of the business (the seller, without the approval of buyer, purchased all of the real estate which it had previously leased on a month-to-month basis), then the seller generally will suffer adverse consequences.

Obviously, there are shades of grey to be negotiated. Should buyer not have to buy your business simply because you failed to list a $25,000.00 contract which is a good contract? Or your company is not qualified to do business in Montana?

The above is a very summary discussion of the sign, due diligence, then close structure.

Due Diligence then Sign and Close Structure. The other approach is one where the seller and buyer are negotiating the sales agreement at the same time that the buyer is conducting its due diligence. Here, the buyer is conducting its due diligence before closing pursuant to the confidentiality and other protective agreements previously negotiated by the parties. The parties then sign the sales agreement after buyer completes its due diligence at the same time they close the deal.

Under this second approach, neither party is bound to close. Each is working under the assumption, and probably the legal requirement, to deal with the other in good faith towards executing a mutually satisfactory sales agreement and then closing. But if the parties cannot come to terms then the deal simply will not close. Also, if problems arise during due diligence, generally buyer's only recourse is to either renegotiate the deal or elect not to proceed.

As with the sign, due diligence, then close structure the seller is still required to make representations and warranties and prepare the disclosure schedule. However, generally the representations and warranties are without legal consequence until the date of closing and money exchanges hands. But the seller must undertake the same level of effort to make certain that the representations and warranties are true and correct, with exceptions duly noted on the disclosure schedule. If the representations and warranties are subsequently shown not to be true as of closing, then the seller will suffer adverse consequences discussed further below.

Finally, sometimes a hybrid approach is employed. The parties may initially pursue a due diligence then sign and close structure, work through all of the details and then sign a sales agreement that must close if one or two very specific conditions are satisfied. For example, the parties initially adopted a due diligence then sign and close structure. Buyer develops concerns because sales have dipped – Seller asserts the dip is a direct result of Seller's focus on the deal which has caused day to day operations to suffer. The parties sign the Sales Agreement and must close provided sales do not further deteriorate.

Comparison. There are obvious pros and cons to both approaches. The most obvious advantage of the first approach to seller is that the buyer is obligated to close if the business is as represented. The disadvantage to the seller are the consequences which might follow if problems arise during due diligence. Also, buyer normally attempts to retain certain somewhat undefined rights to walk if buyer determines, in its discretion, problems exist, or their Board fails to approve the deal, and so forth. Buyer will try to retain an out which they can easily activate. Seller will resist these efforts. Essentially, under what circumstances should buyer be allowed to walk without consequence?

Most of the deals I work on use the second approach. The parties are negotiating their deal at the same time that the buyer is conducting its due diligence. The process is faster. It is also simpler.

From the sellers perspective, while the buyer is contractually obligated to purchase the business under the sign, due diligence, then close structure, there is always the fear that if seller decides that it does not want to proceed with the transaction, then it will find problems during its due diligence investigation which buyer will assert are simply insurmountable. Theoretically, seller could bring suit against buyer for breach because buyer "fabricated"

the reasons not to close in bad faith. But litigation would be a messy process.

Representations and Warranties. Under both approaches, the seller will make representations and warranties to the buyer regarding most, if not all material matters pertaining to the seller's business. The seller is not representing or warranting that the business is free of defects. Rather, the seller is representing and warranting that all material defects have been disclosed to buyer. For example, the seller will represent and warrant that there is no litigation *other than* litigation listed on the disclosure schedule. The representation is not violated unless litigation exist which has not been disclosed.

The representations and warranties serve many different functions. Essentially, understand that disclosure cures a potential breach provided, and this is important, that disclosure is made on the disclosure schedule when the representation and warranty is made.

Representations – Knowledge Qualifiers. Should the representation be limited to seller's knowledge? It might not be appropriate to limit a representation that to seller's *knowledge* it has not received service of any litigation. The seller should generally know whether or not it has been served, so the seller should be required to list such litigation on the disclosure schedule. However, a representation that to seller's *knowledge* there are no facts or circumstances which will lead to litigation is appropriate. A seller may know of a pending dispute if a customer or vendor has threatened litigation. Seller should be required to list such dispute on the disclosure schedule. But the seller should be excused if the existence of the threatened dispute is *not known* to the seller.

But, how do you define what information is known by the seller? Should the seller be charged with knowing each fact and circumstance known by all of his or her employees? Does the seller have the requisite level of knowledge if he or she knew of something several years ago but has since forgotten the matter? And so forth.

Representations – Materiality Qualifiers. Materiality also comes into play. Should buyer represent that it is in compliance with all rules or regulations applicable to its business. Or should buyer represent that to its *knowledge* it is in *material* compliance with rules or regulations which are *material* to the business? As you can anticipate, issues arise when defining what is material compliance and what is material to the business.

Representations - Disclosure. Always keep in mind, however, that disclosure of a problem will tend to cleanse any potential violation; provided the disclosure is made at the time the representation is made. So if there is pending litigation, the representation will read "Except as disclosed on Schedule 3.12, there is no litigation . . ."

However, sometimes the buyer will refuse to accept an identified risk. In our example, even if the litigation is fully disclosed, buyer simply may decide not to assume the risks associated with the litigation. Then other approaches must be considered. Perhaps the seller will agree to indemnify the buyer if the litigation is lost. Or buyer and seller will each bear 50% of any loss. Other alternatives exist.

Representations to Shift Risk. One important aspect of making a representation is to shift the risk associated with the representation made. For example, if seller makes an unqualified absolute representation that there are no environmental issues with his or her business, and then after closing an environmental problem arises, that problem will be seller's problem whether or not seller

knew of the problem beforehand. Under this representation, seller has retained pre-closing environmental risks associated with the business. Obviously, if an environmental problem is identified after closing seller could assert that the problem did not exist as of closing. In making the representation, seller did not agree to guarantee all future environmental compliance. Rather, if buyer can show that an environmental issue existed at closing, then seller will be responsible for damages.

To illustrate an extreme example. I had one client who priced his business under its market value (the transaction was still for millions of dollars). The transaction was with a sophisticated, multinational corporation headquartered in Canada which actively purchased businesses. They were not naïve.

The client told me that under no circumstance did he ever want to be charged with violating a representation or warranty. That when the deal closed, he was putting money into the bank, and that money was to be forever his. .

That direction led to a deal which had only one representation and warranty. The client was only prepared to represent and warrant that he owned his stock. Otherwise, all risks were shifted to the purchaser. Again, this was an extreme case where both the purchaser and the seller recognized that the seller was leaving funds on the table in exchange for shifting risks.

When negotiating representations and warranties there are no "correct" or "fair" positions. Was it "fair" for my client to shift all of the risks to purchaser? Would it have been fair had the buyer suffered a loss which would have been covered under “normal” representations? Was it fair that buyer in fact retained the reduction in purchase price because, as my client anticipated, no problem ever arose? In hindsight the buyer got a very good deal. But the buyer had to bear additional risks to get that deal. Fairness had nothing to do with the determinations of the representations and warranties seller made. The nature and extent of the representations and warranties made is purely a matter of negotiation. And that negotiation is dependent upon a myriad of facts and circumstances.

Again, the above is a very gross simplification of the representations, warranties and scheduling provisions of a sales agreement. There are many factors to consider and negotiate.

Hold Back, Escrows and Indemnification's. Another contentious issue involves holding back a portion of the purchase price to protect the purchaser if a representation or warranty is breached, or if the seller fails to comply with agreements to be performed post-closing. How much should be held back, if any, and when should the escrow be released?

There are many approaches to these issues. For example, the seller should argue that the buyer should not be entitled to any recovery until violations of the representations and warranties in total exceed a given "basket". The seller does not want to be nickeled and dimed for each minor breach. The buyer is entitled to recovery only after total losses exceed the basket, but how large should that basket be? Also, should the buyer recover the excess loss over the agreed upon basket, or should the buyer recover the amount of the basket plus the excess.

Should the buyer be entitled to recovery if the buyer was aware of the potential loss and decided to close anyway? What if the buyer was aware of the potential loss but seller failed to include the item on the disclosure schedule? Should the buyer still be entitled to recovery?

Also, should there be a limit, or cap, to the amount which the buyer can recover? Within what time periods should the buyer have to make a claim? Should a loss be considered if it would have been covered by the insurance program of seller?

I had one client who was selling its business to a multinational corporation. The purchaser maintained an insurance program with what amounted to a $25 million deductible. Breaches of certain representations would have been covered by my client's insurance program less a very reasonable deductible. What would have happened if the purchaser terminated the old policies, adopted its high deductible insurance program for the acquired business, and then actually suffered, say, a $10 million loss to be indemnified by seller. Should the seller have to pay the loss if the loss would have been covered under the old insurance program. As originally drafted, my client would have been responsible for the entire loss. We revised the provisions to protect my client against this eventuality. A loss was not considered a loss if it would have been covered under the old insurance program.

Again, every deal is unique and these issues will be the focal point of much discussion.

Other Agreements. The sales agreement may call for other agreements which must be complied with post-closing. For example, employment agreements, confidentiality agreements, noncompetition agreements, and possibly others may be executed at the closing. Also, the sales agreement itself might call for certain post-closing actions. For example, seller may be required to gain the consent of certain key contracting parties after closing rather than waiting for such consents before closing. Seller might be required to cure certain title defects in real estate post-closing rather than delay closing. There are any number of issues which might be dealt with after closing through post-closing agreements.

Closing and Post-Closing Matters.

Assuming all goes as planned, the parties will close the deal. Money will exchange hands, the escrow, if any, will be formed, assignments and other transfer documents will be signed and delivered, employment agreements and other post-closing agreements will be executed and so forth. Thereafter, certain aspects of the relationship of the parties will continue to be governed by agreement after the closing.

Certain post-closing adjustments to the purchase price might also be called for in the agreement.

The representations and warranties will continue for the time period agreed upon (some may expire in one year, others in 18 months and then others may continue indefinitely -- if you do not own the stock you sold, thereby violating the representation you made that you in fact owned the stock, the purchaser will forever have the right to seek recovery. That representation will never expire). If problems arise claims might be asserted against the escrow. Obviously, the seller will be afforded the opportunity to dispute any claim asserted against the escrow. If no claims are asserted, then the escrowed funds will be released as scheduled. The deferred purchase price, if any, will be paid.

And then at some point, as called for in the sales agreement, for all practical purposes the deal will finally come to rest and the parties will finally go their separate ways.

My Approach to Representing a Party to Purchase and Sales Transactions. I have

worked as legal counsel within corporations which buy and sell businesses. I have sat at the management table as business and legal aspects were considered and negotiation approaches were adopted. In my private practice, I have represented purchasers and sellers in all sized transactions up to in excess of $100,000,000. I have advised clients as both a CPA and a tax attorney on how best to structure transactions from an income tax perspective. I have considered estate planning opportunities when acquiring a business. I have seen these transactions from many perspectives.

Obviously, smaller deals cannot support significant legal expenses. Accordingly, when representing a party to a smaller deal, it is necessary to discuss budgets, scale back the legal representation and focus only on what is most important. When representing parties to more significant transactions, the deal is typically more complicated, the stakes are higher and the legal requirements more demanding.

Also, while my office is admittedly small, I have very good access to outstanding legal assistance when needed. I used to practice with one of the lead partners of Baker & Hostetler, a very large national firm. When faced with unique deal issues, or when faced with issues in specialized areas of the law, I consult with specialists at Baker & Hostettler.

For example, when assisting a client selling its US and Chinese operations I consulted with an international tax expert whose practice focused entirely on international transactions. He was conversant with all applicable issues and was invaluable in structuring the international tax aspects of the deal and protecting our interests. While his rates were high, he already knew most of the answers. So the overall bill to the client was reasonable.

Also, when working on more significant transactions, larger firms will use a team approach. Many attorneys will review the agreements and provide comments. When working on significant deals, I sometimes seek a second review of the proposed agreement from Baker & Hostettler under the same theory that two sets of eyes are better than one (after first consulting with the client). But Baker & Hostettler's role is more limited than the multi-attorney role found in larger firms, thereby better controlling costs (however, obviously, with each review, additional issues may be fleshed out).

I also have relationships with specialist who practice locally (employment law, employee benefits, environmental law, patent law, and so forth). Again, I can call on these specialist when required.

My overall objective is to provide cost effective, high quality legal representation by taking the laboring oar at my reasonable rates, and then calling on experts when additional assistance is required.