

## SELLING YOUR BUSINESS: PRICE IS NOT ALL THAT MATTERS!

If you are interested in selling your business or buying another business, you should be aware of some of the key provisions that typically appear in documentation and are customarily expected by buyers to support an agreement on price, timing, and deal structure – e.g., stock vs assets. Of course, the specifics of all of these provisions are fully negotiable. However, a prudent seller will anticipate that the topics must be addressed in some form.

**Holdback.** Often, a buyer will insist that a substantial portion – typically ten percent to thirty percent - of the price be held in escrow with a financial institution or other third party for two to four years to cover claims that the buyer may have against the seller under the agreement.

**Representations and Warranties.** Invariably, buyers will insist that the seller confirm in writing that the business is what it purports to be and what the seller has claimed in due diligence and negotiations. Matters usually covered are debts and receivables, commitments to employees, customer contracts and cancellability, accuracy of financial statements and often GAAP compliance, tax compliance, legal claims (pending and threatened) and compliance, including environmental compliance where applicable, intellectual property status and company owner status and transaction authorization. If any of these assurances turn out to be untrue and expose the buyer to financial losses, the buyer will want to recoup funds from the holdback escrow.

**Contingencies.** Buyers will not want to be bound to proceed and pay until they have a comfort level that the deal can happen. Larger deals will usually require filings with the Department of Justice and Federal Trade Commission, which will have opportunities to object. In many cases, buyers will not want to be bound until completion of due diligence. In many other cases, there will be a requirement for third party approval from key customers, suppliers and lenders. Buyers may also want an ‘out’ if they cannot obtain the agreement to an employment contract with non-compete or non-solicitation from key managers or if they can not obtain a commitment for financing. In situations with multiple equity owners, sellers may desire an opportunity to pursue other offers to ensure that the sellers are maximizing the sale price of the stock or assets.

**Indemnities.** Buyers will want to be protected from both underlying liability and legal costs associated with business-related claims arising prior to the closing. These provisions can encompass both known and unknown claims. For example, if there is a pending suit for patent infringement or wrongful termination of employment, the buyer will demand that the seller take full responsibility. The same is usually true of claims that have not been presented at the closing but which do show up within some specified time thereafter. Tax claims are often addressed in this context as well.

**Price Adjustments.** Some deals provide for an ‘earnout’ whereby the price is adjusted based upon bottom line performance or other financial metrics during a specified period, typically one to three years following the closing.

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This is often a way of bridging gaps between buyer and seller evaluations. In other cases, adjustments are tied to post-closing audits and levels of inventory, working capital and/or collection of receivables.

**Formalities.** Requirements for shareholder and Board approval and entity good standing certificates are customary. In more complex situations, some buyers will demand seller counsel written legal opinions as to legality of the transaction and prior securities offerings, compliance with material contracts and absence of pending or threatened litigation – i.e. confirming what the seller has warranted.

In our experience, it is usually the case that deals go more smoothly if buyer and seller discuss at an early stage not only price, but also other material elements of the transaction. Our corporate partners are pleased to assist with preparation for and response to such discussion.

As an additional resource to our clients, in a prior newsletter we offered a free [Legal Checklist](#) that a company can use to assist in the review of its records, preferably with the support of counsel. That Legal Checklist can be accessed [here](#). As we noted, this can be useful to a company before undertaking any meaningful financial transaction, whether it be a company sale or other M&A activity.

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