Representing a Buyer or Seller of an Ongoing Business Presentation to NJICLE

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I. Finders Agreement/Investment Broker Agreement

- A. Business Brokers; Finders; or Investment Bankers
- B. Statute of Frauds must be in writing
- C. Fee should be earned on closing. Who pays? (generally Seller)
- D. Auction

II. Letter of Intent (or LOI)

- A. Binding v. Non-Binding
- B. Provisions that are traditionally binding:
 - i) Non-compete; Non-solicit
 - ii) Confidentiality
 - iii) Legal fees
- C. No shop
- D. Confidentiality Agreement (separate)

III. Accounting, Tax & Structuring Issues

- A. Stock sale v. Asset sale v. Merger
- B. Business reasons for stock sales
 - i) Net operating loss
 - ii) Licenses
- C. Accounting Issues
 - i) Type of financials (compilation, audited/unaudited)
 - a) What does the seller have?
 - b) What do the purchaser and/or lender require?
- D. Was Seller required to pay sale tax on its operations?

IV. Due Diligence By Client

- A. Checklist
- B. Client's accountant's diligence
- C. Compare diligence to representations in contract
- V. <u>Contract of Sale</u> We will go through an Asset Purchase Agreement, which is most typical. Most provisions are similar in stock purchase deals. The following provisions are laid out in the order in which they often appear in the Agreement.
 - A. Assets
 - i) Included v. Excluded (Cash is always excluded)
 - ii) Liabilities assumed v. excluded
 - iii) Accounts receivables who collects it? who gets it?
 - iv) Works in process (WIP) who bills it? who collects it?
 - v) Seller's name (seller to change its name)
 - vi) Trademarks and IP
 - vii) Phone numbers
 - viii) Licenses
 - ix) Vendor contracts assignable
 - x) Goodwill

B. Purchase Price

- i) Fixed v. Earn out (tied to a formula)
- ii) Cash at closing
- iii) Promissory note (discussed as part of ancillary documents)
 - a) Secured v. Unsecured
- iv) Payment of Seller's debt
- v) <u>Escrow portion of price (post closing)</u> Tied to:
 - a) Conditions
 - b) Earn Out
 - c) Regulatory approval Licenses; Big deals HSR
- v) Allocation of Purchase Price
 - a) Allocate among: Furniture, Fixtures & Equipment; Leasehold Improvements; Inventory; Restrictive Covenant; Assignment of Lease; Goodwill
 - b) Agree to report consistently pursuant to IRC Section 1060(b)
 - c) Tax treatment of different assets (dealt with by accountant)
 - d) Sales tax

C. Closing

- i) Time and place
- ii) Simultaneous contract and closing? OR
- iii) Contract with conditions precedent to closing and then closing; OR
- iv) Closing in escrow

D. Seller's Representations, Covenants and Warranties

- i) Difference between representation/warranty and covenant
 - a) Representation statement of present facts
 - b) Warranty guaranty of condition
 - c) Covenant promise of future event
- ii) Seller's traditional representations, covenants and warranties:
- a) <u>Organization and Authority</u> Seller is duly organized, in good standing and has full authorization to enter into and consummate the transaction.
 - b) <u>Qualification</u> Seller is qualified to do business in various states.
- c) <u>Authorization; Binding Obligation</u> Execution, delivery and performance of the Agreement was duly authorized and is a binding obligation.
- d) <u>No Violations; Consents (except as disclosed on corresponding schedule)</u> Agreement won't violate charter, by-laws, law, constitute default under any third party contract or cause lien on assets; No third party consents needed, except those disclosed on corresponding schedule.
- e) <u>Financial Statements</u> Attached as schedules are copies of balance sheets, statements of income and possibly others (e.g., cash flow and equity changes for time periods negotiated between the parties); represent how compiled and accounting standard applied; audited or unaudited.

- f) Absence of Changes Except as disclosed on corresponding schedule, Seller has conducted business in ordinary course, in accordance with past practices since last balance sheet, no change that could have material adverse effect; no increase in salaries, except as disclosed on corresponding schedule; business has not suffered any damage to assets in excess of \$10,000; no notice of change or threat of change in its relations with customers; no waiver of any rights material to business; no sale or encumbrance of any assets; no receipt of advance payment from customers.
- g) <u>Assets</u> Seller has good title free of encumbrances (except as disclosed in corresponding schedule); purchased assets constitute all assets buyer needs to operate the business.
- h) <u>Personal Property</u> good operating condition, except for normal wear and operation; suitable for purposes for which presently used.
- i) <u>Permits</u> no governmental permits, licenses, etc. needed to carry on business (except as disclosed in schedule).
- j) <u>Compliance with Laws and Litigation</u> Seller is in compliance with all applicable laws (except as disclosed in corresponding schedule).
- k) <u>Employees</u> List (all or key) employees, seniority, job title/description and salary on corresponding schedule; none covered by union; no written employment or consulting agreements (except as disclosed in corresponding schedule); no unfair labor practice charges pending; no knowledge as to labor organization efforts.
- l) <u>Material Agreements</u> List outstanding contracts on corresponding schedule (or at least those not terminable on 30 days notice); true and correct copies delivered to Buyer; each contract is valid, binding and in full force and effect; no defaults; no agreements not to compete.
- m) <u>Environmental Matters</u> not in violation of environmental law; has all permits; not contaminated with Hazardous Substance; no underground tanks, asbestos, PCBs.
- n) <u>No Undisclosed Liabilities</u> no liabilities, except as reflected on financial statements, and except as disclosed on corresponding schedule (or incurred in ordinary course, consistent with past practice since balance sheet).
- o) <u>Real Estate</u> Disclose ownership/leasehold interest in real property. Certificate of occupancy permits intended use by Buyer of Premises.
- p) <u>Ownership; Subsidiaries</u> List stockholders on corresponding schedule; no ownership in any other corporation.
- q) <u>Tax Matters</u> timely filed complete and accurate tax returns and paid all taxes owed; not received governmental notice of deficiency; no tax liens; satisfied withholding tax requirements; Seller is United States Person per Section 7701(a)(30) of IRC; qualified as S corp?; list states in which Seller has filed tax returns in corresponding schedule; no governmental authority has asserted Seller is subject to tax in a jurisdiction in which it has not filed tax returns.
- r) <u>Employee Benefit Plans</u> List employee benefit plans in corresponding schedule; true and complete copies delivered to Buyer; compliance with laws.
- s) <u>Brokers</u> No brokers used in deal other than those listed in corresponding schedule.
- t) <u>Intellectual Property Rights</u> List all patents, copyrights, trademarks, etc. on corresponding schedule; list owner, jurisdiction in which registered, date of

application; represent schedule is complete and accurate list of IP; seller owns, licenses or has right to use all IP necessary to operate business; Seller is not infringing on third party IP; no pending claims have been made that any third party has violated Seller's IP; all patents, etc. are in full force and not encumbered.

- u) <u>Accounts Receivable</u> accounts receivable not subject to any counter claims or offsets and have been billed and are generally due within 30 days after billing; corresponding schedule lists total amount of accounts receivable and aging.
- v) <u>Insurance</u> list all insurance policies on corresponding schedule; all premiums paid; no defaults; no notice of cancellation; not refused any insurance; occurrence v. claims-based policies.
- w) <u>Inventory</u> inventory shown on financial statements (except as disclosed on corresponding schedule) are valued at lower of cost or market; items saleable in ordinary course of business.
- x) <u>Related Party Transactions</u> Except as disclosed on corresponding schedule, no related party has borrowed money from Seller or loaned money to Seller or received guarantee of any indebtedness of Seller; any contractual or other claim; has any interest in assets; define "related party" (usually officer, director, stockholder or any relative or affiliate of same).
- y) <u>Conduct of Business</u> no extraordinary transactions will be done between contract and closing without Buyer's consent (e.g., Seller will not enter into an agreement that is not terminable at will; Seller will not do anything outside of the ordinary course of business, consistent with past practices).
- z) 10(b)(5) representation (no material omissions) This is a matter of negotiation

iii) Qualifiers as to Reps

- a) Absolute
- b) Knowledge; after due inquiry; knowledge of which officers?
- c) Materiality
- d) Material adverse effect on company as a whole

iv) Schedules

- a) Certain reps have corresponding schedules
- b) Sellers should put as many potential problems on the schedules as they can to avoid problems because then there is no misrepresentation (the risk of not so doing is a claim against Seller).

E. <u>Buyer's Representations, Covenants and Warranties</u>

- i) Buyer's traditional representations, covenants and warranties:
- a) <u>Organization and Authority</u> Buyer is duly organized, in good standing and has full authorization to enter into and consummate the transaction.
- b) <u>Authorization; Binding Obligation</u> Execution, delivery and performance of the Agreement was duly authorized and is a binding obligation.
- c) No Violations Agreement won't violate charter, by-laws, law, constitute default under any third party contract or cause lien on assets; No third party consents needed.
 - d) Brokers Which brokers it dealt with, if any.

e) <u>Due Diligence</u> – Buyer has conducted due diligence, had full opportunity to ask questions and have them answered and is entering into the transaction with knowledge of all issues disclosed or discovered during diligence. Possibly that it is not aware of any misrepresentations by Seller. (This is negotiated.)

F. Non-Compete; Non-Solicitation; Confidentiality

- i) Non-Compete Typically, Seller will agree not to compete with Buyer for a certain period of time and within a certain geography. The definition of "business", the period of time and geographic limitations are negotiated.
- ii) <u>Non-Solicitation</u> Typically, Seller will agree not to solicit or hire Buyer's newly acquired employees or contact Buyer's newly acquired customers for a period of time.
- iii) <u>Confidentiality</u> Seller will agree not to use any confidential information it sold to Buyer.

G. Indemnification

- i) For what?
 - a) Breach of Agreement, representations, warranties
 - b) Third party claims and duty to defend
- ii) Describe mechanism for claiming indemnification
- iii) Are indemnities mutual?
- v) Basket and Caps To be negotiated
- a) <u>Basket</u> Buyer must have \$X of damages before it can make a claim. The parties need to negotiate whether Buyer can only collect above \$X or if it can collect the entire amount of damages once \$X is exceeded.
- b) $\underline{\text{Cap}}$ The maximum amount that a Buyer may recover. It can be less than, equal to or greater than the purchase price.
 - vi) Damages Buyer must have damages to make a claim.
 - vii) Statute of Limitations
- a) Typically 6 yrs. for a contract claim, but parties can negotiate shorter time limitations for certain categories of misrepresentations.
- b) Buyers may try to extend statute of limitations on tax and environmental representations.
- H. <u>Covenants of Seller Between Contract and Closing</u> No extraordinary transactions will be done between contract and closing without Buyer's consent (e.g., Seller will not enter into an agreement that is not terminable at will; Seller will not do anything outside of the ordinary course of business, consistent with past practices).
 - I. Conditions Precedent to Closing (only in non-simultaneous contract and closing)
 - i) Conditions Precedent to Buyer's Obligations:
 - a) Bring down of reps (officer's certificate).
- b) Bring down of financial statements (if financials are worse, it may affect the Purchase Price).
 - c) Board of Directors and/or Shareholder approvals.
 - d) Good standing of Seller.

- e) Required third party consents (e.g., if there is a bank loan, by bank; if there is an assignment of lease, by landlord).
 - f) Lock up key employees (employment agreements) required by
 - g) Opinion of Seller's counsel as to certain conditions may be
- h) File Bulk Sale (Form C-9600) with NJ Division of Taxation Bulk Sale Section at least 10 business days before closing and receive a response; Bulk Sale Section may require part of purchase price to be held in escrow by Buyer's attorney pending NJ Division of Taxation's approval of Seller's final tax returns. Need clearance letter from Bulk Sale Section to pay Seller money held in escrow.
- i) Government clearance, <u>if</u> required (e.g., transfer of licenses or Hart-Scott filings). (Hart-Scott threshold one party to the transaction has total assets or net sales of \$141.8 million or more and the other party has total assets or net sales of \$14.2 million or more.)
 - ii) Conditions Precedent to Seller's Obligations:
 - b) Bring down of reps
 - c) Board of Directors and/or Shareholder approvals
 - e) Third party consents, if required

J. <u>Post-Closing Covenants</u>

Buyer.

required by Buyer.

- i) If there is an earn out or a portion of the purchase price unpaid at closing, there may be restrictions on Buyer as to Buyer's conduct of the business post-closing
- ii) If Seller has a security interest in the assets sold, Buyer will be prohibited from selling such assets without paying proceeds to Seller; Buyer may be required to insure such assets
- iii) If Seller kept accounts receivables, a mechanism must be put in place as to how Buyer collects and remits such sums to Seller post-closing.
- iv) Seller may have to change its corporate name if it includes the name purchased by the Buyer.

K. Miscellaneous

- i) Notices
- ii) Merger clause
- iii) Public announcement
- iv) Consent to jurisdiction and choice of law
- v) Possibly arbitration
- L. <u>Closing</u> Exchange money for Bill of Sale and sign and exchange any ancillary documents.

VI. Ancillary Agreements and Documents

- A. Promissory Note Sellers want all cash and will typically take a discount to get all cash.
 - B. Guaranty
 - C. Security Agreement

- D. Landlord Consent to Assignment of Lease and Estoppel Certificate
- E. Assignment and Assumption of Lease (in asset purchase deal)
- F. Assignment of Contracts
- G. Corporate Minutes (Director/Shareholder/Member)
- H. Confidentiality Agreement
- I. Employment Agreements
- J. Restrictive Covenant Agreements
- K. Bill of Sale
- L. Officer's Certificate Certifies true, correct and complete copies of (i) charter and all amendments thereto (in a stock deal); (ii) bylaws and all amendments thereto (in a stock deal); (iii) board and shareholder resolutions authorizing the execution and delivery of all agreements and documents in connection with the transaction and that none have been amended, modified or rescinded since their adoption and that they are in full force and effect; and (iv) sometimes true specimens of officers' signatures
 - M. Bulk Sale (Form C-9600)
 - N. Shareholders' Agreement

VII. Miscellaneous

- A. Bank Financing For the Buyer, this is a whole other simultaneous deal.
- B. Small Deal Resources
 - i) All-State Form 351 "Contract for Sale of Business (Bulk Transfer)"
 - ii) Blumberg Form of Contract for Sale of Business (NY Form 82)
 - iii) NYSBA "Business/Corporate Law and Practice" (comes with CD of

forms).

- iv) NYSBA "Buying and Selling a Small Business 2011-2012 Forms" (downloadable).
 - v) Lexis Practice Advisor

VIII. Practice Tips

- A. Closing Binders should be created; saves time in the future
- B. If this is not your area of practice, you can co-counsel with corporate counsel