



Mary Hanson



About the Business Advisor

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She provides legal services related to owning, operating, buying, selling, and structuring businesses. Her clients are business owners in many different industries. She handles corporations, LLCs, new businesses, new ventures, and a broad range of contracts and business decision-making.

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CHECKLIST FOR SELLING A BUSINESS

by Mary Hanson

Most business owners sell a business only once in a lifetime. The key to avoiding mistakes is planning ahead and taking advantage of the experience of others. The same issues do come up in most business sales.

Here is a list of some of the common issues the seller of a business needs to be prepared for:

Purchase price. Learn what a buyer looks at (or should look at) to determine a purchase price for your business. Be prepared to negotiate the purchase price you want, based on the value of your business to the buyer. Read up on business valuation before trying to negotiate price.

Don't commit. Don't commit to a purchase price or any other important term, unless it is combined with all other key terms. You need to know a lot more than just the price offered before you can accept an offer of purchase.

Different terms in the sale agreement should cause the purchase price to be higher or lower. The sale price for a business should be much lower if the seller gets cash at closing and the buyer will assume business obligations. The price should be higher if the seller is required to take payments over time, or the seller remains liable for business obligations.

Sale of assets vs. sale of stock. The sale of a business can be accomplished as a sale of stock (if the business is incorporated) or as a sale of assets. If you can get a buyer

to purchase your shares of stock in the corporation, all business assets and liabilities held by the corporation are transferred with the transfer of the shares of stock. The corporation and its books, records, contracts, assets, and liabilities are transferred to the buyer with the transfer of stock.

In the sale of assets (rather than the sale of shares of stock), every asset to be purchased and every liability assumed by the buyer is identified. Only the agreed upon assets and liabilities are picked up by the buyer.

By purchasing assets and not assuming liability, the buyer can avoid liability resulting from sales, contracts, employment, and accidents for which the corporation or prior owners are liable. The seller remains liable.

Even if the buyer agrees to "assume" liabilities, such as a lease or other contracts, the seller still is liable to the other party to the original obligation, unless that party has specifically released the seller from the obligation. If the buyer fails to pay the "assumed" obligations, the seller can be sued for payment.

Indemnification. In a typical purchase, the buyer wants the seller to indemnify the buyer from liability arising from operation of the business prior to the sale – and the seller wants the buyer to indemnify the seller from liability arising after the sale.

If the "indemnified party" is sued or receives a claim from a third party, the "indemnifying party" is contractually responsible for

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handling the claim, defending the suit, or reimbursing the indemnified party, based on the indemnification provision.

Indemnification provisions in the agreement can greatly resemble the terms of an insurance policy, with ceilings, deductibles, and covered and excluded items. Be prepared to negotiate language that limits your exposure.

Liabilities. If you sell a business as a sale of assets, consider what liabilities will remain yours from owning and operating the business in the past. The risks include any potential claims and lawsuits arising out of contracts, employment, product liability, warranties, taxes, and actions by company personnel. Try to find ways to reduce or eliminate risks. If you sell the assets “as is,” without warranty of condition, you reduce your liability to the buyer in the event the assets are not in good condition when transferred. Other types of liability, especially to third parties (not the buyer) are harder to address. Find out what insurance is available, and try to get the buyer to cover other liabilities.

Transfer of Contracts. Go through all your contracts and determine how each one will be resolved. A buyer of your business will normally want to assume your customer contracts. Are they assignable? Can you get them transferred?

You need to figure out what to do with ALL your contracts – including those that the buyer does not want. Plan what to do with utilities, equipment leases, leases of copy machines, postage meters, etc. Let the buyer know that you will be closing accounts. You remain liable on any accounts that are not closed. You must close your accounts and

require the buyer to open its own new accounts with vendors, suppliers, customers, utility companies, etc.

If one of your contracts is a lease for the property occupied by the business, have the buyer get a new lease directly from the landlord, rather than assigning the existing lease to the buyer. The assignment of a contract leaves you still liable on the contract. Avoid this where possible.

Contingencies. A buyer will normally want a number of contingencies in the purchase agreement – contingencies that allow the buyer to call off the purchase if the stated requirement is not met. The typical purchase commitment is contingent upon the buyer obtaining financing, and the buyer being satisfied upon the review of the books and records of the business.

A seller may want to include a seller’s contingency that the seller can back out of the sale if the sale is not concluded by a certain date. If there are delays by the buyer, you eventually want to be free to sell the business to another buyer, rather than being contractually bound to wait for the buyer.

Payment terms. If you contemplate accepting a low down-payment and then payments over time, ask yourself how you will feel if the down payment is the only payment you ever receive. It happens. Even if you are willing to take payments over time, get at least 50% down. If you must accept payments over time, you’ll want a good promissory note for the amount owed, secured by meaningful collateral.

Promissory Note. The promissory note is a commitment of the buyer to

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make payments in accordance with the terms stated. It needs to include an interest rate, a payment schedule, and terms regarding any default by the buyer. You need to be entitled to sue the buyer for the entire unpaid balance in the event of default, and to be compensated for your legal costs.

Collateral. Address the serious risk of not getting paid by getting full payment up front at closing, or securing the promissory note with collateral. A trust deed on the home of the buyer (with adequate equity) is usually the best collateral for a note. If the business has assets that could be good collateral, they may be used to secure the note.

Credit check. If you think you will accept payments over time, check the credit of this potential “debtor” before you make your decision.

Guarantees. Get guarantees where possible. In particular, if the “buyer” of your business is a corporation that is privately owned, have the promissory note guaranteed by the individual owners. Have the individuals also guarantee performance of other obligations under the contract.

Tax impact. Get your tax accountant’s input as soon as you have any thoughts about selling. You need to plan around the tax consequences of a sale, especially if the business has been operated as a corporation for a number of years.

Confidentiality. Have every interested potential buyer sign a nondisclosure agreement (confidentiality agreement), agreeing to hold information about the business confidential and not to use such information. A certain amount of information will be needed by a potential buyer in order to even

consider a purchase. At the next level, a serious potential buyer will want more information and more sensitive information prior to completing a purchase.

Use a confidentiality agreement, but don’t rely on it to the point of giving access to sensitive information without additional precautions. Control what information is disclosed and how it is disclosed. Only disclose sensitive information close to the closing on a purchase – or even after the purchase!

Seller’s Warranties. Give the buyer as few warranties as possible, to reduce the likelihood of a claim from the buyer. Typical warranties are that the books and records are accurate, that the equipment is in working condition, that the seller owns all assets to be transferred free and clear of liens, and that there are no undisclosed legal liabilities, such as lawsuits pending or threatened.

You will be liable to the buyer if you warrant the condition or status of an asset and it later appears that your statement was not correct. For example, you cannot warrant that there are no liens if in fact there is a financing lien on your equipment. A key purpose of the warranties is for the buyer to get complete disclosure from the seller regarding the assets to be purchased and the condition of the business. Disclosing the nature of any liens, claims, conditions, and exceptions to any warranties protects you from warranty claims from the buyer.

Liquidated damages. Have the purchase agreement or escrow instructions state that all or part of the buyer’s funds will be paid to you as liquidated damages if the buyer fails to complete the purchase, except where the buyer is entitled to back out of the purchase. This is

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FROM THE LAW OFFICE OF MARY HANSON

Publisher's Note

The biggest problem for any business owner wishing to sell his or her business is finding a buyer. Typically a business owner's potential buyers are the customers and competitors of the business.

Using your own contacts to identify potential buyers has a number of benefits over using a broker to try to attract buyers. If a broker offers to handle selling your business without having real contacts in your industry, the broker may waste time looking for buyers in the wrong places or looking for the buyers you already know. In addition, by inquiring yourself within your industry, you can find out about the integrity and business practices of your potential buyers.

Completing a sale is not the end of the story. It is the beginning of a relationship, especially if payments are to be made. The business experience, integrity, financial strength, and capability of the buyer and the buyer's personnel will determine whether the transaction has a happy ending.

Mary Hanson
Attorney/Publisher

especially important where your contract with one party prevents you from negotiating with other interested buyers.

Early possession. Don't let a buyer take over your business prior to the closing and transfer of ownership. Although this is done in some small business situations, it is terrible for the seller. As soon as the buyer has possession of the business, the seller is in a very weak position for negotiations.

Allocation of purchase price. When a business is sold as the sale of assets, the total purchase price must be allocated to the various assets transferred (as well as services, such as training). The allocation is used to determine all taxes, including capital gains, sales taxes, and income tax. The purchase

price must be attributed to, for example, fixtures, equipment, vehicles, inventory, customer contracts, trade names, and goodwill. Work with your tax advisor to determine what allocation of the purchase price is best for you.

Letter of intent. Don't sign a letter of intent as an agreement preliminary to a formal agreement, unless it meets a specific objective of yours. Usually the better approach is to negotiate the full formal agreement as the only commitment. Signing agreements before all details are worked out can hamper your ability to make sure the purchase price reflects all the terms of the agreement. A letter of intent can also tie you up so that you are prevented from considering better offers. **BA**

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