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What to consider when buying, selling a business

By Gianfranco A. Pietrafesa, Archer & Griener, P.C., October 4, 2017 at 8:31 AM

As a corporate lawyer, I handle many M&A transactions with small and middle market closely-held and family-owned businesses.

In my experience, there are a number of things that buyers and sellers of businesses do not know or understand about these transactions simply because they have not been involved in such transactions. Some of them occur towards the end of the M&A process and can delay or derail the closing of a transaction. Three recurring topics include third party consents, bulk transfer notices, and indemnification rights and obligations.

Third Party Consents. After the comprehensive and definitive purchase agreement is finalized and executed, there are many details to be dealt with prior to closing. One item that many business owners do not anticipate is contacting the other party to their contracts to get their written consent to a transfer of a contract. For example, if the seller of a business intends to transfer a real estate lease to the buyer, the seller will have to obtain the landlord’s written consent to the transfer. Otherwise, the seller will be in breach and the landlord can terminate the contract, among other things. This applies to all contracts; the more important the contract, the more critical it is to obtain the third party consent. This applies whether the deal is structured as an asset purchase, because of anti-assignment provisions in contracts, or a stock purchase, because of change of control provisions in contracts. Many sellers do not want to disclose that they are selling their businesses, but it is a necessary step and should be handled confidentially towards the end of the transaction prior to closing. It takes time to explain and obtain third party consents, especially if the other party is a larger entity with a legal department since the request for written consent needs to work its way through the corporate bureaucracy.

Bulk Transfer Notice. In an asset purchase, the buyer needs to send a bulk transfer notice (Form C-9600) to the New Jersey Division of Taxation. The notice includes basic information about the seller, buyer and the M&A transaction, including the purchase price and payment terms, such as installment payments over time. If notice is not made, the buyer will be liable for the seller’s state taxes. The notice needs to be sent at least ten business days prior to closing, with a copy of the purchase agreement. The

Division will inform the parties prior to the closing date whether a portion of the purchase price must be held in escrow pending the Division's review of its tax records. The Division will eventually advise the parties whether the escrow monies can be released to the seller or sent to the Division to satisfy a portion of the seller's state tax obligations. A seller should have its accountant prepare an asset transfer tax declaration (Form TTD), which should be given to the buyer to be submitted to the Division with the bulk transfer notice. It identifies the gain or loss on the sale of the business and will reduce the amount of the tax escrow. It can take time to gather the necessary information, so the parties should do so early to avoid unnecessary delays.

<u>Indemnification</u>. Many sellers believe they are no longer responsible after they sell their business. However, almost every private M&A transaction requires the seller to indemnify the buyer for any conditions existing prior to the closing. For example, sellers are typically responsible for any pending litigation, taxes for any periods prior to closing, environmental conditions of the property prior to closing, and obligations to employees. Of course, they are also responsible for any breaches of the representations and warranties about the seller's assets, liabilities and business made in the purchase agreement. Fortunately, a seller's indemnification obligations can be limited by baskets, caps and survival periods. For example, a buyer will not be entitled to indemnification from a seller until the buyer fills a basket with indemnification claims exceeding, for example, $100,000. A seller can also be protected by putting a cap on his indemnification obligation. Depending on the purchase price and the negotiating leverage of the parties, caps can range from 10% up to 100% of the purchase price. However, there are exceptions to the cap, such as litigation, taxes, environmental, employee benefits and title to assets. That is, the seller is always liable for losses incurred by the buyer due to these items. Many sellers argue that they had limited liability as an owner of the company and now they are being asked to have something less than limited liability by being obligated to indemnify a buyer. However, the counterargument is that they are agreeing to indemnify the buyer in exchange for a pile of money from the buyer, which they would not otherwise realize but for a sale of the business. Ideally, the parameters of indemnification should be addressed early in negotiations to ensure that the parties on are the same page. Indemnification can be a sticky issue that can derail negotiations and, as a result, it is better to know the parties' expectations early on. Of course, any specific liability concerns disclosed during due diligence can be addressed as they arise or as the indemnification provisions of the purchase agreement is being negotiated.

If buyers and sellers understand and appreciate these issues, they will be able to work through them with their attorneys to ensure quick resolution and closing of their transactions.

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