

# **M**anaging the Process

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Asked by a young law school graduate how he could become a corporation lawyer, the seasoned practitioner replied: "That is the easiest question to answer I have had today. Just get yourself a corporation for a client." John Eckler, in *30 Bar Examiner* 42 (1961). If becoming a corporate lawyer is simple, the actual practice of business law is more taxing. Advising the business owner who wishes to sell or otherwise dispose of a closely held business interest illustrates that regrettable fact. But whether the client wishes to give the interest to a family member or sell to an outside person or entity, certain principles and procedures are generally applicable that render the process more manageable.

## **Gifts and Deferred Payment Sales**

Many closely held businesses are family affairs with significant participation in the business by one or more generations. In situations where the older generation does not require funds from the business for retirement or other purposes, a business owner can take advantage of the gift tax annual exclusion and transfer significant interests in the business to other family members over time.

If the owner needs money from the business, a deferred payment sale of the business interest may provide the needed cash while allowing the younger family members to pay for the interest from cash flow generated by the business.

## **Sales Outside the Family.**

If other family members do not participate in the business or are unable or unwilling to continue it, the business owner wishing to sell must consider other purchasers. The business's employees are frequently good candidates. The employees' familiarity with the business will often result in fewer troublesome contractual negotiations and make for a smoother management transition.

## **Structural Considerations.**

Whomever the purchaser, the practitioner must advise the seller regarding the appropriate structure for the transaction. Broadly speaking the seller will have four options: (i) a taxable sale of the company's stock; (ii) a taxable sale of the company's assets; (iii) sale of the company's stock in a tax-free exchange; and (iv) the buyer's acquisition of the seller's assets in a tax-free exchange. The type of transaction will typically depend largely on issues related to taxes, contingent liabilities and the nature of the selling company's business.

## **Accounting Issues.**

In certain types of transactions business lawyers must consider whether accountants will treat the disposition of the business interest for accounting purposes as a pooling of interests or a purchase. Under generally accepted accounting principles (GAAP), the decision to treat the buyer's acquisition as a purchase, part purchase, a pooling of interests, or a recapitalization may profoundly affect the buyer's postacquisition net income for accounting purposes, its balance sheet and other accounting results.

Other accounting issues to be considered include whether the buyer will require that the seller provide audited financial statements and whether interim financial statements to update annual or quarterly statements are necessary or desirable.

### **Corporation Law Issues.**

Various other corporation law issues should commonly be considered:

How quickly must the transaction close? Cash transactions typically move more quickly than stock deals because there are fewer compliance issues.

Does the format for the transaction result in appraisal rights for the seller's shareholders under statutory or case law? If so, is an alternative format feasible?

Where the buyer pays for the seller's business interest by issuing shares of stock, does the new stock issue give rise to preemptive rights in the buyer's present shareholders?

What liabilities is the buyer to assume? The resolution of that issue is to a degree dictated by the structure of the transaction. Subject to certain exceptions, the asset buyer does not inherit liabilities - the purchaser of stock does.

Are consents necessary to obtain the assignment of contracts, leases and other agreements?

Are any important agreements in default to which the seller is a party? Obtaining estoppel certificates from the other parties to those agreements is usually prudent.

Are approvals necessary? Necessary approvals include the obvious (e.g., shareholders and directors) and the more esoteric (e.g., regulatory authorities).

Must securities law issues be considered? Does the transaction entail a public or private offering of stock? Is registration or any other type of filing required?

What about antitrust issues? How big is the deal? Analyze the relevant markets. What is the impact on competition in those markets? Review the Department of Justice Merger Guidelines.

### **Human Resources Issues.**

Are employee benefit plans adequately funded? Review the seller's labor relations history. Consider issues related to employment and noncompetition agreements. Are the agreements enforceable? Have key employees signed appropriate agreements?

### **Documenting the Deal.**

In most transactions, a confidentiality agreement is a prerequisite to negotiations. It should adequately define what is confidential, prohibit contact with employees and key personnel other than the designated contact person or persons and require the destruction or return of confidential information if the contemplated transaction is not completed.

A letter of intent, while not always used, can be useful in focusing the parties' attention on key issues and identifying possibly contentious issues. The letter of

intent should define, in a nonbinding description, the basic structure of the transaction, the anticipated purchase price, and any potential adjustments to the purchase price.

The definitive agreement should, among other important matters, comprehensively set forth the representations, warranties and covenants of the parties, the conditions precedent to the seller's obligation to close and provide for remedies if there is a breach.

Depending upon the structure of the transaction and the nature of the business interest sold, various ancillary documents, including employment or consulting agreements with the seller, noncompete agreements and opinions of counsel, may play an important role in adequately documenting the deal.

This article discusses in summary fashion a few of the more important issues typically encountered in conjunction with the sale or other disposition of a closely held business interest. Because the transactions are normally detail-intensive, the careful business lawyer is well advised to develop a systematic approach to dealing with the issues that attend business dispositions.