Preparing for the Asset Purchase Agreement and Avoiding Pitfalls

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leadership
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Introduction
Start with a good checklist of key provisions
What is a priority to your client?
What points are in dispute between the parties?
What to do if there is too much resistance from opposing counsel
Representations and Warranties
How broad do you want your reps and warranties? If you are representing the Seller, limiting such provisions:

- Any violation is a material violation
- Oral reps and warranties void
- Knowledge qualifiers
- Disclosure of information to employees/management
Covenants and Conditions
Do not miss provisions:

- Government approvals
- Normal course of business
- Customer/vendor contracts
- Status of employees and vacation time
- Employee benefit programs
- Covenants not to compete
- Clause survival
Indemnification Provisions
Generally, these provisions are pro-Buyer to provide the buyer a remedy for Seller’s violation of reps and warranties
- Minimum threshold and baskets
- Seller will want early notification
- Insurance considerations
Ways to Make Seller Financing More Attractive
In this economic climate, consider:

• Have the seller financing guaranteed by a person or an entity with excellent credit who is **not** guaranteeing any loan that is being used to purchase the business other than the seller note.

• Negotiate a subordination agreement with the bank which does not allow the bank to tell the buyer to stop making payments to the seller unless the buyer has missed at least two payments to the bank.

• Pull an asset out of the seller which the buyer needs and lease that asset to the buyer unencumbered by any bank financing.

• Have the buyer give you a lien on property not encumbered by the bank guarantee. Note that there needs to be quite a bit of room on the property so that if the buyer defaults, it would be worth the seller’s while to foreclosure on the property even if they have to payout the underlying mortgagee.
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- Have the right of resumption in the document. The right of resumption would mean that in the event X number of payments were missed, seller would have the right to resume the running of the business, and any equity built up by the buyer would be forfeit. It will be structured something like a land contract. Beware that seller would have to make payments on any loans encumbering the property.

- Remove any right of setoff. Have it clear that the note that the seller gets from the buyer is just like any other note, and the buyer cannot stop making payments based upon any claims that the seller, in any way, misrepresented the value of the business.

- Look at using an ESOP to do the purchase in whole or in part for the following reasons:
  - You are more likely to get paid because the payments are tax deductible, and therefore, tax efficient. Thus, the business can pay you approximately 40% more;
  - Employees are more motivated and more productive and the business is more likely to be successful; and
  - Key employees may make a more substantial contribution to continue the ESOP.
• Use a note whose payments are timed to coincide with the cash flow of the business.

• Have a seller note, but on top of the seller note have an earn-out, so if you are subordinate in taking a risk, if the business is more successful, you at least get some of the upside.

• Look at funding sources that will pay a larger percentage of the purchase price. Especially if you are buying a business that is manufacturing or creating jobs.

• Go through an SBA funding group such as Waukesha County Development Corporation (WCDC). They tend to use banks that have less strict equity requirements.
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