

SO YOU WANT TO SELL YOUR COMPANY?

Many of my clients are interested in learning about the process that they will have to go through in the event they sell their company. This article will discuss the major parts of that process, namely the letter of intent, due diligence and the definitive purchase agreement.

Letter of Intent

The letter of intent is the document wherein the buyer provides the seller with the broad terms under which the buyer may be willing to purchase the seller's company. The letter of intent generally includes things such as the price for the purchase, the assets that are being purchased, the liabilities involved in the transaction, confidentiality provisions and exclusivity provisions.

The first, and most important part of the letter of intent, is the statement of the purchase price. The seller, through the letter of intent, can usually determine whether or not the buyer believes the company is worth as much as the seller thinks it is. Often, the letter of intent can educate the seller that either its company is not worth as much as it thinks or the purchaser is the wrong partner for the seller in this transaction. Of course, the purchase price in a letter of intent is negotiable although oftentimes the seller does not try to negotiate to increase the buyer's initial purchase price.

Another important provision in the letter of intent is the exclusivity period associated with it. What this means is that the purchaser generally requests the seller negotiate exclusively with the purchaser for a stated period of time, usually anywhere from 3 to 6 months. This means the seller is not allowed to try to solicit any other offers for its company or negotiate with any other potential purchasers. In most cases, a seller will not agree to any exclusivity unless the seller is comfortable with the purchase price and the other terms of the letter of intent.

Of note most of the provisions in the letter of intent are specifically identified as not being binding on the parties. This is particularly true of the purchase price, which most letters of intent do not hold as a binding provision on the purchaser. Instead, the letter of intent can be seen as more of a statement of interest by the buyer but neither the buyer nor the seller is obligated to follow through with the sale. Given the fact the letter of intent is not binding on the parties, in many transactions it is not used at all.

Due Diligence

The due diligence process is where the buyer obtains information about the seller in order to allow the buyer evaluate the overall nature and value of the transaction. The due diligence process may start at any time and does not necessarily have to begin after a

letter of intent is signed. In most transactions the parties will have some familiarity with each other, so the buyer may not need much information in order to formulate an offer price. In other circumstances, the seller may not be willing to provide any substantive information to the buyer until a letter of intent is sent by the buyer to the seller. The seller may not want to provide a great deal of information about its company until it can verify that the seller is offering a reasonable purchase price.

There are a number of different parts to the due diligence process including evaluation of financial information, contracts, corporate information and intellectual property. An important part of the due diligence process includes a review of documents. The purchaser will provide the seller with a list of documents that the purchaser wishes to see. This is usually an exhaustive list, many pages long, that covers every possible document that could be relevant to the transaction.

Once the documents are compiled, they are forwarded by the seller to the purchaser for review. The review is usually performed by a team of people assisting the purchaser with the attorneys reviewing contracts, corporate documents and other legal records. The financial records are forwarded on to the chief financial officer for the purchaser and possibly to the purchaser's outside accountants. Documents regarding operational issues and intellectual property are generally reviewed by executive employees of the purchaser to allow them to evaluate the strengths and weaknesses of the seller's business operations.

The due diligence process also usually involves a visit by the representatives of the purchaser to the offices of the seller. A team of different members of the management of the purchaser generally review the different categories of documents related to finance, legal and operational issues of the seller. The financial member of the team will review and audit financial records, while the operational members of the team will validate and verify the operational matters of the company, such as confirming all intellectual property assets are as represented by the seller.

The due diligence aspect of the process can be very frustrating given the intrusive nature of the demands made by the purchaser. The purchaser's demands for information often seem overbroad given the nature of the transaction. Also, the due diligence process can have a disruptive impact on the seller because the seller's management staff is working on the sale transaction and not attending to the day-to-day operations of their business. However, the purchaser needs to make sure that it thoroughly evaluates the seller before it can make a binding offer to purchase the company in the definitive purchase agreement.

Purchase Agreement

The definitive document that is binding upon the parties is the Purchase Agreement, whether it is an Asset Purchase Agreement or a Share Purchase Agreement. The sale of a company generally takes one of two forms, either an asset sale or a share sale. In a share sale, the ownership equity of the seller, usually shares of stock, is sold by the shareholders of the seller to the purchaser. In this instance, all the assets and liabilities of the selling company are transferred to the purchaser by virtue of the fact that the purchaser is acquiring the seller's entire company.

The other method of accomplishing the sale is through an asset sale. In an asset sale, the assets of the seller are purchased from the seller and most, if not all, of the liabilities will stay with the selling company. The shareholders of the seller consent to the sale in this case but do not sell their shares in the seller. Instead, the shareholders continue to own the selling company and all the associated obligations of that company. This type of transaction is usually favored by the purchaser since it does not have to assume the debts and obligations of the seller. Conversely, the seller's owners will usually want to have the transaction operate as a share sale in order to make sure that the seller is not liable for the debts and obligations of the company on an ongoing basis.

Unlike the letter of intent, the definitive Purchase Agreement is binding upon the parties. The Purchase Agreement will generally contain a binding purchase price along with a number of representations and warranties made by the seller.

The representations and warranties in the Purchase Agreement are very important. They cover things such as lawsuits, the accuracy of the financial statements provided by the seller, the ability of the seller to enter into the transaction and other information on the existing liabilities of the seller. If any of the representations and warranties made by the seller and its shareholders, are untrue, the seller and the shareholders are obligated to pay any damages that result from untruthfulness of the representation and warranty.

By way of example, one representation and warranty that is generally made by the seller and its shareholders is that there are not any lawsuits pending against the seller other than those that are disclosed by the seller to the purchaser. If the seller fails to disclose any lawsuits that involve the seller, then those lawsuits would be the responsibility of the seller and the shareholders to defend and settle. Therefore, it is imperative for the seller to provide full disclosure to the purchaser of the company.

The process of selling a company can be difficult and time consuming. However, the payoff in the end for the seller, and hopefully the purchaser, are well worth the effort.

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