

BUYING AND SELLING THE SMALL(ER) BUSINESS
UCLA Extension Campus
261 S. Figueroa Street
Los Angeles, California

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1. **INTRODUCTION/WELCOME** (Wayne Johnson) (10 minutes)¹
 - (a) Orientation to facility
 - (b) Discuss Program Format
 - (c) Procedure for questions
 - (d) Introduce panelists

2. **INITIAL CONSIDERATIONS** (All Panelists) (15 minutes)
 - (a) The decision to buy or sell a business. Why?
 - (b) Timing Issues
 - (c) Identifying a Target/Positioning a company for sale
 - (d) Managing the emotion of the Deal
 - (e) Knowing your client – the Unethical or Unwilling Client
 - i) The Unethical or Unwilling Client
 - ii) Sarbanes-Oxley Act (SOX)
 - iii) PATRIOT Act

3. **STARTING THE PROCESS** (Wayne and Michael Ellington) (30 Minutes)
 - (a) Building the Team² –
 - i) *Retaining Deal counsel:*
 - (1) Existing Corporate Counsel or Deal Counsel?
 - (2) Retainer Agreement –
 - (a) B&P § 6148 – must have written fee agreement if reasonably foreseeable expenses will exceed \$1,000
 - (b) Identify Hourly Fees, Nature of Services, Responsibilities of Parties
 - (c) Limited to quantum meruit if don't comply with B&P § 6148
 - (3) Dealing with Conflicts of Interest (Rules 3-310 and 3-600)
 - (4) Fees –
 - (a) Tough to Estimate
 - (b) Hourly v. Percentage (ethical?)
 - (c) Success Premium
 - (d) Get a RETAINER!!!
 - (5) Fee Splitting (Rule 2-200)
 - ii) *Investment Banker/Business Broker:*
 - (1) What's the difference?
 - (2) When should retention be considered?
 - (3) Fee Structure
 - iii) *Accountant:*
 - (1) To what degree should the existing accountant be used?

¹ All times are estimated.

² For further discussion of this topic, see Handbook at pages 1-6.

- (2) Land mine: The unsophisticated long-term accountant
 - iv) *Other Professionals (as needed):*
 - (1) Estate or Tax Counsel
 - (2) Intellectual Property/Patent Counsel
 - (3) Real Estate or Environmental Counsel
 - (4) Pension Experts
 - (5) Labor Counsel
 - (6) Litigation Counsel (to evaluate risks of existing issues)
 - (7) Securities Counsel
 - (8) Escrow Agent (bulk sales, Alcoholic Beverage Control, restaurant, tax clearances, etc.)
 - (9) License Facilitator
 - (10) Unclaimed Property Issues
 - v) *Maintaining Confidences*
 - (b) Coordinating the Team –
 - i) Point of Contact
 - ii) Managing Communications?
 - iii) Client and Deal Management
4. **PREPARING FOR SALE/IDENTIFYING TARGETS** (Michael) (30 Minutes)
- (a) Preparing For Sale/Purchase –
 - i) Taking stock – i.e., “Internal Due Diligence”
 - ii) House Cleaning (Inventory, Personal Expenses, etc.)
 - iii) Identifying Diamonds in the Rough/Dealing with the Warts
 - iv) Review Estate/Income Tax/Charitable Planning Opportunities
 - v) ESOP Strategy?
 - (b) Prepare Hit List
 - (c) Prepare Book and Presentation
 - (d) Bonus Points for Sale Side – Pre-prepare a Due Diligence Package
5. **MAKING INITIAL CONTACT** (Michael and Roger Goff) (20 Minutes)
- (a) Hit List
 - (b) How Should Contact be Made? –
 - i) Blind v. Open
 - ii) Consider Disclosure Issues
 - (c) What Should Contact Consist of? –
 - i) One Sheet
 - ii) Executive Summary
 - iii) Due Diligence
 - (d) Protecting Confidences –
 - i) Use of Non-Disclosure Agreement (When?)
 - ii) Special Technology
 - iii) Unprotected Technology
 - iv) Client/Vendor Lists
 - v) Access to Key Personnel
6. **PRELIMINARY DISCUSSIONS** – (All Panelists) (60 Minutes)
- (a) Principals First Interaction

- (b) Seeing if a Deal Makes Sense
- (c) Discussion of –
 - i) *Price* –
 - (1) Depends upon Type of Consideration
 - (2) Industry Multiples
 - (3) Recalculation of Earnings to remove Saved Expenses
 - ii) *Terms and Conditions of Transaction* –
 - (1) Type of Consideration to be Paid –
 - (a) Cash
 - (b) Stock
 - (c) Notes or other Deferred Payment Form
 - (d) Earn-out
 - (2) Deal Structure³ –
 - (a) Merger
 - (b) Stock Sale
 - (c) Asset Sale
 - (d) Preservation of Net Operating Losses/Capital Losses
 - (e) Change of Ownership Issues
 - (3) Other Items –
 - (a) Escrow of Purchase Price
 - (b) Assets to be Acquired
 - (c) Liabilities to be Assumed
 - (d) Closing Dates
 - (e) Conditions to Performance
 - (f) Allocation of Sales Tax
- (d) Letter of Intent⁴ –
 - i) Needed?
 - ii) Binding v. Non-binding
 - iii) Level of Detail
 - iv) No Shop Clause (Value)
 - v) Break-up Fees
 - vi) Resolution/Consent of Directors Needed
- (e) Set a Timeline for Further Discussions
- (f) High Level Due Diligence Performed at this Stage

7. **DUE DILIGENCE** (Wayne)

(30 Minutes)

- (a) Revisit NDA Matters⁵ –
 - i) Executed?
 - ii) Need Modification?
 - iii) Keep List of Materials Disclosed
 - iv) Require Return of Materials at end
- (b) Discuss Due Diligence Procedures with Client –
 - i) Provide Understanding
 - ii) Set Parameters of Investigation

³ Related Materials can be found in Pages 67-82 of Handbook.

⁴ For further discussion of this topic, see Handbook at Pages 109-121.

⁵ Related materials can be found in Pages 23-48 of Handbook.

- iii) Establish Materiality (Financial or Otherwise)
- (c) Matters to Understand –
 - i) The Business
 - ii) Legal Impediments to Proposed Transaction
 - iii) Financial Structure
- (d) Use of Experts –
 - i) Environmental, Tax, etc.
 - ii) Coordination
- (e) Retention of Due Diligence Records

8. **DOCUMENTING THE TRANSACTION** (Roger) (120 Minutes)

- (a) Documents Involved (and party who typically prepares initial draft) –
 - i) *Acquisition Agreement (Buyer):*
 - (1) Asset Purchase Agreement⁶
 - (2) Stock Purchase Agreement⁷
 - (3) Merger Agreement⁸
 - ii) *Financing Documents:*
 - (1) Promissory Note (Seller/Financier)
 - (2) Security Agreement (Seller/Secured Party)
 - (3) Financing Statement (Seller/Secured Party)
 - (4) Guaranties (Seller/Creditor)
 - (5) Pledge Agreement (Seller/Pledgee)
 - (6) Deed(s) of Trust (Seller/Beneficiary)
 - iii) *Other Documents:*
 - (1) Title Transfer Documents
 - (2) Bills of Sale (Seller)
 - (3) Contract Assignments (Buyer)
 - (4) Copyright Assignments (Buyer)
 - (5) Trademark Assignments (Buyer)
 - (6) Patent Assignments (Buyer)
 - (7) Vehicle Title Documents (Buyer)
 - (8) Real Estate Title Documents (Buyer)
 - (9) Board Minutes (Each party prepares own minutes)
 - (10) Shareholder Minutes (Seller – no Buyer shareholder minutes generally required)
 - (11) Employment Agreements⁹ (Buyer)
 - (12) Consulting Agreements (Buyer)
 - (13) Non-Competition Covenant(s)¹⁰ (Buyer)
 - (14) Leases or Lease Assignment (Landlord)
 - (15) Intellectual Property Licenses¹¹ (Licensor)
 - (16) Specialized Agreements
- (b) Negotiating Points – Asset Purchase Agreement –
 - i) *Assets:*

⁶ For a form of Asset Purchase Agreement, see pages 215-238 of the Handbook.

⁷ For a form of Stock Purchase Agreement, see pages 195-214 of the Handbook.

⁸ See pages 123-194 of the Handbook for a brief discussion and prototype form of Merger Agreement.

⁹ See Handbook for a general discussion of employment contracts.

¹⁰ See Handbook for a discussion of noncompetition covenants, generally.

¹¹ See of Handbook for additional discussion of licensing matters.

- (1) Must include all assets needed to continue business
 - (a) Equipment
 - (b) Inventory
 - (c) Intellectual Property (including phone numbers, websites, know-how, trade secrets, etc.)¹²
 - (d) Books and Records
 - (e) Contracts
 - (f) A/R (if included)
 - (g) Deposits
 - (h) Warranty Rights
 - (i) Other
 - (2) Seller should focus on any excluded assets
 - (a) Cash
 - (b) Personal assets located at business
 - (c) Vehicles
 - (d) Real Estate
 - (e) Other
- ii) Liabilities:*
- (1) Assumed Liabilities
 - (2) Excluded Liabilities
- iii) Purchase Price:*
- (1) How much?
 - (2) How and when are contingent portions calculated?
 - (3) How and when is it paid?
 - (4) How are financed portions secured?
 - (5) Any conditions to payment obligation?
 - (6) How is it allocated among assets?
 - (7) Any allocation to individuals (through consulting agreements, for intellectual property or otherwise)?
- iv) Other issues:*
- (1) Seller's Representations and Warranties
 - (a) Purposes
 - (i) To trigger indemnification provision.
 - (ii) To support action for misrepresentation
 - (b) Negotiating points
 - (i) Level of "knowledge" required
 - (ii) Exclusions
 - (c) Substance of Reps and Warranties
 - (i) Organization, Standing and Qualification - In every territory in which the Seller does business or in which qualification is required
 - (ii) Capital Structure - To assure that proper authorization is being obtained for transaction
 - (iii) Financial Statements – assure accuracy, methodology and no changes since last statement
 1. Often the focus of misrepresentation actions
 2. Small business financials generally not audited or reviewed

¹² See Handbook at page 239 *et Seq.*

- 3. Need to work closely with and rely on company's CPA
 - (iv) Claims and Liabilities
 - 1. Even when liabilities are not assumed, awareness of potential claims is critical
 - 2. Implied successor liability possible, especially in areas of product liability, environmental claims and labor contract obligations
 - (v) Tax issues – all taxes properly calculated and paid
 - 1. Possible successor liability/lien issues
 - 2. Reliance on company's CPA is important
 - (vi) Assets – description, title and risks
 - (vii) Customers – Assess risk of losing important relationships
 - (viii) Employment and ERISA issues
 - 1. Possible employment related claims
 - 2. Unpaid pension or benefit liabilities
 - (ix) Insurance issues – adequate coverage/claims history
 - (x) Contracts –
 - 1. assess liabilities/assure benefits critical to ongoing success of business
 - 2. Suppliers
 - 3. Customers
 - 4. Employment
 - 5. Consulting/Contractors
 - (xi) Compliance with laws
 - (xii) Litigation
 - (xiii) Transaction doesn't breach any agreements or orders
 - (xiv) Authority and consents
 - (xv) Conflicts of interest with customers, suppliers or others
 - (xvi) Full disclosure – the “catch-all” representation
- (2) Buyer's Representations and Warranties
- (a) Organization, Standing and Qualification
 - (b) Authorization
 - (c) Litigation
 - (d) Not in breach of agreements or orders
 - (e) Financing representations – same as any loan or financing agreement
 - (f) Full disclosure – “catch-all” representation
- (3) Selling Parties' Obligations Before Closing
- (a) Buyer's Access to Premises and Information
 - (b) Conduct of Business in Normal Course
 - (c) Preservation of Business and Relationships
 - (d) Corporate Matters
 - (e) Maintenance of Insurance
 - (f) Employees and Compensation
 - (g) New Transactions
 - (h) Dividends, Distributions, and Acquisitions of Stock
 - (i) Payment of Liabilities and Waiver of Claims
 - (j) Existing Agreements
 - (k) Consents of Others
 - (l) Documentation of Procedures and Trade Secrets
 - (m) Representations and Warranties True at Closing

- (n) Corporate and Shareholder Approvals
- (o) Obtain tax clearances – FTB, EDD and BOE, if applicable.
- (4) Buyer's Obligations Before Closing
 - (a) Information To Be Held in Confidence
 - (b) Cooperation in Securing Consents of Third Parties
 - (c) Resale Certificate
 - (d) Bulk Sales Law – Article 6 of UCC
- (5) Conditions Precedent To Buyer's Performance
 - (a) Accuracy of Selling Parties' Representations and Warranties
 - (b) Performance by Selling Parties
 - (c) No Material Adverse Change
 - (d) Certification by Selling Parties
 - (e) Opinion of Selling Parties' Counsel – Often not given in smaller transactions
 - (f) Absence of Litigation
 - (g) Corporate Approval
 - (h) Deeds and Title Policies
 - (i) Franchise Tax Board Clearance
 - (j) Employment Development Department Release
 - (k) Sales and Use Tax on Prior Sales
 - (l) FIRPTA Withholding
 - (m) Consents
 - (n) Employment Agreement or Consulting Agreement
 - (o) Approval of Documentation
- (6) Conditions Precedent To Seller's Performance
 - (a) Accuracy of Buyer's Representations and Warranties
 - (b) Buyer's Performance
 - (c) Opinion of Buyer's Counsel – Unlikely in small transactions
 - (d) Buyer's Corporate Approval
 - (e) Absence of Litigation
- (7) Documents to be Delivered by Seller
 - (a) Asset Purchase Agreement
 - (b) Documents of Title
 - (c) Assignments
 - (d) Minutes
 - (e) Certificates
 - (f) Clearances
 - (g) Opinion of Counsel, if included
- (8) Documents to be Delivered by Buyer
 - (a) Asset Purchase Agreement
 - (b) Check
 - (c) Promissory Note
 - (d) Security Agreement
 - (e) Guaranties, if included
 - (f) Deeds of Trust, if included
 - (g) Pledge Agreement, if included
 - (h) Board Minutes
 - (i) Certificates
 - (j) Opinion of Counsel, if included

- (9) Indemnification¹³
 - (a) Indemnified parties should included, shareholders, management and agents
 - (b) Indemnify for claims arising from:
 - (i) Breach of reps, warranties or covenants
 - (ii) Acts prior to (or subsequent to, as the case may be) closing
 - (c) Who will select defense counsel?
 - (d) At what point is indemnification obligation triggered?
 - (i) Caps
 - (ii) Thresholds
 - (iii) Baskets
 - (iv) Deductibles
 - (v) Must action be filed?
 - (e) When and how is notice given?
 - (f) Are costs of investigation of claims included?
 - (g) When does money actually change hands?
 - (i) For buyer, provide for offset against unpaid portions of purchase price
 - (ii) Who decides on settlement
- (10) “Boilerplate” Issues
 - (a) Applicable Law and Jurisdiction
 - (b) Arbitration
 - (c) Limitations on damages and remedies
- (c) Negotiating Points - Stock Purchase Agreement –
 - i) *Ommership of Assets:*
 - (1) Good Title
 - (2) Works for Hire?
 - ii) *Securities issues*¹⁴:
 - (1) How was the stock originally issued?
 - (2) Any regulatory consents required?
 - (3) Are there restrictions on transfer, either contractual or regulatory?
 - (4) Registration requirements and exclusions
 - (5) Securities representations from Buyer
 - (6) If some Buyers will not be actively running company, there may be a need for additional securities disclosures
 - iii) Liabilities are a larger issue, as they are harder to exclude from transaction
 - iv) Assure proper tax treatment, if this is an issue
- (d) Merger

9. THE CLOSING AND POST CLOSING MATTERS (all Panelists) (10 Minutes)

10. SPECIFIC TRANSACTIONAL ISSUES (all Panelists) (20 Minutes)

- (a) Franchises
- (b) Bankruptcy Purchases¹⁵
- (c) Real estate
- (d) Service Companies

¹³ See pages 48-66 of Handbook.

¹⁴ See pages 119-140 of Handbook for further discussion of Securities Laws aspects of M&A matters.

¹⁵ See pages 119-140 of Handbook for related materials.

(e) Technology Based Firms

11. QUESTIONS AND ANSWERS

(15 Minutes)