# LEGAL DOCUMENTATION
# WHEN SELLING YOUR BUSINESS

Selling your business is often a complex process, and some sellers are surprised by the amount of legal documentation required for an M&A transaction. Unlike selling your car or house, which typically just requires one contract or document, the sale of a business usually involves multiple legal documents, most of which may be unfamiliar to sellers. We always recommend you engage an experienced M&A attorney to work through these documents with you.

## LETTER OF INTENT

Often the first executed document in a transaction, the letter of intent (LOI) is the precursor to the definitive purchase agreement. The LOI is the first opportunity for a seller and buyer to formally align on key terms for the transaction. This is typically a negotiated document; you should use this stage of the transaction to clarify and fully understand material terms for the transaction to confirm your decision to go into partnership with the buyer. Most of the LOI is non-binding, but it typically contains a binding obligation for you to negotiate exclusively with that particular buyer for a period of 30 – 90 days.

### EXPERT TIP

While some sellers don't involve an attorney until after an LOI is signed, we recommend that you involve an experienced M&A attorney in the drafting of the LOI. This allows your attorney to help negotiate on your behalf and typically makes the process of drafting the definitive purchase agreement and other documentation smoother.

## DEFINITIVE PURCHASE AGREEMENT

This is the main document outlining the terms of a transaction and forms the basis for the partnership between seller and buyer. The definitive purchase agreement typically contains three main components.

### TRANSACTION MECHANICS

This includes the payment mechanics and calculations for the purchase price and any purchase price adjustments, such as a net working capital adjustment and payoff of any indebtedness.

### REPRESENTATIONS & WARRANTIES

Generally, the seller's representations and warranties are robust and cover nearly all areas of the target business' operations (ownership, financials, material contracts, taxes, employment and employee benefits, real estate, environmental compliance, litigation, material customers and material suppliers, insurance, compliance with laws, and related-party transactions). The representations and warranties from the buyer are typically minimal.

### SELLER INDEMNIFICATION OBLIGATIONS

A seller will be required to indemnify (make-whole or reimburse) a buyer for damages, costs and expenses that arise post-closing but relate to pre-closing issues of the target business (in particular, any breaches of the representations and warranties of the seller).

## EXPERT TIP

Many of the terms in the definitive purchase agreement, particularly with respect to a seller's post-closing indemnity obligations, have customary limitations, qualifications or ranges. An experienced M&A attorney can guide you through understanding these customary terms and ensure that they are included where appropriate.

# DISCLOSURE SCHEDULES

Similar to seller disclosures when selling your house, disclosure schedules allow you to disclose basic facts or known liabilities about your business prior to the sale. These supplement the seller's representations and warranties in the definitive purchase agreement.

**The process for compiling disclosure schedules can often been seen as tedious or superfluous by sellers, but disclosure schedules actually serve as an important protection for sellers by limiting or qualifying their representations and warranties in the definitive purchase agreement (and thereby limiting the seller's post-closing indemnity exposure).**

The more you disclose to a buyer in the disclosure schedules, the less likely a buyer can successfully make a post-closing indemnity claim.

# OPERATING/SHAREHOLDERS' AGREEMENT

This agreement is generally only relevant where a seller is retaining or "rolling" a portion of their ownership into the post-closing business as it outlines the governing rights and limitations of the business post-closing.

Customary topics covered in an Operating Agreement or Shareholders' Agreement are establishment and composition of a board of directors or managers, approval rights or "blocking" rights for certain material decisions, restrictions on selling ownership interests, and rights to participate in future ownership interest issuances.

## EXPERT TIP

Similar to the definitive purchase agreement, many terms in an Operating Agreement or Shareholders' Agreement have customary limitations, qualifications or ranges. An experienced M&A attorney can guide you through understanding these customary terms and ensure that they are included where appropriate.

# EMPLOYEE-RELATED DOCUMENTS

## EMPLOYMENT CONTRACT

If you plan to have a non-Board operational role in the company post-closing (such as continuing as CEO), you'll likely enter into a new employment contract as part of the transaction. Additionally, a buyer may also want employment contracts with other key employees important to the growth of the business. **Key terms can include compensation (which can include the mechanism for how base salary or bonuses/ incentive equity are calculated), term length, and the scope of responsibilities.** The latter point is often included when a key member of the management team is promoted at closing and sets forward-looking expectations for performance. Employment documentation also typically includes confidentiality and proprietary rights terms to protect the business' proprietary information.

## NON-COMPETE AGREEMENT

Commonly called a "restricted covenant agreement," a non-compete agreement outlines restrictions on your ability to seek employment, start, or otherwise participate in a business similar to that of the company you're selling. It also generally limits your ability to solicit or engage with employees, customers and suppliers of the company you're selling. This may be presented as a separate document or included as a provision in the definitive purchase agreement. **Pay close attention to the scope during negotiations: the business or industry it covers, for what length of time, and the territory applicable.** Despite current headlines regarding non-compete obligations being unenforceable, these obligations remain enforceable in connection with the sale of a business.

## INCENTIVE EQUITY PLAN

A document or set of documents outlining ownership or equity incentives for key employees or future employees. **The goal of an incentive equity plan is to align employees' interests with the interests of the buyer and allow employees to share in the growth or appreciation in value of the business.** The plan will cover how equity is calculated and awarded, which could be in the form of stock options, restricted stock, unit appreciation rights, or phantom equity.

# OTHER DOCUMENTS

## LOAN DOCUMENTS

If part of the transaction purchase price is being funded by debt from a third-party lender, the terms and covenants of the loan will be documented here. These documents are typically negotiated and executed by the buyer and lender with little involvement from sellers.

## ESCROW AGREEMENT

A seller is typically required to place some portion of the purchase price into an escrow account to cover potential purchase price adjustments and potential indemnity claims. An escrow agreement is a standard agreement between the buyer, the seller, and a third party escrow agent governing how the escrowed amounts will be held and how they will be released.

### EXPERT TIP

A representations and warranties insurance policy can significantly reduce the amounts held in escrow for potential indemnity claims; if purchased, the insurance policy will be a separate document to be reviewed and negotiated with the insurer.

## THIRD-PARTY CONSENTS

Most businesses have contracts with customers, suppliers, or landlords that require the consent of that third party if the contract is assigned to a buyer, or those contracts may contain a "change of control" provision that require consent even if the contract isn't assigned but the business' ownership changes (this is very common with real estate leases). Additionally, your business may have some kind of government permit or license that requires the consent of the governmental entity to transfer that permit or license to a buyer (and they often have "change of control" language). Typically, a simple letter is sent to the applicable third party for their signature to consent to the transaction and ensure the contract, permit or license remains in effect post-closing.

### EXPERT TIP

Obtaining third party consents is often a task that can delay closing a transaction. Third parties may be difficult to contact, may have questions about the transaction, or may be hesitant to sign a consent. Having a thorough understanding of your company's contracts and having proactive discussions with any third parties that will need to provide consent can help make this process smoother.