

Unloading business filled with legal pitfalls

Covering All Bases In A Sale

By Albert S. Frank, LL.B.

When selling a business, it is perfectly reasonable to be concerned with issues like the purchase price and how to structure payment from a tax perspective. The most basic question, though, is "will the buyer really pay?"

Background Checking

You would not hire a secretary without checking references. Why treat the sale of a business more casually?

Check out the potential buyer. Does the buyer have good net worth, business ability, and character? Be thorough, because some buyers sign agreements without really being willing and able to pay.

Eliminate Seller's Obligations

I once met a man who had built, and then sold, a thriving real estate business. As a result, he went bankrupt.

Like many other business owners, he had personally guaranteed his business's debt with the bank. This was fine as long as he was in charge, because the business was thriving. Unfortunately, his personal

guarantee remained in place when he sold the business. Presumably he thought the business was so solid that this would never be a problem.

The buyer was crooked or incompetent, and quickly destroyed the business by sucking out the incoming cash and paying little or nothing to the business's creditors. The bank then demanded payment on the seller's personal guarantee. The seller, having been paid only a fraction of the purchase price and no longer having a business, was unable to pay. He had to go bankrupt.

There are con artists who specialize in buying companies, looting them, and departing, leaving behind a ruined business, an unpaid vendor, and numerous debts for which the unpaid vendor might be liable. Of course, honest buyers can also be dangerous.

The seller must be freed from all personal guarantees and other obligations, as early as possible.

Independent Legal Advice

The buyer's lawyer is not a judge or a referee or the seller's friend. The buyer's lawyer will NOT make sure that the seller gets paid or that the terms of the agreement are fair.

The seller needs a lawyer of his or her own.

It is amazing but true that sellers can fall for the sneaky buyer's line, "Why don't we both use my lawyer? We'll save some legal fees." This is like the buyer and the seller jumping out of an airplane together, but only the buyer is wearing a parachute.

Who is Obligated to Pay?

The apparent buyer might not be the actual buyer. The apparent buyer could own the buyer, for example. If the sales agreement says that the buyer is "012345 Ltd.," the mere fact that it is owned by a quality person is no help. The seller usually could only look to 012345 Ltd. for payment.

012345 Ltd. was likely just incorporated, and has little or nothing in the way of assets. If 012345 Ltd. fails to operate the business successfully, the seller probably will not be paid.

Security for the Purchase Price

Once we have something, paying for it is not a priority. Indeed, "buyer's remorse" might strike, and the buyer might feel that the price was excessive. Even an honest buyer might then try to get a discount or to avoid paying altogether.

Another danger is that the buyer might lack the capacity to pay.

So a key question is what security the seller holds for the payment. Personal guarantees, debentures, and mortgages are examples of security that can be used to ensure that the purchase price can be collected.

"As is" Sale

Is the business being sold "as is," or based on representations as to things like the customer base, cash flow, profitability, and so on?

The seller generally prefers an "as is" sale. Otherwise, the buyer could take over the business and then, alleging that the representations were not correct, refuse to pay the outstanding balance of the price. This could lead to a long, expensive lawsuit.

The buyer might also like this approach. After all, as I see in my work as a litigator, representations – and even express written warranties – often turn out to be false. The buyer then might have to sue. Full advance information access could be better than having to sue after buying, when the representations turn out to be false.

Of course, the buyer might want the advance information and also want binding warranties. One possible compromise would be a price that automatically alters based on easily verified results. For example, the price could be based in part on what percentage of the customer base

stays with the business during the first six months of the new ownership.

The Retirement Perspective

Will the seller have enough money for a comfortable retirement that could include, for example, luxurious living in a setting with 24-hour security guards? Or will the seller spend an old age working as a security guard? Getting paid or not getting paid, that is the question.

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The above article first appeared in the Mid-May, 2001 issue of *The Bottom Line*.

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Research has NOT been done to see if this article is still good law. Also, this is general information that might not apply to your particular situation.

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