The Acquisition Agreement

September 06, 2012

Hemenway & Barnes partner Fred Marx wrapped up a four-part series on buying and selling a family business when he co-hosted the Aug. 22, 2012, broadcast of Radio Entrepreneurs with Marc Zwetchkenbaum.

After previously having taken listeners through…

- Selecting an investment banker and the basics of buying and selling a business,
- Drafting the letter of intent, and
- Conducting due diligence

…Mr. Marx delivered pointers on the final step – the acquisition agreement. This, he said, is when all the terms of the deal are negotiated, agreed upon and hammered into a final, binding contract.

He began by describing the two types of agreements; one governing the purchase or acquisition of a company's assets, and the other relating to stock purchase. There are material tax differences between the two of which to one must be aware. An asset sale can involve significantly higher taxes for the seller than a stock sale, especially with a C corporation.

There are several elements to the acquisition agreement that require the scrutiny of both parties and their attorneys. These generally fall into three components of the acquisition agreement:

1. Structure and purchase price. This part refers to the nature of the purchase; that is, whether the buyer is acquiring the assets of the company or purchasing the company's stock. It also establishes the terms, such as earn-outs or contingencies. There is often adjustment language that says that if the company's assets and liabilities don't even out at the time of closing, an adjustment may be made to the purchase price to cover the difference.

2. Representations and warranties. This part sets out warranties by the seller as to the business. For example warranting that the seller owns all the assets, including IP and inventory, has listed all the company's liabilities, has provided an accurate financial statement, and so on. "If they turn out not to be accurate, again there's an adjustment to the purchase price," said Mr. Marx.

The disclosure schedule is provided in connection with this section. This schedule discloses all the exceptions that the seller takes to the representations and warranties.

The disclosure schedule is typically about two inches thick, Mr. Marx noted, and for a good reason: "I tell clients all the time, 'you cannot over-disclose. It's critical to mention everything up front, so there are no surprises."

3. Covenants and indemnification. These are agreements for what the parties do after the closing. If you are the seller and the seller is an S corporation or a limited liability company, you will want no income from the business after closing allocated to you, because you will have to pay taxes on it without money coming in to you from that business. And you will want to make sure all pre closing expenses are allocated to you, so you can take them as tax deductions.

The covenants also traditionally include a non-compete covenant that prohibits the seller from engaging in clearly defined, competitive activities for a specified period of time (for example, two to five years) and from trying to attract the customers and employees of the business.

An indemnification provision is also included that provides that if there were some inaccuracy in the representations and warranties about the business, the seller is required to refund an amount back to the buyer. This requirement is subject to so-called caps which limit the amount required to be refunded and baskets which require some minimum amount of claims be made before any refund is due.

He concluded the interview with a timetable, saying that it typically takes one or two months to negotiate an acquisition agreement.

Mr. Marx recommended enormous care, including engaging the services of an experienced acquisitions attorney. "Attorneys who are expert in this area do 10 or 12 of these transactions a year," Mr. Marx told his radio audience. "Most business owners may do one or two during a lifetime, so it's a very new thing for them."

Contact

Frederic J. Marx at fmarx@hembar.com or 617-557-9717.

Copyright © 2012 Hemenway & Barnes LLP