Mergers and Acquisitions:
Key Points in the Deal Structure
(Mergers, acquisitions, and consolidations)

Bart A. Basi, Doctor of Business Administration
CPA/Attorney at law
and
Senior Advisor
to
The Center for Financial, Legal & Tax Planning, Inc.
4501 West DeYoung Street Suite B200
Marion IL 62959

www.taxplanning.com
# Table of Contents

<table>
<thead>
<tr>
<th>Chapter</th>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Biography</td>
<td></td>
<td>3</td>
</tr>
<tr>
<td>Chapter 1</td>
<td>Introduction</td>
<td>4</td>
</tr>
<tr>
<td>Chapter 2</td>
<td>Background: Business Entity Types</td>
<td>6</td>
</tr>
<tr>
<td>Chapter 3</td>
<td>Purposes of an Acquisition</td>
<td>8</td>
</tr>
<tr>
<td>Chapter 4</td>
<td>Process behind an Acquisition</td>
<td>9</td>
</tr>
<tr>
<td>Chapter 5</td>
<td>The Decision to Acquire</td>
<td>10</td>
</tr>
<tr>
<td>Chapter 6</td>
<td>Obtaining Data: The Presentation Package</td>
<td>14</td>
</tr>
<tr>
<td>Chapter 7</td>
<td>Negotiations for the Deal</td>
<td>16</td>
</tr>
<tr>
<td>Chapter 8</td>
<td>The Letter of Intent</td>
<td>18</td>
</tr>
<tr>
<td>Chapter 9</td>
<td>Due Diligence</td>
<td>19</td>
</tr>
<tr>
<td>Chapter 10</td>
<td>Problems</td>
<td>21</td>
</tr>
<tr>
<td>Chapter 11</td>
<td>Legal Documents</td>
<td>22</td>
</tr>
<tr>
<td>Chapter 12</td>
<td>Closing</td>
<td>24</td>
</tr>
<tr>
<td>Chapter 13</td>
<td>Post Closing</td>
<td>26</td>
</tr>
<tr>
<td>Chapter 14</td>
<td>Concluding Remarks</td>
<td>28</td>
</tr>
</tbody>
</table>

DISCLAIMER: The following materials and accompanying Access MCLE, LLC audio program are for instructional purposes only. Nothing herein constitutes, is intended to constitute, or should be relied on as, legal advice. The author expressly disclaims any responsibility for any direct or consequential damages related in any way to anything contained in the materials or program, which are provided on an “as-is” basis and should be independently verified by experienced counsel before being applied to actual matter. By proceeding further you expressly accept and agree to Author’s absolute and unqualified disclaimer of liability.
Dr. Bart A. Basi

Education
- Bachelor's Degree in Accounting, Utica College of Syracuse University
- Master's Degree in Business Administration, Syracuse University
- Juris Doctor in Law, University of Louisville
- Doctorate in Economics and Accounting, Indiana University
- Post-Graduate study, Stanford University

Professional Licenses

Areas of Expertise
- Dr. Basi is a specialist in the areas of business succession, business valuation, mergers and acquisitions, retirement and estate planning, strategic planning, and tax aspects of business decisions for closely held and family businesses. He speaks nationwide, writes, and researches on all of these areas. He has written five loose-leaf bound books, over 300 articles, and has worked with hundreds of businesses and associations. Journals that have published Dr. Basi's work include Money Matters, The American Journal of Small Business, The Journal of Family Law, The Journal of Estate Planning, The Tax Lawyer, Small Business Taxation, Taxation for Individuals, Taxation for Accountants, Taxation for Lawyers, The CPA Journal and The Tax Executive.

Academic Affiliations
- Currently holds the rank of Professor Emeritus at Southern Illinois University.
- Formerly affiliated with Penn State University, Indiana University, The University of Louisville, and Syracuse University specializing in corporate taxation, estate planning, and business valuations.

Business Affiliations and Memberships
- Senior Advisor, The Center for Financial, Legal and Tax Planning, Inc. The Center values approximately fifty companies per year.
- Memberships have included the American Bar Association’s Tax Committees on estate and gift taxes, business succession, and business planning and valuation.
- Member of the Institute of Business Appraisers.

Former Awards, Honors and Recognitions
- Recipient of educational grants for advanced course work in Taxation from the Practicing Law Institute, New York.
- Listed in The Tax Analyst Directory and the Lexis Computer Tax Library as a tax professional in the U.S., specializing in family and closely held companies.
- Listed as an expert in taxes and business valuations in the Wisconsin and Illinois Register of Expert Witnesses.
- Member of Phi Kappa Phi, national honorary, Beta Alpha Psi, accounting honorary, and Beta Gamma Sigma, business honorary.
Chapter 1
Introduction

The popular phase “the devil is in the details”, could not be more apt than in arranging for the purchase or sale of a business. The vast majority of clients of The Center for Financial, Legal and Tax Planning, Inc. are often amazed by the level of detail involved when it comes time to sell a business or to purchase a new one. Whatever the reasons one has for deciding to buy or sell, a simple handshake will no longer do. There is a wide range of considerations to be made with the purchase or sale of a business.

What is an acquisition?

An acquisition is the purchasing of a business (target) by another company or individual. The target corporation is assimilated into either the acquiring corporation or the buyer sets up a new company. In most situations, the acquirer purchases the assets of the target. Cash and or notes are paid to the target, which then dissolves. Occasionally, an individual purchasing a business will buy the stock of the target and just continue to operate the target company. An acquisition can be represented as $A + B = A$, where $A$ is the acquiring company.

What is a merger?

A merger occurs when two companies combine their assets and receive stock of one of the companies in exchange for the assets of another. One company survives, while the stockholders of both companies end up owning stock in the surviving company in proportion to the value of their respective companies. A merger is referred to as $A + B = B$, where $B$ is the surviving company.

What is a consolidation?

A consolidation occurs when two companies combine their assets, but unlike a merger, they do not issue stock of either one of the original companies. Rather, a new
corporation is formed and both companies’ stockholders exchange the stock they own in their individual companies for stock in a new company.

A consolidation is referred to as A+B=C, where C is the consolidated, new corporate structure.
Chapter 2

Background: Business Entity Types

When acquiring a business, one must understand some basics regarding business entity types and their tax ramifications. Each acquisition or sale will involve different tax consequences. Likewise, each business structure carries different liability to the respective owners. Having a basic understanding of the following allows the professional to understand the foundation of the transaction.

A. Sole Proprietorship

In a sole proprietorship, no formalities exist for its creation and the entity benefits from flow through tax. However, this entity does not benefit the owner with any liability protection for the operations.

B. General Partnership

A partnership may have a formal or informal creation and may arise from an implied arrangement between two or more individuals. Partnerships are also entities which offer flow through taxation, but offer no protection for the owners from liabilities for the operations and, in some cases, from actions of other partners.

C. Limited Partnership

A limited partnership must undergo formal creation under state statute. This entity offers limited liability for the limited partners, while the general partner(s) remain fully liable. This entity also offers flow through taxation.

D. Limited Liability Company

A limited liability company (LLC) must also undergo formal creation under state statute. This entity can be taxed as a partnership, an S Corporation, or a C Corporation depending on the owner's wishes. This is known as the “check the box” regulation. As its name would suggest, the entity members benefit from limited liability protection and can operate as a corporation.
E. C Corporation

A C corporation is one of the most familiar business entities. Ford, General Motors, General Electric, and many other Fortune 500 companies are C corporations. In addition, many successful private companies are also C corporations. A C corporation requires formal creation i.e., state filing and registration. Shareholders enjoy limited liability. This entity, however, pays tax at the corporate level. Its capital gains are taxed at the corporate level rates as well, as opposed to the more friendly personal capital gains rates. Dividends distributed to shareholders are also taxed, but at the shareholder level and at shareholder rates.

F. S Corporation

An S corporation is incorporated in the same way as a C corporation is, but special Internal Revenue Code provisions allow for flow through taxation. Shareholders enjoy limited liability for all business transactions. When acquiring a company holding S status, beware of the ownership restrictions: Currently (2008), the restrictions are:

a) Limited to 100 shareholders
b) Cannot be owned by partnerships
c) Trusts can own stock, but only with special provisions (Qualified Subchapter S Trusts)
d) Non-resident aliens cannot own stock

G. Personal Service Corporation

A personal service corporation requires formal creation. This entity is intended for professionals and individuals selling personal services (engineers, doctors, lawyers, accountants, etc). It is taxed at a flat 35% rate and it does not carry limited liability aspects for its owners.
Chapter 3

Purposes of an Acquisition

Acquisitions generally happen for a purpose. Listed below are the common purposes of acquisitions other than an individual wanting to own his or her own business.

1. To grow sales and profits

2. To eliminate competition

3. To acquire customers

4. To acquire staff

5. To acquire rights to sell products not currently handled

6. To spread overhead and support staff costs over a broader base

7. To afford additional corporate support services

8. To add best practices by adopting superior processes and systems used in the acquired firm

9. To use acquisition as a bridge to future acquisitions

10. To acquire a business name that has a good reputation and following

11. To add existing locations/facilities through the acquired firm

12. To immediately increase revenue levels
Chapter 4
Process behind an Acquisition

The process behind an acquisition is best described as involved and detailed. The decision as to which target to acquire must be carefully considered. The deal must be well negotiated. While due diligence is sometimes neglected, the process and findings are critical in the decision process. It is necessary to take the following steps in order to proceed from the decision to acquire a business to closing the deal:

1. A decision is made to acquire a target
2. Data is gathered
3. Negotiations commence
4. A letter of intent is agreed upon
5. Due Diligence is conducted
6. Problems, concerns, and contingencies are addressed
7. Legal documents are prepared
8. Closing takes place
9. Post Closing adjustments are considered

The following chapters present each of the nine steps involved in an acquisition.
Chapter 5
The Decision to Acquire

The decision to acquire a business is more substantial and complicated than that of purchasing a home. Purchasing a business involves purchasing not only those tangible items that can be seen and touched, but also intangible items such as contractual rights, goodwill, patents, etc. Due to the complexity of a business purchase, the buyer or seller will need to seek professional help and follow timely steps in order to consummate a solid transaction.

A. Team Selection

There are generally five factors in selecting a team of professionals:

1. **Credibility Factor**
   
   Credibility is critical for professionals working in acquisition transactions. A professional lacking credibility with the buyer or seller will have a tendency to be second guessed. Lack of credibility can be disruptive to business transactions.

2. **Relative Size Factor**
   
   A law or accounting firm dealing in the transaction should be both an appropriate size and accustomed to dealing with businesses transactions of the size they are putting together. For example, a firm accustomed to structuring billion dollar mergers may be unaccustomed to the issues facing a five hundred thousand dollar transaction and vice versa.

3. **Contact Factor**
   
   Obtain a list of names from other professionals and/or other business executives in the local area. Key is that the list of names be obtained from sources who are also involved with closely-held businesses.

4. **Credential Factor**
   
   A review of the credentials of those professionals under consideration to participate in the deal should determine whether or not each individual has the minimum qualifications for becoming involved in business transactions.
5. **Interview Factor**

   The final factor to take into consideration is the conducting of a personal interview with the professional. This step is essential prior to engaging a professional for a specific task.

B. **Corporate Records**

   Corporate records are documents prepared by a business to fulfill requirements imposed by state law. Under the Model Business Corporation Act, a corporation shall keep as permanent records:
   
   1. Notices of annual and special meetings.
   2. Stockholder meeting decisions regarding stock certificates.
   3. Director elections.
   4. Authorizations of opening up bank accounts.
   5. Hiring of officers.
   6. All corporate activities requiring activities of the Board of Directors approval.

C. **Financial Statements**

   Approaching a target business involves not only an actual “salesman” type of approach, but also an in-depth examination of the company. As a professional it is necessary to be aware that the acquiring company must examine financial statements, conduct marketing research, and review a formal valuation and/or presentation package presented by the target company.

1. **Balance Sheets-Statement of Financial Condition**

   The balance sheet presents a snapshot of the investing and financing activities of a company at a specific date. In all, a balance sheet is a representation of:

   
   \[
   \begin{align*}
   \text{Property} & = \text{Legal Rights} \\
   \text{Assets} & = \text{Liabilities} + \text{Shareholders Equity} \\
   \text{Investing} & = \text{Financing}
   \end{align*}
   \]

   Assets are economic resources that have the potential to provide future benefits to a
firm. Assets can be divided into monetary assets and non-monetary assets:

- Monetary assets such as cash and accounts receivable appear on the balance sheet at their cash equivalent value.

- Non-monetary assets such as inventory, land, buildings, machinery and equipment appear on the balance sheet at their original acquisition cost or their depreciated costs.

- In most cases, goodwill does not appear on a balance sheet of a company for sale.

2. P & L Statements-Income Statements

The income statement presents the results of the operating activities of a company over a period of time, generally one year. Net income or net loss is measured as the difference between revenue and expenses. Revenues measure the inflows of assets from selling goods and providing service to customers. When inventory is sold to customers, the cash received from the customers, or the promise to pay (Accounts Receivable) is classified as revenues.

Expenses measure the outflow of assets used in generating revenues. When inventory is sold, the cost of that inventory to the company is deducted as the cost of goods sold. Generally, expenses are said to be assets used to generate revenue.

3. Cash Flow Statements

The objectives of successful cash management are:

a) Collection of accounts receivable,

b) Effective inventory system to optimize short-term financing and investment decisions,
c) Efficiency of paying bills,

d) Managing cash flow from investments,

e) Managing cash flow from financing.

The statement of cash flow divides a company’s activities into operating, investing, and financing activities, and shows the principal inflows and outflows of cash from each of these activities. It is critical in today’s society that businesses be evaluated as to their ability to make money, not just report profits.

- A concept referred to as EBITDA is central when acquiring a company. The acronym stands for earnings before interest, taxes, depreciation, and amortization are deducted. Essentially the end result is the free cash flow the company is making.

D. Management Team

Effort should also be put into assembling a management team before the transaction is consummated. The management should be familiar with the industry and capable of working towards upper management goals.

At least three key people are necessary to operate a successful company.

1. An individual who is responsible for the overall direction of the company.
2. An individual who is fully knowledgeable about the products, markets, and customers to handle all selling aspects of the operation
3. An individual who is business oriented so that all internal functions, from accounting to human resources are properly managed.
Chapter 6
Obtaining Data: The Presentation Package

For the Seller

The Seller is the person who holds the information concerning the business to be sold. Being in such a position, the Seller’s best course of action is to present the company in an organized format to any potential Buyer. The industry standard for presentation of data is in a form known as a presentation package.

For the Buyer

As a Buyer, purchasing a business is somewhat of a risky endeavor. Intangibles such as goodwill, contracts, and revenue make up the business as much or more than the tangible assets. To obtain the information necessary to make a preliminary informed decision, the buyer should ask the seller for a presentation package.

What is a Presentation Package?

A presentation package offers a snapshot into the company and its operations. A complete presentation package consists of:

1. **Company Data** including: description of the organization, ownership, history, location, products, services, manufacturers represented, market territory, customers, competitors, and personnel. This data is mainly taken straight from an examination of the company itself.

2. **Economic Conditions** including: overview of the national and local economy, overview of industry, general outlook, and a relevant conclusion for the future of the company. The economic conditions are objectively based upon national reports, local sources on the economy, and the valuator’s input.

3. **Adjustments** and Related Explanations to Financial Statements
Financial Statements are based upon Generally Accepted Accounting Principles (GAAP). What is significant here, is that closely-held and family business owners have a tendency to expense items through their businesses and they often include assets on the company balance sheet that are more personal in nature as opposed to those belonging to the company. There also tend to be expenses reported that are non-recurring and/or isolated. These expenses should be added back to create recasted financial statements.

4. A/R & Inventory Report Summaries
   Inventory and Receivables that are too old can kill deals. The last thing a Buyer wants to purchase is inventory that will never move and/or receivables that are simply uncollectible.

5. Building Information
   One of the largest assets the Buyer may be buying is the building that houses the business. Commercial buildings will typically list for well over $1 million. Having the information about the building, i.e. square footage and appraisal data available immediately and in an organized format is critical to a Buyer.

6. Seller Benefits
   Too many unfunded retirement benefits and health care expenses that are too high can be a significant detriment to any Buyer. Not knowing the benefits that a Seller provides to employees is even worse. The presentation package should be well researched and accurate regarding all information presented.
Chapter 7
Negotiations for the Deal

In buying and selling a company, much is open to negotiation. The tax consequences of the sale are equally as important as the selling price itself. Other items such as real estate and inventory must be examined and purchased at a negotiated value.

Two fundamental ways to purchase/sell a company are known as an asset purchase/sale and a stock purchase/sale. Even though a company may be advertised as a stock sale or as an asset sale, often, in closely-held businesses, the deal can be modified and negotiated to fit the needs of those buying and/or selling the company.

Asset Purchase

An asset purchase is a transaction wherein the assets of a business are sold to a Buyer. This is in contrast to a stock purchase where stock is purchased. In an asset sale, the primary advantage to the buyer is a “stepped up” basis in the assets of the company. The new basis is the value at which the assets are purchased. The disadvantage for the Seller is that a lot of depreciation recapture occurs, resulting in ordinary income for the Seller as opposed to capital gains.

Stock Purchase

As mentioned above, a stock purchase is a transaction wherein the Buyer buys stock as opposed to assets. The primary advantage to the Seller is that the sale qualifies for capital gains tax rates which are lower than ordinary rates. As such, the Buyer does not gain the stepped up basis in the assets that go with such a sale, hence, there is no beneficial tax basis with which to lower income for the Buyer.

Inventory
Inventory is a common deal breaker. Inventory tends to accumulate due to scheduled and planned purchasing. Inventory tends to become obsolete once a newer and better product is produced or if customers no longer desire the inventory on hand. Buyers usually do not want to purchase inventory that has not had any movement in over one year.

**Real Estate**

Agreeing on a cost for real estate can be a daunting task. Often one appraiser will produce an appraised value that is unreasonable on the high side, while another appraiser may produce a value that is unreasonable on the low side. During negotiations, the professionals must determine a value of the real estate to which both parties will agree.
Chapter 8  
The Letter of Intent

The Letter of Intent usually begins the formal negotiation process. The letter of intent should contain the following:

1) The document should be identified as a “Letter of Intent”. This makes it clear that the document is interpreted as a letter of intent and not as a binding contract that can be immediately enforced.

2) The names and addresses of the parties should be clearly stated noting whether this is to be a stock transaction or an asset transaction.

3) Next should be the purchase price and what the purchase price is based upon. Often the purchase price will change depending on the balance sheet. If the balance sheet improves, the purchase price will increase. On the other hand, if the balance sheet disintegrates during negotiation, the purchase price may be dramatically reduced. An example of a “disintegrating balance sheet” is one where movable inventory is reduced, cash is reduced, receivables are reduced, and many assets disappear, while liabilities such as accounts payables, etc., rise.

4) The method of the payment of purchase price and any notes held by the Seller should be stated. In addition the term and interest rate of payments for notes should be stated.

5) The allocation of the purchase price must be disclosed.

6) Other specifics such as the treatment of cash, employment agreements, etc. should be addressed.

7) In the event of a disagreement, there should be a forum selection clause and an arbitration clause.

8) Finally, a place for signatures and dates should be listed.

Once the letter of intent is in place, formal negotiations begin. During formal negotiations, inventory, real estate, family benefits, and other issues are ironed out. This process is known as due diligence.
Chapter 9
Due Diligence

Due Diligence is a process whereby liabilities are checked, assets are verified and all aspects of the Seller are reviewed. Among other items, the list includes: Tort Liability, Contract Liability, Tax Liability, Pension Liability, and Verification of Assets, Employment Agreements, Vendor Contracts.

Following is a sample list of items to review in the due diligence process:

- Brief history of the company
- Key personnel showing experience, job description, and position of importance
- Listing of stockholders and the number of shares owned (include the manner in which shares were obtained, i.e., gift, purchase, or inheritance)
- Copies of key documents involving stock certificates, such as buy/sell agreements
- A complete set of three-years’ financial statements, with attachments, including cash flow statements
- The most current three years’ federal tax returns, along with any gift tax returns
- Totals from accounts receivable aging sheets, related to the most current financial statement
- A list of employee loans and/or stockholder loans, either from the business or to the business. In addition, copies of any loan documents relating to the debts
- A list of all of the equipment owned by the company (even if previously written off) and the fair market replacement value of that equipment
- A line card or similar document identifying different manufacturing firms and products represented
- An analysis of the past five years’ sales, identifying any unusual and/or one-time sales out of the ordinary course of business
- An analysis of the past three years’ expenses, identifying the unusual and/or non-recurring expenses
The front page of any company-owned life insurance policies on the lives of any employees/officers/owners

A summary list of any loan agreements with banks coupled with copies of loan documents placing restrictions on any transfers of stock and/or borrowing capacity.

A complete list of all family related benefits from the past three years, broken down by category

A list of the top ten (or more, depending on the size and nature of the business) key customers (those on a regular basis) of the company

Copies of any contracts with major suppliers

Listing of the top ten key competitors (those on a regular basis) of the company

A current copy of any industry reports in which the company has participated with regard to industry statistics and averages, such as a performance Analysis Report

Copies of any local reports and/or publications, indicating business conditions covering the company’s market territory

Publications and/or reports referencing the market conditions of the customer base

Pictures that you may have of your facilities and/or operations

Name of publicly-traded competitors

Existing, known or potential litigation, legal or regulatory issues

Typically, due diligence consists of two parts:

1. First is the gathering of the data listed above. The items are usually categorized in three areas: Legal, Accounting, and Operational. The data is gathered and analyzed for accuracy.

2. After the data is gathered and reviewed by the professionals retained by the Buyers, an on-site verification of the data is usually done.
Chapter 10
Problems

Media Coverage

Some small and mid-sized businesses attract the attention of local media when interesting activity such as a sale or acquisition occurs. Upon hearing of the news, key employees may be prompted to leave the establishment, thus diminishing the value of the company. Company theft may increase due to a leaking of the news to the media. Additionally, morale can decrease and materially alter the results of the company. It is generally best to try to keep transactions out of news coverage, especially if such news may draw negative reactions from the employees and other third parties.

Family on Payroll

Closely-held and family businesses may have family members on payroll on either an “at-will” or a contractual basis. Family members who work for a company may not always be the best people for their positions as the selection process is not performed at an “arms length,” competitive basis as are most hiring decisions. Sometimes, family members are placed on payroll for the sheer purpose of giving them their inheritance over time. Be that as it may, family members can be problematic when purchasing a company.

Fringe Benefits

Many companies carry fringe benefit packages for their employees as a nontaxable compensation system. Although these systems work well to attract and retain quality employees, the fringe benefits must be reviewed in order to be sure such fringe benefits conform to the goals of the new company.

Pensions and Retirements

Pensions and retirement plans must be closely examined. Too much underfunded pension liability can be a burden on the new owners. It should be addressed before the sale is consummated and closed.
Chapter 11
Legal Documents

The importance of legal documents cannot be understated. Absolutely every agreement should be written very clearly so that it will not be misunderstood, in error, or denied at a later date. Legal Documents are comprehensive. They include:

1. Asset Purchase Agreement

An asset purchase agreement is appropriate when there has been a purchase of assets as opposed to stock. The contract, at a minimum, lists the parties, the terms, the consideration, and provides for a thorough description of the property being sold. What many practitioners miss in the asset purchase agreement is an asset allocation which lists the price paid for each asset purchased. While it may seem unimportant, the Buyer and Seller must list the consideration paid on each class of assets purchased on IRS Form 8594. If the asset allocation is missing from the document, difficult tax problems can arise.

2. Stock Purchase Agreement

A stock purchase agreement is appropriate when stock has been sold. The contract should state, once again, the parties, the consideration, and the stock being sold. Warranties and representations are a key element in stock purchase agreements.

3. Employment Agreement

Sometimes, retaining key individuals in a business is critical to the success of the business. In order to keep these individuals, an employment agreement is a good strategy. Key employees may want some additional pay in order to remain on the job.

4. Consulting Agreement

The new owners will not know every aspect of the business or many of the customers. To retain current customers and clients, it may be necessary to employ the former owners as consultants for a year or possibly even longer. The consulting agreement also has the effect of lessening the tax burden on the seller of C Corporations, making the pay merely a wage as opposed to having the gain through the business reported on the books of the selling business.
5. Non-Compete Agreement

Without a non-compete agreement, many business sales would be worthless; the Seller could immediately open shop elsewhere and draw the same clients back, effectively rendering the business sale worthless. The non-compete agreement should be reasonable both in time and geographical area in order to be enforceable.

6. Personal Goodwill Agreement

Personal goodwill is a relatively new concept brought into existence with the Martin Ice Cream Case (110 TC 189). It has since become an embraced concept by the profession and the IRS. There are two kinds of goodwill, i.e. personal goodwill and company goodwill. Company goodwill is the kind of goodwill that arises within a company and is attributable to the name, location, and other factors of the business. Personal goodwill is the kind of goodwill that is created by an individual. The personal relationships, trustworthy personality, and other positive relationship characteristics of a person create personal goodwill.

To recognize personal goodwill in a transaction, the agreement should be in a separate document from the actual sales contract. The agreement should be explicit in that the agreement is for “the sale of personal goodwill” and is not a “covenant not to compete”. The parties to the contract are the seller individually, and the buyer, whether it be an individual or a corporation.

7. Buy / Sell Agreement

A buy sell agreement is critical when buying or selling a company with more than one party involved. Sooner or later, the owners of the company will want to change the ownership of the business. During such business modification, certain partners or shareholders may be forced out or otherwise asked to leave. When partners leave, they are entitled to the reasonable value of their shares. A buy sell agreement should specify how, when, and at what price their share of the business can be purchased. This is true even if the form of the organization is a limited liability company.
Chapter 12
Closing

Procedure
Closing on a business is similar to closing on a home purchase. The parties will generally meet face to face, documents are signed, and payment is made to the respective parties. The Seller, his legal representatives, the Buyer and his legal representatives should attend the closing. In addition, any other key owners of either party who need to sign documents should either be in attendance or sign the documents prior to closing.

Timing the Closing
The closing should happen as soon as practical after due diligence is completed. During the process of acquisition, target companies face challenges as well and will tend to deteriorate. A rapid closing tends to mitigate deterioration and puts the target company in the hands of the new owners who will practice utmost care to preserve the newly acquired company and help it thrive.

Some practical points to consider are the following:

1. Make sure the closing happens. Don’t allow a transaction or closing to fall through the proverbial cracks and lose thousands of dollars due to failure to close.
2. For the same reason, don’t let closing linger any longer than necessary. Once closing happens, it is important to assimilate the target or define its role, train new staff, tie up loose ends, and adjust price and payment terms, post closing.

Loose Leaf Binder
As a practical matter, the documents should be presented and carried in a loose leaf binder. Carrying loose documents creates the potential hazard of losing or mixing the
documents up at closing. Carrying the documents in a binder does not allow for movement of the documents or for a mix-up to occur before closing.
Chapter 13
Post Closing

Many professionals treat post closing as a minor detail or a string of insignificant events. The fact of the matter is that it is important to pay attention to detail and progressively act on post closing issues. During post closing, adjustments may have to be made to the purchase price due to ongoing issues or contingencies that are material in nature.

**Due Diligence**

In some business sales, due diligence is actually completed post closing. The new owners of the business may find new liabilities in the company eventually and will expect to be paid for those liabilities by the Seller. An example of this is an account payable that has not been accounted for in due diligence. Many companies owe multiple vendors and keeping track of every last vendor can be daunting. Before closing, accounts payable can inadvertently be left out, resulting in a liability to the business buyer. The liability may result in the buyer being able to reduce the purchase price, or alternatively, if an escrow account was established, funds can be released to the buyer. Also, Buyers have a greater chance to inspect and account for inventory after closing. If inventory is short, this may also lessen the purchase price if a post closing agreement is in effect.

**Supplier Issues**

In dealing with suppliers, personal relationships are key. Once a business is sold, suppliers’ relationships with the old business may change due to policy or preference. For instance, a supplier that gives a trade discount to Old Company President may not give the same trade discount to New Company President. Ultimately, the supplier may not even sell to New Company President altogether. In post closing, adjustments may be necessary as a result of supplier issues.
Employee issues

In post closing, purchase contracts may be contingent on employee retention. If key employees leave within a specified time period, this could lead to a reduction in the sales price.

Real Estate

Real Estate in a business sale is a sensitive issue that must be watched. The Buyer may have to obtain financing post-closing. If the Buyer cannot get financing, a long term lease may have to be entered into or a new location may have to be found by the Buyer.
Chapter 14
Concluding Remarks

In deal structuring, there are many details to consider.

It is important to understand the types of entities that are involved in the transactions. A C corporation may need separate contracts dealing with personal goodwill, while an LLC may need individual agreements with its members.

The process behind an acquisition involves negotiation, due diligence, and legal contracts. Many deals fail at the due diligence phase. Always remember that due diligence can lead to additional negotiations if the deal is to be structured so that both the Buyer and Seller are happy.

Finally, after the legal documents are prepared, approved, and signed, post closing events may occur that need attention. Each phase is important to accomplish the overall objective of transferring the ownership of a business.