by Gerald M. Newman
ERA General Counsel

LEGALLY SPEAKING

The mechanics of buying or selling a rep firm

You can't pick up a copy of any industry publication without reading about the acquisition, merger or consolidation of one rep firm by or with another rep firm. Clearly, logistical marketing or just plain survival planning often leads reps to enter into strategic acquisitions of other rep firms or related businesses. Although the purchase or sale of a rep firm may not be as complex as the purchase or sale of other types of businesses, there are a number of steps involved in the deal.

Confidentiality. In most cases, buyers and sellers want to keep a potential deal confidential. Buyers don't want to invite other bidders, and sellers don't want employees, principals, customers or competitors to know the business is for sale. Also, as part of the due diligence process, a seller will have to disclose financial and other sensitive information to the buyer. From the seller's point of view, it is imperative that confidential information be protected from disclosure or improper use by the buyer — particularly if the buyer is a competitor. The need for confidentiality is sometimes covered in a "letter of intent." If handled this way, the letter of intent must make clear that the parties intend to be legally bound by its confidentiality provisions. However, since confidential information must often be disclosed before the parties can even get to the letter of intent state of the transaction, it is best handled in a separate confidentiality agreement.

Letter of intent. Transactions often begin with a letter of intent. The purpose of the letter of intent is to set out the basic business terms of the deal, such as whether it will be a sale of stock or assets, the purchase price, and how and when the purchase price will be paid. Letters of intent are typically "non-binding." In other words, they are not intended to be enforceable in court, since most buyers are unwilling to be legally bound until they have been able to learn more about the seller through the due diligence process. While a letter of intent may not have any legal effect, it does have psychological value. Sellers should not expect to easily renegotiate the purchase price (or any other significant term) once it has been set forth and agreed to in a letter of intent.

Caution is warranted when signing a letter of intent. On one hand, to ensure that a letter of intent is not legally binding, it must clearly say so. Otherwise, a court may find the buyer and seller intended to be bound by their letter of intent as if was an enforceable agreement. On the other hand, the parties to a deal often want provisions in a letter of intent — such as those related to confidentiality or to the seller's agreement not to solicit other buyers — to be legally binding. In this case, the letter of intent must plainly state which provisions are intended to be binding and which are not.

Due diligence. The investigative process each party undertakes is referred to as "due diligence." For the buyer, due diligence is crucial, as it is the only way to "look under the hood" of the business to make sure it really works and is worth the price agreed upon by the parties. Without proper due diligence, the buyer may not end up owning what s/he thought s/he was buying, or, worse yet, may wind up owning problems that s/he doesn't want.

From the seller's point of view, due diligence can be quite burdensome. Sellers can sometime spend weeks digging materials out of files for the buyer to review. For the well-organized seller, the process should not be too painful. For less sophisticated sellers, the due diligence process often involves getting the company into the shape it should have been in the first place.

But rather than view the due diligence process as a necessary evil, the seller should anticipate the process and use it to make his/her business shine. A well-prepared seller can demonstrate his/her firm's strengths and explain away its weaknesses much more effectively than the seller who is disorganized and uninformed.

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Gerald M. Newman, partner in the Chicago law firm of Schoenberg, Fisher, Newman & Rosenberg, Ltd., serves as general counsel to ERA and is a regular contributor to The Representor. *He participates in Expert Access, the program that offers telephone consultations to ERA members.*

Leonard J. Gambino, a partner in Schoenberg, Fisher & Newman, Ltd., co-authored this column.

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Putting it in writing. Once the business deal has been made, someone has to put it in writing. The sophisticated buyer will usually insist that his/her lawyer do this, since the larger part of the agreement is for the buyer's benefit. The seller's lawyer, of course, will then have his/her turn to comment on whatever the buyer's lawyer has prepared. Two issues that the lawyers will typically negotiate heavily are the seller's representations and warranties about the business and the scope of the seller's indemnification of the buyer for the breach of those representations and warranties. Here again, due diligence plays a major role in how these negotiations proceed.

In some cases, a prudent seller will also do his/her own due diligence about the buyer. For example, if all or a part of the purchase price is to be paid in the form of the buyer's stock, the seller should conduct substantial due diligence — after all, by agreeing to take some of the buyer's stock, the seller is purchasing a piece of the buyer's business. Similarly, if the buyer is giving the seller a promissory note as part of the purchase price, the seller should assure him/herself of the buyer's creditworthiness and may also seek personal guarantees.

Third party consents. Often there is a period of several weeks to a few months separating the time when the final agreement is signed and the time is actually closed. In the case of the purchase and sale of a rep firm, it is during this period that the seller will obtain from his/her principals their consent to the transaction. Other third parties that typically will have a right to consent to the transaction are the seller's lender, landlord and equipment lessors.

The prudent seller, however, will not wait until after an agreement is signed with the buyer to prepare his principals for the sale. Needless to say, this can sometimes be a rather delicate matter, but there is little point in the buyer and seller spending time and money negotiating a deal in which the seller's principals are unwilling to go along.

The closing. This is when the deal finally happens. The parties have successfully negotiated and entered into a letter of intent (and likely a separate confidentiality agreement), have completed their due diligence, and have negotiated and signed a definitive agreement for the purchase and sale of the business (and the numerous other documents that the lawyers have undoubtedly prepared in connection with the deal).

At the closing, the business will be transferred to the buyer, and the purchase price will be paid to the seller. The complexity of the closing will vary. If the deal has been structured as an asset sale, each of the assets being sold must be conveyed at the closing. For a larger business, with many different kinds of assets, this can become quite a task. If the deal is a sale of stock or a merger, then the complexity may depend on the number of shareholders. Nonetheless, despite all the differences the parties may have had during their negotiations, with proper advance preparation, closings usually go smoothly.

Some final thoughts. More often than not, for a seller, the sale of a rep firm is as much a beginning as it is an end. Not only will the seller typically have a continuing relationship with the buyer through a consulting or employment agreement, but often, the seller will receive his/her purchase price from the buyer over a period of time. Thus, the success of the deal depends heavily on the ability of the parties to work together for a period of several years following the closing. Like everything else in the rep business, the successful deal will be built on successful relationships and hard work of the parties and their attorneys.

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