Main Street M&A Roadmap

Small Business Purchases + Sales

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The Main Street M&A Legal Experts

Introduction

It's A Big Deal

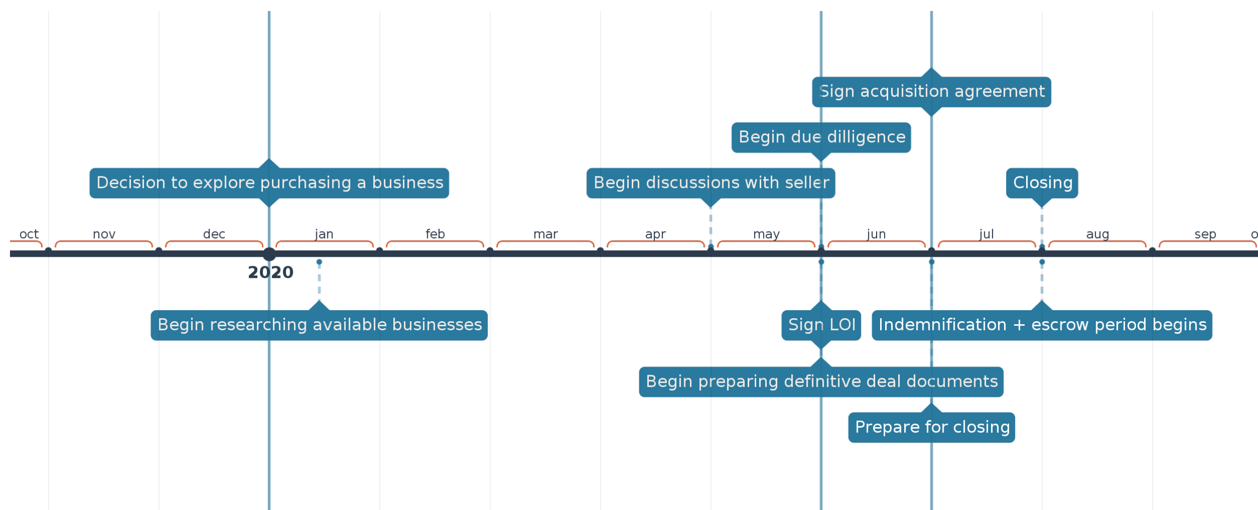
The decision to consider buying or selling a business is a big one and can be motivated by as many factors as there are buyers and sellers. For the purchaser, it can be the chance to start working for herself or it can be a way to grow and expand. For the seller, it can be the path to retirement or freeing up cash and time to pursue other opportunities.

The Process

Business sale and purchase transactions – no matter the scale or dollar value – tend to be "all-in" and involved. For instance, the deal size may be relatively small, but the purchaser may be relocating his family across the country for the opportunity. On the other hand, the seller may have built a business worth millions of dollars and understandably wants to get the sell right to be sure she protects the proceeds.

From deciding to explore a transaction, to finding a suitable buyer or opportunity, to entering discussions, conducting diligence, settling on a structure, and signing a letter of intent (LOI), to negotiating and signing definitive deal documents, to closing and beyond, the process is often complicated, even for the initiated.

The sale process usually takes from three to six months from start to finish, assuming a serious buyer and seller and no major hurdles. Each deal has its own twists and turns, though, so timelines vary. Below is an example timeline for a purchaser who decides to buy a business in January 2020:



Roadmap

This guide is designed to serve as a roadmap for business sale transactions involving "Main Street" or "small" businesses: those will annual revenues of less than $5 million.

While this guide is not intended to be a comprehensive resource and every transaction is unique, it should give you an idea of what you should expect as you consider buying or selling a business.

A Few Notes on Terminology:

Technically, the term "M&A" is properly used to describe transactions for lower middle-market businesses (those with annual revenues of $5 million to $50 million) and up. Weavil Law Office is focused on transactions for "Main Street" businesses, but because "business purchases and sales" / "business purchase and sale transactions" is a mouthful, we refer to Main Street transactions as "M&A" deals, too. After all, even if a deal isn't big by Wall Street standards, you can bet it's big to the participants.

Usually, we will refer to the "buyer" / "purchaser" and "seller," but, occasionally, we use "target" (short for "acquisition target") to describe the business being sold (particularly when discussing the business post-closing, owned and operated by the buyer) and "stockholders" when differentiating between the owners or former owners of the target and the target itself.

Your Deal Team

For both buyers and sellers, you need the right team to get the deal done right:

M&A Advisor — A business broker, investment banker, or other M&A advisor can advise on many aspects of the transaction. They can also help you market your business to potential purchasers and help you identity potential acquisition targets. They can also assist with valuations, diligence, and other aspects of the transaction.

M&A Legal Counsel — An experienced deal attorney can assist with most the matters covered in this guide.

Tax Advisor — A tax advisor is an integral part of the process, advising on deal structuring and other tax issues.

Other Professionals — In many situations, it also makes sense to involve industry consultants, diligence professionals, and HR experts.

For buyers, a good deal team can help you get the deal done in a way that works for you OR avoid a bad deal that's unsalvageable. Sure, experienced advisors are expensive, but nowhere near as expensive as closing on a deal you shouldn't have. For sellers, expert advisors can help you put your best foot forward and get the deal closed in a way that protects your interest.

M&A Advisors

Usually, one of the first steps for a seller considering selling its business is to retain a business broker or other M&A advisor. Business brokers and other M&A professionals bring tremendous value to transactions. Business brokers help the seller prepare the business for a sale, market the business, attract potential buyers, and help with deal terms. On the buy-side, they help identify attractive acquisition candidates and advise on the merits of individual businesses, including the purchase price.

M&A Legal Counsel
Do I Really Need a Lawyer?

In most situations, the seller is represented by a business broker or other M&A professional, and, in some cases, the buyer may be, too. Since a business sales professional is already involved, some purchasers and sellers wonder if using a lawyer is *really* necessary?

The short answer is yes. Attorneys play a different but complimentary role in transactions. For that reason, Transworld Business Advisors, the largest network of business sales, franchise, and M&A professionals in the United States, recommends you use an attorney. Here are some of the reasons why:

Your Interests The seller's business broker works for the seller and has an interest in getting the deal done on terms that make the seller happy. If you're a buyer, you need someone in your corner that represents you and your interests. And if you're a seller, you need someone to advise you on legal issues. Your attorney should represent your interests while being solution-minded and working to get the closed on terms that work for you.

Deal Structure Along with your tax adviser, your attorney can advise you on deal structure. There's no reason to blindly accept a "stock deal" (for more information, see *Deal Structure*) if other options make more sense.

Letter of Intent Your attorney will help ensure that all the important terms, including those that are key to you, are covered in the letter of intent (LOI). There's no reason to spend additional time, money, and energy on a deal if you can't reach agreement on basic issues. For more information, see *Letter of Intent / Term Sheet.*

Legal Due Diligence Your attorney will assist with legal due diligence, including reviewing corporate documents, contracts for termination rights and change-of-control provisions, and assessing regulatory and other risks. For more information, see *Due Diligence.*

Acquisition Agreement Many agreements are done on business broker or other standard forms. Your attorney can help you determine if that's appropriate for your transaction and, if so, will advise on specific changes or "riders" to the form agreement. At Weavil Law Office, we absolutely believe in keeping things as simple as possible and not overcomplicating matters. If a standard form is appropriate, there is no reason not to use it.

Larger and more complex transactions, though, typically involve agreements custom-tailored to the particular transaction. If that's the case for your deal, your attorney will help prepare and negotiate the acquisition agreement and other definitive agreements, as well as ancillary agreements like lease assignments, employment agreements, and others. An experienced M&A attorney will use the acquisition agreement and other agreements not only to implement the key deal terms from the LOI on a more granular level, but also to protect you from and mitigate risks (including those identified in diligence, if you're the buyer). For more information, see *Acquisition Agreement.*

Reasons to Explore Buying or Selling a Business

There are lots of business reasons buyers and sellers consider M&A transactions. The following ones are some of the more typical:

Buying an Established Business Rather than start a new business from the ground up, many purchasers prefer to buy a business that has already proven successful without having to reinvent the wheel.

Cashing Out + Retirement Either to return money to the owners or investors, or to retire, cashing out is a common reason to sell.

Expansion Whether it's to reach a new geographic market, increase presence in an existing market, or to provide complimentary or different offerings to customers (diversification), expansion often motivates business purchases.

Deal Structure

Parties have options available when deciding how to structure a deal. For most Main Street businesses, stock or asset deals usually make sense, although mergers are also an option. Before jumping into a stock deal as the default, though, buyers and sellers should carefully weigh the options:

Stock Deal In a "stock deal," the buyer purchases all of the equity (stock, membership interests, partnership interests, etc.) in the entity from the current owners and ends up owning the entity.

- *Pros:* The positives of this structure can include a more straightforward transition, better tax treatment for the seller, retained employees remain employed by the same entity, and change-of-control provisions in important contracts may not be triggered.

- *Cons:* The negatives of this structure can include inheriting unknown / surprise liabilities, worse tax treatment for the buyer (no increase in

basis), and the deal can be blocked if all the owners aren't on the same page.

Asset Deal In an "asset deal," the buyer purchases all (or most) of the assets of the seller and may assume some limited specified liabilities.

- *Pros:* The positives of this structure can include not inheriting unknown / surprise liabilities, better tax treatment for the purchaser through increased basis, goodwill amortization, easier owner approval, and the ability to cherry pick employees to be retained.

- *Cons:* The negatives of this structure can include deals being complicated by having to tease the assets to be purchased from those to be excluded and having to form a new entity to house the assets, worse tax treatment for the seller, and change-of-control provisions in important contracts may be triggered, requiring third-party consents.

Merger In a merger, the seller's business entity becomes part of the buyer's entity (or a subsidiary) and ceases to exist as an independent entity post-closing. Typically, merger structures are most appropriate for larger businesses.

Tax Implications Often, the tax impact of a particular structure will be a zero-sum game, where what one side realizes in tax efficiency the other loses.

Successor Liability In an asset deal, taking the assets but excluding the liabilities at first blush appears to provide protection against unwanted surprises. In some instances, though, courts may still attribute those liabilities to the acquirer under the doctrine of successor liability, especially where the buyer carries on the same business under the same name using the same locations of facilities.

Letter of Intent / Term Sheet

After initially exploring a transaction but before conducting a full due diligence inquiry, the parties will usually enter into a letter of intent (LOI) or term sheet. A carefully prepared and negotiated LOI will establish critical deal terms prior to drafting and negotiating the definitive agreements. Getting an appropriate LOI in place makes sure the parties really have the foundation for a deal in place and greatly increases the chances that the transaction will close. Many of the terms below are covered more fully under *Acquisition Agreement.*

Common Terms

Deal Structure Stock, assets, or merger.

Purchase Price How much the buyer will pay for the business, including any adjustments.

Payment Terms Whether the purchase price will be paid in cash, equity in the buyer, an earnout, or through seller financing (promissory note).

Indemnification and Escrow Terms	The specifics of the seller's liability for representation breaches and other breaches, as well as whether a portion of the purchase price is held back to cover potential liability.
Restrictive Covenants	Limitations on the seller's ability to compete with the business after the sale closes.
Post-Closing Management	Whether the seller's owners, key employees, and other will stay on after closing, either permanently or to assist with the transition.
Full Due Diligence	The scope of full due diligence to be conducted.
Confidentiality	If the parties haven't already entered into a confidentiality / non-disclosure agreement (NDA), they will typically do so in the LOI to protect the seller's confidential business information that will be provided during full diligence.
No-Shop	Often, prospective purchasers don't want to go to the expense of conducting full diligence and negotiating definitive agreements without the seller's agreement not to engage in discussions with other potential purchases. This is called an exclusivity agreement or a "no-shop."
Definitive Agreements	LOIs often indicate whether the buyer or seller will prepare the first draft of the definitive deal documents. In smaller deals, this can be important, because while "holding the pen" on the acquisition agreement gives a party the ability to shape the agreement to its advantage, it usually entails higher attorney fees for the time involved.

Binding or Non-Binding?

Most of the terms in LOIs are usually non-binding, although they do typically establish firm boundaries for future negotiations, absent surprises. There are exceptions, though. For example, confidentiality and exclusivity provisions are almost always binding.

Due Diligence

Conducting a due diligence examination is a fundamental part of buying a business. Without conducting diligence, a purchaser has no way of knowing whether the business is as presented. Typically, the buyer will send the seller a due diligence request list that will ask for the following, among other things:

Business	Calls and meetings between the purchaser and the seller, the seller's management team, and key customers and suppliers.
Corporate Documents	Certificate, bylaws/ operating agreement, subsidiaries list, and other important corporate records.

Financials + Tax Records	Financial statements, budgets, accounting records, payroll records, tax returns, audit records, and other items.
Contracts	Copies of key agreements used in the business, including those with suppliers and vendors, retailers, distributors, service providers, certain employees, and landlords.
Customers and Vendors	Lists of key customers and vendors / suppliers, along with associated revenues, costs, and agreements.
Marketing + Sales	Marketing and sales materials, budgets and strategies, price lists, and competitor research.
HR	HR records, employee / contractor lists (including compensation information and agreements), benefits information, and policies and handbooks.
Operations	Information on real property, insurance policies, manuals, and policies and procedures.
IP + Other Key Assets	List of all intellectual property (IP) used in the business (whether owned or licensed), licensing agreements, software used, websites, domains, email addresses, and phone numbers.
Legal	Any permits used in the business, along with governmental filings and information on any litigation or investigations.

Supplemental diligence requests are common, and, often, diligence will continue up until closing.

Acquisition Agreement

The Heart of the Deal

The definitive acquisition agreement – whether a stock purchase agreement, an asset purchase agreement, or a merger agreement – is where the transaction terms from the LOI are implemented in a negotiated, binding manner. In large transactions, it's customary in most deal processes for the buyer to prepare the first draft of the acquisition agreement. In small-business transactions, usually the seller's counsel prepares the first draft, though not always. Once the initial draft is prepared, the other side will provide comments, often in the form of an issues list.

Key Provisions

Purchase Price + Payment Mechanics	The price the buyer is paying for the business. The purchase price can be paid in cash at closing, through seller financing in the form of a promissory note, equity in the purchaser, through earnouts and other deferred / contingent payments, or a combination.
Earnouts	An earnout is additional consideration that becomes payable if the business meets certain financial or other metrics over a defined period post-closing. Sellers often

resist earnouts because the seller will no longer be in control of the business after closing. To mitigate that risk when earnouts are used, sellers will typically require the buyer to make certain efforts (for example, by providing funding, personnel, and operational support) to help the business meet the earnout goals.

Purchase Price Adjustments

Often, the purchase price is adjusted to reflect changes in the business between signing and closing. The most frequent type of adjustment is for "net working capital" (current assets minus current liabilities). Other types of adjustments include those for net worth, cash at closing, and accounts receivable. Adjustments can be "downward only" or "two way," and usually a "buffer" is used around the target amount so that small variations don't require an adjustment.

Reps and Warranties

Representations and warranties are a focal point of most transactions. A "rep" is a statement in the agreement by one party to the other concerning a fact about the seller or its business (buyers make reps, too, but buyer reps are usually less important in the overall arc of the deal). Reps touch on areas like finances, taxes, compliance with laws, permits, properties, assets, IP, employees, contracts, customers and suppliers, litigation, and other matters. Reps are usually subject to disclosure schedules, which disclose deviations from the reps. Reps serve several key functions:

- *Accountability:* Reps hold the seller accountable for the accuracy of the information provided about the business.

- *Diligence Function:* Reps and the accompanying disclosure schedules are often a good way to ferret out pertinent information.

- *Conditionality:* As discussed under *Closing Conditions*, at closing, the buyer reaffirms that the reps made at signing are still true at closing (a "bring down"). If the business has changed between signing and closing such that the reps are no longer true, the buyer has the right to walk away and not close. Because of that, the breadth of the reps affects the transaction's conditionality or certainty of closing.

- *Indirect Purchase Price Adjustment:* If indemnification is available (see *Indemnification Provisions*), the reps can serve as a basis for a functional purchase price adjustment: If the rep is untrue, the buyer can seek indemnification for associated loses, indirectly reducing the purchase price.

Reps are often subject to carve-outs and qualifiers, like "knowledge," "materiality" and "Material Adverse Effect." In many instances these qualifiers are appropriate, but seller's counsel will often attempt to overuse them, blunting the force of the reps in order to minimize the seller's exposure and increase closing certainty. The use of carve-outs and qualifiers is negotiated, and experienced counsel can assist with ascertaining what's appropriate and what isn't.

Buyers should use the reps to protect against risks, including specific risks identified during diligence. Sellers need to ensure that the reps are appropriate and not overbroad, giving rise to indemnification rights that aren't truly intended

or giving the buyer an "option on the deal" though too much conditionality. An experienced M&A attorney can help.

Indemnification Provisions

Indemnification rights give the reps and covenants teeth, imposing liability on the seller for the buyer's losses due to the reps not being true. Usually, these provisions are heavily negotiated, with the buyer wanting full, long-lasting protection, and the seller wanting narrow, short-lived indemnification obligations. Some key elements follow:

- *Who's Liable:* In stock deals and mergers, the stockholders of the target will be on the hook; in asset deals, it may be the stockholders or the target entity itself, guaranteed by the stockholders.

- *Time Limits:* Buyers want as long as possible to discover and bring claims, while sellers want a more limited period. Periods from 1 to 2 years are common.

- *Caps:* Similarly, buyers want high total liability for claims, while sellers want to cap their exposure. Around 10-20% of the deal value is typical, but the appropriate number depends on the specific transaction. Often the indemnification escrow (see *Indemnification Escrow + Holdbacks*) will function as the exclusive remedy and effectively establish the cap.

- *Baskets:* Indemnifiable loses usually have to hit a threshold ("fill the basket") before indemnification obligations kick in. Once the threshold is met, liability can be either for amounts over the threshold (a "deductible") or for the entire amount back to the first dollar (a "tipping basket").

- *Carve-Outs:* Certain types of breaches should be carved out from the indemnification limitations. For example, so-called "fundamental reps" concerning authority to enter the transaction and title, as well as reps concerning tax, environmental, and employee benefits matters are usually not subject to the same limits as other reps. Fraud, willful misconduct, and covenant breaches are also usually carved out from the limitations.

- *Offsets:* If all or a portion of the purchase price is subject to future payments from the buyer, as in the case of seller financing or an earnout, indemnification provisions may provide that the payments may be offset by losses.

Indemnification Escrow + Holdbacks

Sometimes, part of the purchase price is put into escrow to secure the seller's indemnification obligations. Alternatively, the buyer may hold back a portion of the purchase price. In many deals, the escrow or holdback will be the purchaser's exclusive remedy for indemnification losses, but in others, it may be the starting fund prior to proceeding against the target shareholders individually.

Closing Conditions

"Simultaneous sign and close" transactions are those where the parties are ready to close when they sign the agreement, and the deal closes the moment the deal documents are signed.

More typically, though, there will be a pre-closing period between singing and closing where the parties handle items required for closing, like obtaining and/or finalizing financing, third-party consents, and other items. Closing conditions include the items that must be finalized before the parties are obligated to close. Some conditions are applicable to both parties, and some may only give one side a right to walk away if not met.

Sellers usually want narrow and minimal closing conditions to increase certainty that the sale actually happens, while buyers want broad and expansive closing conditions for flexibility in case changed circumstances make them rethink the transaction. Broad closing conditions can also be used by buyers to pressure sellers to fix issues prior to closing.

Common closing conditions include the following:

- *Reps and Warranties Bring Down:* That the reps and warranties made by the other party at signing remain true at closing. Buyers will want the reps to be true "in all material respects," while sellers will want the reps to be true except as would not constitute a "Material Adverse Effect" (see beow).

- *Material Adverse Effect:* That a material adverse effect (MAE) (sometimes called a material adverse change or MAC) has not occurred. What constitutes a MAE is the subject of negotiations. The recent COVID-19 pandemic is a good example of a MAE. If a buyer signed an agreement to purchase a business just before the outbreak, and the business's prospects and value suffered as a result of COVID-19, a MAE clause could let the buyer walk away from the transaction.

- *Debt and Liens:* Any required debt has been paid off and required liens have been released.

- *Key Personnel:* Employment agreements, non-compete and similar agreements, consulting / transition agreements, and equity documents have been signed.

- *Regulatory Approvals:* Any approvals required by governmental or other regulatory bodies have been obtained.

- *Third-Party Consents and Approvals:* The seller having received all required consents under its agreements with landlords, customers, suppliers, and other third parties. Sometimes, sellers will successfully negotiate for this to be limited to "material" third-party consents that are listed on a schedule.

- *Financing:* Often, if cash at closing is required, buyers will negotiate for a "financing condition," requiring the buyer to close only if adequate financing (whether from a commercial lender or another source) is in place.

Covenants The acquisition agreement will include covenants or agreements for the parties to take or not take certain actions ("affirmative covenants" and "negative covenants," respectively) before and after closing.

- *Pre-Closing Covenants:* Usually, the pre-closing covenants are relatively standard and not hotly negotiated. For example, the seller's obligations to run the business normally, maintain relationships with customers, suppliers, and others, comply with laws, keep the transaction confidential (if required), facilitate the buyer's continued diligence, not increase employee compensation, not make capital expenditures, and not incur debt or liens.

- *Post-Closing Covenants:* Post-closing covenants are usually subject to more negotiation. These include covenants regarding the seller's stockholders' non-disclosure of the target's confidential information, non-competition with the target, non-solicitation of employees and customers, and non-disparagement of the target. The length of the non-competition and non-solicitation covenants are negotiated within the limits of state law. Periods from 1-5 years are common. The rationale for these covenants is that the purchaser should get protection in exchange for the purchase price it paid. It's important to have these covenants in the acquisition agreement in addition to key managers' employment agreements because courts are more likely to enforce these restrictions in the context of a business sale (and, in fact, states like California may only enforce certain restrictive covenants in connection with business sales). Post-closing convents concerning tax obligations and reporting, as well as financial information if there is an earnout, seller financing, or equity component to the purchase price, are relatively non-controversial.

Ancillary Agreements

In addition to the acquisition agreement, other definitive agreements – called "ancillary agreements" – are often involved. These may include:

Lease Documents An assignment of the existing lease or entering into a new lease (especially if the seller separately owns the property used by the business).

Employment and Other Agreements If key managers will remain after the transaction (potentially including the seller), appropriate transition / consulting agreements or employment agreements will be needed.

General Assignment In as asset deal, a general assignment agreement will be needed to transfer rights to the new owner.

Loan Documents If seller financing is involved, a promissory note along with accompanying security and guarantee agreements, as well as appropriate state UCC filings.

Specialized Agreements	Sometimes, specialized or industry-specific agreements are required. For example, in the sale of a professional practice, a records custody agreement is usually involved.

Other Aspects

Many deals also involve:

Shareholder Approval	Equity holder approval to enter into and consummate the transaction, and formal records documenting that approval (minutes and resolutions or a written consent).
Acquisition Entity Formation	Especially in asset deals, the formation of a new business entity (LLC, corporation, etc.) to hold the purchased assets.
Non-Disclosure Agreement	Entering into a standalone non-disclosure agreement (NDA) in connection with the diligence process.
HR Issues	Deciding which employees will be retained, and carrying out post-closing hirings and terminations.
Ownership Arrangements	If the buyer comprises multiple owners, an appropriate shareholder or operating agreement may be needed to set out the rules for the newly purchased business.

Weavil Law Office

Weavil Law Office's Main Street M&A attorneys are focused on moving transactions forward while protecting our clients' interests. We understand the process and can guide you through it, eliminating unnecessary stress and uncertainty. Our lawyers understand that business sale transactions are inherently risky. Some generalist attorneys are uncomfortable with risk and unique deal terms, and they end up putting up roadblocks and impeding progress towards their clients' goals. We're not like that. Our attorneys are here to identify issues, provide solutions, and get the deal done.

If you're interested in having us on your deal team, visit business.weavillaw.com or email us at contact@weavillaw.com to learn how we can help you achieve your Main Street M&A goals.

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The Main Street M&A Legal Experts