

# **TRICKS AND TRAPS IN BUSINESS ACQUISITIONS**

**HELPING YOUR LENDING CLIENTS  
SECURE THE ASSETS THEY WANT  
AND THE COLLATERAL YOU NEED**

By

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## **I. Introduction**

As a lender, you stand to lose a lot when your client's business acquisition goes bad.

- Your loan might be at risk
- No lender wants to call in a bad loan
- You may lose a great client

Although there are many reasons that a business acquisition fails, many potential risks can be eliminated with proper:

- due diligence and investigation
- acquisition structure
- documentation

## **II. Due Diligence & Investigation**

### **A. General Observations:**

1. Seller often is reluctant to share private business and financial information
2. Clients often are eager to find a reason to minimize due diligence review
3. Buyer believes reduced due diligence = reduced costs
4. But, it is hard to "kick the tires" in a business acquisition

### **B. Recommendations:**

1. Give Seller a Nondisclosure Agreement ("NDA") to address Seller's confidentiality concerns.
2. Encourage client to delegate due diligence/investigation duties to other advisors.
3. Always, always make sure client's CPA is involved, especially to review Financial Statements and income/cash flow projections.
4. Beware of any Seller who won't freely share information.
5. Beware of hidden liability exposure.
6. Make sure Buyer and Seller understand that due diligence will save costs and heartache later (an ounce of prevention is better than a pound of cure).

### **III. Acquisition Structure**

#### **A. If possible, acquire assets rather than stock.**

1. **Stock Purchases** - Buyer assumes all debts, whether known or unknown. Also, Buyer may acquire unfavorable tax attributes of entity.
2. **Asset Purchase** - Buyer gets tax benefits for purchase price and "may" be able to avoid liabilities of seller.
3. In either stock or asset acquisition structure, Buyer can be protected with:
  - (a) representations and warranties;
  - (b) indemnification obligations; and
  - (c) escrows and holdbacks.

#### **B. Escrows, Deferred Payments, Consulting and Noncompete Arrangements**

1. Possible Tax Benefits to Seller
  - deferred tax recognition
  - lower taxes - especially with sales by C corporations where part of purchase price is paid to shareholders through consulting or noncompete payments
2. Escrow Arrangements - At least six (6) months, maybe much longer depending on due diligence or in a stock sale
3. Deferred Payments - Seller financing. Of course, bank needs to be sure seller financing is subordinate to bank's lien.
4. Consulting Agreements and Noncompete Agreements
5. Adequate Security for Representations and Warranties and Indemnification Obligations

#### **IV. Documentation: Key Provisions of Purchase Agreement**

##### **A. Representations and Warranties of Seller and Seller's Owner**

1. Physical condition of assets;
2. Quality of accounts receivable and inventory;
3. Extent of current and potential liabilities (including ongoing contracts that will be assumed by Buyer);
4. Condition of customer and supplier relationships;
5. Correctness of financial statements;
6. Adequacy of internal accounting procedures;
7. No other matters not disclosed by Seller;
8. Scope of representations and warranties - "Best of Knowledge" vs. Unconditional Representations and Warranties
9. Parties to Representations and Warranties - Seller and Owner
10. Telling a lie vs. allocating risk

##### **B. Indemnification Provisions**

1. Seller and Owner agree to indemnify Buyer for "Losses" incurred by Buyer for:
  - (a) outstanding liabilities;
  - (b) prior operation of business;
  - (c) breach of representations and warranties;
  - (d) breach of other agreements (consulting, noncompetes, etc.)
2. Definition of Indemnified Losses:
  - (a) lost profits and loss of bargained purchase value;
  - (b) out-of-pocket costs, such as attorneys fees and court costs;

(c) liquidated damages may be appropriate.

C. Scope of Liability

- Seller and Owner should be jointly and severally liable
- Liability “Baskets” and other "Cap" limits

D. Time Limits for Bringing Claims

- Survival of representations and warranties

E. Cross Default Other Agreements (Consulting, Noncompetes, Other Deferred Payments)

F. Other Provisions

1. Litigation Venue and Jurisdiction

2. Beware of Merger Clauses

- a “double edge” sword
- “This agreement constitutes the entire agreement of the parties...”

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