

CORPORATE MATTERS: INITIAL STEPS IN SELLING A PRIVATELY HELD CORPORATION

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Tags
Corporate Law
Due Diligence
Sale

The owner of a corporation can decide at any time to sell his or her business. There are many reasons why an owner may want to sell – including retirement, a general desire to cash out, and fatigue. Further, if the business has multiple owners, some owners may want out and have a drag-along right or, upon hearing that some owners want to sell and their reasons for selling, the other owners may decide it is a good time for them to sell, also. Once the decision has been made – what happens next?

The owners can decide among themselves when to sell, how much to sell for, and the terms of the sale. It may be that there are many potential purchasers, or there could be just one. In any event, any purchaser will want to find out as much as they can about the company before any commitment with respect to a purchase is made.

In determining how much information to provide, a seller usually thinks along the lines of “as little information as possible to keep the buyer interested.” Most sellers are naturally hesitant about providing commercially sensitive information about their company until they are certain the transaction is going to close. On the other side of that equation is a buyer who wants to know everything they can about the target company before proceeding. Initially, it is not a bad idea for a seller to provide basic information – enough to keep potential buyers interested until it can be determined which of them is likely to complete the purchase.

The principal questions a seller should ask are, “How confidential is the information?” and “How can it be used against me?” The answers to these questions will determine the scope and nature of the information to be initially provided to a buyer.¹

Once the initial information is supplied and the potential buyer has become genuinely interested, the seller should expect to receive a full-blown due diligence request list. While the seller may still be hesitant to provide information, at this point in the transaction it is likely that a buyer will not proceed unless the documents requested in the due diligence request list are provided. In some instances, the seller’s reluctance may not be warranted – in less competitive industries, specific information can be provided without jeopardizing the business. In those industries where a seller’s business may be adversely affected by the dissemination of the information, the utilization of a nondisclosure agreement can lessen the impact of any adverse effects stemming from disclosure.²

A nondisclosure agreement seeks to limit the use of the information provided to the analysis required to enable the buyer to make a decision regarding whether or not to buy, and prohibits the reproduction or distribution of the information for any

¹ Sifton, Lawrence C. *How to Buy or Sell the Closely Held Corporation*. Englewood Cliffs, NJ: Prentice-Hall, 1987.

² *Id.*

other purpose. The seller can stipulate the level of confidentiality required and also specify exactly what information is confidential. In practice, information is often provided by way of an electronic data room, and the seller can also seek to limit the individuals that have access to the room.

Often included in a nondisclosure agreement is an exclusivity clause, because, from a buyer's point of view, with genuine interest comes genuine cost. A buyer may have employed a team of accountants and lawyers to review the financial and legal documentation, and they would not want the deal to continue to be "shopped" during this stage. The exclusivity clause contained in the nondisclosure agreement would provide assurance that for a certain time period, the seller will not, and will not permit any of its representatives to, directly or indirectly solicit or encourage the initiation of any expression of interest from any person relating to a possible business transaction along the lines of the one currently being pursued by the buyer. An exclusivity clause would also prohibit the seller from participating in any discussions with, or providing any non-public information to, any person in connection with such a business transaction.

Once the nondisclosure agreement has been entered into, the seller can expect to receive a due diligence request list covering matters such as the following:

- General corporate documentation
- Capitalization
- Personnel
- Customer and supplier documentation
- General financial and tax information
- Properties
- Intellectual property
- Environmental matters
- Litigation
- Regulatory matters
- Consents
- General business information

It cannot be stressed enough that at this stage the seller should have already assembled its "team." At a minimum, a lawyer and an accountant will be required for a transaction of any size. Moving ahead without the proper advisors, even at this early stage, may limit the chances of a successful transaction and frustrate a buyer who has assembled a team. In transactions involving a middle market company, it is common to hear from sellers that they are frustrated with the level of due diligence and that they "have a business to run." The bottom line is that they also have a business they are trying to sell. In order for them to continue running their business, either to ensure its continued profitability in the event the transaction does not close or to keep potential buyer(s) interested with ongoing solid results, the seller must rely on its professional advisors.

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