

# Legal Checklist: Buying and Selling a Rep Firm

## ✓ Letter of Intent (LOI)

This typically non-binding document lists the basic terms of the deal, including whether it will be a sale of stock or assets, the purchase price, and how and when the purchase price will be paid. While LOIs are usually nonbinding, sometimes certain provisions of the letter will be explicitly binding – such as the seller's agreement not to solicit other buyers or a confidentiality agreement.

## ✓ Due Diligence

Buyers should ensure the business is functioning properly and is worth the agreed upon price. Sellers should expect to make all their files, records, offices, and staff available for the buyer's review. If the buyer is giving the seller a promissory note as part of the purchase price, the seller should verify the buyer's creditworthiness, seek personal guarantees, and have a right to take back the business if the buyer fails to pay. If part of the buyer's payment to the seller includes shares in the buyer's company, the seller should do its own due diligence on the buyer.

## ✓ Transaction Structure

Generally, the sale of a business is structured either as an asset or stock sale. An asset sale is the purchase of individual assets and liabilities, whereas a stock sale is the purchase of the owner's shares of the corporation. Tax implications and potential liabilities are primary concerns when negotiating the type of transaction. From the buyer's perspective, an asset sale is ideal, while sellers typically prefer stock sales.

## ✓ Valuing the Business

The typical standard with rep firm valuations is that they are worth around 100% of the previous year's gross commission income. This valuation can be higher if there are stable relationships with principals and customers, the products market growth potential, and there has been steady growth in the firm's commission income. Sellers can maximize purchase price by sharing risk with the buyer. For example, the price could be 15% of gross commission income for eight years after the sale.

## ✓ Written Agreements

Many important provisions should be in writing, including the seller's representations and warranties about the business, payment terms, transfer of title, consents of third-parties, and the rights of either party if the other breaches the agreement. In addition, the seller should expect for the buyer to ask for a covenant not to compete, which is generally enforceable. In addition, a consulting agreement is useful to ensure the seller remains available to the business for a period of time after the sale. This is especially crucial with rep firms that rely heavily on relationships with principals and customers. A sizeable part of the overall price paid for the business may be allocated to the consulting agreements.

## ✓ Tax Analysis

A business sale can be structured many ways, from a tax perspective, having a significant financial impact on the buyer and seller. In general, sellers and buyers have adverse tax interests: they both want preferential tax treatment. Ignoring the tax characterization of a business sale can result in significant tax costs to an inattentive seller or buyer.

## ✓ Third Party Consents

After the final agreement is signed but before it closes, the seller of the rep firm will obtain principals' consent to the transaction. In addition, sellers' contracts with third-parties—such as the seller's landlord and equipment lessors—usually require those third-parties consent to a sale of the business.

## ✓ Closing

At the closing, the business will finally be transferred to the buyer and the purchase price will be paid to the seller. If the transaction was structured as an asset sale, each of the assets being sold must be conveyed at the closing. If the deal involved seller financing, the seller may suspend a transfer of ownership until the buyer pays off the debt.