

DAVID J. MOFENSON
BARBARA D. DALLIS
JEREMY E. POOCK

OFFICE: 781-247-4200
FAX: 781-247-4201

Legal Pitfalls for A Business Broker to Avoid

By: Jeremy E. Poock, Esq.

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About The Presenter:

Attorney Jeremy E. Poock leads the Business Law Practice for the Mofenson Law Offices in Needham, Massachusetts.

Focusing on purchases and sales of Massachusetts businesses, Attorney Poock works with buyer and seller clients from the initial letter of intent phase to the closing, advising clients about all aspects of a given transaction.

Having owned his own import/export and retail business, Attorney Poock understands the variety of legal and non-legal issues that business owners encounter on a daily basis. Leveraging his business ownership experience with his expertise in business law, Attorney Poock offers practical legal solutions to his business law clients.

In addition to leading the Business Law Practice, Attorney Poock assists clients in the areas of dispute resolution, landlord-tenant matters, and Probate.

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I. Best Practices to Minimize Liability

A. What to Keep in Mind

The major source of litigation involving business brokers results from claims of lack of disclosures and misrepresentations.¹

To paraphrase Professor Howard Abrams of Emory University School of Law: "If it is between your seller client and you being sued, choose your seller client."

B. Pre-Listing Steps

In the words of Michael W. Camerota, J.D., CBI of Touchstone Advisors, LLC: "Do the dirty work upfront."

¹ Lanza, Dora, "In a Litigious Society, Safeguard Your Practice from Potential Litigation," presented at the Spring 2008 IBBA- M&A Source Joint Conference for Professional Development.

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Examples include the following documents attached as Exhibits “A” and “B” from Touchstone Advisors, LLC:

1. Seller’s Disclosure Statement.
2. Authorization to Commence Marketing Effort.

Additional examples include:

1. Familiarizing your seller clients with your Non-Disclosure Agreement; and
2. Explaining whether co-brokering will apply, including what the co-broker’s relationship is to the listing broker.

C. Exclusive Listing Agreements – Recommended Sections

1. Establish That The Seller Will Indemnify and Hold The Broker Harmless Against Claims Relating to Information Provided by the Seller:

Seller represents and warrants that all information previously or hereafter furnished to Broker is true and correct and/or complete and accurate in all material respects. Seller understands and acknowledges that all information supplied to Broker as described above will be relied upon by Broker when promoting the Business to prospective Purchasers. Broker will make no independent investigation with respect to any and all of Seller’s representations. Seller shall therefore indemnify and hold harmless the Broker from any and all claims, demands, causes of action or liability whatsoever, including costs, expenses and reasonable attorney's fees, arising out of a breach of the warranty to supply information as described above.

2. Confirm Corporate Authority to List & Sell The Business:

Seller represents and warrants that Seller is duly authorized to represent all owners, direct or indirect, legal and/or equitable, of the Business, in the sale of the Business, and that all such owners are bound by the terms and conditions of this Agreement. More particularly, if a vote is required (by law or by contract) to authorize the sale of the Business, Seller represents that such vote has been taken at a fully authorized meeting after due notice to all entitled to vote, and that the requisite majority of those entitled to vote have authorized such sale. Seller agrees to promptly deliver authenticated copies of documents evidencing any such vote, if requested by Broker. Further, Seller represents and warrants that Seller, the principals of Seller, or Seller's agents or representatives will not take any action which will impair the salability or marketability of the property or Business that is the subject of this Agreement.

3. Establish Broker Exclusivity:

Seller represents and warrants that this Agreement shall constitute an Exclusive Listing with Broker and that, except for Broker, Seller has not employed or agreed to compensate, and shall not employ or agree to compensate, any other broker, dealer, salesman or agent with regard to the subject sale for or during the term of this Agreement. Seller shall indemnify and hold harmless Broker from any

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and all claims, demands, causes of action or liability whatsoever, including costs, expenses and reasonable attorney's fees, arising out of a breach of the warranty of exclusivity herein.

4. General Indemnification:

Seller hereby indemnifies and holds harmless Broker and its agents, employees, officers, directors, shareholders, co-brokers and affiliates against any and all losses, claims, damages, expenses or liabilities whatsoever, joint or several, which may arise out of or in connection with the good faith performance of this Agreement, or the good faith performance of Broker in connection with this Agreement. This indemnification and hold harmless agreement of Seller shall not apply to any intentionally wrongful acts of Broker or the gross negligence of Broker, its agents, employees, officers, directors, shareholders, co-brokers and affiliates. Further, the indemnity shall be cumulative and shall be in addition to any other liability which may be imposed upon Seller.

5. Provide Sellers with Sufficient Time to Consider Your ELA:

Seller acknowledges having read this Agreement and having had the opportunity for review of this Agreement by Seller's legal counsel.

D. Buyer NDA – Recommended Sections

1. Establish That The Seller Is the Source of Information Shared with The Buyer:

The Information furnished by Broker has been prepared by or is based upon representations of the Seller alone, and Broker has made no independent investigation or verification of said Information. Buyer hereby expressly releases and discharges Broker from any and all responsibility and/or liability in connection with the accuracy, completeness or any other aspects of the Information and accepts sole and final responsibility for the evaluation and/or verification of the Information and all other factors relating to the Business.

2. General Indemnification from the Buyer to the Broker & Seller:

Buyer will indemnify and hold harmless the Broker and/or Seller from all costs and damages suffered arising from any and all claims or actions due to Buyer's acts or failures to act that constitute negligence, gross negligence or intentional misconduct in pursuing the purchase of the Business, including, but without limitation, reasonable attorney's fees and other expenses incurred by Broker.

E. Confidential Business Reviews

1. Request that Sellers provide written approval of your Confidential Business Review (CBR).
2. As a best practice, obtain Seller consent before sharing a CBR with a prospective buyer.
3. Include the following footer to each page of your CBR:

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The information contained in the Confidential Business Review was obtained by the Seller and has not been independently verified by the Broker. The Broker assumes no responsibility for the correctness or accuracy of the information contained herein.

F. Offer to Purchase – Recommended Sections

1. Waiver of Liability:

The Broker shall bear no liability to either of the Buyer or the Seller should either party fail to fulfill any of the obligations set forth in this Offer.

2. Provide The Parties with Sufficient Time to Consider the Offer to Purchase:

This is a legally binding document. Read it carefully. If you do not understand it, consult an attorney. The Broker is not authorized to give legal advice.

II. Best Practices to Ensure Commission Payment

A. ELA – Suggested Sections

1. Establish That The Full Commission Will Be Paid at Closing:

Broker's commission will be paid in full at closing, regardless of whether any portion of the sale price is due after the closing.

2. Create Safeguards to Ensure Payment (note that the following is overtly pro-broker, and you may decide to utilize portions of this section based upon the applicable transaction):

Seller hereby grants Broker a security interest in the proceeds from the sale of Business to secure the payment of Broker's commission due under this Agreement, and hereby authorizes Broker to publicly record evidence of the lien or security interest created hereunder.

Seller authorizes and instructs any person or entity who may be handling the closing of the Business to pay and disburse out of the sale proceeds directly to Broker, an amount equal to the commission due under the terms of this Agreement, and hereby expressly waives any and all right to instruct such person to withhold any portion of said commission for any offset or other claim(s) of Seller. Such person or entity handling the closing of the sale of the Business is entitled to rely on the written instructions and directions of the Broker for the payment of the commission due hereunder as long as the person or entity handling the closing is given a copy of this Agreement.

Seller and Broker jointly and severally covenant and agree to indemnify and hold harmless the person or entity handling the closing of and from any claim arising from or relating to the authorization contained in this paragraph, so long as said person or entity acts in good faith and in conformance with its terms and conditions.

The parties hereto acknowledge that specific performance of this clause at the stated time for performance is of the essence of this agreement and that a breach hereof would cause severe, and possibly irreparable harm to Broker. The parties therefore agree that the Broker may bring an

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equitable action to specifically enforce the terms of this clause in advance of actual breach where either the Seller or the closing person or entity has threatened to breach any of the terms of this clause.

3. Liquidated Damages & Rights to Commission upon for Early Termination:

If during the Listing Term Seller decides to withdraw from selling the Business, Seller may, upon payment to Broker of [INSERT LIQUIDATED DAMAGES AMOUNT], terminate the Listing Term and cancel the Broker's exclusive rights to list the Business. If a sale of the Business subsequently is agreed to during what would have been the Listing Term, or if a sale of the Business subsequently is agreed to with a qualified prospect during the defined Tail Period, the Commission, which would otherwise been due as provided herein, shall be due to Broker, less a credit for any termination fee paid hereunder.

4. Establish That All Deposits Shall Be Held in Escrow by the Broker:

Seller irrevocably authorizes Broker to hold all Buyer deposits or down payments in its escrow account. If a prospective buyer's deposit or down payment is forfeited, it shall be divided between Seller and Broker, in equal portions, but in no event shall the Broker's portion exceed the amount of the Commission owed Broker hereunder.

B. Include A Reference to The Commission in The NDA – Recommended Section

1. Provision to Avoid A Buyer Circumventing The Broker to Purchase The Business (note that the Commission Term should be customized to mimic the Listing Term and any applicable tail period):

For consideration of One Dollar, this day paid from Broker to Buyer, and other good and valuable consideration, the receipt and sufficiency of which is hereby expressly acknowledged, Buyer covenants to Broker that, for a period of two (2) years from the date hereof (the "Commission Term"), Buyer shall not take any action, nor promote or introduce any third party to buy the Business from Seller, that results in circumventing or defeating the Broker's commission due from the Seller. Further, Buyer specifically agrees that the inherent covenant of good faith and fair dealing applies to the relationship between Buyer and Broker as to the commission of Broker due from Seller.

This clause shall be presumed to have been breached if Buyer purchases the Business from the Seller during the Commission Term and with the Buyer's knowledge that the sale of the Business did not include payment of the commission due from the Seller to the Broker.

C. Offer to Purchase – Suggested Provisions

1. Establish the Buyer's Acknowledgement of the Commission Owed to Broker:

The Buyer and Seller acknowledge that in accordance with that certain Exclusive Listing Agreement between the Seller and the Broker, the Broker is entitled to a commission, the payment of which is due Broker at the Closing, based upon the Total Purchase Price (the "Commission").

2. **Create Safeguards to Ensure Payment:**

Seller and Buyer authorize and instruct any person or entity who may be handling the closing of the Business to pay and disburse out of the sale proceeds directly to Broker, an amount equal to the Commission. Further, such person or entity handling the closing of the sale of the Business is entitled to rely on the written instructions and directions of the Broker for the payment of the Commission as long as the person or entity handling the closing is given a copy of this Offer to Purchase.

The Seller and Buyer acknowledge that a breach hereof would cause severe, and possibly irreparable harm to Broker. The parties therefore agree that the Broker may bring an equitable action to specifically enforce the terms of this clause in advance of actual breach where either the Seller, Buyer, or the closing person or entity has threatened to breach any of the terms of this clause.

3. **Escrow Clause:**

All deposits shall be held by the Broker in its escrow account. The Broker shall have no liability to the Buyer or the Seller for any action or omission that the Broker takes or makes in good faith and which is believed by the Broker to be authorized or within its rights to do. Furthermore, the Buyer and Seller covenant and agree jointly and severally to pay on demand, as well as to indemnify and hold the Broker harmless from and against, all costs, damages, judgments, attorneys' fees, expenses, obligations and liabilities of any kind or nature which in good faith the Broker may incur or sustain in connection with or arising out of the holding in escrow of deposit(s) which pertain to this Offer.

4. **Survival Clause to Avoid a Purchase & Sale Agreement Superseding Offer to Purchase Terms That Are Favorable to Brokers:**

The Buyer and Seller agree that all provisions of this Offer pertaining to the Broker shall survive the execution of any Purchase & Sale Agreement executed by the Buyer and Seller.

III. **Co-Brokerage**

A. **Suggested Disclosures**

1. **Listing Broker Disclosure to Seller:** Listing brokers should seek Seller authorization to co-broker the Seller's business, including the sharing of defined information with co-brokers.
2. **Co-Broker Disclosure to Buyers:** As a best practice, co-brokers should establish, in writing, with buyers whether the co-broker acts as the Listing Broker's sub-agent or as a Buyer's Agent.

B. **Recommended Section to Include in Exclusive Listing Agreement (assumes participation in the Business Brokers Alliance of New England)**

1. **Authorization by the Seller to Permit Co-Brokering:**

Seller is aware that Broker participates in the Business Brokers Alliance of New England (BBANE), a co-brokering alliance of business brokers whose purpose is to expedite the marketing

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of businesses such as Seller's Business to Qualified Prospects affiliated with BBANE members.

- Seller authorizes Broker to co-broker this listing _____.
- Seller does not authorize the Broker to co-broker this listing _____.

By authorizing Broker to co-broker this listing, Seller further authorizes Broker to:

- a. Post the following Seller information to the BBANE website: (i) Description of the business; (ii) Asking Price; (iii) Most recent year's sales; (iv) Most recent year's owner's cash flow (SDE); (v) Inventory value and whether included in Sale Price; (vi) Financing; and (vii) Reason for sale, including whether the business is re-locatable; and (viii) Non-Routine Restrictions imposed by a seller.
- b. Release Seller's CBR to qualified prospects referred by a co-broker provided that: (i) Broker exercises substantial effort before determining that the co-broker's referral is a qualified prospect; and (ii) All qualified prospects execute a Confidentiality Agreement specific to the Business.
- c. Share a percentage of the Commission with the applicable co-broker.

C. Agreement Between The Listing Broker & Co-Broker – Recommended Sections

1. Ensure Co-Broker Properly Shares Seller Confidential Information:

Prior to sharing the identity, availability for sale, or any other confidential information relating to the Business, Co-Broker shall require every prospective purchaser to execute a non-disclosure agreement provided by or acceptable to the Listing Broker. Listing Broker reserves the right of final approval with respect to any such prospective purchaser.

2. Co-Broker's Written Obligation to Disclose Who The Co-Broker Represents (assumes sub-agency to the Listing Broker):

The Co-Broker shall clearly disclose, in writing, to any prospective purchaser that the Co-Broker and Listing Broker act as agents for the Seller of the Business.

3. General Indemnification Clause:

Broker and Co-Broker, including their respective agents, employees, officers, directors, shareholders and affiliates, hereby mutually agree to indemnify and hold each other harmless against any and all losses, claims, damages, expenses or liabilities whatsoever, joint or several, which may arise out of or in connection with their respective performances of this Agreement, where the party found to have been at fault in any action for breach, tort or otherwise, in relation to this Agreement shall make the other party hereto whole for all damages, costs, interest and attorney's fees incurred by said other party in defending against said action.

IV. General Legal Tips for Brokers to Consider at The Outset of A Listing

1. Confirm that corporate records are updated (annual meetings, annual reports, officers, directors, stock certificates, etc.).
2. Check corporate By-Laws and LLC operating agreements to ascertain whether a required

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percentage interest to authorize a sale of substantially all the assets of the business is required.

3. Determine how commercial leases address assignment/sublet clauses and also determine whether commercial leases include options to extend.
4. Determine whether regulatory boards will need to be involved in business sales (ex.: liquor license transfers).
5. Check for liens, encumbrances and adverse claims (real and personal property; litigation; governmental/administrative proceedings) associated with the Seller's business.

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Exhibit "A"



SELLER'S DISCLOSURE STATEMENT

Company Name

This series of questions and answers is to inform the prospective buyer about this transaction. It has been done by the seller to provide relevant information and to answer frequently asked questions, but it does not take the place of the buyer's inspection of the business and of its financial and other records. These things must be carefully examined and approved by the buyer. This information is not a warranty. *Touchstone Advisors has verified neither the accuracy nor completeness of any of the information supplied here by the seller.*

A. Business Conditions	Yes	No
1. Are you aware of any circumstances in the industry or market area of the business that may adversely affect the future profitability of the business?	_____	_____
2. Are there any revenues or expenses of the business that are not clearly reflected in the financial statements you will be presenting to the buyer?	_____	_____
3. Is the business in default on any of its financial or contractual obligations?	_____	_____
4. Has the business or any of its owners been the subject of any bankruptcy filing, assignment for benefit of creditors or insolvency proceedings of any kind during the last five years, or consulted with any attorney or advisor regarding such proceedings?	_____	_____
5. Is there any one customer who accounts for more than 10% of annual gross sales? If Yes, list each by name and indicate the approximate percentage of the annual gross sales and any relationship to the business or its owners.	_____	_____
6. Are there any commitments to employees or independent contractors regarding future compensation increases?	_____	_____
7. Are there any suppliers who have a personal or special relationship with the business or its owners? If Yes, list them by name and indicate the approximate amount of annual purchases from such suppliers and describe those relationships.	_____	_____
8. Are any of the employees or independent contractors related to any of the owners of the business or to one another? If Yes, list by name and describe their relationship.	_____	_____
9. Have you had or do you anticipate any disputes with the landlord or problems with the premises the business occupies?	_____	_____
10. Is there any equipment used in the business that it does not own?	_____	_____
11. Is there any equipment used in the business that is not in good and operable condition, or for which maintenance has been deferred or is not suitable for the current usage?	_____	_____
12. Are there any terms or conditions of the premises lease with which the business or the landlord are not in full compliance?	_____	_____

Initial_____ Initial_____

Date_____ Date_____

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Business Conditions (continued)

Yes No

- 13. Is the business a franchise or a distributorship? If Yes, please provide a copy of each such franchise or distributorship agreement _____

- 14. Have there been any deaths, violent crimes or other criminal activity on the premises within the last three years? _____

- 15. Are you aware of any substances, materials or products on or near the premises which may be an environmental hazard such as, but not limited to, asbestos, formaldehyde, radon gas, paint, solvent, fuel, medical waste, surface or underground storage tanks or contaminated soil or water? _____

B. Regulations

Yes No

- 1. Is the business or its operators required to have any licenses or permits other than a local business license? _____

- 2. Must the new owner personally qualify for any license or permit? _____

- 3. Are there any alleged violations filed or under investigation by authorities issuing licenses or permits by the following agencies?

	Yes	No		Yes	No
Police Department	_____	_____	OSHA	_____	_____
Health Department	_____	_____	Fire Department	_____	_____
Building Inspector	_____	_____	Internal Rev. Ser.	_____	_____
Zoning Commission	_____	_____	Franchisor	_____	_____
Water Pollution Control	_____	_____	Fire Department	_____	_____
Environmental Protection Agen.	_____	_____	Dept of Consumer Protection	_____	_____
Department of Insurance	_____	_____			

- 4. Are you aware of any pending zoning changes, redevelopment or nearby major construction that might affect your business? _____

C. Legal Considerations

- 1. Does the business have any of the following?

	Yes	No
Union or other employment agreements	_____	_____
Employee stock ownership plan (ESOP)	_____	_____
Unfunded pension liabilities	_____	_____
Back wages or claims for same	_____	_____

Initial _____ Initial _____

Date _____ Date _____

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SELLER'S DISCLOSURE STATEMENT (continued)

C. Legal Considerations (continued)

	Yes	No
Unpaid medical or insurance premiums	_____	_____
Lease agreements (other than the premises)	_____	_____
Equipment maintenance agreements	_____	_____
Advertising contracts (including Yellow Pages)	_____	_____
Outstanding contracts or agreements	_____	_____
Pending litigation	_____	_____
Unresolved insurance claims	_____	_____
Product liability exposure	_____	_____
Customer warranty obligations	_____	_____
Tax or Workman's Compensation refunds	_____	_____
Anticipated supplier rebates	_____	_____

D. Other

Yes No

1. Are there any other facts or conditions not disclosed above that may adversely affect the operation of the business or a buyer's decision to purchase? _____

2. During the past two years, were there any significant sales or sales within a category which were substantial in aggregate and which are not likely to repeat within the next two years? If so, please identify, listing customer(s) and amounts. _____

IF YOU HAVE ANSWERED YES TO ANY OF THE ABOVE QUESTION, PLEASE ATTACH A COMPLETE EXPLANATION

SELLER(S)

Seller's name
Company Name

Buyer Name
Company Name

Date: _____

Date: _____

BY INITIALING BELOW, SELLER(S) CERTIFIES THAT THE ABOVE INFORMATION HE HAS PROVIDED IS TRUE AND CORRECT AND ACKNOWLEDGES RECEIPT OF A COPY OF THIS DISCLOSURE STATEMENT.

Initial _____ Initial _____
 Date _____ Date _____

BY INITIALING BELOW, BUYER(S) ACKNOWLEDGES RECEIPT AND APPROVAL OF THIS DISCLOSURE STATEMENT SIGNED BY THE SELLER (s).

Initial _____ Initial _____
 Date _____ Date _____

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Exhibit "B"



Authorization to Commence Marketing Effort

By this addendum Touchstone Advisors, LLC is authorized to commence efforts to market and sell the business known as:
COMPANY NAME

Parameters of Sale may include the following terms:

- (A) Cash at Closing 50 to 100%;
- (B) Earn-out of remaining purchase price over 1 to 5 years;
- (C) Employment or Consulting Agreement with Owner(s);
- (D) Promissory Note with Owner(s);
- (E) Covenant not to compete with Purchaser.

Total Anticipated purchase price is between 5.0X and 7.0X EBITDA, depending on the terms, employment or consulting agreement(s), growth, and earn-out.

Total Consideration anticipated \$17,500,000 and \$24,500,000.

This Addendum is part of the Engagement Agreement dated April 29th, 2009.

SELLER NAME
COMPANY NAME

SELLER NAME
COMPANY NAME

Date: _____

Date: _____

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