

How to Buy a Business

The subject of how to buy a business is addressed by summarizing issues that are likely to arise when you buy a business. The focus is on three stages that you may encounter when you buy a business: the letter of intent stage, the due diligence stage, and the purchase agreement stage. For those interested in bankruptcy sales, the bankruptcy sale process is briefly discussed. The article also reviews topics that may be of interest when you buy a business, including the difference between an asset purchase agreement and stock purchase agreement. AbdulJaami, PLLC provides legal advice about business law, corporate law and contract law. Our attorneys will help you buy a business.

[AbdulJaami, PLLC](#)

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If you are interested in finding out how to buy a business, it is likely that your goal is to do at least one of four things: (1) control your destiny – “do your own thing”; (2) stop working for someone else; (3) make the best use of your skills and abilities; (4) make money – the maximum amount of money with the least amount of capital. If you are not a United States citizen, you may want to buy a business so that you can live in the U.S. (for more information, see [Buying a U.S. Small Business](#)).

This article will help you learn how to buy a business. The process of buying a business is broken down into three stages: (i) the letter of intent stage, (ii) the due diligence stage, and (iii) the purchase agreement stage. The purchase agreement section includes a discussion of the difference between an asset purchase agreement and a stock purchase agreement. The article also includes an overview of bankruptcy sales and how to buy a business free and clear of liens and liabilities. Finally, the article briefly highlights topics that may be of great interest to you when you finally buy a business.

How to Buy a Business – Letter of Intent

The letter of intent stage marks the beginning of your serious efforts to buy a business. You will have already found potential businesses through methods such as internet searches, local or national newspapers, directly contacting businesses that you are interested in or even hiring a business broker. You will have also reviewed basic information about the businesses that you discovered during your search, and you may have even entered into one or more confidentiality agreements so that you could take a closer look at the businesses that caught your attention. Now, having completed your initial research, you are ready to begin serious negotiations with the seller so that you can finally buy a business.

The letter of intent is your preliminary agreement with the seller for the purchase and sale of the seller’s business. At its most basic level, the letter of intent says that, as long as certain things that are specified in the letter of intent happen or do not happen, seller will sell its business and you will buy the business. The letter of intent may also be referred to as an agreement in principle, or a memorandum of understanding (MOU).

When you negotiate the letter of intent, your focus will be on gaining access to further information about the company. You will also want to increase your opportunity to buy the business by minimizing the chance that seller will sell to someone else looking to buy a business. You will also want to ensure that you can walk away from the deal without liability if you find something you do not like. Letters of intent are sometimes treated as binding agreements under U.S. law and should therefore be negotiated with care.

Whether or not you formally enter into a letter of intent, the letter of intent stage is the period when you and the seller get serious about negotiating your purchase of seller’s business.

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How to Buy a Business – Due Diligence

The due diligence stage is the point at which you begin to thoroughly investigate the company by reviewing non-public information that you previously did not have access to. If you negotiated a letter of intent, you may have devoted time to addressing the structure of your due diligence review and related due diligence issues. The goal of due diligence is to get a good understanding of the risks and rewards associated with buying a particular business. Business acquisition due diligence typically focuses on four areas: (i) legal due diligence, (ii) business due diligence, (iii) operational due diligence, and (iv) financial due diligence.

Structured due diligence is the most effective acquisition due diligence. This helps you to minimize your risks when you buy a business. Ideally, you will have already thought about key areas of concern and developed a due diligence checklist. You can then give the due diligence checklist to the seller and request that seller provide you with information that addresses the particular concern. An example of some typical concerns follows:

Focus of Acquisition Due Diligence Efforts

Broad Topics of Concern

Business due diligence	<ul style="list-style-type: none"> • Products • Customers • Suppliers • Markets and Sales • Competitors
Operational due diligence	<ul style="list-style-type: none"> • Personnel • Capital expenditures • Technology/Information Technology • Supply Chain
Financial due diligence	<ul style="list-style-type: none"> • Property, Plant and Equipment • Revenue • Cost of Goods Sold • Accounts Receivable • Inventory • Liabilities and Accounts Payable
Legal due diligence	<ul style="list-style-type: none"> • Corporate Documents • Tax Filings • Material Contracts • Litigation • Employment • Government Regulation • Intellectual Property • Environmental



How to Buy a Business – Purchase Agreement

The business purchase agreement is the definitive agreement between you and the seller and means that you are near the end of your quest to buy a business. Although the complexity of the purchase agreement will depend on the particulars of your transaction, all purchase agreements share a common structure.

Generally, the purchase agreement begins with contract provisions that discuss the cost of buying the business and the legal structure of the transaction. The purchase agreement will include buyer and seller representations and warranties. When you buy a business, the representations and warranties provide you with legal assurance that certain facts are true. If you find that those facts are not true, you may be able to walk away from the deal or require the seller to indemnify you for any loss you suffered. A simple example of a representation and warranty is seller stating that the business does not have any debts as of some specific date. If you find out that the business did have debts on or after that date, you either might not have to buy the business or, if you already consummated the transaction, might be able to claim indemnification from the seller.

The purchase agreement will also contain covenants which are your promises to seller and seller's promises to you. The covenants may either be promises to do something or promises to not do something (negative covenants). A business purchase agreement's negative covenants will usually be from seller to buyer and will usually deal with seller's operation of the business between the time you begin negotiating to buy the business and you actually own the business "lock, stock and barrel." Other important purchase agreement provisions deal with closing conditions, indemnification and boilerplate provisions. (See [Sample Contract](#) to learn more about basic contract structure.)

Business purchase agreements are generally of two types: (i) the asset purchase agreement, and (ii) the stock purchase agreement. An asset purchase agreement is a purchase agreement that you use to buy a business by purchasing the assets of the business. A stock purchase agreement is a purchase agreement that you use to buy a business by purchasing the business's stock or equity. Some of the benefits and drawbacks of an asset purchase as compared to a stock purchase are as follows:

	Asset purchase agreement	Stock purchase agreement
Potential benefit	<ul style="list-style-type: none"> • Fewer formalities • No need to transfer each asset 	<ul style="list-style-type: none"> • Ability to choose particular assets • Can choose to assume/not-assume one or more liabilities • May not need consent of all shareholders
Potential drawback	<ul style="list-style-type: none"> • Need consent of all shareholders • Not practical if there are many shareholders • Assume all liabilities 	<ul style="list-style-type: none"> • Must separately transfer each asset, including real estate • Transferring assets may be time consuming and costly



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| <ul style="list-style-type: none"> Contingent liabilities “hidden” | <ul style="list-style-type: none"> May need to get third-party consents to transfer leases, contracts, intellectual property, etc. May disrupt business relationships including customer, supplier, employment |
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How to Buy a Business – Bankruptcy Sales

If you are interested in buying a business that is experiencing significant difficulties, it is possible to buy a business through a bankruptcy sale. Chapter 11 of the U.S. Bankruptcy Code allows a company that has entered bankruptcy, a “debtor,” to sell assets. The bankruptcy court may allow the debtor to sell substantially all of its assets. You may be able to buy a business through bankruptcy sales in two different ways: (i) by purchasing substantially all of the assets of a business, or (ii) by purchasing assets from or a business division of a large company.

Section 363 of the Bankruptcy Code allows a debtor to sell assets free and clear of all liens. This means bankruptcy sales may allow you to buy a business without buying many of the problems that put the business into bankruptcy. A potential downside is that bankruptcy sales require that you invest more time and effort in order to buy a business.

A purchase of assets through a section 363 bankruptcy sale can be completed in 30 to 60 days by making a motion to the court. However, if you are buying substantially all of debtor’s assets, a section 363 bankruptcy sale on motion may not be available. Instead, the court may require that you buy the business through a plan of reorganization. If the court requires a plan of reorganization, it will take significantly longer than 30 to 60 days for you to buy a business. It is possible that if the purchase price is fair and reasonable, and the debtor can show that a preplan bankruptcy sale is necessary to preserve the value of the business as a “going concern,” the court may allow the section 363 bankruptcy sale to proceed on motion.

How to Buy a Business – Topics of Interest

As you continue to research how to buy a business, you will begin to identify areas of concern that are of particular interest to you. Certain questions such as how to legally structure the transaction, the availability of financing and possible alternatives, and the identification of various areas of potential liability, always come up. Make notes of your areas of concern so that you are better positioned to buy a business. The below table will help you get started.

Topic of Interest	Subtopic
Legal structure of purchase	<ul style="list-style-type: none">Stock purchaseAsset purchaseStatutory Merger
Financing	<ul style="list-style-type: none">BankSeller financing

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Licensing/Regulatory

- Other
- Regulations the business is subject to
- Intellectual Property licenses
- Seller's ability to assign IP/Regulatory licenses

Potential Contingent Legal Liability

- Environmental
- ERISA
- Product Liability
- Creditor Claims

Employment Issues

- Employment Agreements (survival of old; new)
- Noncompetition Agreements
- Incentives (equity or otherwise)

Tax Effects

- Taxable Transaction
- Installment Sale
- Tax-free Reorganization

Conclusion

Hopefully, this article has taught you something about how to buy a business. You should now have an idea of the three general stages that you will encounter when you buy a business. The three stages, letter of intent, due diligence and purchase agreement, interconnect. During the letter of intent stage, you should begin thinking about the information that you need to make a decision about whether to buy a particular business. The due diligence stage is your opportunity to request specific information to better understand potential risks and rewards. The purchase agreement stage is when you use the information gained from due diligence to shape the business purchase agreement to best protect you. The article gave a brief overview of the potential of bankruptcy sales to increase your ability to buy a business. Finally, the topics of interest table should better position you to buy a business.

If this article was helpful, please forward the link to a friend or colleague.

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