

to deal adequately with them, one need only review some of the examples appearing in previous chapters. These examples are valuable even though they were offered to illustrate other points. Particularly noteworthy would be Examples 8.3 and 8.9 showing bad lawyers in action. Further examples will be shown below.

The reader has already seen examples of bad lawyers in action. It is time for an example of a good lawyer in action and the concomitant benefits. Example 10.1 is offered below. This example also will illustrate why the extra effort to find a good lawyer is more than justified.

Example 10.1 A prospective buyer responding to a broker's advertisement announces that he has been searching for this kind of a business for several years and that now that he has found it, is intent on making the purchase. Almost in the same breath, the buyer states that there is something that the broker needs to understand. He (the buyer) generally gets along with people but only up to a point. Past that point, he walks away. Once he walks, he never comes back. Never. The broker expresses his understanding of the buyer's needs, then proceeds to describe the business and answer the buyer's questions. Although the business has not shown a profit in the last three years, the poor performance is apparently explained by the absentee ownership (the owner lives in a distant city) and by suspected ongoing employee theft. The business shows strong potential for a buyer who will manage full time on the premises, as this buyer plans to do.

The buyer is provided ample financial data but the data are hard to understand (partly due to disorderly bookkeeping). The buyer consults with his lawyer who, after examining the data, calls in a respected accountant for analysis. The accountant, with the lawyer overseeing, prepares cash-flow projections showing a lucrative return on investment if the business can be bought for \$400,000. If bought at the seller's price of \$550,000, the business might still be a good investment but would involve more risk and

turnaround speculation than the buyer cares to accept. Further, the buyer can only put \$65,000 down and will need seller financing for the balance. Bank financing would be difficult because of the recent failure to show a profit and, possibly, because of a declining neighborhood. After the broker's commission of 9%, the seller will realize only \$29,000 cash at closing and will have to pay his legal fees and taxes out of that.

The lawyer writes a letter of intent for the buyer's signature similar to the one written by Acme Widget's buyer in Figure 8.1. That letter, like the one for Acme, is cordial and workmanlike in tone. Then the lawyer writes another letter, also for the buyer's signature, to explain the buyer's low offer and put everything in perspective for both buyer and seller. That second letter, to cover the letter of intent, reads as follows:

Dear Mr. Smith:

I realize that my offer in the enclosed letter of intent falls short of your price and that it will be disappointing to you. I sincerely wish that I could offer the full \$550,000 simply because the business seems worth that much and because I want to be as fair as possible. I am limited, however, by modest funds and my family responsibilities. This is the best I can do.

If you would like to put my offer aside while trying to find an offer closer to the true value of your business, I will understand. In the meantime, I will keep my offer open in case you wish to reconsider.

Respectfully,

Charles Brown (signed)

A few days after the buyer mails the offer, the broker receives a long-distance telephone call from the seller. The call is not pleasant. In vituperative terms and with scathing voice, the seller scolds and berates the broker for having sent an unqualified buyer. The scolding lasts for four or five minutes. Then, without the broker having said more than a word or two, the seller says that he will get back later and he hangs up. Only then does the broker realize that this was the seller's way of accepting the offer.

A day or two later, the buyer's lawyer calls the broker to discuss the deal. After only a minute or so, the lawyer interrupts himself to ask the broker if he has spoken to the seller yet. The broker says that he has but that it wasn't very pleasant. Then the lawyer reveals that he too was severely scolded and that he has already gotten it twice. The lawyer adds that he does not understand the seller nor does he relish further conversation with him. All that really matters is closing the deal. The broker agrees and now they have a team of sorts working to the mutual satisfaction of their clients. They also have a bond of sympathy. And they are working for the same goal even though, in a sense, their respective clients are adversaries.

The lawyer takes charge of the deal, prepares the proper documents, mails them to the seller, and negotiates the details with the seller's lawyer. Then a problem arises. The seller informs the buyer's lawyer that he refuses to provide all of the financing. He will settle for the price offered but he wants more cash. The lawyer describes the problem to the broker and asks if he knows of a solution. The broker says no, then they cordially say goodbye. Several days go by with the deal in limbo. Then the broker reconsiders and calls the lawyer to offer to take a note in partial payment for the commission. The lawyer is delighted, predicts that the broker's sharing the financing will unblock the deal, and is proven to be right.

Now the deal is running smoothly, at least legally. Extralegal-

ly, it is also running smoothly except that the seller continues to call both the lawyer and the broker to inflict such verbal abuse as neither has heard before and that both find increasingly hard to tolerate. One day, the seller's wife calls the broker and proves to be her husband's match at scathing vituperation. (The broker wonders how two persons of such temperament can exist under the same roof but he puts the thought aside as not being pertinent to the deal.) In any case, one thing is good: the buyer has been spared any of the abuse and the deal is being preserved because of it.

With all the details falling into place—the buyer's lawyer has taken care of permits, the lease, equipment checkout, and so on—the closing is set to occur in the office of a local lawyer who will represent the seller. The seller will fly to St. Louis to attend. (The seller's wife will have signed in advance and will therefore not have to accompany her husband.)

Now the day has arrived for the closing. The attendees are the seller, the buyer and his wife, the two lawyers, the broker, the lessor's agent, an insurance agent, and two others acting in advisory capacities. They are seated around a conference table with the seller at the head of the table and with the buyer at one side with his lawyer next to him. The meeting begins with such routine matters as minor questions to be answered, which documents are to be signed, and so forth. Then the seller brings up the matter of inventory evaluation. It is not nearly enough to pay for the quantity included in the sale or for the quality of it. The buyer's lawyer modestly explains how the evaluation was made. The explanation is unsatisfactory to the seller, one thing leads to another, and the seller launches a scathing attack. The attack itself is not a surprise nor is the severity of it. The surprise is that it does not end but goes on beyond reason—six minutes, eight minutes, maybe longer—but way beyond the point of being a simple emotional outburst. The seller is out of control, the deal now seems threat-

ened, and nobody in the room knows what to do. The buyer's face has already turned red when the seller's attack turns personal and he challenges the buyer to make an explanation. At this point, the seller stops bellowing and waits for a reply whereupon the lawyer, seeing his client's distress, slips his arm around the buyer's shoulders and says, "Charlie, you've waited too long to find this business to lose it now. Let me do the talking." Before the lawyer can say anything, however, the seller resumes his attack with no letup in severity. It has been ten, maybe 12 minutes since the attack began with still no end in sight. Now everyone in the room is stupefied except the lawyer who still has his arm around the buyer but who now places his other hand on top of the buyer's and takes hold. It is clear that the lawyer is going to get that business for his client and that no one is going to stop him.

Now another surprise. The seller himself turns red, he quits his tirade, and walks briskly out of the room without saying a word. The others remain in their chairs, mostly dumbfounded, and wonder what in the world will happen next. After a few minutes, the seller has not returned. The others stand and mill about. Ten more minutes go by, someone looks to no avail down the hallway and in the men's room, then speculation becomes rife on the seller's intentions. No one has an answer so all stand by and wait. Finally, 45 minutes after the seller had walked out, he returns as though nothing had happened, the closing resumes, and it is over in 20 minutes. The buyer has his business, the seller has his payment, the broker has his commission, everybody is at least quiet, if not satisfied, and the deal is done.

Note all that the buyer's lawyer did that was right and some things he did not do that would have been wrong: he recognized his own limitations in financial analysis and hired a good accountant, probably an auditor experienced in digging through mazes of data, to do most of the work, an exceptionally noteworthy action considering that this lawyer was expert in estate planning

and taxes. He recognized the value of cash-flow projections in preparing an offer. He recognized the value of a letter of intent. (Incidentally, that lawyer's letter became the model for the letter described in Chapter 8.) He wrote a cover letter which was praiseworthy for the concept but even more so for its execution and its achievement of a preemptive first strike. That cover letter was a psychological gem which, stripped of its polite phrasing, required the seller to take it or leave it, but did it so palatably that the seller accepted a disagreeable offer. The lawyer established a team spirit with the broker. He might have questioned the amount of the broker's commission (as other lawyers occasionally do) but, whatever his thoughts, he wisely kept them to himself. When the seller insisted on more cash up front, the lawyer described the problem to the broker in gentlemanly terms and never even hinted at a solution involving the broker's commission. In other words, he maintained a team spirit and continued to encourage positive thinking by all parties concerned. Moreover, he bore the brunt of the seller's abuse although, to be sure, the broker got battered too. The lawyer remained calm throughout and never let his focus stray from the goal of the transaction: to get that business for his client. At the closing, he monitored his client's feelings, saw his client's distress, gave support when support was called for, and did it under fire. The lawyer helped his client fulfill the dream of a lifetime and to do it at a bargain price.

As a corollary, the lawyer protected the interests of the secondary parties. The employees' jobs were preserved, as were the business's services for the customers. And the community received a much needed lift from the competent new management.

Despite the lawyer's good performance, however, his cover letter is subject to question. The take-it-or-leave-it offer could have been rejected, losing this dearly-sought business for his client. In reply, had the seller rejected, the buyer could have reconsidered and reopened the negotiation, albeit with some loss of credibility. In any case, it is presumed that the buyer and his lawyer discussed these possibilities and acted accordingly. On the other hand, the \$400,000 limit may have been genuine for the exact reasons given, in which case it was no bluff. If that is the case, the lawyer is a hero for snatching that

business for his financially limited client. Whether or not the offer actually was a bluff, no one will ever know except the lawyer and his client.

(Incidentally, the buyer started his ownership with a bad break: A major piece of equipment ruptured just six weeks after closing and cost \$25,000 to replace. That hurt the buyer but made his fiscally conservative offer look good. Fortunately, the buyer exceeded his own sales forecast. New customers were recruited and old customers were lured back to try the new, improved management, and, at last report, he was doing well. As for the broker's commission, the seller was late on the first and last installments but did complete payments eight months after closing, just two weeks later than promised.) Example 10.1 showed how beneficial a good lawyer can be and provided a standard for lawyers to emulate. Example 10.2 very sadly shows the opposite. It also shows why brokers sometimes refer to lawyers as "deal-killers." Although such epithets are not only mostly untrue and unjust, but also immoral because of their false generalization, they are understandable in light of such examples as the following.

Example 10.2 This example is a continuation of Example 9.1 wherein the owners of a small manufacturing company were forced to sell after 30 years in business due to old age and the husband's declining health. The owners, lacking business acumen, had financed the purchase to an unqualified buyer and, in only a few months' time, were forced to take back a damaged business, losing their entire \$60,000 down payment and more.

Now the owners list with a broker who, only a few weeks after listing, has the good luck to introduce them to qualified buyers, another husband-and-wife team. The buyers are delighted to find this business not only because it suits their desires so well but also because they have been looking for several years and now are enjoying their first sweet taste of success. The husband will manage the shop and the wife will manage the retail store and office. The salient part of the matchup is that the business needs sales badly while the buying husband has had a long and successful career in

sales. Even better, his specialty is making cold calls; with the attractive product line this company has, there is no question that he will bring in new business.

After carefully and cautiously fact-finding the business for about four months—with the buying husband spending many hours in the shop getting a detailed introduction to overcome his weakness in manufacturing—the buyers make an offer and negotiate a cash price of \$180,000 contingent on bank financing. Considering that the shop equipment required to manufacture the product line would probably cost at least two or three times the purchase price to replace, and considering that the business has national potential which the buying husband has the skill to exploit (he makes sales calls regularly throughout the United States and Canada), the agreed price is a bargain. The broker prepares a loan application, including cash-flow projections, which is accepted at the first bank he approaches contingent on obtaining SBA participation. The banker, noting how well established the business is, the relatively safe product line, and the good matchup of the buyers to the business, compliments the broker on the matchup and explains that the only reason he insists on SBA involvement is that it is a procedural requirement (at least at his bank) for most depressed businesses.

With financing now practically secured, the broker prepares a contract (on a pre-printed form) for the buyers' signatures, whereupon the buyers hire an accountant and a lawyer. A few days later, the buyers' lawyer calls the broker to discuss the contract. The lawyer's tone is not cordial, but cold and barely civil, and he has a few comments and questions, mostly for clarity on minor items. One of the questions involves his clients' making a \$100 earnest deposit. The broker, who sees earnest deposits as useless nuisances except in cases where they have a clearly identifiable purpose, asks the lawyer for his reason. The lawyer gives a vague response. The broker asks if the deposit might be to somehow give weight to

the buyers' enforcing the contract should the sellers for some reason wish to back out. The lawyer says yes. Then the broker asks if the sellers, who have spent 30 years of their lives building this business, should be expected to allow themselves to be tied down by a deposit of \$100. The lawyer says that yes, that is the idea. The broker says that he will run it by the sellers and see how they feel about it. Not much more is said and the conversation ends. Now the sellers and their broker wait for the signed contract to be submitted or at least to be sent back with changes.

A few days later, the buyers call to inform the broker that they have lowered their offer to \$140,000. They also have decided to refuse bank financing, especially with SBA involvement, and will insist on seller financing. The broker notices that something else has changed. He used to have—or at least he thought he used to have—good rapport with the buyers with a friendly, forthright relationship and open flow of ideas. Now the buyers are addressing the broker with a disrespectful tone and snippiness. The broker questions the change in price. They reply that their lawyer told them that brokers always get the highest prices that buyers are willing to pay because that way brokers get the highest commissions. The broker's intuition tells him not to prolong this conversation but he feels justified to ask why their refusal of bank financing. The buyers reply that this is the way they want it. The broker then thanks the buyers for calling and politely says goodbye.

After informing the sellers of the status of the deal (and feeling terrible about it), the broker waits a day to allow his thoughts and his feelings to settle and then calls the buyers' lawyer for explanations. That conversation is best described by the following letter from the broker to the lawyer. The letter is edited for purposes of disguise. Personal names are fictitious.

March 15, 19xx

J. Q. Lawyer
Smith and Jones, Attorneys at Law
xxxx Forsyth Boulevard
St. Louis, Missouri 63105

Dear Mr. Lawyer:

This letter is in response to our telephone conversation of last Thursday when you advised that it would take longer, in case of a default on a business loan, for a seller-financier to take the borrower's home than it would for the SBA. Your reasoning was that the seller would have accepted an unsecured promissory note and would thus be forced into lengthy litigation, while the SBA, having the borrower's home as collateral, would swiftly foreclose and force the borrower out on to the street. You also felt that seller financing could be had at a lower rate and that it would give the seller an incentive to help the buyer, should the business develop problems. Thus you have advised Bob and Mary Butler to avoid the SBA and to obtain seller financing.

To determine the SBA's policies in dealing with defaulted loans, I telephoned the following parties last Thursday and Friday:

Mr. John Tucker
Office of Business Development
xxxx Elm Grove Avenue
St. Louis, Missouri 63100
123-1234

(The OBD is supported by municipal tax funds for the purpose of providing certain kinds of assistance to business people in the City of St. Louis.)

Mr. Al Peters, Assistant Vice President
Friendly Bank of Missouri
21555 Main Street
St. Louis, Missouri 63100
123-2345

Ms. Diane Carter
Small Business Administration
815 Olive Street, Room 999
St. Louis, Missouri 63101
539-6600

Mr. Don Johnson
Business Development Center
Scholarly University
St. Louis, Missouri 63100
123-3456

(The Business Development Center is staffed by University faculty and supported by federal tax funds to provide certain kinds of assistance to business people in the St. Louis area.)

Following is a summary of the comments I received from these parties. Their statements regarding the intent, the purpose, and the policies of the SBA were unanimous. When a borrower defaults on an SBA-backed loan, the initial efforts to collect are done by the banker who tries to work with the borrower. If something cannot be worked out (several months may elapse in the meantime), the bank collects from the SBA which, in turn, takes over in working with the borrower. The SBA fully intends to collect its loans. However, the SBA, being non-profit and in existence solely to assist business owners, will provide several alternatives for a problem loan. These include stretched-out pay-

ment plan, moratorium, and liquidation. The SBA prefers that stretch-outs and moratoriums be brief; however, they can last for years if the circumstances warrant. In some cases, the SBA has delayed payment indefinitely to the time when the borrower sells his home at his own convenience. Liquidation is considered a last resort and even then the business is liquidated first, and then the home. Since the SBA is the friendliest of all possible lenders or guarantors (except, perhaps, family), SBA participation is considered a major advantage to a borrower. In contrast, since the sellers in our transaction are in their mid-sixties, their patience, not to mention the patience of their attorney, would likely be considerably less than the SBA's. It would seem, therefore, that insofar as the safety of their home is concerned, the buyers will be much more secure with the SBA.

With respect to the lower interest cost usually associated with seller financing, assume that \$60,000 could be seller-financed for five years at 8% instead of 10%. (We must also assume, however questionably, that the sellers and their attorney would agree to an unsecured loan.) The amortization tables give us the following:

\$60,000, 5-year loan: at 10%	\$1274.83/month
at 8%	<u>1216.59/month</u>
savings = \$	58.24/month
annual pre-tax savings = \$	698.88
annual after-tax savings around \$	600
total 5-year savings around	\$3,000

I advised Bob and Mary of the possible savings about three

months ago when they were in my office contemplating their first offer. It was my advice then, as it is now, that due to the marginal savings combined with the sellers' very strong desire for cash, a cash offer would be preferable, more negotiable, and would probably result in a lower sale price. Thus, the buyers have already realized the benefits of seller financing by foregoing it in favor of a lower sale price.

With respect to maintaining the sellers' support during the term of the seller financing, the sellers' support is already assured during the first year of new ownership by the terms of the purchase and sale agreement, which you have a copy of. After the first year, even though the sellers intend to remain in St. Louis and to be available from time to time on a consulting basis, I have advised Bob and Mary not to buy this business if they do not feel comfortably capable of exploiting its potential using their own abilities. Granted that it is nice to have the sellers around for a few years in case there is a problem. But if the security of having them around for more than the first year enters into the decision to buy, then it is a bad decision based on false security. It is a bad decision because it places the buyers' focus on the wrong abilities, the sellers', instead of on the right abilities, their own.

Furthermore, there are other motivations, some of them powerful, for the sellers to help the buyers in the event of a problem. The sellers are also the landlords and they wish to collect the rent. The sellers' name will be retained by the buyers, providing the sellers, who are childless, with a form of perpetuity, and a very nice form at that. The continuation of the business also provides the sellers, who have a sense of propriety and rectitude, with the knowledge that their efforts and creations and all of the considerable quality they built into the business during the past thirty years

will not be lost to the community. Finally, the buyers, who themselves have a sense of graciousness and respect, have informed the sellers that they will always be welcome to visit.

In the unlikely case that the sellers are for some reason not available, the buyers can always hire a consultant.

There is one other aspect of this purchase and sale which bears mentioning. When a buyer of a business obtains financing through a bank, he may pay a higher interest rate than he otherwise would to the seller but, in exchange, he receives the banker's professional expertise in determining whether the business is viable, stable, and reasonably priced and whether he has the capability of running that business, developing its potential, and repaying the loan. Further, I sensed in our telephone conversation that you feel that the banks and the SBA don't care about the buyer; that as long as they have the collateral, they will lend money to unqualified buyers to buy undesirable businesses and simply foreclose when the business fails and move on to the next customer. My entire experience as a broker and consultant has been to the contrary. As an example, I recently sold a well established and profitable retail business, priced at \$20,000 plus \$80,000 inventory at cost, to a buyer whose net worth was \$600,000. The buyer had an MBA and an excellent track record during twenty-one years in industry. The buyer applied for a \$40,000 loan and offered both the business and his personal assets as collateral. Yet he was rejected by two banks because he had no sales experience. A third bank (which, incidentally, was Friendly Bank of Missouri) refused a business loan of any kind whether SBA-guaranteed or not but allowed that, in view of his very sizeable net worth, it might grant a small personal loan to be used as he saw fit. Other examples like this one could be

cited but I think you get the point.

To summarize the above, SBA financing is business-like, humane, and designed to be beneficial to the community. Seller financing and concomitant lower interest cost have already been looked at and dealt with and are not necessarily desirable anyway.

In closing, you could do a service to all of the parties involved, including Friendly Bank of Missouri and the SBA, if you would share with us the source of your insights on bank and SBA financing. It might also be helpful to know the source of your statement that most sales of businesses are seller-financed, especially if you include comparative rates of failure between seller financing and bank financing.

Perhaps we could serve our clients better in the future if you and I could discuss any business advice you might be proposing before you propose it. I myself tend to be extremely cautious about proposing legal advice. I would be happy to share my time and my knowledge at no cost to you or to Bob and Mary and they would get the benefit of advice which is more thoroughly thought out and much less contested. The purchase of a business usually inflicts a heavy emotional drain on both buyer and seller. If the banker, accountant, lawyer, and broker can work together, the transaction can be much more smooth and profitable for all parties concerned.

Yours very truly,

J. Q. Broker (signed)

Copy: Bob and Mary Butler

The broker hand-carries the letter to the lawyer's office to be sure

that it gets there, to promote a possible chat with the lawyer, and simply to get a look at the lawyer's office. The broker is greeted by the firm's receptionist who informs him that the lawyer is out sick today but that she will see that he receives the letter. The broker thanks the receptionist and exits.

The broker waits a few days in hopes of getting a response either from the lawyer or the buyers but none is forthcoming. The broker calls the sellers and learns that, since the broker's listing agreement has expired, the sellers have listed with another broker. The husband elaborates on what has transpired: he felt so depressed to learn what the buyers had done—especially after all the time he and his wife had spent with them over the last four months—that the same day that the broker had called with the bad news, he had called another broker selected from the *Yellow Pages*. That second broker then brought a buyer with no experience in manufacturing or in sales and who made the following offer: He would buy the business if the sellers would do 100% financing with no money down. In response, the seller told the second broker and his buyer to get out and not to come back. Now he regrets that he listed with the second broker and he apologizes for having done so and for removing him from any possibility—at least for the next six months—of further representing the sellers. The broker tells the seller that he understands the seller's feelings and why he acted as he did and that no apology is necessary. The broker now expresses how bad he feels about what happened, but that he does not know if there is anything he can do to make things right. The two say goodbye and the conversation ends.

A few months later, the first broker calls the selling husband to see how things are going and learns that the sellers have agreed to sell their equipment, inventory, and patents to a company from another city. They will receive a distress-sale price for the business, but have little choice because of the husband's health. The broker again expresses his regrets at the way things went. Their relationship is over.