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Post-closing seller liabilities when transferring a company - by Aaron Soury

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Approximately eight out of ten businesses fail within the first 18 months; only 4% make it to $1 million in revenue and only 0.4% to $10 million, according to Forbes. Thus, for any business owner having succeeded among the 500,000+ businesses started each year and come to the point where they are ready to sell is an impressive feat.

But, while managing and then transferring a business is a matter in itself, the life for the owner post-closing is quite a different challenge.

Post-closing, life will be without the same challenges as running a daily business–even though it is "very lonely at the top" for many entrepreneurs. Short of re-investing into a new venture, gone is the need for great leadership over large teams. And often the skillset of a great business leader does not transfer to social settings or other tasks. Furthermore, the influx of a considerable amount of money can become quite isolating for some as well.

"Despite the aforementioned, many business owners are 'burnt out' after fifteen to twenty years," said Achim Neumann, president of A Neumann & Associates, LLC, a N.J.-based mergers & acquisitions advisory firm, "and simply want 'out.' They often approach us to put a team of transaction attorneys, CPAs and M&A experts together to facilitate a business transfer in an efficient, confidential manner."

One key consideration in every business transfer is the post-closing liability for the business seller. Naturally, every buyer will attempt not to assume any liabilities, and likewise for a seller who won't want to continue carrying liabilities.

For example, this can include explicit liabilities such as product or service warranties, customer pre-payments, vendor payments, environmental or tax liabilities. Hidden liabilities exist as well, such as a negative change in customer structure, pending competitor pricing pressures, or endangered supply routes.

It's important that all knowable liabilities are clearly disclosed and allocated to the party assuming (or retaining) to avoid any post-closing litigation. Very often, such assignment is a negotiation of 'give and take' among the respective attorneys of either party during the Definitive Agreement formulation, but it can sometimes be resolved in the early stages during the deal negotiation phase by the M&A advisor (at much less cost).

Often, a part of the liabilities transfer can be avoided by structuring a deal as an asset sale, whereas the business buyer creates a new company acquiring clearly defined assets and liabilities.

Obviously, the lesser liability exposure a buyer has, the higher the deal price as any buyer will fold liability into a transaction price.

Sellers beware: A seasoned business buyer or investor–certainly a smart buyer's transaction attorney–will most definitely identify liability risks during the due-diligence phase.

Consciously not disclosing such liabilities, in an ultimately fraudulent transfer, will in all likelihood subsequently surface and result in litigation expenses at a multiple of the original liability expenses. If such a discovery was not already made in the due-diligence phase, there will be a complete loss of the seller's credibility resulting in an aborted transaction by the buyer.

In short, post-closing, many facets in the life of a seller will already change, and litigation due to improper liability limitation should be one aspect to be avoided.

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