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Real Estate, Business, Construction and Environmental Law Alert

10 Terms For Your Term Sheet

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Clients often ask what steps they need to take to buy or sell (or invest in) a business. Commonly, they need to finish hammering out the business terms with the other side and then prepare a Term Sheet (or a Letter of Intent (LOI), or Memorandum of Understanding (MOU)) to outline the principal business points.

The purpose of the Term Sheet is to create a road map for the transaction, so the parties know where they are headed as they enter into the deal. Although the "typical" Term Sheet is non-binding (more on that, below), it nonetheless is important to identify the key terms the parties have "agreed to agree" on if they ultimately go forward. The terms in the Term Sheet can be replaced with the final deal documents.

Here are "10 Terms for Your Term Sheet" for discussion with the other side along with other items unique to your deal:

1. Price and Consideration: This should identify what the parties are exchanging, for instance, a certain dollar amount in exchange for all or part of the company or a certain parcel of land or interest in a building. In addition, discuss whether the price will be paid in cash or some other property (e.g., stock in a company, real estate, services, etc.) and if financing is involved.

2. Structure of the Deal: If it is a business sale, confirm whether it is an asset purchase or a stock purchase. With an asset purchase, the buyer acquires certain assets

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while leaving other assets (and liabilities) with the seller. However, if it is a stock purchase, the buyer acquires the stock of the company (its assets as well as its liabilities). Naturally, when taking on broader liabilities, due diligence may become more important (see below). If it is a real estate deal, confirm the type of interest involved (e.g., fee simple, a phase of a condominium development, a lease, certain rights in a project, etc.).

3. Payment Terms: Discuss whether the buyer will pay a lump sum at closing or make payments in installments. If there are installment payments, discuss if they are conditioned on the company's future performance, such as the company reaching certain financial milestones. (In May 2011, I circulated a Memo on business succession and exit planning. Please contact me if you would like a copy.)

4. Is Financing Involved? If the buyer requires outside financing, discuss a financing contingency, obtaining appropriate commitment letters, complying with the lender's closing conditions, and providing some amount of down payment or deposit. If the seller is providing the financing, discuss the interest rate, term, and collateral to protect the seller. For instance, collateral may be a pledge of the company stock or business property or some individual assets of the buyer.

5. Due Diligence: The buyer may want a reasonable time to evaluate the assets, liabilities, operations and financial condition of the business. (See Confidentiality, below.) This may necessitate access to the seller's management and other representatives as well as financial data and other business information. If land or buildings are included in the deal, due diligence may include environmental, zoning, structural and other inquiry into the property.

6. Confidentiality: The buyer and its agents should anticipate that the seller may want them to sign a confidentiality and nondisclosure agreement related to the confidential business information that is provided during due diligence. Although the Term Sheet may be nonbinding, the Confidentiality provision may be identified as binding and surviving the expiration or earlier termination of the Term Sheet.

7. Assignment and Transfer Issues: The parties should attempt to identify the assets that need consent from a third-party to be transferred to the buyer. For instance, the transfer of real estate leases, customer or vendor contracts, and financing agreements may trigger third-party consent. In addition, consent may be required if there is a transfer of the company's stock or controlling interest even if the company's name on the underlying contract does not change.

8. Covenant Not to Compete: If the buyer wants the seller and its key employees to help run the business after the closing, the parties should reference employment agreements and consulting agreements that will need to be executed. If the buyer is prepared to run the business on its own, it may want to prevent the seller from

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competing for a certain period of time. In Massachusetts, noncompete agreements that are reasonable as to time, scope and geography are enforceable. (Please contact me if you would like a copy of the Memo I circulated in April 2012 on noncompete agreements.)

9. Exclusivity and "No Shop" Provision: Buyers often want to prevent the seller from using the offer to shop for a better deal. Thus, consider a provision preventing the seller from soliciting or negotiating alternative proposals during the due diligence and up to the binding agreement. Unlike other terms, this provision should be binding.

10. Post-Closing Obligations: The parties should specify the items they may need to complete after the closing, such as completing tax filings, obtaining approvals from third parties, consulting or employment agreements, and noncompete agreements

Although the terms of the Term Sheet limit the binding nature of the proposal, a buyer and seller can nonetheless agree to make all reasonable efforts to consummate the transaction in accordance with the terms they have outlined. If buyer's due diligence is successful, the parties can proceed to drafting the final documents, such as the purchase agreement, assignments, and consents, and proceed to closing the transaction and performing any post-closing obligations.

The buyer and seller should give the Term Sheet serious consideration even though it might seem informal due to its nonbinding nature. The key terms that have been negotiated will likely be difficult to re-negotiate once the parties get to drafting the binding purchase agreement and final deal documents.

Please contact me if you or a colleague have any questions regarding the purchase or sale of a business or real estate.

I also post this "Alert" on my BLOG (masslegalalerts.blogspot.com), which you can use if you want to comment on this Alert or other subjects on which I have written.

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