



Buying or Selling a Business in Arizona

I am a business attorney in Phoenix Arizona. Here are some tips for buying or selling a business in Arizona:

I. Buying a Business in Arizona

A. Business Brokers, Pros and cons

Business brokers are a good place to find an Arizona business. They often have good qualifications; some are attorneys or former attorneys or accountants. And they understand financial statements and doing the deal. But, business brokers take an extremely high commission right off the top (discussed below in the section on SELLING YOUR BUSINESS IN ARIZONA). And, because the broker only gets paid if the deal closes, they have no incentive to work with intermediaries like lawyers and accountants, but rather to simply get the deal done and get their check, which can often exceed the down payment to the seller (see below). By all means do NOT use the broker's purchase/sale forms. They are written to please both the buyer and the seller with, typically, inadequate protection for both. So what often happens is the deal closes, then issues that should have been handled prior to the closing arise, but with no language in the contract to deal with the situation. And, the broker has had each party sign a Disclaimer saying that the parties relied on themselves and each other and have no claims against the broker. This leaves the buyer and seller looking at each other, asking themselves: "What did we just agree to?"

B. Due Diligence in the Purchase of an Arizona Business

"Due Diligence" is the process of investigating a company to determine its financial performance, goodwill and reputation in the industry and community. Market and personal changes are often undisclosed. Usually the stated reason for selling is not the real reason, and the law will not protect those who do not protect themselves to a reasonable degree. While the seller cannot knowingly or negligently misrepresent the business, YOU have the duty to ask the right questions and to get the answers. Often this law firm confronts the situation where the buyer asks for documentation, but the seller convinces the buyer that it is not necessary, is not available, would come later, etc. Often these answers are untrue and just "stonewalling" in the hope that you will say "Never mind" and buy the business anyway. Don't do that. You may wind up, as one client did, paying \$55,000.00 cash for a piece of equipment the seller did not even own; it was leased. Brokers often have "Disclosure" forms that they have the Seller prepare, but if you compare that form to the Disclosure Form a house seller must complete in Arizona, you can see how inadequate the typical broker's Disclosure form is. However, it can be a good place to start.

C. **The Agreement for Your Purchase of a Business in Arizona**

Whether you are buying a business in Arizona or selling a business in Arizona, it is NOT a form transaction. Clients sometimes do not understand that legal representation in the purchase or sale of a business is an adversarial transaction – a zero sum game; that is, what one party gains the other loses. You will see this by comparing some examples of what the buyer wants and needs in the transaction versus what the seller wants and needs (as discussed in the next section).

For example, the buyer will want the [contract](#) to include extensive “Representations and Warranties,” including provisions which state the seller has the right to sell, the sale will not breach any other contract, the company and or assets are being sold “free and clear” of all liens and encumbrances, and the sales, net profits, assets and net worth of the company are as portrayed in the company’s financial documents which the buyer reviews as part of Due Diligence. These Representations and Warranties can go on for a page and a half. In contrast the Seller may want the contract to say the business and its assets are being sold “As Is” with no representations or warranties at all. Obviously, this is a huge conflict and helps explain why hiring one attorney to represent both sides, or just using a “form” is a recipe for disaster (I put quotation marks around “form” because to quote myself: “there are form documents only to non-attorneys.”). In the real world “one size does not fit all” and the contract must be tailored to the facts and circumstances of the deal. The buyer will also want a non-compete. I had a client who came to me (after the sale) where the hair salon seller just moved across the parking lot and opened a new salon because the contract did not prohibit that. The customers went across the lot and the buyers got next to nothing for their money. These are just examples. Bottom line: buying or selling a business is one of the more important events of your life and needs to be treated as such.

II. Selling an Arizona Business

When you are selling a business in Phoenix or Arizona the same considerations apply (as those discussed above) except in reverse.

A. **The Business Broker**

In addition to the dangers and considerations mentioned above, some key points for the Seller in using a business broker are determining the purchase price and commission. Brokers sell businesses, and typically they know what they are doing. For example, the typical small business has a relatively low net profit for reasons which include the following: high owner salaries (e.g. paying oneself a \$100,000.00 salary when you could hire a manager for \$60,000.00), use of company funds like credit cards for quasi-personal expenses (like cars, art on the wall, etc.). The business broker knows this and will help you add back a fair portion of these expenses to obtain a true picture of the company’s earning power and cash flow. Then, the broker may use a multiple – based on industry standards – of this adjusted net profit or cash flow to determine the company’s “fair market value” (whether it is fair or not is the buyer’s job to determine in Due Diligence). This fair market value becomes the “list price” or “asking price” of the company. This “add back” process is good because it adds value to the seller. A negative point to the seller for using a business broker is the commission, which is typically 12%! And, typically the broker takes this right off the top. So, for example, say you are selling a business for \$100,000.00. Because you need to transfer the business and/or its assets free and clear of liens this means that you must use the sales proceeds to pay off company debt. Let’s assume the company has \$60,000.00 owed to the bank, \$10,000.00 on credit cards and open accounts with vendors of \$20,000.00. This adds up to \$90,000.00. So this would leave a \$10,000.00 profit to the Seller (of course a real company may have more or less in value versus debt). EXCEPT that the broker would get 12% or \$12,000.00 off the top. This means, in this example, the Seller would get nothing, but instead would have to come up with \$2,000.00 out of pocket to close the deal. This is the “catch 22” that sellers face when using a broker: They may not be able to afford to use; may not be able to afford not to. Sometimes, brokers will negotiate pay out of commission as money is received, but do not count on it and they won’t typically be generous because problems often arise later as mentioned above under Buying a Business in Arizona. They would prefer to “take the money and run.”

B. **[Due Diligence](#) in the Sale of a Business for the Seller**

Selling a business – or buying a business – requires some work. For the Seller, “Due Diligence” means producing information for the potential Buyer to review. This can be dangerous because the potential Buyer may simply be a “wolf in sheep’s clothing” who wants to learn your trade secrets and steal them. To help protect yourself you will need one or more of the following: (1) a Non-Disclosure Agreement, saying they can’t use or disclose the information, with legal remedies stated, and (2) a Letter of Intent, including among

other things, confidentiality provisions. You as the business seller also need to protect yourself from unintended representations. Material misstatements or omissions are legally actionable and suits based on alleged fraud or negligent misrepresentation are common outcomes in the purchase or sale of a business in the Phoenix Metropolitan Area or Arizona, especially where the contract has strong “Representations and Warranties” in favor of the Buyer, as discussed above. As a general rule “hiding the ball” or “delaying the game” by withholding information or holding back its production in the hope the Buyer will buy anyway is a strong signal to the Buyer that the Seller is not trustworthy. Chances are “slim to none” that a Buyer represented by a business lawyer would allow the sale to continue until the information was furnished or stipulations made. This is just one of the many advantages of having a business attorney who practices business law on your team. But, Buyers are often anxious and if unrepresented by business legal counsel, may do foolish things. This may result in litigation, which can be a life altering event for both the Buyer and the Seller.

C. The Sales Agreement for the Sale of a Business in Phoenix or Arizona

As we discussed above, the Seller would like to sell the business without any – or as few as possible – representations and warranties. This probably will not happen. The reason is that in many ways what the Buyer is buying in the purchase of a small business or owner-operated business is the “legal stuff,” e.g. the representation that the business is free and clear of liens, that the Seller owns it, that the stated financial performance is real and that the Seller will not compete for the same clients, in the same trade area, and/or in the same type of business, etc. So, careful negotiation of these points is necessary. Also very important for the Seller are the “loan documents.” By “loan documents” I mean the promissory note, security agreement and, perhaps, personal guaranty that the Buyer will sign if the Seller finances the deal. Generally, wherever possible, the Seller should attempt to avoid financing the deal – at least no more than necessary, because what happens in the common event of a dispute is that the Buyer just stops paying. Obviously, the buyer could not do this if it borrowed the money from a bank rather than you. But, for small businesses or owner-operated business it is common for the Seller to carry back part of the loan. In this case the ability to collect the amounts due is only as good as the loan documents. It is very important that the Seller have a business attorney draft or review these documents.

These are just some of the things you need to know about the purchase of a business or the sale of a business in Phoenix or Arizona. I hope you will contact and retain this business law firm to represent you as you prepare to buy or sell a business in Arizona.

If you have any questions about business law, call The Law Office of Donald W. Hudspeth toll free at 602-265-7997 or toll free at 866-696-2033, or contact us via our [web form](#). We are Phoenix's business law resource – <http://www.AZBUSLAW.com>.

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