

# Buying a Business in a Recession

By Matt Joyner, Esq.

Buying a business is a major undertaking in the best of times. In the current recession, however, it becomes an even more complicated proposition. One critical difference can be boiled down to this: In good times the business seller usually is selling because he wants to, is happy to be selling and is looking forward to leaving his business. In a recession, however, the seller frequently is selling not because he *wants to*, but because he *has to*. This difference in the seller's motivation has a big impact on the purchase transaction in many ways, some obvious and some not so obvious. Here are four important considerations when buying a business in a recession:

## Public Record Search on the Business Owner.

A public record search on the individual seller of the business is often informative and helpful in understanding the seller and his motivation in selling the business. It can also alert the buyer to potential problems early in the process. If the seller has a history of bringing lawsuits against others or of being sued by others this is a warning sign of trouble ahead. Outstanding judgments, liens, litigation and criminal proceedings against an individual seller are more likely in the current economy and can have a big impact on a buyer's decision whether to proceed with negotiations with the seller.

During the economic downturn I represented a buyer of a local franchised service business who took my advice to do a public record search on the seller and received a bit of a shock. As a result of his search the buyer discovered that the seller recently had been charged with attempted murder of a former employee. Apparently the seller went to confront the former employee about the former employee's improper solicitation of business from the seller's customers. The seller took his brother-in-law along for back up. When the verbal confrontation with the former employee became heated, the brother-in-law pulled a handgun he was carrying. The police were called and the seller and his brother-in-law were both charged with attempted murder. The public record search tipped the buyer off to both the issue of the business' loss of customers as well as to the more alarming issue of the seller's potential for violence.

## Public Record Search on the Business.

In any business purchase the prospective buyer should conduct a thorough search of the public records with regard to the business to determine whether there are any liens encumbering the seller's assets, i.e. whether a third party has rights in the assets that would be superior to the buyer's. If so, the buyer would be at risk of paying the seller once for the assets and then having to pay the party holding the lien a second time for the same assets. In a recession the likelihood of liens on the seller's assets increases because the likelihood of the seller being in debt increases.

Sellers usually are embarrassed by liens on their property and are not eager to disclose them for fear of scaring a potential buyer. They seldom understand that their failure to disclose the liens up front only undermines their credibility when they are discovered by the buyer's review of the public records. A review of Uniform Commercial Code financing statements on file with regard to the business will reveal whether any of the assets being purchased are pledged as collateral for the seller's debts. A review of judgment records will reveal whether there are any out-

standing judgments against the seller that would act as a lien on the seller's assets, including any liens for unpaid taxes. It is essential that the liens be discovered and that the purchase transaction structured to remove them from the purchased assets.

## Buyer Protection in Seller Financed Deals.

The difficulty of borrowing acquisition funds from a bank in this recession has resulted in an upswing in seller financing of business sales, i.e. instead of being paid in cash at the closing, the seller agrees to be paid over time by the buyer, frequently out of the proceeds of the future operation of the business. This situation makes it easier for a buyer to withhold payment of purchase funds from the seller in the event there is a dispute after the closing regarding the business and the accuracy of the seller's representations and warranties about the business to the buyer in the sale. Buyers need to protect themselves in the deal through provisions allowing them to escrow a portion of the purchase funds or to offset against the future payments owed any claims the buyer develops against the seller after the closing.

## Noncompetition and Nonsolicitation Agreements.

In a recession it becomes even more important to get from the seller a binding, enforceable noncompetition agreement and a nonsolicitation agreement. Remember, since the seller in a recession is selling because he has to not because he wants to, the seller is now more likely to be looking for the next opportunity to get back into business rather than to retire to the golf course. Consequently the buyer has to concern himself with what the seller plans to do after the closing. If the buyer actually needs or can use the services of the seller in the business for a transition period after the closing, the buyer will want to consider entering into a consulting agreement with the seller whereby the seller agrees to support the new owner's operations in a specified way for a specified time. Regardless of whether the seller is under a consulting agreement, the buyer needs to protect himself from the seller opening a competing business while his industry and customer contacts are still fresh. Likewise the seller needs to protect himself from the seller soliciting business from his old customers or suppliers, or soliciting his old employees to leave the business and join a rival employer. The North Carolina Court of Appeals and Supreme Court regularly tweak and fine tune the law of noncompetition agreements and nonsolicitation agreements in the state, so buyers need to understand the current limits they can place on sellers.

Buying a business is always complicated, but even more so in times of recession. With the assistance of experienced counsel a buyer can identify and address important deal issues that arise during a time of economic recession, and increase his chances of making his new business a success.

*This Article provides only a general overview of complex legal issues. It is not intended to be legal advice or a substitute for obtaining legal advice from an attorney familiar with the facts of your situation.*

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