

## Warranties, representations protect buyer

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### Law Talk

By Denice A. Gierach

Many business owners are retrenching in this current economic turmoil, but those who are able to project beyond the current crisis see business opportunities.

There are many business owners (potential sellers) who are at or close to retirement or no longer "have the fire in their belly" to continue to operate in this business clime. It is true that the marketplace is challenging and it is not for the timid.

Let's assume you are the business owner with the foresight to see the opportunities in your marketplace and decide to buy a business to expand into another market or just to add market share in your own area. After executing a confidentiality agreement, the selling business has provided you with access to its records to allow you to do your due diligence. You are about to do a contract, having arrived at what you feel is an appropriate price. What else should you be thinking about?

Although you have been provided with the documents that you have requested, you, the prospective purchaser, do not know all that there is to know about this business. Yet, the expectation of the purchaser in making an offer is that the seller has told him everything about the business that would form the basis for the offer.

Since the purchaser never knows all of the information, it is necessary to use warranties and representations in the offer.

There are representations that are routinely placed in contracts relating to corporate organization, such as that the corporation is an Illinois corporation in good standing, that the seller has title to the stock that is being sold (if you contemplate a stock purchase) or that the company has good title to the assets being purchased (if you contemplate an asset purchase) and that there are no liens against such assets.

These are usually followed by representations about the financial condition of the company, such as: "there have been no material adverse changes to the business and assets of the business since the last financial statements"; that "there are no liabilities contingent or otherwise that are not disclosed in the financial statements"; and that "all taxes are current with federal, state and municipal governments."

In addition, there are representations as to the state of the equipment, machinery or other assets that will be purchased. If there is real estate involved, besides the representations on title, it is important to have a series of representations concerning the environmental condition of the property and the compliance with all federal and state laws in the environmental arena.

The purchaser may also want the seller to make other covenants, such as that the seller will operate the business in its normal course between the time the contract is signed and the date of closing, that the seller will provide additional information as to any changes to the company or its assets in the same time frame, and that the seller will refrain from soliciting or accepting any other offers to purchase the company.

Another important covenant is the non-competition provisions in the contract. The purchaser does not want the seller to be able to open a new business that directly competes, go in business as an owner, shareholder or employee with a business that directly competes, while the seller is in the "honeymoon" period of time for maybe a year or two after the purchase.

This allows the purchaser time to get their people in place, to visit customers and cement relationships. Without these provisions, the seller could open a competing business next door to the business that you, as a purchaser, pay good money for, and then proceed to cherry pick the customers of the business.

These representations are normally coupled with indemnification provisions, which entitle the purchaser to claim damages post-closing for losses caused by the breach of a representation or covenant by the other party. These provisions may include that the seller will indemnify or make the purchaser whole upon receipt of a written demand from the purchaser. There are procedures in the contract to determine whether the claim is subject to insurance first or whether the seller should participate in the defense of a claim made post-closing.

While you are looking for opportunities that will allow you to expand your business, be mindful of the adage—buyer beware—and use representations, warranties and indemnification provisions in your contracts to protect yourself.

*Denice A. Gierach is a lawyer and owner of The Gierach Law Firm in Naperville. She is a certified public accountant and has a master's degree in management. Contact her at [deniceg@gierachlawfirm.com](mailto:deniceg@gierachlawfirm.com) or 630-756-1160.*

Posted on Tuesday, March 10, 2009 (Archive on Tuesday, March 17, 2009)  
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