So You Want To Buy A Business – Caveat Emptor

by Joshua Horn, Esq.

The current economic climate presents the small business with both challenges and opportunities. Some businesses are merely trying to stay alive until the economy turns the corner. Businesses more financially sound are in the unique position to expand their business by acquiring others. Even though the latter may be in a better position to manage the current economic environment, missteps in the acquisition of a business present the greatest risk for an acquirer to manage.

> "A prudent business can use today's economic reality to expand for a more successful future."
> – Joshua Horn

Although an acquirer may believe that potential synergies between it and the target are the most important considerations, the acquirer has typically already performed that analysis by the time it identified the target. What the acquirer does to document the transaction may ultimately be the difference of long-term success and outright failure.

Of the many provisions found in a transactional document, the representations and warranties are critical. Under Pennsylvania law, a representation or warranty is only as good as the paper on which it is written. Agreements always have a provision that states that all of the terms of the agreement are in the agreement itself; as a result, any oral or prior written representations that do not find their way into the final definitive written agreement will not be part of the agreement. If the acquirer wants the target to represent and warrant some fact, it must be in the document or (except in very rare circumstances) it will not exist in the eyes of the law. In the absence of a representation and warranty, the acquirer will be hard-pressed to claim that the seller misrepresented some fact that was material to the transaction.

A due diligence proviso is also typically included in such agreements. Such provisions go hand-in-hand with the representations and warranties because an acquirer may learn something in due diligence that it wants the target to represent and warrant. A diligence proviso states that the acquirer agrees that it had a full and fair opportunity to conduct due diligence on the target and that the target provided and/or made available to the acquirer all information that the acquirer requested. Accordingly, an acquirer must perform that level of due diligence that it deems appropriate to determine whether to go through with the transaction. If the acquirer opts against conducting due diligence or conducts limited due diligence, Pennsylvania law will not provide the acquirer a safety net in which to fall. In simple terms, if the information was made available to the acquirer and the acquirer failed to review it, a court will not entertain a complaint about information that the acquirer chose not to review because the acquirer was in the best position to manage its own risk and assumed the risk of loss.

The most prudent way to manage the risks associated with the acquisition of any entity is to have the right people working on the transaction. The acquirer should have internal individuals designated to run the transaction to ensure that all information is properly gathered and assimilated in a definitive agreement. Similarly, the acquirer should employ outside resources such as accountants/ financial consultants and lawyers to review the wealth of financial information and document the transaction to afford the acquirer the maximum available protection. No transaction is risk-free, but a prudent business can use today's economic reality to expand its business for a more successful future. ▼

Editor's Note: Joshua Horn is a partner in the Philadelphia office of Fox Rothschild LLP. For the past 11 years, he has focused his practice on representing financial advisory companies and individual advisors in arbitrations before FINRA and the NYSE. He has also represented individual brokers on disciplinary matters before FINRA. He can be reached at 215.299.2723. Information: www.foxrothschild.com.