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ICCFA Magazine author spotlight

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➤Educational information, including copies of this article, can be found at ***www.theforesightcompanies.com***

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Editor's note: The Cemetery Impossible column is written by the staff of The Foresight Companies. **If you have a question you want to be featured in this column, please send it to danisard@ theforesightcompanies.com.** Dan Isard or a member of his staff will call you to get more information and a recommendation will be provided via this column, helping not only you but also others who are facing similar challenges.

CONTRACTS

Selling a business can be nerve-wracking, especially when the buyer wants all of your warranties and representations unqualified. Is this a reasonable position for the buyer to maintain?

Cemetery Impossible

When is it OK to insert 'to the best of my knowledge' in warranties & representations?

Dear Dan,

I was recently in the process of selling my cemetery. The lawyers produced a sale agreement. When it came to the representations and warranties of the seller (me), there were items that I know are accurate and I can opine to. However, on some items I asked my lawyer to insert the phrase, "to the best of my knowledge." The buyer would not allow this modification. They wanted an unlimited statement from me which I felt unqualified to give.

I called off the sale. I know you are not a lawyer, but I also know you have been through hundreds of transactions in your lifetime. Was my lawyer wrong or was the buyer's lawyer wrong?

X

Dear X,

In any business transaction, there are fears and insecurities present for all parties involved. The seller's fear is that they will not get paid. The buyer's fear is that they are buying a "pig in a poke." To mitigate each fear, the lawyers step in and write terms and conditions within the contract to protect their respective clients.

The seller's attorney will insert language regarding the security on any note that the seller will assume. Of course, no one defaults on cash paid at closing. However, there could be a clawing back of some of that cash paid at closing if it is determined the seller misrepresented something.

To protect the buyer, their lawyer will attempt to make certain that the things the seller told the buyer during the negotiations are accurate. There are two broad actions that buyers take to make sure they are buying what they think they are buying. These are called warranties and representations.

The first step buyers take to know the business is to perform due diligence. During this investigation, the buyers learn a lot

about the business. The warranties and representations memorialize the statements and points of evidence the seller presents the buyer about the business.

The second step a buyer will take is contained in the legal documents. As you mentioned, warranties and representations are contained within the purchase/sale agreement. These two areas of the contract attempt to protect the buyer. Of course, there are representations and warranties the buyer opines to as well, but they are much less important if the seller gets cash.

Warranties, in contract law, have many meanings. A warranty by one party to another party says that specific facts or conditions are true or will happen. This factual guarantee may be enforced regardless of materiality, which allows for a legal remedy if that promise is not true or followed.

A representation is used in a contract to reference any expressed or implied statement made by one of the parties regarding a particular fact or circumstance that serves to influence the consummation of the deal.

For example, if you are buying a car, the odometer might read 12,103 miles. The seller will typically give the buyer a representation that the odometer has not been altered.

In a typical asset or stock sale agreement, the buyer can make warranties and representations as to:

a. Being duly organized as a business entity.

b. Having the right and authority to make the purchase.

c. There being nothing pending against the buyer that could interfere with the closing.

d. Whether the buyer used a broker or

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finder in their acquisition.

Most of these are pretty simple and nothing that can kill a deal. However, in a typical asset or stock sale agreement, the seller is asked to make warranties and representations to a number of items, all of which are pretty material in nature:

a. Environmental hazards are not on the property.

b. The seller has the right to sell.

c. The seller owns all the shares.

d. Schedule or list of assets being bought with the business including furniture, fixtures and livery, is accurate.

e. No known litigation pending or threatened.

f. All of the accounts receivable are accurate.

g. The list of all employees and their compensation is accurate.

h. The account of historical operations, including case count and advance sales, is accurate.

i. Financial statements are accurate and accounting is consistently applied.

j. There will be no change in the business up to the day of closing.

k. Funeral preneed (if any) was properly handled.

l. Seller has clear title to all assets.

m. And many other items.

The key for the buyer is to make sure that they are able to have those assets the moment after closing if they give you a boatload of money.

If it seems like the seller gives more warranties and representations than the buyer, that is correct. The buyer gives money and the seller says, "There, there; everything will be all right." This is why lawyers get paid the big bucks.

The warranties and representations will survive the closing. That means that for some period of time after the closing, if I find out someone misstated something in a warranty or representation, I have the right to sue.

The term of survival is one of the big items lawyers will fight about. This is where it is beneficial to have someone who has considerable closing experience. If a lawyer wants a survival to last 10 years, but someone else involved knows the typical term is five years, they can negotiate it.

Sometimes a seller wants to limit the unconditional representation with the phrase, "To the best of my knowledge." This limits the matter from an absolute to something less.

For example, I warranty and represent there are no environmental problems with anything on my property. That is a very absolute answer. If it is later found there is an environmental issue, the seller is going to pay to clean it up.

If that seller had said, "to the best of my knowledge there are no environmental problems with anything on my property," and it *is* later found there is an environmental issue, the seller may not be accountable for this if they truly didn't know it existed. Sometimes the buyers will agree to this limitation.

However, the question in law is, what should I, the seller, have known? This is where we start to split legal hairs. For example, if I drive my car every day and no one else drives it and I say, "to the best of my knowledge, the car was never in an accident," a buyer should be able to live with that.

However, suppose I own a 200-year-old building on my cemetery and I say, "to the best of my knowledge, there are no environmental problems," and later a problem is found—say the building had lead paint from the 1930s that had been painted over five times. Should I have known about it? This is where jury trials may come into your life.

Clearly there are some things that you, the seller, should be able to say absolutely, without adding "to the best of my knowledge." Your lawyer should know the difference, if they are a business lawyer. Keep in mind, in a small town, lawyers have to know many different aspects of the law. They may not know transaction law and may think the modifier is fair in all cases. It is not.

Ask yourself this: If you were the buyer, would you accept the representation with that modifier? If so, have a go at it. If not, then why should you expect your buyer to accept it? ❐