"HIGHEST & WORST" DEAL

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The term "Highest & Best" deal has been well-known in the bankruptcy field for many years. In a bankruptcy auction of a business or real property, the judges, trustees and creditors recognize that the better deal is not always the one that offers the highest price. It is not uncommon to approve and accept a deal with a lower price in that arena if that offer includes more favorable terms and/or comes from a buyer that is either more qualified and/or more likely to perform.

It is surprising and, oftentimes, disappointing how this basic concept is missed or ignored in the buy-sell context. I have seen too many failed attempts to sell a dealership or large block of stores that have fallen prey to the lure of the higher bid. The seller proceeded with a suspect buyer and/or accepted unfavorable terms. In the end, the buyer simply scuttled the deal and left the seller to pick up the pieces.

Needless to say, the consequences of this mistake can be enormous in a declining market. I have seen this problem in a recent example of a substantial deal negotiated almost a year ago (at the height of the post-covid market). The seller decided to proceed with the buyer that offered the highest price. Unfortunately, it accepted one-sided terms, including broad and protracted contingencies. In the end, and after some many months of processing the contingencies, including due diligence and factory approvals, the buyer simply elected to walk from the deal and, because of the onerous terms imposed on the seller, did so with complete impunity. As a result, the seller was back to the beginning with nothing to show for its efforts and the wasted time and disruption, except substantial professional fees. Worse, the seller must restart the marketing effort in a market that has receded to less attractive blue sky values/multiples and one that more favors the buyers. Currently, this looks like a price reduction of at least 20%. To place this in perspective, the second highest buyer in the original deal was within 5% of the original buyer's price. Proceeding with the buyer offering the slightly lower price may have been the wiser choice.

How does one avoid this unfortunate scenario? How does one choose the right deal and the right buyer? How does one negotiate the buy-sell in a fashion that maximizes the chance of a successful transaction and precludes the buyer from simply waltzing away in the end? Of course, no deal is guaranteed and, as we know from experience, circumstances can develop (some completely unexpected!) that can jeopardize a deal. However, with effective negotiations and the proper drafting of a strong buy-sell agreement, these risks can be significantly reduced and the probability of a successful transaction increased substantially.

Here are some of the ways to accomplish this goal:

- **<u>THE RIGHT BUYER</u>**
  One should never forget the old adage: you can't do a good deal with a bad person. Understanding your buyer is as crucial as the buyer understanding your dealership. As wise seller is likely to do as much due diligence on his/her buyer as the latter conducts on the seller.

  Here are some of the salient considerations:
  - What is the buyer's reputation?

- What is the buyer's track record? Do they close their deals or abort? Are they notorious "tire-kickers", or have a strong record of closing deals?
- Do they move quickly or string out the seller? One of the worst experiences for a seller is a buyer inflicted with "paralysis by analysis".
- Does the buyer tend to renegotiate after the deal is inked?
- What is the buyer's track record with the manufacturer(s)? Has the buyer been turned down by the same franchisor or is highly regarded?
- Does the buyer have immediately available funds for the deal, or requires lender and/or investor approval?

- **THE RIGHT TERMS**

  There is nothing more dreadful for a seller than a termination notice after months of processing a deal. By this time, the manufacturer(s) and lender are notified of the deal and the rumors are rampant. An aborted deal places enormous pressure on the seller to "put humpty dumpty back together again". Needless to say, it is no mean task.

  So, what can the seller to do avoid this unfortunate result in a buy-sell? Virtually, every termination notice issued by a buyer is based upon the purported failure of one of the contingencies contained in the buy-sell agreement. This is where the game is won or lost. How the contingencies are handled in the deal will be a strong factor in controlling the destiny and viability of a transaction.

  The most volatile of the contingencies is financial due diligence. The reason for this is this is the one contingency that a seller can't control. In this regard, the language of this contingency typically gives the right to the buyer to terminate if the buyer is not "satisfied" with the results of its financial evaluation or, worse, the right to "terminate for any reason or no reason".

  It is for this reason that a seller is cautioned against the execution of a formal buy-sell agreement and the processing of a deal with such a contingency. The better approach is to require that the buyer complete its financial due diligence prior to the execution of the formal agreement. For example, this can be accomplished when the parties have executed a non-binding letter of intent. Alternatively, the financial due diligence can be conducted after the execution of the formal agreement in the first stage of the transaction. Under this approach, the manufacturer(s) and other third parties (e.g. the lender) are not notified of the deal unless and until the due diligence is deemed satisfied. It should be noted that the latter is the less desirable approach since a staged buy-sell can be quite protracted. The seller is well-advised to avoid buyers who resist or reject either of these approaches.

  The concern, however, extends beyond the financial due diligence contingency. Careful attention should be given to the other contingencies in the deal. These principally include: franchise approval, financing approval (if applicable), environmental investigation and physical inspection. Each one of these should be crafted in a manner where the seller can control the result or, at minimum, gives the seller the highest likelihood that the contingency will be satisfied. For

example, a franchise approval contingency should not be based upon what the buyer considers to be “satisfactory terms and conditions”. Rather, the contingency should only require “standard” or “reasonable” terms and conditions. As another example, an environmental investigation contingency should entitle seller the option (but not the obligation) to cure any legitimate environmental concerns.

- **VIGILANCE**
  Another way to enhance the success of a buy-sell transaction, from the seller’s perspective, is constant vigilance over both the buyer’s performance and the performance of the necessary third parties, such as the manufacturer(s). Upon execution of a formal agreement, the seller should carefully docket each of the requisite contingencies and stair-steps in the deal and closely monitor the progress of each, constantly inquiring with both the buyer and the third parties. In this way, the chances of proper and efficient performance by the buyer and the third parties will be greatly enhanced.

CONCLUSION:

Of course, all sellers want the maximum price for their dealerships and one should never lose sight of that goal. However, placing a deal at risk for the optimum price can be regretted. In the end, the seller should balance the optimum price against the optimum terms in pursuit of the best deal.