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SMP Briefing:

Multiseller Transactions – Issues to deal with in a sellers' agreement

Intro

A common feature of almost every exit transaction of VC-backed companies is the large number of sellers involved. This is one of the main reasons why so-called multiseller transactions are rather complex. The different groups of selling shareholders, including founders, business angels, financial investors and possibly strategic investors, often pursue different interests which have to be aligned for the success of the transaction.
Prior to an exit, the shareholders' interests are coordinated by way of a shareholders' agreement. However, no shareholders' agreement will include sufficiently detailed provisions regarding the exit considering that, at the time of the conclusion of the shareholders' agreement, the specifics of the different exit scenarios are not yet foreseeable.
Therefore, to coordinate the shareholders' interests with regard to the exit transaction and to provide for a set of rules governing the relationship amongst the selling shareholders as of closing of the exit transaction, the sellers often enter into a so-called (internal) sellers' agreement.

Key Features

The content of a sellers' agreement largely depends on the specific structure of the shareholders and the exit transaction. There are, however, a number of key features which can be found in almost every sellers' agreement:

I. Parties

The Parties to the sellers' agreement are all (selling) shareholders in the target company. In contrast to a shareholders' agreement, the target company itself does not usually become a party to the sellers' agreement; otherwise, the internal arrangements amongst the sellers would (indirectly via the target company) be privy to the purchaser. Furthermore, any amendments to the sellers' agreement would require the consent of the target company which, post-closing, will be owned by the purchaser.

II. Lead negotiator / Deal team

Given the potentially large number of sellers with oftentimes divergent interests and exit/return expectations, it is key that the negotiations with the buy-side are led by a single negotiator or a deal

team representing the sellers. In practice, the negotiations are often led by one of the major investors together with one of the founders. The appointment of the deal team is generally rather informal or at least no written agreement setting forth the rights and duties of the negotiators is in place. Thus, to ensure that there is a "clear cut" for the deal team's task, the sellers' agreement should release the lead negotiators from their duties and provide for a confirmation that all outstanding claims in this respect have been fully settled.

III. Sellers' representative

With regard to the post-signing phase, many purchasers expect to have one single point of contact on the sell-side. The sellers therefore often appoint a sellers' representative, who is in many occasions one of the lead investors. The sellers' representative is usually authorized in the share purchase agreement (i.e., not only in the sellers' agreement) to give the purchaser sufficient comfort that the authorization cannot be revoked without the purchaser's consent (except for cause which under German law cannot be restricted).

The sellers' representative is often authorized to make and receive all declarations in connection with the transaction for and on behalf of all sellers, e.g. the sellers' rights in relation to tax or other third-party proceedings. The sellers' agreement generally also stipulates when, how and to whom the sellers' representative shall forward any notices and declarations received on their behalf.

Another key aspect to be covered in the sellers' agreement in this respect is the internal decision-making process amongst the sellers, in particular where the sellers' rights are to be exercised in a uniform manner, e.g. rescission of the share purchase agreement. While in some cases the sellers' representative is granted broad discretion, most sellers' agreements provide for more detailed rules, including voting requirements with a qualified majority or the establishment of a board-like body (which could be similar to the board according to existing shareholders' agreement).

In general, the sellers' representative is not awarded any remuneration for his activities but will be reimbursed for any (reasonable) expenses incurred in connection with his or her duties. In cases where the duties of the sellers' representative are complex or extensive, a moderate remuneration may, however, be justified. The liability of the sellers' representative vis-à-vis the (other) sellers is in practice often limited to gross negligence and sometimes even to intent.

IV. Allocation and distribution of purchase price

In many multiseller transactions, the purchase price is paid at closing to a joint sellers' bank account (as opposed to separate payments to each respective individual seller's account). From a purchaser's perspective, this practice has the benefit of reducing the number of transactions to be made at closing. Also, from the perspective of the sellers, having one payment wired can be advantageous in terms of deal certainty since the receipt of only one payment needs to be evidenced as a condition precedent to closing or closing action on the closing date.

The holder of the sellers' account is often the sellers' representative, but it can also be agreed to appoint the acting notary or a third party/advisor to take care of this.

Upon receipt of the purchase price, the sellers' representative is obligated to distribute the (net) purchase price to the sellers on the basis of a pre-determined allocation scheme. The allocation would usually be based on the sellers' pro rata shareholding but could deviate from it depending on any liquidation preference in the shareholders' agreement. The amount distributed from the sellers' account is usually the net purchase price, i.e., the amount received on the sellers' account minus any transaction costs that have been incurred until that point. In addition, sometimes an additional holdback/escrow amount is subtracted to cover post-closing transaction costs, service fees for the sellers' account, or any potential downward purchase price adjustment. While many sellers will prefer to increase their immediate payout, such internal retention amount can facilitate the post-closing settlement of the transaction and save the sellers from post-closing capital calls.

V. Compensation for liability

In multiseller transactions (in particular in a VC context) it is not uncommon that business warranties are given only by the founders but not by the investors. This is because, in most cases, the latter are not involved in the daily business operations of the target company and therefore have little knowledge about the correctness and completeness of the business warranties. To provide the purchaser with a sufficient liability amount without putting too much of the founders' purchase price at risk, oftentimes an escrow account is established which is (economically) funded by all sellers, including the investors. Any claims for breach of a business warranty would (only) be settled by this escrow account and, upon the expiry of the limitation period, any remaining amounts would be released to the sellers' joint account for further distribution amongst the sellers.

VI. Term

As a matter of precaution, sellers' agreements (just like any shareholders' agreements) can provide for a fixed term to avoid an (ordinary) termination of the agreements under applicable partnership law. It should be taken into account that the right to terminate sellers' agreements for cause (*aus wichtigem Grund*) cannot be validly excluded.

Notarization requirement?

If the target company is a German limited liability company (GmbH), the sellers' agreement might require notarization under German law (Sec. 15 para. 4 sentence 1 Limited Liability Company Act, GmbHG). Notarization is, in particular, required when the sellers' agreement contains an obligation regarding the assignment of shares in the target company or an obligation to (re-)enter into a shareholders' agreement which is itself subject to notarization (e.g., in the rare case where the exit transaction is terminated post-closing).
The mere fact that the sellers' agreement is entered into in the context of a share purchase agreement (which itself is subject to notarization) does, however, not trigger a notarization requirement for the sellers' agreement.

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Wrap-up

The sellers' agreement is (together with the share purchase agreement) one of the key documents of almost every exit transaction of VC-backed companies. In particular where a large number of sellers is involved, a sellers' agreement is essential to supplement and specify the provisions of the (terminating) shareholders' agreement with a view to the exit transaction.

If you speak German and would like to learn more about multiseller transactions, in particular, if you're a lawyer and interested in learning more about best practices for the liability regime in multiseller transactions, please refer to the following journal articles:

- Martin Schaper/Benjamin Ullrich, Multiseller-Transaktionen - Teil 1: Das Haftungsregime, GmbH-Rundschau 2019, pp. 625 et seqq.
- Benjamin Ullrich/Martin Schaper, Multiseller-Transaktionen - Teil 2: Die Verkäufervereinbarung, GmbH-Rundschau 2019, pp. 1334 et seqq.

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