

A Guide to Buying and Selling a Business



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INTRODUCTION

What follows is a brief overview of a complex legal area in which many traps and pitfalls await those unprepared.

This guide outlines the main considerations that apply in buying or selling a business with practical advice based upon our own experiences of buying and selling numerous businesses for our clients over the years.

There is no substitute for early, fast, pragmatic legal and other professional advice to guide you through the transaction whilst allowing you to remain focussed on the key management and operational decisions affecting the business.

In our experience, every deal is unique.

Ashtons Legal, Corporate and Commercial team

2. So Where Do I Begin The Process?

Proper legal advice is essential early in any major transaction for two key reasons:

1. To ensure certainty – are you clear exactly what it is you are buying or selling? Does the agreement reflect that? Don't get "caught out."
2. To protect your investment, or the proceeds of your sale, against unexpected liabilities.

Why am I buying?

You must be certain that you have carried out market research and analysed carefully why you wish to make the acquisition and whether it will add value to what you currently do. Does it tie in with your current activities? Are there geographical constraints to managing the newly acquired business? You can't be in two places at once! Are there key contracts, facilities, employees or liabilities which you do (or don't) want?

Is the timing right?

If selling, you need to take detailed tax advice to ensure that the timing and structure is right for you. Would there be an unforeseen tax "break" if the sale were to be delayed for six months?

What preparation can I undertake?

When selling, it is also vital to make sure your "house" is in order. Protecting yourself from claims by the buyer after the sale is very much a thorough paper-trail exercise.

If you have filed accessible copies of all your customer, supplier, employee and other contracts, plus accounts,

accreditations and licences, and if your company books are up-to-date and complete, this will be a major step on the way to better protection from the buyer.

These are all issues that will inevitably be raised during the course of the transaction and can cause delay and distraction at the vital moment.

Look before you leap

Ideally, you should take legal advice at the outset – even before beginning negotiations. Before you agree the basics of the deal, let us discuss the implications with you. If you have to move the goalposts later on, you may find your negotiating position is much weaker, or that it will impact on the price for the business.

How can I be sure that my "trade secrets" will remain confidential?

A seller will be exposing to a buyer all his confidential and sensitive commercial information – pricing, customer lists, trade secrets etc. It is important that the buyer recognises this and agrees not to use or disclose the confidential information which could form the biggest asset of the business.

Before disclosing any details, the first step should always be to ensure the buyer signs a confidentiality agreement (also known as a non-disclosure agreement) and agrees practical steps to avoid unauthorised disclosure and use. It is extremely difficult to protect information at a later stage without this.

Remember, sensitive information and trade secrets cannot be 'unlearned'.

3. Shares or Assets?

If the business is run by a sole trader or a partnership then there will be no shares to buy. The assets including contracts and goodwill of the business will be sold by the seller – an "asset sale".

If the business is owned by a company there is a choice of buying the assets from the company, or buying the whole company itself by acquiring its shares from its shareholders.

Much of what follows concentrates on share sales and purchases, but most of the principles are very similar in an asset sale. We have highlighted the main differences where appropriate.

The general rule of thumb for a company sale is that a buyer will normally prefer to buy the assets of a business and the seller will prefer to sell the shares; the next section explains why.

The important point to remember is that in an asset sale, the company itself will be selling the assets, whereas in a share sale, the individual shareholders of the company will be the sellers.



Ashtons Legal 'has the edge in client care'.

Legal 500

3.1 From the Sellers Perspective

Share Sale

If a shareholder sells his shares in a company then he achieves a complete break in the relationship between him and the company. However, the buyer will probably insist on some contractual promises (warranties) and indemnities about the company, which will continue to bind the shareholder after the sale.

No Liability for Debts

Assuming that the seller of shares is released from all third party guarantees (eg: as a director, any personal guarantees given to the bank) at completion, he will have no liability for the debts of the business which remain the responsibility of the company in the hands of the new owners, because in law a company has a separate legal personality from its directors and shareholders.

Asset Sale

If there is an asset sale, then, with a few exceptions (eg: employees – see section 12), the seller will keep all the current liabilities of the business – unless he can negotiate with the buyer to take them over with the business.

Purchase Price

By selling his shares, the selling shareholder will usually receive the purchase price directly himself. If there is an asset sale then the money is received by the selling company. The owners (shareholders) of the company have the problem of extracting that money either by dividends (often tax inefficient) or liquidation (expensive).

Tax Clearance

In some circumstances the seller's accountant will need to apply to HMRC to obtain "clearance" for the structure of the deal to avoid unexpected tax liabilities after completion.



3.2 From the Buyer's Perspective

The buyer will generally prefer to buy the assets and goodwill of a company, as this will enable him to pick exactly which assets he is buying and identify precisely those liabilities he wishes to take over. All other liabilities will be left with the seller.

“Warts and All”

As mentioned above, when buying shares, a buyer takes the company “warts and all” – which is why thorough due diligence is so important. Although the buyer can take warranties from the seller and receive indemnities, they are generally only as good as the wealth of the person giving them. Also, the buyer may be forced into expensive litigation to recover monies under the warranties/indemnities.

Retention

Sometimes the buyer may be advised to keep back part of the purchase price (“a retention”) as security against unwelcome undisclosed liabilities after completion.



Due Diligence

In-depth business, legal and accounting investigations into the target company (called “due diligence”) will inevitably be more extensive in a share sale than would be the case in an asset purchase. This does cost time and money but we strongly recommend that you take the opportunity to make these enquiries to assess the true position of the business before you are committed to the deal. For more detailed discussion on due diligence please see section 10.

3.3 When would a buyer choose to buy shares rather than assets?

There are several instances where this might be the case:

- There may be important contracts that are non-transferable, or certain licences and consents might be unique to the seller.
- Sometimes a buyer will want simply to preserve as many of the customer relations as possible.
- There may be tax losses that can be set against future profits to minimise tax liabilities.
- The company may occupy leasehold premises and there may be a problem or significant delay in obtaining the landlord's consent to an assignment (i.e. a transfer) of the lease. Alternatively, the buyer may not be in a position to take an assignment without personal guarantees being given in support of the buying company by its directors, which may not be acceptable.
- The buyer may not want to alert the company's customers to a change of ownership.

Stamp Duty

If shares are purchased, the duty will be payable at the rate of 1/2% of the total consideration paid for the shares. Only once the duty has been paid, and the stock transfer forms have been received back from the Stamp Office, can the transfer be registered in the target company's books.

The Price

The decision to buy or sell shares or assets is one that has to be made early on in the transaction following negotiation between the buyer and seller. This should be one of the first points you agree. To change when the legal process is underway can add unnecessary substantial fees. Whichever route is followed, it will have an effect on the format and structure of the deal and crucially on the price paid by the buyer.

4. How Much is My Business Worth?

There is no such thing as “a correct valuation” of a private business. It could be argued that the only accurate valuation is the highest amount which a buyer is willing to pay for the business at that moment. It should also be borne in mind that the valuation of a business or shares is an art and not a science. Ten valuers may come up with ten different valuations. It is important to obtain advice from an independent corporate financial adviser or your accountant. Valuations are not something that we advise on but we would be happy to make an introduction one of the corporate finance advisers we regularly work with.

However, there are some common features which need to be considered.

Past Results

Although the basis of any valuation should be the profit and cash flow projections for the current and future years, past results provide a useful indicator of performance and should not be ignored.

Profit Growth

A buyer is likely to look for consistent sales and profit growth, rather than a business which has performed erratically in recent years, or is losing money. A buyer is unlikely to believe the seller claiming that there is about to be a dramatic growth of profits which is inconsistent with previous performance.

One-Off Events

Sales and profit performances over the last few years should not be accepted at face value. They may have been bolstered by one-off events. Reliance by the business on only a few key customers for the majority of its business could cause a buyer to be concerned at potential exposure to risk. Examine trends carefully.

Scarcity Value

If there is a lack of suitable acquisition targets in a particular market sector, then this will place a scarcity value on the business and is likely to increase the price payable.

Main Criteria

The main valuation techniques and criteria commonly used are as follows:

- Return on investment
- Discounted cash flow analysis techniques
- An earnings multiple valuation
- Net asset valuation

Use Two Techniques

Any business valuation should be based on the use of at least two valuation techniques, because any one method tends to have an in-built bias. Your accountants should be able to advise as to which two, taken together, are most appropriate to give an accurate picture.

Additional Factors

Other factors which may be taken into account include the following:

- Whether any salary increases will be needed after an acquisition to bring people in line with the current employees of the buyer's company
- Additional staffing requirements
- Any additional pension costs likely to be incurred
- Relocation costs, if appropriate
- Withdrawal of a product or the closure of a site/factory
- Redundancy costs
- Savings likely to be made following the departure of a director who does not need to be replaced and/or his relatives who currently work in the business
- Whether any cash can be generated by selling an asset which is not required
- Refinancing costs
- Simple (but easily overlooked) costs, such as rebranding or replacing out of date stationery and advertising

This is not intended to be an exhaustive list – it simply serves to indicate the sort of issues which the buyer needs to consider when calculating the price to be paid.

5. Deal Structure

The valuation of a business and the deal structure proposed for an acquisition are interrelated and must be considered together.

The structure will often have important implications for tax planning and should be discussed at a very early stage with your accountants. Changing the structure of a deal at the 11th hour can be time consuming and costly, and may weaken your bargaining position.

For example if the net asset backing of the business is low compared to the overall valuation, the buyer would be taking an unacceptable risk to pay the full price on completion. Alternatively it might be an acceptable risk for the seller to agree to defer the purchase price over a longer period.

6. When Do I Have To Pay?

Deferred Payments

Clearly, the seller will want as close to a ‘clean break’ as he can get, with all his money at completion. Whereas a cautious buyer would be looking to preserve his cash flow by negotiating stage payments or deferred payments. A prudent seller should consider taking security for any deferred payments but, any security might end up being ranked behind that being taken by any funder or bank, which could limit its value.

A cynic might also say that by deferring payment in part, the buyer is protecting his position should there be a claim under the warranties or if there is a tax problem.

Earn-out

Where the seller is being kept on to run the business on behalf of (or together with) the buyer, an earn-out deal may be the best option. An earn-out formula is one whereby the seller receives additional payment according to the performance of the company after the sale. Earn out deals are a common way of achieving the price expectations of the seller, whilst giving the buyer some practical assurance during the earn-out period.

Motivation

Earn-out deals can also motivate the seller to continue performing well on behalf of the new owner. The buyer, however, must appreciate that he may face restrictions on control of the business by virtue of the fact that the seller and/or his management team will want to remain in day to day control to be able to perform efficiently. One aspect which must not be overlooked by a seller, who will continue in the business through the earn-out,

is his change in mindset which usually emerges as the seller no longer “owns” the business in which he will continue to be involved.

“Triggers”

The biggest source of disagreement between buyers and sellers regarding earn-out deals is over the profit figure to be used to calculate the earn-out payment. It is important that the formulae and timescale for payment are clear, unarguable and agreed by the parties with reference to their professional advisers.

Loan Notes

There are other ways in which the price can be paid. The buyer may wish to offer payment, in part at least, by issuing shares in his own company, or written promises for his company to pay by a certain date. These are effectively loans from the seller to the buyer for the outstanding price which is repayable on fixed dates. They are called “loan notes”, which come in many forms, each with technically detailed differences which can be attractive to a seller as they can minimise and defer liability to Capital Gains Tax. If a significant sum is payable as loan notes, they can be secured against the assets of the purchaser.

Pre-sale Dividends

It is also worth considering that if the target company has substantial undistributed profits, a pre-sale dividend can be paid to the selling shareholders thus reducing the value of the target company and the price the buyer has to pay.

7. Where is the Money Coming From?

It is a fortunate buyer indeed who can finance the acquisition out of his own resources. At the outset it is essential that the seller obtains evidence from the buyer that the funds will be available to complete the purchase.

Venture Capital

Almost invariably, the buyer has to approach a bank for either an extension of overdraft facilities or a long-term loan. Another option is to speak with venture capitalists who will take an equity stake in the target company in exchange for advancing monies, but usually with heavy restrictions on the buyer’s management decisions. However, be warned – a venture capitalist will normally require a hefty return on his investment for each year and is likely to bring pressure on the new owner of the business to package it for sale within a short to medium timescale, so that the venture capitalist can recoup his investment. Generally the venture capitalist is looking for a certain “escape route” from the outset.

Management / Business Plan

Whatever source of finance is chosen, it is vitally important that a credible management team is assembled.

Further, a detailed and achievable business plan must be prepared to demonstrate why the required investment is worthwhile from the backer’s point of view and, crucially, showing that there is sufficient cash flow within the forecasts to “service” and to repay the debt.

Subscription Agreement

When dealing with a venture capitalist, there will be an additional level of paperwork as there will be a “Subscription Agreement” which will set out how much is being invested and how many shares the venture capitalist gets for his money. The Subscription Agreement will also list various issues which will require the consent of the venture capitalist before a decision can be made. Inevitably, a venture capital firm will require at least a seat on the board and monthly management accounts to be produced and will seek to regulate the payment of dividends by the company; for higher levels of borrowing, further restrictions on management decisions may be required.

8. Management Buy-Outs (“MBOS”) And Management Buy-Ins (“MBIS”)

An MBO is where the existing management buys the business they are employed in from the current owners. These sorts of purchases are nearly always funded by borrowed money.

An MBI is where an outside management team buys and takes control of a business, again usually with borrowed money.

Personal Investment

The management team will normally be expected to invest a substantial sum personally in the acquisition. It is fair to say that one of the reasons some MBOs have been so successful in the past is that they often relate to a long neglected subsidiary of a large group of companies. All that is required to improve the position is an investment of fresh capital and initiative. The management team are in an ideal position to provide this, having worked in the business and therefore know a great deal about it.

Although always risky, the MBO “industry” has grown substantially over the years and there are many instances where MBO teams have amassed a personal fortune from acquiring the company they work in.

Buying managers have to be alert to the great potential for conflict between their role as directors and employees of the company answerable to the current shareholders and their role as prospective owners.

Contacts

It is important to speak to the right backers. Ashtons Legal have an extensive network of contacts in this field and we are happy to make the necessary introductions.

9. Do I Need Heads of Agreement (“Heads”)?

“Heads” is the term used to describe a skeletal outline which is agreed by the buyer and seller, setting out the main points of the deal. It should be stated to be “subject to contract” and therefore non-binding, save in a few key points such as exclusivity (see below). The buyer should avoid entering into binding agreements at this early stage, as until all the necessary investigations have been carried out, the buyer might still wish to withdraw from the transaction, and needs to ensure his investment is adequately protected.

Negotiations

- The purchase price (or the method by which the price will be calculated)
- The timing and the form of the payment - should any deferred payment be secured?
- Whether the transaction is to be a sale of shares or assets
- What is included/excluded from the sale
- Purchase of personal assets by directors of the selling company
- Premises – are these freehold or leased?
- Transfer of pension fund
- Intellectual property rights
- Removal of directors’ personal guarantees to the bank
- The future involvement of the seller in the business (if any) and restrictions on competing
- Service contracts/consultancy agreements
- Warranties and indemnities
- Earn-out period and how the formula works

Confidentiality

It is usually important to ensure that the proposed sale is kept confidential from third parties (e.g. customers and staff). If the purchaser has not already signed a confidentiality agreement some detailed provisions (stated to be binding on the buyer) should be included in the Heads of Agreement, including a commitment not to use the confidential information for any purpose other than the proposed purpose.

Exclusivity

In addition, it is sometimes useful to negotiate an exclusive period during which the seller will not be allowed to offer the company for sale to anyone else. This can be a valuable concession for the buyer, as the buyer will be investing time and money in investigating the target company and will not normally be willing to compete with three or four other bidders.

“Ashtons Legal has helped us to navigate through many of the business landscapes ranging from employment to business acquisitions. Through quick and intelligent advice they have allowed us to move and scale faster than our contemporaries.”

Legal 500

10. Take a Good Look At The Target

“Due diligence” is the name given to the process whereby the buyer and his professional team investigate the target business to make sure he gets what he is shown and expects. Due diligence is especially important if the buyer is purchasing shares in the target company, as in this case he will be buying the company “warts and all”. It is essentially a “paper trail” exercise to show documentation reflecting all the key aspects of the company’s business.

The process is usually begun by the buyer issuing a questionnaire, asking for particular documents and any points he needs clarifying. These answers will form the basis of the warranties in the sale and purchase agreement.

Timetable

It is vital to establish a timetable for these investigations and, in particular, to identify when the relevant information can be expected to be received from the seller and his professional advisers.

The process should not be left until the last minute. The buyer will want to evaluate the information received. Due diligence should not commence before the Heads of Agreement have been signed and certainly not before a confidentiality agreement is in place. From a prospective buyer’s point of view, there is a risk of wasting money. There are many instances of substantial amounts of money being spent on due diligence where the deal fails to go through as a price cannot be agreed.

Staff Awareness

There is a tactical point here – if due diligence is conducted at the seller’s business premises it is almost inevitable that the seller’s staff will realise that the business is being sold and this could be unsettling.

. In most cases an electronic data room containing all the necessary information can be used, although in some circumstances, this may not be practically possible. In any event, getting documents together to upload to a data room or send out to the buyer can be difficult to achieve discretely. The seller should take into his confidence one or more key personnel to handle the heavy administrative burden of due diligence.

The Due Diligence Team

In any significant acquisition, the buyer should instruct investigating accountants to confirm whether the buyer’s assessment of the value of the business is justified. If shares are to be purchased then the accountants will need to investigate and advise on the target company’s tax position. Depending on the nature of the business and the deal, other forms of commercial due diligence that drill into the wider operations and market that the target business operates in may be required.

Solicitors’ role

It is usual to include solicitors in the due diligence process as there are many issues that need to be considered from a legal viewpoint.

Questionnaire

The buyer’s solicitors will prepare a detailed questionnaire for the seller to complete to flush out all relevant legal matters. The buyer’s accountant may do likewise on financial and tax issues.

Issues

No list can be exhaustive, but the following should give a flavour of what is required:



General Commercial Overview

Our experience has shown that commercial due diligence receives less than adequate attention from many buyers. There appears to be a willingness by buyers to accept anecdotal evidence put forward on an informal basis by sellers. Usually, very little effort is made to verify such statements. It is true to say that one of the prime reasons that acquisitions are less successful than expected, is the failure properly to assess commercial matters within the target company.

There are no hard and fast rules on this. However, the buyer should bear in mind that the main purpose of due diligence is to identify every aspect of the target company and the business environment in which it operates, and to identify further those issues which may have a significant effect on the success of the business in the future. The more information which is given, the narrower the seller’s warranties may need to be focused to give the buyer adequate comfort.

Property

The buyer will need to carry out property searches and review the title documents to ensure that ownership of the property is as intended. There may be matters such as covenants (restrictions) and easements (rights of way) which will affect the value of the property. Are those covenants being adhered to?

Planning

Are the premises being used in accordance with the relevant planning permission?

Survey

It makes good sense to instruct surveyors to survey and value the property, especially if the value of the business is dependant on what is often the largest single fixed asset, i.e. a freehold property.

Lease

Where the property is held under a lease, the terms of the lease itself will need to be examined. There are many variations of leases and some can be extremely costly to comply with. There may already exist substantial liabilities to repair the property. Again a surveyor should be retained to advise on the buyers potential liability in this respect.

Environmental Issues

Increasingly, environmental issues have to be considered. There is no doubt that this will become an increasingly important area in the future. The subject of environmental law is a specialist one, but it is fair to say that the principle on which the whole area is based is “strict liability”. There has been an increase in the use of specialists to carry out environmental audits of potentially contaminated sites to alert a purchaser to potentially expensive problems.

Customers

The customer and supplier base must be analysed. Are any customers pivotally important? To what extent does the target company rely on one or two very large customers (or suppliers)? Any contracts with such customers/suppliers will have to be examined. Are they as sound and reliable as the seller makes out? Are all contracts in writing and in clear terms? Some contracts can be affected by a change in ownership and some cannot be assigned (i.e. transferred) to the new owner. Are the key employees subject to valid restraints against poaching customers? The principle is that the buyer does not want to pay money for contracts which disappear as soon as he arrives.

Finance Agreements

Nearly every business now has detailed finance agreements such as hire purchase and lease agreements for equipment, and these need to be examined. From our experience this neglected area of analysis often throws up a disproportionate number of problems, so the sooner they are tackled the better.

“Ashtons Legal is a strong firm, and they are able to deal with things very quickly. When a matter is urgent, the team is able to commit resources at short notice.”

Chambers & Partners

Employees

The employees need to be identified and their terms of employment must be investigated. Employment law is an increasingly complicated subject, but the general position is that if you are buying the shares in a company, the employees will remain employed by that company. If you are buying the assets of a company which forms an identifiable business then the employees are likely to pass automatically to the buyer with all their accrued employment rights (see the reference to TUPE below – section 12).

Liabilities

The buyer will therefore need to take detailed legal advice so as to be able to assess and quantify the employment liabilities being taken on. We advise that this is an area which is explored in depth during the due diligence.

Redundancies

If there is to be a restructuring of the business after completion, then the redundancy costs etc must be calculated beforehand. This can have an impact on the price and can be the subject of negotiation between the buyer and seller. Sufficient time has to be allowed for the very strict consultation procedures.

Contracts of Employment

It is a moot point as to whether certain key employees should be signed up on new contracts. The buyer should be aware that there may be little point in giving long fixed-term contracts to key employees – it might subsequently be discovered that these people are not up to standard and need to be replaced.

Intellectual Property

This covers copyrights, patents, design rights and trademarks, all of which may be essential to the business. Their validity and any doubts as to their ownership must be investigated, particularly if any such rights have been registered. Increasingly, the wealth of a business is reflected in such “intangibles”.

Trade Secrets, Confidential Info and Know-how

If the buyer is acquiring a skills base, he must be sure that the individuals concerned are legally restrained from removing the trade secrets and confidential information of the target company; although if this is no longer ‘secret’ or has become part of the accumulated skill of the employees, it may be difficult to protect.

Pension Scheme

It may be necessary to take actuarial advice on the valuation of a pension fund. Failure to deal with pensions issues properly can lead to an underfunded pension scheme – which could potentially exceed the cost of the acquisition. Again, from our experience, there are often a multiplicity of pension schemes, each with its own rules.

Litigation

Actual or potential litigation needs to be considered, so that the buyer is able to assess the likely costs and effect on the company and its business.

Regulation and Compliance

Businesses are increasingly regulated with rules relating to things such as Data Protection applying to all businesses and other more specific regulations applying to businesses in certain sectors e.g. finance or care services. It is important to ensure that proper authorisations, policies and processes are in place where required and to understand whether the change of ownership of the business will affect any authorisations that are in place.

11. Share Purchase - The Legal Paperwork

Share Purchase

The buyer's solicitors will normally prepare the Share Sale & Purchase Agreement. The reason for this is that the agreement will contain warranties and indemnities intended to benefit and protect the buyer, and it is not realistic to expect the seller's advisers to "draft against" their own client.

Share Sale and Purchase Agreement

In an ideal world, the preparation of the agreement would not take place until all due diligence matters have been finalised. However, in practice, the time constraints on such transactions usually mean that the processes take place side by side.

A typical Share Sale & Purchase Agreement or "SPA" will deal with the following matters:

- **Selling the Shares**

Once the shares have been transferred, ownership of the target company will pass to the buyer. Obviously, the buyer will want to appoint new directors, auditors etc. The buyer may also wish to remove the current officers.

- **Warranties**

Put simply, warranties are statements on completion by the seller relating to the target company and its business (these are not guarantees relating to future performance). They are usually based on information gathered during the due diligence exercise.

The warranties have two purposes:

1. To "flush out" any information which the buyer ought to know and which could affect the value of the company or, indeed, the buyer's decision to buy the company, in particular if it contrasts with the due diligence.
2. To give the buyer some comfort in the event that the company is not as the buyer represented to him (eg: profitability, hidden problem or litigation). In general terms, if a warranty turns out to be untrue and the buyer suffers a loss as a result, they can claim that back from the seller.

Comprehensive

It is now common practice for warranties to run to tens of pages in the agreement. The intention is to cover every aspect of the company and its business.

Scope

Some warranties are reasonable and some unreasonable. The seller will naturally seek to resist giving unreasonable warranties and will seek to limit the scope of a warranty statement. The position can become polarised and often the settling of warranties can be a time consuming matter.

Disclosure Letter

The seller will be permitted to prepare a "Disclosure Letter". This is the seller's opportunity to set the record straight and to provide information to the buyer where the actual position is not as stated in the warranties.

Generalities

The buyer will be concerned to ensure that the seller does not make over-general disclosures. The seller should be asked to provide specific disclosures to specific warranties. Coupled with the use of a Disclosure Letter there are general clauses limiting the seller's liability for breach of warranties called "Seller's Protection".

Seller's Protection

The seller will normally seek to include clauses to limit his liability both in the amount of his potential liability and the time during which he remains exposed to a claim for breach of warranty. Sensible liability "caps" on the total liability and minimum thresholds (to avoid trivial claims) have to be agreed.

Though a trite observation, both sides should always bear in mind that they are trying to achieve a deal by consensus. Accordingly, they should seek reasonable warranties against which specific disclosures can be made and be prepared to settle issues which can rapidly become "deal breakers" unless dealt with equitably. The subject of warranties often dominates the drafting negotiations. It is important that the seller does not become "battle weary" and give unduly onerous warranties.

Tax Indemnity

This will be a separate document which, simply put, states that the tax liabilities of the target company have been dealt with correctly and have been properly provided for in its statutory accounts.

Reimbursement

Under the Tax Indemnity, there will be an obligation on the seller to reimburse the buyer if it is later discovered that there is unpaid or undisclosed tax which can be assessed on the company, where that liability relates to a period when the seller owned the company.

Indemnities

If in the course of due diligence the buyer flushes out a prohibitive problem, he may seek a specific indemnity against such problems arising in the future. An indemnity is much more powerful than a simple warranty.

Restrictive Covenants

The intention of these is to prevent the seller from competing with the buyer for a limited period. This is a complex area of law and such covenants require careful drafting to be enforceable. Though on the face of it they may be attractive, covenants which are too widely drawn will probably be void. A balance has to be struck to go no further than the reasonable legitimate protection of the business being bought.

Completion Accounts

On a Share Sale, to ensure that the financial position of the company on completion is the same as that which was agreed at the outset, immediately after completion, Completion Accounts may be prepared. How this works is that if the balance sheet of the Completion Accounts show the net asset position of the company to be better than that which was agreed, the purchase price will be adjusted upwards and the buyer will pay the additional sum. If however the position is worse than that which was agreed, then the difference will be refunded to the buyer. Both payments will usually take place shortly after Completion Accounts have been agreed.

An alternative price adjustment mechanism is the "locked box". This enables the parties to agree the price based on a set of accounts prepared before completion. The accounts can either be year-end accounts, recent management accounts or a balance sheet specifically prepared and agreed for the transaction. The agreement will then contain certain undertakings from the seller restricting any unauthorised "leakage" from the value of the target company after the locked box date. If there has been any unauthorised leakage, the seller has to recompense the buyer. The definition of leakage is an important point here and typically includes certain carve-outs in respect of "permitted leakage" which usually includes ordinary course operating expenses such as staff wages and supplier payments.

Schedules

Depending upon the complexity of the transaction, there will be various Schedules attached to the main agreement. Matters such as earn-outs and post-completion adjustments to the price must be dealt with, as must any provisions relating to the transfer of a pension fund.

"Your firm has been the simplest and easiest firm we've had the pleasure of dealing with."

Ashtons Legal Client



12. Asset Purchase – The Legal Paperwork

Once again, it is customary for the buyer to prepare the Asset Purchase Agreement for the same reasons as previously mentioned.

Assets

It is important to identify exactly what is being purchased – i.e. plant and machinery, stock, contracts, premises, work in progress, know-how and goodwill (and other intellectual property).

Excluded Assets

Equally, it is as important to identify what is not being purchased, i.e. whether existing creditors and debtors are being left behind etc, or if part only of the business is being purchased.

Loose Ends

It is fair to say that there are more “loose ends” in an asset acquisition than there are in a share purchase. Therefore, the documentation can appear to be more complex.

Asset Purchase Agreement

A standard Asset Purchase Agreement would deal with most, if not all, of the following matters:

- **Stock**
This must be identified and a mechanism put in place for valuation at the completion date. Usually an estimated value is used, with a stock take on or after completion providing an actual value, which if different from the estimate, will vary the purchase price. Similar issues arise in connection with work in progress.
- **Goodwill**
Roughly, goodwill equates to the expectation that having purchased something from a business, the customer will return. The buyer will want to know that he is protected from the seller adversely affecting this goodwill. As with share purchases, it is normal to take non-competition covenants from the seller.

- **Employees – What is TUPE?**

TUPE is the name of the Regulations which protect employees’ rights on the transfer of the assets of a business.

Both the buyer and the seller have to liaise early in the deal to inform and consult with affected employees through their elected representatives.

On an asset sale, both sides will need detailed early advice on TUPE and its financial consequences, which can be substantial.

The fundamental principle of TUPE is that if you are buying the assets of a business as a “going concern”, then the employees engaged in that business will be deemed to transfer to you automatically. They will bring with them their existing terms of employment and any statutory rights that they have accrued - their ‘employment history’. In an asset purchase, the question of employee related liabilities in respect of those employees must be addressed. It must be understood however, that just because the company as a whole is not being sold, it does not stop the transfer of employees employed primarily in the part which is sold if that part is an identifiable economic unit. In many cases, the transfer of some key assets equals the transfer of an undertaking. It all depends on the facts of each individual transaction.

- **Plant and Machinery**

Obviously, it is essential to know what is being purchased – this is usually incorporated within a schedule where it is relatively easy to list machine identification numbers etc. A properly maintained asset register can be very valuable at this stage, together with copies of all hire purchase or lease arrangements.

- **Contracts**

Every business has a range of contracts. This can be a complex area to check. Provisions will have to be included to deal with the

respective liabilities under the contracts that are being taken over. Often, third parties will have to consent to the transfer of contracts to a buyer. The parties will have to consider what will happen if the third party refuses to give consent.

For hire purchase or lease hire agreements, formal assignments will be required, but usually a hire company will want to continue the revenue stream from their assets.

All of the contracts and agreements relating to the business should be examined by the buyer’s solicitors during the due diligence process.

Premises

There will need to be a formal transfer document (as with any other conveyance).

Leasehold

The situation is more complicated where a leasehold property is involved, as the landlord’s consent to the transfer, or assignment will be required. This can be time consuming and costly and the landlord will expect his legal expenses to be covered. It should therefore be a priority. There may also be issues of confidentiality if the assignment process is started before the deal has been concluded.

Early Possession

If there is not sufficient time to deal with the question of transferring a lease before completion, the seller often allows the buyer in to the premises under a licence, on the basis that they will both cooperate in obtaining the landlord’s consent as soon as possible after completion.

Personal Guarantees

Once again, the agreement needs to deal with what happens if the landlord refuses to consent to the transfer of the lease. Does the landlord require personal guarantees from the incoming directors? What other form of security would the landlord be prepared to accept?

Intellectual Property

These days what we called intangible assets are often more important than the physical assets. The title to all intellectual property will have to be checked. Formal assignments (i.e. transfers) of registered and unregistered intellectual property will be required, and applications to update the register of trade marks, patents and registered designs.

Creditors

Often, creditors up to completion will remain the liability of the seller. The buyer will be concerned that the seller fulfils the obligation to pay the creditors promptly, as this could impact upon the goodwill of the recently acquired business. In some instances, the buyer might consider taking over the creditors and reducing the purchase price accordingly.

Debtors

Again, debtors at completion are often retained by the seller and set against the cost of meeting the creditors. The buyer may prefer to take control over the collection of the debts and payment of creditors so as to be certain that there is no damage to the goodwill of the business.

Warranties

As with a share purchase, warranties will be taken from the seller. However, the warranties will generally be much less extensive, as in an asset purchase the buyer purchases specific assets and takes on responsibility for specific liabilities.

VAT

If the business is purchased as a “going concern”, then VAT can be ignored as long as both parties are VAT registered. The agreement will contain clauses required to deal with this.

13. Buying from an Administrator or Liquidator

This will nearly always be a sale of assets. The Administrator will expect to have his own advisers prepare the draft sale agreement.

Difference

As the business will be insolvent, the price will be very much lower than buying a solvent business as a going concern. The risk to the buyer is much greater because the Administrator will give no warranties and will seek indemnities from the buyer in order to avoid any ongoing liability from the insolvent business.

14. Completion

After the documentation has been finalised and the financing of the transaction is settled then the papers can be signed.

If there are pre-conditions to completion, then it is normal to have a period between exchange of contracts and completion. In most cases, however, exchange and completion is simultaneous.

Completion Agenda

There are many practical issues that a buyer has to deal with at completion such as (for an asset purchase) VAT registration, payroll, PAYE and National Insurance, and buildings and contents insurance.

15. Legal Costs

Legal fees are a significant but necessary expense in ensuring your investment is adequately protected, and that there are no potentially damaging “hidden dangers” in the deal. They should be discussed with your solicitor at the outset.

We understand that clients need a pragmatic approach to costs.

We are upfront about fees and in most cases, are able to set a cap on fees at the outset, so that our clients are able to budget appropriately and do not face unexpected legal fees on completion. We are also happy to discuss sharing the risk on fees with our clients, where a transaction does not proceed, through no fault of our client.

We also have pricing models for smaller transactions where more traditional fee arrangements can become disproportionate to the deal value.

Ashtons Legal is a ‘very competent, efficient firm, and undoubtedly one of the leaders in the region.

Legal 500

Generally, in respect of the last item, risk passes to the buyer at completion. A completion agenda will be prepared and used as a checklist.

For a share purchase, detailed board minutes dealing with the share transfer and any formal requirements.

Announcement

Finally, it is normal to agree an announcement to be circulated to suppliers, customers and employees, and/or a general press release.



Meet the Team

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Geoff is a partner and Head of the Corporate & Commercial team. He acts for clients in a number of sectors which include a number of professional partnerships and LLPs who have required assistance with LLP incorporations, LLP and Partnership agreements and partner appointments and retirements. In addition to this he also acts for clients providing general commercial advice as well as advice on corporate acquisitions, corporate finance and banking.

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Nick is an experienced and collaborative corporate lawyer. He focuses on advising established companies and the entrepreneurs behind them, providing practical and holistic advice to help expand their business, consolidate their position and maximise exit potentials. Nick's approach is commercial and he always starts by looking to understand your business and what you want to achieve.

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Craig is experienced in advising on and managing corporate transactions such as acquisitions, sales and restructurings, including management buyouts and purchases from companies in administration. He acts for a variety of clients including individuals and small and large companies, both locally and nationally, and drafts and advises on a wide range of general commercial, corporate and company law matters.

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Richard is a partner in our company commercial team and one of Ashtons Legals' most experienced solicitors. He advises on large scale corporate transactions, non contentious intellectual property and directors' duties. Richard has received national recognition for his work in the area of commercial agency and franchising. He represents numerous national and international trade organisations and associations.

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David helps businesses to licence, use, buy and sell technology and steers them through regulatory frameworks such as data protection laws. He has particular interest in advising innovative, high-growth start-ups get going and scale up through creating the right business structure, exploiting their technology, taking on investment, and growing organically.

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Mark advises upon a broad range of corporate transactions including partnership and LLP matters. Mark also advises on a variety of complex commercial arrangements and agreements. Clients include a range of local and national businesses, in a variety of sectors, together with our panel banks and other financial institutions whom Mark advises as part of our cross-team banking group.

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