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Buying and selling a business

Here are some legal and practical issues to consider when buying or selling a business.

Structuring the sale

What is being bought or sold?

- **Shares.** The whole company is sold with all its assets and liabilities, 'lock, stock and barrel'.

- **Assets.** Some or all of the business and assets are sold. This means that the seller or the buyer can choose which assets to sell or buy.

Preparing for a sale

- **Contracts.** The seller should review any contracts entered into by the business being sold. A contract may prohibit the sale of a specific asset or may even terminate on a sale of the business. Verbal or rolled over agreements should where possible be documented before the sale process starts.

- **Regulatory approval.** Take legal advice about any regulatory approvals that may be required and the timing implications. For example, the transaction may need the approval of:

    - industry regulators;

    - competition authorities; or

    - Pensions Regulator.

- **Other third party approvals.** The seller may need the consent of other third parties (such as customers, suppliers or lenders). On an asset sale, trading obligations (for example, an obligation to pay a supplier) will not normally transfer to the buyer without the consent of the trading partner.

- **Tax.** The sellers should take specialist tax advice on the tax implications of a sale, in particular the taxation of any gains made. The buyer will also need to consider the potential tax implications of different structures.

- **Intellectual property rights.** The seller should carefully review any intellectual property rights used in the business being sold (such as a brand or patent). Check that the business:

    - owns the rights;
    - has adequately protected the rights; and
    - may transfer the rights.

- **Employees.** Carefully consider how and when to tell employees about the sale and how to deal with any adverse reaction. The seller may be required to inform and consult employees about the sale, a process the buyer will need to be concerned with if any changes to staff levels or terms of employment are proposed.

- **Disputes.** The seller should check whether the business is involved in any major disputes and, if so, whether these can be settled before the sale.

Early stage negotiations: key points to remember

- Make sure that the representatives of the buyer or seller have the authority to enter into negotiations and, in the case of the buyer, that it has the necessary finance to buy the business.

- Take legal advice before starting any discussions or exchanging information. Acquisitions are highly business sensitive. Only speak to people that need to know about the deal. Sign a confidentiality agreement at an early stage in the negotiations. All confidential information should be marked “confidential” before it is handed over.

- Always be honest and act in good faith.

- Avoid making a legal commitment by mistake. A binding deal can be made without anything in writing (for example, through a conversation). When talking or writing, make sure the other party is aware that nothing is legally binding until the formal agreements are signed (for example, mark all correspondence “subject to contract”).

Due diligence

- The purpose of due diligence is for the buyer to investigate the assets, liabilities, trading performance and finances of the business being sold.

- The buyer and its advisers will request information about the business, normally in the form of a due diligence questionnaire.

- Sellers should not hold back any critical information which could influence the buyer’s decision to proceed, but the seller can consider the timing of the disclosure from a tactical point of view.

Documents

Heads of terms

- Heads of terms (also known as heads of agreement, memorandum of understanding, letter of intent or term sheet) are usually signed at an early stage of the deal.

- They set out the key terms of the deal and are generally not legally binding. However, legal obligations can be created inadvertently and a strong "moral commitment" can be created which could influence the negotiating position of the parties later on.

- Heads of terms can include protections that are legally binding (for example, the seller may require an undertaking from a buyer not to poach customers or employees; a buyer may require a binding exclusivity period).

Acquisition agreement

The acquisition agreement contains the mechanics of the deal (for example, the parties involved, the amount to be paid and any consents or approvals required before completion). It will contain a number of provisions designed to protect the buyer, including:

- **Warranties.** These are contractual promises given by the seller about different aspects of the business (for example, that the seller owns all the assets and there are no disputes with any third parties). If they are untrue, the buyer can sue the seller for damages (unless the seller has disclosed to the buyer why they are untrue).

- **Indemnities.** These require the seller to compensate the buyer (on a pound for pound basis) for specific liabilities if they arise (for example, potential tax or environmental liabilities).

- **Restrictive covenants.** These can prevent the seller from competing with the buyer or poaching key customers or employees for a period of time. They will only be enforceable if their scope is reasonable.

Limitation on claims

- The seller will want to try and limit the claims that can be made under warranties and indemnities (for example, limiting the time within which the claim can be brought and the amount that can be claimed).

- An expiry date of between two or three years is common for non-tax warranties and six years for tax warranties. Sellers usually limit the aggregate liability under the warranties to the amount received from the buyer. The seller may also want to impose a minimum limit for individual and aggregate claims.

Disclosure letter

- The disclosure letter is an important document that must be read in conjunction with the warranties in the acquisition agreement.

- The seller must disclose any potential problems with the business in this letter. The buyer cannot make a warranty claim for anything disclosed in it.

- The seller must review the warranties carefully and make full, fair and clear disclosure against them in the disclosure letter.

Signing and completion

- Signing and completion can be simultaneous, but there is sometimes a gap between them when there are conditions to completion that need to be fulfilled (for example, obtaining regulatory approval).
- If there is a gap, the buyer will usually ask for warranties to be repeated at completion and the seller will be given the opportunity to update the disclosure letter as unforeseen problems may arise between signing and completion.

More information

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We recommend that you seek legal advice at the start of any transaction.