Ashton Bond Gigg solicitors

GUIDANCE NOTE

Selling a Business

February 2012

This guidance note sets out the legal issues to consider when selling a business. You should always take legal advice at the start of any sale.

1. Structuring the sale

You can either sell the shares of a business or its underlying assets:

- **Share sale.** You sell the whole company with all its assets and liabilities.
- **Asset sale.** You can choose which assets to sell. However, you cannot transfer liabilities (for example, debts) without the consent of the person you owe the liability to.

2. Single buyer or auction sale

You can either negotiate with a single buyer or conduct a formal auction with a number of potential buyers. The main advantages of an auction sale are:

- You can create price competition between bidders.
- You control the process and draft the sale documentation.

3. Preparing for a sale

- **Contracts.** You must 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. Try to document any verbal or rolled over agreements before the sale process starts.
- **Regulatory approval.** Take legal advice about any regulatory approvals that may be required and the timing implications. For example, you may need the approval of:
  - industry regulators;
  - competition authorities; or
  - Pensions Regulator.

- **Other third party approvals.** You 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.** Take specialist tax advice on the tax implications of a sale, in particular the taxation of any gains made. You should also consider the potential tax implications for the buyer of different structures.

- **Key staff.** Consider whether:

    - the buyer is likely to want to tie in key staff or management on special terms; and

    - there are any key staff you wish to retain.

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

    - owns the rights;

    - has adequately protected the rights; and

    - may transfer the rights.

- **Employees.** Carefully consider how and when you will tell your employees about the sale and how to deal with any adverse reaction. You may be required to inform and consult employees about the sale.

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

4. Early stage negotiations: key points to remember

- Make sure that the person you are dealing with has the authority to talk to you and the necessary finance to buy the business.

- If the buyer is a competitor, you must take legal advice before starting any discussions or exchanging information. Sharing business sensitive information could breach competition law, which may lead to your business incurring a large fine.

- Always be honest and act in good faith. If the buyer enters into the deal on the basis of false information, they may be entitled to compensation.

- 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 buyer is aware that nothing is legally binding until the formal agreements are signed (for example, mark all correspondence “subject to contract”).

- Acquisitions are highly business sensitive. Only speak to people that need to know about the deal. Sign a confidentiality agreement with the buyer at an early stage in the negotiations. All confidential information should be marked "confidential" before it is handed over.

5. Sale process: auction or single buyer?

The sale will depend on whether you are selling by auction or to a single buyer.

5.1 Auction sale

You control the process of an auction sale and draft most of the documents. You must:

- Send summary information about the business being sold to potential bidders (this is known as an information memorandum). All statements and financial information in this document must be true.
- Prepare a data room, giving bidders access to information about the business.
- Draft the acquisition agreement and disclosure letter. Ask bidders to mark up any comments.
- Try and prevent the successful bidder from trying to negotiate changes to the deal once it has won the auction.
- Never mislead bidders about the interest from other bidders or the amount that they are offering. This can lead to a claim for damages.

5.2 Single buyer

The buyer usually drafts the main documents and drives the deal. The parties will normally agree the main terms of the deal in heads of terms. The buyer will then conduct due diligence.

6. Due diligence

- The purpose of due diligence is for the buyer to investigate the assets, liabilities, trading performance and finances of the business you are selling.
- The buyer and its advisers will request information about the business, normally in the form of a due diligence questionnaire.
- You should not hold back any critical information which could influence the buyer's decision to proceed, but you can consider the timing of the disclosure from a tactical point of view.

7. Documents

7.1 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 weaken your negotiating position later on.
- Heads of terms can include protections that you want to be legally binding (for example, you may require an undertaking from a buyer not to poach customers or employees). You should take legal advice to make sure the undertaking is enforceable.

7.2 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 you own all the assets and there are no disputes with any third parties). If they are untrue, the buyer can sue you for damages (unless you have 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 the length of time is reasonable.

7.3 Limitation on claims

- You 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 it received from the buyer. You may also impose a minimum limit for individual and aggregate claims.

7.4 Disclosure letter

- The disclosure letter is an important document that must be read in conjunction with the warranties in the acquisition agreement.
- You must disclose any potential problems with the business in this letter. The buyer cannot make a warranty claim for anything disclosed in it.
- You must review the warranties carefully and make full, fair and clear disclosure against them in the disclosure letter.

7.5 Signing and completion

- Signing and completion can be simultaneous, but there is usually a gap between them when the conditions to completion are fulfilled (for example, obtaining regulatory approval).
- The buyer may also ask for warranties to be repeated at completion. You should resist this or insist that you can also update the disclosure letter as unforeseen problems may arise between signing and completion.

8. Retained business

If you are selling part of a business or some of its assets rather than the whole business, you should consider whether any:

- Assets or services you are selling will need to be replaced to continue running your existing business.
- Any services provided by the target business continue to be provided to the retained business for a transitional period after completion.

The comments in this guidance note are of a general nature only. Full advice should be sought on any specific problems or issues

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