Briefing Note: Buying a Business

An Introduction to the Briefing Note

This Briefing Note highlights the main legal risks you need to consider if you are buying another business or enterprise. Your business should always take legal advice at the outset of any acquisition. This briefing note should not be relied upon as legal advice and you should contact us for advice on your specific circumstances.

Briefing Note
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Structuring the acquisition

Your business can buy either the shares of the company that owns the target business or simply buy the assets which make up the business:

- **Share purchase.** Your business buys the whole company (including liabilities that you may not know about).
- **Asset (or business) purchase.** Your business chooses the assets that you want to buy. This will provide more flexibility, but it can be complicated to identify and transfer specific assets.
- **Tax and accounting issues.** Check, in particular, how any goodwill on the acquisition is likely to be treated for tax and accounting purposes. Asset deals are typically less tax efficient for sellers than share deals, which can affect the price you pay.

Deal breakers

Employees

If your business buys a company as a going concern (even via an asset purchase), you must take on the employees on their existing contract terms.

Pensions

Your business may have to take over the target company's existing pension arrangements (which you should ensure are fully funded) or offer prescribed pension arrangements to transferring employees.

Intellectual property rights

A brand or patent may be the most valuable asset of the target business. Take legal advice to check that the target business:

- Owns the rights.
- Has adequately protected the rights.
- Can transfer the rights.

Environmental issues

Your business could face huge liabilities (possibly including criminal liability) if you buy contaminated land or a company that caused or allowed contamination.

Shared assets

If you are buying a business that is part of a group, it may share assets such as computer systems, property and insurance policies with other group members. Consider whether these arrangements can be unravelled without incurring prohibitive costs or disruption to the business. Your business can draft an agreement to deal with how the assets are divided and shared after the completion of the sale.

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Key staff

Consider whether you want to tie in key staff or management on special terms.

Consents and third party approvals

- Your business may need the approval of third parties (for example, industry regulators) or require approval from competition authorities. Consider when to approach them and whether you are likely to get their consent.
- If you are acquiring all the shares in the target business, check that no important contracts can be terminated on the change of control of the target company.
- The transaction may require approval from your business' shareholders or the target business' shareholders.

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 power to give you the information your business requires.
- If the seller or target company is a competitor, you must take legal advice before starting any discussions or exchanging information. If you share business sensitive information, you could breach competition law, which could lead to your business incurring a large fine.
- Always be honest and act in good faith. Your business can be sued if you do not. You could also be committing a criminal offence.
- Avoid making a legal commitment by mistake. A binding deal can be made without anything in writing (even through conversation or e-mail). When talking or writing, make sure the seller is aware that nothing is legally binding until due diligence has been completed and the formal agreements signed (for example, mark 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 seller at an early stage in the negotiations.

Process and documents

Planning

Acquisitions can be complex, involve a lot of people and take a long time to complete. Make sure you compile a detailed plan with key deadlines and responsibilities.

Confidentiality agreement

Sign a confidentiality agreement (also called a non-disclosure agreement) at an early stage. This will generally require both parties to keep the deal secret until it is formally announced and protect any information that you exchange with the seller. You should take legal advice before signing a confidentiality agreement, to ensure your position is adequately protected.

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Heads of terms

Heads of terms are usually signed at an early stage of a deal before detailed due diligence. They may also be known as:

- Heads of agreement.
- Memorandum of understanding.
- Letter of intent.
- Term sheet.

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 that could weaken your negotiating position later on. As the buyer, your business will normally prepare this document. You should always take legal advice before signing this document.

Due diligence

The purpose of due diligence is to investigate the assets and liabilities of the target business. You must take legal advice to ensure you get the legal protections that your business requires. If your business becomes aware of any significant problems in the due diligence process, you can:

- Abort the deal.
- Negotiate a price reduction.
- Seek specific protections in the acquisition agreement.

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 it owns all the assets and there are no disputes with third parties). If they are untrue, your business can sue for damages.
- **Indemnities.** These require the seller to compensate you as a buyer for specific liabilities if they arise (for example, potential tax or environmental liabilities).
- **Restrictive covenants.** These can prevent the seller from competing with you or poaching key customers or employees for a period of time. They will only be enforceable if the length of time is reasonable.

Seller limitations on claims

The seller will 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).

Disclosure letter

The disclosure letter is an important document that must be read in conjunction with the warranties in the acquisition agreement. You cannot make a warranty claim for anything disclosed in this letter, although you may want to negotiate alternative protection (such as a price reduction or an indemnity to cover this issue). If you knew about a problem before signing, you may not be able to make a warranty claim about it even if it not disclosed in the disclosure letter.

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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:

- Informing and consulting with any transferring employees.
- Getting approval from the competition authorities.
- Obtaining shareholder consent to the transaction.

After the acquisition

- Prepare a detailed integration plan for the new business after completion. Poor integration planning is often cited as the most common reason for acquisitions to fail.
- Carry out the post-completion filings with Companies House, update the company books (if necessary) and pay any stamp duty due.
- Take legal advice immediately if you think you have a possible claim for compensation from the seller (time limits for bringing claims under the new acquisition agreement usually expire once the buyer has completed its first audit of the new enlarged business, although the time limit will usually be longer for tax claims).

If you would like to know more about this topic or our other legal services, please contact Mark Williams on 01323 435900 or by email mew@gabyhardwicke.co.uk :

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