

A Guide to Selling Your Business

The Initial Stages

When a deal is being negotiated at the outset, the terms are usually set down in a document referred to as the *Heads of Terms*. Although the *Heads of Terms* are not legally binding, they contain the principal terms of the deal such as the parties, the price, timescale, preparation of completion accounts and provisions about restrictive covenants and warranties.

The *Heads of Terms* may make reference to certain specific conditions such as a period of exclusivity, confidentiality or the underwriting of costs by either party in the event that the deal fails to proceed. These provisions are usually legally binding.

It is important that professional advice is taken on the drafting of the *Heads of Terms* to ensure that the terms do not have to be changed for legal or taxation reasons.

Share Sale or Asset Sale – The differences

In a share sale, the buyer purchases the entire issued share capital of a company from the existing shareholders. The company's legal identity does not change, even if, following completion, the name of the company is changed. The consideration paid for the shares goes directly to the sellers and they will normally pay capital gains tax as a result. A buyer of the shares of a company is buying all the company's assets and liabilities, including any hidden liabilities.

In an asset sale, the buyer cherry picks which assets and liabilities it will take over at completion. If the assets are being purchased from a company, the selling company retains its identity and receives the consideration for the assets. The company will then be taxed on any gain and the shareholders will be taxed again when they extract the money from the company.

It is vital that the purchaser and seller seek the advice of their respective accountants at an early stage, to ensure which method of sale or purchase is most beneficial to them. Inevitably, this can lead to a conflict of interest between what the purchaser and the seller would ideally like. It is then a matter of negotiation between the parties to resolve which method is used and this can sometimes result in a change to the agreed purchase price.

The Due Diligence Exercise

Once the parties have signed the ***Heads of Terms***, the buyer's solicitors will prepare a list of due diligence enquiries which will be sent to the seller's solicitors.

The size of the *Heads of Terms* document will be dependent on whether the deal is going ahead as a share sale or an asset sale. With an asset sale, the questions will be tailored to the particular assets being purchased, whereas if it is a company sale, they will be much more extensive to cover all aspects of the company, its assets and more importantly, its liabilities. The typical questions raised will be in relation to:

- employees;
- pension funds;
- premises of the business;
- environmental issues;
- intellectual property;
- trading contracts;
- lease hire contracts;
- business' lenders/banks;
- licences;
- vehicles;
- book debts;
- insurances;
- distribution or marketing agreement;
- liabilities;
- fixtures and fittings;
- tax; and
- accounts.

The seller's solicitors will provide answers to the due diligence enquiries and these should, wherever possible, be backed-up with documentary evidence and copies of relevant documents. Depending on the size of the transaction, the replies to these enquiries can be anything from a few pages to a number of large files.

A seller should not be surprised at the extent of the information and documentation that a buyer's solicitor will be requesting, especially in a company sale. The purpose of the due diligence process is for the buyer to establish exactly what he is buying into and to weed out any weaknesses in the company's records or administration or any hidden liabilities that there may be. If hidden liabilities or problematic issues do arise during this process, it can increase the time it takes and therefore the cost of the transaction. If there is any doubt in the mind of the purchaser in respect of any issues, they may request specific indemnities in the contract or in the worst-case scenario, renegotiate the price of the deal.

It is highly advisable that a seller spends the time to get the company or its business records in order before the start of the due diligence process. It is also advisable to keep a very good record of what information has been submitted to the purchaser or their solicitors.

The Sale and Purchase Agreement

If it is a share sale, the first draft of the Sale and Purchase Agreement and other documentation required would normally be prepared by the buyer's solicitor. Where it is an assets sale, it will normally be the seller's solicitor who produces the first drafts. The drafting of these documents would normally be undertaken at the same time as the due diligence exercise is going on, although they will obviously be subject to change, depending on what is highlighted by the due diligence process.

Warranties

The buyer of a company or the assets of a business obtains little protection under the law if the bargain turns out to be not what was expected (unless there has been misrepresentation or fraud by the sellers). It is a case of "let the buyer beware". The effect of this is to leave the buyer at risk that the business has unknown onerous liabilities, or that the assets are not what they seem. It is for this reason that the due diligence exercise is so important. It is normal for the buyer to receive assurances from the sellers as to the assets of the company and the business and, where the acquisition is of shares, as to the liabilities which attach to the company. The assurances are given by way of warranties.

Warranties are statements of fact in respect of the assets and/or liabilities of a business or company. Where such statements are not accurate, it will create a potential liability for the sellers to the extent of any loss suffered by the buyer, unless the statement is qualified in a document called the Disclosure Letter.

Warranties serve two purposes. The first is that of disclosure and the second is that of risk apportionment.

Warranties are designed to bring the points that are of concern to the buyer to the attention of the sellers. The process of checking the warranties should result in the disclosure to the buyer of all potential problems known to the sellers. If these problems are sufficiently serious, the buyer is at liberty to renegotiate the deal or even withdraw from the deal.

The effect of the warranties is to impose legal liability on the sellers, if it turns out that something is not as warranted. When the parties are negotiating the warranties, it must be remembered that they are also there to allocate risk as between the sellers and the buyers. For example, there may be a warranty that 'no employee has brought any discrimination claim or has any grievance against the business or company'. Unknown to the sellers, there may be an employee who has a grievance claim against the business but has yet to bring the claim to the attention of the sellers or the business management. The buyer would be able to sue for breach of warranty if the pre-completion liability was discovered after completion.

Indemnities

Should a potential onerous liability be highlighted during the due diligence process and the negotiation of the warranties, the buyer may seek a specific indemnity to protect himself against that particular liability. Such indemnities will be written into the Sale and Purchase Agreement.

Normally, the buyer's remedy in the case of a breach of warranty, is a contractual claim for the recovery of losses directly suffered, plus legal costs in enforcing the claim.

However, if the sellers have given an indemnity, the remedy for the buyer is a right to recover all losses suffered and all costs incurred as a result of the indemnity applying. This may result in a bigger claim than would otherwise be for a claim for breach of warranty.

Limitations To The Warranties

The seller's solicitors will include a section in the Sale and Purchase Agreement which deals with limiting the seller's liability under the warranties. Typically the types of limitation will include:

- a maximum liability (this is usually the total purchase price);
- a minimum threshold before a warranty claim can be made;
- a time limit within which a warranty claim must be brought;
- the manner in which a warranty claim must be brought; and
- the notice requirements for a warranty claim.

From the seller's perspective, this section of the agreement is extremely important and therefore, tough and lengthy negotiations can entail as a result. This can sometimes lead to delays due to the time taken to agree this section.

Planning Ahead For A Business Sale or Purchase

It is essential to plan ahead for a sale or purchase of a business and/or a company. As part of this planning, you should ensure you appoint a good legal advisor and accountant to assist in the process. You should not leave it until negotiations have begun with a potential purchaser, before you appoint your legal advisor.

Appointing your advisors early and planning ahead can save an awful lot of time and stress and does not need to cost a great deal. Following is a list of points that should be remembered when planning for a sale.

- ✦ The sale of any business and/or company is a stressful and lengthy process, therefore be prepared and ensure that you are really committed to the sale.
- ✦ In the run up to planning a business sale, it is essential to ensure that all the business paperwork is in order and up to date. Remember that the purchaser is going to want every detail and every document in relation to the business. Therefore, start by preparing a due diligence disclosure bundle which will include copies of all relevant documentation in relation to the business from employee contracts, trading contracts to utility contracts. Then there is the financial side of the business such as previous accounts, tax returns, VAT returns etc.
- ✦ As there will be a huge amount of documentation involved, you should prepare the documentation in a logical order and index everything so that it is easy to locate items in the future. You should also prepare two copies of everything you prepare, one copy to hand over to the other side and their professional advisors and one copy to be retained by yourself so that you are sure what has been handed over.
- ✦ The process of putting together this disclosure or due diligence bundle will highlight any weaknesses in your business records and therefore, you will have time in order to rectify these issues before you get into the negotiations with the other side. More importantly, it will be at your own time and cost rather than your professional advisor's fee costs.

Remember that this process will take longer than you expect, therefore plan ahead for this process to overrun.

If you are the owner of the business and you are also responsible for the running of the business, you may find that profitability declines due to the amount of time that you are devoting to the sale process. Therefore, if you plan ahead, you can avoid the impact of this substantially, by ensuring other people are covering your responsibilities.

CALL NOW to speak to a member of the Company & Commercial team.

We would be happy to discuss your particular situation and offer specific guidance to help you navigate this transition more effectively and efficiently.

Disclaimer

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