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A guide to buying a business

We have prepared a basic guide of matters to be considered when buying a business or company. This guide may be particularly useful if you are considering an acquisition for the first time.

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

- **Share purchase -** the buyer buys the whole company (including liabilities that he may not know about).
- **Asset (or business) purchase -** the buyer chooses the assets that he wants to buy. This will provide more flexibility, but it can be complicated to identify and transfer specific assets.

Dealbreakers

The following issues may arise during the course of a transaction:

Due diligence

The purpose of due diligence is to investigate the assets and liabilities of the target business. A buyer must take legal advice to ensure it gets the legal protection that it requires. If the buyer becomes aware of any significant problems in the due diligence process, it can:

- abort the deal
- negotiate a price reduction
- seek specific protection in the acquisition agreement, such as an indemnity (see below).

Employees

If a buyer buys a business as a going concern (even via an asset purchase), it must take on its employees on their existing contract terms. Consultation with employees is usually required for an asset purchase in advance of completing the deal.

This does not apply in the context of a share purchase as the company will remain the employer.

Pensions

The buyer may have to take over the target company's existing pension arrangements or offer equivalent pension arrangements to transferring employees.

Intellectual property rights

A brand, trade mark 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 to the buyer in the case of an asset sale.

Environmental issues

The buyer could face huge liabilities (possibly including criminal liability) if it buys contaminated land or a company that caused or allowed contamination.

Shared assets

If the target business is part of a larger corporate 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 target business.

An agreement can be drafted to deal with how the assets are divided and shared after the completion of the sale.

Key staff

Consider whether the buyer wants to incentivise or tie in key staff or management on special terms.

Consents and third party approval

The acquisition may need the approval of third parties (for example, industry regulators) or require approval from competition authorities. Consider when to approach them and whether consent is likely to be given.

If the buyer is acquiring all the shares in the target company, check that no important contracts can be terminated on a change of control.

If the buyer is acquiring the assets, check that any contracts can be assigned to the buyer and that this is not prohibited under the terms of the contract.

The transaction may require approval from either the buyer's or the seller's shareholders.

Documentation

The following paragraphs give a guide to the various documents which may be required on purchasing a business:

Confidentiality agreement

Acquisitions are highly business sensitive. Depending on the size and nature of the transaction, you should try and 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 exchanged by the parties.

A buyer should take legal advice before signing a confidentiality agreement to ensure that its position is adequately protected and its obligations under the agreement are reasonable.

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Heads of terms

Heads of terms are usually signed at an early stage of a deal before detailed due diligence. Heads of terms are also 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 the buyer's negotiating position later on. The buyer will normally prepare this document. A buyer should always take legal advice before signing such a document.

Exclusivity agreement

An exclusivity agreement (also known as a lock-out agreement) gives the buyer a period of exclusivity in which to negotiate the transaction by preventing the seller from actively seeking or negotiating with other prospective buyers during the specified period.

An exclusivity commitment can be dealt with in a separate agreement or as part of the heads of terms for the transaction.

Acquisition agreement

The acquisition agreement sets out the agreed terms governing the transaction and the mechanics of the deal (for example, the parties involved, the consideration for the shares/business, the timing of completion and any consents or approvals required before completion). It will typically 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 target business (for example, that it owns all the assets and there are no disputes with third parties). If they are untrue, the buyer can sue for damages
- **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 target business or poaching key customers or employees for a period following completion. They will only be enforceable if they are reasonable in scope, duration and geography.

Disclosure letter

The disclosure letter is an important document that must be read in conjunction with the warranties in the acquisition agreement. A buyer cannot make a warranty claim for anything disclosed in this letter, although it may want to negotiate alternative protection for disclosed issues (such as a price reduction or an indemnity to cover the issue).

If the buyer knew about a problem before signing the acquisition agreement, it may be unable to make a warranty claim for that issue even if it is not disclosed in the disclosure letter.

Contact

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