MacSweeney & Company
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:: Selling Your Business

When a commercial decision is made to sell a company and a deal has been struck on price with a buyer, there is often a feeling among the parties that the deal has already been done. This article is intended to highlight for sellers some of the key concerns in the legal process which follows and to suggest what their legal advisers should do to protect them.

Heads of Agreement

The Buyer's first requirement will be to conduct a limited financial due diligence exercise on the Company. This will involve the Buyer analysing the accounts of the company and deciding whether the company is a worthwhile investment for the buyer.

The due diligence exercise will involve the disclosure of confidential written documentation and oral information to the Buyer and its advisers. It is vital from the Seller's perspective that processes are put in place so that a company's confidential information remains confidential prior to the Buyer actually completing the transaction.

Although many would view the damage to be irreparable once confidential information is disclosed, the existence of written confidentiality obligations on the Buyer is important in focusing the minds of the Buyer and it is vital if the Seller is to gain any remedy where such disclosure is threatened or has already occurred. Such written terms would bind the Buyer and its advisers to (i) keep any sensitive information disclosed to it confidential and (ii) not to disclose the existence of negotiations to any party other than its professional advisors. The latter obligation is to prevent the Buyer from leaking the existence of negotiations to a Company's employees, which would be hugely damaging to the business. Some form of exclusivity is also common at this stage (usually about 3 months). This is to restrict the Seller from negotiating the sale of the Company with any party other than the Buyer.

Usually the Buyer and the Seller will enter into a non-binding agreement before the legal due diligence is commenced. This is known as the "heads of agreement" or "term sheet". Proper heads of agreement will contain both exclusivity and confidentiality provisions. This document should also contain details of the price being paid and any pre-conditions to the transactions, for example proper and thorough due diligence exercise.

Due Diligence

Once heads of agreement have been entered, the Buyer will conduct a thorough due diligence exercise. Examples of issues which would be covered by a comprehensive financial and legal due diligence:

- outstanding litigation against the Company;
- formal contracts with customers;
- that any taxes due have been paid;
- employment agreements and any bonus obligations on the Company towards its staff.

A comprehensive due diligence should be done by the Buyer's legal and financial advisors. The extent of this due diligence will depend on the size of the transaction and the extent of knowledge the Buyer has about the Company he is proposing to acquire.

Warranties and Indemnities

The Buyer will, as a matter of course, expect warranty protection in the main share purchase agreement. The share purchase agreement is the legal contract in which the Buyer will buy the entire issued share capital of the Company from the Seller(s), and it will be more or less detailed depending on the size of the Company being sold and the consideration being paid by the Buyer.

The importance of warranty protection to the Buyer is that it allows it to recover part or all of the purchase price should any matter come to light which detracts from the value of what they thought they were buying. Another purpose of the warranties from the Buyer's perspective is to flush out instances where the warranties are untrue (in the form of disclosures and documentation) from the Seller which gives the Buyer a better understanding of the Company that it is buying.

The Buyer will also seek to receive indemnity protection from the Seller for any tax owed by the Company relating to any event before completion of the acquisition. This indemnity protection should provide that the Buyer need only show that (i) the Company is liable to pay tax and that (ii) the taxable event occurred prior to completion. The rationale is that unpaid tax is such a serious issue for any Company that the Buyer should be able to recover against the Seller for any unpaid taxes however they arise.

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Seller's Future Liability

When a Seller sells his Company, he doesn't want to have to worry about warranty and/ or indemnity claims against him by the Buyer. As it is normal that a Seller will be required to give warranty and indemnity protection to the Buyer, a Seller should seek to satisfy himself that the chances of any such warranty or indemnity claim are low, and this should be done before selling the Company.

The Seller is usually given the opportunity to make disclosures against the warranties. The best protection for a Seller is that it provides as full and detailed a Disclosure Letter as possible. Anything which is fairly disclosed within this Letter cannot afterwards be the subject of a warranty claim. Therefore it is important for the Seller to formally disclose as much as possible to the Buyer. This would hopefully reduce the likelihood of the Seller being the subject of a warranty claim from the Buyer.

Non-Compete Obligations

As part of the Share Purchase Agreement, a prudent Buyer would often demand non-compete covenants from Seller and the key executives.

It is standard for a Seller to be obliged not to be involved in any business activity going forward which competes with the Company nor solicit the customers or employees of the Company.

These protections are intended to protect the goodwill of the Company and so that the Seller does not set up a competing business and thereby reduce the value of the Company he has just sold! Negotiating a robust non-compete clause is essential for the Buyer in order to prevent the Seller soliciting suppliers, customers or employees from the Company he has just sold.

Advice should be taken in all circumstances, however, as these restrictions raise complicated enforceability issues.

Conclusion

Buying or selling a Company is unique and raises significantly different issue to those which arise when you are buying or selling commercial property.

Adopting a professional approach to a transaction can help ensure that from the Buyer's perspective he is not sold a pup. And from the Seller's perspective that he isn't going to be liable to the Buyer for insignificant issues that surface after completion and which relate to the period in which he owned the Company.

This article provides and outline of the various options and proper legal advice should be sought in all circumstances.

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