

BUYING A BUSINESS (ASSET PURCHASE)

GENERAL

An asset purchase is a purchase of all or only some of the assets of a business, e.g. goodwill, fixtures and fittings, property. The buyer may also take on some or all liabilities of the business.

Although every purchase is different, the legal terminology and some of the terms of the agreement will apply to most purchases. This guidance note is to help you understand the purchase process and some of the terminology that may appear in your asset purchase agreement.

We expect to work closely with your accountants throughout the purchase process.

PRELIMINARY DOCUMENTS

Heads of Terms

Once agreement has been reached in principle on the key terms of a purchase it is common practice to record those terms in writing as heads of terms. Heads of terms are not usually legally binding, but legal advice should be obtained on the heads as it is often difficult to renegotiate the terms at a later date.

Confidentiality Agreement

It is standard practice for a seller to ask a buyer to sign a confidentiality agreement to prevent the buyer from using or disclosing the information it receives about the business.

Legal advice should be taken before a confidentiality agreement is signed.

DUE DILIGENCE PROCESS

We will produce a detailed due diligence questionnaire raising questions about the business to elicit as much information as possible about the way the business operates, its assets, employees, contracts with customers and suppliers etc.

THE ASSET PURCHASE AGREEMENT

This is the key document in the sale and is usually drafted by the buyer's solicitor. The key provisions are:

(a) Warranties

Full warranties (i.e. assurances given to a buyer) relating to the assets being sold are usually included in the agreement. The warranty schedule is usually very lengthy and is heavily negotiated.

Purpose of warranties:

The buyer has little protection if the deal turns out not to be what it expected. Warranties "flush out" potential problems so that they can be negotiated and dealt with before the purchase is completed and warranties also enable the buyer to obtain compensation if the business is not as the seller warranted.

The effect of warranties:

Warranties impose a legal liability on a seller to give complete and accurate information on the business. If a seller makes inaccurate statements about the business as a result of which its value is reduced or a buyer suffers a loss, the buyer may have grounds to sue the seller for damages for breach of warranty. In effect, warranties give the buyer the opportunity after completion to adjust the price.

Who gives the warranties:

Usually the seller. If there is more than one seller, the buyer will usually require the seller to give the warranties "jointly and severally" which means that each of the sellers is responsible for the full amount of any claim if the warranties are not correct. In practice, a buyer can sue whichever seller it considers is more likely to be able to meet a warranty claim for the full amount of that claim.

Where the seller is a company, the company gives the warranties, but the shareholders may also be asked to give warranties personally to reinforce the company's warranties, especially if the company will have little substance post completion.

The scope of the warranties:

The warranties are drafted by the buyer's solicitor usually on the basis of information gained from due diligence. The warranties are usually general, wide and as far reaching as possible.

Limiting the warranties:

Because of the effect of the warranties, the sellers' solicitor will try to limit the sellers' exposure by deleting those warranties which are not applicable, qualifying some warranties "so far as the seller is aware" and drafting specific limitations on the sellers' liability.

Typical limitations include:

- (a) limiting the amount of any claims that can be brought by the buyer to a maximum sum (very often the purchase price);
- (b) limiting the timescales within which a claim must be brought;
- (c) excluding small claims;
- (d) forcing the buyer to do what it can to reduce any loss it has suffered;
- (e) disclosing exceptions to the warranties in a "disclosure letter".

(b) Indemnities:

If a buyer knows about a potential liability a seller may be required to indemnify the buyer against any loss.

An indemnity effectively provides pound for pound compensation for the buyer's actual loss for breach. If there is no indemnity, then the buyer would need to sue for breach of warranty and the buyer's claim would be subject to all the restrictions under general law on claiming damages for breach of contract. From a buyer's point of view an indemnity is more valuable.

(c) Consents

A number of consents or approvals are likely to be required on an asset purchase. For example, if a business occupies leasehold property, the landlord's consent to an assignment will be required.

(d) Apportioning the price between the assets

A buyer should take accountant's advice on the apportionment of the price as between the various assets being purchased so that the tax consequences are fully understood.

(e) Employees

When a business is transferred, the employees of the business transfer to the buyer on their current terms of employment. This is the effect of TUPE ("Transfer of Undertakings (Protection of Employment) Regulations 2006"). Generally, the seller will be liable for claims regarding any failures in respect of employment obligations to employees up to completion and the buyer for anything after completion. As this is a complex and fast changing area of the law a buyer will need advice from our Employment Team on the way in which TUPE may impact on the purchase.

Amongst other obligations on sellers under TUPE, there are two important requirements under TUPE:

- (i) At least 14 days before the purchase (but preferably sooner), the seller must provide the buyer with, what is known under TUPE as, 'employee liability information'. This information includes the particulars of employment of all of the seller's employees together with details of any disciplinary action, grievance complaints and employment claims in the previous two years (amongst other employee information);
- (ii) The seller must consult with employees before any purchase with regard to any 'measures' (changes to employee's working arrangements) the buyer intends to take after the purchase. The seller usually obtains information regarding 'measures' from the buyer as soon as possible so that it can consult with its

employees in good time. TUPE sets out a specific consultation procedure.

Our Employment Team will advise on any employment law aspects.

(e) Property

If a property is being purchased a buyer will need to take advice from and involve a commercial property specialist from our Commercial Property Team.

OTHER DOCUMENTS

Disclosure letter:

This is a very important document. It lists any exceptions or inaccuracies in the warranties, e.g. the seller may be asked to warrant that “the company is not involved in any litigation”. If in fact it is, the details should be disclosed. All the disclosures are collected together in a “disclosure letter”.

The disclosure letter protects the seller because if the seller properly discloses anything inconsistent with a particular warranty, the seller cannot be sued for breach of that warranty.

The disclosure letter will be reviewed and approved by us in consultation with you and by your accountants.

Disclosure bundle:

These are the copy documents which relate to any matters disclosed in the disclosure letter. In the example above, these could be copies of the court papers and correspondence concerning the dispute which led to the litigation.