



## A Guide to the Sale and Purchase of Shares and Assets

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# A Guide to the Sale or Purchase of Shares and Assets

## 1. Introduction

- 1.1. Whatever the commercial objectives behind a sale or acquisition of a business, the process can be lengthy and complicated. Whether you are the buyer or the seller, we can advise you on this process, guide you through every step and take the necessary action to make sure that the best possible result is achieved for you.
- 1.2. A business is normally bought or sold in one of two ways:
  - 1.2.1. **Share Purchase:** the buyer takes ownership of a company through purchasing its shares; or
  - 1.2.2. **Asset Purchase:** the buyer purchases some or all of the assets of the target business.
- 1.3. Both the buyer and the seller need to be certain as to the type of transaction they want as there are fundamental differences between them: if shares are purchased, the buyer also takes on all the assets, liabilities and obligations of the company, however, if assets are purchased, only the assets (and in certain circumstances the liabilities) that the buyer agrees to are taken on. If you are looking to buy a company but are unsure which transaction would best suit you, we can advise you on your options and discuss them with you in relation to your commercial objectives.
- 1.4. In this guide, we will highlight the issues to be considered by both the buyer and the seller in a sale or acquisition of a company through a **share purchase**. If you need advice on an asset purchase, please contact us for further information. This guide also assumes that neither of the parties nor the target company are listed companies and that the purchase is for 100% of the shares in the company. For advice and assistance where a listed company is involved, please contact us for further information.

## 2. First Steps

- 2.1. For the seller, the first decision to make is whether or not the business in question is to be sold via a share purchase or an asset purchase. The buyer will need to make a similar decision. This guide assumes that a share purchase is decided upon.
- 2.2. Before the share purchase agreement is drafted, a prudent next step for the seller would be to prepare the company for sale (for further information on this, please see our “Briefing Note: Preparing your Business for Sale”) and for both parties to seek tax advice.
- 2.3. It is useful to have an overview of the whole purchase process so that you can understand the order of events:
  - 2.3.1 **Heads of Terms:** although not strictly necessary this document or similar ones (letter of intent, confidentiality agreement) are very useful in starting the process. It will set out the structure of the transaction and the key terms such as purchase price.

- 2.3.2 **Due Diligence:** this is the process by which the buyer will request information about the target company so that he becomes familiar with the details of the company.
- 2.3.3 **Share Purchase Agreement:** this is the main transaction document which will include the price (how and when it is paid), conditions that need to be completed (conditions precedent), restrictive covenants (if any), limitations of liability, warranties, and many other provisions. One of the most important provisions will be the warranties (promises) given by the seller to the buyer.
- 2.3.4 **Disclosure Letter:** this document allows the seller to “disclose” against the warranties. This means that the seller can say that a warranty is true except for the matters informed to the buyer (as disclosures).
- 2.3.5 **Ancillary Documents:** there will be a number of additional documents required in the transaction which may include resignation as a director, indemnity of a lost share certificate, stock transfer form, board minutes, security documents (if any) etc.

Each of these matters is more fully reviewed in this Guide.

### 3. Preliminary Agreements

- 3.1. Although there is no requirement for any preliminary agreements to be drafted, it is almost always in the interests of the parties that some form of written record is made regarding what has already been agreed in principle.
- 3.2. The preliminary transactional agreements that the parties typically enter into include the following:

#### 3.2.1. **Heads of Terms**

Where key terms of the deal have already been agreed in principle by both parties (such as the purchase price), the Heads of Terms will provide a written record of that agreement. The Heads of Terms can be completely non-binding, partially binding or fully binding. It is common for the parties to want the Head of Terms to generally be non-binding except for certain clauses, such as:

- 3.2.1.1. **Exclusivity Clauses** – these prevent either party from entering into competing negotiations for a specified period of time.
- 3.2.1.2. **Confidentiality Clauses** – these prevent the parties from disclosing any confidential information to others except their advisers.
- 3.2.1.3. **Costs Clauses** – normally both parties will want to set out that they will be responsible for their own costs in the event the transaction does not complete.
- 3.2.1.4. **Governing Law and Jurisdiction Clauses** – these determine which country’s laws apply to the Heads of Terms. This clause is particularly important as some jurisdictions may consider agreements such as a Heads of Terms automatically binding, even if this is not the intention of the parties.

3.2.1.5. **Circumstances of Termination Clauses** – these make provision for termination of the Heads of Terms by either party should there be a decision not to proceed with negotiations.

### 3.2.2. **Exclusivity Agreement**

Also known as a “lock-out agreement”, these are typically required from the seller by the buyer. These agreements usually require the seller to agree to not seek out or negotiate with any other potential buyers for a specified period of time. This type of agreement can be either a useful alternative to Heads of Terms if the transaction is relatively simple, or can be required by the buyer before even agreeing to enter into a Heads of Terms.

### 3.2.3. **Confidentiality Agreement (or Non-Disclosure Agreement)**

Part of the preliminary process involves the buyer requiring access to a significant amount of information concerning the target business (see Due Diligence below). A lot of this information is likely to be confidential in nature and so the seller will typically require the buyer to enter into a confidentiality (or non-disclosure) agreement which restricts the buyer’s use and ability to disclose that information to others. This is arguably a key document for the seller and should be required by them, especially if no other preliminary agreement is drawn up.

Each of the above agreements can be drafted and entered into before either party seeks legal advice. However, it is best to get this advice beforehand in order to avoid problematic situations such as becoming legally bound to an agreement when there was no intention from either party to be bound by it. We strongly recommend that you take legal advice at the earliest opportunity and we are willing to meet and discuss issues with you at a preliminary no cost meeting to make sure that you are on the right tracks from the start.

## 4. **Due Diligence**

- 4.1. Due diligence is an important element of the transaction for the buyer, as the results could persuade the buyer to seek an amendment to the price, the purchase terms or even pull out of the deal altogether. Due diligence is the process by which the buyer investigates the target company and its business before agreeing to contractually commit itself to the acquisition and is conducted by gathering as much information on the company as possible and reviewing it.
- 4.2. The due diligence process is a chance for the buyer to get a thorough understanding of the target company by reviewing its assets, liabilities and financial information, thereby identifying possible risks or issues that need to be addressed before proceeding.
- 4.3. Due diligence can be a long process as it involves not only the buyer reviewing information on the target company from a commercial point of view (commercial due diligence), but will also involve the buyer’s accountants (financial due diligence) and solicitors (legal due diligence) undertaking due diligence in their respective fields. The solicitors will consider information relating to, for example, any intellectual property rights, current or pending litigation or disputes, contracts, title to assets, property, employment contracts and records and many other matters. The findings can assist the buyer’s solicitors in drafting any appropriate warranties and indemnities that cover

specific risks or situations that have been revealed and it will also assist with the disclosure to be made by the seller. This is not an exhaustive list and the legal due diligence undertaken is dependant on the nature of the target company.

- 4.4. The results of due diligence can have an impact on subsequent negotiations, such as the warranties the buyer wants the seller to give or even the price that the buyer is willing to pay. If the risks or issues uncovered are significant enough and they cannot be mitigated in any other way, it may even cause the buyer to pull out altogether.

## 5. Share Purchase Agreement (SPA)

- 5.1. The SPA is the main contract in the transaction. This means that it is crucial for both parties to be happy with, and agree to, all of the provisions contained within it before completion takes place. These provisions include not only the basic details of the target company but also the obligations and liabilities that will bind both parties.

- 5.2. It is usual practice for the first version of the SPA to be drafted by the buyer's solicitor because the buyer will want to include protections that they want the seller to adhere to. This is why SPAs tend to include the following:

- 5.2.1. **Restrictive Covenants** – these are provisions that prevent a party from doing something. The most common provision is preventing the seller from establishing a competing business following completion, thereby protecting the goodwill of the target company (non-compete). Other key restrictive covenants are designed to prevent the seller from taking suppliers or employees.

- 5.2.2. **Warranties** – on an acquisition (whether of shares or assets) the principle of *caveat emptor* (buyer beware) applies. The law provides no statutory or common law protection for the buyer as to the nature or extent of the assets and liabilities it is acquiring. Hence the need for extensive contractual statements in the form of warranties. Warranties are a way of reducing the buyer's risk in the acquisition. In a share sale the buyer will be buying the shares so he will also be taking over all the liabilities and obligations of the company. On an asset purchase, liabilities for the business will generally remain with the seller, unless the buyer agrees to accept them (although please note employment liabilities under TUPE).

- 5.2.3. Warranties are contractual statements (like promises) mainly given by the seller as to the condition of the business, such that if a warranty is untrue then the buyer can make a claim. Warranties serve two main purposes, firstly to provide the buyer with a remedy, and secondly, to encourage the seller to disclose known problems. If a seller does disclose against a warranty then generally a buyer cannot make a claim.

- 5.2.4. The warranties can be limited in a number of ways by, limiting the wording in the warranty, limiting the extent, or limiting the number of warranties. This stage of the negotiation process can be lengthy and time consuming, as the seller needs to review each warranty, confirm the warranty can be given, and identify any disclosures, while the solicitor will try to limit the warranties (if acting for the seller) or preserve or extend them (if acting for the buyer).

- 5.2.5. **Indemnities** – these are provisions that allow the buyer to seek compensation from the seller for any losses or liabilities that may arise.

- 5.3. Agreeing the SPA can take time as, following receipt of the first version, the seller's solicitor will almost inevitably make amendments to it in order to protect the seller's position. Usually such protection will involve limiting the claims that can be made by the buyer. The length of time taken to finalise the SPA is also dependent on the nature of the transaction: if that transaction is complex there could be a significant number of warranties and indemnities that are negotiable, all of which need to be reviewed and amended as required.
- 5.4. Common provisions found in SPAs include the following:
- 5.4.1. **Parties** – although seemingly obvious, it is important that the SPA details who the parties to the transaction are, especially where additional parties such as guarantors are involved. This can be the case where the transaction is complex.
  - 5.4.2. **Definitions and Interpretation** – this section defines all of the important aspects of the SPA, such as the purchase price and, for example, what "Warranties" can include (this being a particularly important definition for the seller). Generally, the more complex the transaction, the longer the definitions section tends to be.
  - 5.4.3. **Agreement to Sell and Purchase Shares** – this is a vital provision that confirms to the parties that title to the shares is transferred to the buyer at completion.
  - 5.4.4. **Conditions Precedent** – this provision tends to be included when the exchanging of contracts and completion of the transaction do not happen on the same day. This will usually happen if there are aspects of the transaction that need to be actioned before completion occurs, such as acquiring any relevant third party consent, licence, registration, or authorisation to the sale. This section provides conditions that need to be satisfied before completion can take place.
  - 5.4.5. **Consideration** – this section confirms how the seller will be paid and how the buyer is purchasing the acquisition. The most common forms of consideration are as the following:
    - 5.4.5.1. cash;
    - 5.4.5.2. an allotment and issue of shares in the buyer to the seller;
    - 5.4.5.3. some form of debt instrument (such as loan notes – see below "Loan Note Documents") issued by the buyer to the seller;
    - 5.4.5.4. deferred consideration is often used and can take many forms but the most often used mechanism is an earn out or loan note.
  - 5.4.6. **Warranties and Indemnities** – this section details all the warranties and the indemnities sought by the buyer following the identification of problems revealed during its due diligence. A significant amount of the negotiating time will be spent on agreeing this section.

- 5.4.7. **Restrictive Covenants** – this section details the provisions that prevent the parties from doing certain things, such as the seller establishing a competing business as mentioned above.
- 5.4.8. **Completion** – this section lists all of the actions that both parties must take at completion of the transaction, as well as all of the documents that need to be delivered by one party to the other. One typical example includes delivery of executed stock transfer forms and share certificates.

## 6. Tax Advice

Tax advice plays an important role in company acquisitions. We do not provide tax advice but we will work closely with your accountant on all tax, accounting and finance matters. Tax is usually a factor in determining many aspects of the transaction including the overall structure, whether or not a share purchase is preferable to an asset purchase, and personal tax issues. The buyer will need to rely on their accountant to provide tax advice in relation to this.

We recommend that if you are selling or buying a business then you discuss succession planning with us, you update your will, and consider Inheritance Tax planning arrangements before you start the process.

## 7. Ancillary Documents

- 7.1. Although the SPA contains the details that form the basis of the acquisition, other documents are often used to cover additional legal issues. These vary depending on the nature of the transaction but usually include:
  - 7.1.1. **Stock Transfer Form** - in order for the buyer to purchase the legal title to the shares, it will need to receive a duly completed and executed stock transfer form by the seller.
  - 7.1.2. **Disclosure Letter** - please see below (“Disclosure”) for further information on the Disclosure Letter.
  - 7.1.3. **Taking Security and Security Release** - if a third party (such as a lender) has a charge over the shares being purchased or the company, or over any property owned by the company, then security release documents may be required to release that security.
  - 7.1.4. **Escrow** - the parties may agree that some of the consideration is not immediately paid to the seller but instead is paid into an escrow account for a period of time. These funds can be used, for example, to pay for costs that are to be paid by the seller but the exact amount isn’t known yet. In such circumstances, documentation confirming the account details and how to deal with the escrow arrangements will be required.
  - 7.1.5. **Loan Note** - an alternative to using cash in a share purchase is the use of loan notes. These create a debt from the buyer (or normally the company) to the seller and enable the seller to receive payments over a period of time, possibly with an interest rate applied. Where used, additional documentation may be required that not only constitutes the loan notes themselves but also sets out the terms of the issue.

- 7.1.6. **Service Agreements** - if the seller will stay on, for example, as an employee or director, following completion of the transaction, the buyer may want the seller to enter into a new service agreement.
- 7.1.7. **Guarantee** - where the buyer requires a third party guarantor to guarantee performance of the obligations and liabilities of the seller under the SPA, a guarantee may be required.
- 7.1.8. **Board Minutes** - board minutes record the decisions made at a board meeting and sometimes the reasons for those decisions.
- 7.1.9. **Indemnity for Lost Share Certificates** - in the event that the share certificate relating to the shares being sold has been lost, an indemnity is normally required from the seller in respect of the original certificate.
- 7.1.10. **Letter of Resignation** - if any director or the Company Secretary is resigning then a formal letter of resignation will be required. This will often include a statement that they have no claims against the company.

The above is a non-exhaustive list and the exact documentary requirements will depend on the requirements of the transaction. Nevertheless, those listed above tend to be the most common ancillary documents to supplement the SPA.

- 7.2 **Completion Agenda** - in many transactions the solicitors will prepare a completion agenda which sets out the key documents in the transaction, the party responsible for that document, and any relevant timeframes. The completion agenda is intended to act as a way to monitor the documents' progression and to ensure that the parties are aware of their respective obligations.

## 8. **Disclosure**

- 8.1. When deciding on whether or not to purchase a company, a buyer will consider all aspects of the proposed transaction including the purchase price, information from due diligence, as well as commercial considerations. In order to reduce risk the buyer will most probably ask for warranties to be given by the seller in the SPA. As we have mentioned previously warranties are statements given by the seller about the target company, the shares, the assets etc.
- 8.2. Given the importance of the warranties, should any of them turn out to be either partially or fully incorrect or misleading, it is important to preserve the right of the buyer to make a claim for damages, provided it has suffered a loss as a result. This means it is vital for the seller to ensure that the warranties they provide are accurate or, if there are any issues with the warranties being given, mitigating action is taken as a means of protection.
- 8.3. One method available to the seller to protect itself against giving warranties is to make disclosures to the buyer. A disclosure is made by the seller in a Disclosure Letter and normally consists of a statement of fact which shows there is a breach of a warranty. As the buyer is being made aware of the breach of warranty it won't be able to make a claim in relation to the matters disclosed.
- 8.4. The Disclosure Letter is a key document in a private acquisition and assists in the process of the seller making general and specific disclosures against the warranties contained in an SPA.

- 8.5. Disclosure Letters are a mutually beneficial tool. The buyer will be able to combine the letter's contents with their own findings to create a more complete picture of the target company and the seller will have a defence to any breach of warranty claim or even negate the possibility of such a claim being brought altogether.
- 8.6. The Disclosure Letter is a crucial document in the acquisition process and the seller (through their solicitor) should take the time to ensure that it is as comprehensive as possible, regardless of whether or not the buyer is already aware of what is to be disclosed. This will involve the seller having to make enquiries with all relevant staff and personnel to ensure that anything disclosable is included in the letter. There can also be the need to create and deliver a (potentially extensive) Disclosure Bundle if certain warranties require specific information or documents to be provided alongside the Disclosure Letter.

## 9. Exchange and Completion

- 9.1 The conclusion of a share purchase is exchange and completion. The parties sign and exchange contracts, followed by the requisite steps to bring the transaction to a close. Exchange and completion can occur simultaneously or separately, depending on the timing and method of implementing these adopted by the parties.

- 9.1.1. **Exchange** - the signing, dating and exchange of contracts (the SPAs) is the point where the parties become legally bound to complete the transaction. It is therefore imperative that everything is agreed and the parties are completely happy with the final version of the SPA (and ancillary documents) before signing and dating it.

9.1.1.1. it will also be at this stage where ancillary documents such as the Disclosure Letter and, if separate, the Tax Covenant will be signed and delivered along with the SPA.

9.1.1.2. where there is to be a period of time between exchange and completion in order to allow for the fulfilment of certain obligations or conditions (e.g. obtaining a consent or a licence), it must be clear to both parties who has responsibility for each of those conditions or obligations, and in what timeframe they need to be completed. Often a deposit is payable at exchange. These details should be included in the SPA and the parties should be clear on these before exchange takes place.

- 9.1.2. **Completion** - on the date of completion of the acquisition, the seller will transfer ownership of the target company's shares to the buyer and the buyer will pay the purchase price in accordance with the terms of the SPA. The specific completion process will usually be detailed in the SPA itself and it will also list the documents that need to be delivered by each party.

## 10. Post-Completion

- 10.1. Following completion, the buyer may need to take care of a number of post-completion matters. These matters depend on the nature of the transaction but include the following:

- 10.1.1 attending to various filings with Companies House, such as notifying any changes in directors;
  - 10.1.2. paying any stamp duty due on the transfer of the shares;
  - 10.1.3. updating the target company's statutory registers, including its register of members and register of people with significant control over the company.
- 10.2. If the buyer is unsure as to: 1) what matters they need to attend to or, 2) if they have taken care of all of the necessary requirements, they can seek advice and guidance from their solicitors.

## 11. **Summary**

As demonstrated above, the process for buying and selling a company can be a lengthy one with a lot of steps involved. Whether you are the buyer or the seller, our expert team can advise and guide you through this process from start to finish, making sure that you achieve the best possible outcome in line with your commercial objectives.

## 12. **About Whitehead Monckton**

With offices in Canterbury, London, Maidstone and Tenterden, Whitehead Monckton is one of the largest legal practices in Kent. We offer a wide range of services specifically for businesses together with legal support for you as an individual. You can see our lawyers at the office most convenient to you or we can meet at your office or home. It's important to us that we are recognised within Kent as being a very approachable and professional firm. Many of our staff, including a number of Directors, completed their legal training with the firm and our ethos of client support and care is very important to all members of the firm.

We can trace our roots back over 230 years to the time when George III was on the throne, William and Caroline Herschel discovered Uranus, the British were beaten by the Americans and the French at the Battle of Yorktown (but they were outnumbered!), William Pitt was the youngest person elected to Parliament at the tender age of 22 and railway engineer George Stephenson was born. As you can see we are in illustrious company. With over 230 years of history we have some very long standing clients. For example, we have advised Kentstone Properties Limited since it was incorporated in 1862. This makes it the second eldest trading company in the county. For individuals we have often advised more than three generations of families providing continuity and innovation as the changing regulations offer challenges and opportunities.

Our mains service lines include:

1. Company, commercial and finance
2. Commercial and residential property
3. Employment
4. Dispute resolution
5. Wills and estates
6. Succession planning
7. Family law including pre-nuptial agreements
8. Wealth management

As part of our commitment to excellent client care, in April 2017 we obtained the quality management standard ISO9001. In addition we have achieved specific Law Society accreditations through the following schemes:

- Wills and Inheritance Quality Scheme
- Conveyancing Quality Scheme
- Family Law Accreditation Scheme

Whitehead Monckton is authorised and regulated by the Solicitors Regulation Authority (no: 608279). We are committed to offering opportunities to all and the firm has an Equality & Diversity Policy. In addition we also have an Anti-Bribery Policy designed to ensure all transactions and relationships are in the best interests of the clients. If you would like a copy of either of these, please contact us. Whitehead Monckton became a Limited Company in 2014 and joined LawNet in August 2015.

### **Disclaimer**

This guidance note is in no way held out to be legal advice and should not be viewed as such. If you require further information on this subject, please contact one of our solicitors.

### **CONTACT US**

If you would like to know about our law firm then please see: [www.whitehead-monckton.co.uk](http://www.whitehead-monckton.co.uk). If you would like more information on the matters set out in this Guide, or you would just like to discuss a potential sale or purchase, then please do not hesitate to contact one of the following:

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