The top 7 legal considerations

PREPARING FOR THE SALE OF YOUR BUSINESS

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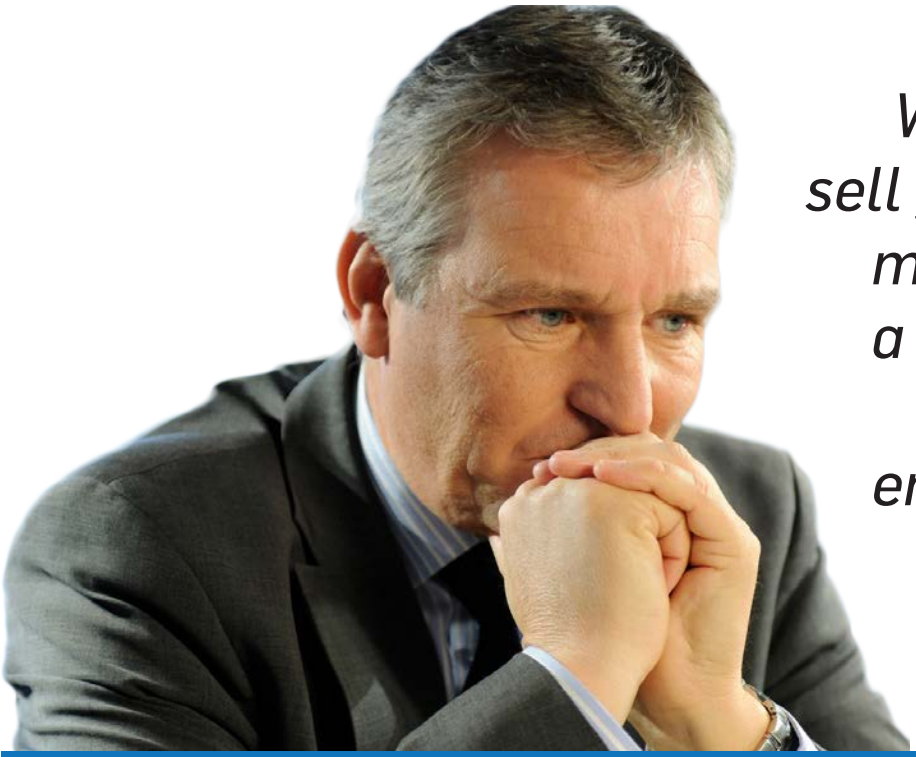

When you decide to sell your business, you may be walking into a minefield of issues that you have not encountered before.

In this e-book we provide a summary of some of the most important legal considerations to be aware of, as you prepare yourself for a sale.

Some of these areas may seem pretty obvious, but our experience has been that even the most obvious areas are often forgotten or considered too late – which can have important ramifications on the sale and the sale price.

It is never too early to start planning for your eventual sale!

aspect legal's specialist business sale and acquisition services

OUR KEY DIFFERENCES TO OTHER LAWYERS

- Experience and Quality
- Responsive services
- Quick turn-arounds
- Commercial focus
- Team players
- We truly care

OUR SERVICES FOR SELLERS

- Preparing the business for sale
- Preparing pre-sale documents
- Drafting & negotiating sale documents
- Finalising the deal

Free sale preparation review

Information pack

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Preparing for the sale of your business

THE TOP 7 LEGAL CONSIDERATIONS

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Joanna is passionate about business, and about providing high quality proactive legal support in the area of business sales and acquisitions.

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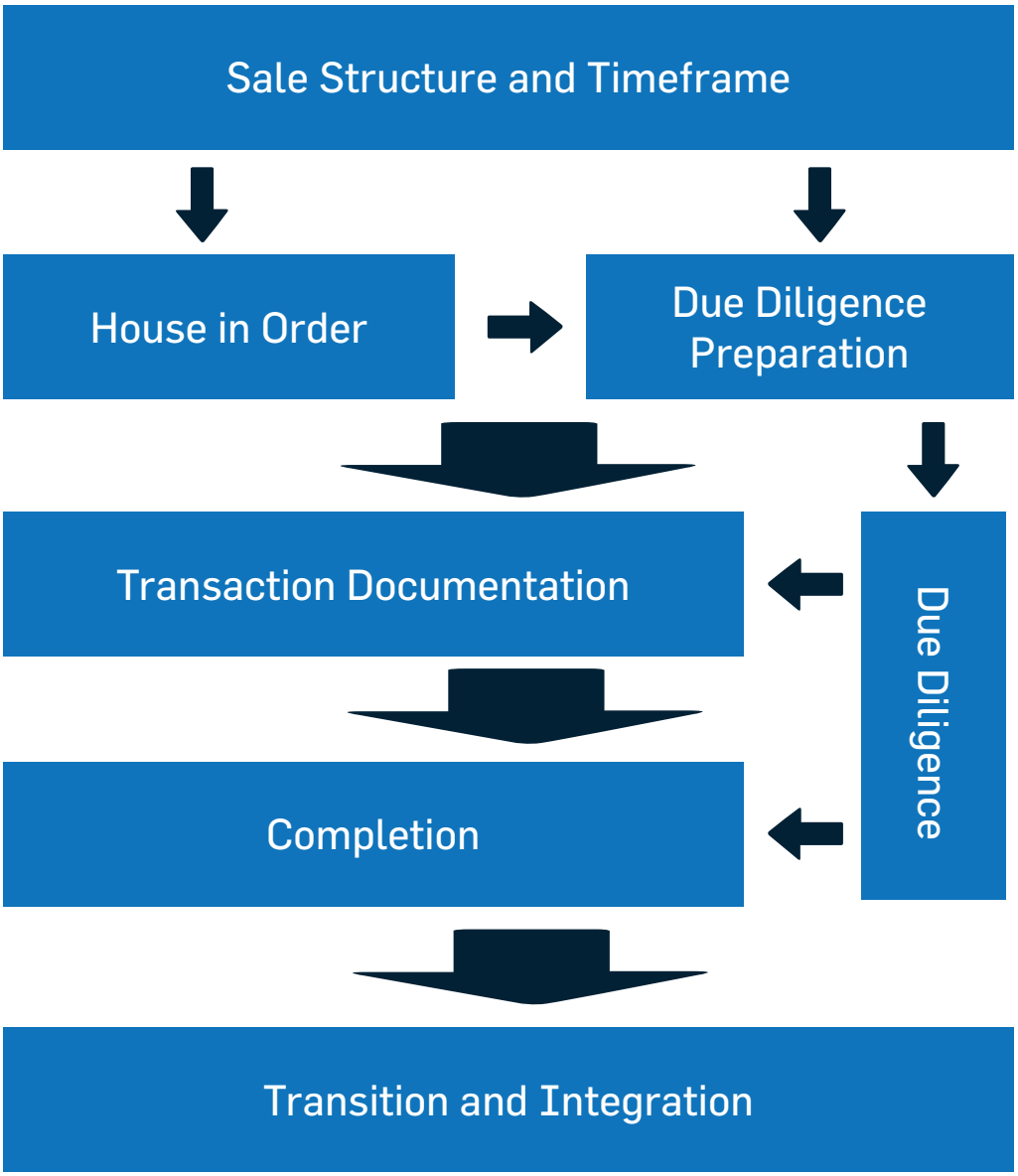
Summary Transaction Flow



SALE STRUCTURE

Key Differences in Share Sale vs Asset Sale

The most common transactions effected in a sale and purchase transaction are either via share sale of a company or asset sale. Usually the structure of a transaction will be driven by a seller's tax considerations. There is no one size fits all solution for all sellers. Relevant considerations may include accessibility to small business capital gains tax concessions, the ownership structure of the business, whether the seller seeks capital gains tax rollover relief and so forth.

It is common for sellers to prefer to sell through a share sale if they trade through a company. However this is not usually preferred by buyers due to the risk of inherited liabilities, particularly in relation to companies with a lengthy trading history. A summary of the key differences in a share sale vs asset sale are set out below.

Share Sale	Asset Sale
Less stamp duty liability for the buyer	Greater stamp duty liability for the buyer
Less income tax for the seller	More income tax for the seller, but depending on your personal circumstances, you might incur less income tax
Less effort and time involved in transferring client, supplier, employment and other contracts because they remain with the company except where there is change in control clause	More effort, cost and risk involved in transferring client, supplier, employment and other contracts to buyer
You are likely to be required to provide more extensive warranties and indemnities because the buyer is purchasing all liability attached to the company	Less risk to buyer post completion because liability remains with you because you will be retaining the company
Less effort and risk in ensuring the company will continue to own assets including intellectual property	Greater effort, cost and risk in ensuring assets and intellectual property are transferred to buyer

There are ways to mitigate risks associated with needing to provide more extensive, such as insurance or by giving appropriate disclosures to the buyer. The only way to know what option is best for you is to get comprehensive legal and accounting/financial/tax advice well in advance before you search for or have a buyer. Bear in mind, if you have time, you may even be able to restructure your business to optimise it for a future sale. The earlier you look at the most optimal structure for a sale, the easier, cheaper and more effective a restructure will be.

SALE STRUCTURE

Once you find a buyer - consider carefully how you might want the sale to be structured

Some examples of considerations you might give to the structure of the sale:

- Will the sale be structured as cash, shares, or cash and shares?
- If cash, will this be a one off cash payment? Or upfront plus a deferred payment?
- If you are taking part of the sale as a deferred payment, what are the conditions to the deferral – will this be an agreed amount, or will it be calculated by reference to the performance of the business after sale?

There are many important legal implications tied to each of these decisions. An upfront payment may be the most appealing option, but a buyer may often require that the deal is comprised of some deferred payment.

If part of your payment will be deferred (as is often the case) then it is very important to consider what steps you should be taking to secure those payments. Will the deferred payment be guaranteed? Will you be able to take some security over the purchaser, over the shares, or over the assets of the company?

If your payment is tied in part to an earn-out, you must ensure that you have worked through the details of the calculation of the earn-out payment very closely. This can often be an area of dispute – so it is very important that you work through these calculations carefully. And while earn-outs may increase the final amount you receive, you have to bear in mind that you may not receive as much as you expect (or at worst, you may not receive anything under the earn-out at all).

Take time to sit down with your advisers and go through the options in detail. Often times the options can contain considerations you may not have originally thought of, so the more time you have to get across these issues, the better.

TIMEFRAME

Know your proposed timeframe – and get realistic about it

If you want to move quickly on a sale you need to make sure you have "all of your ducks in line", so to speak.

A sale can take a long time to negotiate, get the contract agreed, and do all of the steps required in transacting the sale – and sellers often badly misjudge how long the process will take.

Make sure you get good solid advice from the start to help you build realistic timeframes around all of the key steps that are involved once you find a buyer.

HOUSE IN ORDER

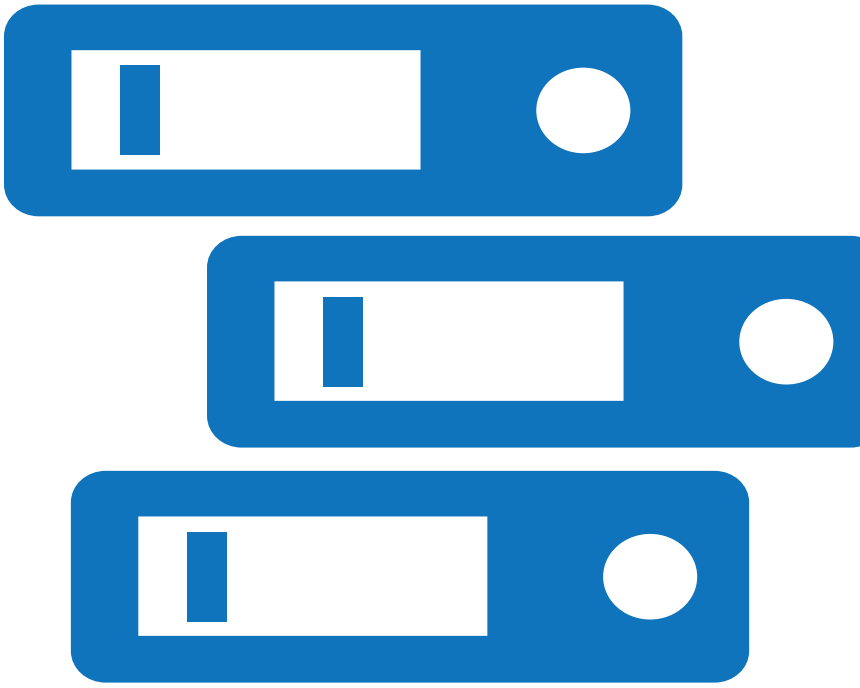
Get your contracts in order, and key clients and suppliers locked in

In the previous chapter we touched on the need to collate and organise your current contracts in your preparations for due diligence. However collating your written contracts is not the only consideration you should be giving to the area of contracts. Prior to the sale you should give serious consideration to whether or not you have the right written contracts in place. Usually a business will have some deficiencies in this area, but serious deficiencies can start to have an impact on the value of your business.

As a minimum, make sure that all of the key relationships in your business are supported by solid written agreements that are up to date. This includes relationships with any key clients, key suppliers, your contractors etc.

Also make sure that these agreements are up to date. Many times I have seen these contracts pulled out, only to find that they had expired a long time ago – and it can create quite a pain if you need to start the process of getting contracts renewed when the focus is on the sale.

Your contracts should also be specifically geared up for a sale, and contain clauses that assist you in an easy transition to a new owner.



I highly recommend that you make sure all of these contracts are reviewed and updated regularly to ensure that when the time comes for a sale, your sale price is not diluted as a consequence of a buyer taking a dim view of the protections you have in your contracts.

Bear in mind that these contracts can often be pivotal in helping you to prove that your business has locked-in and transferable value.

HOUSE IN ORDER

Get your premises secure

Review your business leases and ensure that the lease does not expire during the time you are looking to sell the business if the premises or location is an important component of the business.

Be prepared to deal with an assignment of the lease to the buyers.

Sometimes when sellers are in a hurry to sell, they forget that issues like the assignment of leases can take time.

If the premises are freehold, it may be worth considering if a sale and leaseback would be beneficial

DUE DILIGENCE PREPARATION

Getting ready for due diligence

As part of the sale process, a buyer will want to conduct due diligence of your business. This is when they will review the accounts, and investigate other areas of your business, so that they are more aware of the business that they are hoping to buy (and to gauge the level of risk tied with the business).

Being prepared for due diligence will make the process quicker and easier. And result in a higher likelihood of a smooth transaction.

I have known of many transactions that have fallen apart at this due diligence phase because the seller had not been prepared before hand – make sure that's not you. Preparing for due diligence requires that you first understand what is likely to be involved in the due diligence process, so make sure you understand the financial and legal items that a prospective buyer will be looking for, so that you can show your business in the best sale-ready condition.

Preparations for due diligence from a legal perspective should include at a minimum unearthing the following **documents**:

- Corporate structure and organisation chart
- Copies of key insurance policies relating to the business and its officers (if relevant) and an outline of dates of cover
- Copies of all contracts containing retention of title clauses or PPS clauses
- Copies of any other financing documents, security agreements and any other finance/credit related documents
- Description of any intercompany arrangements
- Copies (or at least a listing of) all non-compete restrictions (eg of employees, contractors etc)
- Copies of all contracts that the business is a party to (this might include contracts with employees, contractors, customers, suppliers, business partners, leases, contracts relating to IP, licensing or royalties etc)
- Intellectual property documentation (for example details of business name registrations, trademarks, patents, copyrights, domain registrations etc)
- Copies of permits, licences and other registrations required to operate the business
- Any other legal document that is relevant to the business.

This is only a short summary of the legal items you should be preparing for due diligence. If we are acting for you, we will provide you with a more detailed overview of the legal preparations you should be considering for due diligence.

And of course don't forget that this is just the legal side – there are many other due diligence considerations outside of the legal context.

Obviously gathering all of this information can take some time and effort, but it is well worth doing in advance, to give you the opportunity to spot and fix holes rather than leaving them for a potential buyer to discover.

CONFIDENTIALITY AGREEMENT

Get a good confidentiality agreement ready to go

You should have a good quality confidentiality agreement ready to hand out to potential buyers before discussing any specifics about your business, and definitely before releasing any financials, client details or company documents.

This document should be on hand and ready to go well before the search for potential buyers begins.

TRANSACTION DOCUMENTATION

Typically a seller's lawyer will prepare all relevant transaction documentation in relation to the sale. This puts you in control of the way in which documentation are drafted and presented to a buyer. If you are selling to a large corporate it is possible they may have template documentation they prefer to use. Whilst you might save costs upfront because you do not have to engage your lawyer to prepare the initial drafts of the transaction documentation, this approach may be riskier to you because you do not have the benefit of your lawyer drafting documentation who is acting on your behalf. It would then be up to your lawyer to go through the documentation presented by the buyer in detail and request for changes to the documentation. If the documentation is particularly one-sided, this may be a lot more work for your lawyer and you end up paying for it anyway! If this is suggested to you, it would be reasonable for you to respond by saying that it is customary for the seller's lawyer to prepare transaction documentation and your preference is to have your lawyer prepare them.

Transaction documents you can expect to be involved in negotiating are:

- Heads of agreement/letter of intent/memorandum of understanding – these agreements are normally entered into as a statement of intention before the due diligence phase. They can be of a binding or non-binding nature. They might include an exclusivity for a limited period of time. They will also outline the timeframe in which the parties propose to conduct themselves from due diligence through to completion
- Long form sale and purchase agreement – this is the agreement which sets out in detail the commercial terms the parties have agreed to buy and sell. This document will also contain detailed provisions which allocate risk of the transaction through terms such as indemnities and warranties
- Employment agreement – if there is an earn-out period and you are required to remain as an employee, you and other key personnel may be required to sign an employment agreements
- Put and call option agreements – this is where the sale and purchase is structured in a way which does not involve the full purchase upfront.

In our experience, the simpler and fairer the documentation is to begin with, the lesser the angst for all involved in negotiating them. This will of course also translate to a quicker transaction and less legal costs.

BUSINESS AS USUAL

Whilst this is a really simple concept and it goes without saying, you should consider what impact the sale process might have on your business. Ideally you want your business to continue as usual without any disruption as a result of the sale process.

However, you could be required to spend many hours attending to various matters relating to the sale process. You could be involved in hours of meetings with your business broker, accountant, lawyer, tax adviser or potential buyers or making decisions relating to the sale process. You could also be involved in collating all the information needed by your various advisers or potential purchasers. All these activities take time. You should consider how you will manage your time in attending to the needs of the business as well as the time needed to dedicate to selling your business.

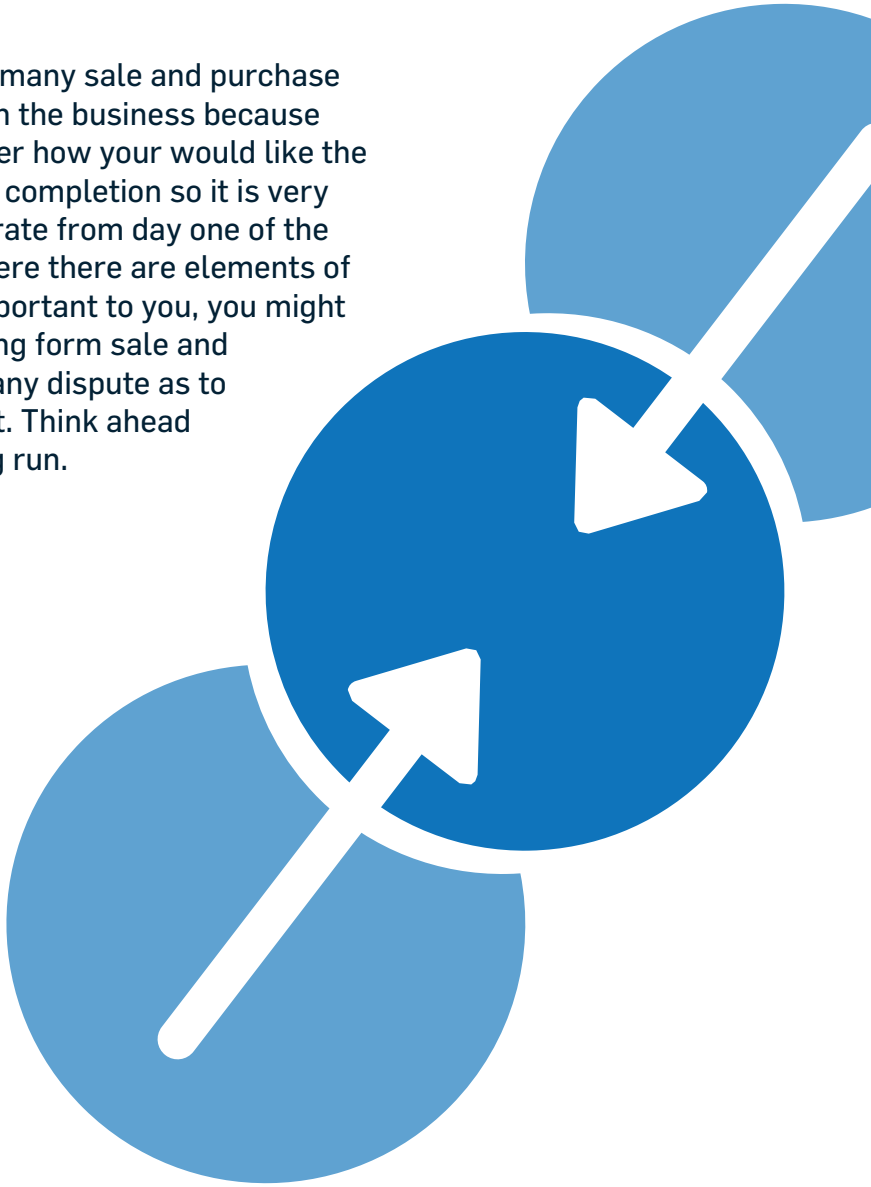
Do not underestimate how the sale process might impact your employees and their performance. If you are not acting in the ordinary course of business, your employees might become distracted about what is happening behind the scenes. Consider how much information you would like to share with your employees and to whom. If they do not have signed employment agreements with confidentiality obligations, you might consider putting them in place before you discuss any details of the proposed sale with them. You might be able to enlist their assistance to free up your time to focus on the more important parts of the sale process and the business.

It is very important you can manage the process in a way that enables your business to operate as usual without too much distraction. Sale and purchase agreements typically contain provisions which require the seller to keep operating the business in the usual manner between the time of exchange of contracts and completion. Performance still matters to the buyers. Do not get caught in a situation where your business suffers and you are faced with having to renegotiate the deal because the buyer has grounds to retreat from the deal. The last thing you want is for potential buyers to get last minute jitters because your business starts to underperform. Surround yourself with support people who know your business well and professional advisers who can expertly guide you throughout the sale process.

TRANSITION AND INTEGRATION

Getting the deal across the line at completion usually involves a lot of paper work and often stressful due to the timing pressure. Therefore, plan ahead as much as you can for a smooth transition when completion occurs. Try to understand as early as possible from your lawyer what is required of you in order for the deal to complete so you can start organising all that needs to happen. We have detailed checklists we can share with you. But these will need to be tailored to take into consideration the specific deal terms of your long form sale and purchase agreement and the commercial terms of your deal.

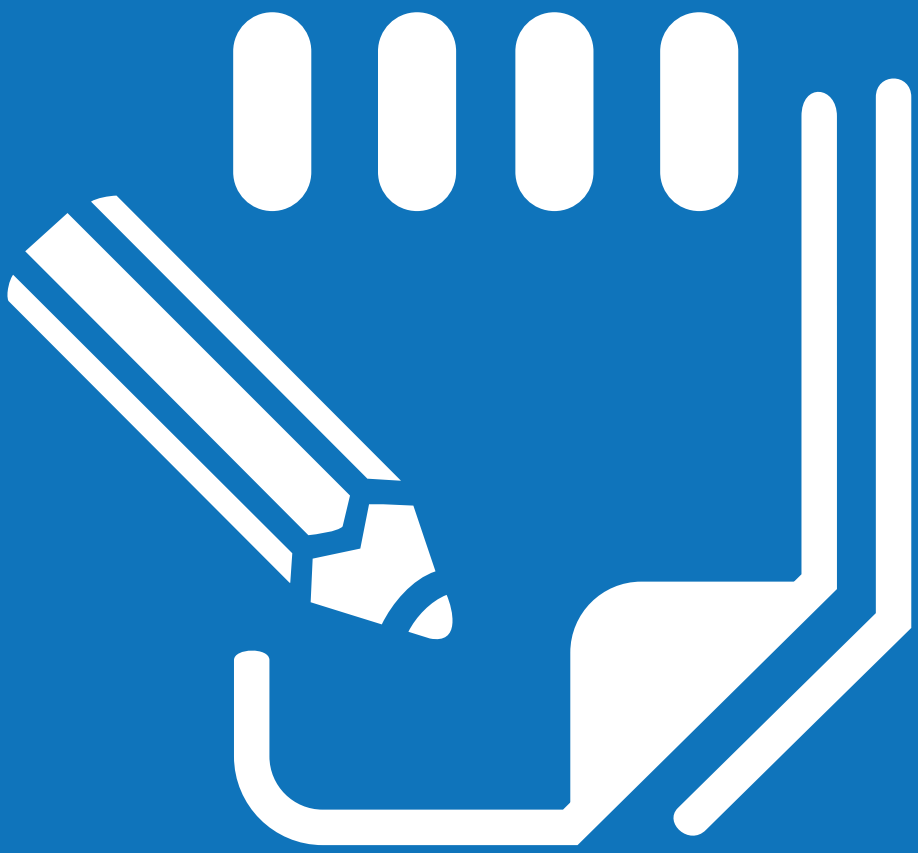
Integration is often an afterthought in many sale and purchase transactions. If you are continuing with the business because there is an earn out, you should consider how your would like the business to look like immediately after completion so it is very clear to you how the business will operate from day one of the business in the hands of the buyer. Where there are elements of how day one operates that are very important to you, you might consider having this reflected in the long form sale and purchase agreement in order to avoid any dispute as to how this might impact on your earn out. Think ahead and it will pay you dividends in the long run.



A FINAL NOTE

Many of these items will need to be addressed a long time before you start down the path of gearing up for a sale. For example you may need to restructure the business to optimise it for sale – and if that is the case, this may need to be done years before a sale.

A large proportion of sellers that I meet have just not thought about these issues in the detail that they should have, and sometimes by the time I come along, its too late.



The message is that there is a lot to do to prepare yourself for a sale, and it is never too early to start planning towards achieving a great outcome.

Checklist

	Seller's Checklist	What We Can Do to Assist
	Sale Structure and Timeframe	
☐	Engage advisers	Prepare confidentiality agreement
☐	Investigate the different ways to structure the sale in terms of the business structure and the deal structure and determine pros and cons; list controls that can protect your position or mitigate risks	Give advice on risks and benefits of different business and deal structures
☐	Get an estimate on the tax implications of the alternative structures from your accountant/financial adviser and lawyer; calculate best case and worst case scenarios	Stamp duty advice
☐	Decide on business structure and deal structure	Restructure business, if applicable
☐	Formulate a realistic timeframe and continually revisit and test it	Provide timeline for work to be done
	House in Order	
☐	Review key contracts with clients, suppliers, employees and contractors legally enforceable? e.g. are the contracting parties the right parties? Have any contracts expired? Do they need updating? Do the contracts contain provisions you expect them to contain from a commercial perspective?	Review, negotiate and update
☐	Consider if property lease will be important to the buyer. If so, ensure you have secured it	Review and negotiate changes with landlord as required
☐	Are there any key contracts missing?	Draft and negotiate to put them in place
	Due Diligence Preparation	
☐	Consider what you will need to provide during the due diligence process	Provide a checklist of documents, review documents and discuss related issues that might arise during due diligence
☐	Knowing your business for what it is, consider what a reasonable buyer would want to know about your business (good and bad news)	Provide advice about the management and disclosure of bad news
☐	If there are several potential buyers, consider preparing a vendor due diligence report to facilitate timeliness and efficiency of running a due diligence process	Prepare vendor due diligence report, if applicable
	Transaction Documentation	
☐	Instruct lawyer to prepare various transaction documentation as required to suit the deal structure and discuss and agree on timing to prepare documents. e.g. heads of agreement/letter of intent/memorandum of understanding, long form sale and purchase agreement, employment agreement, put and call option agreement and any other ancillary documentation	Prepare documents as required
☐	Review documents prepared by lawyer and ensure you are happy that they reflect the commercial terms. Have your financial/tax adviser review the documents to ensure they accord with their understanding of the structure of the deal	Amend documents as required
☐	Release transaction documents to buyer or their lawyer and negotiate terms	Negotiate documents as required and ensure proper execution of transaction documents
	Due Diligence	
☐	Provide access to due diligence materials	Assist with managing due diligence process and responding to questions
	Completion	
☐	Discuss and agree with lawyer who is doing what in relation to pre-completion obligations the seller has under the transaction documentation	Prepare completion checklist, and undertake all relevant steps required to complete the sale and transfer
	Transition and Integration	
☐	Determine action items to be undertaken by you and by advisers post completion to ensure smooth transition and integration of business	Prepare post-completion checklist
☐	Follow up on all post completion items and ensure they have been attended to or completed	Assist as required

WHERE DO I BEGIN?

aspect legal offers a number of services to help business owners in the lead up to a sale.

We start with a free initial consultation that provides an in-depth discussion of your business, the legal steps involved in a sale, the timeline for each step, and the other items you should be considering.

We also provide a number of business audits and contract review services for businesses that are looking to gear themselves up for a future sale.

And once you have started down the sale path, we provide checklists and regular updates throughout the sale process, to keep you fully informed about timelines, what we are doing, and what you need to be doing.

If you would like to get started with a free initial consultation or a discussion with us about your matter, click on one of the buttons below

Free Sale Preparation Review

Information pack

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