

NEIL  
MYERSON  
LLP

SOLICITORS

# **Guide to Selling a Company**

## **(An Overview of the Legal Issues)**

The Cottages  
Regent Road  
Altrincham  
Cheshire  
WA14 1RX

**T** (0161) 941 4000  
**F** (0161) 941 4411  
**E** [lawyers@neilmyerson.co.uk](mailto:lawyers@neilmyerson.co.uk)  
**W** [www.neilmyerson.co.uk](http://www.neilmyerson.co.uk)

## **1. Preliminary Stages**

This will largely concern negotiations over price. Before getting involved in detailed discussions, you should insist that any potential purchaser signs a confidentiality agreement. Some times you might be asked to sign a "lock out" agreement which will prevent you from negotiating with other potential purchasers. Even though a potential purchaser might have signed a confidentiality agreement, you should give serious thought as to when it is appropriate to disclose sensitive information such as details of customers. It is also good practice not to inform employees about the possible sale of the Company as this could cause uncertainty and potential problems with the workforce.

You need to carefully consider your tax position prior to a sale so as to establish whether it is possible to do any pre-sale tax planning. It is vital that tax planning considerations are taken into account when negotiating the structure of a sale. In addition, you should ensure that the Company is in the best possible condition for sale. This means ensuring that the Company's statutory books are up to date and locating all share certificates, title deeds and other documents of title. In addition, you should ensure that all key contracts are readily available and ascertain whether there are any "change of control" provisions in them which might allow another party to them to terminate such a contract.

If you are not the only shareholder of the Company, you need to ensure that all shareholders are in agreement with a sale and, if not, you need to ascertain what impact this might have. If difficulties arise with other shareholders, you need to consider your position under any shareholders agreement you might have signed and the Company's Articles of Association.

## **2. Due Diligence and Warranties**

The initial approach on due diligence will be for the purchaser to construct a draft shopping list for full information. The purpose of this exercise for the purchaser is to extract information about the Company in order to identify the risks of the acquisition and consequently the scope and extent of warranty protection the purchaser will seek from you.

During the due diligence exercise you will need to work closely with your lawyers who will manage the process and with your accountants who will be providing necessary financial information.

## **3. Employment**

Assuming that the shares of the Company are purchased (as opposed to business assets) no serious immediate employment problems should arise, as existing service contracts need not be disturbed. However, new service contracts may need to be negotiated if any of the existing directors of the Company are to remain.

## **4. Tax**

The acquisition will involve a wide variety of tax issues and will require your lawyers and accountants to work closely with you. The purchaser will need to be satisfied as to the present tax liabilities of the Company and be aware of likely future liabilities, taking particular account of your business plan.

It is customary for the purchaser to require that a Tax Deed be entered into which normally takes the form of a covenant from you to pay to the purchaser a sum to cover all pre-completion tax liabilities, other than those about which the purchaser knows.

Your lawyers will need to work closely with your accountants to ensure that appropriate amendments are made to the draft contract.

## **5. The Sale and Purchase Agreement**

The main provisions of the agreement deal with:

- (i) the sale of shares;
- (ii) the calculation of the purchase price and its payment, including deferred consideration and security for any deferred consideration;
- (iii) completion accounts;
- (iv) the composition of the board after completion;
- (v) the entering into of any service agreements with any directors and senior managers who are to continue being employed after completion;
- (vi) the entering into of the tax indemnity;
- (vii) the warranties and any limitations on them;

- (viii) the delivery of the disclosure letter;
- (ix) non-competition covenants by the vendor; and
- (x) any agreed pension arrangements.

## **6. The Disclosure Process, the Questionnaire, the Warranties and the Disclosure Letter**

- 6.1 The last thing the purchaser wants is to have a claim against the vendor after completion. Nearly always the purchaser negotiates the price before being able to carry out an extensive investigation of the Company. Before he becomes obliged to buy the Company, he wants as much information as possible to verify the assumptions on which the price was agreed and to ensure that there are no horrors in the cupboard. Information goes to price, and most of it has to come from the vendor.
- 6.2 The disclosure process often starts with the purchaser's solicitors sending out a questionnaire raising basic questions about the corporate structure of the Company, its assets and liabilities, its properties, its contracts, its insurance arrangements, its employees, its intellectual property and its tax position. Answering the questionnaire involves a lot of work for the vendor, his accountants and solicitors.
- 6.3 There are no standard warranties, and no warranties are implied by law in the sale of shares. It is the duty of the purchaser's solicitors to ensure that full and adequate warranties are obtained by the purchaser tailored to the particular deal.
- 6.4 Most clients gasp at the length of modern warranties. They find the length daunting and frustrating because of the time required to read, let alone to negotiate, the warranties. This attitude is understandable because clients naturally have confidence in the deal they have struck and want to clinch it. Solicitors, on the other hand, are professional pessimists and assume that what can go wrong, will go wrong. Their duty is to protect the client against his own over-optimism.
- 6.5 Warranties briefly cover five areas relating to the Company:
- (i) the commercial aspects of its business, including its contracts;
  - (ii) its properties;
  - (iii) its financial and tax position;
  - (iv) its intellectual property;
  - (v) its pension scheme.

The commercial warranties provide a check list designed to produce information relating, for example, to the Company's last audited accounts, its assets and liabilities, its employees and any litigation in which it may be involved. There is always a certain overlap between the information disclosed in answer to the questionnaire and the disclosures made in respect of the warranties.

- 6.6 Warranties have three main purposes for the purchaser:
- (i) to obtain disclosure;
  - (ii) to provide protection if some undisclosed liability arises; and
  - (iii) to shift the risk on to the vendor for unknown liabilities.
- 6.7 Let us illustrate this by considering a usual warranty - "the Company is not a party to any litigation or arbitration proceedings, there are no claims or actions pending or threatened or anticipated against the Company, and there are no facts likely to give rise to any such proceedings, actions or claims". Suppose that the Company manufactures sophisticated machinery which is protected by a patent. The purchaser obviously wants to know if the Company is in dispute with one of its main suppliers of components used in manufacturing the machinery. If the vendor discloses that the Company is in dispute with one of its suppliers of steel, the purchaser is unlikely to be too concerned, because many companies supply steel. On the other hand, the purchaser is much more likely to be concerned if the vendor discloses that he knows of another manufacturer whose machinery may infringe the Company's patent.

- 6.8 The issue will also arise whether the Company's machinery infringes the patents of any other manufacturer. The vendor may say that, as far as he is aware, it does not. The question is whether it is the purchaser or the vendor who is to bear the risk of an enraged manufacturer slapping a writ for patent infringements on the Company the day after completion. As we are in the realms of the unknown, the answer is one of risk allocation or apportionment, not disclosure.
- 6.9 The purchaser cannot claim for breach of warranty where the vendor has made a proper disclosure. The disclosure letter, which contains the disclosures, is, therefore, a crucial document and involves time-consuming work and, perhaps, several visits to the Company's premises by the vendor's solicitors. The time and care is well spent because neither party wants to end up with a claim after completion.
- 6.10 Where the vendor makes an unwelcome disclosure, the purchaser has various choices. He can accept it. He can insist on reducing the price. He can, in an extreme case, withdraw from the deal. He can, where appropriate, ask for an indemnity. This will shift the risk back to the vendor.

## **7. Tax Indemnity and Indemnities**

- 7.1 There are two main differences between warranties and indemnities:
- (i) A purchaser can claim under an indemnity where he knew at the time it was given that there might be a claim. He cannot sue for breach of warranty in such a case.
  - (ii) Damages under an indemnity are easier to establish because an indemnity allows a specific sum to be claimed. Damages for breach of warranty are calculated by reference to the reduction in the market value of the shares in the Company as a result of the liability, and, furthermore, the purchaser has a duty to mitigate his loss. There is no duty to mitigate with a claim under an indemnity.
- 7.2 An example will illustrate this. Suppose that the Company has an undisclosed liability of £100,000 and the purchaser makes a claim for breach of warranty. The vendor will argue that, with corporation tax at 30%, the Company's loss is only £70,000, and that the market value of the shares in the Company has not fallen by £100,000 but only, say, by £70,000. Under an indemnity the purchaser would claim £100,000.
- 7.3 Indemnities in connection with the sale of shares in private companies cover taxation and protect the purchaser in respect of certain negotiated items which the vendor has disclosed. The indemnities for taxation appear in a separate Tax Indemnity or Tax Deed, to which the Company may be a party; they provide an indemnity in respect of all the Company's taxation up to completion, except for the tax provided for in the last audited accounts and except for corporation tax, PAYE and VAT arising in the normal course of business since those accounts were prepared. Making the Company a party enables it to claim under the indemnity and ensures that the money is put back in the right pocket but, as a result of the decision in *Zim Properties*, it is not tax effective to give the Company any chose in action such as the right to claim under a tax indemnity as the Company will be taxed on a disposal of that right which it received for no consideration.

## **8. Limitations to Warranties and Indemnities**

- 8.1 There are no standard limitations. The limitations have to be negotiated afresh for each deal.
- 8.2 There are nonetheless some usual limitations. The principal ones are:
- (i) place a cap equal to the purchase price on the vendor's liability, although, if the purchaser has had to advance money to the Company to discharge its indebtedness to the vendor, the purchaser will want the cap also to include the sum advanced;
  - (ii) set a threshold below which the purchaser cannot claim. This is usually at least 1% of the purchase price;
  - (iii) provide that claims must be made within a certain period after completion. This is nearly always longer for claims relating to tax, because the Revenue has (at least and in certain cases more than) six years in which to make an assessment in the absence of fraud, wilful neglect or default.

## **9. Summary**

After a deal the clients may find that warranties, indemnities and their limitations echo in the mind like a bad dream and think that too much time in the negotiations had been taken up discussing them. That is a mistake, because warranties and indemnities are intended to protect the purchaser against "nasties" that he would normally not have thought of and limitations and the disclosure process to protect the vendor. The happiest outcome is for the Company's business, after completion, to thrive and for the documents, over which there was so much struggle, to gather dust in the safe.

## Appendix

### List of documents normally required in the sale of shares

<b>Key:</b>	Pur	:	Purchaser
	Ven	:	Vendor
	PSol	:	Solicitors to Purchaser
	VSol	:	Solicitors to Vendor
	PAcc	:	[Purchaser's Accountants]
	VAcc	:	[Vendor's Accountants]

#### 1. Preliminary

1.1	Heads of agreement	Pur/Ven
1.2	Lock out agreement	PSol
1.3	Confidentiality undertaking	VSol
1.4	Legal due diligence questionnaire	PSol
1.5	Financial due diligence	PAcc
	<ul style="list-style-type: none"><li>• review long form report (if available)</li><li>• audited accounts</li><li>• management accounts</li></ul>	

#### 2. Sale and Purchase Agreement

2.1	Agreement between Vendor and Purchaser	PSol/VSol
2.2	Tax Deed	PSol/VSol
2.3	Share certificates (or deed of indemnity for lost certificates)	VSol
2.4	Stock transfer forms	VSol
2.5	Cheques / bank drafts	Ven
2.6	New bank mandates	Ven
2.7	Waiver of pre-emption rights	VSol
2.8	Certificate of incorporation, seals, financial records, statutory books, title deeds, other documents arising from due diligence exercise	Ven
2.9	Resignation letters (where appropriate) of existing directors and secretary	VSol
2.10	Resignation letters of existing auditors	PSol

#### 3. Disclosure letter

VSol

#### 4. Tax considerations

Review requirement for tax clearance letters	PAcc
--	------

#### 5. Pensions

Review pension implications	PSol
-----------------------------	------

## 6. Loans

- 6.1 Venture Capitalist loans
- Debenture release
- 6.2 Bank loans
- Debenture release
- 6.3 Other finance considerations:
- Intra-group debt dealt with?
  - Debts/guarantees released?
  - Other charges removed?

## 7. Service contracts

- 7.1 Service contracts for continuing executive directors PSol
- 7.2 Resignation letters PSol

## 8. Internal business

- 8.1 Completion Board minutes of purchaser to approve the transaction and documents PSol
- 8.2 Completion Board minutes of vendor to approve the transaction and documents VSol
- 8.3 Shareholder approvals (if required) PSol/VSol

## 9. Property/Land

- 9.1 Detailed requirements depend on whether title is registered or unregistered PSol/VSol
- 9.2 (If appropriate) a certificate of title (in the agreed form) VSol

## 10. Miscellaneous

- 10.1 Completion Accounts? PAcc
- 10.2 Announcements Pur
- 10.3 Filing at Companies House (watch time limits) PSol

## Contacts

If you have any queries please do not hesitate to contact a member of our dedicated team.

**Akeel Latif** T 0161 941 4000  
E akeel.latif@neilmyerson.co.uk

**Carl Newton** T 0161 941 4000  
E carl.newton@neilmyerson.co.uk