BIC Bites

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An Introduction to Mergers, Acquisitions & Divestments

Mergers, acquisitions and divestments are processes by which the ownership of an organisation or an organisation's assets are transferred or consolidated with that of another organisation. These processes allow organisations to change the nature of their business, often to try and obtain competitive advantage or maximise the value of the acquiring organisation. This BIC Bite explains some of the background to these often complex deals.

Deal structure

The overall structure of any deal should be considered carefully; changing the structure down the line can be time-consuming and costly, and could weaken your bargaining position. The final structure is likely to be heavily influenced by the information gathered by the buyer as part of the due diligence process (see below).

An acquisition can be structured either as a purchase of the shares of a company (**share sale**) or as a purchase of a collection of assets that make up a business (**asset sale**). Generally, a buyer will favour an asset sale as it can 'cherry-pick' the assets which it acquires, whilst a seller will prefer a share sale as all of the assets and liabilities of the company automatically transfer.

In relation to the purchase price, a seller usually prefers to be paid in full upfront, whilst a buyer may prefer deferred payments or earn-outs (where the seller receives additional funds based on the future performance of the business).

Preliminary documents

- **Heads of terms –** usually a non-binding agreement setting out the key deal terms and providing important guidance to the legal teams drafting the deal documentation.
- **Confidentiality agreement –** protects the seller against leaks of confidential information by prospective buyers.
- **Exclusivity agreement –** prevents the seller from offering the business to a third party for a certain period of time. A seller should only agree to this if it is based on genuine commercial reasons, e.g. an offer over market value, and only if the exclusivity period is reasonable.

Due diligence

The buyer and its legal advisors should carry out legal, commercial, tax and financial due diligence on the target business or company. This is essentially a fact-finding exercise to identify any risk areas which could reduce the value of the target. The process usually begins with the buyer issuing a questionnaire and requesting sight of particular documents. The seller's answers form the basis of the warranties set out in the main agreement (see below), and therefore this process is a key part of the risk-allocation exercise.

> *For example, the buyer of a publishing company will request a full list of titles clearly indicating whether the copyright for each title is owned or licensed. Specific questions may focus on what trademarks the business owns, how and where it stores its personal data, and the shape and security of its IT systems, as well as more general business questions concerning employees and property arrangements.*

Key questions to consider at this stage:

- **What is the most efficient way to structure the deal from a tax perspective?**
- **Are any third party consents required before the deal can take place (e.g. from landlords, counterparties of commercial contracts, or regulatory authorities)?**
- **Will the seller need to provide certain services to the buyer after completion?**
- **If an asset sale, does legislation regarding the transfer of employees (TUPE) apply?**

Documenting the deal

Once the buyer is content with the answers it has received during due diligence (and has made any necessary amendments to the purchase price based on its findings), the legal teams will start to negotiate the deal documents. The primary negotiated document will be a share purchase agreement (in the case of a share sale), or an asset purchase agreement (in the case of an asset sale).

Main agreement – typically a purchase agreement has several important and inter-related sections:

- **Purchase price**
- **Warranties and indemnities** – these protect the buyer in the event that the target company is found to be worth less than was understood at the time of the purchase. **Warranties** are statements of fact about the target company; if found to be untrue, the buyer can sue for damages. An **indemnity** is a promise given by the seller to reimburse the buyer in respect of a particular type of liability, should it arise; these are often given with respect to specific issues discovered during due diligence.
- **Limitations** – the seller will seek to include liability caps and time limitations with respect to any claims the buyer may bring.
- **Restrictive covenants –** prevent the seller from competing with the buyer for a limited period after the deal.

Disclosure Letter – disclosures are used by the seller to qualify the warranties. If a warranted fact turns out to be incorrect, the buyer has a claim for breach of contract unless such facts were disclosed in the disclosure letter.

> *For example, a warranty may be given by a selling publisher that it is the owner of all of the copyright for its titles. If, in fact, the publisher is only a licensee for two of its titles, this should be set out in the disclosure letter; if not, the buyer could claim for any loss it incurs, such as the amount of the annual licence fees.*

The disclosure letter is a key document for both parties. If a seller makes inadequate disclosures, the buyer may make a claim for breach of warranty. If a buyer does not adequately review the disclosure letter, there may be some unwelcome surprises after completion.

Signing, completion and post-completion

If there are any conditions to completion, there will be a gap between signing of contracts and completion. Otherwise, signing and completion will be simultaneous. A number of actions will be then be required by both parties, including Companies House flings, paying any relevant taxes, and making announcements to third parties.

Further information on processes and best practice post-completion

For guidelines on how to manage this process, please see BIC's "Acquisitions & Divestments Best Practice Guidelines", which can be found here: (physical products) https://www.bic.org.uk/209/Acquisitions-and-Divestments-for-Physical-Products/ and here: (digital products) https://www.bic.org.uk/189/Acquisitions-and-Divestments-for-Digital-Products/

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