

THE LEGAL DIFFERENCES BETWEEN AN ASSET PURCHASE AND A SHARE PURCHASE

AN EVOLUTION CBS WHITE PAPER

Special points of interest:

- *Asset Purchase*
- *Share Purchase*

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One of the biggest decisions for a seller or purchaser of a business is whether to opt for a share or asset purchase. There can be some confusion between the two and, dependent on the business, there could be certain liabilities or benefits which make one better suited to your purchase or sale than the other.

At Gill Akaster we deal with both types regularly and thought it may be helpful to explain some of the main differences between them and the reasons for it. The accountancy and tax positions often vary hugely depending on which model is used but there are also significant legal differences that need to be considered.



Asset Purchase

Here, the buyer 'cherry picks' the items or assets of the business they wish to purchase. It is important to identify exactly what is being selected; such as machinery, stock, work in progress, premises, contracts, goodwill, etc. It is equally as important to identify which items are not going to be purchased such as existing creditors and debtors.

The main document will be an Asset Purchase Agreement and this will normally deal with some if not all of the following matters:-

Premises (Freehold or leasehold property to be included and any posses-

sion or personal guarantee issues that need to be dealt with)

Goodwill (The likelihood of repeat custom due to the goodwill the business has built up over time. This is often one of the most important assets purchased. Restrictive covenants are likely to be included so the seller cannot compete with the business for a set time frame in a given geographical area)

Contracts (It's important to identify all contracts being purchased and to review their terms carefully. Any potential liabilities under the contracts will need to be

checked and provisions included in the agreement to deal with these)

Stock and Work in Progress (This must be identified early on and an agreed schedule drawn up at completion. Often this will be estimated given the constant fluctuation of these items within a business)

Plant and Machinery (It is normal to have a detailed schedule setting out all physical pieces of plant and machinery to be purchased, with outlines of their current condition and any relevant lease or hire purchase agreements)

Employees (When purchasing a business through an Asset Purchase, 'TUPE' legislation protects employees' rights on the transfer of the assets of the business. It is extremely important to identify which employees are to be automatically transferred to the buyer under TUPE regulations as there can be a high cost associated with them)

Creditors and Debtors (These often remain with the seller so the buyer has a clean start)

Intellectual Property (These assets have become more and more important over time and include trademarks, patents, registered designs, etc. It is important to identify these early on, as well as who owns them and to ensure there are formal assignments/transfers put in place so these go across to the buyer)

VAT (If the business is purchased as a going concern then VAT will not be applicable as long as both parties are VAT registered)

Warranties (Less extensive than in a share purchase, but there will still be warranties (statements) made by the seller in relation to the assets being sold. If any prove untrue then the buyer will have a potential warranty claim for any losses suffered)



Share Purchase

WITH A SHARE PURCHASE THE BUYER PURCHASES THE SHARES IN A COMPANY FROM THE SHAREHOLDERS AND ONCE THESE HAVE BEEN TRANSFERRED, OWNERSHIP OF THAT COMPANY WILL PASS TO THE BUYER- AND WILL INCLUDE ANY ASSETS OR LIABILITIES.

If the shares in the company who run the business are being acquired then normally it will be the buyer's solicitors who prepare the initial documentation. This is

because there will be extensive warranties and indemnities in the documentation to protect the buyer which makes it sensible for their solicitor to prepare them.

With a share purchase the buyer purchases the shares in a company from the shareholders and once these have been transferred, ownership of that company will pass to the buyer- and will include any assets or liabilities. As the buyer is not 'cherry picking' assets then the

potential for the buyer taking on liabilities is much greater.

The main document in a share purchase is a Share Purchase Agreement that, as well as dealing with the transfer of the ownership of the shares in the company, will deal with the following matters:-

Completion Accounts (These are prepared immediately after completion and ensure both parties are aware of the company's financial position. Often the purchase price will be adjusted if the completion accounts are not exactly as anticipated)

Restrictive Covenants (As with a share purchase the buyer will want to ensure the seller does not compete with them for a limited period of time in a certain geographical area. The period and area will depend on the size of the business and the area in which it operates. Careful consideration needs to be

given to the drafting of these clauses – if drafted too wide then the court will class them as void and unenforceable)

Indemnities (During the process of due diligence, if any significant issues are highlighted a specific indemnity against any related issues may be required to be given by the seller. This is more powerful than a warranty as the enforcement options for the buyer are much more extensive. Tax issues are often dealt with this way and, in larger transactions; there can be a separate detailed tax indemnity document. If any indemnities are broken then the seller is under a duty to compensate the buyer accordingly)

Schedules (Often attached to the Share Purchase Agreement will be several schedules, which will go into more detail in particular areas, such as any adjustments post-completion to the price or any future payments

that are to be made that are conditional upon future performance of the company)

Warranties (A large part of the Share Purchase Agreement will deal with warranties. These are statements made by the seller in relation to the company and are based on information gathered during the due diligence exercise. The purpose of a warranty is for the buyer to flush out any information that should be known before entering into a legally binding contract. This could include any litigation, hidden issues with the company or lower profitability than originally appeared.

There is much negotiation to the exact wording of the warranties given and the scope of them. The buyer will want wide and detailed warranties so they have a potential claim against the seller; the seller will not want to give any general warranties for fear of a future claim.

However, there are two means of protecting the seller. Firstly, there is the disclosure letter. This is a letter with supporting documents which is sent by the seller to the buyer and details the exceptions or qualifications to the warranties contained in the sale agreement. Secondly, there will often be a clause or schedule setting out limits on the potential liability of the seller in terms of value and time for any potential claims to be brought against them.

Although, in theory, if a warranty is found to be untrue, the buyer has a claim for damages against the seller, these are often very difficult and time consuming to prove. Therefore it is always much better to make sure that the buyer carries out full and detailed due diligence of the target company, rather than rely on any potential breach of warranty claim).

The above outlines just some of the key legal differences between a

Share Purchase and an Asset Purchase. There are of course many other areas that may be included depending on the complexity or the particular circumstances of the deal. Due to this complexity, guidance from a professional and experienced solicitor is essential to ensure you remain protected.



About the Author



James Perterson has been with Gill Akaster LLP since 2006. He graduated with a Law Degree (LLB) from Plymouth University in 2004 and went on to study his LPC at Exeter University. James qualified as a Solicitor in 2009 and is now a member of the company's commercial team.

James is building up a strong following in the local community for his increasing levels of work in the field of company/commercial law, including business sales and purchases, company advice, commercial agreements and advice on partnerships.



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