

Initial Steps

Heads of Agreement, Confidentiality and Exclusivity

It is common for %heads of agreement+ or %heads of terms+ to be entered at an early stage in a share purchase or asset purchase transaction. The expressions mean much the same thing and refer to a non-binding agreement in principle. The heads usually set out the principal terms of the purchase and sale, in non-binding terms. The heads of agreement often contain binding provision in relation to confidentiality, exclusivity and fees.

Once a decision is taken to sell shares or assets, the vendor will generally want to keep a number of matters confidential. This will include the fact of the negotiations and confidential business information that may be disclosed in the course of due diligence. A confidentiality agreement imposes a duty of confidentiality on the buyer in respect of information disclosed in relation to the target company in the course of a prospective sale.

A written confidentiality agreement is desirable as the common law of confidentiality is uncertain in scope. It creates a simple obligation which is easy to enforce and understand, makes the obligation of the parties clear. Although it may be possible to obtain an injunction to enforce the agreement, it may not be possible to anticipate that a breach is about to take place. Once information is disclosed, it may be too late.

Once information is in the public domain, no confidentiality agreement will make it secret. Damages may be the only remedy but they may not be adequate. Proving a breach can be difficult. Even if there is no intentional breach, it is difficult to prevent to the recipient of information from taking account of the information, once it is known.

A buyer may require exclusivity in return for its investment of time and resources in advancing a proposed transaction. The buyer will not want the risk that a third party will gazump him prior to a legal agreement being reached. For this reason, exclusivity obligations are often entered at an early stage. The exclusivity obligation will have a set period, which may be extended by agreement.

The exclusivity and confidentiality provisions in the heads of agreement will usually be binding, even if the heads of terms itself is not binding. Despite the above practical limitations, confidentiality agreements are useful and advisable.

Due Diligence

The seller may limit the members of the buyer's organisation that have access to the business. It may provide that access may only be had at certain off site locations. It may provide for procedures, so as to minimise the risk that information is leaked. The confidentiality agreement should define the information that is protected by an obligation to keep it secret and set out the circumstances in which it is permitted to be disclosed.

It is usual that the confidentiality agreement provides the buyer is not to disclose the information or to use, it except for permitted purposes which will usually relate to the valuation of the business and the negotiation of the prospective transaction. The buyer will wish to disclose information to certain parties for the purpose of the review. They may wish to involve parties such as a bank, professional advisors and consultants.

Auction arrangements

Where a target company is sold by a controlled auction, the seller and its advisers prepare and circulate an Information Memorandum about the company. The format and content will be a matter for the seller. It will generally summarise the key investment considerations. It may also contain financial information analysis, key personnel, markets and other appropriate information to enable prospective purchasers to appraise the value of the company.

Buyers will be required to sign a Confidentiality Agreement and a draft Share Purchase Agreement will be produced. They may be asked to mark up the seller's draft Share Purchase Agreement and submit any amendments they propose, with an indicative offer.

The seller will then draw up a short list of bidders, who will be given access to a data room. A data room can now be accessed on-line. It will be strictly controlled. It will contain key documentary information about the company for sale.

The advantage from a seller's point of view is that there are other interested parties potentially available. The buyer may find its bargaining powers severely reduced. Typically in a two party transaction, the document will start as the seller's document and the buyer will seek to negotiate more favourable terms.

Financial assistance

There is a prohibition under UK law on companies granting financial assistance on the purchase of their own shares. The terms of the prohibition has been limited by the recent Companies Act, 2006 so that it no longer applies to most private companies. The prohibition relates to assistance given before or after the time the shares are acquired.

Approvals and Consents

Approvals may be necessary to complete the share purchase. The acquisitions may need to be considered and approved by the Boards of both the vendor and the purchaser company or duly authorised committees of the directors. A listed company may have specific obligations in relation to the acquisition.

Shareholder approval may be required under a company's articles of association. Shareholders agreements or Articles of Association may prevent directors from making

significant assets, acquisitions or disposals without shareholders consent. In some cases, transactions with a director or person connected with a director involving substantial assets (broadly over £10,000 or 10% of net asset value) must be approved by the shareholders.

If one party is a listed company or subsidiary of a listed company and the other party is related (which means anyone is or was within the last 12 months a director, or a substantial shareholder in a group company) shareholder approval may be required under the Listing Rules. Shareholding approval is also required if the transaction is a so called "Class 1" transaction under the Listing Rules.

Regulatory authority consent may be necessary to the sale of shares or business assets in some cases. The nature of the business may be such that it is regulated in the public interest. The requirements that apply depend on the particular legislation and regulation that applies.

Competition Law

A relevant merger situation occurs when an "enterprise ceases to be distinct. A merger can arise either where there is a change of control in a company or where there is a change of control or ownership of a business. Merger law implications arise when certain levels of control (25% or 50%) are first acquired.

A merger may be investigated by the Office of Fair Trading and referred to the Competition Commission for a detailed investigation, if it creates or strengthens a share of supply of more than 25% in the UK or a substantial part of it (the share of supply test), and/or involves the acquisition of a target company which has a UK turnover of more than £70 million (the turnover test)

The share of supply depends on the definition of the market. This allows the Office of Fair Trading flexibility to consider segments of the market that may be considerably

narrower than the market as a whole. There is no obligation to notify the transaction if the thresholds set out above are met. However, where the thresholds are met, the Office of Fair Trading may exercise power over the transaction which may result in the transaction being notified to the Competition Commission. Therefore, notifications are often made to ensure that the Office of Fair Trading will not decide to refer the transaction.

The Office of Fair Trading will have a duty to refer a relevant merger situation to the Competition Commission where it holds a reasonable belief that there is a reasonable prospect that the situation has, or may be expected, to result in a substantial lessening of competition within any market or markets in the UK for goods or services.

A merger may lead to a substantial lessening of competition when it is "expected to weaken rivalry to such an extent that the competitive process would no longer deliver a similar level of customer benefit as it would without the merger". The post-merger effects are such as would be expected to be sustained for more than a short period of time.

The parties to a merger may ask for confirmation from the Office of Fair Trading that it does not intend to make a reference to the Competition Commission for a detailed investigation. There are three ways of obtaining the Office of Fair Trading's view on a merger:

- By making an informal application,
- by applying under the statutory merger notice procedure for clearance or
- by obtaining informal advice from the Office of Fair Trading.

This Guide is intended as an overview and broad outline of the matters covered in it. Its purpose is to inform and raise awareness. We are happy to offer specific legal advice on particular circumstances.

This Guide should not be relied on as a substitute for comprehensive legal advice with reference to the particular circumstances.

While we have taken due care in the preparation of this publication, we do not accept legal liability as a result of any reliance placed on anything in this Guide. The reader should rely only on specific legal or taxation advice.

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