A Business Lawyer's Guide to Selling and Buying a Business

1. Before Selling the Business (for the Seller)

(a) Financial Information and Valuations

Ensure that all relevant business and financial information is up to date and, in particular, have current financial statements (balance sheet, profit and loss statements) as well as going back at least 2 or 3 years.

It is also useful to obtain a current business valuation, whether from a licensed business valuer or from your accountant based on your business' appropriate industry valuation methods.

(b) Selling Agents

When seeking to use a business broker or selling agent, ensure that you have carefully read and understood their sale/agency agreement (there is no such thing as a "standard agreement") and that they have appropriate experience with selling your type of business.

Consider also using multi-listing of sales' agents and whether there are existing potential buyers within your business, known other third parties or competitors that may be interested before utilising an agent.

(c) Key Staff

Ensure that your key staff are secure in their employment (as best as possible) whilst at the same time not usually advising of any proposed sale until it is a known fact (i.e. just before settlement).

(d) Key Contracts

If your business has 'key contracts' such as supply arrangements, agency agreements or renewable clients/customers ensure where practical and possible that these are committed to writing; whether by way of contract, terms of trade or other formal methods.

(e) Intellectual Property and Business Goodwill

Ensure all intellectual property, business name(s) and other things affecting the goodwill of the business (e.g. website, copyright on documentation, client/customer data base) are properly identified, documented and protected/registered where practical.

(f) Site-Based Goodwill

Make sure that, if your business' goodwill is also determinant on its location (i.e. site-based goodwill) such as for a retail store or where the business is well-exposed to potential customers, the lease is current and that there is sufficient term (and any further terms or options to renew) left available for any prospective buyer.

Note: Anything less than, say, 4-5 years left in the lease's term may present difficulties for a buyer to obtain a sufficient 'return on investment' for the purchase price. Particularly if the new buyer may subsequently be forced to relocate or redevelop the leased business premises. This is not uncommon in retail shops situated in large shopping centres.

2. Before Buying a Business (For the Buyer)

(a) Know the Business

If this is your first time buying into a business or you are buying a (type of) business you have previously not worked in, ensure you first obtain appropriate advice; particularly so from an experienced business advisor, your accountant and your business lawyer (once you are ready to proceed).

Things to consider are:

(i) Third Parties

Does the business require certain licences, permits or rights (e.g. Local Government Eating House Licences, grant of franchise rights, Government authority approvals, approval of a third-party, key supplier or customer/client and the like)?

(ii) Your Other "Masters"

Who will be your "Masters"?: your financier or the purchase price lender (e.g. bank), the business premises lessor, a franchisor or possibly even the seller, if you are obtaining "vendor finance"?

(iii) How Much Funds do you Need?

Do you have **all** necessary finances in place (e.g. the purchase price plus GST (particularly if it is a business asset sale and not a sale of the business "as a going concern"), lease assignment costs, advisor costs for due diligence, payments for settlement and transfer duty, and sufficient working capital for stock purchases and ongoing trading requirements)?

(iv) Your Appropriate Buyer Entity

Before signing any form of contract relating to your purchase of the business, despite whether it is an "offer to purchase", "heads of agreement", "business sale agreement" or "memorandum of understanding", make sure that you first obtain appropriate accounting and legal advice. This is important to determine the correct buying entity in which you should ultimately own your business e.g.:

(1) **Family trust** using a company as its corporate trustee (generally for family-owned businesses and not intended to introduce third party part-owners at a later date); or

(2) **Unit trusts**, or a **company**, with the respective unit/shares held by the ultimate buyer(s)' family trusts. These types of business-owning structures are more flexible to the later introduction/exit of third party equity owners in the business.

(v) Equity Owner and Management Agreement

Also, if you are going to buy using a company, unit trust or even a partnership it is our strongest advice that a customised share/unit holder or partnership agreement is produced. This is in **addition to** the necessary prior creation of the prospective trust deed, company constitution or partnership arrangement.

3. The Business Sale Agreement

(a) The Offer

Once:

(i) the 'in-principle' business sale negotiations have concluded between the seller (such as considering any information memorandum, sales brochures, disclosure documents or the like); and

(ii) the parties are then interested in proceeding to a formal contract (i.e. the Business Sale/Purchase Agreement);

a formal business offer needs to be presented by the buyer.

(b) The Formal Business Sale/Purchase Agreement

Usually the offer is presented by the buyer to the Seller or the seller's agent and, dependent if it is:

(i) a relatively standard type of business (e.g. a non-franchise, retail business (such as a restaurant, clothing store, mechanical parts business etc.) then a REIWA or WA Business Broker's form of Sale of Business Agreement (as a Going Concern) can be utilised; **or**

(ii) if it is a complex type of business or sale transaction (e.g. sale of financial planning business, sale of client-base or rent-roll part-sale of business) or, particularly a sale of equity (e.g. sale of units or shares) then you should obtain appropriate legal advice and will most probably need a specifically prepared purchase agreement.

(c) Special Conditions or Conditions Precedent

These "subject to" conditions that are included in the business purchase agreement (i.e. the purchase offer). It is important that a buyer makes sure that they specify any appropriate special conditions and/or conditions precedent to the settlement (i.e. completion of the business sale), such as "due diligence".

These conditions may involve a number of the earlier mentioned factors, consent of appropriate "masters" (e.g. the business' lessor or franchisor) and, ultimately, bank finance.

(d) Finance Approval

Ensure that your due diligence and all the relevant other approvals and information are accepted **before** approaching a bank, as they will commonly require these to be in place before they will **unconditionally approve** It is also highly recommended to have obviously spoken to your bank or financier well before making the offer, so that you know what your actual financial capacity is.

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(e) Deposit

With the offer itself, in addition to due diligence, the buyer should pay a deposit. Based on common law this should be no more than 10% of the purchase price.

It is also recommended that the deposit should become non-refundable once the seller has begun to incur not-insignificant expenses as part of the conditional sale agreement e.g. lessor's consent for assignment to lease, which even if the buyer is rejected as an assignee of the lease, the seller will still be required to pay the lessor's costs for properly considering/evaluating the lease assignment request matter.

(f) Third Party Approvals

Determine what third party approvals you require and these should also be conditions of the sale agreement as previously mentioned. This should almost always be in writing; such as lessor's consent, grant of statutory licence/permit, issue of new franchise agreement, key staff agreeing to transfer employment to the buyer etc.

(g) Settlement Dates

Before settlement, whilst it is commonly desired particularly by the parties to have a fixed date of settlement, in our extensive experience we recommend that settlement should be based on a "trigger event" e.g. five (5) business days after the **last of** the due diligence, third party approvals and finance is formally approved and notified (i.e. usually after the last condition precedent is met.

This way the seller has more "incentive" to accelerate the provision of all relevant information to the buyer in seeking necessary third-party approvals. So that in turn a buyer can then proceed with obtaining unconditional finance and thereafter proceeding to settlement.

Not uncommonly if a fixed settlement date is specified, even through no direct fault of one party, and there is a delay on settlement, default interest and costs can be incurred in addition or reduction of the purchase price (dependent on who is "contractually" at fault).

4. Performing the Sale Agreement

(a) Financial Information

All the financial information relating to the business' turnover, expenses and profitability (or goodwill) should be carefully reviewed in conjunction with appropriate business advice; particularly by the buyers.

(b) Plant and Equipment

A list of assets (or plant and equipment) to be sold with the business should be clearly specified and usually should be confirmed by way of the seller's depreciation schedule of those assets at the "written down value". The seller should advise, but the buyer should be aware to determine which business assets are actually:

(i) owned by the seller; **or**

(ii) subject to a lease or other secured-finance arrangements (such as hire-purchase or business loan).

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Therefore, the buyer must check if it is a company, whether there are any encumbrances such as registered "charges" (i.e. debentures) over the seller company, whether fixed or fixed and floating.

(c) Intellectual Property

If the business relies on any form of valuable intellectual property; such as trademarks, patents, designs etc. that these have been properly registered, normally through the authority IP Australia (ipaustralia.gov.au) or copyright has been expressly asserted on any copyrighted material; such as websites, business drawings, texts or publications, manuals etc.

(d) Employees

Ensure that a detailed list of the business' employees is provided by the seller. This list should set out their names, age, position/job description, whether they are full-time, part-time or casual, starting date and current wage or hourly rates.

Importantly the business and employees' formal employment agreements or arrangements should be carefully reviewed to determine whether they comply with any applicable awards. Particularly note the requirements of the Fair Work Act as from 1 July 2010 for corporate-based employer businesses and that "long-term casuals" are usually actually part-time employees.

Determination whether accrued entitlements/liabilities e.g. annual leave, long service leave, sick leave and any other entitlements are to be taken over by the buyer. Therefore, there is sometimes a reduction to the purchase price to be paid by the buyer, or whether they are to be paid out by the seller.

Determine which employees are to be transferred and which ones are not. It should be the seller's responsibility to provide any redundancy payments. It is particularly so if an employee is a potential problem employee or simply the buyer will not require as many staff, noting that experienced employees can retain important intangible business knowledge.

(e) Key Persons

Ensure that any key person(s)' employment agreements are in place and any Key-Performance Indicators ("**KPIs**") are agreed. The seller should also make sure that the lessor/ franchisor/licensor/supplier provides their prior written consent, or indicative approval. Note that, commonly, franchisors have a first-right-of-refusal to acquire the seller franchisee's business **before** they are able to sell to a third party buyer.

Also, check that specific business contracts such as the lease agreement, which must have the lessor's approval before the assignment of the business' premises lease can occur. Further some supply agreements contractually prohibit the assignment or change in ownership of the business without prior consent or notification to the other party.

(f) Adjustment of Purchase Price

The buyer needs to consider whether there needs to be an adjustment of the purchase price “mechanism” based:

(i) On the buyer’s initial, lesser level knowledge of business value knowledge prior to its due diligence; and

(ii) Yet still have the ability to keep the agreement on foot but the purchase price, for example, may decrease if the purchase price is ascertained after:

(1) A detailed review and advice on the business’ financials (e.g. plant and equipment not being in working order or written down value, the business profitability is not actually as initially represented); or

(2) Other unforeseen costs may be incurred by the buyer (e.g. new fit-out is shortly required by the lessor for the business’ leased premises).

(g) Retention or “Clawback” Clauses

If the business’ financial earnings cannot be fully or properly determined for a period of time, particularly for businesses based on the seller’s personal goodwill for non-renewable clients (e.g. “key man”), then either a portion of the purchase price should be held in trust (i.e. a retained sum) to be payable subject to the buyer meeting an agreed net income value of an agreed period e.g. 6 months, 1 year, 18 months and with an agreed formula to adjust up or down based on whether the seller’s represented net income is achieved.

Commonly this is effected by a condition that the seller will continue to work in the business after settlement, either as an employee or a consultant for an agreed period to ensure appropriate ‘client transition’.

Alternatively, to a retained sum, could be a ‘claw-back provision’ that the buyer is entitled to seek a repayment of some of the purchase price from the seller, if the business’ agreed net income is not reached within a specified timeframe or formula.

We usually do not recommend a clawback clause as this as it is similar to a seller warranty and commonly the seller will have either spent the disbursed paid purchase price monies, or possibly even may become insolvent, in the meantime.

5. Default or Failure of Sale Agreement

Unfortunately, from time to time, despite the best efforts (and possibly not) of the parties, defaults may arise during the performance of the sale agreement prior to settlement.

(a) Default

If this is the case it is very important that any defaults are put in writing and sent to the relevant party or their agent in accordance with the terms of the sale agreement.

(b) Specific Performance

If one party seeks to not perform the agreement (i.e. repudiate or ‘walk away’), then the other party may not only be entitled to sue them for loss but, if it is the buyer walking away they possibly forfeit the deposit in addition to a claim against them by the seller for damages.

If it is the seller walking away, then the buyer can also seek to seek specific performance (i.e. a Court can enforce that the contract's settlement must take place) and the business must transfer for the agreed purchase price less costs and penalty interest.

(c) Termination

If the sale agreement is to be terminated (and if it is not mutually agreed by the parties) after appropriate Default Notice(s) have been served and the relevant time periods have expired without rectification of the default by the defaulting party, then a Termination Notice needs to be prepared and sent by the non-defaulting party, which may address the above matters or may reserve the non-defaulting party's rights.

It is very important that this is properly done and legal advice is promptly sought because if the business needs to be re-sold by:

(i) The non-defaulting seller, they need to ensure that no (counter-claims) claims can be made by the defaulting buyer; or

(ii) The non-defaulting buyer needs to ensure that the seller cannot sell the business to a third party and that they can enforce their right to acquire the business (i.e. specific performance).

6. Settlement

Assuming that all condition precedents have been met and all necessary approvals in place, the actual act of settlement is usually a very quick process. Settlement commonly involves the exchange of Business Name transfers, keys for access to premises, security codes and cheques for payment by the buyer together with relevant third party approval documents (such as lessor's deed of assignment of lease, franchisor's new franchise agreement or approval by the Department of Racing, Gaming and Liquor).

(a) Stock

Businesses that operate an inventory usually require a "stock take" to occur, usually on the day before or morning of settlement.

It is common to see businesses sold for the purchase price (i.e. plant equipment plus goodwill values) plus PSAV (Plus Stock At Value). If a business does involve stock, it will be important that a sufficient level of stock is maintained by the seller to the date of settlement. This is so that the buyer does not have to acquire same on the settlement date.

If there is any dispute as to the value of the stock this should not stop settlement but rather an agreed sum should be retained in trust (usually held by the buyer's settlement agent or solicitor) pending an independent qualified stock taker arbitrating on the value of the stock, if the parties cannot agree on same. Therefore, an appropriate "stock take and valuation" clause should be put in the sale agreement.

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(b) Discharge of Encumbrance(s)

The seller will need to provide at settlement any release of security interests on the PPSR for secured bank loans, equipment finance etc. These secured parties will normally require a payout figure adjusted on settlement date.

Sometimes there is also a release or exchange of bank guarantees, particularly for businesses that operate large lines of credit or for leases.

7. Other Matters

(a) Transfer Duty

Note that all business sale agreements will be subject to transfer duty assessable at the Office of State Revenue ("**OSR**").

Agreements should be lodged within two (2) months of the date of the agreement (i.e. when the last party signed the agreement) or upon settlement, whichever occurs earlier. Transfer duty is payable on plant and equipment and goodwill but not on stock. Motor vehicles are assessed at a different rate.

In addition to penalty interest for the buyer for late lodgement of the sale agreement, there is a $20,000 fine for failure to lodge the sale agreement for assessment of duty with OSR. Transfer duty previously was going to be abolished on business sale agreements by OSR but, apparently due to the "Global Financial Crisis", it is not going to happen any time soon.

(b) Document Management

Lastly, the buyer should ensure that all relevant copies of all business documents, contracts, transfers, key contract and contact details are securely retained. At this point notification should have been given to staff, clients/customers and third-party suppliers and possible new or updated advertising of the business.

For further information contact Murfett Legal by telephone on +61 8 9388 3100, via our website at www.murfett.com.au or email one of the following directors:

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