

Business

Due Diligence on Business Sales and Acquisitions

Due diligence is the key element of any proposed sale or purchase. It is when we distinguish the facts from interpretation, supposition and possible hyperbole.

Understanding due diligence will save you time and money

Due diligence, both legal and financial will always be required and being in control of the process will save you time and probably money. For a Seller, preparing the company for sale is in the main preparing to satisfy the Due Diligence process and should be undertaken with care and thought at an early stage.

As lawyers, there are aspects of due diligence that we are not called to comment upon, e.g. age of plant and machinery and suitability to operate profitably; so what follows is focused on the legal element of due diligence.

What information do you want?

While you will already know a lot about the other business, you need to decide what information is vital to the transaction. If you have bought and sold businesses before, you will already have discovered that there are no hard and fast rules as every situation is unique. You should consult fellow directors and your professional advisers when drawing up the shortlist of type and extent of information required.

Typical content

The following headings are not exhaustive but may help you to decide the actual content you wish to include:

Employment

You need to think about every aspect of employment, not just obvious matters such as the existence of employment contracts, but things like non-competition clauses for senior staff and the history of staff grievances/claims; in particular have they all been dealt with and where appropriate, have procedures/working practices changed? Look in particular at 'key staff' who may not be senior management, for instance who is the best performing salesperson and what would be the outcome if that person left the business? Is the business adequately protected in its contracts of employment with key staff by means of non-compete and non-solicitation of customers and co-workers.

Make sure that someone in your 'team' of professional advisors is an employment expert because staff issues are of paramount importance.

Premises

The effect that either freehold or leasehold premises can have on the success of the transaction cannot be over-estimated and in some cases, acquisition of the premises may be the driving reason for the sale/purchase. Establishing the correct legal position regarding not just the premises at hand but also the wider implications regarding planning applications, rights of way etc of nearby sites is vital. The effect of Environmental legislation on properties and processes must be considered as the adverse result of an environmental audit can decimate the selling price if an expensive "clean up" is required.

Terms and Conditions

If a business has not paid attention to getting the basics right, what other problems will you discover? That is the philosophy you should apply to Terms and Conditions. Is unique wording in existence or has a copy of somebody else's been used? Check on matters like compliance with all current legislation, the payment terms that are specified and whether there is an entitlement to charge interest on late payments.

Customers

Whilst you need to make sure that you know where customers come from, how they are acquired and at what cost, etc., our concern would be with any warranties given and outstanding claims made against the business. Will any key customers be entitled to withdraw from contracts as a result of the sale? This may seriously affect the ability of the business to trade profitably post deal.

Suppliers

Do not overlook the significance of suppliers of both raw materials and services. You need to know if materials suppliers are under contract and what dependency there may be on suppliers of unique items. Information regarding service suppliers, such as IT and/or telephone companies, should also be reviewed to ensure that costs and length of contracts are not punitive.

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Website

Even if the business is not internet based, understanding how the website is used, owned, controlled and what information it carries is essential.

Director's loans and Dividends

While financial accounting issues of this type may not be our main concern as lawyers, ensuring that all payments to and from the company have been carried out in accordance with the Memorandum and Articles of Association of the company most certainly is.

Intellectual property

If you are acquiring a business because of the strength of any of its products and or unique processes, you must ensure that all aspects of ownership and usage have been 'ring-fenced' and are within the ownership and control of the Company and are enforceable as legal rights against third parties. This will also extend to any trade marks etc.

Pension

Although we are not concerned with the detail of the financial arrangements, we are involved in ensuring that legal procedures are being correctly observed. This concerns both the establishment of the scheme and how the scheme operates in relation to employees and the obligations of the Pension Trustees generally.

Data protection

The Data Protection Act 1988 is a far reaching piece of legislation that touches a great many aspects of a modern business. Personal data, individual contacts, and email addresses are all affected by the Act, and how such matters have been

dealt with requires investigation.

Statutory register and minute books

Companies have a legal obligation to maintain certain statutory registers and keep minute books. In extreme cases, failure to comply can result in disqualification of a director.

Key issues

Hopefully this guide gives a feel for the task at hand. It is important that you identify all the key issues that are of paramount importance to the sale/purchase so that you can communicate these to your 'team'.

Planning and preparation

Armed with the above information it will be easier to set about the task of planning and preparation. In particular:

- A list of all the due diligence steps you require
- The order in which issues are to be looked at
- A checklist for all matters within each area
- Any specific due diligence tasks that require particular attention should be itemised
- A checklist of all the documents/ materials that you wish to be made available from the seller/purchaser.

We will produce a Due Diligence Questionnaire in liaison with a client who is buying a business, or assist a seller in collating replies.

Timescales

The size of the list that you have now established will give you an indication of how long the due diligence process should take. It is important that once you have a timescale, you do not compromise it due to pressure; making everyone aware of the timetable should go some way to avoiding this situation. You may also want to allow for some overrunning of the process in case unforeseen matters are unearthed that require greater attention.

Letters of engagement

Now is the time to request Letters of Engagement from your team of professionals. This needs to be a formal document setting out precisely what work you expect to be carried out and the fees to be paid. Reviewing the Letters of engagement from solicitors, accountants and others should help to avoid unnecessary duplication.

Liaising with vendor/purchaser To ensure that the due diligence process is carried out with minimal disruption to all parties involved, it is worthwhile to consider such matters as liaison, and agree with all parties who will be the point of contact and who they will report to. Other reporting issues that may need clarification are:

- Lines of communication - is everything being dealt with by a co-ordinator or not?
- Written format - if you want summaries for key issues, is everyone using the same software and presentation style?

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- Verbal reports - if important matters are discovered, what are the arrangements regarding immediate communication of such matters?

Who to contact for assistance

Due diligence can be a complex process and should not be treated lightly. If you require any further information about due diligence or any other commercial matter, please do not hesitate to contact us. We are experienced in assessing the commercial and legal implications of business decisions and this means that we deliver comprehensive and valued results time after time.