

The importance of sale readiness

The importance of sale readiness is often underestimated and not considered until such time as the decision to sell is made.

The purpose of this article is to address key legal considerations in terms of sale readiness. Please note that, in addition to legal issues, there will be a range of financial, accounting and tax issues to consider as well. This article does not address these non-legal issues.

Control of the share register

Whether a business is being sold via a share sale or an asset sale, it will be important to consider the makeup of the share register and the ability of the key shareholders to deliver 100% of the shares or to approve an asset sale as a major transaction.

It is not uncommon for shareholders to enter a sale process without detailed consideration of the position of small or minority shareholders. Sometimes, the majority shareholder can "drag along" those minorities through "drag along rights" and other times they are not. In a tightly held company, in addition to the ability to drag along minority shareholders, it is important to consult and ensure that there is alignment on the sale. In addition to the obvious commercial issues such as price, the issue can arise in terms of there being a disparity with respect to risk appetite in terms of warranties and liability limits that each shareholder is prepared to provide.

Control of the share register issues also arise in relation to options or first rights of refusal that may have been granted to third parties. A vendor will be required to provide warranties that they own the share capital and that it is the complete (i.e. there are no outstanding options). If there are outstanding options that are likely to be exercised, it is unlikely that the purchaser will increase the purchase price to accommodate those

options. Accordingly, the exercise of any options will dilute the value of the existing shareholders.

Sometimes there are first rights of refusal granted in respect of assets held by the company (e.g. a certain property) that must be exhausted prior to the sale taking place. A first right of refusal generally is a hindrance to a clean sale process and should not be treated lightly.

Lastly, the issue of shares to employees should be controlled through an employee share scheme that allows the company to require the employee to sell to the purchaser.

Crowd-based funding can lead to hundreds of small shareholders and needs to be treated with caution. Share sales are likely to be impractical, although including minority buy-out provisions in a constitution where shareholders holding 90% or more of the shares on issue can require the sale of the remaining 10% or less, can assist. The Takeovers Code will apply to companies with more than 50 shareholders and more than 50 parcels of voting shares, which adds another layer of complexity.

Consider who owns the shares

It is important to consider not only control of the share register but also who owns those shares. If it is a family trust that also owns the house and key lifestyle assets, then a purchaser will require this entity to give a large range of warranties in a significant transaction. It is therefore often prudent to ensure that the correct entity owns the shares and will be providing the warranties and indemnities under a standard SPA agreement.

Where the vendor owns the business premises

Often the vendor of the business will seek to retain the business premises as landlord to provide a retirement income. This is an issue best dealt with in advance with a family trust or other entity owning the building with an arms' length lease to the business being put in place, so all these aspects are in place prior to entering into negotiations with a purchaser. Not only will this

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streamline sale process but will also place the vendor in a better negotiating position as he or she can point to an existing lease arrangement.

Key contracts

Ideally any key customer contracts, distribution agreements or other material contracts underpinning the business should be in place prior to the sale process. Any key tenders or contracts that are mid-negotiation can create a large degree of uncertainty in the sale and due diligence process. Sometimes this is unavoidable if the business consists of large number of income streams underpinned by regular tenders, but to the extent possible this should be minimised.

Legal audit

In addition to key contracts, a general legal audit should be undertaken of other issues that are likely to arise in a purchaser's due diligence. This is often referred to as vendor due diligence and, the sooner that this is undertaken, the better. It is better to be aware of issues and seek to resolve any key liabilities in advance rather than having these arise as part of the purchaser's due diligence or as part of vendor due diligence that commenced late. Potential deal killers include unresolved lease issues with key premises, land and environmental issues, significant employment disputes with a key employee, intellectual property disputes in relation to key pieces of intellectual property and litigation matters.

To use a simple housing analogy, key renovations, a good spring clean and tidying of the garden will maximize the sale value.

Want to know more?

If you have any questions about sale readiness, please contact [David Goodman](#) or [Reuben Adams-Cook](#) or our specialist Corporate Commercial Team.