

A LEGAL GUIDE TO PURCHASING A BUSINESS

The purchase of a business will usually represent a major financial and legal decision for a buyer. The purpose of this guide is to highlight some of the major issues and key considerations that apply when purchasing a business in Victoria.

DUE DILIGENCE

The satisfaction of buying a new business can easily turn to frustration if it becomes apparent – after settlement has occurred – that the business is not trading as expected, or there is some legal issue which adversely affects the business.

Whilst risk can never be eliminated in these situations, a thorough due diligence will help to ‘flush out’ any relevant issues before you become fully committed. A purchaser will then be in a better position to either remove or manage those risks.

One of the most important considerations when purchasing a business is determining whether, having regard to the purchase price and the level of investment required, the business is profitable, or has a reasonable prospect of becoming so.

A thorough financial due diligence should be undertaken in conjunction with your business advisor and/or accountant to determine if the purchase price is justified, and to provide some analysis of the business’ financial records.

There also needs to be an evaluation as to whether you have the necessary skills, experience and capital to carry on the business.

You might also wish to engage an industry specific advisor to assist you in this process.

What is the role of a lawyer?

A legal due diligence is important to ensure that you are actually buying what you *think* you are buying.

At this preliminary stage, if you are being properly advised, your lawyer should be able to:-

- confirm whether the vendor has complied with its disclosure obligations
- help to facilitate all legal due diligence enquires
- conduct relevant searches and check the ownership of all major assets
- review and advise you on all key contracts (e.g. supplier agreements, franchise agreements, management agreements, leases, licences etc.).

What am I buying?

It is important to determine whether or not the business is to be sold by way of a sale of the business’ assets (Asset Sale) or a sale of the shares in the company that owns the assets (Share Sale). The answer can have important implications for both parties.

- “Share Sale” - By acquiring the shares in a company, the purchaser indirectly becomes the owner of everything that the company owns including the assets *and* the liabilities. For this reason, it is not necessary to specify all of the

assets and liabilities in order to effect their change of ownership.

- “Asset Sale” - If you are buying the assets of a business, the sale agreement will stipulate which specific assets are to be sold. A purchaser will want to ensure that the definition of assets is broad enough to capture all the assets which are necessary to conduct the business.

Whether the sale is conducted by way of a Share Sale or an Asset Sale will have a significant bearing on how the sale is conducted. As such, you should discuss this with your lawyer from the outset of the transaction.

What Assets are included?

It is important to determine what assets are to be transferred with the business. Whilst each business is different, most business sales would include:-

- the business name
- all licences and registrations required in the operation of the business
- rights attaching to the Lease
- goodwill
- work-in-progress or stock-in-trade
- customer/supplier lists
- intellectual property (e.g. trademarks, patents, copyright etc.)
- the plant and equipment listed in the contract

What about Stock-in-Trade and/or Work-in-Progress?

There are two main ways that stock-in-trade and work-in-progress (WIP) are dealt with in the context of a business sale:-

- “Walk-in, walk-out” – this means that the business is purchased inclusive of any work-in-progress or stock; or
- “Plus WIP/Stock-in-trade” – this means that the business is purchased without the WIP or stock included in the purchase price. In a retail business, it is usually the case that stock will be payable in addition to the purchase price and capped at a specified value.

What searches should be undertaken?

The type of pre-contract searches to be undertaken will vary depending upon the particular business in question. Your lawyer can advise you in this regard. However, the following are often sought:-

(a) Title Search

A title search will disclose if the entity offering the lease actually owns the premises. It will also disclose if there are any registered encumbrances on title which may affect the leasehold.

(b) Planning Search

A planning search should be undertaken to ensure that the underlying zoning supports the use of the premises for the operation of the business. If a planning permit has been issued, it is important to also determine if the business is being conducted in accordance with the permit.

(c) Food Act Registration

All retail food premises must be registered with the local council under the Food Act (Vic). In food businesses, it is always recommended that a transfer inspection be arranged to determine if there are any

orders or notifications which affect the business.

(d) Liquor Licence

If applicable, a search should be made through the liquor licensing authority to obtain copies of any licence, the red-line plan, and details of any notices or orders which might affect the licence.

(e) Vendor company search

A vendor company search should be undertaken to confirm if the vendor entity is registered with ASIC, and to correctly identify the officers of the company.

(f) Personal Property Securities Act (Cth) (PPSA)

A PPSA search will show any registered security interests against the assets of the vendor. If so, any encumbrances need to be discharged at settlement.

Although there is provision in some contracts for enquiries to be made after the contract is entered into, most searches should be undertaken prior to entering into the contract.

LEGAL DOCUMENTS

(a) Heads of Agreement

The selling agent may require you to enter into a heads of agreement which sets out the principal terms of the proposed sale. It is essential to determine if the document is binding or non-binding. This should be reviewed by your lawyer.

(b) Confidentiality Agreement

A vendor will often require a potential buyer to enter into a confidentiality

agreement before disclosing information in relation to the business. The main purpose of the document is to clarify which information can be disclosed without making sensitive information public.

(c) Contract

The contract formalises the deal and can address any issues identified in the due diligence process.

THE CONTRACT

In Victoria, most contracts for the purchase of a business are based on the standard form contract approved by the REIV (Real Estate Institute of Victoria) and the LIV (Law Institute of Victoria).

The standard form contract should only be modified by a lawyer to meet the requirements of an individual transaction. However, it should only be used in circumstances where the vendor is selling a Victorian business as a going concern.

All changes to the Schedules and General Conditions need to be recorded as Special Conditions.

It is important to ensure that you have either completed your financial due diligence before entering into the contract, or that a due diligence period is specifically negotiated.

If you intend to obtain finance to fund the purchase, you should ensure that any offer is made subject to finance being approved on conditions which are satisfactory to you. This protects you in circumstances where finance may be approved subject to onerous and unreasonable conditions.

The sale contract should be carefully negotiated by your lawyer. A lawyer's role is to ensure that the sale document accurately reflects the informal agreement reached by the parties.

Your lawyer will need to carefully consider the following issues:

- If applicable, has the vendor complied with its obligations in relation to the provision of a Section 52 trading statement?
- are the assets of the business accurately defined in the sale agreement?
- are the proposed warranties and indemnities to be provided by the vendor adequate?
- are the vendor's and the vendor's guarantor's post completion restraints adequate to protect the goodwill of the business?
- can the lease and any key contracts (e.g. management agreements, franchise agreements, supply agreements etc.) be validly assigned?
- are the purchaser's interests sufficiently protected having regard to the contract conditions?

A purchaser should also ensure that they have discussed the ownership structure of the business with their accountant. In particular, will the business be owned by a company, trust, partnership or individual? The decision in this regard can have important implications from an asset protection and taxation point of view.

CONCLUSION

There are a significant number of issues which need to be addressed in the context of purchasing a business. An experienced business lawyer should always be engaged to assist you to navigate the complexities of the transaction and to complete the sale process.

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Matthew is an experienced commercial and property lawyer who regularly advises clients in relation to the purchase and sale of businesses. He is a member of the Law Institute of Victoria (LIV) and an associate member of the Australian Institute of Business Brokers (AIBB).

Disclaimer:

The information contained in this article is intended to provide general information only and is not legal advice or a substitute for it. You should always consult your own legal advisors to discuss your particular circumstances.

