Buying a business - the basics.

The basics

Buying a business may seem simple enough, but it needs to be done with great care. Unlike real estate, there is no cooling off period and a major part of the business asset may be intangible.

The legal maxim of "caveat emptor" (buyer beware) applies in buying a business.

1. Sale of Shares or Sale of Business Assets?

If the business is owned by a sole proprietor or a partnership, the business will be purchased by way of an asset sale.

If the business structure is by way of a company, the business may be purchased as an asset sale or a share sale.

Whether to buy the business assets as opposed to shares depends on too many factors for discussion in this article. Suffice to say that in considering to purchase the assets or the shares, accounting and legal advice is crucial.

2. Contract

Once you have reached an agreement, normally the Seller's Lawyer will draw up the Contract for your review.

It is important to have your lawyer review the Contract to ensure that it accurately reflects the bargain struck between you and the Seller.

If there has been something left out, or it contains something that was not agreed, your lawyer can negotiate the appropriate changes. Once the Contract is signed, it will be extremely difficult, if not impossible, to make changes later on.

3. Due Diligence

One of the most, if not the most, important step following the signing of the Contract is to conduct due diligence on the business and the Seller. Basically "due diligence" is the conducting of a thorough investigation of the business.

Depending on the nature of the transaction, you would normally engage Lawyers and accountants to provide their assistance. You may also engage industry specific experts to provide technical expertise and insight.

One of the aspects of due diligence is the legal due diligence which is conducted to make sure that you are buying what you think you are buying. It basically involves examining ownership documents, third party agreements, employee contracts, supply contracts, leases etc to ensure that these documents can be assigned or transferred to the Buyer.

The legal due diligence should also involve investigating the Seller for contingent liabilities, pending law suits and legal compliance.

4. Premises

If the Seller owns the business premises, an agreement should be entered into to either buy or lease the premises.

This will necessarily involve preparing further documentation such as a sale of land Contract or a Lease.

If the Seller leases the business premises, the Lease will need to be assigned to the Buyer.

It is paramount that this process begins immediately following the signing of the Business Contract as the process can be complicated and drawn out.

5. Employees

How employees are dealt with depends on whether you buy the shares or the assets of the business.

Buying the shares in the company is the simplest process from an employment perspective as the legal identity of the employer remains the same and existing contracts of employment continue as if nothing happened.

The situation is very different when you buy the assets of the business. The employee who operates under a contract for personal services cannot be “transferred”.

Accordingly, it will be necessary for the Seller to terminate the employment contract and it will be up to the Buyer to enter into new contracts of employment with the employees it requires.

These employees are often referred to as “transferring employees”. The term can be misleading as those employees are not “transferred” as such but rather are “re-employed”.

The rules governing the transfer of employees can be complex due to the variety of industrial awards. As a Buyer you would need to make good on the accrued employee entitlements after settlement. Therefore it is important that you ensure that the Seller pays you or makes an allowance in your favour for the transferring employees wages, holiday pay, long service leave and other accrued entitlements that may be owing to the retained employees.

You will also need to make sure that the Seller directly pays the employees that you do not wish to retain. At the very least, you should ensure that the Seller provides an indemnity with regard to any claim made against you for those employees.

An important consideration in respect to employees is to find out from the Seller if any key employee should be retained, or whether any key employee has recently left. This can affect the future goodwill of the business or may have an mpact on the customer base.

6. Restraint of Trade

In order to protect the goodwill you are purchasing, most contracts will have a restraint of trade clause preventing the Seller from setting up a competing business within an agreed radius and an agreed time period.

There is no point in buying a customer base only to have the Seller start up a business in competition with you and accessing the customers you basically paid for.

However, it is crucial with a restraint clause to be reasonable as disputes with regards to these clauses often end up in Court and there is no guarantee that the Courts will enforce them.

On the contrary, the presumption is that restraint of trade clauses are prima facie invalid unless they are shown to be reasonable.

The onus will be on the person relying on the clause (the Buyer) to prove reasonableness. Each case is judged on its merits and it is basically a question of degree.

For example, if you buy a hairdressing salon for only $30,000.00, a clause not to open another salon within 50kms for the next ten years would almost certainly be unreasonable.

The above is only a brief outline of some of the considerations in buying a business. Other considerations may include allocation of purchase price, intellectual property, plant and equipment, vendor warranties, permits and licences, seller's tuition / assistance and many others.

Finally there are many times in purchasing a business where you will encounter unplanned or unknown variables and these will often cause you the greatest headaches and can be solved by your Lawyers.

John Palermo

(Sally)

Our Offices:

Springfield
PO Box 4629
IPSWICH QLD 4300
Ph: 07 3470 3600
Fax: 07 3470 1300

Ipswich Central
PO Box 359
IPSWICH QLD 4305
Ph: 07 3812 2300
Fax: 07 3812 2340

Gatton
PO Box 116
GATTON QLD 4343
Ph: 07 5462 1566
Fax: 07 5462 3087