**Asset and share sales**

This section focuses on the differences between and advantages and disadvantages of asset sales and share sales

**Introduction**

Having looked at share sales in detail it is now worth examining the differences between share sales and assets sales and why a seller might wish to proceed with an asset sale instead of a share sale.

An asset sale occurs when a buyer purchases the whole of the business of a company as a **going concern**. If a company has separate and distinct trading divisions, then the buyer may just purchase one or more of those trading divisions as a going concern. This may be referred to as a "carve out" transaction.

By ‘a going concern’ we mean that the whole of a business is purchased (or rather the assets being purchased are capable of operating as a business on their own), so that the business can trade after completion of the purchase just as it did prior to completion. This means that the buyer will need to acquire assets such as **goodwill**, work in progress, the benefit of third party contracts, intellectual property rights, property and plant and machinery.

On completion, ownership of the selling company does not change but the business that is being sold does change hands. If the selling company has sold the whole of its business, then following the sale it will now be a **cash shell,** a company with no assets other than the cash proceeds of the asset sale.

The majority of sales of solvent businesses are share sales. Asset sales are more common if the seller is selling distressed assets e.g., a sale by administrators or liquidators.

In practice, you may encounter more complex asset sales where multiple sellers within a group transfer different assets, for example a collection of IP rights or a collection of shopping malls. These may not necessarily constitute a going concern. These more complex transactions are beyond the cope of this course.

**Essential differences between a share and asset sale**

Share sale

The buyer acquires the shares in the target company which owns all of the assets and liabilities of the business.

Due to the company having separate legal personality there is limited change to the operation of the business (subject to change of control provisions).

The seller(s) will be the shareholder(s) of the company.

Asset sale

The buyer acquires the business and assets of the target (and any liabilities it chooses).

The buyer can be selective about the risks it is prepared to take on, though that is subject to the bargaining strength of the parties and to certain exceptions mainly related to employees.

The seller will be the target company.

Each of the asset classes need to be transferred separately.

The different transaction structures are shown on the diagrams on the following slides.

Share sale – diagram

*Alt Text*

*The diagram compares the ownership structure of a company before and after a share sale.*

* ***Pre-sale position****:*
  + *A****shareholder****owns****shares in the target company****.*
  + *The****target company****owns the****business and assets****.*
* ***Post-sale position****:*
  + *The****buyer****now owns the****shares in the target company****.*
  + *The****target company****still owns the****business and assets****.*

Asset Sale Diagram

*Alt text: The diagram shows the ownership structure of a company before and after an asset sale.*

* ***Pre-sale position****:*
  + *A****shareholder****owns the****target company****.*
  + *The****target company****owns the****business and assets****.*
* ***Post-sale position****:*
  + *The****buyer****now owns the****business and assets****directly.*
  + *The****target company****remains owned by the original****shareholder****, but it no longer owns the business—it has sold it.*
  + *The****target company****receives****cash (£££)****from the buyer in exchange for the business and assets, as documented in a****contract****.*

**Why an asset sale?**

* An asset sale is necessary where a business is run as an unincorporated business, such as the sale of a business by a sole trader or a traditional partnership.
* It is more common when there is a division of a company being sold that does not operate as a separate subsidiary. This requires the assets relating to the business unit to be separated out and sold to the buyer.
* An asset sale may also be used for the buyer to leave behind specific liabilities as you will see on the next slide.
* An asset sale may also be appropriate if there are dissenting minority shareholders who are not prepared to transfer their shares as shareholder consent and involvement is limited (subject to the terms of the articles and any shareholders agreements).
* There may be tax benefits to an asset sale. The detail of the tax structuring is beyond the scope of this course.

**What is transferred on an asset sale**

Typically, on an asset sale the buyer wants to acquire a business as a going concern. This means that the business is generally able to continue to trade and operate with limited disruption. The precise composition of assets will be specific to the type of business but the following assets are typically transferred:

* Business information and records.
* Goodwill.
* Information technology and IT systems.
* Intellectual property rights.
* Plant and machinery.
* Real property.
* Stock.
* The benefit of business contracts.
* Other assets for the continued operation of the business.

Liabilities can be transferred on an assets sale, but this is more unusual and will depend on the circumstances. The parties may agree, for example in the sale of a division, that liabilities will transfer as the commercial intent is not that the buyer can pick and choose as the transaction structure has arisen from an historic accident that means a business sale is required instead of a share sale.

**The Process**

You are already familiar with the process for a share sale. An asset sale follows a very similar structure but there are certain key difference that arise:

* Initial documentation:

On an Asset sale you may want both the target company (as seller) **and** its shareholders to be party to the exclusivity to avoid the shares being sold.

* Due diligence:  
  The risks of unknown liabilities may be reduced on an asset sale, as the transaction will often be structured so that many liabilities will remain with the seller.  
  However, the buyer will still want to understand that the values being paid for the assets is appropriate and there are not faults in the assets themselves (e.g. to ensure any real property has good title).  
  In addition, it is very important to confirm which assets and liabilities form the target business and will need to be transferred.
* Transaction document:  
  This will be considered in more detail in the next Element
* Completion:  
  On an asset sale each of the assets need to be transferred separately. For some assets (e.g. debtors) a provision in the acquisition agreement will suffice, for others (e.g. property) the relevant formalities need to be followed.

As a result, there are significantly more documents and post-completion documents to be managed on an assets sale as you will see on the next few slides.

* Overseas Assets  
  This course is focused on UK law but if there are any assets located, registered in or governed by law in other jurisdictions then it will be necessary to consult local counsel to ensure the appropriate documentation and perfection is completed.

**Methods of transfer of UK assets typically included in an asset sale**

|  |  |
| --- | --- |
| **Asset** | **Method of transfer** |
| Premises | By deed – TR1 |
| Fixed plant and equipment | Title will transfer with the premises |
| Loose plant and equipment | Title will pass by delivery |
| Raw materials | Title will transfer by delivery |
| Work in progress | Title will pass by delivery |
| Stock | Title will pass by delivery |
| Vehicles | Registration of new registered keeper at DVLA |
| Existing contracts with customers and suppliers | Assignment or novation |
| Books and records | Title will pass by delivery |
| Intellectual property | Assignment (and registration if applicable) |
| Goodwill | Title will pass in accordance with the acquisition agreement or there may be a separate deed of assignment |
| IT systems | Hardware will pass by delivery and software by assignment |
| Employees | Contracts of relevant employees will automatically transfer under TUPE |
| Debtors | Assignment / novation / renegotiation |
| Shares in UK subsidiary | Stock transfer form |

**Third party contracts**

The buyer will want to ensure that it receives the benefit of all key contracts entered into between the seller and third parties (e.g., customer contracts). There are three ways in which the buyer might acquire such third-party contracts in an asset sale:

* Assignment
* Novation
* Negotiation of a fresh contract

We will now consider each method in turn.

**Third party contracts - assignment**

A contract has both a **benefit and a burden**. For example, in a distribution agreement, the seller produces goods which are then passed to the third party for distribution around a relevant market. The benefit for the seller is receiving a price for the goods passed on but the corresponding burden is to produce and make the goods which are to be distributed.

 If the buyer wants to take on the distribution arrangements, the seller may be able to assign the benefit of the contracts to the buyer but in law the **burden cannot be assigned**. Every contract must be examined as part of the due diligence process to see if it can be assigned or whether any clauses prevent this.  There may be an outright prohibition on assignment or assignment may only be permitted with the prior consent of the third party (see the example below).

**Example:** “This agreement is personal to the parties and no party shall, without the prior written consent of the other party (such consent not to be unreasonably withheld or delayed), assign, transfer or sub-contract any of its rights or obligations under this agreement.”

**Third party contracts – Novation and negotiation of a fresh contract**

Novation

If the seller wants to be released from outstanding obligations, it may be possible for the contract to be novated.

Novation means that the other contracting party will release the seller from the contract and allow the buyer to take over both the benefit and the burden of the contract (effectively the buyer steps into the seller’s shoes and becomes a party to the original contract in place of the seller).

Novation will always require the consent of the third party and is often used for key contracts or unassignable contracts.

Negotiation of a fresh contract

If the third party does not agree to novation and assignment is either not permitted under the contract or is not commercially acceptable as the seller wants to pass both the benefit and burden of the contract to the buyer, then the buyer may want to try and negotiate a fresh contract with the third party.

This gives the buyer scope to negotiate new terms and conditions if the current ones are commercially unacceptable. The terms of any fresh contract will, of course, depend on the relative bargaining power of the buyer and also the third party.

However, negotiating a fresh contract will raise issues of confidentiality and timing.

**Debtors and creditors**

The sums owed to a business by third parties are known **as book debts or receivables**. The balance sheet of the company will treat these sums as assets and the buyer will often wish to acquire them as part of the acquisition if, as is common, the intention is for the buyer to acquire the whole of the business. There are two reasons for this.

* First, the debts may be worth a lot of money;
* Secondly, if the debtors owing the debts continue to be customers of the business after completion, the buyer will want to maintain good relations with them. If the buyer does not acquire the debts, they will remain with the seller. In these circumstances, the buyer might be concerned that the seller could pursue the debts too vigorously. This could damage the goodwill of the business that the buyer has just acquired.

If the debts are to be sold to the buyer, the seller will expect a payment for them. The buyer will then be left with the task of collecting them. The buyer’s concern will be that it may not be able to collect in all of the debts as some may prove to be bad debts and need to be reduced or written off. This problem may be overcome by the buyer buying the debts at **a discount.**

**Example:** If the debts have a face value of 100, the parties may agree that the buyer pays 65 for them. If the buyer collects more than 65 (as it will seek to do), it will make a profit (another reason why buyers often wish to purchase the debts).

**Transferring trade creditors**

In terms of trade creditors, a buyer will often agree to assume certain liabilities towards the seller’s creditors under an asset deal

This means that the buyer is agreeing to assume a liability to pay money to a third party in the future in addition to the price it has paid for the business. Where the commercial intention is for the buyer to be in the same position as if it had purchased the shares of the target business, it may be fair and appropriate for the buyer to assume all liabilities relating to the business. an alternative would be for the buyer to assume only those liabilities arising from the conduct of the business after completion or to assume only specifically identified liabilities.

Acquiring liabilities gives the buyer **control** over the payment to the relevant creditor so it can ensure the relationship with the creditor is preserved for the general welfare of the business. To leave the liability with the seller may mean the seller fails to pay it and this may damage the on-going relationship between the buyer and the creditor.

Legally, though, a creditor cannot be transferred from the seller to the buyer. The creditor will always have its claim against the seller. All that be done is to transfer the liability economically. This would normally be done by the buyer giving an **indemnity** to the seller in respect of the liability the buyer has agreed to assume on terms that the buyer will, in the seller’s name, control the handling of the claim

**‘Cherry picking’**

The difficulty for a buyer buying a company is in assessing the full extent of that company’s actual and potential liabilities, so that the buyer can determine what the company is truly worth. In an asset sale there may be scope for the buyer to decide which assets to buy and which liabilities of the business it will assume. This process is often referred to as “**cherry picking”** by the buyer. There are certain liabilities of the business which will be left behind with the seller as a matter of course, such as tax liabilities and outstanding litigation.

However, there is a limit to how significantly the buyer may select assets:

* It may not be possible for the business to operate without certain assets;
* The transfer of employees, and all liabilities associated with them, is governed by statute so it is not possible to cherry pick employees. (you will look at this in more detail later in this Topic.
* In order to benefit from an exemption on charging VAT on the transfer of assets there must be a transfer of a going concern.

Legally most liabilities cannot be transferred from the seller to the buyer. The creditor will always have its claim against the seller (the target company). You will consider how the economic risk can be transferred in the next element.

**Cash shell**

If the selling company has sold the whole of its business, then following the sale it will now be a **cash shell**, a company with no assets other than the cash proceeds of the asset sale.

The shareholders of a cash shell will want to extract the cash, whether by solvent liquidation or a dividend. You will consider the tax implication for the seller in a later element. However, a cash shell seller presents an issue for a buyer. As shown on the diagram the contract, containing all of the warranties, indemnities and covenants is between the target company and the buyer. If that company has no assets or ceases to exist the buyer cannot make any claims under the contract. It is therefore necessary to include appropriate protections:

* **Guarantee:** The shareholder(s) of the target company may be required to guarantee the obligations in the contract.
* **Retention/ Escrow account**: Part of the consideration is paid into a separate account in the joint names of the parties. The buyer can then make a claim against this account in the event of any claim.

Note, a cash shell can also arise on a share sale if a holding company has disposed of a portfolio company by way of a share sale. These protections would also be appropriate in that circumstance.

**Asset Sale: Seller Advantages and Disadvantages**

Advantages

* There may be scope for the seller to **exclude assets from the sale it does not want to transfer** this is particularly useful if there is a transfer of a business unit.
* There may be tax advantages in relation to the application of losses for the seller.

Disadvantages

* The transaction may be structured so that **liabilities** of the selling company remain with the seller after completion.
* It can be **logistically complicated** as each asset needs to be transferred. This can increase the costs of transfer
* There might be a **double tax charge** on the proceeds of sale (see Tax Issues on an asset sale)

**Asset Sale: Buyer Advantages and Disadvantages**

Advantages

* The **liabilities** of the target business (e.g., tax and litigation liabilities) remain with the selling company / seller unless the buyer specifically agrees to acquire them (other than in relation to employees).
* Buyer may be able to **choose** which assets it wants to take and **leave** any unnecessary assets.
* As liabilities remain with the seller there can be fewer warranties and less due diligence. However, due diligence is still needed to identify all of the necessary assets.

Disadvantages

* There are **additional formalities** needed to effect the transfer lawfully as each asset needs to be transferred following its own process.
* The transfer is more **disruptive** for the business. Employees will be notified of the TUPE change and there is no continuity of contract for all supplier and customer contracts.
* The risk of **third party consents** not being forthcoming, such as consent to assignment of a lease is more likely.

**Share Sale: Seller Advantages and Disadvantages**

Advantages

* The **seller** does not retain any liabilities of the company.
* Once completion has occurred the seller(s) will hold the purchase price with **no additional steps** to wind up the selling company or extract proceeds.
* It is a relatively simple transaction to effect.

Disadvantages

* If the seller wants to extract assets from the target company, there is a risk of the seller bearing **a tax liability** for doing so. (Note: the details of this tax liability are beyond the scope of the course, but you need to be aware that there might be such a liability).
* Warranties and indemnities, including a tax covenant, will be more extensive to cover the risk of unknown issues for the buyer.

**Share Sale: Buyer Advantages and Disadvantages**

Advantages

* Administratively **simple** to transfer the assets.
* **Continuity of trading** and operations for target (save that there may be change of control consents).
* **Valuation** is more **straightforward** and reliable looking at company accounts rather than attributing earnings to a business unit or excluding certain assets.

Disadvantages

* As the buyer is buying the target with all its liabilities, the buyer needs to carry out **extensive** and detailed **due diligence** to be able to buy with full awareness of those liabilities.
* Even with warranties and indemnities there is a higher risk of **unidentified liabilities** for the Buyer.

**How is the decision made?**

Much will depend on the specific circumstances of the deal in question, such as the bargaining strength of the parties, what the seller is willing to sell and the if there are significant liabilities. For example, a significant liability may make a target company undesirable as a share sale but an asset sale may make that more desirable.

A buyer may also prefer an asset sale to limit the number of subsidiaries they hold.

Tax arrangements in particular can be a strong driver for the structure of a sale.   
It is very important for legal advisers to understand why their clients have decided on a particular structure, and what the client’s expectations are, so that the correct advice can be given during negotiations.

**Summary**

* In a share sale, the buyer acquires all the shares in the target company. In an asset sale, the buyer identifies all the assets it wishes to buy and the formalities needed to transfer those assets are followed to ensure all the identified assets are transferred.
* The key advantage for a buyer to choose an asset sale is the ability to pick and choose the assets they wish to acquire, and importantly, the liabilities to leave behind. However, there is a risk that the buyer does not transfer all of the assets needed.
* Asset sales are administratively more complex as each of the assets needs to be transferred. The selling company may also be a cash shell and proceeds passed on to shareholders.
* Share sales are simpler to complete but the buyer takes on more risks so due diligence may be more extensive