**Introduction to auction sales**

This section provides an overview of a sale by auction

**Introduction**

An auction sale involves the seller seeking bids for the target company or business from several prospective buyers in a competitive bid process. As you will recall a bilateral sale is where the seller negotiates with just one buyer.

We will first consider the stages of an auction sale and then we will compare the preliminary documents used in a bilateral sale and those preliminary documents used in an auction.

Auction sales grew in popularity when sellers were in a strong bargaining position with a number of buyers able to fund a transaction with cheap debt and low interest rates. More recently, with rising interest rates and global market instability, buyers may be more cautious and there has been a reduction of the number of auctions.

Private equity sellers particularly favour an auction process given the relative speed and certainty that can be achieved through an auction sale.

**Overview of the auction sale process**

The stages in a typical sale by way of an auction are:

1. Preliminary considerations
2. Investigation
3. Negotiation
4. Completion
5. Post-completion

We will examine each of these stages further.

The key driver of the auction process is to maintain the competitive tension between bidders and there are a number of tactics that a seller’s adviser team may recommend to drive that. This process, if well managed, should drive the best possible terms for a seller.

1. **Preliminary considerations**

The initial stage when the seller will typically engage a financial adviser and prepare an **information memorandum** and **process letter**. Potential bidders are identified, and they execute confidentiality agreements before receiving the information memorandum and process letter and submitting preliminary indicative bids based on the information memorandum and any publicly available information. The parties also consider any necessary regulatory or other consents that may affect the bid timetable.

1. **Investigation**

The shortlisted bidders (chosen on the basis of their **indicative bids**) carry out their due diligence investigations, usually by examining the information in a data room established by the seller and attending presentations given by the target’s management. The seller may have engaged accountants and other professionals to prepare vendor due diligence reports on the business which may be made available to the bidders admitted to the data room.

1. **Negotiation**

The acquisition agreement (and sometimes other key transaction documents) will be drafted by the seller. A typical auction process may require bidders to submit a mark-up of the draft acquisition agreement . This allows the seller to consider the legal terms alongside commercial and financial details of a final bid. The key transaction agreements including the disclosure letter will then be negotiated between the seller and, possibly, a single preferred bidder.

1. **Signing and completion: and 5. Post-Completion**

The successful bidder completes the sale. The process of completion and post-completion is the same as for a bilateral sale.

**TIMELINE**

*Alt text description: This slide presents a timeline-style visual outlining the stages of a typical auction sale. The process is broken down into four main stages:*

1. *Preparation – This includes negotiation of confidentiality agreements and circulation of the process letter and information memorandum.*
2. *Indicative Bids – Bidders submit initial offers based on the information provided.*
3. *Secondary and Final Bids – Shortlisted bidders conduct further due diligence, attend management presentations, and submit final bids, often including a mark-up of the acquisition agreement.*
4. *Exclusivity/Completion – The seller selects a preferred bidder, final negotiations occur, and the transaction is completed.*

*The slide emphasizes that at each stage, the number of bidders is typically reduced, maintaining competitive tension throughout the process.*

# Acquisition agreement mark-up

**Auction Sales – Seller tactics**

As the auction sale process involves more up-front costs for a seller it is important to maintain the competitive process to drive better terms and higher valuation for the seller to compensate for the additional cost.

**Seller side tactics**

* While buyers will want a period of exclusivity, this will be resisted by the seller for as long as possible.
* In some processes a strong seller may refuse to grant exclusivity and run a “**contract race**” between several preferred bidders with the first party to complete being the buyer.
* When granting exclusivity, a seller may only allow for a short period of exclusivity encouraging the bidder to negotiate less and complete quicker or risk another bidder stepping in once that exclusivity ends.

**Auction Sales – Buyer tactics**

**Buyer side tactics**

* To break the competitive tension, or avoid missing out on a desirable asset, a buyer may make a pre-emptive bid. This is made at an early stage in the process, before the deadlines in the process letter. This may include a particularly strong valuation or favourable terms but be conditional on the seller abandoning the auction process and granting exclusivity immediately.
* Some buyers may make a particularly strong bid during the process to gain exclusivity with the intention of making adjustments once exclusivity is granted.
* Some buyers refuse to participate in an auction sale process at all on the grounds that they do not want to be pushed into a bad deal.

**Auction Sales – Risks**

**Buyer risks**

* The main risk for the buyer is that they overpay for the target having been driven by the process to secure the bid.
* If a buyer fails to complete proper due diligence or negotiate better terms, they may acquire unidentified risks. If working for a buyer, it is key to ensure that appropriate diligence is completed or that the buyer is aware of the risks of a reduced scope of diligence.
* If a bidder is not selected as the preferred buyer, it will have wasted the costs of the initial stages.

**Seller risks**

* If an auction process does not proceed to completion, the seller/target will have wasted significant costs of preparing for the process. In addition, as the market will be aware of the sales process the target may be devalued by having not found a seller in an auction process.
* As some parties will not engage in an auction process on principle the seller may miss out on a high valuation or a strategic partnership from those buyers. This may be particularly pertinent where managers are sellers who wish to continue in the business.
* An auction process can be very intensive for the target taking attention away from operating the business and resulting in short term poor performance.
* There is a risk that a bidder engages in the initial process with no intention of proceeding to purchase just so they can review the data room.

**Preliminary documents**

1. **Confidentiality agreement**
2. **Process letter and Information memorandum**
3. **Indicative bids**

We will now consider the preliminary documents used in a sale by auction in more detail.

**Confidentiality agreement**

Confidentiality agreements are as, if not more, relevant on an auction sale as on a bilateral sale as the potential buyers will still wish to learn all about the target to ensure that:

1. it is a worthwhile acquisition; and
2. it is worth the consideration being offered,

but there may be many potential bidders which will mean that the risk of a leak of confidential information is potentially higher than the risk on a bilateral sale.

As you will see during this knowledge stream, all the potential bidders in an auction will be required to sign confidentiality agreements before any information about the target or the transaction in question is released to them.

In an auction sale, the confidentiality agreements may be drafted to state that they are for the benefit of the future owners of the target from time to time, as well as for the benefit of the current owner, i.e., the seller and its group. Under the **Contracts (Rights of Third Parties) Act 1999**, this will allow the successful bidder to enforce the obligations in the confidentiality agreement against unsuccessful bidders.

**Confidentiality agreement and disclosure**

Despite bidders having signed confidentiality agreements, sellers will often still be concerned about disclosing commercially sensitive information (whether in relation to key contracts or claims against the target).

Sellers may deal with these concerns by withholding some information initially from the data room, providing summaries of relevant contracts, redacting certain information from the versions of relevant contracts included in the data room or indicating that oral presentations will be provided on certain aspects.

Where a bidder is a competitor, the target should take additional care as disclosure of certain information may infringe competition law. You may need consult the antitrust team to ensure appropriate protections are put in place.

**Process letter and Information memoranda**

Once the confidentiality agreements have been signed by the potential bidders and returned to the seller’s solicitors, a letter will typically be sent to the bidders on behalf of the seller, setting out the procedure and timing requirements for the proposed auction sale. This “process letter” will typically set out the process for the auction and will include a list of questions the bidders are required to answer to help the seller analyse, on a like for like basis, which bidders are most committed to / able to complete the acquisition.

This process letter will also usually enclose the information memorandum. This memorandum is a document containing enough information about the target to give the bidders a basis on which to make an indicative offer for the target.

If there are multiple bidding stages of an auction process it is common for multiple process letters to be produced.

There is no similar letter in a bilateral sale and there is also not usually an information memorandum.

**Indicative bids**

In a bilateral sale, the document that sets out the initial understanding between the parties is typically the heads of terms (also referred to as the term sheet or MOU (for “memorandum of understanding”) although these are not always used. Heads of terms do not usually form part of the process in an auction sale.

In a successful auction there will be several bidders and each of those bidders will draw up a document setting out the basic terms upon which it is prepared to buy the target. These documents are generally known as indicative bids and are based only on the information about the target provided by the seller in the information memorandum and information otherwise available to the bidders in the public domain. The seller then reviews the indicative bids and decides which bidders to invite to move forward in the process and conduct due diligence.

Secondary and final bids are based on the more detailed review of the target and may include a full mark-up of the acquisition agreement rather than a term sheet.

**Bilateral sale v auction sale**

The preliminary documents used in a bilateral sale and an auction differ for the following reasons:

1. heads of terms are rarely used in an auction as there are often several bidders and so this document is replaced by the indicative bids/final bids;
2. exclusivity will not be granted in an auction until the preferred bidder is chosen, if at all. A seller would prefer not to grant exclusivity and will not do so if it is in a strong bargaining position; and
3. due to the nature of an auction with the involvement of several bidders, the information memorandum and process letter are used to give all bidders information about the target and how the sale process will work (these may be accompanied by vendor due diligence reports). This is not necessary in a bilateral sale.

The document common to both types of sale, however, is the confidentiality agreement also known as an NDA, the non-disclosure agreement.

**Warranty and Indemnity (‘W&I’) Insurance**

You briefly considered W&I insurance in an earlier Topic.

You will recall that W&I insurance is designed to cover against financial loss that may arise from a breach of warranty in a share or asset purchase agreement. While it was originally devised as a product taken out by a seller to protect it against claims under the warranties, this was incredibly rarely used in practice.

Almost all W&I insurance policies are now taken out by buyers, often in the context of deals where recourse against the seller under the business warranties, which will still be negotiated in the agreement, is capped at a nominal amount (e.g., £1). Note fundamental warranties on title of the shares and capacity to sell are usually still subject to a larger cap as seen in Topic 3.

In an auction sale, particularly where private equity are selling, W&I insurance may be proposed by a seller in a “**stapled**” manner, allowing the seller to maximise transaction value by offering improved warranty recourse and providing the buyer with access to a pre-arranged package of insurance as part of the arrangements for the auction.

Although the name refers to indemnities this is slightly misleading standard W&I policies only cover warranties.

The primary negotiation over the **insurance policy** will be between the buyer and the insurer. While negotiation of the warranties in the agreement will remain between buyer and seller.

The buyer and its advisors will review and comment on the W&I policy and it will be their responsibility to make sure the policy aligns with the acquisition agreement.

Areas for negotiation will include:

* the size of **premium** (and whether the seller contributes to payment of the premium);
* the warranties covered by the policy;
* the extent of the cover (often between 10% and 30% of the target’s enterprise value – so a long way down from 100% of the consideration);
* the size of the excess i.e., agreed sum that the insured will be responsible for before the insurer becomes liable for the remainder in relation to a claim (generally at least 0.5% of target enterprise value); and
* de minimis thresholds for claims.

The seller is not involved with this negotiation and will simply want to ensure that the subrogation waiver from the SPA (which prevents the insurer from recouping from the seller any monies paid out under a claim) is reflected in the W&I policy. The buyer will usually seek permission from the insurer to share an extract of the subrogation wording from the final insurance policy with the seller.

In a standard W&I insurance policy known risks will not be covered, and a buyer will be required to make a no claims declaration to the insurer confirming that they are not aware of any claims existing at the time of completion.

W&I policies commonly exclude coverage of certain warranties including:

* bribery and corruption;
* certain environmental and regulatory issues;
* financial warranties (including any leakage on a locked box transaction);  
  pension shortfalls; and
* certain tax issues.

While additional specialist cover may be purchased to cover excluded or known risks a buyer should ensure that any issues identified in the investigation of the target have been ‘priced in’ or that appropriate indemnities have been included in the SPA and that they have completed due diligence of the excluded areas to limit their risk.

It is worth noting W&I insurance is not a substitute for due diligence and the parties still need to negotiate the warranties and complete a meaningful due disclosure exercise. An insurer will also want to ensure they have enough information to price the risks and will want to see the evidence of a full data room and disclosure.

**Summary**

* A bilateral sale is the process of selling a business or target company in a transaction negotiated between the seller and the buyer. An auction sale is where the seller seeks competing bids for the target company from multiple prospective buyers.
* The information memorandum is a document which gives bidders a reasonable amount of information about the target company to enable the bidders to make indicative bids.
* The seller will issue to prospective bidders a process letter at the same time as the information memorandum. The letter explains the rules and procedures of the auction.
* The seller will require all the prospective bidders to sign a confidentiality agreement.
* Warranty and indemnity insurance is a common feature of sales by auction and allows a buyer to increase the competitiveness of its bid.