

Selling your business: heads of terms, exclusivity and protecting confidential information

INTRODUCTION

Once you start negotiating a sale and before you give the buyer access to information and launch full scale into the sale process you should first consider entering into heads of terms and ensure that you have protected confidential information.

If, having considered this guide, you would like to know more or to discuss your own circumstances in greater detail, please speak to your usual contact at Stevens & Bolton or a contact listed at the end of this guide.

WHAT ARE HEADS OF TERMS?

Heads of terms (also referred to as letters of intent or memoranda of understanding) set out the key commercial terms of the sale that has been reached between the parties.

Heads of terms are not intended to create a legally binding commitment on the parties to enter into a sale and purchase agreement and this should be made clear in the document. The heads of terms do however demonstrate serious intent and are likely to be regarded as morally binding. There are some provisions commonly included in the heads which the parties would expect to have legal effect and these are mentioned below.

WHAT WOULD HEADS OF TERMS GENERALLY COVER?

Heads of terms are not intended to be an exhaustive document setting out all the terms of the sale and should instead focus on the key issues.

One of the key areas that should be covered by the heads is the price to be paid for the business, possibly including how this has been arrived at (for example, whether it is based on a multiple of turnover or profits), and how the price is to be satisfied. For example, will it be paid in cash on completion, the issue of shares in the buyer, payment in cash on a deferred basis, possibly subject to certain performance targets of the business being met, or a combination of some or all of these elements?

The heads of terms would also generally cover the following:

- any other key commercial terms of the transaction – for example, whether key employees are required to enter into new service agreements;
- any conditions to the sale of the business completing – for example, the buyer being satisfied with the results of its due diligence exercise on the business or receiving the consent of its board or speaking to key clients to ensure they will continue to deal with the business after sale; and
- a timetable for the process setting out when completion of the transaction is anticipated.

LEGALLY BINDING TERMS - EXCLUSIVITY

There are some elements of the heads of terms which the parties would intend to have legally binding effect, one of which is the granting of exclusivity.

The buyer will be investing time and money in undertaking the due diligence exercise on the business and instructing professional advisers to assist with the sale process generally. It is therefore common for the buyer to request a period of exclusivity. This means that the seller agrees for a specified period of time not to enter into discussions with a third party in connection with a sale or supply any information concerning the business to a third party. This is an obligation that should be legally binding so that it can be enforced if required.

PROS AND CONS OF HEADS OF TERMS

The main benefits of putting in place heads of terms are that all parties are clear from the outset that agreement has been reached on the key commercial areas. Whilst there will be no legally binding obligation on either party to conclude a sale, the heads will have strong moral force if a party goes back on a principle that was agreed without having any justification for it. Heads of terms can also be a useful framework for the parties' advisers to work from in drafting and negotiating the sale and purchase agreement.

As mentioned above, heads of terms do carry strong moral weight and can mean that room for manoeuvre is limited. This can work against both the seller and the buyer although the buyer has less information about the business and may therefore be at more of a disadvantage. It is also important that the parties do not get bogged down in detail in drafting the heads of terms which can lead to protracted negotiations and higher costs before the sale process has even properly begun.

PROTECTING CONFIDENTIAL INFORMATION

As part of selling a business, the buyer will generally be given access to a wide variety of information in order to obtain a complete picture of the business that it is acquiring and any issues/liabilities that may exist. This will usually include financial information so that the buyer can investigate the financial performance/standing of the business, commercial information regarding the relationship with customers and suppliers of the business and legal information regarding the contracts, employees and property interests of the business. Before giving the buyer access to such information, the seller needs to ensure that such information is kept confidential by the buyer and that the buyer does not use the information for its own gain, particularly if the buyer is a competitor.

Sellers would be strongly advised to enter into a confidentiality agreement. Not only does this protect the seller, but the confidentiality obligations can also work both ways so that there is an obligation on both parties not to disclose that they are in negotiations in connection with a possible sale. Alternatively, confidentiality provisions can be incorporated into heads of terms. If this is the case, the confidentiality obligations are one of the provisions that would need to be legally binding so that, in the event of a breach, the non-defaulting party could seek to take action against the party in default.

SUMMARY

Before agreeing commercial terms with a potential buyer it is advisable to contact your advisers to discuss next steps and whether heads of terms should be entered into and to ensure that confidential information is protected. Generally heads of terms help to focus all parties' minds and can highlight whether there are any major areas that are not agreed at an early stage and thereby reduce time and costs in the long run.

CONTACT US

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The information contained in this guide is intended to be a general introductory summary of the subject matters covered only. It does not purport to be exhaustive, or to provide legal advice, and should not be used as a substitute for such advice.

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