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Legal Issues in Acquisitions

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Abstract

Acquisition can be a means to achieve a substantial growth in market share, not attainable through organic growth and hence lead to tremendous value creation. It can be exciting and fun for the sellers, buyers and employees of both the acquiring and purchasing company. On the other hand it is fraught with difficulties on many fronts:

- What integration strategy to use to exploit the synergies of the two companies while not destroying the value of the entity being purchased (In some cases not integrating the two companies after acquisition, and allowing them to compete, might be in the best interest of the shareholders!)
- HR integration and company morale issues
- The difficulty of accurate due diligence
- Retention of key staff members
- Estimation of Contingent Liabilities, such as warranty returns
- Regulatory issues
- Sufficient coverage of pertinent issues in Heads of Agreements

This White paper focuses on the legal issues and negotiations leading up to the acquisition, not the post-acquisition strategy.

It provides a plain-English explanation of the issues and is aimed at General Managers or owners (either buyers or sellers) rather than Lawyers.

Disclaimer (The lawyers make me do this)

This white paper provides both factual statements, and views and opinions. The factual statements, and the views expressed by Shawn Rogut in this white paper represent his own personal opinion and/or are based on his understanding of the industry and of information believed to be reliable. Further, while this white paper discusses a number of legal issues, it does not represent securities advice or legal advice in any way, and persons should discuss their own situation with their financial and legal adviser before taking action in any matter relating to the subject of this white paper. Neither Shawn Rogut nor Beagle Computing Pty Ltd shall be liable for loss or damage of any kind whatsoever arising as a result of any opinion or information disclosed in respect of this white paper.

Introduction

This white paper examines the contractual and legal issues surrounding acquisitions. Many other factors affect the success of an acquisition, such as the post acquisition integration strategy, staff sentiment and customer sentiment. These other issues are only discussed to the extent that they impact the contractual and legal aspects.

This white paper looks primarily at the Australian context. Acquisitions are often international, and where relevant, the issues affecting acquisition of a foreign company are highlighted in this paper, but requirements for countries other than Australia are not dealt with in any amount of detail.

Different Acquisition Structures

The most appropriate acquisition structure and process varies according to the type of company being acquired, and the strategic motivations of the buyer and the seller. The structures can be divided broadly into four categories, according to the diagram below

<table>
<tr><th colspan="3">Acquire the legal entity</th><th rowspan="3">Acquire the business</th></tr>
<tr><th rowspan="2">Off-Market</th><th colspan="2">On-Market</th></tr>
<tr><th>Negotiated</th><th>Hostile</th></tr>
</table>

Figure 1 - Different Acquisition Structures

The legal issues to consider, and the contracts required, differ for each of these four acquisition processes.

Acquisition of the legal entity

When a buyer acquires the legal entity of the business, whether it is a listed or Pty. Ltd. Company, the buyer must be cognisant of the fact that the liabilities of the legal entity remain with the legal entity. These liabilities extend beyond the obvious liabilities that the company may have on its balance sheet, such as unpaid wages and creditors, to contingent liabilities and other area of liability that may be less obvious.

Areas of liability that may not be obvious at first, range from such items as long service leave or redundancy payments, to areas which are far more difficult to quantify, and may potentially be far more costly, such as damages due to the company's past activities. Redundancy payments should be considered even if the acquirer does not intent to reduce staff numbers to take advantages of synergies with its current business – they should also be considered as part of the possible costs in case the business being acquired does not perform as well as expected. Damages due to the company's past activities may include health claims by consumers, employees or the public, due to faults or health risks in the company's products, poor occupational health practices, or poor environmental practices. Examples include the liability that tobacco companies may inevitably face; clean up bills due to damage to the environment; damages (including punitive damages) demanded by nearby residents of a plant or high voltage power lines where poor environmental practices (or ignorance of the risks) has resulted in health problems of these residents; companies whose employees handled asbestos in the past; products sold which may fail soon, before the warranty period is up; and so on.

In summary, a seller will usually try to sell the legal entity if it is selling the whole of its business, and the buyer should understand that buying the legal entity includes buying its past and its liabilities, and the contracts should make allowance for these issues.

Off-Market Acquisition of the legal entity

In a private sale, the buyer should try to buy the business, but not the legal entity. If the seller is not willing, then the buyer should try to limit its contingent liabilities in two ways: Firstly, any indemnities should be clearly defined in the contract, and secondly the indemnity should be secured. If the indemnity is not secured, the only recourse the buyer may have is to sue the previous owners, but by that time the previous owners may have dispersed all their assets. A common way of obtaining at least part of such a guarantee is to delay settlement terms, and have part of the settlement retained in escrow until some of the contingencies (for example product warranty periods) have lapsed.

Negotiated Acquisition of Listed Entity

A negotiated acquisition of a listed company involves the buyer and the seller discussing and agreeing the terms of the acquisition at board level, and the board of the selling company then recommending to its shareholders to accept the offer. The offer may consist of cash and/or scrip or shares in the acquiring company.

A 'merger' falls into this category, and can be thought of as an acquisition where a premium is not paid for control. In many cases premium is paid and control is gained, but the term 'merger' is used to retain staff morale.

Such negotiations are often, unfortunately, characterised by the egos of the directors, and often the acquisition results in a substantial increase in the personal wealth of the directors of the sellers, as they relinquish their status and power in return for cash. This aspect of the acquisition is important to understand when considering the contractual issues, as it plays a large part in the contract negotiations.

In an acquisition of a listed entity, it is not possible for the buyer to indemnify itself against contingent liabilities. On the other hand, public companies are subject to transparency requirements so there are often greater amounts of information publicly available to allow the buyer to make an assessment of such contingent liabilities.

Hostile Takeover of Listed Entity

A hostile take-over occurs when an entity is able to acquire enough of the acquired entities shares to gain control, against the wishes of the acquired company's directors, and is considered by the market as a mechanism to remove poor performing directors[i]. Just as in a negotiated acquisition of a listed entity, it is not possible for the buyer to indemnify itself against contingent liabilities. But in the case of a hostile take-over, the position is worse in that the hostile environment makes it very difficult for the buyer to get 'inside information' in the due diligence phase, and so must rely on other methods to gather intelligence, such as from open sources. Consequently the buyers understanding of the contingent liabilities may be incomplete. This may be one reason for the poor success rate of hostile take-overs[ii].

For a hostile takeover to occur, the regulatory environment must allow hostile takeovers. In Australia this is allowed, and further regulatory implications are discussed in the 'Regulatory' section below.

Take-Over of the Business

A seller may sell the business or a part of the business, without selling the legal entity. For example, the seller may sell a plant, or other assets, or perhaps a large corporation with multiple businesses may sell one of its business units, together with the goodwill.

Buying the business without the legal entity may expose the buyer to far less risk of contingent liabilities, so this option is often the most attractive to buyers, if the seller is willing to sell the business in this way. The legal considerations still include many of the issues of the other forms of acquisitions, such as due diligence prior to the acquisition to ensure that the purchaser knows what is being purchased, and post-acquisition audit before final settlement to ensure the purchaser got what was promised. However, the legal considerations are considerably simplified as guarantees against and protection from contingent liabilities do not need to be considered.

While the legal issues may be simplified, there are still a number of issues that need consideration. These include:

- Consideration of land, licences, or any other item that would need to be transferred. In some cases, such as land, the transfer would incur considerable cost in stamp duty. In other cases, such as access to water in farming districts, regulations may have changed, with the previous owner receiving its licence under a grandfather clause, but the authority refusing to issue a similar licence to the new owner, or at least refusing to issue it under favourable terms.
- Employee contracts need to be transferred to the new owner, and where they are not, redundancy payments may be due.

Consequently it is important to clearly define the indemnities in such an acquisition contract.

The Acquisition Process

The process that will be followed varies, depending on the structure of the acquisition. In a negotiated acquisition, the following process is common:

- Targeting and selection
- Approach by seller
- Non-Disclosure Agreement and perhaps Letter of Intent
- Heads of Agreement (and negotiations)
- Due Diligence (often concurrent with the Heads of Agreement, in iterative cycles
- Contract for sale (and negotiations)

The contracts and legal documents associated with the above process, such as the Non-Disclosure Agreement, are described in greater detail in the 'Documents & Contracts' section above. Areas associated with the process, and requirements for the process, are described below.

For an on-market acquisition, a similar process is followed. Where the negotiation is hostile, however, the buyer must limit its due diligence activities to information that can be acquired through open sources. The area that does differ significantly is the bidding phase. The negotiations are often with the board, but the sale is with the shareholders. Legal and regulatory issues in this area are reviewed in the 'Regulatory' section below.

Due Diligence

Once the acquisition gets beyond the point of general agreement, the buyer will perform a due diligence to gather information about the seller to ensure a thorough understanding of the issues that are relevant to the acquisition. The items to be investigated can generally be divided into the following categories:

- Assets
- Liabilities
- Contingent Liabilities
- Staff
- Sales
- Customers
- Suppliers

Detailed issues which should be investigated in each of these categories are shown in Table 2 on page 6. To perform adequate due diligence often requires the assistance of expert advice, for example in valuation of assets and operational practices. In addition to those items referred to in Table 2, the following items should also be investigated:

Accounting Issues

As part of the due diligence process, it is important to examine any liabilities that the company might have, or might arise from the sale, which may not be obvious on the companies books. In particular, issues relating to income tax, such as commercial debt release, and issues relating to Capital Gains Tax. It is important that as part of an acquisition, the buyers and the sellers appreciate the complexity of capital gains tax, and the fast pace of change in the area.

In addition to the tax issues, there are also legal issues to consider in contracts with venture capitalists or financiers, when the bid is being negotiated.

Contingent Liabilities Associated with Employee Contracts

Top-level executives often fear that they may have their employment terminated if the company is acquired for reasons of 'synergy' with the acquirer. To protect themselves, they may include some form of compensation in their employment contract that pays them a large lump sum should the ownership of the company change substantially. It is important for the acquirer to learn of such conditions during the due diligence phase.

Documents & Contracts

Non-Disclosure Agreement

In the preliminary phases of an acquisition the buyer will gather information about the seller to ensure a thorough understanding of the issues that are relevant to the acquisition, and in particular, the potential liabilities and the value of the acquisition. Some of this intelligence may come from open sources, but in the case of a negotiated acquisition, a large part of the intelligence will come from the buyer performing a due diligence on the seller. This will involve the seller providing competitive information that is sensitive and confidential, such as the seller's business strategies, its customers and market share, customer contacts, production process, the competitive strengths and weaknesses of the company, etc.

This information should not be disclosed unless there is an appropriate non-disclosure agreement (NDA) in place between the parties. Furthermore, it is safest to ensure that each person receiving the competitive information signs a non-disclosure agreement, rather than a single non-disclosure agreement signed on behalf of the acquiring company.

Even with a non-disclosure agreement in place, the seller is not completely protected, for a number of reasons:

- The potential buyer may be a competitor, and information such as customers, strategy, and production process may all be valuable information.
- Even with the best of intensions and the most noble and ethical character, it is difficult to 'forget' something that you have just learnt. For example, examination of your competitor's strategy might have revealed to you a blind spot or deficiency in your own strategy. The dilemma is analogous to the sometimes comic instruction from a judge to a jury to 'disregard that statement', which, like any form of censorship, only makes the information seem more interesting and the jury pay even more attention to it.
- Over time the information an individual learns on the job becomes part of his/her 'tools of the trade', and he/she starts to legitimately use them in their job, and the line between information learnt under NDA vs not under NDA becomes blurred. This is particularly the case where the employee leaves for another firm.
- In some severe cases, it may be the case that the potential acquirer is simply posing as a buyer for the sake of illegally gaining competitive information.

For these reasons, it is important that the seller does not rely only on the NDA document for protection. The seller should not provide information which is commercially sensitive until there is some form of guarantee, such as a letter of intent or heads of agreement, to state that subject to the satisfactory outcome of the due diligence exercise, the sale will proceed (and the 'satisfactory outcome' should be clearly defined). The implication is that negotiated acquisitions should have a sense of creeping commitment, moving from a letter of intent to a heads of agreement to a final offer.

From the perspective of the buyer's interest; it is important that the NDA does not unnecessarily restrict the buyer in conducting business if the sale does not proceed.

Regulatory

In Australia, the main bodies that administer regulation of acquisitions are:

- **Australian Securities and Investments Commission (ASIC) –** One of the three Commonwealth Government bodies that regulate financial services. Their functions are listed on their website[iii], and include regulation of Australia's 1.2 million companies, protecting investors, superannuants, depositors and insurance policy holders, and regulating and enforcing laws that promote honesty and fairness in financial markets, including administration of company legislation, and in particular the disclosure requirements set out in the Corporations Law. ASIC's policy statement – 159, for example, describes ASIC's discretionary powers, and how it intends to use them with respect to buyers creeping their stake in a target, and other related issues.
- **Australian Competition and Consumer Commission (ACCC) –** The ACCC has, as one of its targets, the notion of promoting a culture of competition throughout the world, in the interests of developing more competitive and fair oversees markets, and improving Australian exporters access to those markets[iv].
- **Australian Stock Exchange (ASX)**.
- **Foreign Investments Review Board (FIRB)**.

The roles of these bodies in acquisitions are described in greater detail below.

Legal Issues That May Prevent an Acquisition

A hostile takeover can only occur in a regulatory environment which allows it. Australia, the UK, Canada, New Zealand and the US allow hostile takeovers. However, regulation in many other countries (particularly Asian countries such as Vietnam, Thailand, Malaysia and China) prevent foreign ownership and hence acquisition, unless the government sees the acquisition as being in the interest of the country.

The target company's constitution must allow the takeover, and this is particularly significant in the case of a hostile takeover. For example, the seller's Memorandum and Articles of Association (or more recently, the 'replaced rules', must allow for the transfer of shares under hostile conditions. Similarly, in the case of a Government Organization which was privatised, such as Qantas, the government may hold a 'golden share' to enable it to veto an acquisition that it feels is not in Australia's interests. Issues around foreign investment are described further below.

In some countries (but not in Australia), government approval must be sought if the acquirer intends to make large staffing changes as part of the post-acquisition integration.

On-Market Acquisition Regulatory Issues

Acquiring a listed company involves buying the shares of that company. Normally the acquirer will take a stake to the maximum permitted, and then make a takeover offer. The regulations specify a number of share ownership thresholds at which point the acquirer must disclose certain information or undertake certain activities, as shown in the table below:

Percentage	Action
5%	The acquirer must disclose to the market its shareholdings, and its intensions
14.99%	Foreign acquirers must obtain FIRB approval before increasing its shareholdings further
20%	Acquirer must proceed to a formal bid before increasing its shareholdings. The formal bid is characterised by issuing a 'Part A' offer document, which is described further below.

Table 1 - On-Market Thresholds

The above table show the thresholds currently in place in Australia. These thresholds have recently changed as part of CLERP, and they do change from time to time, and other countries have different thresholds. The percentage ownership is taken to be the sum of ownership of associates and subsidiary companies. Furthermore, it is important to note that it is illegal to 'warehouse'. That is, it is illegal to get friends to buy shares and store them for you until you need them. The NCA and Federal Police look carefully at associations between company directors to ensure that this does not occur.

The price paid for any shares in the 4 months leading up to the bid sets the floor on the price to be offered to other shareholders. Consequently an acquirer should exercise care in the months leading up to the acquisition, as a small shareholding bought just for the sake of being on the membership register to obtain company reports may set the floor price, as might the price paid by the acquiring company's superannuation fund. This is known as the 'minimum bid price principle'[iii]. ASIC policy statement 163 provides explanation of the minimum bid price principle as set out in the Corporations Law Section 621 (3)-(5).

Foreign Investment Approval

In Australia, the FIRB regulates investment by foreign entities in Australia[v]. The *Foreign Acquisitions and Takeovers Act 1975* gives the government the power to block an acquisition that it may consider to be against the public interest. The FIRB is the agency which regulates this act, as well as implements the further changes in the government's foreign investment policy, as outlined in the treasurer's press release of 3 September 1999. A foreign entity wishing to acquire an Australian company will need approval by the FIRB. The FIRB guidelines encompass guidelines and regulations per sector, and specific legislation placing foreign ownership limits is in place for some key industries[vi]. For example:

- **Urban Land**
- **Banking** - The Banking Act 1959 and the Financial Sector (Shareholdings) Act 1998
- **Civil Aviation** – Restrictions, particularly as applied to ownership of Qantas
- **Airports** – Airports Act 1996
- **Shipping** – Shipping Registration Act 1981
- **Media** – Broadcasting Services Act 1992, and other restrictions on Newspaper ownership
- **Telecommunications** – Restrictions on the ownership of Telstra as well as the establishment of new entrants.

In addition, the government and its foreign investment policies also might place constraints on a foreign entity's acquisition of an Australian company, where the government feels that the acquisition might not be in the best interest of Australia.

Anti-Trust Issues

Mergers and Monopolies or Anti-Trust approval may be required for an acquisition to proceed, and the requirements vary from country to country. In Australia the regulatory body responsible for this is the Australian Competition and Consumer Commission (ACCC)[iv], and it administers this area of the Trade Practices Act (TPA). Section 50 of the TPA is specifically relevant to the ACCC's assessment of mergers and acquisitions.

There is no formal requirement for an acquirer to provide notification to the ACCC prior to an acquisition attempt, as there is in some countries, although the ACCC is willing to receive informal submissions for consideration. The consequence is that in some cases the ACCC is not consulted prior to the acquisition, and hence only gets involved after the acquisition has become public, in which case it may (through the courts) force the acquirer to sell off some of its recent acquisition – by the ACCC's own admission, a lengthy and costly process[vii].

A number of experts (e.g. [viii]) believe that the ACCC's staff have a narrow focus on microeconomics, instead of the broad macroeconomic or business perspective required, so their policies may be detrimental to Australia. The ACCC's belief that the domestic market is large enough to foster efficiency gains through competition rather than economies of scale is highlighted by some of their policy publications[vii]. For example, the ACCC's assessment criteria sites the likelihood of increased imports as a criteria which would improve competition domestically and hence a criteria which would encourage the ACCC to allow a merger. On the other hand, the ACCC's criteria do not consider the effect on international competition. The result has often been that a local player is prevented from taking over an Australian business, and instead the business is acquired by a large multinational that has not been active in the local market. The consequences are two-fold: (a) global competition decreases as the multinational increases its market share, and (b) Australian businesses are prevented from acquiring the size and skills needed to become competitive on the global stage. Two examples of this are:

- The ACCC prevented Arnotts from acquiring Nabisco as that would decrease the number of domestic players and increase Arnotts' market share to 60%. That paved the way for the New Zealand Company 'Lanes' to acquire Nabisco instead, which may not have been in the interest of international competition or Australian industry.[ix]
- The ACCC prevented the Australian-owned Wattels from purchasing Taubmans from the international player, ICI. This facilitated Taubmans being purchased by a foreign company (Plascon, a subsidiary of Barlow Limited of South Africa). This retained the number of major competitors in Australia, but probably reduced the number of competitors internationally. Had Wattels purchased Taubmans, it might have been able to gain the scale required to compete with the international leaders ICI and International Paints.[x]

While the intent of this white paper is not to 'bag' the ACCC (who do a wonderful job to maintain competition in many respects), we do wish to warn companies who are about to embark on an acquisition, of the sometimes perplexing events which can disrupt otherwise sensible acquisition plans.

Bidder and Target Statements

ASIC has provided guidance on the application of recent amendments to the Corporations Law, in particular, the new Chapter 6 introduced on 13 March 2000 as part of the Corporations Law Economic Reform Program (CLERP)[xi]. Section 636 describes the requirements for the bidders statements and Target's statements.

A buyer who wishes to purchase a company listed on the Australian Stock Exchange (ASX) may makes a **Bidder Statement,** which is an offer to the shareholders, to make either a conditional or unconditional offer. The bidder statement provides full details of the buyer's offer to the shareholders, as well as details of the buyer's intensions, and any deal that may be promised to the company or its directors.

The offer is subject to scrutiny and approval by ASIC, and can only be withdrawn with ASIC's consent, and only after prescribed conditions, such as a substantial change in the business being acquired.

While the offer is being considered, the buyer may continue with on-market purchasing. Should the shareholders accept the offer, settlement occurs after close of the offer.

The minimum offer period is one month

As per the 'minimum bid price principle'[iii], the floor price is the highest price the acquirer has paid for shares in the company in the preceding four months.

The 'bidder statement' is relatively new, having been introduced in March 2000 with the Corporate Law Economic Reform Program (CLERP). Before the changes implemented as part of CLERP it was known as 'Part A' for conditional or scrip offers, and 'Part C' of unconditional cash offers.

The target company must respond to the Bidder Statement offer with a **Target's Statement** response within 14 days of the Bidder Statement issue. Given the size and legal requirements of the Target Statement, this requirement is often unreasonable and not feasible, so the target company will often seek injunctions and delays to give them more time to prepare the response, particularly if the acquisition is hostile. The 'takeover panel' has been introduced as part of CLERP (section 656 to 659) to reduce the use of such delay tactics, among other considerations.

As with the 'bidder statement', the 'target's statement' was also introduced by CLERP, and was previously known as the Part B or Part D response (to a part A or Part C offer, respectively).

The legal issues around on-market take-over bids have undergone some changes recently, and it is likely that further changes will occur. Issues that were under debate as part of CLERP include:

- The 20% threshold, and whether or not buyers can continue to buy after making the offer, before the offer is accepted.
- The level of disclosure to the seller as part of the 'Part A offer' which has since been replaced by the 'Bidder Statement'
- A general disclosure statement was recently introduced in place of the Section 750 checklist
- A '**Takeover Panel**' has been put in place (as part of CLERP section 656 to 659) to replace the Administrative Appeals Tribunal and the courts. In order to prevent the previous practice of injunctions requested by lawyers to delay a hostile bid, the takeover panel may receive applications to stop a bid,

from only ASIC or a public Authority. The takeover panel The takeover panel is governed by the Corporations Law (Chapter 6), the ASIC Act (ss171 – 201A), and rules made under the ASIC act (s195), and has a number of powers, including the authority to prevent someone from buying certain shares, or force someone to dispose of certain shares (for example, if a shareholder increases their holding to past the 20% threshold), as well as order an award for costs.[iii]

Compulsory Acquisition

A buyer can force minority shareholders to sell their shares under certain conditions. There are a number of methods whereby shares can be acquired compulsorily, but the primary mechanism as it relates to a takeover falls under section 701 of the Corporations Law, and requires that the offeror already has 90% of the shares and 75% of the members have disposed of their shares since the offer was issued[xii].

Some of this legislation has been put in place to reduce the power of a 'greenmailer', who takes out a blocking stake on the register of potential takeover targets, expecting the buyer to pay them a premium for that stake. The legislation also prevents a company from thwarting its competitor's bid for a company.

Heads of Agreement

A heads of agreement is an agreement which states in principle the intension of the buyer to acquire the seller, subject to certain issues being resolved during the due diligence exercise, and subject to satisfactory resolution of certain issues during the contract negotiations.

The heads of agreement is typically less onerous than the complete contract of sale, and contains less legalese. It is best for the managers negotiating the sale to write it and have it vetted by their lawyers rather than have their lawyers write it. This is because contract negotiation for an acquisition involves the two sides establishing a large amount of trust for each other and developing a working relationship. Egos are also usually involved. By a simple mistake or omission, a lawyer who sends a draft document to the other party's lawyer may inadvertently create an antagonistic situation. It is, however, important that the lawyers do vet the heads of agreement.

The heads of agreement can be written in a binding way, and often clauses agreed are used as part of the final contract of sale. Negotiating the heads of agreement also facilitates discussion around post acquisition issues and plans, and can be used to secure such conditions such as the retention of key management.

The intent of a heads of agreement is to provide in-principle agreement, and hence avoid having the process stall because of non-agreements in the details. Nonetheless, areas that may (and in some cases should) be covered by the heads of agreement include:

- Assets
- Liabilities
- Contingent Liabilities
- Staff
- Sales
- Customers
- Suppliers

Each of these is described in further in the table detail below

Table 2 - Issues to Consider During Due Diligence and Heads of Agreement

Assets	• Stock levels, including goods in transit and work in progress • Methods of stock valuation (for example, LIFO, FIFO, averaged, discounts for slow-moving stock, etc) • Stock quality • Quality, value (and valuation method), and state of repair of all assets, including vehicles, buildings, plant, etc. • Stock depreciation methods used • Debtors. The buyer would generally prefer to pay less, and for the seller to retain the debtors, rather than wear the risk of debtors defaulting. If this is

	not possible, the buyer should try to get a guarantee (secured), on the debtors. If the seller does retain the debtors, a mechanism needs to be agreed regarding how the debts are collected and reimbursed to the seller. The new owner would like to maintain the friendly relationships in place with customers, and hence not have the previous owner harassing customers. • Royalty agreements • Technology, including production processes. • Trademarks, Patents, Business Names, trade secrets, Brand Names
Liabilities	• Creditors • Warranties and the expected return rates for goods, or support calls for software products under warranty.
Contingent Liabilities	• Tax implications for a range of issues, such as payroll tax, Capital Gains Tax, etc. (A suitably qualified tax accountant performing an audit on the company's accounts should investigate this.) • Liabilities for Products sold, and means of identifying newly created products vs products created when the seller owned the firm. • Past activities of the firm with respect to: o Occupational health and safety o Environmental pollution o Potential product defects which may be hazardous • Legal compliance of the seller's business and practices to industry-specific regulations. • Details of insurance policies in place and held in the past by the seller
Staff	• Names of key staff that are to be retained, and consequences to the deal if those staff do not stay for some agreed minimum period. • Retrenchment agreements in place with staff. To calculate potential retrenchment liabilities, the buyer must obtain details of all employees, salaries, start date, etc. • Outstanding annual leave and sick leave for all employees • Details of all agreements and packages in place with employees. • Agreements that the seller will not poach staff after the sale • Superannuation • Details of unions active in the company and employees memberships in unions
Sales	• Guarantees on projected sales and margin on those sales. The seller would typically want to specify the extent to which the buyer must take partial responsibility, as the new manager of the business, to ensure these sales. • Sales mix across the product range • Current and future orders.
Customers	• Key contracts currently in place • The reaction that key customers may have to the acquisition (and guarantees that the seller can provide in this regard. • Any other agreements currently in place, such as preferred supplier arrangements • Any requirements particular customers may have, such as quality requirements (ISO9000, for example). • Details of all contracts being executed, such as large project delivery, their value, status, profitability, resource requirements, etc. • Agreements that the seller will not poach customers after the sale
Suppliers	• Willingness of suppliers to do business with the company after the acquisition. This may be an issue if some suppliers would perceive the new owner as a competitor. This is particularly the case with technology being used by the seller.

The sale	• What is being sold (the business or the legal entity) • Price and the nature of this (cash vs scrip, etc) • Conditions of sale, and conditions the sale is subject to • Settlement terms, including terms for payment of any goodwill component. • Guarantees and security against indemnity for contingent liabilities. • Dispute settlement

Contract for the Acquisition

The contract for the acquisition is more formal and contains further legal details, which are required to ensure a fair transaction. However, the body of the agreement may often be pasted in from the heads of agreement already agreed. The remaining issues to be stipulated in the contract are further specific clarification of some items in the heads of agreement, and some warranties which the buyer will consider essential, such as that there are no hidden contingent liabilities.

Employment Issues and Contracts

Retaining Key Employees

In a business, it is usually the case that the value of the business rests in a number of key employees. In almost all acquisitions other that those that are made only for the sake of liquidating overvalued assets, it is important to ensure the value of the business being purchased is retained. To this end, it is vital that key employees do not leave because of the uncertainties that usually accompany an acquisition. Obviously retaining staff relies on good corporate cultural and Human Resources practices, more than legalities; nonetheless, contractual issues play a part to assist and facilitate this, as described below.

Where the business is purchased, or in a private (off market) sale, such key staff are often named in the sales contract, with a condition of sale included to stipulate that a certain minimum percentage of these key staff must stay for a stipulated amount of time after the acquisition. The seller often guarantees such a condition, with a proportion of payment delayed until after the stipulated period.

In the case where the legal entity has been purchased, there is no formal need to agree a new employment contract, as the employee is still working for the same legal entity. However, when the new business is being absorbed into the rest of the acquirer's business, rather than preserved as a separate independent entity, it is usual that new contracts are put in place for employees, so as to standardise on terms, conditions and benefits across its workforce.

If the business but not the legal entity has been purchased, the need to put in place new employment contracts with all acquired employees (or inform these employees that their previous contract has been taken over by the acquirer) is more urgent. For employees which are not taken over, either through the employer's or the acquirer's choice, the seller is responsible for redundancy payment.

Whether the legal entity has been purchased or the business has been purchased, the employees of the acquired company expect their conditions, remuneration and benefits to be at least as good as it was with the seller. When a buyer takes over a public sector function (during privatisation), the conditions that the employees are used to and hence expecting may differ dramatically from the standard conditions that the buyer's company has in place, such as in superannuation or long service leave, and these issues will need to be resolved with the employees.

Summary and Conclusion

The contractual and legal considerations of an acquisition vary depending on the structure of the acquisition. The three main variables in this regard are:

1. **Negotiated vs Hostile** – Major impact is the degree and success of the due diligence
2. **Buy the Business vs Buy the Legal Entity** – Major consideration is the contingent liabilities associated with buying the legal entity, and the unknowns around what possible contingent liabilities might arise.
3. **Private vs On-Market Sale** – In a private sale, the owner of the company (or his/her agent) is the one that the seller would negotiate with, and the sale can only be negotiated (although the seller might be forced to sell for financial reasons). In the case of an on-market sale, the buyer may or may not negotiate with the Board of Directors (depending on how hostile the take-over was), but the sellers are the shareholders, not the Directors. To ensure stability of the market and to ensure that appropriate information is disclosed to the shareholders in an appropriate timeframe, there is legislation in place, legislated by ASIC, that the buyer must comply with, such as issuing a 'Bidders Statement'

In addition to these variables and their implications on aspects such as the due diligence phase and the Heads of Agreement, this report has also reviewed the major regulatory bodies active in Australia which influence acquisitions, such as the ACCC, the FIRB, the ASX, and ASIC.

Finally, this report examines the legal and regulatory issues at play in an acquisition. It is important to note that these issues must be handled correctly to ensure a successful acquisition, and this almost always requires expert legal council experienced in this area. However, acquisitions are essentially human endeavours in that they involve negotiations at the front end, and integration and change management at the tail end. To ensure the success of the acquisition, it is not enough to only focus on the legal and contractual issues; there should be a sound strategic motive for the acquisition, and the human skills (ranging from integrative negotiation skills to change management) should be well developed.

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