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Private equity deals in the United States: separated from the United Kingdom by a common language?

J David Kim
Howard Sobel
Huw Thomas
David J Walker
Latham & Watkins

Acquisition documentation

Paul Dolman
Travers Smith LLP

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1. Introduction

The negotiation of acquisition documents on a private equity transaction is similar to the negotiation of acquisition documents on any other private M&A transaction. However, the involvement of private equity investors – whether on the sell side, buy side or both – will impact on overall deal dynamics and the terms and structure of the transaction. Private equity sellers, in particular, approach the negotiation of deal terms very differently from founder or corporate sellers, largely driven by their need to distribute the proceeds of the sale promptly to investors without contingent liability.

This chapter looks at some of the key issues that impact on deal dynamics, the typical structure of a private equity transaction and – with a particular focus on secondary buyouts (where private equity investors are on both sides of the negotiating table) – the typical approach to negotiation of a share purchase agreement, highlighting those features which distinguish a private equity transaction from other private M&A transactions.

Deal terms will also be significantly influenced by market trends. As a backdrop to the discussions in this chapter, it is worth noting that in recent years the market in the United Kingdom has been particularly seller friendly. It is well documented that good-quality assets are highly sought after by private equity, with a wall of 'dry powder' being available to deploy, supported by debt markets with ready supplies of acquisition finance. Competition for assets has increased further due to a wider pool of buyers, including corporates, international buyers and other types of financial institutions (eg, hedge funds, family offices and sovereign wealth funds) competing in auction processes and often willing to pay significant premiums. In the current market, particularly on competitive auction processes, buyers cannot afford to be too demanding over deal protection.

2. Anticipating transaction dynamics

2.1 Trade or private equity?

Private company acquisitions fall into two main categories for practical

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purposes: trade purchases and buyouts. Trade purchases are those where the buyer is a commercial, trading enterprise, often in a similar line of business to the target, and where the funding is provided by the buyer, albeit often using bank finance or the proceeds of an equity fundraising. The buyer may be public or private, but the target is private. Buyouts are acquisitions funded by one or more private equity investors. The term 'buyout' is used generically to describe management buyouts, management buy-ins, management buy-ins/buyouts and secondary or subsequent buyouts, all of which have at their heart a private company acquisition funded by private equity investment. A secondary (or tertiary or subsequent) buyout can be distinguished from other forms of buyout as the target is being sold by one private equity owner to another. A buyout of a public company is a public-to-private (also referred to as a 'take private' transaction), which falls outside the scope of this chapter.

The identity of the parties involved (on both the sell side and buy side) will have considerable impact on deal dynamics and the process, structure and terms of the transaction. Where a company is being sold to a trade buyer, the buyer will often be a direct competitor of the business being sold and the sellers may therefore be particularly concerned about sharing business sensitive information early in the process, when there is no certainty that the sale to that buyer will proceed. A sale to trade will also typically be the end of all sellers' relationship with the target; whereas a buyout will, if some of the managers own shares in the target, likely involve them reinvesting some of their proceeds to sit alongside the new private equity owner, necessitating the negotiation of an equity deal.

There are, perhaps, more distinctions to be drawn when the transaction involves a private equity seller as opposed to founder or trade sellers. The private equity seller will already have been through a thorough due diligence process on its acquisition of the target and will be well placed to run an efficient process, with orderly information flows and possibly vendor due diligence (VDD). VDD is a common tool used by private equity sellers to accelerate the deal process. In relation to deal terms, there are significant differences in the approach to warranties and restrictive covenants, all of which are discussed in further detail below.

2.2 Shares or assets?

A number of factors will dictate whether the sale is structured as a share or asset sale. As there are advantages and disadvantages in both routes for buyers and sellers, the choice will be dictated by the balance of advantage, usually for the strongest party in the transaction. A seller will typically prefer a share sale, transferring a company lock, stock and barrel. This is because the sellers will then be liable only to the extent of the warranties and indemnities that they agree to give in the sale agreement, or to the extent that they agree to retain

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certain assets and/or liabilities expressly. However, there may be benefit for the buyer in cherry-picking the assets it purchases, leaving behind any significant liabilities identified during the due diligence process. On an asset sale (sometimes referred to as a business sale), the transaction documents will specifically identify those assets that are to be transferred and the liabilities that will be assumed by the buyer and those that will stay behind, and the transfer mechanics (including consent and assignments) will need to be considered carefully. Tax will usually be the key determinant in the deal structure, as the tax treatment associated with a particular structure will usually outweigh all other considerations. The tax treatment can vary materially depending on the jurisdictions involved. In the United Kingdom, a seller will commonly prefer a share sale – as well as the tax history generally going with the acquired company, a seller is more likely to be subject to capital gains tax on the proceeds (and not incur two levels of tax – one on the asset sale and another on the cash being paid out to the seller) and a UK corporate seller will often be able to sell tax free (relying on the 'substantial shareholdings' exemption). On the other hand, a buyer may pay lower stamp duties on an asset purchase and has the opportunity to pay less tax in the future if it can step up its tax basis in the assets and then depreciate that cost in the future, with that step-up not generally available (at least outside the United States) on a share purchase. As can be seen from this, the parties may have entirely different and often conflicting objectives as far as tax planning is concerned. The structure adopted is likely to be the most tax efficient one for the dominant party in the negotiations. The default position is to adopt a share sale, unless there are difficult historic issues in the target or the tax benefits of an asset sale strongly outweigh those for a share sale.

In this chapter, we largely focus on share deals, being by far the most common form of private equity transaction – although much of what is said will apply equally to asset deals.

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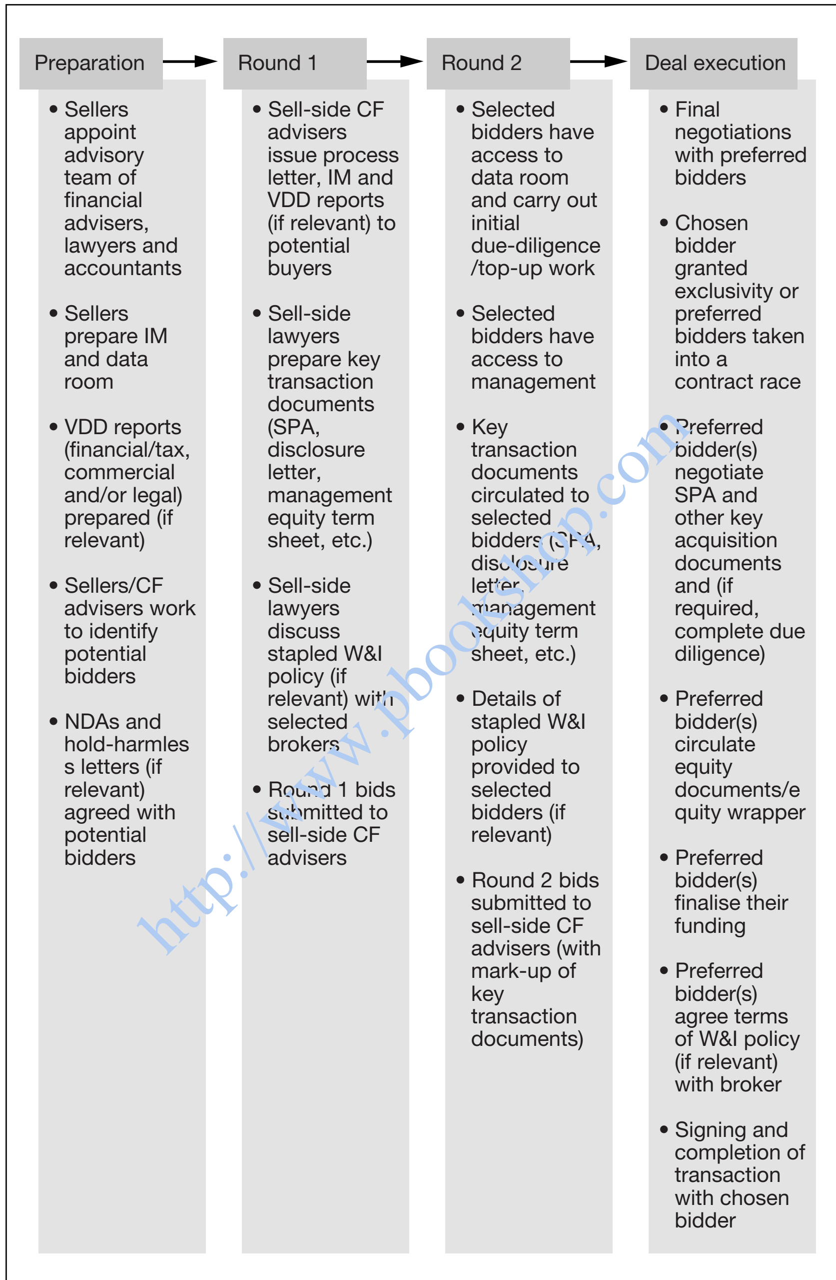
2.3 Deal process

While the holy grail of investment opportunities for private equity is the off-market proprietary deal, there is no doubting the prevalence of the competitive auction process in the UK market in recent years. From a seller's perspective (whether a private equity seller or otherwise), an auction process can be used to create a competitive environment between interested parties with a view to maximising the sale price, returns to the sellers and legal deal terms. It is unsurprising that auction processes have become very popular in a seller-friendly market.

The timeline in Figure 1 illustrates the different phases of a formal auction process, what happens at each phase and the documents that will be drafted/negotiated.

Figure 1. Auction process timeline



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In the first round of a formal auction process, after bidders have entered into a confidentiality agreement (also referred to as a non-disclosure agreement)

with the sellers (see section 4), potential first round bidders will receive a process letter outlining how the auction process will be run, the deadlines for first round offers and the information required to be submitted when making the offer (eg, the identity of the acquiring entity, the strategic rationale for the acquisition, the purchase price and basis of valuation, conditionality, internal approvals and other timing considerations). Bidders will also receive an information memorandum on the target and sometimes, subject to signing appropriate non-reliance and hold harmless letters, vendor due diligence reports will be disclosed in the first round (although these are much more often provided to those bidders which are in the second round). A first round offer will be a non-binding indicative offer to the sellers.

Bidders that progress to the second round will receive a second-round process letter outlining the second phase of the auction, the date for submission of final binding offers and the detail to be included in such offer. Bidders in the second round will be granted access to an online data room, so that they can carry out their own detailed due diligence on the target (or conduct top-up due diligence where there is VDD), and will have the opportunity to attend management presentations. At this stage, the sellers will also share drafts of key transactional documents (including the share purchase agreement, disclosure letter and, if management will reinvest, a management equity term sheet) and, where warranty and indemnity (W&I) insurance is contemplated, details of any stapled W&I policy. The price offered continues to be of high importance at this stage, but bidders will be competing against each other on other factors too, all of which will be referred to in the second offer letter, including:

- the required level of conditionality;
- the degree of negotiation of the sale documentation (which will be evident from the mark-ups of key transactional documents submitted with each second round offer);
- deliverability;
- the package being offered to the management team on reinvestment (assuming that management is valued, private equity buyers will likely offer an attractive and tax-efficient incentivisation structure in the form of 'sweet equity');
- the bidder's willingness to assume informed risk; and
- the extent of any additional buy-side due diligence or (if relevant) top-up due diligence.

Although pricing often works in the favour of corporate buyers, private equity investors will often have the edge in terms of light negotiation, as corporate buyers tend to be more demanding over deal protection (eg, warranty coverage, tax indemnities and post-completion adjustments). Private equity investors also often have the edge in terms of deal deliverability and speed of

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execution too – due diligence by corporate buyers may be more involved, given the need to ensure synergies and corporate fit; and in certain cases corporate buyers may present more regulatory risk where antitrust issues apply. As private equity investors are in the business of executing deals, there may also be a presumption that they are more streamlined than corporates when it comes to approval processes.

The sellers will almost always prepare the draft sale and purchase agreement and bidders that can accept the draft sale agreement with fewest amendments are much more likely to be attractive to the seller. The key features of the sale and purchase agreement are considered below.

The timetable will vary from one auction process to another. During boom times, auctions might be run on very tight timetables, with the parties expecting to sign a binding sale and purchase agreement within as little as 24 to 48 hours after the submission of final bids. Generally speaking, in a weaker or more uncertain economic climate, there is more room for slippage in the auction timetable. It is not unusual for processes to be extended once a preferred bidder has been identified, to allow additional time for the completion of due diligence and negotiation of the sale and purchase agreement. The preferred bidder is also likely to ask for exclusivity during this period – not only for deal certainty, but also to justify incurring the additional costs involved at this stage in the process (see section 4). Occasionally, in hotly contested auction processes, the sellers may run two preferred bidders against each other in what is referred to as a 'contract race', in order to maintain the competitive tension up to the point of execution of the transaction – both preferred bidders negotiate the finer detail of the transaction documents until the sellers select their chosen bidder. This is relatively rare, given the timing and cost implications on all parties.

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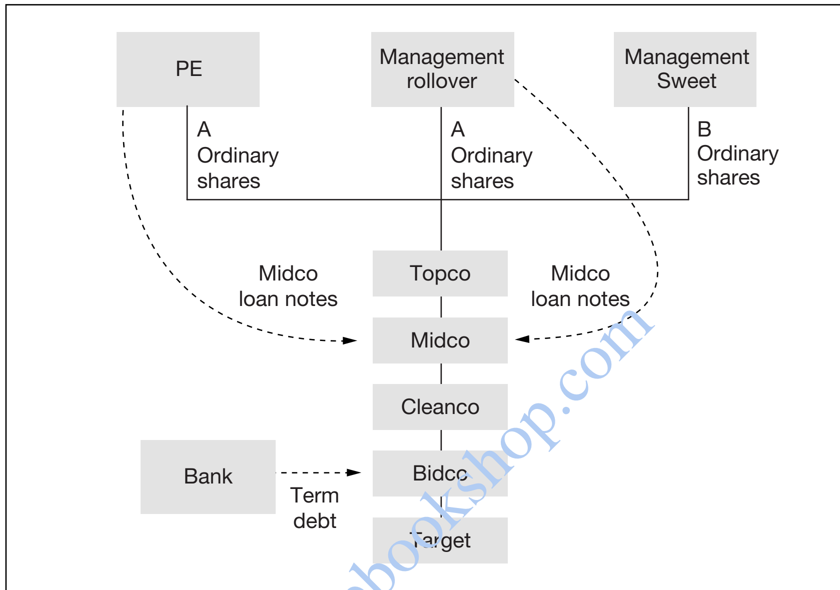
The favourable market conditions for sellers witnessed over the last few years have resulted in increased competition between bidders in auction processes and this tension has manifested itself in a material number of instances of bidders trying to 'bust the process' by making pre-emptive bids. The real possibility of pre-emptive bids is impacting on how auction processes are run and how sellers are preparing themselves for exit. Given the premiums often associated with pre-emptive bids, sellers are increasingly keen to position themselves so that they can take advantage of such a bid should the opportunity present itself.

3. Acquisition structure

Private equity investors (whether on a primary, secondary or subsequent buyout) will rarely invest directly in the target. The bid for the target will almost always be made by a newly formed company ('Bidco'), which will be funded indirectly by the private equity investor (and, on a leveraged transaction, the

bank) through a stack of additional newly formed companies (together, referred to as the 'newco stack'). A simple structure is shown in Figure 2.

Figure 2. Post-completion group structure diagram



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It is Bidco that will enter into the share purchase agreement (and other deal documentation) as buyer, not the private equity investor or reinvesting managers. This acquisition structure is largely driven by the structuring objectives of the private equity investor, the requirements of the bank on a leveraged transaction and tax considerations.

4. Preliminary acquisition documents

4.1 Heads of agreement, confidentiality and exclusivity

Occasionally, and usually when an auction process is not involved, the parties to a transaction may, having struck a deal on the principal terms, wish to set out their agreement in heads of terms – also sometimes referred to as a letter of intent, memorandum of understanding or heads of agreement. Essentially, this is an outline of the terms that the parties have agreed in principle, but is not designed to be legally binding. The principal terms often include the identity of the shares/assets to be acquired, the liabilities to be assumed, the price to be paid and the form of consideration, and any conditions to be satisfied. Heads of agreement will often also set out the various tasks to be accomplished and conditions to be satisfied before the parties can sign definitive agreements. This

will often include completion of a satisfactory due diligence exercise by the buyer and the obtaining of certain consents (unless such consents are to be conditions in the share purchase agreement itself). The key feature of heads of agreement is that they are not intended to be legally binding, but confirm a moral commitment on both sides (with the exception of exclusivity and/or confidentiality provisions, which are often contained in heads of agreement and expressed to be legally binding). For this reason, heads of agreement are usually expressed to be 'subject to contract', with the exception of specific clauses which the parties expressly state are to have legal effect. It is also crucial that the parties do not rely entirely on the words 'subject to contract', particularly if all the evidence points to an intention to create legally binding obligations.[1]

However, given the prevalence of auction processes, heads of agreement have become relatively rare. On auction processes, the typical starting point is a standalone confidentiality agreement to be entered into between each bidder and the sellers at the very outset of the auction process (ie, the first round as shown in the timeline in Figure 1), setting out the restrictions on the bidder's use and ability to disclose the confidential information it receives in relation to the target group and the target business. Confidentiality provisions are designed to protect the seller in particular, since it will be handing over documents and information to bidders, much of which may be commercially sensitive, at a point at which it has no certainty which bidder (if any) will proceed with the acquisition. In addition to standard non-disclosure obligations, the confidentiality agreement is likely to include other restrictions on the bidder designed to prevent the miss-use of information received, including:

- a non-solicitation clause, restricting the bidder's ability to solicit or entice away any directors, employees or consultants of the target group; and
- a non-contact clause, restricting the bidder's ability to approach any person or entity that has a business relationship with the target group (eg, clients, customers, suppliers and distributors).

Such restrictive covenants will be limited in time, with a period of 12 to 24 months from the date of the confidentiality agreement being standard.

On private equity transactions, the industry-wide standard form confidentiality agreements for buyouts produced by the British Private Equity & Venture Capital Association (BVCA) are commonly used. Using an industry-

1 Use of the phrase 'subject to contract' creates a strong presumption that the parties do not want to be bound (Winn v Bull [1877] 7 Ch D 29), but its effectiveness may be overridden by other circumstances. A court will look to other words used in the heads of agreement, the conduct of the parties and the factual context to determine its effectiveness in negating legal relations. For example, where the parties start to perform the contract before a formal agreement is entered into, a court will be inclined to find that the 'subject to contract' reservation has been waived (*RTS Flexible Systems v Müller* [2010] UKSC 14).

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standard confidentiality agreement can be a useful way of avoiding unnecessary negotiation, although it is often the case that provisions dealing with the ability to share information with associated entities and advisers (and responsibility for the same), restrictive covenants and compliance with data protection laws[2] are the subject of some negotiation. Very recently, the BVCA launched a new approach to confidentiality agreements on auction processes, through the introduction of the 'short form auction confidentiality agreement for buyouts', which is essentially a two-page abbreviated version to be used in the very early stages of an auction process where there are several bidders being granted access to very limited information. Where all that is being disclosed to bidders is a basic overview of the business (typically in an information memorandum and/or a process letter), the provisions which are most heavily negotiated in longer-form confidentiality agreements are unnecessary. The BVCA's first round auction standard, which includes all the confidentiality protections required in relation to such limited information, can be presented to bidders for signature on the understanding that they will be required to enter into a longer-form confidentiality agreement at the next phase of the transaction, before access is granted to further information. The benefits of this approach are clear on the sell side, and bidders are also saved from incurring unnecessary negotiation costs at an early stage in a transaction when there is no certainty as to whether they wish to proceed.

The exclusivity letter, on the other hand, is about buy-side protection. At the later stages of an auction (and also relevant to off-market purchases), the potential buyer is likely to seek comfort that it has a period during which it can negotiate the purchase freely without the risk that the seller is negotiating with another party at the same time, behind the scenes. This is particularly important given that the buyer will be expending a considerable amount of time, money and resources on due diligence and negotiating the acquisition in the pre-contract phase. Break fees (or a cost underwrite) can be used to protect the buyer against abort costs where the transaction falls over on account of the sellers, but this is rare in the current market. Where used, it is important from an enforceability perspective that break fees provide reasonable compensation for costs incurred and are not punitive in nature.

4.2 Due diligence reports

Due diligence is the information-gathering/risk assessment process carried out

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2 Following the introduction of the EU General Data Protection Regulation (2016/679), provisions relating to compliance with data protection legislation feature more prominently in confidentiality agreements where the disclosure of personal data is envisaged. Theoretically, data protection is something parties should always have considered complying with; but following the decision of the Court of Justice of the European Union in Schrems in October 2015 it has become standard practice to request that bidders sign up to a set of European Commission pre-approved model clauses as a means of establishing a 'valid gateway' where personal data is to be exported by the seller outside of the European Economic Area.

by and on behalf of the buyer to find out as much as possible about the target early on in the process. The due diligence findings, as set out in due diligence reports, will inform the buyer's decision on whether to proceed with the acquisition and if so, on what terms (including price and deal protections).

Sometimes, the seller may carry out its own due diligence on the company or business it is selling and will have its advisers prepare a VDD report which is made available (and addressed) to the buyer. Often a vendor due diligence exercise is carried out to speed up a sale process, but the extent to which the buyer will take the seller's due diligence report on trust will vary from deal to deal. While VDD may pre-empt an extensive due diligence investigation on the part of the buyer, most financial sponsors will at the very least want the VDD report warranted by the seller/management.

5. Principal acquisition documents

The sale and purchase agreement (SPA) is the principal agreement setting out the detailed terms of the sale of the target. It includes:

- the mechanics for transferring the target shares;
- conditions to completion of the sale (eg, any requirement for antitrust clearances);
- the purchase price;
- warranties on the target business;
- limitations on warranty claims;
- restrictive covenants; and
- undertakings regarding the manner in which the business will be conducted during any period between the date of signing the SPA and completion.

On a secondary buyout, a number of key provisions in the SPA will differ from the usual position on a primary buyout. These include, in particular, the level of warranty protection, the purchase price mechanism and restrictive covenants. We look at each of these in more detail below.

In order for the target to register the transfer of shares to the buyer, a stock transfer form will also be required, being the 'proper instrument of transfer' required as a matter of corporate law. The SPA will include an obligation on the sellers to deliver a properly executed stock transfer form in respect of the transfer of their shares on completion. In principle, the SPA could be drafted such that it constitutes the proper instrument of transfer; but as the SPA covers such a wide range of provisions, not merely the mechanic for transferring the shares, a stock transfer form is invariably used in order to protect the confidentiality of the commercial agreement set out in the SPA. For UK companies, the stock transfer form will be sent to Her Majesty's Revenue & Customs (HMRC) for stamping.

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5.1 Structure and conditionality

The SPA may be drafted in anticipation of a simultaneous signing and completion. However, it is very common for completion of transactions to be delayed beyond signing. In some cases, this may be to give the buyer time to draw down funds from its investors. In others, completion may be conditional on an independent event, such as obtaining consent from the target group's customers, suppliers, finance providers or regulators; or, most commonly, in respect of merger control.

Split signing and completion is particularly prevalent where merger control thresholds are met, since many merger control regimes around the world require a clearance to be obtained prior to completion. Merger control notifications are usually more likely to be required where the turnover of one or both of the parties is high or the deal value is high. However, specific merger control regimes vary considerably around the world and there has been little sense of convergence between them over time. That variation is reflected in different definitions of what counts as a relevant 'merger', jurisdictional thresholds and time periods required for competition authorities to investigate transactions.

As regards what counts as a relevant 'merger', while many regimes employ some form of 'control' standard, that is by no means always the case and some are explicitly designed to capture acquisitions of relatively small minority stakes. By way of example, a transaction may fall within the scope of the EU regime where it involves a lasting change in the control of an undertaking, 'control' being defined as the ability to exercise 'decisive influence' over an undertaking. This can arise in circumstances of sole control, but also a range of joint investment or consortium scenarios where two or more parties may each have the possibility of exercising decisive influence over the target undertaking. Within the EU member states, while many jurisdictions (eg, France) have adopted the decisive influence standard used by the European Union or something very similar to it, others have not (eg, a transaction may fall within the scope of the German merger control regime where it involves the acquisition of voting rights reaching or exceeding 25%, regardless of the level of decisive influence).

Assuming that the transaction amounts to a 'merger' for the purposes of the relevant regime, specific jurisdictional thresholds – some of which are revised annually – can vary quite significantly between countries. The European Union operates alternative thresholds,[3] and if either is met, then the transaction will be notifiable to the European Commission. Within the European member states, as might be expected, the relevant merger control thresholds are set at lower levels than those at the EU level.

The time periods required for competition authorities to investigate transactions can also vary significantly. It is not uncommon for competition authorities to divide their investigations into a first and second phase, in order to separate out the relatively straightforward transactions (which can be cleared

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at Phase 1) from the relatively more complicated transactions (which may require a detailed Phase 2 investigation). Under the EU regime, there is a statutory 25 working day period for the Phase 1 investigation and a 90 working day period for the Phase 2 investigation, both of which may be extended depending on whether remedies are offered. However, depending on the nature of the case, the European Commission may in effect require a significant further period (weeks or even months) of non-statutory pre-notification prior to being prepared to start the Phase 1 clock. Within the European member states, it is not unusual for Phase 1 processes to have a statutory deadline of around one month. Phase 2 periods and any requirement for pre-notification engagement with the authority tend to vary materially depending on the nature of the case and the member state in question.

While the United Kingdom remains a voluntary notification regime, a split signing and completion to allow for a UK merger control clearance may nonetheless be agreed where there is a significant overlap between the commercial activities of the parties and/or the deal involves certain public interest considerations (including media plurality and, increasingly, national security concerns).

Split signing and completion is also common on transactions where the target is a financial services business (eg, a bank, insurer or asset manager); or where the business as a whole is not in the financial services sector, but one or more entities within a target group carry on an activity regulated by a financial services regulator (eg, arranging consumer credit for the benefit of the target's customers or arranging insurance coverage for other group entities). This is because regulatory approval is highly likely to be required where a share sale[4] entails a change of 'control' of a regulated entity and – at least in the United Kingdom and the European Union – thresholds for 'control' are usually as low as 10% or 20% (depending on the type of activities carried on by the entity) and the term often captures a range of indirect controllers.

In the United Kingdom, failure to obtain regulatory change of control

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3 Under the first threshold, a notification will be required where:
- the combined aggregate worldwide turnover of all the undertakings concerned is more than €5 billion; and
- the aggregate EU-wide turnover of each of at least two of the undertakings is more than €250 million, unless each of the undertakings concerned achieves more than two-thirds of its aggregate EU-wide turnover in one and the same member state.

Under the second threshold, a notification will be required where:
- the combined aggregate worldwide turnover of all the undertakings concerned is more than €2.5 billion;
- in each of at least three member states, the combined aggregate turnover of all the undertakings concerned is more than €100 million;
- in each of at least three of those member states, the aggregate turnover of each of at least two of the undertakings concerned is more than €25 million; and
- the aggregate EU-wide turnover of each of at least two of the undertakings concerned is more than €100 million, unless each of the undertakings concerned achieves more than two-thirds of its aggregate EU wide turnover within one and the same member state.

4 While other regulatory considerations may apply on asset sales, there is no requirement for a formal change of control approval.

approval before completion is a criminal offence, and failures by the seller or the target to notify the regulator in advance of a change of control are criminal offences and regulatory breaches, respectively. It is therefore in all parties' interests that the correct change of control procedure be observed and reflected in the SPA. The UK regulator has up to 60 business days (in theory, extendable by up to 20 or 30 business days) from submission of a complete application to decide whether to approve it (these figures are broadly similar across the rest of the European Union); and it is worth noting also that preparing an application – even on a straightforward transaction – can take significant time, as it invariably entails gathering together a substantial amount of information about the buyer, its group and key individuals. The nature of both the target (eg, whether it is a financial services business or simply has a single entity authorised by a financial services regulator for 'low-level' regulated activities) and the buyer (eg, whether it is a trade buyer and whether it is itself regulated) may also affect the speed and rigour of the regulator's review of an application.

Where there is a gap between signing and completion, the SPA will specify the applicable conditions to completion (the 'conditions precedent') and when and how each condition must be satisfied. There will typically be a longstop date beyond which the SPA will terminate if the conditions are not satisfied or waived; and in order to limit the risk of the conditions not being satisfied by the longstop date, the SPA will set out the steps to be taken for satisfaction of the conditions and will allocate responsibility for taking those steps[5] (which will vary depending on the nature of the conditions and the bargaining position of the parties). The SPA will also contain provisions to cover the period between exchange and completion, including:

- positive and negative undertakings given by the seller to ensure that, during that period, the target business is conducted only in the ordinary course of business and in accordance with the SPA;[6]
- repetition of warranties at completion – although this is increasingly rare

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5 Often, a discussion will be had as regards the level of obligation to be placed on the party taking responsibility for satisfaction of the conditions. As to the difference between 'best endeavours', 'all reasonable endeavours' and 'reasonable endeavours', an obligation to use 'best endeavours' should not be taken as "the next best thing to an absolute obligation or a guarantee" (*Midland Land Reclamation Limited v Warren Energy Limited*, 1997 unreported), but will impose a duty to do what is reasonable in the circumstances, including incurring expenditure which is reasonable in taking such action – although a company which has given a best endeavours undertaking will only be obliged to take action which is in the best interests of the company (*Rackham v Peek Foods* [1990] BCLC 895). 'Reasonable endeavours' is less burdensome than 'best endeavours' and case law suggests that if the use of reasonable endeavours would result in any financial or other commercial disadvantage to the obligor, no action is required (*Phillips Petroleum Company UK Limited v Enron Europe Limited*, as reported in PLC, 1996, VII (10), and *Rhodia International Holdings v Huntsman International LLC* (2007) All ER (D) 264). 'All reasonable endeavours' is described as the middle position between 'best endeavours' and 'reasonable endeavours' (see *UBH (Mechanical Services) Ltd v Standard Life Assuranc*e, reported in *The Times*, 13 November 1986).

6 For example:
- negative undertakings around distributions, changes to share capital, entry into high value contracts, financing and granting security; and
- positive covenants such as information and access and maintenance of insurance arrangements.

in respect of business warranties and more often than not will be limited to the repetition of title and capacity warranties only; and

- provisions entitling the buyer to terminate the agreement for material breaches by the sellers between exchange and completion.

In relation to the third point above, it should be noted that walkaway rights are relatively uncommon, but where included the most common trigger is the material unremedied breach of a pre-completion undertaking. In the United Kingdom (in contrast to the United States), it is extremely rare nowadays to have a walkaway right linked to material adverse change or breach of business warranties when repeated on completion.

Where there is split signing and completion, the sellers will want comfort, on signing, that the buyer will have the funds to pay the consideration payable to the seller on completion (and any other relevant payment obligations under the SPA, such as repaying existing shareholder loan notes and/or bank debt). Where the buyer is a private equity investor, this will be set out in an equity commitment letter, which will usually take one of two approaches:

- a full equity underwrite, where the private equity fund agrees to underwrite the debt (assuming a leveraged transaction) in addition to each investor agreeing to underwrite its individual equity portion; or
- only the equity portion of each investor being underwritten.

The second option above is typically agreed only if there is a full certain funds package in place at exchange or if – provided that the investors and the sellers get comfortable with it – a debt commitment letter is entered into on exchange.

The concern for the incoming investor is that it could be liable for a damages claim under the equity commitment letter if long-form banking documents (ie, the full debt package) are not in place for completion and the buyer is therefore not in receipt of all the moneys required to complete such that the buyer defaults under the SPA. There is an argument that coverage of the equity portion only should be sufficient on the grounds that a court is very unlikely to grant an order for specific performance of an SPA, with the only likely means to redress being a damages claim.[7]

It is increasingly common nowadays for the equity commitment letter also to include a confirmation from the investor that it will put the buyer in funds to settle any amount due for breach of the SPA by the buyer prior to completion. The investor will be keen to ensure that any commitment in relation to breach of SPA

7 The damages available will always need to be assessed on a case-by-case basis. However, the starting point is that they should, so far as possible, put the seller into the position it would have been in had the SPA been performed. The normal measure will therefore be the contract price for the relevant shares less their market price as at the date when completion should have taken place. In the alternative, the seller could claim damages representing the wasted costs it has incurred in negotiating with the buyer.

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is limited to the failure to satisfy specific conditions to completion and only to the extent that satisfaction of such conditions is within the buyer's control.

5.2 Risk allocation

A buyer will usually expect to obtain a comprehensive set of warranties from the sellers, which will give some protection against existing liabilities of the target group which lead to a diminution in value. However, the position is very different on a secondary buyout where there is a private equity seller. Although the private equity seller will usually hold a majority of the shares in the company which is the subject of the secondary buyout, and will therefore receive the greatest proportion of the sale proceeds, private equity investors in the United Kingdom (in contrast to the position in some other countries, as detailed in the country-specific chapters) will almost certainly refuse to give any warranty or indemnity protection when selling a portfolio business, other than warranties regarding their title to the shares and their capacity to enter into the SPA.

When disposing of an investment, the private equity firm wants to be free to distribute the sale proceeds back to investors. Contingent liabilities in the form of potential warranty claims would inhibit their ability to return funds to investors and could therefore have a negative impact on the internal rate of return achieved on an investment. In addition, private equity investors commonly cite a lack of knowledge about the business, on the basis that they do not have a role in the day-to-day running of the business, as a further reason for not giving a full suite of warranties.

The buyer on a secondary buyout is therefore likely to find itself with fairly limited warranty protection. There are several ways in which the buyer can seek to minimise its potential exposure, including and very commonly obtaining warranties from the management team relating to historic issues in the business, carrying out more extensive due diligence to identify any risks in the business (the extent of the due diligence largely being driven by the scope of business warranties offered up by the management sellers) and purchasing W&I insurance.

As well as giving the buyer some financial recourse in the event that a liability comes to light post-completion,[8] management warranties are useful for

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8 The general aim of contractual damages is to put the claimant in the same position as if the contract had been correctly performed (*Robinson v Harman* [1843-60] All ER Rep 383). For a buyer bringing a warranty claim, this means "the difference between the price actually paid, that is to say with the benefit of the warranty, and the true value of the business at the time of the agreement" (*Senate Electrical Wholesalers Limited v Alcatel Submarine Networks Limited* [1999] 2 Lloyd's Rep 423). This creates two problems for the buyer: having to show what the true value of the business was and how this was reduced by the warranty breach. There are no absolute rules on how the true value of the business is to be established and this question will not necessarily be referred to experts (*Joiner v George* [2003] BCC 299). In *Senate Electrical*, where the Court of Appeal had to establish the true value of the business, it did so by following the valuation method previously employed by the buyer. Current practice is that, in the absence of an agreement to the contrary, a business which was sold as and continues to trade as a going concern should be valued on a discounted cash-flow rather than a net-assets basis (*Triumph Controls UK Ltd v Primus International Holding Company* [2019] EWHC 565 (TCC)).

eliciting disclosure of material issues by focusing the minds of the management team on the potential risks to the buyer. Arguably, given the approach to limitation of liability where business warranties are given by managers, the use of warranties as a tool to elicit disclosure is most crucial. Management's liability must be realistically limited to what is reasonable for them as individuals and liability caps will therefore be relatively low, negotiated on the basis of sale proceeds received by the individual managers, as opposed to the enterprise value of the target business. Subject to further adjustments where warranty and indemnity insurance is being proposed (see below), managers' liability caps have generally reduced in recent years to 10% to 30% of their personal sale proceeds, net of tax and any reinvestment. It is also increasingly common for certain business warranties to be qualified by the knowledge of the warrantor. On higher-value transactions, it is not unusual for there to be a £1 liability cap and/or a 'blanket' awareness qualification whereby all business warranties are limited to awareness of the warrantors (referred to as 'limited recourse' or 'non-recourse' transactions), reflecting the strong position held by sellers in the current market; where this is the case, W&I insurance clearly plays a significant role in buy-side protection, as further detailed below.

Furthermore, the private equity investor will ordinarily be backing the management sellers to run the business going forward and will therefore be extremely reluctant to make a claim against warranties given by its own management team. Warranties against this backcloth do not have the same risk sharing purpose as they do in other private sale and purchase contracts. The incoming private equity investor in a secondary buyout is likely to take more comfort from the amount of the continuing management rollover or reinvestment.

Where a specific risk or potential liability is identified through due diligence, the private equity seller may consider giving a specific indemnity rather than agreeing to reduce the purchase price upfront. An indemnity will allow the buyer to recover compensation from the sellers on a pound for pound basis if the liability crystallises post-completion. This is relatively rare and will be given only where the risk is real (but not certain, as then a price adjustment would be made) and quantifiable. Such an indemnity will usually be capped and limited in time. Sometimes, indemnities may be accompanied by an escrow arrangement, where a portion of the purchase price is ring-fenced in an escrow account for an agreed period post-completion. This will give the buyer additional comfort that funds are available to compensate it, should a liability arise.

W&I insurance can come into play because of the absence of warranties from the private equity seller and the low cap on management warranties, and can be a neat way of bridging the warranty gap by providing cover for losses arising from a breach of warranty. In competitive auction processes, bidders are

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often encouraged to take out a buy-side policy, so that the warrantors can either cap their liability at the level of the self-insured excess or, in some cases, give warranties on a non-recourse basis (ie, subject to a £1 liability cap)[9]. This use of a 'soft-staple' W&I policy has been a common feature of auction processes for some time, whereby sellers and their advisers negotiate the preliminary terms of a policy which can then be handed over to the winning bidder to finalise. Although both buy-side and sell-side W&I insurance policies are available, the vast majority of policies are buy-side policies, as these require the buyer to run the claims process without the involvement of the seller, do not leave the sellers at risk of insurer default and are cleaner in their tax treatment. Figure 3 on the next page provides a useful illustration of how buy-side and sell-side W&I policies operate in practice and the key differences between them.

Where the sellers agree to indemnify the buyer in respect of potential liabilities discovered during the due diligence process, it may be possible to obtain coverage under the W&I policy (although the insurer will require full disclosure of the relevant facts and how the risk has been quantified, and will inevitably request an increased premium). More often than not, it will be more difficult to get the underwriter to stand behind the indemnity than the sellers; or there may be another more appropriate and specialised insurance product on the market.

Generally, the cost of arranging W&I insurance is relatively low, with premiums in the region of 1% to 2% of the amount insured. The insurance can be put in place quite quickly, with insurers generally requiring days rather than weeks to read due diligence reports, ask underwriting questions and prepare the policy documents. Although certain matters will be excluded from the insurance cover – such as known issues raised in the due diligence and disclosure process and fraud – the breadth of cover available is increasing, with insurers willing to cover a broader range of risks. However, some fairly material gaps remain in coverage of tax risks (see section 6 for more on tax W&I trends).

W&I insurance has evolved to plug the gap between buyers that want a full set of business warranties given on an absolute basis and sellers that insist on a blanket awareness qualification (as referred to above). To bring a claim for breach of warranties that are subject to an awareness qualification, the buyer must prove not only that the warranted statement was incorrect, but also that the warrantor was aware that it was incorrect. It is becoming increasingly common for awareness qualifications (blanket or otherwise) to be deemed to be removed for the purpose of making claims against a W&I policy (ie, for the policy to respond to unknown risks, even where a claim would not exist against the warranties themselves), albeit sometimes for an increased premium and

9 Where W&I insurance is being sought on a non-recourse transaction, the insurer will be particularly careful to ensure that a proper and meaningful disclosure (and due diligence) process has been undertaken.

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Figure 3. Buy-side and sell-side W&I policy

	Buy-side policy	Sell-side policy
What does the policy cover?	The loss suffered by the buyer due to a breach of warranty or the tax covenant given by the warrantors	The loss suffered by the warrantors as a result of having to make a payment to the buyer in respect of a warranty or tax covenant breach
What can be recovered?	A buy-side policy covers losses incurred by the buyer from the level of the self-insured excess up to the policy limit. It is common to match the self-insured excess with the cap on the warrantors' liability under the sale agreement. This means that, once the threshold for bringing claims under the sale agreement has been met, the buyer can first bring claims against the warrantors for amounts up to the self-insured excess and can claim against the W&I policy for amounts in excess of that (up to the policy limit). Buyer can bring a claim under the W&I policy up to the amount of the policy limit Warrantors liable to the extent their liability cap is aligned with the self-insured excess Self-insured excess not covered under W&I policy	The warrantors remain liable to the buyer for amounts in excess of the threshold (up to the level of the overall cap on their liability in the sale agreement). The warrantors are then able to seek to recover any amounts paid to the buyer which exceed the self-insured excess from the insurer. Warrantors can seek to recover any amounts paid to the buyer from the level of the self-insured excess up to the policy limit (often coinciding with SPA threshold) Warrantors are liable to the buyer for all amounts above the threshold up to their liability cap. SPA Threshold
Who bears the risk of the policy failing?	Buyer	Warrantors

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with exceptions sometimes being made for specific warranties. This is known as a 'knowledge scrape'.

5.3 Pricing and consideration mechanics

The way in which the purchase price for a target is calculated, and any adjustments to the purchase price, will differ from transaction to transaction (and from country to country). The purchase price can be a fixed price, or it can be calculated by reference to a purchase price mechanism set out in the SPA – namely completion accounts or a locked box mechanism.

(a) Completion accounts

Where completion accounts are used, the buyer pays the purchase price to the sellers on completion (most commonly less a retention to be used or released once the completion accounts process has concluded), which is usually calculated based on an estimate of what the company's accounts will look like at completion. Following completion, a set of completion accounts are drawn up in accordance with an agreed procedure and accounting policies, as set out in the SPA. Once the completion accounts are agreed the purchase price is adjusted, with a balancing payment made by the buyer or the sellers (as appropriate). The basis for the purchase price adjustment can vary, but the most common adjustments relate to the level of working capital, debt, cash or the net assets of the business. The completion accounts process creates uncertainty for both parties and can often result in disputes over the amount of any adjustment to the purchase price; where this is the case, and the parties fail to reach agreement on the adjustment within a specified period, the matter in dispute will be referred to an independent chartered accountant for final and binding determination. For private equity sellers in particular, the desire for certainty and the reluctance to accept post realisation liability under an SPA has resulted in a move away from the traditional completion accounts approach in favour of the locked box approach described below.

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(b) Locked box

The use of locked box mechanisms has become an established feature of UK M&A and undoubtedly the most common approach to pricing for UK buyouts. Under this mechanism, the parties fix the equity price by reference to a set of accounts as at a date prior to exchange (the 'locked box date'), and the economic risks and rewards associated with owning the business are passed to the buyer with effect from that date. The sellers then provide a 'no leakage' covenant to the buyer, providing pound for pound recovery for any value leakage to the sellers (or their connected persons) between the locked box date and completion (eg, dividends, bonuses or the incurrence of fees for the sellers' benefit). The sellers severally covenant to pay to the buyer an amount in cash

capped at the amount of any 'leakage' actually received by that seller or its connected persons (often extended to include costs of recovery and other losses arising from leakage where those are recoverable under the leakage covenant) during the locked box period, provided that written notice of a claim is made within a specified period of usually six to nine months following the completion date. The SPA will contain a list of items considered to be 'leakage' and will carve out certain payments ('permitted leakage') which will not be subject to the locked box covenant, such as exit bonus payments and monitoring fees payable to the private equity sellers – the amounts of which will be quantifiable and will be taken into account by the buyer when determining the purchase price. This gives the sellers certainty over the price which they will ultimately receive, while still offering a reasonable level of comfort to the buyer that it will acquire the business with the balance sheet that it is expecting (and which will be the focus of the due diligence). Buyers accepting a locked box pricing mechanism will need to be comfortable with the level of financial diligence carried out on the locked box balance sheet, given the lack of any opportunity to adjust the price post-completion.

On locked box transactions with a split exchange and completion, sellers often argue that they should benefit from notional cash profits generated in the business between the locked box date and completion, often referred to as an 'equity ticker'. Most commonly, equity tickers are structured as:

- a day rate calculated by reference to profits generated in the locked box period (post a deduction for the accrual of interest on any loan notes held by the sellers); or
- a day rate calculated by reference to a fixed interest percentage (eg, 5%).

On some transactions, part of the consideration may be deferred and sometimes, deferred consideration will take the form of an 'earn-out'. Earn-outs operate so that if the future performance of the target reaches certain hurdles, an additional amount of consideration will be paid to the sellers. Usually, an earn-out will be linked to the profits of the target over a period of time (eg, one or two financial years) post-completion. This method of linking part of the purchase price to the target's future performance can be used to bridge any gap in price expectations between the sellers and the buyer. It can also operate as an additional incentive for any management sellers remaining with the business post-completion – both the buyer and selling managers will have an interest in maximising future profits (although the buyer's focus will clearly be on the longer-term benefit for the target group, not the impact of profitability on the managers' consideration package). For sellers that are not reinvesting in the business, an earn-out is unlikely to be attractive, as it would cut across the desire for a 'clean break' from the business on completion. The differing objectives of the parties and other factors, such as the difficulty of dealing with profit

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fluctuations in some sectors in particular, can result in much negotiation and complex drafting. There are also important tax considerations in relation to the terms of an earn-out. HMRC has in recent years shown more willingness to challenge earn-outs if it believes that the earn-out is too closely tied to employment (and if so, to seek to tax managers on earn out proceeds as if earnings of employment).

5.4 Restrictive covenants

Usually, any buyer would expect the sellers to give various undertakings not to compete with the target business and not to solicit employees, customers or suppliers of the business post-completion. Such restrictions are a restraint on trade and must be carefully drafted, not going further than is reasonably necessary to protect the legitimate interests of the buyer in order to be upheld by a court. From a buy-side perspective, the drafting of restrictive covenants is something of a fine art, ensuring that the correct balance is struck between deterring anti-competitive behaviour by the sellers post-completion and agreeing a geographical scope and time period that would be enforceable by law. As a rule of thumb, restrictive covenant periods in European sale/acquisition documentation will have a restrictive period of somewhere between 12 and 36 months, with 24 months being the most common.[10]

On a secondary buyout, it would be very unusual for the private equity seller to agree to such restrictive covenants, although it is common for the management sellers to do so. Since the private equity business model is to invest in companies in certain sectors, private equity sellers regard this type of undertaking as an unreasonable restriction on their investment activities and it is therefore rare to see private equity sellers agreeing to any form of non-compete undertaking when disposing of a portfolio business.

Often, restrictive covenants will be contained in the investment agreement and a manager's service agreement, as well as the SPA, providing the buyer with overlapping protection. Although the covenants are drafted in similar terms in all three documents, there are some key differences in terms of enforceability, who can enforce them and time periods, as discussed below.

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10 The European Commission guidelines (Commission Notice on restrictions directly related and necessary to concentrations, OJ [2005] c 56/24) should be used as a starting point when drafting the restrictive covenants in share (and asset) sales. Restrictive covenants which exceed the limits specified in the guidelines are at serious risk of being unenforceable under UK and/or EU competition law. The guidelines place the following 'ceilings' on duration:
- goodwill only – up to two years;
- goodwill and know-how – up to three years; and
- longer periods only in exceptional cases.

The duration must not in any event exceed the period which the buyer reasonably needs, for example, to consolidate relationships with customers – which may well be less than the ceilings stated in the guidelines, in which case a duration based on those ceilings will be regarded as excessive and therefore unenforceable. 'Know-how' is a package of non-patented practical information, resulting from experience and testing, which is secret, substantial (ie, of significant value to the business) and identified (eg, described in a manual) – in practice, this is a fairly narrow concept.

(a) ***Enforceability***

A restrictive covenant contained in an SPA or investment agreement is more likely to be enforced by a court than a restrictive covenant linked to employment in a manager's service agreement. Restrictions against ex-employees are deemed unfair if they prevent someone from earning a living. Another important point on enforceability is that, where a party is in breach of contract, it is generally barred from enforcing covenants given to it under that contract. If, therefore, an employing entity were to summarily dismiss a manager where no power to do so was expressly contained in the service agreement, the restrictive covenant in the service agreement could not be relied on the grounds of being unenforceable – it is helpful, therefore, that restrictive covenants in other documents may be relied on.

(b) ***Who can enforce?***

It is helpful that restrictive covenants given under the investment agreement are given directly to the private equity investor (as opposed to a newco), as this can sometimes simplify enforcement.

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(c) ***Timing***

The duration of restrictive covenants will differ across the three documents. As already noted above, this will be somewhere between 12 and 36 months from the completion date in a European SPA, with 24 months being the most common. The restrictive period in service agreements will rarely exceed 12 months from the date of ceasing employment (or being placed on garden leave); and in an investment agreement, somewhere between 12 to 24 months from the date on which the departing manager ceases to hold shares in the newco group is not uncommon in practice. From a common law restraint of trade perspective, it is arguable that a period of restriction extending beyond the employment restrictive covenant can be justified by reference to the manager acting in a different capacity in relation to the investment agreement (ie, as a business owner, rather than as an employee). However, to the extent that EU or UK competition law applies, the longer period could be open to challenge and in practice, this approach is often resisted by managers who could be bound for a very long period.

6. Other key documents

6.1 Tax covenant

If given on a transaction, the tax covenant (also referred to as a tax schedule, tax indemnity or tax deed) sits alongside the share purchase agreement (as either a schedule to the SPA or a separate agreement) and, in general terms, apportions tax liability between the buyer and seller. Taxes generally stay with

the person that is liable for them, so on acquiring the shares of the target, the buyer will inherit the tax liabilities of that company. Commercially, the parties will often agree that the pre-closing (or pre-locked box date) taxes should reduce price or otherwise fall to the seller. The tax covenant seeks to restore that commercial position, as it essentially contains a promise by the seller to reimburse the buyer for any tax liabilities that are referable to the period prior to completion.

Despite the pro-seller market, there has been a recent increase in the use of tax covenants, because they are now often used as vehicles for W&I insurance. In these circumstances, the liability under the tax covenant is negligible, with the buyer getting coverage through W&I insurance. Typically, W&I insurance relating to tax covenants is provided on the basis of a tax covenant negotiated between buyer and seller, but some insurers have their own 'synthetic' deeds in a form they are prepared to insure. However, there are some quite significant shortcomings to W&I coverage of tax covenants. Certain areas are uniformly excluded (including transfer pricing, which is a big risk area for international groups); and the insurer will insist on disclosure and/or knowledge exclusions which would not apply to tax covenants from a seller/manager.

Where no significant historic tax issues are revealed in due diligence and the tax affairs seem well managed and low risk, many buyers remain willing to accept tax protection via warranties in the SPA and/or W&I insurance.

6.2 Disclosure letter

Hand in hand with the SPA, the warrantors will serve up a disclosure letter, setting out the general and specific disclosures that they are making against the warranties. A valid disclosure qualifies the statements made in the warranties. For example, there may be a warranty stating that "the Company is not involved in any litigation, nor is any litigation threatened or pending against the Company". The seller may want to disclose that it has received a letter from a customer threatening to bring proceedings against the target for an unpaid invoice. The effect of this disclosure is that, if that customer eventually sues the target following completion in respect of the disclosed matter, the buyer will not be entitled to bring a claim under any of the warranties in respect of that claim.

It should be obvious, therefore, that the disclosure letter is just as important as the warranties in the SPA; and while hours are often spent negotiating the form and content of the warranties in the period leading up to completion, the disclosure letter is often produced at the eleventh hour and the opportunity for careful analysis of the impact of the disclosures is severely limited. The buyer should avoid this situation if at all possible and make sure that it has proper notice of disclosures, and the opportunity to review the relevant disclosure documentation and assess the nature and scale of the liability or potential

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liability which is being disclosed. Disclosure will be of particular importance where management want a £1 cap on their liability under the warranties (as discussed above), as the buyer, in deciding whether to accept this, will want the reassurance that a proper and meaningful disclosure process has taken place.

A properly-advised buyer will only accept 'fair' disclosures and it should be specifically agreed in the SPA that only fair disclosures will be counted as valid. To be considered 'fair', the disclosure should provide sufficient detail about the subject matter of the disclosure to enable the buyer to ascertain the nature and extent of the matter being disclosed.[11] Vague, general or unquantified disclosures should not be accepted. For example, a disclosure which states that "there are some bad and doubtful debts" should not be accepted. The disclosure letter must specify precisely which debts are bad, which are doubtful and what amounts are involved. Equally, it is not considered "fair" disclosure to expect the buyer to accept disclosure of an enormous quantity of documents without drawing the attention of the buyer to the matters specifically disclosed by the contents of such documents.

It is common and accepted practice, however, for the seller's disclosure letter to be divided into two sections: general disclosures and specific disclosures. The concept of 'fair' disclosure should apply to both categories of disclosure, although this is not to say that certain 'general' disclosures should not be acceptable to a reasonable buyer. In this context, the word 'general' means "of general application to all (or a number of) the warranties". So the general disclosures may include reference to, for example, the bundle of disclosure documents, the results of searches of public registers which a reasonable buyer would be expected to carry out and matters disclosed in correspondence between solicitors (eg, replies to property enquiries). However, buyers' solicitors should be extremely wary of general disclosures which are often, by their nature, dangerously wide and unspecific (eg, "all information in the public domain").

Often, there will be a negotiation over whether the full contents of the data

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11 In the case of *New Hearts v Cosmopolitan Investments* [1997] 2 BCLC 249, there was an alleged breach of the true and fair view warranty. The warranties had been qualified by the words "subject to matters fairly disclosed (with sufficient details to identify the nature and scope of the matter disclosed) in the Disclosure Letter". There had been general disclosure of the accounts which the seller claimed disclosed the problem. The court disagreed, saying: "Mere reference to a source of information, which is in itself a complex document, within which the diligent enquirer might find relevant information, will not satisfy the requirements of a clause providing for fair disclosure with sufficient details to identify the nature and scope of the matter disclosed." The case implies a high standard where disclosures are contractually required to be fair. However, in *Infiniteland v Artisan Contracting Limited* [2005] EWCA 758 the Court of Appeal implied a lower standard to disclosures where there was no contractual requirement for the disclosures to be fair or any attempt to define what fair disclosure should mean. The Court of Appeal contrasted the *Infiniteland* contract, which qualified the warranties simply with the words "save as disclosed", with the standard required by the wording in the *New Hearts* case, in which disclosures were required not only to be fair, but 'fair disclosure' was defined to mean "with sufficient details to identify the nature and scope of the matter disclosed". Following Infiniteland, therefore, when acting for a buyer, it is important to provide contractually that disclosures must be fair in order to be valid and to define what fair disclosure should mean, using wording similar to that used in *New Hearts*.

room should be generally disclosed against the warranties. From a sell-side perspective, the argument is that the information has been readily available for the buyer to review. From the buyer's perspective, the key objection is that general disclosure, without specific indication of what is being qualified in the warranties, goes against the principle of fair disclosure. However, it is not uncommon for a buyer to accept general disclosure of the data room; and in practice the buyer will need to consider carefully how orderly the data room is, whether the buyer or its advisers have actually reviewed the information or at least been given a fair opportunity to review it. Often, the relative bargaining strength of the buyer and seller will dictate whether such general disclosure is accepted.

If the buyer is presented with an unpalatable disclosure, in the same way as a discovery made in its own due diligence exercise, the buyer can request a price reduction or an indemnity from the seller; or as a last resort, can walk away from the deal. It is not enough simply to strike the disclosure out of the disclosure letter, since the buyer risks being fixed with knowledge of the disclosure in any event.

6.3 Ancillary documents

In addition to the SPA, the tax covenant (if there is one), the disclosure letter and (if relevant) the W&I insurance policy, there will be a raft of other transfer and ancillary documents, all of which are usually drafted by lawyers, who will often also 'project manage' the entire process.

The publisher acknowledges Richard Lever and Lorraine Robinson for their contribution to this chapter in the previous edition.

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