Private Mergers and Acquisitions in the UK: Overview

Phil Cheveley, Maegen Morrison, Paul Strecker, Simon Burrows, Nick Withers, Richard Porter, and Michael Scargill, Shearman & Sterling LLP

global.practicallaw.com/3-552-5708

MARKET OVERVIEW

1. What are the current major trends in the private M&A market?

In-keeping with trends in public M&A, deal activity increased significantly in 2021, despite the ongoing challenges of the COVID-19 pandemic. This was the case in most industry sectors, with notable sectors including technology, health care, and renewable energy.

This increased activity showed a number of trends that continued into 2022:

- Private equity buyers drove a significant percentage of deal activity across the private M&A market.
- Buyers are looking to pursue "transformative" M&A transactions involving a fundamental shift in a significant part of their business. This is particularly the case in digital transformation, where longstanding industrial buyers seek to digitise their businesses through targeted acquisitions of technologically sophisticated companies. While not an entirely new trend, the COVD-19 pandemic appears to have accelerated this kind of M&A activity.
- Buyers are focusing on securing employee talent through targeted acquisitions, which has become particularly important in a challenging market for employee retention.
- Environmental, social and governance (ESG) considerations regularly drive target selection, divestment strategy, and deal terms. Companies seek to ensure their assets comply with increasingly standardised ESG legal requirements and stakeholder expectations. ESG also influences deal financing, with funding becoming increasingly limited for investments not considered ESG-friendly.

STRUCTURING AN ACQUISITION

Current Structures

2. What are the current trends in structuring private M&A transactions?

The traditional private M&A structures of share sale and asset sale remain widely used (see *Question 6* and*Question 7*). However, there are the following notable trends in structuring private M&A transactions in 2021 and early 2022:

- Carve-out transactions, minority investments, and joint venture structures have been prevalent to mitigate transaction risk (while achieving some of the objectives highlighted in *Question 1*). This is partly to generate funds due to recent economic challenges and ongoing challenges with company valuations.
- Alternative consideration forms such as earn-outs and escrow mechanisms have been useful for buyers to manage valuation risk after completion, including due to the COVID-19 pandemic.
- Increased scrutiny of foreign ownership, including the National Security and Investment Act 2021 (NISA) in the UK, has created an increased focus on foreign ownership restrictions in certain industry sectors, which can impact on deal structures and timing.

Terms and Documentation

3. What are the current trends in the terms and documentation of private M&A transactions?

The COVID-19 pandemic may have been expected to have a lasting impact on private M&A transaction documents but this has generally not been the case. Only limited specific provisions relating to COVID-19 have become common (for example, a carve out from pre-completion covenants).

Deal documentation has reacted to the increase in foreign investment regulation, with conditions to address the NISA in the UK and foreign investment regulations in other jurisdictions.

The authors are starting to see specific ESG-related warranties and covenants in deal documentation, which had previously largely been dealt with through general compliance warranties and covenants. The authors expect this trend to continue, as ESG legal requirements and stakeholder expectations become increasingly standardised and sophisticated.

Conduct of Transactions

4. What are the current trends in how private M&A transactions are conducted?

Logistical challenges due to the COVID-19 pandemic have altered, perhaps irreversibly, the way M&A transactions are conducted. Most recent private M&A transactions have been conducted entirely or almost entirely remotely, with limitations on face-to-face negotiations, site visits, and due diligence. While there is an expectation (and a desire from some practitioners) to return to conducting these processes in person, certain aspects are likely to remain virtual.

Another sign of the importance of ESG in private M&A transactions is the increased focus on specific ESG due diligence, including the use of

specialist ESG consultants. There are challenges due to the availability of useful ESG data in due diligence, particularly in emerging market transactions, but the authors expect this to improve.

A number of new (or improved) technology products have become widely available in M&A transactions, from data analytics to deal automation. Consistent with the broader M&A trend of digital transformation, the use of this kind of technology accelerated during the COVID-19 pandemic and the authors expect that trend to continue. M&A practitioners will need to be more aware than ever of cybersecurity concerns.

Corporate Entities

5. What are the main corporate entities commonly involved in private acquisitions?

In private acquisitions the buyer is typically a limited liability company, either public or private. If a limited liability company buyer does not have sufficient assets or is a newly created company, the seller will typically ask for a corporate guarantee from the buyer's owners.

The seller is usually a private limited company or a public limited company.

Ways to Acquire a Private Company

6. What are the main ways to acquire a private company? Which methods are most commonly used and in what circumstances?

Typically, a private company is acquired by buying all of its issued and to be issued share capital.

Any options that might be in issue (or agreed to be issued) need to be included in the acquisition, either following the exercise or by waiver of the options.

Share Purchases and Asset Purchases

7. What are the main advantages and disadvantages of a share purchase (compared to an asset purchase)?

Transfer of Assets/Liabilities

Share sale. In a share sale, all the target company's assets and liabilities are acquired. Appropriate due diligence must be carried out and a comprehensive list of warranties (and/or indemnities) must be obtained.

Asset sale. In an asset purchase, only identified assets and liabilities are acquired (other than those acquired by operation of law in relation to employees). A transfer of such assets and liabilities may require third party consent (depending on the terms of the assets and liabilities).

Where a business or undertaking transfers from one employer to another and retains its identity, the employment and employment terms of employees transfer automatically, by operation of law under the Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE). This applies to an asset sale where employees are involved and a business (or part of it) continues as a going concern post-closing. Exceptions to the application of TUPE are limited and it cannot be excluded.

TUPE also automatically transfers to the buyer most existing employment liabilities relating to the transferring employees. It is not possible to contract out of these provisions, although it is common for the buyer to seek indemnities from the seller for such pre-transfer liabilities.

Other assets and liabilities (including tax liabilities) do not automatically transfer. They must be specified in the asset sale agreement as an asset that is to transfer or a liability that is to be assumed, subject to any consent or approval that may be required. It is vital that the schedule of assets and assumed liabilities is clear so that there is no dispute as to what is transferred.

Complexity of the Transaction

Share sale. In a share sale, there is generally no need to consult with third parties or obtain consents to assign contracts, subject to any change of control provisions in documents such as contracts, licences, and so on relating to the target's business and any merger control issues.

There are usually no or very limited requirements to inform and/or consult trade unions/employee representatives in a share sale.

Asset sale. In an asset sale, most assets and liabilities do not automatically transfer (depending on their terms), therefore assignments of contracts and novations of liabilities are usually required. If an asset is not specifically included or a liability not specifically assumed in the asset sale, the buyer does not obtain title to the asset or the seller is left with the liability. This is sometimes dealt with through a "wrong pockets" clause in the agreement.

In an asset sale, there are usually requirements under TUPE to inform and consult trade unions/employee representatives. Affected employees must be identified early, in terms of potential liabilities and to enable compliance with informing and consulting obligations required by TUPE (see *Question 37*). Failure to do so can incur substantial penalties.

Tax Considerations

Broadly, sellers are likely to prefer a share sale due to tax considerations, although this must be evaluated in the circumstances of each deal.

At its simplest, a share sale involves the seller carrying out only one transaction in tax terms. It also offers a relatively clean break, as the target company remains primarily liable for its prior tax history following the sale (although the commercial effect of this can be largely reversed under a tax deed). Gains realised by a UK corporate seller of shares often benefit from the substantial shareholding exemption.

In an asset sale, a third-party buyer may benefit from a step up in the base cost of the assets (and amortisation relief for purchased intangible fixed assets), while a UK seller is typically subject to tax.

For further discussion of UK tax considerations, including stamp duty on share sales and stamp duty land tax on real estate transactions, see *Question 31* to*Question 36*.

Auctions

8. Are sales of companies by auction common? Briefly outline the typical procedure and any regulations that apply.

If a company is owned by a private equity sponsor, it is typically sold by auction but can also be sold in a bilateral deal. Equally, non-private equity sales can be bilateral transactions or by auction.

Generally, no particular English law rules or regulations apply to an auction (unless the parties agree otherwise). Most sellers (operating through their financial advisers) tend to follow a process similar to the following:

- An auction is conducted by a corporate finance adviser, who sends out a memorandum of interest. In the meantime, the seller puts together a data room, which is increasingly likely to be a virtual or digital collection of documents, containing confidential information about the target company.
- The corporate finance adviser then receives "outline bids" from interested parties, based on the initial information memorandum and limited information in the data room.
- Once a shortlist of buyers is identified they receive more confidential information, including the transactional documentation, which they are then required to mark up and resubmit with their final offer.
- A particular buyer is then chosen, who is usually given exclusivity and further confidential information about the target company.
- The final transactional documentation is then negotiated. In some cases, several bidders negotiate with the seller at the same time in a "contract race."

The seller will reserve the right to cancel the auction at any time and to structure a sale on an alternative basis.

Foreign Ownership Restrictions

9. Are there any restrictions on acquisitions by foreign buyers?

Depending on the market concerned there can be regulatory restrictions on foreign ownership of shares in UK companies. The UK has traditionally operated a relatively liberal regime in this respect. However, recent developments in UK national security policy and regulation mean that there is much greater scrutiny of an acquisition that may raise national security concerns.

Regulatory restrictions can arise for targets that operate in certain industries such as defence, energy, rail, financial services, and broadcasting.

Mandatory notification of proposed transactions is now required under the NSIA for targets or assets that fall within 17 prescribed sectors (see *Question 42*). If a private company target has significant contracts with government agencies, an acquisition of it by any buyer, including foreign or foreign-controlled buyers, must be checked carefully.

The Enterprise Act 2002 used to govern the UK's foreign investment review regime. NSIA has now largely replaced the role of the Enterprise Act 2002 in that regime. Previously, grounds for intervention under the Enterprise Act 2002 included public interest cases (section 42), special public interest cases (section 59), and protection of legitimate interests (section 67).

For a merger that raises public interest concerns (on financial stability, public health emergency, or media plurality grounds) the Secretary of State can issue a public interest intervention notice, requesting the *Competition and Markets Authority (CMA)* to prepare a Phase 1 report on the public interest issue (see *Question 40*). The CMA's report will provide a recommendation on whether the CMA has jurisdiction and if public interest concerns are raised. This can lead to the merger proceeding, to the agreement of undertakings offered by the parties or, if appropriate, to the Secretary of State referring it to the CMA for a Phase 2 investigation.

NSIA has very significantly strengthened the government's powers to scrutinise investments, particularly those that may give rise to a national security risk (see *Question 42*).

PRELIMINARY AGREEMENTS

10. What preliminary agreements are commonly made between the buyer and the seller before negotiating or executing the primary acquisition documents?

Letters of Intent

In a bilateral transaction, a letter of intent (or heads of terms) may be negotiated, which broadly sets out the main contractual terms of the intended sale. These terms typically include:

- The purchase price and any adjustments to it, for example use of locked box or closing accounts.
- Types of warranties that may be given.
- Non-compete covenants that may be given.

Letters of intent often include an indicative timetable and exclusivity and/or confidentiality (or non-disclosure) provisions. Other than in relation to confidentiality and exclusivity provisions, a letter of intent is not normally (and is specifically stated not to be) legally binding.

Exclusivity Agreements

These allow a buyer the right to negotiate exclusively for a period of time with the seller in relation to the acquisition. Typically, a seller will agree to terminate any current talks with third parties, not to solicit any further offers, and not to provide any information to any third party relating to the target.

Unlike in an agreement to negotiate, equitable relief is normally available for an exclusivity agreement, giving the buyer the right to seek an injunction to prevent or stop a breach by the seller. Alternatively, a buyer can seek damages, normally relating to costs incurred by the buyer in relation to the negotiations. It is important that not only the seller but also their advisers and the company's employees are bound by the exclusivity provisions.

An exclusivity agreement also often contains confidentiality provisions. The buyer will also want an exclusivity provision to apply for a longer period than it believes necessary to complete the transaction. A seller is keen to agree a shorter time period, to encourage the buyer to complete the transaction quickly.

Non-Disclosure Agreements

From a seller's perspective, it is important that the buyer maintains confidentiality in relation to the potential sale of the target and the information the seller provides about it. The seller is also keen to ensure that the buyer does not try to poach any employees nor approach any of the target's suppliers or customers.

Equitable relief is normally available in relation to confidentiality agreements, allowing the seller to seek an injunction to prevent breaches of the non-disclosure obligations. Non-disclosure agreements are increasingly mutual, so that the seller must also maintain confidentiality and not disclose any information the buyer may provide to the seller about its business. The seller and buyer will want to ensure that agents, advisers, and employees of the other side are also bound by the non-disclosure requirements.

If the transaction does not proceed, it is important that the seller can require the buyer to return all documentation that it has received, and to destroy any documentation it has derived from information

sent to it or which cannot be physically returned, including deleting copies of such information in its IT systems.

It is best practice to allow the ultimate buyer of a business to enforce any confidentiality obligations given by other potential buyers, sometimes by making the target a party to all confidentiality agreements between the seller and potential buyers.

DUE DILIGENCE

11. How is due diligence typically carried out and what main areas does it usually cover?

Buyers in private acquisitions often engage separate advisers to conduct commercial, legal, financial, and tax due diligence. Depending on the nature of the transaction, expert advisers may also be instructed to carry out specialist due diligence (for example, environmental or pensions).

The buyer and its financial advisers often perform an initial due diligence of the target company to understand its financial position and establish a proposed valuation of the target shares or assets. Once initial discussions have ended and the parties have executed any preliminary documents (such as heads of terms and non-disclosure agreements), the buyer typically sits down with its advisers to determine the scope of the due diligence to be performed before signing the acquisition agreement.

The scope of due diligence varies according to the parties, the type of business conducted by the target, its location, and the structure and value of the transaction. The parties must consider the costs, time, and resources involved in due diligence. It has become common for due diligence to focus on "red flags" or areas of concern that may affect the value of the target shares or assets or expose the buyer to liabilities, rather than reporting on every detail and aspect of the target or its assets. Buyers often set a materiality threshold under which any identified risks or liabilities are not subject to further analysis or investigation.

Typically, the buyer provides the seller with a due diligence request list to categorise and outline the information and documents that the buyer wishes to review. The buyer also reviews any publicly available information, such as filings and records at Companies House. The due diligence request list is typically a working document between the parties, in which the seller provides the relevant information and the buyer follows up with further questions or requests in the "Q&A process." The parties typically use a data room (usually virtual) to which documents or information can be added by the seller for review by the buyer.

The main areas of investigation in a due diligence exercise typically include:

- Share capital and corporate structure. Crucial in a share sale, corporate due diligence investigates:
  - whether the seller(s) has good title to the target shares free from encumbrances;
  - any issues with the share capital of the target and its subsidiaries (if applicable);
  - any options, warrants, and other rights or restrictions relating to the issuance, subscription, or transfer of the target shares; and
  - any issues with the target's articles of association and corporate authorisations.
- Financial advisers examine the target's accounts (and related auditors' reports), to understand the target's financial performance and determine any issues or risks in the accounts that require an adjustment of the initial valuation for the target shares or assets or contractual protections in the purchase agreement.
- Financial and legal advisers examine the target's financial arrangements to understand the target's creditors (or debtors) and how much debt the target has incurred or is owed. Legal advisers usually review the terms of any credit arrangements to which the target is a party or any debt instruments held or issued by the target, to understand their terms and impact on the transaction.
- Due diligence of business assets is particularly relevant in asset sales and buyers seek to identify all material fixed and current assets (such as plant, machinery, equipment, and stock) included in the sale, together with any associated defaults, liabilities, liens, or restrictions on transfer.
- Key contracts are examined to determine if there are any change of control provisions that give a party the right to vary or terminate the agreement. In an asset sale, key contracts are also examined to determine if there are any provisions restricting assignment and their consequences. Typically, buyers seek to identify any other potentially problematic areas such as exclusivity provisions, unusual payment, indemnity and penalty provisions, limitations on operational flexibility, and non-compete.
- Tax due diligence is typically done by financial advisers or accountants during the financial due diligence. It guides the parties when determining the transaction structure. It involves examining whether the target has complied with its tax obligations and identifying any past or potential tax liabilities.
- Intellectual property (IP) due diligence examines the nature, ownership, and status of any IP leased, owned, or used by the target or its business, the impact the transaction may have on such IP rights, and examining whether the target has complied with any arrangements for IP it leases or uses but does not own.
- To assess what employment and pensions liabilities the buyer will inherit on completion, a buyer will want to examine documents such as employee lists, employment policies, employment contracts, contractor agreements, offer letters, employee claims, collective bargaining agreements, pension plan documents, deferred compensation plans, and any other benefit plans or arrangements (such as medical and life insurance policies). TUPE may apply in an asset sale, so that employees transfer to the buyer on their existing terms of employment, together with related rights and liabilities.
- Real estate due diligence typically involves examining title to any real property owned by the target and any leases or licences entered into by the target that are part of the transaction, including any provisions relating to a change of control, restrictions on assignment, indemnities, and payment obligations.
- Environmental due diligence is typically carried out through a legal review of:
  - available documents on a target's site permits;
  - any regulatory enforcement or private claims concerning environmental matters; and
  - capital budgets and accounting reserves relating to the target's environmental projects and liabilities.

- In addition, a standard diligence tool is a Phase 1 and, if needed, Phase 2 environmental site assessment by an independent consultant on some or all of the target sites. Broadly, a Phase 1 assessment involves a fresh regulatory and public database review of a site (including its historical uses) and a site visit, to determine any environmental conditions that can present an obligation or liability. A Phase 2 assessment goes further to involve invasive sampling of soil and/or groundwater to determine the presence of pollutants.
- A recent additional due diligence trend is to review a target's record on environmentally sustainable practices and its greenhouse gas emissions footprint, often against the target's own voluntary benchmarks.

- A buyer will want to know if there is or has been any litigation, arbitration, or governmental proceedings to which the target or its directors have been a party, or whether any such proceedings have been threatened against the target or its directors.

CONSENTS AND APPROVALS

12. Briefly outline the main consents and approvals typically required for an acquisition.

Corporate Approvals

Both buyer and seller will need to seek board approval for the transaction, the various documents required to implement the transaction, and the entry into of those documents. The board will typically consider any advice, including financial, that it may have received in connection with the transaction and any representations, warranties, indemnities, and other commitments that the relevant company will be providing or receiving.

The board meeting or board resolution may also delegate signing authority for the transaction documents to specific directors or officers of the company, including, where appropriate, authority to agree any or certain modifications to the form of documents as reviewed and approved by the board.

In conditional acquisitions, further board meetings may be required at completion to deal with documents to be executed and handed over at completion, including, for the buyer, any documentation or steps required in connection with the issue or payment of consideration for the acquisition.

The target board will need to approve registration of the share transfer(s) that will follow completion of the transaction, as well as the associated board membership and other corporate changes (appointment of new directors, possible change of registered office and auditor, change of company name and amendment of bank authorities, and so on).

Shareholder Approval

The articles of association and any shareholders' agreement must be checked for any rights shareholders may have to make offers before a share transfer or other restrictions on share transfers.

If the target has a number of shareholders there could also be drag and tag-along rights:

- A drag-along right entitles a selling shareholder (usually the largest shareholder) to require all the other shareholders to sell their shares in connection with its sale of shares.
- A tag-along right entitles a shareholder to require a selling shareholder to include in its sale of shares the shares of that shareholder.

Recent cases indicate that these provisions are strictly construed by the courts so that, for example, a restriction on a transfer of an interest in a share does not catch a sale of an interest in the holder of that share. For such a transaction to be caught, the articles must contain appropriate provisions triggering transfer obligations on a change of control of (say) the relevant shareholder.

Other provisions may permit certain transfers between groups of shareholders or, for example, allow shareholders to grant certain security interests over their shares, often without triggering any of the above rights.

Following a Phase 2 referral (see *Question 40*), the Enterprise Act 2002 prohibits, except with the CMA's consent, any party to a completed merger from undertaking further integration or any party to an anticipated merger from acquiring an "interest in shares" in another. The CMA rarely grants such consent. The CMA can also restrain closing and order the unwinding of integration steps at any point in the merger review process.

Contractual Consents

See *Question 7, Complexity of the Transaction*.

As a matter of general law creditors do not need to be notified or give consent to a transfer of assets. However, the terms of the seller's loan and other creditor agreements must be checked to ensure that there are no restrictions or prior notification requirements in the agreement.

If a creditor has security over the assets to be transferred, it is necessary to inform the secured creditor of the sale and to obtain a release and confirmation of non-crystallisation of that security before the transfer of the asset. Such creditors can include a bank that has lent money to the seller, a landlord with a rent deposit, or a finance company providing assets through hire purchase or leasing arrangements. Leasing and hire purchase agreements must be novated by the third-party creditor for the buyer's benefit.

Where a deposit-taking business is being transferred under Part VII of the Financial Services and Markets Act 2000 (as amended), no creditor consents are required, although there is a requirement to advertise the relevant court hearings and creditors can attend and register grievances as part of the procedure.

Different considerations apply if the asset sale is through an administration or insolvency process, or if there is a pension scheme and the trustees have certain powers and rights to, for example, approve the asset sale.

Regulatory Approval

A share or asset sale can be subject to the approval of certain regulators or compliance with certain regulatory regimes, depending on the target and the parties. For example, a transaction:

- Within the UK national security review regime created by the NSIA (see *Question 42*).
- Qualifying as a "significant transaction" or "related party transaction" for premium listed sellers or buyers under the Listing Rules of the Financial Conduct Authority (FCA) or as a reverse takeover under the London Stock Exchange's AIM Rules of Companies (which require shareholder approval of the seller or buyer).
- Involving the acquisition of control of UK "authorised persons" (requiring approval by the FCA).
- By a person subject to restrictions on purchasing "significant assets" under Rule 2.8 of the UK Takeover Code.
- Subject to the UK's merger control regime (see *Question 40*).

MAIN DOCUMENTS

13. What are the main documents in an acquisition and who generally prepares the first draft?

In a share sale, typical documents include:

- The sale and purchase agreement (in an auction, usually prepared by the seller and in a bilateral arrangement, sometimes produced by the buyer).
- A disclosure letter qualifying the warranties, produced by the seller.
- A tax deed, under which the seller agrees to pay to the buyer amounts for pre-closing tax liabilities of the target (alternatively, this can be part of the sale and purchase agreement).
- Board minutes, dealing with the change of directors, bank auditors, and the registered office, and approval of share transfers on closing.
- Stock transfer form(s) to transfer shares.
- New employment contracts or similar (sometimes).
- Any change of control consents.
- Any release(s) of security documentation.

In an asset sale, there is also a sale and purchase agreement (sometimes called an asset sale or business sale agreement) to transfer the assets and liabilities. In an auction, this is produced by the seller and in a bilateral process it is sometimes produced by the buyer. In addition, there is usually:

- A disclosure letter qualifying the warranties, produced by the seller.
- Notices of assignment of contracts and/or novation agreements where necessary.
- Consultation documentation under TUPE.
- Assignments that may be required for registered IP, goodwill, software licences, and leased property.
- Transfers of freehold property, where relevant.

In both a share sale and an asset sale, transitional services agreements may be required, if the target company or the businesses being sold cannot operate on a standalone basis immediately following closing of the sale. The transitional service agreement often contains provisions relating to, for example, payroll, IT, insurance, legal, and administrative services, but this is highly transaction specific.

ACQUISITION AGREEMENTS

14. What are the main substantive clauses in an acquisition agreement?

In a share sale and purchase agreement typical provisions include:

- Definitions.
- The general obligation to sell and purchase the shares.
- Conditions and closing requirements.
- Warranties.
- Limitations on the seller's liabilities relating to the sale (for example, under the warranties).
- Any specific indemnities (the tax deed and certain other indemnities may be contained in separate deeds of indemnity).
- Non-compete restrictions.
- If appropriate, a parent company guarantee (usually in respect of the seller).
- Confidentiality restrictions.
- Boilerplate clauses relating to announcements, costs, interests, notices, assignments, third party rights, entire agreement, and further assurance.
- Governing law and jurisdiction clauses.

Typically, a share sale and purchase agreement contains schedules relating to:

- The sellers (if more than one).
- Details of the target company and its subsidiaries.
- Warranties.
- Closing arrangements and where applicable escrow arrangements.
- Conduct of the target's business between signing and closing.
- Any adjustment to the consideration by way of, for example, a working capital adjustment, any arrangements for an earn out, additional or deferred consideration, and limitations on liability.
- In "locked box" deals (with no adjustment to the purchase price following closing), any items of "permitted leakage" (outflows of money or assets from the target group permitted before closing without triggering a corresponding indemnity).

An asset sale and purchase agreement contains similar provisions but also contain provisions relating to:

- Consultation with employees under TUPE.
- Apportionments of prepayments, and so on.
- Assignment of contracts.
- Assumption of liabilities (including indemnities by the buyer for assumed liabilities and by the seller for any liabilities of the target's business excluded from the sale).

An asset sale and purchase agreement also contains:

- Schedules listing all the assets and liabilities and transferred employees.
- Provisions dealing with third party consents, for example in relation to contracts and leasehold properties.
- Provisions dealing with arrangements agreed for the seller's pension scheme (see *Question 39*).

WARRANTIES AND INDEMNITIES

15. Are seller warranties/indemnities typically included in acquisition agreements and what main areas do they cover?

Warranties and indemnities are an important part of any acquisition agreement, in a share sale and an asset sale. In a share sale, warranties typically cover:

- The company's share capital and group structure.

- Capacity of the seller(s) to enter into the agreement and sell.
- Financial accounts and records.
- Other information (possibly contained in a data room or the disclosure letter).
- Changes since the accounting date.
- Assets, such as unencumbered title, condition, and adequacy for the target's current business.
- IP rights.
- Computer systems.
- Employees.
- Pensions.
- Contracts, including suppliers and customers.
- Insurance.
- Litigation/disputes/investigations.
- Tax.
- Environmental issues.
- Compliance with laws.
- Anti-bribery compliance.
- Insolvency.
- Change of control provisions and other effects of the sale on the target's business.

In a share sale, there is also likely to be a separate tax deed for tax matters (see *Question 13*).

In share sale and purchase agreement, remedies for breach of warranties are often left subject to common law principles. If there is a breach of warranty, subject to any agreed limitations on the seller's liability, the measure of damage is the diminution in value of the shares acquired.

In an asset sale, warranties are similar but focus on the assets and liabilities acquired. The measure of damage for breach of warranties in an asset sale is, in principle, usually the same as for a share sale, unless the parties agree a different measure (for example, damages on an indemnity basis for any missing or "damaged" assets).

16. What are the main limitations on warranties?

Limitations on Warranties

Limitations on warranties typically include:

- Time periods in which a claim can be made (see *Question 17*).
- A cap on liability, which typically can be between 30% and 100% of the consideration but is often closer to 50% (or even less) other than for fundamental warranties on ownership.
- De minimis levels before claims can be made, on an individual and an aggregate basis.
- Provisions on how to conduct a dispute that may arise relating to a breach of warranty and a third-party claim.
- A general obligation to mitigate any loss suffered.
- Matters disclosed in the disclosure letter.

Other restrictions include:

- The seller qualifying warranties within the knowledge of certain individuals.
- Preventing double recovery and requiring credit to be given for certain provisions or reserves in accounts.
- Requiring the buyer to exhaust its rights against insurers and other relevant third parties.
- Excluding the seller's liability for contingent claims until or unless they become actual.
- In some circumstances, limiting the buyer's right to recovery by way of the buyer's knowledge (this is often resisted).

Certain core or fundamental warranties (for example, relating to the seller's title to the shares or assets sold) are typically not subject to the same limitations as apply to "business warranties."

Qualifying Warranties by Disclosure

Warranties are normally qualified by way of a disclosure letter, that is, they are given subject to matters (usually stated to be "fully and fairly") disclosed in the disclosure letter. A warranty can within its wording be absolute, but the seller can qualify the warranty by informing the buyer through a disclosure letter of issues relating to the warranty. For example, if a warranty states that there is no relevant litigation and the disclosure letter lists litigation that actually exists.

Typically, there are both general disclosures, for example, disclosures of matters in public records, the Companies Registry, or Land Registry, and specific disclosures relating to specific warranties.

To the extent that a matter is disclosed and therefore qualifies the warranties, no claim can be made in relation to the warranties to the extent of the disclosure.

The sale agreement usually contains a definition of what is deemed to be a disclosure or disclosed and requires this to meet a "full and fair" disclosure test. For example, by requiring any disclosures to be "disclosed in such a manner and with such detail as to enable the buyer to make a reasonable informed assessment of the fact, matter, or information concerned, its nature, and effect."

17. What are the remedies for breach of a warranty? What are the time limits for bringing claims under warranties?

Remedies

Remedies are typically on a common law basis or if the parties agree in the documentation on an indemnity basis.

At common law, if there is a breach of warranty, subject to any agreed limitations on the seller's liability, the measure of damage is the diminution in value of the shares or assets acquired.

An indemnity basis of recovery covers the cost of remedying the breach, irrespective of whether there has been a diminution in value of the shares or assets acquired.

Time Limits for Claims Under Warranties

These are open to negotiation between the parties. The time limits for non-tax warranty claims cover at least the first (and often the second) audit of the target under its new ownership and can extend up to three years for general warranties.

The time limit for tax claims (under the tax warranties and the tax deed) is typically longer and can extend up to six or seven years in UK deals (or the statute of limitations in other jurisdictions such as the

US). Other areas such as environment and IP may also have longer time limits.

In an asset sale, there may be a shorter time limit for general warranties because only identified liabilities and identified assets transfer. A buyer should be able to identify in a shorter time whether any of the warranties have been breached.

SIGNING AND CLOSING

Conditions Precedent

18. What common conditions precedent are typically included in a private acquisition agreement?

Conditions precedent are highly transaction and leverage specific, but may include, among others:

- Shareholder approval.
- No material adverse change since the sale agreement was signed.
- Approval of competition authorities.
- Tax clearances (normally for the benefit of sellers).
- Reorganisation of the target business.
- Any industry specific consents.
- Any third-party consents, for example, change of control provisions in a contract or from a regulator.

It is not typical in the UK for there to be a financing or board approval condition. These are normally expected to have been obtained before signing.

Main Steps at Signing and Closing

19. What are the main steps at signing and closing in a private share sale and asset sale? What main documents are commonly produced and executed?

Signing

If there is a gap between signing and closing, at signing the sale and purchase agreement and the disclosure letter are signed. Other documents are usually in agreed form. Typically, board resolutions approving the documentation that is being entered into and the transaction overall are also signed at this stage.

Closing

In a share sale, the following are often produced and executed on closing:

- Stock transfer form(s).
- Any waivers or consents to give full and legal beneficial title.
- Resignation letters of officers and appointment letters for new officers.
- New bank mandate forms.
- Board meetings and minutes to record the formal transfer and resignations and appointments.

In an asset sale, the following are also typically produced on closing:

- Title documents for all the assets being transferred. For example, in relation to real estate, original documentation and any assignment of a leasehold interest or transfer of freehold property.
- Duly executed assignments of business IP rights.
- Consents from any third party to the assignment of IP licences.
- Consents to assignment of any IT contracts and consequential licence arrangements.
- Assignments of any contracts being transferred or novations.
- Evidence of release and discharge of any security over relevant assets.

Execution of Documents

20. How are documents executed by companies in your jurisdiction? Are there specific formalities to execute certain types of documents?

Most transaction documents can be executed by a company under hand or as a deed.

If executed under hand, the documents simply need to be signed by an authorised officer (and are usually supported by an appropriate board minute).

If executed as a deed, the documents must be signed by two authorised signatories (two directors or a director and the company secretary) or by one director in the presence of a witness (usually supported by an appropriate board minute).

It should be clear that the entire document was joined together upon execution (physically or circulated as an entire document by e-mail in accordance with The Law Society practice note *Execution of documents by virtual means*) (that is, that signature pages are not signed separately and then attached to the relevant document).

Documents can also be executed under the company's common seal (if the company has one).

In England and Wales, there is no need to have such executions formally notarised.

It is generally sufficient for foreign companies to simply execute documents in accordance with their own charter and laws. Typically, a legal opinion is sought on the validity of the signature and enforceability of the contract.

21. Are digital signatures binding and enforceable as evidence of execution?

Electronic or digital signatures are binding and enforceable as evidence of execution. They are admissible in evidence in legal proceedings in relation to any questions about the authenticity of the signatory. The Electronic Communications Act 2000 provides for the admissibility of electronic signatures as evidence in relation to the authenticity of communications and so on.

In addition, Regulation (EU) No. 910/2014 on electronic identification and trust services for electronic transactions in the internal market provides that an electronic signature will not be denied legal effect and admissibility as evidence in legal proceedings solely on the grounds that it is in electronic form or does not qualify as a "qualified electronic signature." Under this Regulation, a qualified electronic signature has the legal effect of a handwritten signature and is an electronic signature which, among other requirements, must be uniquely linked to the signatory. However, qualified electronic signatures are little used in England and Wales. The Law Society practice note *Execution of a document using an electronic signature*

should be borne in mind when parties propose to execute a document using electronic signatures.

Transferring Title to Shares

22. What formalities are required to transfer title to shares in a private company?

To transfer title to shares in a private limited company:

- A stock transfer form must be signed.
- Stamp duty arising on the stock transfer form must be paid and a copy of the executed stock transfer form submitted electronically to HM Revenue and Customs (HMRC) (see *Question 31*).

The register of members can only be updated after HMRC have checked and confirmed due receipt of the submission and appropriate payment and the transfer has been approved by the company's board.

Under the Companies Act 2006, legal ownership of shares is determined by entries in the company's register of members. Until the register of members is updated, the buyer has beneficial ownership of the shares, and normally obtains a power of attorney from the seller to exercise any rights of the legal owner it needs for the shares.

An acquisition of a UK company is also likely to require updating of the company's register of people with significant control over it (as well as certain other registers of the company).

Seller's Title and Liability

23. Are there any terms implied by law as to the seller's title to the shares in a share sale? Is any specific wording necessary and do buyers normally impose a higher standard than is implied by law?

Where the sellers are stated in the sale agreement to be selling the shares or assets with "full title guarantee," the following covenants are implied into the sale:

- The seller has the right to make the sale.
- The seller will make reasonable efforts to pass title to the buyer at its own cost.
- The shares or assets being sold are free from charges, encumbrances, and adverse rights, other than those that the seller does not know about or could not reasonably be expected to know.
- Certain additional implied covenants, in a sale or transfer of real property.

As a buyer is not usually prepared to accept the above "reasonable efforts" or "known encumbrances" limitations, the sale agreement usually contains an express and unqualified covenant as to the seller's title to the shares or assets.

24. Can a seller and its advisers be liable for pre-contractual misrepresentation, misleading statements, or similar matters?

Seller

Sellers can be liable for a pre-contractual misrepresentation, misleading statements, or negligent or fraudulent representations. However, an entire agreement clause is typically included in the sale documentation, with a specific exclusion of any pre-contractual misrepresentation, misleading statements, or similar matters, so that the only actionable statements made in relation to the target are those contained in the sale documentation. However, fraudulent misrepresentation cannot be excluded by contract.

Advisers

To the extent that advisers are negligent, they could be liable for negligent misstatements. As agent for the seller (or buyer), their misrepresentations could lead to liability for the seller as if the seller (or buyer) had made such statements themselves (see above, *Seller*).

They may also incur liability to their client, the seller (or buyer), on similar grounds. However, typically, an adviser will exclude that liability in its engagement letter with their client and obtain an indemnity against any claims made by a third party.

GOVERNING LAW AND ARBITRATION

25. Can a share purchase agreement provide for a foreign governing law? Is an arbitration provision usually included in private M&A documents?

Choice of Law

Contracting parties are generally free to agree and specify in their share purchase agreement the governing law that applies to the agreement. This could be the law of the target asset, the law of the place of incorporation of any of the contracting parties, or another law.

English law is one of the most common governing laws chosen by parties for international commercial contracts, due to its transparency, predictability and stability, respect for freedom of contract, and pro-business approach. English law is often chosen to govern transactions with no connection to the UK.

Mandatory provisions of English law might still apply despite a choice of a foreign governing law, for example in relation to employee consultation, formalities to transfer assets or shares, execution of legal agreements, and certain corporate issues, such as financial assistance and UK corporate parties (see *Question 30*).

In relation to applying foreign law, enforcement provisions also need to be considered, for example, grounds on which an English court will not apply a foreign law (because it was contrary to public policy and so on), and relevant treaties on enforcing foreign judgments.

Arbitration

It is common for arbitration provisions to be included in private M&A agreements, particularly transactions with a cross-border element. Disputes about M&A agreements are a significant proportion of cases administered by arbitral institutions. The advantages of arbitration often align with the structure of M&A transactions, for example the parties' desire for confidentiality, the finality of arbitration awards, and the ease with which arbitration awards can be enforced in the UK and internationally.

For institutional arbitrations, the *LCIA* and *ICC* rules are common. For ad hoc arbitrations, the UNICTRAL rules are popular.

Arbitration clauses are enforceable in England and Wales. The courts strive to uphold arbitration agreements and to prevent litigation in breach of arbitration agreements.

Arbitral awards issued in England and Wales are generally enforceable in other states that are party to the *New York Convention*, and awards made in those states are generally enforceable in England and Wales.

CONSIDERATION AND ACQUISITION FINANCING

Forms of Consideration

26. What forms of consideration are commonly offered in a share sale?

Forms of Consideration

By far the most typical form of consideration is cash. There may be a cash retention or escrow against warranty claims. In addition to cash, from a tax planning perspective, sellers may prefer to receive loan notes and sometimes equity is also offered.

Factors in Choice of Consideration

Typically, these are driven by the seller's tax planning. If a seller wants to defer some of the capital gains that may arise on the sale of the shares, instead of cash the seller may wish to receive securities that allow capital gains to be deferred. These securities can be loan notes or equity.

From a buyer's perspective, there is often little tax advantage in any particular structure. However, if the buyer can defer some of the payment of cash, this may be attractive from a treasury perspective.

Price Adjustments and Deferred Consideration

27. How is the price typically assessed and agreed? Is the price commonly adjusted?

There are two main pricing mechanisms used to determine the price payable for target shares or assets: a locked box and completion accounts.

In a locked box mechanism, the price is fixed in the acquisition agreement based on recent historical reference accounts drawn up to a date prior to signing ("locked box date"). The buyer then relies on contractual protections to preserve the value of the shares or assets underlying the agreed price between the locked box date and closing. The acquisition agreement typically provides a list of items that are "leakage" (namely, a transfer of value from the target to the seller and its connected parties) and "permitted leakage." The seller provides an indemnity to the buyer for any leakage occurring between the locked box date and closing. Post-closing, the price is not usually subject to any adjustments other than for leakage claims.

Where completion accounts are used, the actual price of the target shares or assets is calculated after closing by reference to completion accounts. These are accounts relating to the target or its business drawn up to the closing date in accordance with a methodology pre-agreed by the parties in the acquisition agreement. Since the actual price is not known at the time of closing, the buyer usually pays an estimate of the price on closing. Post-closing, the estimated price is adjusted to reflect the actual price calculated according to the completion accounts. If the actual price is higher than the estimated price, the buyer makes a top-up payment to the seller equal to the difference. If the actual price is lower than the estimated price, the seller repays the difference to the buyer.

A fundamental difference between these two pricing mechanisms is the date on which economic risk transfers. In a locked box structure, it passes on the locked box date. In a completion accounts structure, it passes on closing.

Completion accounts are typically viewed as more buyer-friendly and as the default mechanism for price adjustment. However, in recent years, the locked box mechanism has become more widespread. In practice, which structure is used depends on a variety of factors, including price certainty, level of due diligence performed, costs, speed of execution, potential for post-closing disputes, availability of third-party financing, and so on.

In certain circumstances, the parties may agree a hybrid mechanism, incorporating aspects from both locked box and completion accounts mechanisms and/or additional forms of price-adjustments. Examples include:

- Earn outs, which provide for a future payment to the seller if the target achieves certain pre-defined financial or operational objectives after closing (usually where parties are unable to agree a valuation of the target's shares or assets before signing).
- Anti-embarrassment provisions, which require a buyer to provide the seller with an additional payment if the target shares or assets are sold to a third party at a higher price within a certain period after closing.

28. Do buyers typically pay the price in full on closing, or is deferred consideration common?

Sellers often prefer the price for the target shares or assets to be paid in full on closing (subject to post-closing adjustments where a completion accounts pricing mechanism is used). However, the price may include a deferred element for a variety of reasons, including:

- If part of the price is contingent on the performance of the business or certain events occurring post-closing (for example, if the parties have agreed an earn out or an anti-embarrassment provision).
- If the buyer has insufficient cash resources to fund the price and is unable or unwilling to raise external finance. In this case, the parties may agree that the buyer pays the price in instalments or, more commonly, the buyer issues loan notes to the seller (usually interest bearing and redeemable at a fixed date).
- In certain circumstances, the buyer may request that part of the price payable on closing is retained in escrow. This usually occurs if the buyer has concerns about the seller's financial substance and wishes to ensure performance of the seller's potential post-closing obligations (for example, payment obligations under warranty or indemnity claims).
- Where completion accounts are used, the parties may also agree to a retention arrangement, to ensure that their potential payment or repayment obligations following the adjustment of the price after closing are performed.

29. If a buyer listed in your jurisdiction issues shares to raise cash to acquire a private company, how is the issue typically

structured? What consents and regulatory approvals are required?

Typical Structures

The main ways for a UK-listed company to raise equity finance are a rights issue, open offer, placing, or vendor placing.

A listed company needs to consider the impact of a fundraising on its existing shareholders, and whether it should be:

- Pre-emptive, through a rights issue or an open offer.
- Non-pre-emptive, through a placing or vendor placing.

Small acquisitions are likely to be done by a non-pre-emptive placing. To do this, the company must obtain the shareholder authorisations for share issues under the Companies Act 2006, for the board to issue shares and for the issue to be made on a non-pre-emptive basis.

Vendor placings can be used irrespective of whether the board has authority to issue shares on a non-pre-emptive basis. A vendor placing is not a cash issue for the purposes of section 561 of the Companies Act, as the shares are issued in exchange for shares and not for cash. In a typical vendor placing:

- The buyer issues shares that are allotted to the seller in exchange for shares in the target.
- The shares allotted to the seller are placed in the market by the buyer's bank on the seller's behalf, and the seller receives cash from that placing.

Premium listed companies must also follow requirements of the FCA's Listing Rules on rights issues, open offers, and placings, and the share capital maintenance and pre-emption requirements of the Investment Association and the Pre-emption Group.

Consents and Approvals

Any necessary shareholder approval or authority for an equity financing issue must be obtained (see above, *Typical Structures*).

If the acquisition is of a certain size, a premium listed company may also have to obtain shareholder approval for the acquisition or disposal. If, under certain percentage tests, the calculation is 25% or more, it is necessary to obtain shareholder approval. The tests are:

- Gross asset test: dividing the gross assets subject to the transaction by the gross assets of the listed company.
- Profits test: dividing the profits attributable to the assets subject to the transaction by the profits of the listed company.
- Consideration test: taking the consideration for the transaction as a percentage of the total market value of the listed company's ordinary shares.
- Gross capital test: dividing the gross capital in the company being acquired by the gross capital of the listed company.

A prospectus may be required for the share issue if the acquiring company's equity financing involves an offer to the public or an admission of shares to trading on a regulated market (such as the London Stock Exchange's Main Market). Different exemptions apply, depending on whether the shares are offered to the public or admitted to trading on a regulated market. For example, the following does not require a prospectus:

- An offer of shares to fewer than 150 persons per EEA member state or solely to "qualified investors."
- An admission of shares to trading that represent, over a period of 12 months, less than 20% of shares of the same class of the issuer already admitted to trading.

Financial Assistance

30. Can a company give financial assistance to a potential buyer of shares in that company?

Generally, private companies can give financial assistance for the purchase of shares in themselves.

A private company cannot directly or indirectly give financial assistance for the purchase of shares in its public holding company (or a reduction of liability incurred for the purposes of such an acquisition).

A public company cannot directly or indirectly give financial assistance for the purchase of its own shares or shares in its private holding company (or a reduction of liability incurred for the purposes of such an acquisition).

Financial assistance includes granting security over assets, repayment of existing indebtedness, selling assets at the time of the acquisition of the shares, and any other material financial assistance.

Even where financial assistance can be given, the directors must generally be satisfied that the assistance is given in good faith in the interests of the company, and otherwise is consistent with their duty to act in a way that they consider in good faith would most likely promote the success of the company for the benefit of its members as a whole.

TAX

Transfer Tax

31. What transfer taxes are payable on a share sale and an asset sale? What are the applicable rates?

Share Sale

Subject to certain exceptions, stamp duty and/or stamp duty reserve tax is payable on a share sale, at the rate of 0.5% of the consideration paid for the shares (for stamp duty, the consideration paid for each stock transfer form is rounded up to the nearest GBP5).

A copy of the executed stock transfer form must be submitted electronically and payment of the stamp duty made to HMRC. HMRC can then check and confirm that, following due receipt of the stock transfer form and payment, the stock transfer form is treated as duly stamped.

Asset Sale

Stamp duty land tax is payable on a transfer of real estate. It is charged as a percentage of the amount of consideration paid and allocated to the real estate, at the following rates for commercial real estate (different rates apply to residential real estate):

- The portion up to GBP150,000: nil.
- Any portion over GBP150,000 up to GBP250,000: 2%.
- Any portion over GBP250,000: 5%.

If a new leasehold interest is granted to a buyer (instead of transferring an existing interest in land), duty is charged on the "net present value" of the rents reserved under the lease (according to a formula set out in the relevant legislation), as follows:

- The portion up to GBP150,000: nil.
- Any portion over GBP150,000 up to GBP5 million: 1%.
- Any portion over GBP5 million: 2%

Stamp duty land tax is also payable on any premium paid on the grant of the lease, at the rates set out above for commercial real estate.

32. What are the main transfer tax exemptions and reliefs in a share sale and an asset sale? Are there any common ways used to mitigate transfer tax liability?

Share Sale

No stamp duty is generally payable if the consideration for the shares is up to GBP1,000. Otherwise, there are no stamp duty exemptions or reliefs available to a third party/unconnected buyer on a share sale.

Under general stamp duty principles, if the buyer agrees to discharge the target company's/group's debt, this forms part of the consideration for the shares it acquires and is subject to stamp duty. However, it may be possible to restructure such an obligation or agreement so that this element is not subject to stamp duty.

There is no stamp duty on shares quoted on growth markets such as the London Stock Exchange's Alternative Investment Market and Euronext Growth Dublin. To qualify for recognition by HMRC as a "recognised growth market," a market must be a "recognised stock exchange" and satisfy certain other requirements about the average market capitalisation and history of growth of companies trading on the market.

A targeted market value rule charges stamp duty and SDRT on transfers of listed securities to connected companies by reference to deemed consideration equal to the higher of the market value of the listed securities transferred and consideration paid (if any).

A similar deemed consideration rule applies to a transfer of unlisted securities to a connected company where some or all of the consideration for the transfer of the unlisted securities consists of the issue of shares.

Asset Sale

There are no stamp duty land tax exemptions or reliefs available to a third party/unconnected buyer acquiring real estate as part of an asset sale.

It may be possible to mitigate liability by apportioning consideration away from any real estate to other assets. However, this must be done on a just and reasonable basis. If not, the relevant legislation will re-allocate the consideration on this basis to determine stamp duty land tax liability.

Corporate Taxes

33. What corporate taxes are payable on a share sale and an asset sale? What are the applicable rates?

Share Sale

Corporation tax is payable by a corporate seller on a gain made on a share sale. Broadly, this is the difference between the amount paid for the shares and the amount received on the sale.

The current main rate of UK corporation tax is 19% for non-ring fence profits (the main rate increases to 25% with effect from 1 April 2023).

Asset Sale

Corporation tax is payable by a corporate seller on income profits and gains arising on an asset sale, at the same rates (see above, *Share Sale*).

It is determined by the nature of the assets sold (for example, capital assets and trading stock), their tax value, and the amount of the consideration allocated to them.

34. What are the main corporate tax exemptions and reliefs in a share sale and an asset sale? Are there any common ways used to mitigate corporate tax liability?

Share Sale

A gain made by a corporate seller is exempt from UK corporation tax if the disposal qualifies for the UK's substantial shareholding exemption. In outline, the basic conditions that usually need to be satisfied to qualify for this exemption are:

- The seller holds at least 10% of the ordinary share capital of the company being sold throughout a 12-month period, beginning no more than six years before the date of disposal (and is beneficially entitled to at least 10% of the profits available on distribution and assets available on a winding up to the equity holders of the company). Alternative conditions may be available if the seller is at least 25% owned by certain types of institutional investors.
- The company being sold must have been a trading company (or the holding company of a trading subgroup) from the beginning of the ownership period set out in the bullet point above until the time of the disposal. In limited circumstances (for example, if the disposal is made to a connected buyer), this must also be the case immediately after the time of the disposal.

Asset Sale

There are no specific exemptions or reliefs available on an asset sale to a third party/unconnected buyer. However, a seller can try to minimise corporation tax that would otherwise arise on the sale, for example:

- The seller can try to allocate more consideration to assets with a higher tax base cost (to reduce the amount of gain arising).
- If the seller has unused capital losses, it may consider allocating more consideration to capital assets if gains arising can be offset by those losses.
- Reducing the consideration allocated to stock, which is otherwise treated as taxable trading income, unless the seller has unused trading losses that could be set against this income.
- Reducing the consideration allocated to plant and machinery to increase allowances or reduce charges under the UK's capital allowances regime.
- Increasing the consideration allocated to land, fixed plant and machinery, and IP, if the seller intends to reinvest part of the consideration in similar replacement assets that qualify for rollover relief. This would defer any tax charge until a subsequent disposal of the replacement assets.

However, each must be balanced with the buyer's tax position/objectives. The amounts allocated to the various assets form the buyer's tax base cost in those assets, and impact on the amount of tax allowances available to it. It also potentially affects the amount of stamp duty land tax payable by the buyer (see *Question 31*).

Other Taxes

35. Are other taxes potentially payable on a share sale and an asset sale?

Value added tax (VAT) may be payable by a buyer on an asset sale if it does not qualify as a transfer of a going concern. This may be an absolute cost to a buyer if it cannot recover all of its input VAT. A share sale is VAT exempt.

Tax Group Consolidation

36. Is tax consolidation of corporate groups possible in your jurisdiction? Are companies in the same group able to surrender losses to each other for tax purposes?

Companies in the same group relief group are generally able to surrender losses for tax purposes. Losses available for surrender in this way include trading losses and, for example, losses generated in a bid vehicle through payment of interest expenses.

However, some restrictions can limit this ability. In particular, companies are not able to surrender capital losses (although in practice there are other ways to enable companies to access capital losses of other members of their group).

Losses can be carried forward and offset against profits from other income streams or which accrue to other affiliates. However, companies can only use carried-forward losses against up to 50% of their taxable profits in any given period (that exceed a GBP5 million group allowance). Special rules apply to the oil and gas ring fence regime. From 1 April 2020, the use each year of carried-forward capital losses of companies is also restricted to 50% of the capital gains realised in the year. The same GBP5 million group allowance which applies to income losses is also available to cover capital losses.

Further, interest cap rules restrict the amount of a group's UK tax deductions of corporate interest payments to, very broadly, 30% of a group's UK EBITDA (or, potentially, the group's worldwide ratio of net interest expenses to EBITDA, if that exceeds 30%), subject to a de minimis of GBP2 million of net UK interest expenses.

In short, deductions for interest expenses on bid financing can be carried forward against future operating profits if they are not used in the year they arise, but there is a 50% cap on carry-forwards and a general cap by reference to EBITDA.

EMPLOYEES

Information and Consultation

37. Are there obligations to inform or consult employees or their representatives or obtain employee consent to a share sale or asset sale?

Asset Sale

Where employees are involved in the sale, TUPE requires both the seller and buyer to inform and potentially consult with employee representatives. This is in addition to obligations under TUPE that require the seller to provide employee liability information to the buyer.

Appropriate employee representatives can be a recognised trade union or elected employee representatives. An employer with fewer than ten employees can inform and consult directly with the employees if there are no representatives. The representatives of all employees affected by the sale, including those not transferring, must be provided with specified information, including when the sale is due to take place, the reasons for it, and the likely impact on them.

The buyer must also inform the seller of any post-transfer measures it envisages due to the asset sale that will affect the transferring employees, for example redundancies, changes to employee benefits, or different working arrangements. Where any such measures are anticipated, this triggers an additional obligation under TUPE to consult with the employee representatives.

No specific timeframe for completing the informing and consulting exercise is prescribed by TUPE, except that the duty to inform employee representatives must be undertaken long enough before the sale/transfer to enable adequate consultation to take place, where it is required. Where there is a gap between signing the sale agreement and closing, the informing and consulting exercise is typically carried out during this period.

TUPE permits the buyer to undertake consultation on planned post-transfer redundancies directly with representatives of the seller's employees before the transfer, subject to conditions including the seller's consent.

Employee consent to an asset sale is not required but TUPE does allow employees to object to the transfer of their employment. In that event, and assuming there is no underlying claim for unfair dismissal, the employees are deemed to have resigned with effect from the transfer date without any rights to severance payments.

Share Sale

In employment terms, a share sale does not involve a change in employer. As a result, the employees' contracts continue and there is no statutory obligation to inform or consult employees. There is also no need to obtain employee consent.

However, an obligation to inform and/or consult employees under TUPE could still apply before or following a share sale, for example, if an asset sale precedes the share sale or the employees transfer to a holding company following the share sale. Any agreements with trade unions or employee representatives should also be checked to ensure that they do not require consultation in a share sale, although this is rare in practice.

Transfer in a Business Sale and Other Protections

38. Are employees automatically transferred to the buyer in a business sale? What other protection do employees have against dismissal in the context of a share sale or asset sale?

Transfer on a Business Sale

TUPE applies to an asset sale where employees are involved and a business (or part of it) constitutes an economic entity and retains its identity after closing. Exceptions to the application of TUPE are limited and any attempts to exclude it are void.

Where TUPE applies, the employment and employment terms of the employees, along with most of the seller's related liabilities, transfer automatically to the buyer by operation of law.

In this case, the transfer itself cannot be legitimate grounds for dismissal. Dismissal of transferring employees due to the transfer is automatically unfair (a liability which itself transfers to the buyer) unless the employer can establish an economic, technical, or organisational reason entailing changes in the workforce. Redundancy is such a reason but the seller cannot simply dismiss transferring employees because the buyer wants to take the business

with fewer employees. The buyer must show genuine organisational or structural changes in its own business.

Other Protections

In employment terms, a share sale does not involve a change in employer. The employees' contracts continue, and any associated or contemporaneous dismissals are subject to the normal unfair dismissal rules.

PENSIONS

39. Do employees commonly participate in private pension schemes established by their employer? If an employee is transferred as part of a business acquisition, is the transferee obliged to honour existing pension rights or provide equivalent rights?

Private Pension Schemes

Participation rates vary between employers. However, the vast majority of employees participate in a workplace pension scheme, due to automatic enrolment which applies to all employers in the UK.

Employers must automatically enrol eligible workers into a workplace pension scheme and pay a minimum level of contributions or provide a minimum level of benefits. Workers can opt-out after they have been automatically enrolled.

Pension schemes are either personal pensions provided by a financial services provider or occupational schemes. An occupational scheme is either set up by the employer itself or its group, or increasingly is under an authorised master trust operated by a financial services provider.

Pensions on a Business Transfer

Unlike most employment terms, rights to old-age, invalidity, and survivors' benefits under an occupational pension scheme do not transfer to the new employer on a business transfer covered by TUPE. Therefore, if the former employer operated an occupational pension scheme for its staff, the right to those benefits does not generally transfer under TUPE.

However, in a series of cases, the Court of Justice of the European Union has held that the right to a benefit under an occupational pension scheme that is not an old-age, invalidity, or survivors' benefit, such as pensions payable on redundancy or early retirement, do transfer under TUPE and can be enforced against the new employer. These are commonly referred to as Beckmann and Martin rights, after the cases that established this principle. A buyer will often seek an indemnity from the seller for any such rights that may transfer but sellers increasingly push back on the grounds that the risk of claim is usually very low.

In addition, if the former employer provided the transferring employees with access to an occupational pension scheme to which it contributed, the new employer must (at minimum) provide the transferring employees with access to a pension scheme. Under this scheme, the new employer must pay employer contributions that either match the employee's contributions up to 6% of basic pay or provide the same employer and employee contribution rates as the former employer provided.

Alternatively, if the transferring employees have a contractual right to join a contract-based pension scheme (such as a group personal pension scheme or a self-invested personal pension) and to receive employer pension contributions, that contractual right will transfer and be enforceable against the new employer under TUPE. In addition, any other contractual pension entitlement rights of a transferring employee are enforceable against the new employer under TUPE.

The pension provided by the buyer may not be exactly the same as the seller's, particularly if it is with a different provider, and may give rise to different charges and a different default fund. If these are significant, they may be measures in a TUPE context.

Following a business transfer, the new employer must comply with the automatic enrolment requirements for the transferring employees immediately after the transfer.

COMPETITION/ANTI-TRUST ISSUES

40. Outline the regulatory competition law framework that can apply to private acquisitions.

EU Competition Law

Under the EU Merger Regulation, there is a mandatory notification and clearance requirement for concentrations with an EU dimension. The jurisdictional thresholds for notification to the European Commission are either (unless, in either case, each of the parties achieves two-thirds of its EU turnover in one and the same EU member state):

- The combined worldwide turnover of the parties exceeds EUR5 billion and the EU-wide turnover of at least two of the parties exceeds EUR250 million.
- All the following conditions apply:
  - combined worldwide turnover exceeds EUR2.5 billion;
  - EU-wide turnover of at least two of the parties exceeds EUR100 million each;
  - combined turnover in each of at least three member states exceeds EUR100 million; and
  - turnover in each of those three member states by each of at least two of the parties exceeds EUR25 million.

The substantive test for clearance is whether the concentration will significantly impede effective competition in the EU or a substantial part of it, in particular by creating or strengthening a dominant position.

Since the end of the UK's Brexit implementation period (31 December 2020), mergers are no longer subject to the EU's "one-stop shop" jurisdictional principle in relation to the UK. The CMA can investigate mergers that satisfy the EU thresholds set out above in parallel with the European Commission where the UK jurisdictional thresholds are also met (see below, *UK Competition Law*). The European Commission also no longer has jurisdiction to investigate the substantive effects in the UK of any mergers, with the CMA having jurisdiction (if the thresholds under the Enterprise Act 2002 are met).

UK Competition Law

The UK operates a voluntary two-phase merger review procedure. Under the Enterprise Act 2002, the UK authorities have jurisdiction where one of the following tests is satisfied:

- The UK turnover of the target exceeds GBP70 million.
- The merger creates or enhances a 25% share of supply (or purchases) of goods or services in the UK (or a substantial part of it).

Upon entry into force of the NISA on 4 January 2022, lower jurisdictional thresholds introduced in June 2018 for mergers in which the target business (or part of it) is active in certain sectors considered relevant to national security (in particular, military, dual-use, computing hardware, and quantum technology) were repealed from the Enterprise Act 2002.

The UK government has announced proposals to update the jurisdictional tests (see *Question 42*).

Notification is currently voluntary and non-suspensory. A merger can be completed without making any notification to or obtaining clearance from the CMA.

The CMA has a market intelligence function to identify potentially problematic transactions. The CMA can refer a transaction for an in-depth investigation up to four months after the transaction becomes unconditional and is made public.

If the CMA believes that a relevant merger has resulted or may be expected to result in a substantial lessening of competition in a UK market, the CMA must refer the merger (anticipated or completed) for an in-depth Phase 2 investigation by an independent group of at least three experts, selected from a panel appointed by the Secretary of State (the Inquiry Group). It is possible to secure conditional clearance in Phase 1 by offering a remedy to address concerns that would otherwise warrant an in-depth Phase 2 investigation.

On such a reference, if the Inquiry Group finds the merger has resulted or may be expected to result in a substantial lessening of competition, it must determine how to remedy, mitigate, or prevent the adverse effects. At the end of its investigation, the Inquiry Group will clear, impose conditions on, or block the transaction.

As mentioned above, mergers can now be subject to review by both the CMA and the European Commission where the relevant jurisdictional thresholds are met.

Other Merger Control Jurisdictions

A merger may trigger notification obligations in jurisdictions outside the UK and the EU. The laws of any such jurisdiction should be checked on a case-by-case basis for suspensory effect and timing implications.

ENVIRONMENT

41. Who is liable for clean-up of contaminated land? In what circumstances can a buyer inherit and a seller retain liability in an asset sale and a share sale?

Under the contaminated land regime (Part 2A of the Environmental Protection Act 1990), primary liability for contaminated land lies with the person or entity that caused or knowingly permitted the contamination. If this person or entity cannot be found it is possible for the current owner or occupier to be liable for any costs of a clean-up. Contamination is often an issue at development sites and its remediation is often imposed under the Town and Country Planning Act 1990 as a condition to procuring consents for development.

In an asset sale, the buyer does not usually automatically acquire historical liabilities of the selling company. However, these are some ways in which legacy environmental conditions at a site can become the liability of the buyer/new owner or occupier.

In a share sale, because the buyer acquires an entire company, all liabilities of the target company, including environmental liabilities, remain with the target company.

Sellers and buyers can contractually allocate environmental liability between them through warranties and indemnities. There is no set formula for these allocations. The terms of a transaction depend, among other factors, on the specific environmental liabilities and risks involved, the value of the transaction, and the parties' relative bargaining power.

Due diligence is typically carried out (see *Question 11*). In addition, due diligence should be carried out on leases to ensure that they do not contain tenant obligations relating to historic environmental liabilities, and in a share sale on formerly owned or occupied sites to ensure there are no residual environmental liabilities for the target company.

RECENT DEVELOPMENTS AND REFORM PROPOSALS

42. Have there been any significant recent or proposed legal developments affecting the market that could impact on transactions?

UK Merger Control

The UK government has announced proposals to revise the thresholds for the CMA's jurisdiction to review mergers (see *Question 40*) including:

- Increasing the current turnover threshold from GBP70 million to GBP100 million.
- Creating a safe harbour for mergers between small businesses, by excluding transactions from review where the worldwide turnover of each of the merging parties is less than GBP10 million.
- Creating a new jurisdictional threshold to give the CMA jurisdiction if at least one of the merging parties has an existing 33% share of supply of any goods or services in the UK (or a substantial part of it) and a UK turnover of more than GBP350 million. This would include a "UK nexus" criterion and is intended to enable a review of "killer acquisitions" and other mergers not involving direct competitors.

National Security Review

Perhaps the most significant recent development for UK private M&A is the NSIA. The NISA gives the UK government very significant powers to review a wide range of transactions that may trigger UK national security concerns. These powers apply to foreign and UK acquirers, and are exercised by the Investment Security Unit (ISU), a unit in the Department of Business, Energy, and Industrial Strategy (BEIS) dedicated to carrying out national security reviews.

Transactions can be called in for review on "national security" grounds, up to the earlier of five years after closing and six months of the government becoming aware of the transaction. NSIA does not define what "national security" includes but requires the Secretary of State to publish a statement setting out how they expect to exercise their call-in power (and to review that statement at least every five years). The statement that has been published provides some general and basic guidance, including that mandatory notifiable transactions are more likely to be called in for review than voluntarily notified ones, and that loans, conditional acquisitions, and options are unlikely to be called in for review.

Transactions that can be called in for review in a UK takeover include acquiring control through an increase in ownership or voting rights beyond 25% (including an increase in voting rights enabling a person to pass or prevent the passing of a target resolution). They can also include an acquisition of material influence (even with a smaller ownership interest than 25%) of a relevant entity or asset. Unlike a

review of transactions under the Enterprise Act 2002 by the CMA, there are no other materiality thresholds applicable to review under NSIA.

Mandatory notification is required for transactions that involve the above increase in ownership or voting rights in 17 prescribed sensitive sectors (including AI, communications, data infrastructure, defence, energy, and transport). If the transaction closes without receiving government approval, it is void. Voluntary notification is also possible for transactions that may raise a "national security" concern.

NSIA imposes on the government strict time limits to carry out its national security reviews. It has 30 days to decide whether to call in a transaction for review following notification and a further 30 days to carry out its review (extendable at the government's option by a further 45 days and thereafter by agreement with the relevant party). This will likely run in tandem with any CMA review (see *Question 40*).

The government can issue interim orders during the review. Following the review, the government can issue a final order to impose restrictions on, grant clearance to or, as a last resort, prohibit the transaction.

Criminal sanctions can be incurred for failing to comply with the NISA regime, including fines (such as up to 5% of the worldwide turnover of the relevant business and imprisonment of up to five years).

- It is not yet clear how much of an issue this new clearance regime will prove for most private M&A transactions. Early indications are encouraging from the first statutory annual report published by the government on the operation of NSIA, covering the three-month period ending 31 March 2022. In that period, the ISU received 222 notifications of which 17 were called in for review. None were subject to a final order under NSIA restricting or prohibiting the acquisition, three were cleared, and the remainder were still under review at the end of that period. Extrapolating those figures over a 12-month period, this would indicate that there are fewer transactions being affected by NSIA notification and review procedures than initial government estimates suggested. However, a decline in M&A activity over Q1 2022 may also explain why these extrapolated figures appear to fall below the government's earlier estimates.

43. What will be the main factors affecting the market next year, and how do you expect the market to develop?

See *Question 1* and *Question 42*.

Practical Law Contributor Profiles

Phil Cheveley

Shearman & Sterling (London) LLP

T +44 20 7655 5822
E phil.cheveley@shearman.com
W www.shearman.com

Professional qualifications. England and Wales, Solicitor

Areas of practice. Public and private mergers and acquisitions; co-investments; joint ventures; equity capital markets; restructurings.

Recent transactions

- Canaccord Genuity Group, Inc. on the investment by HPS Investment Partners LLC in Canaccord Genuity's European Wealth Management division.
- Hovis Holdings Limited on its auction sale by Premier Foods plc and the Gores Group to Endless Private Equity.
- TA Associates on the GBP370 million sale of Merian Global Investors Limited to Jupiter Fund Management plc.
- Carpetright plc on its company voluntary arrangement and associated debt refinancing and placing and open offer, and its subsequent takeover by Meditor.
- Conforama Investissement on its GBP673 million cash offer for Darty Group plc.
- Ashtead Group plc on the auction sale of Ashtead Technology Rentals Limited.
- Canaccord Genuity Wealth Management on the acquisition of Hargreave Hale Limited.
- Steinhoff International Holdings on its GBP1.4 billion takeover approach to Home Retail Group.

Maegen Morrison

Shearman & Sterling (London) LLP

T +44 20 7655 5064
E maegen.morrison@shearman.com
W www.shearman.com

Professional qualifications. England and Wales, Solicitor, 2004

Areas of practice. Public and private mergers and acquisitions; corporate finance; co-investments; joint ventures; equity capital markets; demergers and restructurings

Recent transactions

- Optimal Payments on its EUR1.1 billion reverse takeover of Skrill and associated GBP450 million rights issue.*
- A UK financial institution on its disposals of non-core financial assets in the UK, Spain, and Italy.*
- The Icelandic government on the restructuring of the Icelandic banking system, a high profile, complicated, and innovative transaction.*
- A UK financial institution on the disposal of a 50% interest in a challenger bank.*
- SABMiller plc on its combination of its US operations in a joint venture with Molson Coors.*
- SABMiller on a strategic alliance with the Anadolu Group and Anadolu Efes to transfer its Russian and Ukrainian beer business to Anadolu Efes, in a transaction worth about USD1.9 billion.*
- SABMiller on the non-Australian aspects of SABMiller's GBP7.8 billion acquisition of the Australian brewer, Foster's Group Limited.*
- SABMiller on the disposal of the Colombian Brisa bottled water business from Bavaria, a subsidiary of SABMiller.*

*Denotes prior firm experience

Paul Strecker

Shearman & Sterling (London) LLP

T +44 20 7655 5047
E paul.strecker@shearman.com
W www.shearman.com

Professional qualifications. England and Wales, Solicitor; New York, California, and Hong Kong

Areas of practice. Private equity transactions; public and private M&A; leveraged buy-outs; minority investments; strategic alliances; joint ventures; general corporate advisory transactions.

Recent transactions

- Chipita S.A. on the sale of its business to Mondelēz International, Inc. for about USD2 billion.
- Goldman Sachs as financial adviser to Kuwait Finance House on its USD8.8 billion merger with Ahli United Bank.
- EDP on the USD11 billion tender offer by China Three Gorges for the outstanding shares of EDP.
- CPPIB on various investments, including in Postal Savings Bank of China.
- Nidera B.V. on its USD1.2 billion sale of a majority stake to COFCO.
- Bain Capital on various investments, including in VXI Global Solutions and its sale to Carlyle.

Simon Burrows

Shearman & Sterling (London) LLP

T +44 20 7655 5696
E simon.burrows@shearman.com
W www.shearman.com/sburrows

Professional qualifications. England and Wales, Solicitor

Areas of practice. Private equity transactions; public and private mergers and acquisitions; co-investments; joint ventures; restructurings; private funds.

Recent transactions

- AlbaCore Capital on its investment in Babylon Holdings.
- TASC Towers on its acquisition of telco tower assets from Zain Jordan.
- CPPIB on its investment in 10x Future Technologies.
- Liberty Global Ventures on the sale of a stake in Skillz.
- SS&C Technologies Holdings, Inc. on its acquisition of Capita Life & Pensions Services (Ireland) Limited.
- Yamma Investments, a consortium of investors led by Metric Capital, on its USD200 million investment in Sanovel.

Nick Withers

Shearman & Sterling (London) LLP

T +44 20 7655 5956
E nick.withers@shearman.com
W www.shearman.com

Professional qualifications. England and Wales, Solicitor, 2009

Areas of practice. Equity capital markets; cross-border private mergers and acquisitions; private equity and joint ventures.

Recent transactions

- Fairfax Financial Holdings Limited on the sale of RiverStone to CVC.
- Marubeni Corporation, INCJ, and Mitsui O.S.K. Lines on the disposal of the shipping vessel group, Seajacks.
- Integration Appliance, Inc. on the acquisition of the entire issued share capital of Repstor Limited.
- DBAY Advisors Limited on the acquisition of a 51% stake in the trading entities of Eddie Stobart Logistics plc and the associated recapitalisation of the business.
- Cyprus Cooperative Bank on the sale of assets and deposits to Hellenic Bank.
- Engie on the sale of its stakes in Paiton (Indonesian power assets) to Nebras Power and Mitsui for about USD1.5 billion and in Meenakshi (Indian power assets) for an undisclosed sum.

Richard Porter

Shearman & Sterling LLP

T +65 6230 3806
E richard.porter@shearman.com
W www.shearman.com/rporter

Professional qualifications. England and Wales, Solicitor

Areas of practice. Cross-border private and public mergers and acquisitions; private equity transactions; restructurings; joint ventures.

Recent transactions

- Chipita S.A. on the sale of its business to Mondelēz International, Inc. for about USD2 billion.
- CVC Capital Partners Fund VII on its investment in Skroutz, Greece's leading e-commerce platform.
- GE on the USD3.25 billion sale of its Distributed Power business to Advent International.
- Discovery, Inc. on its agreement with BBC Studios to separate their 50/50 UKTV joint venture, following which the parties hold UKTV's former lifestyle and entertainment businesses respectively.
- ViacomCBS on the USD500 million sale of CNET Media Group to Red Ventures.

Michael Scargill

Shearman & Sterling (London) LLP

T +44 20 7655 5161
E michael.scargill@shearman.com
W www.shearman.com

Professional qualifications. England and Wales, Solicitor, 1980

Areas of practice. Public and private M&A; joint ventures; cross-border mergers; equity capital markets; corporate governance; corporate knowhow management.

Recent transactions

- Ardagh Group S.A. in connection with the combination of its metal packaging business with Gores Holdings V, Inc.
- Deutsche Beteiligungs AG and funds advised by DBAG on the acquisition of Pfaudler Process Solutions Group, a part of National Oilwell Varco Inc.
- Eurobank Ergasias in connection with its sale of 20% of the share capital of Grivalia Properties.
- Chipita S.A. on the sale of its business to Mondelēz International, Inc. for about USD2 billion.
- Singapore Airlines Limited in relation to the sale of its 49% stake in Virgin Atlantic Limited to Delta Airlines, Inc.