“A Practical Guide to Buying a Business in Australia” is current as at March 2010. It is intended to provide general information and address common questions and issues raised by foreign investors. This guide does not constitute legal advice and should not be used as a substitution for specific advice concerning the application of Australian laws to particular proposals or transactions. Please contact Maddocks for further information.
An overview of the key legal steps to buying a business in Australia

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- Select advisers – legal, accounting and industry experts
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A PRACTICAL GUIDE TO BUYING A BUSINESS IN AUSTRALIA

INTRODUCTION

Are you interested in buying a business in Australia and are looking for guidance as to what to do next? If so, this guide is intended to provide you with some practical information and tips to help put you on the right path.

STEP 1: UNDERSTANDING THE TARGET

We have assumed for the purposes of this guide that you already have in mind a target business to purchase. In selecting that business, you have likely already conducted a preliminary commercial analysis of the business. However, before putting pen to paper on a deal, it is often prudent to engage legal, financial and industry-specific advisors to assist with investigations on the target.

A key consideration in finalising the purchase of a business in Australia can be overcoming regulatory hurdles. We briefly discuss the main regulatory bodies you may need to obtain approval from, or need to consult with, before you are able to proceed with the purchase. Relevant websites for these regulatory bodies can be found at the back of this guide. Industry specific approvals may also be required depending on the nature of the target business. In this case, legal advice should be obtained to clarify any additional regulatory requirements.

Selecting advisers and conducting due diligence investigation

Before committing to purchase a business, it is important to conduct investigations of the business. This is often referred to as undertaking ‘due diligence’. It is generally conducted after you have established that you are interested in purchasing the business and before you sign any agreements to purchase. A comprehensive due diligence investigation is a fundamental component of most business acquisitions. Depending on the nature of the transaction, you would usually engage legal and accounting advisers to assist you. You should also consider whether there are any industry specific experts that may be useful. Due diligence is often most effective when advisers liaise and work together.

The key to effective due diligence is to ensure your advisers understand your business priorities that underlie the purchase of the target business. The better informed your advisers are of the nature of your business and the reasons for your purchase, the better equipped they will be to focus on and to advise you of the key commercial or legal issues arising out of the due diligence process.

Legal due diligence is important to ensure that you are in fact buying what you think you are buying. It is an important tool in analysing the target for legal compliance, pending lawsuits and contingent liabilities that might affect the business. Your legal representatives will look at the ownership documents to make sure the party selling you the business actually owns the business, will examine the agreements and contracts of the business such as customer contracts, supplier contracts and leases, to ensure there are no hidden legal risks in the business.

Financial due diligence investigation is important in analysing the financial status of the business, taxation implications and appropriateness of the purchase price. Generally, a buyer would engage accountants to conduct financial due diligence.

Depending on the business being purchased, there may be industry specific advisers who can provide invaluable technical expertise and insight into the particular industry that the target business operates. In addition to this, it may be useful to consult an environmental specialist, particularly if the target business involves manufacturing or a process which may result in waste or by-products.

Before undertaking due diligence, you may be asked by the seller to enter into a Confidentiality Agreement before you or your representatives are granted access to documents of the business. Please refer to Step 3 for commentary regarding Confidentiality Agreements.
Consider whether regulatory approvals are required

Purchases of Australian businesses by a foreign person will often raise regulatory issues, depending on the type of business being purchased, the industry the business operates in and the level of foreign ownership. You should consider whether you will need approvals from, or require consultation with, regulatory bodies before proceeding with the purchase. If so, it is often best to start this process as soon as possible. We set out below details of the key regulatory approval regimes applicable to foreign investors.

(a) Foreign Investment Review Board (FIRB)

Foreign investment in Australia is regulated principally by FIRB which administers the Foreign Acquisitions and Takeovers Act 1975 (Cth) (FATA). For the purposes of FATA, a 'foreign person' is broadly defined as a natural person not ordinarily a resident in Australia and any corporation, business or trust in which there is a 'substantial' foreign interest, regardless of whether the corporation, business or trust is foreign controlled.

A 'substantial' foreign interest in a corporation, business or trust is a holding of 15% or more by a single non-resident person or foreign corporation (alone or with associates) or 40% or more in the aggregate by 2 or more corporations (alone or with associates).

The FATA requires certain proposals to be notified to FIRB. Proposals falling within the scope of the FATA broadly comprise:
- acquisitions of developed non-residential commercial real estate which has a value of A$5 million or more in the case of heritage listed property, and a value of A$50 million or more in the case of property which is not subject to a heritage listing;
- a substantial interest in or control of an Australian business where the value of its gross assets, or the proposal values it above, A$231 million;
- portfolio investments in the media of 5% or more and all non-portfolio investments irrespective of size;
- takeovers of offshore companies whose Australian subsidiaries or gross assets exceed A$231 million;
- direct investments by foreign governments or their agencies, regardless of size; and
- acquisitions of interests in urban real estate, regardless of value subject to certain exemptions.

FIRB releases its Merger Guidelines in November 2009. Notification of a merger to the ACCC is required to proceed with the transaction.

(b) Australian Competition and Consumer Commission (ACCC)

If you intend to purchase or merge with a business that is in a similar industry or market in Australia or in a State or Territory of Australia, then it is important to consider whether approval from the ACCC is required to proceed with the transaction.

The ACCC administers the Trade Practices Act 1974 (Cth) (TPA) with regards to competition. Section 50 of the TPA prohibits any acquisition of assets or shares if the acquisition would have the effect, or be likely to have the effect, of substantially lessening competition in any substantial market in Australia as a whole or in a State or Territory in Australia. The ACCC released its Merger Guidelines in November 2008.

Parties can apply for an informal clearance which enables the parties to seek the ACCC's view on whether it would stop the merger proceeding. A formal clearance, if granted, provides the merger parties with legal protection from court action under Section 50 of the TPA.

(c) Industry specific licences and approvals

Depending on the nature of the business being purchased, there may be particular licences or approvals that may need to be obtained from an industry specific regulator. For example, if you were looking to acquire an interest in a bank, credit union, insurance company or superannuation company, you would need to consult with and abide by the guidelines of the Australian Prudential Regulation Authority (APRA).
Obtaining approvals from government regulatory bodies or industry specific regulators can be a lengthy process and so it is often best to commence any necessary applications or consultations early on in the acquisition process. You should however be mindful of any confidentiality agreement or obligations you have. If necessary, you may need the vendor's co-operation and consent to consult with a regulatory body.

**STEP 2: WORKING OUT THE TRANSACTION STRUCTURE**

It is important to discuss with your advisers the type of transaction structure you wish to undertake to ensure that your proposed acquisition is conducted in a manner which best achieves your commercial objectives. There are various options you may consider, however we have focused our attention on the most common types of acquisitions in Australia: buying the assets of the business and buying the equity of the business structure.

When structuring the purchase of a business, it is also important to consider the taxation implications and the most appropriate method for financing the purchase.

**Types of transaction structures**

The two most common ways to buy a business in Australia are;

1. buy the assets of the business; or
2. buy the equity of the business structure of the target (eg buy the shares of the company that operates the target business).

When buying the assets of the business, you are buying only the assets and perhaps some liabilities that are explicitly detailed (eg accrued employee entitlements) and you leave the 'selling vehicle' behind. Asset purchases are commonly used to protect the buyer from unforeseen liabilities including hidden tax risks.

Buying the assets can however be quite complex as you need to identify and prescribe a method of transfer for each asset. This will typically include the individual supply arrangements, customer contracts, real property conveyances, leasing arrangements and material contracts of the business. Sometimes, the transfer of these contracts will require consent from third parties before the transfer can take place. It is important to identify all material to be transferred which require third party consents early on in the process. This is one of the items which your legal advisers will be able to assist with in their due diligence process.

Buying the equity of the business structure involves the purchase of the shares of the target company for a specified price. When purchasing the shares, you take on all of the historical, actual and contingent liabilities of the business. In order to manage the risks associated with taking on such liabilities, a buyer will often seek extensive warranties and indemnities from the seller to protect themselves against these liabilities. In addition to this, a buyer may also seek to have part of the purchase price held on trust for a period of time as security in the event of a breach of a warranty or indemnity by the seller. Please refer to the commentary under Step 3 regarding warranties for further details.

(a) Employee Issues

How employees are dealt with will differ depending on whether you buy the assets or the shares of the business. If you are buying the shares in a company, from an employment perspective, this is the simplest situation. Apart from possible provisions in employee contracts which provide for resignation and specific benefits to be paid upon change of control of the business, the legal identity of the employer remains the same. As a general rule, the existing contracts of employment as at the date of sale continue to operate.

The situation is more complicated when you are buying the assets of the business and you wish to retain some of the employees in your acquired business. An employee’s current employment contract will usually be with the seller or entities controlled by the seller. When buying the assets, the employment relationship cannot be 'transferred' from the seller entity to the buyer as employment contracts are personal in nature. Ordinarily, it will be necessary for the seller to terminate the employment contract with the employee and for the buyer to enter into employment contracts with the employees. The rules governing the transfer of employees are complex as there are various industrial instruments (awards and certified agreements) which are industry specific and legislation (which differ from state to state) that the buyer will need to consider in order to gain a full picture of the obligations they will take on as the new employer. Buyers should be aware of the amount of accrued entitlements and costs arising from recognition of past employee service, which can vary depending on the terms and conditions of employment of each employee.
(b) Taxation issues

There are different taxation and duties implications depending on whether you choose to purchase the shares or assets of the business. The form of purchaser acquisition vehicle, the structure of the purchase price, the location, the nature of the assets and the history of the assets being purchased and tax indemnities sought, are some of the factors which may affect the tax implications of the transaction. Prior to entering into the purchase, you should consult your legal/tax advisers to fully understand the potential tax implications of the transaction.

Identity of target entities

There are a number of different forms a target entity can take, including companies, partnerships, joint ventures and trusts. Different business structures will have different implications for the buyer. The most common form of business structure in Australia is a company limited by shares, which can take the form of either a proprietary company (called a private company in many other countries) or a public company. A public company may also be listed on the Australian Securities Exchange, (ASX) unlike a proprietary company.

There are special rules governing the purchase of shares in a listed entity. A listed company is one in which shares are traded on the Australian Securities Exchange. The Australian Securities Exchange has rules, referred to as ‘Listing Rules’, which govern companies listed on it. When buying shares in a company which is listed on the Australian Securities Exchange, the Listing Rules must be taken into account, and abided by.

In addition, the Corporations Act 2001 (Cth) limits the circumstances in which a person may acquire more than 20% of the voting power in a listed company or listed managed investment scheme, or an unlisted company with more than 50 members. There are various exceptions to the takeover rules and the application of the rules is complex. You should seek advice as to whether the rules will apply to you if you intend to acquire a stake in a listed company.

Financing the purchase

You should consider how you intend to finance the purchase early on in the process. There are many alternatives, however three common examples include:

- paying cash for the assets or shares;
- borrowing the funds; or
- utilising a combination of cash and borrowings to fund the acquisition.

If you intend to borrow funds you should consider approaching financiers at the first available opportunity. The method of financing the purchase can influence the transaction structure of the purchase.

If you elect to borrow funds, a financier will likely require security for the funds lent to you to purchase the business. The types of security that a financier may ask for include:

- a fixed or fixed and floating charge over assets which could involve the financier taking a ‘fixed’ charge over assets of the target such as real property, plant and equipment, intellectual property rights and contracts and a 'floating' charge over cash and stock-in-trade;
- a mortgage over the shares purchased in the target company;
- guarantees and/or indemnities by the directors of the buyer; and/or
- if applicable, guarantees and/or indemnities by the holding company of the buyer.

STEP 3: ENTERING INTO LEGAL DOCUMENTS

With due diligence investigations well under way and the purchasing structure decided, the next step is to enter into legal documents to document the purchase of the business. There are various legal documents that you may need to enter into, including a ‘Heads of Agreement’ (or what is also referred to as a 'Letter of Intent', 'Terms Sheet' or ‘Memorandum of Understanding’), a Confidentiality Agreement and a Sale Agreement.

Heads of Agreement

A Heads of Agreement is a document which parties may enter into at the initial stages of a proposed transaction which sets out the key terms of a commercial deal agreed in principle between the parties.

A Heads of Agreement should be concise and deal only with the broader and fundamental issues rather than on the details as these will be dealt with in the formal agreements. The following is a list of items commonly covered in a Heads of Agreement:

- the nature of the transaction;
- the price – you would usually want to be very specific on price and how price can vary;
- details of any approvals required and conditions to the transaction;
- timeline for the transaction;
- warranties and indemnities to be provided by the seller, usually in general terms;
- whether the agreement will be exclusive;
- confidential provisions to bind both parties, if a separate confidentiality agreement has not been signed; and
- the ‘binding’ nature of the document.
Usually the parties to this document will specifically state whether the document is binding on them or not. A ‘binding’ document will have legal effects and ramifications for the parties, whereas a ‘non binding document’ is one which merely outlines the ‘tentative agreement’ between the parties. It is possible for the parties to identify certain provisions of the document to be binding such as exclusivity (an agreement that the parties cannot deal with other parties for a period of time) and confidentiality obligations.

It is important that the parties spell out clearly in the Heads of Agreements which terms are and which are not to have legal effect to avoid any subsequent disputes between the parties regarding the legal intent of the document.

Confidentiality Agreement

A seller will often require a potential buyer to enter into a confidentiality agreement before disclosing information on the target entity to the buyer. The main purpose of the confidentiality agreement is to provide clarity on the type of disclosure that can safely be made by the parties without the fear that sensitive business information (such as management accounts, trade secrets and know-how) or details of the proposed transaction will be made public. It will also normally detail the parties that are to be bound by the agreement. Protecting sensitive business information can make the Confidentiality Agreement an indispensable part of the business sale process.

Sale Agreement

The sale agreement can put formality to the deal negotiated between parties and can factor in any necessary adjustments required as a result of due diligence investigations. Your legal advisers can be a valuable resource to assist you to negotiate the agreements and to help put you in the strongest position possible on matters such as adjustment to purchase price, dealing with assets that need to be transferred, identifying and satisfying any conditions the purchase may be subject to, imposing non-compete restrictions on the seller and warranties and indemnities to be provided by the seller.

Protecting the buyer against the risks associated with the acquisition is normally achieved by way of warranties and indemnities. Warranties, and limitations on the seller’s exposure under those warranties, are usually one of the most negotiated aspects of any sale agreement. Depending on the nature and extent of the risks associated with the relevant acquisition, it may be prudent for the buyer to retain or hold back part of the purchase price to offset against any subsequent claims the buyer may have against the seller, which would usually be in the nature of a warranty and indemnity claim.

A warranty is an assurance from the seller about a particular state of affair company or business. The warranties will often cover the conduct of the company or business, the ownership and completeness of its assets, its financial and tax position, compliance with the law and potential litigation and environmental issues. The buyer will be entitled to seek some form of remedy (usually a claim for damages) if the statements made about the company or business later prove to be incorrect and the value of the company is thereby reduced.

An indemnity, on the other hand, is a promise by the seller to reimburse the buyer in respect of a particular type of liability should it arise, for example, a tax liability. The purpose of an indemnity is to provide the buyer with a guaranteed remedy (on a dollar-for-dollar basis) where a breach of warranty may not give rise to a claim in damages, or to provide a specific remedy which might not otherwise be available at law. A buyer may also seek indemnities for the warranties which involves the seller compensating the buyer for any loss or damage suffered as a result of any warranties being found to be untrue.

It is important to note that signing the Sale Agreement does not mean that the deal is finalised. Once you have signed and exchanged contracts with the seller, there is often an interim period before the purchase price is paid and the deal is said to have been ‘completed’.

Often the Sale Agreement will stipulate conditions that may be referred to as ‘Conditions Precedents’ (CPs) that you will need to satisfy in order for the deal to be able to complete. For a buyer, a potential CP could be obtaining the requisite approvals from the types of regulatory bodies referred to in Step 1. For a seller, a CP could be obtaining the consent of a landlord to the assignment of the lease to the buyer. You should consider whether there are particular conditions that you would like the seller to satisfy before the purchase is completed. CPs are a very important consideration as a Sale Agreement may stipulate that, in the event that a CP is not satisfied, one or both parties has a right to terminate the agreement.

**STEP 4: POST PURCHASE CONSIDERATIONS**

Once the legal documents are finalised and purchase price paid, the purchaser’s responsibilities may not end there. It is not uncommon for a sale agreement to place obligations on the buyer and/or seller after the purchase has been completed. You should also consider whether there are ongoing obligations for you as the buyer once you have purchased the business such as ongoing reporting obligations. The Australian Securities and Investments Commission and the ASX are two examples of regulators which may require you to report and disclose certain information as the new owner of the business.
TO FIND OUT MORE

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Useful websites for further information:

**FIRB**
Foreign Investment Review Board
www.firb.gov.au

**ATO**
Australian Taxation Office
www.ato.gov.au

**ASIC**
Australian Securities and Investments Commission
www.asic.gov.au

**ASX**
Australian Securities Exchange
www.asx.com.au

**ACCC**
Australian Competition and Consumer Commission
www.accc.gov.au

**IATA**

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