Australia

Negotiated M&A Guide

Corporate and M&A Law Committee

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1 Introduction

The laws of Australia governing the sale and purchase of businesses are largely embodied in contractual principles developed under Australian common law. Specific legislation and regulations also apply either to acquisitions generally or to acquisitions in specific categories or circumstances (largely depending on the nature of the legal entities involved as well as the nature of the business or assets involved).

As a democracy, Australia adheres to the principles of responsible government. Australia has three tiers of government - Commonwealth, State and Territory, and local government, each of which can pass laws and regulations. The laws and regulations regulating the sale and purchase of businesses are legislated at the Commonwealth and State and Territory levels, and are also embodied in the general law (known as common law) which is developed by the courts.

Examples of the types of legislation which commonly apply to the sale and purchase of businesses in Australia are:

(a) *Corporations Act 2001* (Cth)

The *Corporations Act 2001* (Cth) ("**Corporations Act**") regulates companies in Australia, their basic features and types, how they are incorporated and the rights of shareholders, officers and directors. The Corporations Act also sets out rules governing how company and directors meetings are held, the financial reporting and registration requirements of companies, and how they are wound up and deregistered. Key chapters of the Corporations Act also deal with fundraising (offering and issuing shares), the regulation of managed investment schemes (funds) and the licensing of providers of financial products and services, insider trading prohibitions, and sets out a takeovers regime for change control transactions affecting listed companies and other large private companies.

(b) *Foreign Acquisitions and Takeovers Act 1975* (Cth)

The *Foreign Acquisitions and Takeovers Act 1975 (Cth)* ("**FATA**"), together with the *Foreign Acquisitions and Takeovers Regulation 2015* ("**Regulation**") and Australia's Foreign Investment Policy, regulate foreign investment in Australia, and set out the requirements for notifying the Australian Federal Treasurer ("**Treasurer**") (through the Foreign Investment Review Board ("**FIRB**")) of a proposed investment when certain thresholds and criteria are satisfied. The Treasurer has the power to block a proposed acquisition or (if the acquisition has already completed in breach of the FATA) to order that an acquisition be reversed.

(c) *Competition and Consumer Act 2010* (Cth)

The *Competition and Consumer Act 2010* (Cth) ("**CCA**") (formerly the *Trade Practices Act 1974* (Cth)), amongst other things, sets out laws relating to restrictive trade practices (including merger control) and consumer protection, and also sets out access regimes for particular regulated industries (eg telecommunications). This Act is particularly relevant for transactions between parties where there is the potential to lessen competition in a particular market.

Other legislation and rules will also apply to specific industries (eg airports, mining, media, communications and financial services) and transactions involving listed companies.

2 Structure of the transaction

2.1 Form of acquisition - shares or assets

The two principal forms of acquiring a business are either through acquiring the shares of the legal entity which owns and operates the business (and/or the units of any applicable trust), or by acquiring the assets and goodwill of the business itself. The choice will depend on multiple factors driven principally by the structure and circumstances of the business being sold. The structure may also be strongly influenced by the seller in certain circumstances. For example, if the sale is a competitive process there may be less ability, or greater risk from a competitive stand point, for the buyer to structure the acquisition in a different manner to that proposed by the seller.

Practical considerations can often discount a particular type of acquisition altogether. For example, the sale of only a division of a company or the sale of assets used in the operation of a business which are owned by multiple entities not all of which can themselves be sold, will often involve the acquisition of assets rather than shares.

Each approach has various advantages and disadvantages.

2.2 Sale and purchase of shares

A sale and purchase of shares will typically involve a change in the control of the target company. This usually involves the acquisition of all of the shares in the company which comprises the business, but may also involve the acquisition of only a stake (ie a proportion of the shares) in the target company. The advantages and disadvantages highlighted below are generic statements. The individual circumstances of each of the seller and buyer could mean that apparent advantages are in fact disadvantages for a particular party, and vice versa.

(a) Advantages

(i) Procedurally less complex than an asset sale and purchase as there is (usually) only one class of asset being acquired - namely shares in the target company (and all of its subsidiaries and equity holdings are therefore indirectly acquired).

(ii) Certain tax attributes may continue to vest in the corporate entity being acquired, which may be of value to the buyer.

(iii) Continuity of employment is maintained with the business' employees.

(iv) Usually, lower stamp duty costs are incurred on a transfer of shares than on the acquisition of assets (although this depends on the nature and location of the relevant assets).

(v) The corporate structure for the operation of the business being acquired will already be in place. This may be of advantage to the buyer who is looking to treat the purchased business as a separate entity (eg operate it as a subsidiary).

(b) Disadvantages

(i) The buyer acquires the corporate vehicle which owns the business, thereby acquiring all the residual liabilities and hidden defects with that entity (and any of its subsidiaries).

(ii) As a result, the approach requires extensive due diligence to be undertaken to explore these potential hidden liabilities in the target company and group.

(iii) The buyer has an increased reliance on the seller's warranties and thus has a higher risk profile than a buyer under an asset acquisition.

(iv) There may be minority shareholders who refuse to sell their shares in the target company to the buyer.

Naturally, in conducting acquisitions by way of share sale and purchase, it is important to look for restrictions on a change of control of the target company (or any of its subsidiaries). For example, these may be found in company contracts (eg leases, material supplier/customer agreements or external financing documents). It is also important to check that all material assets (eg intellectual property) that the buyer wishes to acquire are already owned, leased or licensed by the target company and group. If not, these assets will need to be transferred into the target company prior to completion of the sale or transferred to the buyer separately.

2.3 Sale and purchase of assets

Asset acquisitions involve not only the sale, transfer or assignment of certain assets, other rights and goodwill, but usually also the assumption of certain business liabilities by the buyer. The advantages and disadvantages highlighted below are generic statements. The individual circumstances of each of the seller and buyer could mean that apparent advantages are in fact disadvantages for a particular party, and vice versa.

(a) Advantages

(i) Provides certainty and flexibility over the precise assets to be acquired. The buyer is able to 'cherry pick' the precise assets which it requires. Similarly, the approach enables the seller clearly to identify what assets are sold and what (if anything) is to remain.

(ii) As only specified liabilities are assumed, the buyer has greater protection against hidden legacy liabilities (including the ability not to assume certain tax and other liabilities). At its extreme, the buyer can insist that the seller retain all liabilities from the period up to completion of the sale.

(iii) An arm's length agreement between the parties as to the appropriate apportionment of consideration between the various assets being acquired should provide more certainty with respect to a buyer's and seller's tax and stamp duty position.

(iv) Enables a more targeted due diligence to be undertaken.

(b) Disadvantages

(i) Procedurally the transfer approach is more complicated, usually as a result of the volume of assignment or transfer (novation) documents, and third party consents, required for completion of the transaction although this will depend greatly on the size and extent of the business being acquired.

(ii) Employment offers will need to be made by the buyer to existing employees, as the employment of employees cannot automatically be transferred to the buyer under Australian law simply because the business is being sold. Consequently, the buyer runs the risk of key employees not accepting the terms offered, and the seller bears possible severance and redundancy risks.

(iii) Certain tax advantages vesting in the corporate entity (eg accumulated tax losses or franking credits) will not be available to the buyer, and may not be able to be utilised by the seller.

(iv) Depending on the nature and location of the assets being acquired, there may be higher stamp duty costs payable for the acquisition of a business compared to a share acquisition.

(v) The buyer and seller need to identify all relevant assets and liabilities to be acquired or assumed. This may be complicated depending on the nature and size of the business being acquired and how the business and assets are currently held by the seller.

Naturally, in conducting acquisitions by way of asset sale and purchase, it is important to look out for restrictions on the sale, assignment or novation of assets, agreements (eg key contracts or leases), and the approvals and/or consents required. In this regard, the cost of obtaining such approvals and consents, as well as the time taken to obtain them, should be considered.

2.4 Tax

The sale or purchase of a business will give rise to various tax issues which need to be considered carefully. The specific circumstances of a buyer or seller will be critical in determining the associated costs, incidence of taxes, and availability of any relief. Early consideration of tax consequences is important when structuring a transaction and drafting the transaction documents.

If the buyer (or seller) is a foreign entity or the business in question is conducted (in whole or in part) outside of Australia, then foreign tax issues may also be relevant. Additionally, an amount on account of foreign resident capital gains withholding tax (up to 12.5% for contracts entered into after 1 July 2017) may need to be withheld from the purchase price by the buyer unless certain criteria are met. This may be the case even where both parties are Australian residents.

This guide does not seek to delve into issues of taxation in detail, as these are key areas where specialist advice should be sought, however please note the following general observations on two key tax areas which will be relevant for sales and acquisitions of businesses in Australia:

(a) Stamp Duty

Stamp duty costs on the acquisition of shares usually work out to be less than that on asset acquisitions, although this may not always be the case. Some practical issues to bear in mind in relation to stamp duty on acquisitions are:

(i) There is no stamp duty payable on the transfer of shares in companies if the company does not directly or indirectly hold land in Australia. Where the company holds land (either directly or indirectly), stamp duty may be payable on the acquisition of the shares based on the applicable duty rate (of typically up to 5.75%) multiplied by the market value of the land, and, in some cases, plant and equipment.

(ii) Asset sales ordinarily attract the imposition of ad valorem stamp duty (eg up to 5.5%). Stamp duty is not imposed on a transfer of some categories of assets (eg inventory and in some jurisdictions, goodwill), although this is not available in all States and Territories in Australia. The stamp duty treatment of particular assets will therefore need to be considered in each jurisdiction in which assets are located.

(iii) The time periods for the lodgment of documents and payment of stamp duty needs to be monitored closely to avoid penalties and interest. The acquisition agreement is usually the principal instrument on which stamp duty is payable. If signing and completion occur at separate times (eg if conditions precedent need first to be satisfied) the acquisition agreement may need to be stamped before completion and any purchase price adjustments are made.

(iv) Usually the buyer is liable to pay stamp duty on the acquisition, although legislation in some States and Territories in Australia will hold both the seller and buyer liable to pay this duty.

(b) Goods and Services Tax ("GST")

Australia has a broad based goods and services tax (currently 10%). If a business is sold as a going concern, then subject to certain conditions being satisfied, the supply can be GST-free (and the seller is not required to pay the GST on the purchase price to the Federal Government, and the buyer will not be required (usually) to reimburse the seller for this payment). If however the business is not sold as a going concern, the seller will be liable to pay GST on the purchase price to the Federal Government and will look to the buyer to reimburse it for this amount. If GST is reimburseable by the purchaser, then the stamp duty payable on the transaction will likely increase as GST is taken to be consideration for stamp duty purposes. Where the purchaser pays an amount on account of GST, the purchaser may be entitled to a credit for that amount.

The question of whether a business is sold as a going concern requires the sale of the entire business, hence care should be taken where (for example) the seller is only selling a division or part of its business.

GST is not payable on the acquisition of a business by way of shares or units.

3 Pre-agreement

In Australia, certain preliminary documents are often prepared prior to negotiating and executing formal transaction documents. These are explored in further detail below.

3.1 Letters of intent, term sheets, heads of agreement ("HOAs") and memorandums of understanding ("MOUs")

Letters of intent (or term sheets, HOAs or MOUs) are commonly used in negotiated M&A transactions in Australia. These documents set out the main commercial terms of the proposed transaction. The typical issues covered in these documents are:

(a) proposed parties and structure of the transaction (including target companies or assets);

(b) price range or valuation basis;

(c) key conditions precedent or regulatory approvals required;

(d) key commercial terms of the transaction (including costs and any proposed break fee);

(e) timetable for conducting due diligence, and negotiating and finalising transaction documents;

(f) contact points, exclusivity period (if applicable), and confidentiality provisions; and

(g) governing law.

These documents are usually expressed to be non-binding, other than for certain clauses in the document (typically confidentiality, exclusivity (if applicable), and governing law). If it is intended that the document not be legally binding, it is important that this is expressly set out in the document, and that qualification language be used consistently throughout the document when describing the offer (such as "non-binding, indicative offer").

Sometimes these documents are intended and expressed to be legally binding, with an acknowledgment that they will be superseded by formal transaction documents in the future. Care should be taken in these circumstances to ensure that the documents are sufficiently complete and certain (so as to be legally enforceable) and that no adverse tax consequences will arise (such as double stamp duty being payable - firstly on the letter of intent and secondly on the main transaction document).

These documents can be advantageous in identifying the key commercial terms for a transaction, and in setting out the procedures and protocols for the proposed transaction, and how it could be structured. They can also assist to clarify a party's thinking and intent. There can, however, be certain disadvantages of these documents, including if parties spend a lot of time and resources negotiating them instead of the main agreements. Also, care needs to be taken to ensure that parties do not inadvertently create binding obligations or make representations from which they may later seek to depart.

3.2 Lock-ups (exclusivity)

Lock-ups, or exclusivity arrangements, are often negotiated as part of negotiated M&A transactions in Australia. They are often requested by buyers in order to secure exclusive access to the seller and the target company, thereby locking out other potential buyers. Sellers, however, may also offer exclusivity in order to attract buyers and show a genuine commitment to a particular sale process.

Exclusivity arrangements should cover a number of matters, including:

(a) the period of exclusivity;

(b) what is to happen during the exclusivity period and by when (often a timetable is set out) (eg conducting due diligence and management interviews/site visits, preparing and circulating draft transaction documents and negotiating and finalising them);

(c) the grounds upon which the exclusivity period can be terminated early; and

(d) fiduciary carveouts in favour of the seller's directors to enable the exclusivity period to be brought to an early close if a superior proposal is received by the seller.

In a competitive sale process, exclusivity may only be offered to a preferred bidder after submission of final bids. Exclusivity in these scenarios is usually for a very limited period of time for the bidder to review any final remaining blackbox due diligence materials provided at this stage and to finalise and execute the transaction documents.

3.3 Due diligence

Conducting due diligence forms an essential part of negotiated M&A transactions, and the undertaking of a formalised due diligence process is common practice in Australia. The results of due diligence enquiries help both buyer and seller identify what is being sold or acquired, what needs to be done in order to sell or acquire a company or a business, what are the associated risks, and other factors affecting value. It is more common in Australia for due diligence to be conducted prior to signing the transaction documents, rather than signing the transaction documents with completion being subject to a condition precedent that satisfactory due diligence has been conducted.

The following practical issues will need to be addressed in conducting legal due diligence:

(a) setting qualitative and quantitative materiality thresholds for the investigations;

(b) preparing and collating information for disclosure;

(c) the time available for undertaking due diligence enquiries; and

(d) the terms of conducting due diligence (eg confidentiality and access).

It is also common for financial due diligence, accounting due diligence, tax due diligence and (depending on the subject matter of the target business) other specialist due diligence (eg environmental or technical (such as software and other IT, mining or engineering) due diligence) to be conducted.

A seller will often undertake an informal due diligence on the business or assets it proposes to sell, as it will be interested in ensuring that it has a saleable asset, and that the assets to be sold are able to be severed from those which are to be retained. It also positions the seller to have greater control over the scope of the buyer's due diligence, helps identify or affirm the value of what is being sold or the replacement cost of assets to be sold, and helps to identify potential aspects of risk which, if not warranted or indemnified, will adversely affect the purchase price. In order to expedite a sale process, or minimise disruptions to its business if multiple potential buyers wish to undertake due diligence, sellers sometimes undertake a seller's due diligence and prepare a report upon which the successful buyer may rely.

Sellers should also ensure, when disclosing information for due diligence purposes, to minimise the likelihood of incurring liability under the CCA, *Australian Securities and Investments Commission Act 2001* (Cth) or applicable State or Territory *Fair Trading Acts* for misleading and deceptive conduct. This can usually be achieved by obtaining acknowledgments from senior personnel that, to the best of their knowledge, the documents made available to the buyer are accurate and that all material information has been provided.

Whilst a key matter for negotiation, sellers will usually be asked to warrant that the due diligence information provided to the buyer is complete and accurate in all material respects, and does not contain any information (or omit any information) which is misleading in any material respect. The identification of due diligence material is very important, and the extent to which a matter or risk is adequately disclosed in due diligence material is critical, and is often an area for dispute between buyers and sellers.

Section 5 of this section of the guide contains links to various information and on-line resources regarding Australian companies and businesses which may be useful starting points for due diligence enquiries.

3.4 Confidentiality and non-disclosure agreements

A confidentiality agreement (or non-disclosure agreement) is an essential document to be prepared and executed early in any negotiated M&A transaction, especially if buyers are competitors of sellers and information exchanged between them may be commercially sensitive.

A confidentiality agreement is often circulated and signed during the early stages of a potential transaction, and it is important not to lose sight of its scope or terms if a transaction subsequently changes during the course of negotiation. This could result in information being disclosed or used for purposes not covered by the original agreement.

Matters which need to be covered in these types of agreements include:

(a) who are the parties entering into the agreement, and who is the agreement to bind?

(b) what is the purpose for which disclosed information can be used?

(c) to whom may recipients disclose information and on what terms or restrictions? Certain exceptions to a general non-disclosure will be required (eg Australian listed companies will require the ability to disclose information if required to do so by the rules of the stock exchange on which its shares are listed).

(d) how long does the agreement last, and what happens on expiration or termination (eg return and/or destruction of confidential information)?

(e) if the buyer or seller are listed entities, not to trade in, or procure someone else to trade in, the shares of the listed company in breach of the insider trading provisions in Division 3, Part 7.10 of the Corporations Act.

The scope and permitted disclosures set out in these agreements are important as the terms of this agreement will often flow through to govern the terms under which disclosures are made in a formal data room and also in the main transaction documents.

4 Acquisition agreement

4.1 Purchase price

(a) Determination, form of consideration, adjustments and payment structure

The purchase price is usually determined on the enterprise value on a cash free / debt free basis or under a "locked box" mechanism, but the latter is less common in Australia.

The most common form of consideration offered on a share/asset purchase is cash, followed by a combination of cash and shares in the buyer company. A loan from the vendor (eg vendor loan notes) can also be used as a form of consideration, but is less common. The tax consequences of the consideration offered are also an important consideration - particularly where capital gains tax roll over relief may be available when shares are exchanged for shares in another company. Importantly:

(i) in certain circumstances, where an exemption is not available, the issue of shares will require the buyer company to issue a disclosure document (exemptions include offers to sophisticated investors that meet specific financial thresholds, and personal offers that result in share issues to a maximum of 20 persons in any 12 month period to raise a maximum of A$2 million); and

(ii) the Corporations Act permits a company to give financial assistance (broadly defined) to a third party to acquire shares (or units of shares) in the company or that company's holding company (eg where a target company gives security over its assets as security for the buyer's acquisition debt finance) if:

(A) giving the assistance does not materially prejudice the interests of the company or its shareholders, or the company's ability to pay its creditors (directors usually avoid having to rely on this exemption); or

(B) the assistance is approved by the company's shareholders (and the notice of meeting and explanatory statement is lodged with the Australian Securities and Investments Commission ("**ASIC**")); or

(C) the assistance is covered by an exemption (eg distributions by way of a share buy-back or capital reduction are exempt).

This issue does not apply to asset acquisitions.

The purchase price is often subject to adjustment by reference to completion accounts. Purchase price adjustments are often made as at the completion date for changes in the amount/value of all or some only of cash, plant and equipment, receivables, inventory, prepayments, accounts payable, accruals, provisions for tax, and employee entitlements such as annual leave and long service leave (but usually excluding contingent liabilities such as sick leave), since the last accounts or since signing. The two most common purchase price adjustments are for changes in net assets and working capital compared to a reference or target amount for those items. The acquisition agreement will identify:

(i) whether the seller or the buyer will prepare the completion accounts and adjustment statement;

(ii) what the completion accounts and adjustment statement will include as well as how they must be prepared (eg in a manner consistent with the last accounts and, where not inconsistent, in accordance with the accounting standards as defined in the Corporations Act and generally accepted Australian accounting principles);

(iii) whether the completion accounts will be audited and the adjustment statement reviewed by a specified auditor;

(iv) the basis on which an adjustment amount will be paid by either party (eg only if a threshold is exceeded); and

(v) a dispute resolution mechanism (which will usually require a period of good faith negotiation between the parties, before allowing either party to refer the disagreement to an independent accountant that is either identified in the agreement, jointly appointed by the parties at the time of the dispute or, failing agreement, an accountant appointed by a neutral party such as the Resolution Institute).

The purchase price may be structured to include:

(i) deposit on signing - forming part of the purchase price on completion, or to be returned together with interest if the transaction is terminated through no fault of the buyer. In Australia, deposits in negotiated M&A transactions are rare but not unheard of;

(ii) full payment on completion;

(iii) retention amounts - retaining a percentage of the purchase price to enable adjustments to be made post completion (eg for working capital and inventory, to reflect the change in financial position between the last set of audited accounts and completion accounts) or as a security for warranty or indemnity claims; and

(iv) earn out payments - payment of part of the purchase price is deferred and depends on the performance of the business in subsequent financial years. This is often a complex option requiring firm parameters to be set out about the conduct of the business and performance targets during the earn out period.

(b) Retention amounts

Purchase price retentions are seen in Australia, but not in a majority of transactions. However, valid circumstances in which a buyer may require a retention amount include, where there is:

(i) uncertainty about the ability of the seller (or difficulties if there are multiple sellers), post completion, to make payment in the event of a warranty or indemnity claim being made or if it is required to pay a completion adjustment to the buyer (eg where the seller is in financial distress, a trust or a foreign entity or where there is a disparate group of sellers and a buyer would have to chase multiple persons for varying proportions to ensure it obtains full payment); or

(ii) a liability that the parties consider may be difficult to quantify (such as the total cost of cleaning up environmental pollution).

The seller will resist this, but if it agrees to a retention, it will most likely require an escrow arrangement where the retention is paid into an escrow account (usually in the joint names of the parties or in the name of a third party escrow agent) and an escrow agreement is entered into which sets out the terms on which the retention is to be held and released to either party (including entitlement to interest). Retention amounts are usually 10 - 30% of the purchase price and commonly held until the end of the limitation period for warranty claims under the acquisition agreement or at least 12-18 months to allow the buyer to operate the business for a full accounting cycle. A bank guarantee may be used instead of a retention, however, these are less common as they can be expensive to obtain.

(c) Earn outs

Earn outs are typically used where:

(i) there is a significant difference of opinion between the seller and the buyer as to the value and likely future performance of the business; and/or

(ii) the seller and/or key management sellers retain an interest in the business and the buyer is concerned to provide an incentive for these sellers to continue to ensure that business performance is robust after completion; and/or

(iii) the future performance or value of the business is not certain due to factors such as economic outlook or regulatory developments.

Earn outs are usually structured so that earn out payments are made for one to two years (sometimes longer) after the initial purchase price payment at completion, and calculated by reference to the revenue or profit performance (eg EBITDA) of the target company. The earn out is sometimes structured as a fixed total amount payable in instalments at specified intervals if certain performance hurdles are achieved, or as a percentage of profit, again payable at specified intervals.

Earn out arrangements will set out:

(i) the targets to be achieved;

(ii) responsibility for preparation of the accounts from which the earn out amounts will be calculated (usually the buyer’s accountants);

(iii) a dispute resolution mechanism;

(iv) the accounting principles and practices to be applied in preparing the accounts;

(v) a framework for management of the business during the earn out term;

(vi) treatment of benefits arising from synergies achieved by integrating the target business into the buyer’s business; and

(vii) whether any warranty or indemnity claim can be set off against earn-out payments. A seller is particularly likely to resist this because it puts the onus on it to pursue the buyer for earn-out payments rather than the buyer pursuing it for warranty claims.

Parties should carefully consider the tax implications associated with earn out arrangements. In 2007, the Australian Taxation Office published Taxation Ruling TR 2007/D10 which provided that a separate asset is created at the time of sale in connection with an earn out arrangement. This approach may lead to undesirable outcomes for parties. From 7 December 2016, TR 2007/D10 was withdrawn.

Earn out arrangements created on or after 24 April 2015 that satisfy certain requirements will qualify for look-through treatment under legislation that was enacted on 26 February 2016. Under this treatment:

(i) any capital gain or capital loss relating to the creation of a qualifying look-through earn out right will be disregarded;

(ii) for the acquirer of the business, any financial benefits provided (or received) under the right will be treated as forming part of (or reducing) the cost base or reduced cost base of the business assets; and

(iii) for the seller of the business, any financial benefits received (or provided) under the right will be treated as increasing (or reducing) the capital proceeds for the business assets.

Where the earn out rights do not qualify under the new legislation, the ATO's views set out in TR 2007/D10 will still apply.

(d) Asset acquisition

Important issues to consider on an asset acquisition:

(i) apportioning the purchase price between various categories of assets (eg inventory, leases, other contracts and goodwill) may result in a lower amount of stamp duty costs, as lower rates of duty (or no duty) will apply in some Australian jurisdictions for the transfer of certain categories of assets; and

(ii) purchase price adjustments to be made for prepayments or accrued expenses for the period straddling the transfer in ownership.

If the assets being acquired include intellectual property (including trade marks, patents or copyright materials/software), it is important to consider whether any of this intellectual property will be shared between the buyer and the seller following completion of the transaction. It is also important to consider whether the seller will retain any intellectual property that the buyer will need to use to operate the business being transferred. In either case, transitional services arrangements can be used to manage these issues in the short term, or a licence or co-existence agreements may be entered into for longer term use of these assets.

4.2 Conditions precedent and completion deliverables

(a) Conditions precedent

Whilst some transactions sign and complete simultaneously, a gap between signing and completion may be unavoidable if conditions need to be satisfied before the legal transfer of the target can occur. A buyer or seller may also insist on certain conditions precedent to completion to provide them with further protection from risks associated with the transaction. Common conditions precedent include:

(i) approval from the Australian Competition and Consumer Commission ("**ACCC**") (see *Competition approval* below for more detail);

(ii) a no objections notification to the proposal issued under the FATA by the Treasurer (through FIRB) where there is a buyer that is foreign for the purposes of the FATA (see *Foreign investment approval* below for more detail);

(iii) other relevant regulatory approvals (see *Other regulatory approvals* below for more detail);

(iv) consent to change of control under, or assignment of, material contracts, including major customer contracts, major supplier contracts, real property leases and equipment leases;

(v) key employees (usually management) and/or a percentage of all employees accepting an employment offer from the buyer;

(vi) the buyer securing debt financing for the transaction on reasonably acceptable terms;

(vii) no material adverse change in the business of the target (see *No material adverse change* below for more detail);

(viii) representations and warranties of the seller being true and correct at completion; and

(ix) the buyer's securities being admitted to trade on the Australian Securities Exchange, where the buyer offers to issue its securities to the seller as part of the consideration.

It is common for acquisition agreements to include an express reasonable endeavours undertaking from the buyer and seller to do all things within their power to ensure the conditions precedent are satisfied, to the extent that the condition is within their control. If the satisfaction or waiver of a condition is for the benefit of one party only, such as the buyer obtaining approval from the ACCC, then that party alone will have the ability to waive that condition.

Acquisition agreements will usually include a sunset date by which all of the conditions precedent must be satisfied or waived. If one of the conditions has not been satisfied by the sunset date and the parties will not waive the condition (ie the buyer does not have consent from their financier to waive the condition or it is illegal for the transaction to complete without the satisfaction of the condition), then the agreement will generally provide for termination. There is case law that suggests that the requirement to satisfy a condition precedent imposes an implied obligation on the party on whom the satisfaction of a condition precedent is dependent to use its reasonable endeavours to procure the satisfaction of that condition precedent. Whether there is such an implied obligation will however turn on the facts of each individual case.

(b) Completion documentation

Completion of a share or asset acquisition will also be conditional on the delivery of agreed completion documentation. The documentation required will differ significantly depending on whether the transaction is a share acquisition or asset acquisition. Common documentation which is required to be delivered at the completion of a share acquisition includes:

(i) share transfer form(s) in respect of the shares being acquired;

(ii) original share certificates in respect of the shares being acquired;

(iii) the corporate records and common seal (if any) of the company being acquired and its subsidiaries;

(iv) written resignations of each director and secretary who is retiring from the company or its subsidiaries;

(v) signed consents from each director and secretary who is being appointed to the company or its subsidiaries;

(vi) a resolution of the board of directors of the company resolving to register the transfer of shares from the seller to the buyer (subject to the payment of any stamp duty), appointing any directors and secretaries nominated by the buyer and accepting the resignation of certain directors and secretaries;

(vii) signed services agreements between the company and certain executives of the company;

(viii) signed releases of any guarantees and indemnities given the company or any subsidiary to the seller or a related company;

(ix) any necessary consents to the change of control of the company being acquired;

(x) if necessary, signed assignments of intellectual property into the company being acquired; and

(xi) documents to release security interests given by the company over any of its assets.

In relation to item (xi) above, following the enactment of the *Personal Property Securities Act 2012* (Cth) ("**PPSA**"), certain security interests (including those contained in the former ASIC Register of Company Charges and other state and territory Bills of Sale Registers) have been migrated to a Personal Property Securities Register, which was established under the PPSA. The new PPSA regime came into effect on 30 January 2012 and replaces the previous system of taking security over personal property assets in Australia. It has resulted in significant changes to the way in which security interests are recorded and searched in Australia and how security interests are released at completion of a sale transaction. Therefore, parties should seek specialist advice on how the PPSA may affect their proposed transaction.

Common documentation which is required to be delivered at the completion of an asset acquisition includes:

(i) all documents of title relating to the assets;

(ii) signed assignments of intellectual property such as patents, trademarks and any copyright material (including proprietary software);

(iii) signed transfer forms and/or unlock codes of domain names (the administrative process for transfer of domain names varies, depending on the domain names themselves and/or their registrars);

(iv) consent to transfer number (obtained from ASIC) for any business names being transferred;

(v) signed assignments of property leases and equipment leases;

(vi) signed assignments of customer and supplier contracts;

(vii) signed executive services agreements with certain executives; and

(viii) all documents necessary to discharge security interests over any of the assets.

(c) Competition approval

Section 50 of the CCA (formerly the *Trade Practices Act 1974* (Cth)) prohibits mergers or acquisitions that would have the effect, or be likely to have the effect, of substantially lessening competition in a market. If a transaction is between two competitors in the same market, the buyer and seller may consider including approval from the ACCC (which enforces the CCA) as a condition to completion. There is no requirement to notify the ACCC of a proposed merger under the CCA. However, the ACCC can apply for an injunction to prevent a merger (and seek divestiture and penalties) if it believes the merger will be likely to substantially lessen competition in a market. Generally, the ACCC will closely investigate a merger if the merged entity will have a market share of

20% of more following the transaction. However, in some circumstances, the ACCC also investigates mergers where the merged entity will have a market share of less than 20%, or where the acquisition involves a minority stake.

Approval from the ACCC can be obtained through two methods, informal clearance and formal clearance. Informal clearance involves approaching the ACCC (which initially can be done on a confidential basis) and seeking a comfort letter stating the ACCC does not intend to oppose the merger. Formal clearance involves following the procedures set out in the CCA and if obtained will provide formal immunity from proceedings under section 50 of the CCA. Due to its flexibility, informal clearance is the most popular method of approval in Australia. To date, the formal clearance procedures have not been used.

Currently, merger parties also have the option of applying for statutory authorisation for a transaction from the Australian Competition Tribunal ("**Tribunal**"), as an alternative to seeking clearance from the ACCC.

As at September 2017 the Federal Parliament is considering legislative reform which would fold the current authorisation and formal merger review processes into a new streamlined formal process, under which the ACCC would be the first instance decision maker, with a limited right of review by the Tribunal. Even if these reforms are passed, parties will still have the option of the informal merger process which will remain unchanged. Therefore, at the time of any transaction parties should seek specialist advice on how the merger processes may be relevant to, or used for, their proposed transaction.

If the buyer and the seller are comfortable that their transaction will not substantially lessen competition, it is still common to provide a courtesy notification to the ACCC of the proposed transaction, however as noted above there are no formal merger notification requirements under the CCA.

(d) Foreign investment approval

Foreign investment in Australia is regulated principally under Federal legislation, including the FATA and the Regulation, as well as by Australia's Foreign Investment Policy ("**Policy**").

Under FATA, certain proposed investments by foreign persons (including any corporation, business or trust in which there is a substantial foreign interest) are required to be notified and a "no objections notification" obtained. These include:

(i) acquisitions of 20% or more in an Australian entity (with gross assets of A$252 million or more (indexed annually)) - the 20% may be of actual shares, units, voting power, potential voting power or rights to shares or units;

(ii) acquisitions of interests in Australian land. (An interest in land, which may be legal or equitable, may arise by purchasing the land, under a lease or licence, financing and profit sharing arrangements, or an interest in a land corporation or trust). Some exemptions apply under FATA and the Regulations;

(iii) acquisitions of 10% or more in an agribusiness where the consideration for the interest is $55 million or more (indexed annually). An agribusiness is an entity that has 25% of its assets or revenue in a primary production business; and

(iv) acquisitions by foreign government investors of 10% or more in an Australian entity regardless of value (or any interest if a control element is acquired such as the right to appoint a director).

Under FATA, certain proposed investments by foreign persons are “significant actions” that may activate the Treasurer’s powers and it is recommended that a “no objections notification” be obtained:

(v) acquisitions of 20% or more in an existing Australian business (where the gross assets of the business are valued at A$252 million or more (indexed annually)); and

(vi) takeovers of offshore companies with Australian assets where the gross Australian assets of the company are valued at A$252 million or more (indexed annually).

In respect of 4.2(d)(i), (v) and (vi) above, a higher monetary threshold of A$1,094 million (indexed annually) applies to investors that are from nations prescribed under the FATA’s Regulations (currently, the United States, New Zealand, South Korea, Chile, Japan and China), provided there is no government ownership in the investor and the investment is not in a prescribed sensitive sector. The higher threshold of A$1,094 million applies to agribusiness investments, but only for investors from United States, New Zealand and Chile.

The prescribed sensitive sectors for business acquisitions are: media; telecommunications; transport; military and defence related activities; encryption and security technologies and the extraction of uranium or plutonium or the operation of nuclear facilities. Where the investment is in a prescribed sensitive sector or by an entity controlled by a government of a prescribed country, a monetary threshold of A$252 million (indexed annually) applies.

The purpose of the regime is to empower the Treasurer to make adverse orders (including prohibition or disposal orders) in respect of proposals that are considered by the Treasurer to be “contrary to the national interest”. In addition, certain transactions are compulsorily notifiable, and criminal sanctions may apply where a prior no objections notification is not obtained.

Additional criteria are applicable with respect to foreign government investors and prescribed investors, and with respect to investments involving the following sectors - banking, telecommunication, airports and airlines, shipping, media and resource sectors.

(e) Other regulatory approvals

As noted above, if a transaction involves a company or business in a regulated industry, it may require regulatory approval under specific government policies and legislation. Transactions in the following industries could include the following regulatory approvals as conditions to completion:

(i) Banking - approval under the *Financial Sector (Shareholdings) Act 1998* (Cth), which will apply if a stake of 15% or more is acquired in a financial sector company and approval from the Australian Prudential Regulation Authority;

(ii) Media - approval from the Australian Communications and Media Authority under the *Broadcasting Services Act 1992* (Cth), which regulates media ownership including unacceptable media diversity situations; and

(iii) Airports - the *Airports Act 1996* (Cth) restricts foreign ownership of airports to 49%, ownership of certain pairs of airports to 15% in a paired airport and airline ownership of airports to 5% (per airline).

(f) No material adverse change ("MAC")

"No MAC" conditions are commonly found in Australian acquisition agreements and can be drafted by reference to a material adverse change occurring to the buyer, the target or the market between signing and completion (often referred to as Bidder MAC, Target MAC and Market MAC). No MAC conditions effectively allow the buyer to terminate the acquisition agreement prior to completion following the occurrence of an event or series of events (such as rapid deterioration in the financial position of the target). These conditions have become reasonably common (particularly the Target MAC) and are expected to continue to be popular with buyers, especially where there is expected to be a reasonable period of time between signing and completion of the transaction.

4.3 Covenants of the seller

(a) Conduct of business between signing and completion

Where there is a timing gap between signing and completion of the transaction, the buyer will seek covenants from the seller about the conduct of the business prior to completion - essentially a series of restrictions designed to preserve the value of the business being acquired. The common general restrictions are: (i) the seller will only conduct the business in its ordinary course; (ii) key or material shares or assets will not be sold or encumbered; and (iii) the goodwill of the business and the seller's relationship with financiers, customers and suppliers of the business will be maintained.

It is preferable, from both buyer and seller perspectives, for the acquisition agreement to have specific restrictions that address the areas which are of concern to the buyer whilst still allowing management to have maximum flexibility in operating the business. Examples of key specific restrictions are that the seller will not, without buyer approval:

(i) alter inventory levels beyond set limits;

(ii) enter into, terminate or vary any material contracts other than in the ordinary course of business;

(iii) terminate or hire employees (except in the ordinary and normal course of business and where the total annual remuneration of that person is not greater than a certain amount) or amend employment terms and conditions;

(iv) change accounting practices or make any tax decisions;

(v) forgive debt;

(vi) lease assets;

(vii) licence or assign intellectual property to a third party other than in the ordinary and normal course of business;

(viii) cancel any insurance policies insuring the business;

(ix) settle claims;

(x) incur capital expenditure out of the ordinary course or in excess of a certain amount; or

(xi) enter into any lending or borrowing commitments with any third parties, except in relation to trade debts or payables in the ordinary and normal course of business.

Similarly for share sales, the company which owns the business should also not issue or dispose of shares to any person other than the seller, make or declare a dividend payment, buy back shares, reduce its capital, sell or give any option, mortgage, charge or other form of security interest or encumbrance over shares, or change the constitution of the company. Importantly, to avoid stifling the business being acquired, thresholds on restricted activity are often imposed - for example by permitting fluctuations in working capital, inventory and capital expenditure within certain thresholds.

(b) Asset sale - assignment of leases, material contracts and IP

In an asset sale, the acquisition agreement will contain provisions setting out procedures for dealing with certain classes of assets. For example, in relation to equipment and property leases, the seller will covenant either to assign these to the buyer or pay them out. Buyers should consider whether certain leases or contracts should be assigned or novated to them, or whether new contracts should be entered into - particularly technology and intellectual property contracts. For example, a buyer may be able to obtain better supply terms with a third party supplier by negotiating a new agreement.

Under the terms of the relevant contract, the consent of the counterparties will need to be obtained to the assignment/novation of the contract and this is usually a condition precedent to completion of the acquisition in respect of key material contracts. A key consideration is what happens if third party consents are not obtained for less material contract on or before completion. In this case, it is common for the parties to agree in the acquisition agreement that the buyer will perform the burdens of the contract, and be entitled to the benefits, after completion until the contract can be assigned or novated. In other cases, for example in relation to technology and intellectual property contracts, the seller may seek to deem the contracts for which consent was not obtained as “excluded assets” - with no purchase price impact. However, the buyer will likely seek a sub-licence of the contracts (if the contract terms permit), or that the relevant services are provided by the seller under a transitional services arrangement that as far as practical ensures the ongoing conduct and continuity of the business, or a purchase price reduction (being an amount equivalent to the difference between the cost of new contracts and the cost of the existing contracts). The acquisition agreement should also identify whether the buyer or the seller will bear the third party costs of obtaining third party consents and approvals.

In addition, the seller will often seek an indemnity from the buyer for acts or omissions after the assignment of material contracts.

If the acquisition involves the transfer of software, the parties should also consider how to verify the transfer of source code and other technical materials from the seller to the buyer and associated knowledge transfer arrangements.

(c) Restraint of trade

To protect its investment in the business it acquires, the buyer will usually seek a restraint of trade clause which prevents the seller from establishing (or becoming involved with) a similar business within the proximate geographic area, within a period of time, and also restrains the seller from soliciting customers or enticing away employees during that period. The most common restraints include restraint of business activities, assisting competitors, acting for clients of the business, soliciting past or present customers and suppliers, disclosing confidential information, and soliciting or interfering with present or future employees. However, the buyer must exercise care in drafting or seeking amendments to this clause because broad or all encompassing restraints risk being struck down as being too wide or uncertain and thus invalid.

For the restraint of trade clause to be enforceable, the buyer must prove that it does not go beyond what is reasonable to protect the goodwill of the business which it is acquiring, and is not contrary to public policy. The clause will be 'reasonable' between the parties if it gives no more than adequate or necessary protection to the buyer given the nature of the business being purchased. For example, a clause which describes the activity sought to be restrained and confines the scope of the restraint both geographically (by reference to the geographical areas in which the business operates) and in time to what is required to protect the goodwill of the business. Additionally, any consideration referrable to the restraint is relevant to the consideration of reasonableness. The validity of the restraint will be determined at the time when the restraint has been imposed - at the time that the acquisition agreement is entered into. The CCA also contains a limited exception to the application of that Act for post-acquisition restraint provisions that are solely for the protection of the purchaser in respect of the goodwill in the business acquired.

Unless the governing law of the sale agreement is New South Wales law, the restraint of trade clause will usually be drafted to contain a series of cascading restraints which are gradually less restrictive (eg by geography and or time) with the intent that if the restraint is challenged in a court, the court will look at each alternative and or combination of alternatives to determine what is reasonable in the circumstances - and only sever the broadest restraints so as to leave the restraint combination which is acceptable. In drafting the restraint, consideration should also be had to necessary carve-outs - for example, small holdings in public companies, existing directorships and existing interests in competing businesses. In New South Wales, legislation permits the Supreme Court to read down a restraint of trade clause whether it is in severable terms or not, whereas in other jurisdictions courts tend not to read down unreasonable restraint provisions (they are only saved to the extent the agreement provides that unreasonable provisions can be severed). Importantly, if there are too many permutations of restraint, the clause could be void for uncertainty in that the court will not create a valid restraint out of an invalid one unless it can be done by a reading down process.

The buyer will also usually obtain an undertaking from the seller that it will not disclose or use the business' confidential information after completion.

4.4 Covenants of the buyer

(a) Employees

The employment and industrial relations issues that arise in a purchase of business differ significantly depending on whether the buyer proceeds by way of an acquisition of shares or assets.

(i) Share acquisitions

Share acquisitions are the simplest form of purchase from an employment perspective because, subject to any change of control provisions, employment contracts remain in place. Employees of the business continue to be employed by their current employer under their existing terms and conditions of employment, and all that changes is the ownership of the employer. As such, the focus in a share acquisition is on:

(A) reviewing the existing employment arrangements as these will continue to apply and bind the buyer, in its role as employer, post acquisition and could impact on potential restructuring;

(B) identifying any change of control provisions in the employment arrangements; and

(C) assessing the materiality of employee liabilities (eg litigation or non compliance with industrial instruments) and ensuring adequate provision has been made for accrued employee entitlements.

(ii) Asset acquisitions

Mechanics of employee transfer

Employment issues are more complex in a purchase of assets scenario because employees must be “transferred” from the seller to the buyer. To effect the “transfer”:

(A) the buyer must make offers of employment to the employees it wishes to transfer; and

(B) the employees that take up the buyer’s offer of employment (“**Transferring Employees**”) must have their employment with the seller lawfully terminated.

If employees of the seller decline to accept employment with the buyer, the seller will be required to terminate their employment unless they can be deployed to other parts of the seller’s business. This creates a potential risk of termination payment liabilities for the seller, but ordinarily this issue can be managed (see below). There have also been transactions in the past where employees have successfully claimed redundancy payments even where they transfer to employment with the buyer. However, based on recent case law, this is unlikely to be a problem if the employment offered by the buyer is on no less favourable terms as their existing employment with the seller, and continuity of service is recognised.

The focus of employment due diligence will be on:

(A) reviewing terms and conditions of employment to see whether it is commercially acceptable for the buyer to agree to offer employment on no less favourable terms; and

(B) identifying applicable industrial instruments and determining whether these will continue to bind the buyer post completion.

Termination entitlements

The key termination entitlements of employees arise under statute, as well as under each employee’s individual terms and conditions of employment, and are as follows:

(A) Notice of termination - Transferring Employees are entitled to the period of notice of termination required by their employment contract (whether express or implied) or payment in lieu of notice.

(B) Redundancy/severance pay - From 1 January 2010, employees have a statutory entitlement to severance pay on redundancy and may have a further entitlement by virtue of their employment contract or industrial instrument. However, there is no statutory entitlement to severance pay when a buyer (i) offers an employee employment on the same terms as currently offered by the seller and (ii) recognises the employees' prior service with the seller. It is common for employment contracts and industrial instruments to contain similar exemptions. The buyer will need to review the existing terms of employment to ensure that it can offer the same terms.

(C) Leave entitlements - These will either be paid out by the seller or transferred by agreement to the buyer. In most transactions the parties agree to transfer these entitlements, provided the buyer receives a purchase price adjustment for the liabilities it is assuming.

Consultation obligations

Prior to any restructure or transfer of employees, the seller will need to comply with any provisions in industrial instruments or legislation which require an employer to consult with or notify union representatives or third parties where there are major changes in the production or structure of its operations that are likely to have significant effects on employees.

Transfer of industrial instruments

The *Fair Work Act 2009* (Cth) deems that, in a "transfer of business", certain industrial instruments will transmit on completion and will bind the buyer with respect to Transferring Employees. The effect of these provisions is that the buyer will need to comply with the minimum terms and conditions of employment prescribed by these industrial instruments.

Other payments due and employee rights

The seller and buyer should also review individual employment contracts and industrial awards to ascertain whether the employees have any other entitlements triggered by the acquisition (such as retention payments or entitlements arising out of a change of control).

Buyers should also consider the superannuation requirements for Transferring Employees.

(b) Conduct of business after completion

Unless a brand licence is included as part of the acquisition, following completion the buyer will be prohibited from using any trade mark, logo, business name, brand name or similar rights (whether registered or unregistered) of the seller which is not transferred to the buyer as part of the acquisition ("**Seller Mark**"), as well as any mark that is deceptively similar or substantially identical to a Seller Mark. However, the buyer will often seek a short term licence to use the Seller Marks (usually 60-90 days from completion) to enable the efficient and effective transition of the conduct and operation of the business from ownership of the seller to ownership of the buyer.

4.5 Mutual and interchangeable covenants

(a) Access to records after completion

The parties will usually agree that:

(i) after completion, the buyer will keep the records obtained by it on completion and the seller will keep the books, records and other documents relating to the business which are required to be kept or maintained by the seller - for a period of at least five years from the date of the creation of the relevant document; and

(ii) during the retention period, the seller and the buyer will permit each other to have access to those books and documents (including tax returns and tax working papers relating to the business), to the extent they are required by the other party to satisfy a legal or regulatory requirement.

(b) Customers

The acquisition agreement will usually provide that within a short period after completion either: (i) the buyer must, at its expense, notify the sale to each customer, client and supplier of the business in a form agreed with the seller; or (ii) the seller must use reasonable endeavours to arrange for the buyer to have introductions to the material customers, clients and suppliers that it nominates.

4.6 Representations and warranties, and liability regime

It is common in negotiated M&A transactions for the seller to give the buyer a series of representations and warranties about the business and assets being sold. These are statements upon which the buyer relies and which induce the buyer (amongst other things) to be bound by its promise to acquire the business and assets for an agreed price. The breadth and depth of these representations and warranties, and the contractual regime governing the seller's liability to the buyer, are usually the most heavily negotiated aspects of negotiated M&A transactions, as it is the main avenue by which risks associated with the business and assets, or the transaction itself, are allocated between the buyer and the seller.

(a) Representations and warranties

Sellers will most likely make a number of representations to the buyer during the course of negotiations, as well as in the body of the acquisition agreement itself. If these representations turn out to be false, then the buyer may have a cause of action in common law damages or contractual damages, and may even be entitled to rescind the contract. Sellers can seek to reduce this potential exposure by:

(i) excluding liability for any representations not otherwise expressly set out in the acquisition agreement;

(ii) reducing the breadth and depth of warranties given; and

(iii) including an entire agreement clause in the acquisition agreement.

Sellers should also be aware of potential liability under the CCA if they engage in misleading and deceptive conduct, or liability under the *Australian Securities and Investments Commission Act 2001* (Cth) if they make misleading representations or engage in unconscionable conduct.

Warranties are factual statements made by the seller about the target and its business, as at particular dates. They often fall into two broad categories. The first deals with warranties relating to the seller (eg the seller's ability to enter into and be bound by the acquisition agreement, the seller's title to the relevant assets, and the seller's ability to transfer the assets free of encumbrances or the need to obtain approvals). The second deals with warranties relating to the assets or business being sold. This second set of warranties helps the buyer form a more complete picture of the assets and business being acquired, and helps firm up valuation and modelling assumptions. These warranties usually include warranties about the business, financial statements, assets, contracts, leases, real property, IP, employees, tax, operations, litigation, records, information disclosed in due diligence, insurance arrangements, and environmental and regulatory compliance.

The usual remedy for a breach of warranty is damages, although the buyer will usually wish to negotiate a contractual right to terminate the agreement if a seller's warranty is breached between signing and completing the acquisition. In order to bring a damages claim, the buyer will need to have suffered some form of loss (which the buyer will be under an obligation to mitigate), however the seller will seek to limit the buyer's ability to bring a claim by limiting its liability in certain ways (see below for further detail).

(b) Disclosures against warranties

The seller will usually look to have the buyer expressly acknowledge all matters disclosed to the buyer, and the due diligence undertaken by the buyer, as matters which are fairly disclosed and which act to qualify or 'read down' the warranties given by the seller. These include matters actually disclosed in a data room or in the disclosure material, matters that would have been disclosed had the buyer conducted searches of public records, and matters set out in a disclosure letter.

The seller may also seek to have the buyer acknowledge that the buyer has only relied on the warranties set out in the acquisition agreement, that the buyer has an opportunity to conduct due diligence and has satisfied itself in relation to matters arising from due diligence, that the seller has made no representation or warranty as to the accuracy or completeness of information disclosed, and that the seller owes no duty of care to the buyer in relation to any information disclosed.

Often a disclosure letter is provided, which allows the seller to disclose information either generally or specifically against the warranties which it is required to give. If provided, the buyer should consider the information in the disclosure letter carefully as the buyer will usually not be able to make a claim for breach of a warranty in respect of a matter which has been disclosed in the disclosure letter. The buyer should also ensure that any general disclosures made in the letter are consistent with the disclosure and liability regime which is negotiated under the acquisition agreement.

(c) Liability regime, exclusions and qualifications

Sellers will seek to limit their liability to the buyer through a combination of:

(i) limiting the number of representations and warranties given (and their scope), and qualifying warranties by materiality or awareness (as opposed to making absolute statements);

(ii) expressly limiting liability for breach of the acquisition agreement, or breach of warranty, to a percentage of the purchase price (usually 100% of the purchase price for warranties relating to title, power and authority and (in some cases) tax, and a smaller percentage (typically from 10-50% of the purchase price) for other breaches;

(iii) limiting the time period during which claims may be brought against the seller (1-2 years is normal, covering at least one audit cycle of the target company, although tax warranties usually have longer time limits - usually between 4-6 years);

(iv) excluding claims below certain monetary thresholds, and preventing the buyer from being able to make a claim until the quantum of claims exceeds a *de minimus* threshold;

(v) excluding certain categories of loss (usually indirect and consequential losses);

(vi) excluding liability in circumstances where the buyer had prior knowledge of or contributed to the breach, or that the facts or circumstances giving rise to the liability were already provided for in the target company's accounts or were disclosed to the buyer during due diligence;

(vii) requiring the buyer to claim under an insurance policy to recover loss before making a claim against the seller;

(viii) in some cases, limiting the buyer's remedy for a breach of warranty to recoveries under a warranty and indemnity insurance policy (see below); and

(ix) having the buyer make certain acknowledgments about the seller, the target business, the due diligence material and representations made by the seller, which the seller can seek to rely upon in defending an action by the buyer.

The seller will also usually wish to set out a procedure which the buyer must follow in order to make a claim, including in relation to third party claims against the buyer which may then result in the buyer making a claim against the seller.

The buyer's liability is not usually limited to the same extent as the seller's, although it should be considered if the acquisition agreement provides for the buyer to perform obligations after completion back to the seller (eg transitional services).

(d) Insurance

In some instances, and principally for larger transactions, warranty and indemnity insurance may be available for sellers and buyers. The insurance typically covers the warranties and, in share sale transactions, any tax indemnity. It is particularly attractive to sellers (such as private equity funds) which wish to make a clean exit from an investment without having to wait for warranty periods to expire before knowing whether it may still be at risk for a claim.

Warranty and indemnity insurance policies are either "sell-side" which means they protect the seller (if it is required to make a payment under a warranty claim), or "buy-side" which means they protect the buyer (by enabling the buyer to claim for breach of warranty directly against the insurer rather than the seller). This is advantageous to the buyer in circumstances where the buyer requires a long period of time to bring warranty claims but is unable to obtain comfort from the seller that the seller will have sufficient funds for the warranty period to meet any claims that may be brought. The trend in the Australian market is for the majority of warranty and indemnity insurance policies to be "buy-side" policies.

It is important to note that insurance is not a cure-all mechanism as not all of the risk which a seller or buyer bears can be offset. As an insurance contract, the insured is required to disclose all information the insurer reasonably requires to determine whether to insure the risk (and, if so, upon what terms). This can be broader than the due diligence information provided. Insurance relies on material disclosure of all relevant information to the insurer, pursuant to ordinary duties under *Insurance Contracts Act 1984* (Cth). Further, the insurer may deem some warranties to be amended for the purpose of coverage under the policy so that the policy only responds if the warranty (as amended) is breached. Some warranties may be excluded from cover altogether.

Standard exclusions are likely to apply to any such policies, such as reliance on the buyer's due diligence, absence of seller fraud or material non-disclosure, and no coverage of certain types of risk (eg superannuation), forward looking warranties and the completion accounts.

4.7 Indemnities

It is common for indemnities to be included in an acquisition agreement to deal with specific identifiable risks relating to the seller's business or assets identified as part of due diligence. In these circumstances, an indemnity is required (over a warranty) as any warranties given by the seller about such risks are usually read down by the due diligence material made available to the buyer, thus negating the value of any warranty given when the known issue is disclosed to the buyer. Care should be taken as to whether indemnities are subject to the same limitations and exclusions of liability as other contractual provisions in the transaction documents.

Indemnities are often sought by buyers not only for breach of any seller warranty but also for any breach by the seller of any of its obligations under the acquisition agreement. There is no market standard position, and ultimately this is a matter for negotiation between the parties.

Indemnities are often provided by sellers (in share sales) in relation to any tax liabilities of the target company which might arise after completion of the acquisition but which relate to pre-completion matters.

The advantage of the buyer obtaining an indemnity is that the buyer is able to claim directly for its loss, without having to make a general damages claim for a breach of warranty. If the buyer is unsure whether the seller is creditworthy, it could attempt to negotiate retaining part of the purchase price (for the duration of the warranty period) for the purpose of paying out any warranty claims, or look for other security such as a guarantee or insurance. If the seller's payment is guaranteed, the buyer should ideally ensure that the guarantor owes its obligation to the buyer as primary debtor thus entitling the buyer to make a claim directly against the guarantor.

4.8 Dispute resolution mechanisms

Australian acquisition agreements generally require the parties to refer a dispute to mediation or arbitration before commencing court proceedings. A common exception to this is where one of the parties is seeking injunctive relief. It is also common to require the parties to meet informally to attempt to resolve the dispute before starting mediation or arbitration. There are mediation and arbitration guides published in Australia under which mediation or arbitration can be governed. In a cross-border transaction neither party may be comfortable submitting to the jurisdiction of the other party. In these circumstances, it is common for parties to elect to conduct their international arbitration at a neutral venue.

If a dispute arises in respect of the completion accounts or trading stock calculations (and any post-completion purchase price adjustment), the acquisition agreement will usually provide for the dispute to be referred to an independent accountant agreed between the parties. If the parties cannot agree, it is common to have the independent accountant selected by the Resolution Institute.

Acquisition agreements will also usually contain a specific procedure for dealing with warranty claims (including third party claims relating to the period before completion of the transaction) and taxation claims by the buyer. These procedures are often linked to retention or escrow amounts, which put the buyer in a stronger position when negotiating a settlement. The buyer will usually have to provide a notice of claim within a certain period of time and in the case of taxation claims and third party claims, will often have to give the seller the opportunity to take over conduct of the claim. A warranty or tax claim from by buyer will also be subject to the agreed time and monetary limits (described above in section 4.6(c)).

A party can enforce a judgment from a foreign court at common law or under the *Foreign Judgments Act 1991* (Cth) ("**Foreign Judgments Act**"). Under the Foreign Judgments Act and the Foreign Judgments Regulations 1992, judgments from prescribed superior and inferior courts of certain countries can be registered. Registered judgments can then be enforced in either a state or territory Supreme Court in Australia or the Federal Court of Australia. Some of the prescribed courts include:

(a) Supreme Court of the United Kingdom;

(b) Court of Final Appeal of Hong Kong, Special Administrative Region of the People's Republic of China;

(c) Supreme Court of Singapore;

(d) Supreme Court, Republic of Korea;

(e) Supreme Court, Japan; and

(f) Supreme Court, Taiwan.

Judgements from New Zealand courts can also be enforced in Australia in accordance with the *Trans-Tasman Proceedings Act 2010* (Cth). An application can be made to have a registrable New Zealand judgment registered in an Australian court. Registrable judgments include final and conclusive judgments requiring a person to pay money, or requiring a person to do something (e.g. to return specific property). If a New Zealand judgment is registered in Australia, the judgment has the same force, and may be enforced in an Australian court, as if the New Zealand judgment had been given by an Australian court.

Judgments of non-prescribed courts of foreign countries may also be enforceable at common law in the Supreme Court of each state and territory in Australia provided that certain conditions are established, including that:

(a) the judgment is final and conclusive, and for a fixed sum;

(b) the foreign court acted according to "natural justice"; and

(c) the foreign court had jurisdiction to make the original judgment.

5 Useful links and other information

The following links can provide useful background and information when considering participating in the sale or acquisition of an Australian business:

5.1 Doing Business in Australia

King & Wood Mallesons has prepared a guide about Doing Business in Australia. This can be found at http://www.kwm.com/en/au/knowledge/downloads/a-guide-to-doing-business-in-australia-20140101

5.2 Company Information

Information about Australian Companies is available from the Australian Securities & Investments Commission ("**ASIC**"). ASIC provides free on-line searches of its national names database, which contains basic information about registered and deregistered companies, business/trading names and documents lodged by Australian companies. Detailed current and historical extracts of companies and company officers are available for a fee. It is a very useful resource, as it will also list recent documentation lodged by companies.

Visit: www.asic.gov.au

5.3 Business Names

ASIC maintains a national register of Australian business names. Business name searches can be conducted on the ASIC database. Searching the ASIC business names register is separate to searching the ASIC companies register.

Visit: www.asicconnect.asic.gov.au

5.4 Registered trade marks, patents, designs, and domain names

Searches of registered Australian trade marks, patents and designs can be undertaken through IP Australia.

Visit: www.ipaustralia.gov.au

The registered owners of internet domain names can be searched through organisations such as WhoIs DomainTools. There is no functionality to search domain names by proprietor.

Visit: http://whois.domaintools.com

5.5 Listed companies

Listed company information can also be searched at and obtained from the Australian Securities Exchange ("**ASX**"). All company announcements made to the ASX, as well as details of trading history (share volume and price) are available from the ASX.

Visit: www.asx.com.au

5.6 Australian Taxation

Information about Australian's taxation regime is available on the Australian Taxation Office's website.

Visit: www.ato.gov.au

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