Cyprus

Negotiated M&A Guide

Corporate and M&A Law Committee

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A. Introduction

The Republic of Cyprus was a colony of the United Kingdom until 1960. Following its independence, it still forms part of the Commonwealth and retains a common law legal system. Furthermore, the Republic of Cyprus has adopted most legislation which applied during British colonial rule in the same form, however, with amendments to reflect the reality of a modern democratic republic.

As of 1 May 2004, Cyprus is also a member state of the European Union, and therefore, all EU legislation takes precedence in Cyprus.

In the context of acquisitions of Cyprus private companies, the main legislation which is applicable is the Cyprus Companies Law, Cap 113 and Cyprus Contract Law, Cap 149. These laws are rooted in their respective English law and were adopted in the same form as existed prior to independence. As a result, the same common law principles apply.

Depending on the circumstances, a proposed acquisition transaction must be considered in light of other legislation, ranging from competition law to employee protection provisions. EU Directives on these matters, as well as legislation applicable to the particular business carried on by the target company, must be considered.

B. Structure of Transaction

1. Types of Acquisition

There are two main methods of acquiring a business.

The first is an asset acquisition ("Asset Acquisition") where the assets (sometimes along with the liabilities) of a business are sold. The seller in such a case will be the individual, partnership or company that owns the assets to be sold.

The second method is a share acquisition ("Share Acquisition") where the business to be sold is carried on by a company. The control of such a company will be transferred by the shareholders, through selling their shares in that company.

There are both legal and practical advantages and disadvantages for the seller and the buyer in both of these proposed methods of acquisition, the most important of which are set out briefly below.

2. Asset Acquisition

(a) Reasons for choosing the Asset Acquisition

From the buyer's point of view, the Asset Acquisition provides for greater flexibility as the buyer can cherry pick the assets which it desires to buy, ensuring that it does not take on any unwanted liabilities of the business. The fact that the buyer can specifically choose which assets of the business to acquire is the most important advantage of the Asset Acquisition. The Asset Acquisition also essentially means that the buyer is integrating the newly acquired assets into his existing business, which may result in cost saving.

From the seller's point of view, the mechanics of the transaction are much simpler than those of the Share Acquisition. The seller gives fewer warranties and indemnities as most of the liabilities remain with the seller.

(b) Reasons why the Asset Acquisition may not be appropriate

However, there are also important disadvantages to consider in the Asset Acquisition which may make the Share Acquisition more attractive. From the buyer's point of view, complications may arise since every asset of the business acquired must be transferred individually, which could become over-complicated when dealing with a large number of assets. This can be particularly tricky with business contracts which must be individually transferred through assignment or novation and may also require third party consent, leading to delayed negotiations and frustration for all parties involved, becoming costly and time-consuming. In considering employment protection issues and tax disadvantages, the buyer may not be keen to proceed via the Asset Acquisition.

The same considerations apply to the seller, including the fact that the seller may retain liabilities after the Asset Acquisition is completed.

3. Share Acquisition

(a) Advantages to the Share Acquisition

There are a great number of advantages to the Share Acquisition.

From the buyer's point of view, the Share Acquisition achieves continuity of trade, with minimum disruption and with little effect on third party dealings with the target and its business. Very little appears to have changed and the target continues to trade as before. Further, in the Share Acquisition the due diligence process is more thorough, which gives the buyer further assurances concerning the acquisition. The mechanics of the Share Acquisition are much simpler. Finally, there are some important tax advantages to consider, the most important being that the sale of shares is totally exempt from all taxes in Cyprus (except for the sale of shares of a Cyprus company which owns immovable property, which is subject to capital gains tax).

From the seller's point of view, the Share Acquisition releases it absolutely from its relationship with the business; all liabilities remain with the target and the seller does not have to deal with any employment issues that may arise. Further, the seller also benefits from the fact that the mechanics of the transaction are much smoother and the tax advantages of the Share Acquisition. Finally, the seller-shareholder receives consideration for the sale directly, and not through the subsequent issue of dividends from the selling company's profits.

(b) Disadvantages to the Share Acquisition

Nevertheless, even though the benefits of the Share Acquisition are indeed attractive, the disadvantages must also be considered.

For the buyer, there is always a risk that third parties may wish to sever their relationship with the target following change of control. The buyer is also acquiring all of the assets and liabilities of the target with all inherent apparent risks. Some further expenses can be contemplated as a result of the extensive due diligence process which is usually, almost invariably, carried out.

Finally, for the seller, the due diligence process may prove to be quite a long and exhaustive process, notwithstanding the seller will provide the buyer with extensive warranties, representations and indemnities.

4. Practical focus of this guide

Even though an acquisition transaction may take both forms, when one takes into account all of the practical considerations and the realities of the Cypriot market, there is a tendency to opt for the Share Acquisition. The Share Acquisition is indeed the most popular option as the advantages (especially for tax purposes) for both the buyer and the seller make it the most attractive option.

The rest of this guide will mainly focus on the Share Acquisition.

C. Pre-Agreement Stage

1. Letter of Intent - Heads of Agreement - Memorandum of Understanding

Once the negotiations of an acquisition transaction have reached a certain degree of certainty, the parties may feel comfortable setting out in written form the main terms on which they wish to proceed with the transaction.

This usually takes the form of a formal letter, usually prepared by the buyer's legal adviser and addressed to the seller(s). This formal letter is a technique used in a number of jurisdictions, and takes various names such as the letter of intent, or heads of agreement. In Cyprus, it is more commonly referred to as the memorandum of understanding ("MOU").

The MOU is considered an optional stage in the transaction. While it may be used for the comfort of the parties, it may also delay the real negotiations and drafting of the acquisition agreement. However, since it does sometimes form the first stage of an acquisition transaction, brief reference is made to it below.

(a) Content

The MOU sets out and makes clear the principal commercial terms of the acquisition. It usually describes whether the proposed transaction is an Asset or Share Acquisition, the conditions that need to be fulfilled by the acquisition date, the price and payment terms, and an outline of the timetable for the acquisition.

Further, the MOU serves as an outline of the various parties' intentions, and sets out the basis for further negotiation. Finally, it may also serve as a useful guide to the transaction for the parties and their legal advisors alike.

(b) Legal Status

The MOU is not intended to be, and accordingly usually is not, legally binding. The buyer in particular will prefer that the MOU is not legally binding. This is because its signing takes place before the buyer has had the chance to undertake a detailed investigation of the target, the outcome of which may convince the buyer that the particular transaction is not worth pursuing.

One technique used by legal advisors is to mark the MOU as "subject to contract". However, this may not be enough to discharge the legal status of the document, so it is advisable to insert an express statement providing "the provisions of this memorandum of understanding are not intended to be legally binding under any circumstances".

If either of the parties intend that one or more provisions inserted in the MOU, such as exclusivity and confidentiality (which are both discussed in more detail below) or liability for costs in the event of an abortive transaction, be binding, then this should be expressly stated in the MOU itself.

2. Exclusivity

One of the main terms in the MOU which is intended to be legally binding is the exclusive bargaining right given to the buyer for a specific period of time. During this time, the seller shall be prohibited from entering into negotiations with any one else. Where an MOU is not used, an exclusivity clause may be inserted in the confidentiality agreement.

Care must be taken when drafting an exclusivity clause so as not to create a "lock-in" clause where the buyer demands that the parties will only negotiate with each other. Such a provision would be void for uncertainty and not enforceable.

The proper form of exclusivity clause is a "lock-out" clause, which is drafted to provide that the parties will not negotiate with anyone else. Such a "lock-out" clause will be enforceable if it is sufficiently certain. In order to achieve this, the clause should be clear that there is an obligation not to negotiate with others for a fixed reasonable and time period (usually 30 days, however depending on the circumstances, i.e. size and complexity), for which consideration is provided for (usually the buyer's commitment to finance the due diligence investigation) and for which remedies are available for breach, such as the recovery of costs incurred in pursuing the transaction.

3. Confidentiality Agreement

(a) Confidential information

There are two main areas of confidential information that are of concern to the parties, namely: (i) information about the target or asset(s), and (ii) information about the acquisition itself.

The seller will be expected to provide a wide range of commercially sensitive information during the due diligence process. If the buyer is a competitor, the seller may raise concerns about revealing much of its information to the buyer, such as customer lists, important contracts and other sensitive information that the buyer may be able to manipulate if the proposed acquisition falls through. For these reasons, the seller usually requires that the buyer enters into a confidentiality agreement ("Confidentiality Agreement") before any sensitive information is released.

It is in the interests of both parties to keep the terms of the deal confidential. Accordingly, the parties usually enter into a confidentiality agreement specifying the parties' obligations in relation to the confidential information, procedures for handling confidential matters and the remedies for breach of confidentiality.

The initial draft is usually prepared by the seller's legal adviser and is then negotiated between the parties.

From the seller's point of view, the agreement should cover as much information as possible, and contain a wide definition of the term "confidential" to protect itself to a satisfactory level. The seller should also demand precise procedures for the use and safe-keeping of the information.

The buyer, on the other hand, should seek to reduce the restrictions desired to be imposed with the aim of reducing costs. Accordingly, the buyer should insist that restrictions apply only to the most sensitive information.

Accordingly, the conflicting priorities of the parties must always be borne in mind when negotiating a Confidentiality Agreement.

(b) Content of Confidentiality Agreement

The Confidentiality Agreement should include a comprehensive definition of "confidential information". The definition should exclude information already in the public domain and information that the buyer is already aware of. Additionally, the definition should include information obtained from the seller and its advisers and should extend to documents that have been prepared by the buyer on the basis of the information provided.

The Confidentiality Agreement should expressly state to whom documents can be disclosed and how this information should be used by such authorised persons.

A common clause of the Confidentiality Agreement is an undertaking by the buyer to return or destroy any confidential information, including copies, if the acquisition falls through. If particularly sensitive information is involved, then agreed procedures for the tracking of such documents must also be incorporated into the agreement. These undertakings may take the form of a separate letter, the consideration for which will usually be the fact that the seller is providing the confidential information.

The Confidentiality Agreement should also impose an obligation on the buyer not to disclose any confidential information except for authorised purposes. For this reason, care should also be taken to define “authorised purposes” appropriately. This definition should also include a specific list of authorised personnel entitled to receive such information.

The seller should be careful not to draft the agreement in a manner that will be construed as a restraint of trading, making it void.

The Confidentiality Agreement should include the agreement of the parties that they will not, without the written consent of the other, make any disclosure of their negotiations regarding the proposed acquisition transaction.

Finally, the Confidentiality Agreement should cover the duration for which it shall have effect, any relevant exclusions, and of course the remedies for breach (which are usually damages, as an injunction would be of limited value after wrongful disclosure).

4. Due Diligence

(a) The buyer’s objectives

In the initial stages of the transaction, the buyer expresses an interest in the proposed acquisition, but may not have any detailed knowledge of the target. For this reason, the buyer does not enter into a binding commitment to acquire the target before it has enough information to make an informed decision.

The aim of the due diligence investigation (“Due Diligence”) is to allow the buyer to gather as much essential information about the target as possible, in order to reach a decision whether to proceed with the proposed acquisition and, if so, on what terms.

The Due Diligence is usually conducted prior to the share purchase agreement (“SPA”), but may also be conducted following the execution of the SPA but prior to closing.

Whilst through the Due Diligence a buyer is provided with significant information about the target, nevertheless it is crucial to keep in mind the basic common law principle of *caveat emptor* [“let the buyer beware”]. This principle essentially means that upon the completion of the acquisition, if the buyer subsequently discovers something about the target which was previously not discovered in the investigation and which is detrimental to him, then he has no remedy against the seller unless the discovery results in a breach of a representation or warranty in the acquisition agreement.

Due to the strictness of this rule, the buyer must elicit as much information as possible from the Due Diligence process. Some protection may be provided for the buyer through warranties and indemnities in the SPA, but no matter how extensive these are the strictness of the rule of *caveat emptor* will always be upheld.

(b) Divisions/ Types of the Due Diligence

The Due Diligence can essentially be divided into three parts.

The first part is undertaken by business advisers, who conduct a preliminary commercial assessment on behalf of the buyer.

The second part is undertaken by professional advisers who provide accounting and tax services and produce a wide-ranging report covering areas such as the commercial activities of the target, the management and human resources structure, taxation, profitability, accounting systems and balance sheet strength.

Finally, the third part is undertaken by the buyer's legal advisers, and is the part on which this guide will focus. It should be noted however, that in many cases the buyer engages the services of a team of professional advisers to conduct all three parts of the investigation, and produce a single report.

(c) Scope of Legal Due Diligence

The legal due diligence ("the Legal Due Diligence") focuses on the constitutional framework of the target, the terms on which it is trading, ownership of assets and any restrictions on their use and the extent of any potential liabilities of the target.

When the legal adviser is engaged to carry out legal due diligence, the first step is to customise the structure of this investigation for the particular client. There are a number of factors which should be taken into account during this first step. The legal adviser should look at what the commercial aims of the buyer are, any pre-existing relationships the buyer may have with the target, and make sure he is aware of the particular reasons for which the acquisition is taking place. Furthermore, all areas of risk should be identified and taken into account.

What is also of importance is the type of acquisition taking place; due diligence for a Share Acquisition is more detailed than that for an Asset Acquisition.

In addition to this, the extent of contractual protection to be provided by the seller is also of significance; the less protected the buyer feels the more detailed the investigation will be.

Finally, there are practical considerations that may limit the scope of the investigation, such as time constraints, financial resources and confidentiality.

(d) Process of the Legal Due Diligence

To some extent, it is up to the individual legal adviser to select the way in which he will conduct his investigation. Good organisation, diligence and creativity are skills that will assist an experienced lawyer in this field.

However, there is a widely accepted process used in conducting Legal Due Diligence.

The first limb of the investigation is to conduct public searches of the target. This search should include a full company search, an IP rights search (if necessary) with the Registrar of Companies and Trademarks, respectively, a search with the land registry if the target owns property, with the public files of any regulator under the regulation of which the activities of the target company may fall. Depending on the circumstances, searches in relevant websites, trade press and commercial organisations are also advisable.

The second limb of the investigation is to issue a due diligence questionnaire to the seller's legal advisers in order to obtain as much information as possible about the target. Such a questionnaire should be tailored to the particular business involved. It is important to be professional and not send out a general template with irrelevant requests of information. The legal adviser should also liaise with the business and tax advisers of the buyer so as to not overwhelm the seller's legal advisers with double requests for information. Provided a confidentiality agreement has been signed, or will be signed in conjunction with the investigation, the seller should have no problem in responding to the questionnaire with full and frank replies to the enquiries. The replies will have a significant bearing on the drafting of the warranties and indemnities which will form part of the SPA.

Finally, in the case where highly classified information is involved, a data room may be set up where the seller, through its legal advisers, will make available key documentation. The use of a data room can be particularly helpful in a transaction where the seller has particularly sensitive information to share and will need this kind of reassurance to enable it to feel confident about disclosure. The data room is usually operated by designated employees who may also be asked to sign a confidentiality agreement.

(e) Common areas of investigation

There is no exhaustive list of information that may be investigated when performing due diligence. Most legal advisors use their own pre-prepared checklist as a starting point, and from which they add or subtract parts which are relevant or irrelevant to the specific transaction.

(i) Corporate Information

The first group of documents that are usually investigated are those which contain the corporate information of the target. Corporate information can be further divided into three separate sub-categories of information, the first of which are the constitutional documents of the target.

For the Asset Acquisition, it is important to check the objects clause of the memorandum of association to see whether the company has the power to dispose of its (relevant) assets. Furthermore, the articles of association will have to be checked to identify the persons authorised to dispose them.

For the Share Acquisition, it is again important to scrutinise thoroughly the objects clause in the memorandum to ensure that the company has the power to carry on the business that the buyer is interested in purchasing. The articles of association will also be helpful to the legal advisers in planning the stages from exchange of contract to completion, especially if the articles provide for restrictions on share transfers (such as pre-emption rights).

The second sub-category relates to information on directors and shareholders.

In the Share Acquisition, it is crucial to request accurate information about the shareholders in order to ensure that the correct persons are entered into the SPA.

In any kind of acquisition it is also important to collect sufficient information about the current directors so that the buyer may make its decisions.

Finally, the third part relates to the company's internal registers and minutes.

The register of members and their minute books must be checked to ensure that all allotments and transfers of shares were carried out in accordance with both company law and the company's internal regulations. The register of directors and their minute books (along with their service contracts) should also be reviewed to make sure that the correct procedures were followed at all times. Finally, the charges register of the company should be checked, as the buyer in the Share Acquisition will be acquiring the company along with all its encumbrances. A thorough review of the charges register may help the buyer decide whether an encumbrance exists that makes the acquisition not worth proceeding with.

(ii) Financial Information

Even though the financial advisers will be carrying out their own investigation, legal advisers should also look at some financial information, in order to make an all-round assessment. For the first part, the target's audited accounts should be checked to ensure that they have been filed for at least the past three years leading up to the date of the acquisition, and that they fully comply with all legal requirements relating to audited accounts. Studying the audited accounts may also enable the legal adviser to start considering the extent to which warranties and indemnities should be included in the SPA.

Another issue that has to be examined is the financing of the company. In the Asset Acquisition, it should be confirmed whether any of the assets being transferred are subject to a charge (which may also be revealed on the charges register, discussed above). In such a case, the buyer should demand that the charge is removed upon completion, or ask for the consent of the chargee for the asset to be transferred subject to the charge. In the Share Acquisition, it is even more important to check the loans of the company. The legal adviser should ask for copies of all loan documentation in order to ascertain the nature and extent of the target company's borrowing commitments and obligations. It must also be checked whether any loans are repayable on demand or entitle the lender to demand immediate repayment of the balance on change of control of the target. If this is so, this can be remedied either by the buyer making arrangements with the lender directly, or by making it a term of the SPA that the seller will settle the loan. Also important to be checked is whether the seller has guaranteed any obligations of the target, or whether the target has guaranteed obligations of a third party. This is more relevant if the target is a member of a group of companies. The buyer will want to ensure that such obligations do not continue after completion.

Finally, the solvency of the seller has to be ascertained by making bankruptcy/solvency enquiries against the seller, including with the Registrar for Companies and Official Receiver. This is important as any proceedings entered into after bankruptcy or insolvency may be void.

(iii) Key Contracts

A crucial part of the investigation is the review of the key contracts of the target. The degree of scrutiny depends on the type of acquisition. For example, in the Share Acquisition the ownership of the target is changing and this could affect some or all of the key contracts of the company. In many situations one of the main reasons for the acquisition will be the buyer's desire to take the benefit of such key contracts, so it must be ensured that this will be secured.

Accordingly, in a Share Acquisition, the buyer should check whether any crucial contracts are due to expire in the near future. It is also important to check all contracts for any "change of control" clauses, which may render the contract terminable on the sale of the target. The buyer may consider renegotiating the purchase price of the target if it is going to lose certain valuable contracts. Finally, the buyer must be satisfied that all fundamental contracts have been properly executed and that there are no provisions which infringe any EC, Cyprus, or other applicable legislation.

In an Asset Acquisition, the buyer should require full details and copies of all significant contracts the target has entered into. This is important as the benefit of such contracts will not pass to the buyer unless the contracts are assigned or novated. Therefore, the buyer should closely examine all contracts which it considers vital to the well-being of the business, to see whether they require consent to assignment or contain any other restrictions.

(iv) Intellectual Property (IP) Rights

If the target holds any IP rights, the Legal Due Diligence must also involve a thorough search with the Registrar of Trademarks to ensure that trademarks are properly registered and adequately protected. Pending litigation in relation to such rights will be an issue for due diligence.

(v) Real Property and Other Assets

With regards to land and premises, it is advisable to request a structural survey, if there is enough time to obtain one. Certificates of title for any such assets should also be obtained and reviewed. As a result of the investigation, the SPA will later be drafted to include a warranty by the seller that it (or the target company) has good title and the property is free from encumbrances. It is also advisable to check whether all relevant planning legislation has been complied with, especially if the buyer intends to make alterations or improvements to any buildings, or is planning to effect any new construction.

Similarly, in relation to other significant assets of the target, it is important to investigate any existing charges thereon. For this, an independent search may be conducted with the Registrar of Companies, however, it is important to note that this would not be sufficient, as not all charges are required to be registered therewith.

(vi) Employees and Pensions

Part of the investigation should also cover the target's workforce, and in particular the directors and managers of the target. This is important in both an Asset, as well as a Share Acquisition, as in both transactions the rights and obligations of employees are transferred automatically to the buyer. The buyer should have a clear picture of the situation with regards to the employees of the company, so service contracts must be checked for details of any discretionary or customary arrangements. The records of the company should also be checked for any recent disputes, dismissals or changes in terms and conditions of employment which may result to a potential claim by any employee. It is also important to review whether there are any persons working in the business who are not formally employed by the target.

Furthermore, it is important to check any pension schemes set up by the target or which the target is involved in. The trust deed under which the pension fund is administered should be reviewed, and so should a list of its members. Since this is a complex area, specialist advice is usually obtained to ensure that pension schemes are properly set up and administered.

(vii) Environmental Matters

In recent years, environmental issues have gained more importance and relevance due to national and EC legislation. Therefore, where and to the extent they are relevant, legal advisers should spend some time investigating any environmental matters which relate to the target company. It should be confirmed whether the target has obtained all relevant environmental licences that should be in place in relation to the business it runs, and that the licenses will be transferred to the buyer upon completion. If such licences have not been obtained, it may give rise to criminal sanctions involving financial penalties, or even revocation of licence.

Moreover, the premises of the target should be physically inspected to ensure that the site is not polluted, especially in situations where the target owns assets such as a factory. The buyer will be directly liable after completion for cleaning up a polluted site, and this can prove costly and time consuming. Pollution may also give rise to third party claims against the target, and surely this is something the buyer will want to avoid. Finally, as environmental awareness has become all the more relevant in today's society, the buyer will want to ensure that it is acquiring a business which has a good reputation with regards to its carbon footprint and corporate social responsibility towards the environment.

(viii) Pending and Threatened Litigation

The Due Diligence should also cover any recent, pending or contemplated litigation. The buyer's legal advisers should seek details of any litigation, arbitration or other dispute in which the seller is or may become involved and which affects the business, together with details or copies of all pleadings made, settlement levels and estimated legal costs. If possible, the litigation files of the target should be sought in order to conduct this part of the investigation in as much detail as possible. Furthermore, details of any complaints by, or disputes with, customers, suppliers, employees or other third parties should be investigated and a proper risk assessment should be made if any exist.

D. Acquisition Agreement

Once the buyer has received the final version of the due diligence report, and has been advised by its advisers, it can make an informed decision as to whether to proceed with the acquisition. Having satisfied itself that the proposed acquisition is a sound investment, the buyer notifies the seller that it is willing to go through with the acquisition. The seller's legal advisers then prepare a first draft of the SPA, and send it to the buyer for review and further negotiation.

1. Structure of the SPA – The operative terms

Even though there is no strict rule as to how the SPA should be drafted, it is considered best practice to draft the terms in a carefully structured manner, with a logical flow. Many legal advisers opt for the use of schedules in order to make the SPA easier to read. Nevertheless, whatever structure is followed to draft the SPA, there are a number of operative provisions which should be included in order to safeguard the rights and ensure the obligations of both parties involved.

Before proceeding to analyse such terms, it should be emphasized that there exist matters which should be included in the SPA for its validity under Cyprus Law, such as clearly stating all the parties involved, the date of the agreement, the agreement for the sale, the consideration and conditions of sale.

(a) Definitions and Conditions Precedent

The SPA first of all should include a comprehensive list of all definitions which are used throughout the agreement. The second clause usually covers conditions precedent to the agreement, especially in the situation where completion will not occur on exchange, but at a later date. Therefore, the SPA may be entered into on the basis that it will be completed if certain conditions are fulfilled. This can include an obligation of the parties to seek fulfilment of such conditions, and also a longstop date by which they must be fulfilled, or waived. Depending on the circumstances, a time-frame may also be included.

(b) Agreement for Sale, Consideration and Completion

The agreement should then set out what is being bought and sold, either by reference to a schedule, or outright in the clause. It must be specified whether a full or limited title guarantee is granted in order to safeguard the buyer's interests. The consideration to be paid for the acquisition, stipulating the price, form and timing should be set out. In the Asset Acquisition, a schedule may also be used to set out the amount attributable to each asset. The consideration may be fixed or a provision may be included to allow for price adjustments in the case where the exchange will not occur simultaneously.

When negotiating, the parties are making a valuation based on dated information, such as the latest audited accounts. The buyer will want to verify this projection at the completion date. Therefore, parties may agree to adjust the price to reflect the actual net assets and profits of the target on the date of completion. This can be determined by a set of agreed accounts which are drawn up at or after completion, known as completion accounts. The SPA usually provides for a maximum purchase price, to which further adjustments (or repayments) are to be made once the completion accounts have been prepared.

Another arrangement that can be made is to link part of the consideration to the future profitability of the target for a specified period after completion. Typically, part of the purchase price is agreed to be paid at completion, to be followed by further payment(s) made depending on the profits of the target within the period specified. This is known as an earn-out provision. Such a provision avoids the buyer having to pay too much for a target which fails to perform as expected, and also acts as a motivating factor for the target's directors, especially if they are to remain in their position after completion.

Furthermore, in the case where completion will follow at a later date, the SPA should include provisions covering payment terms, often by way of a fixed amount to be paid in cash on the completion date. However, the seller may agree to deferred consideration, where the buyer will pay in instalments.

In such a case, interest might be payable on any outstanding sums, and the price may be adjusted subject to completion accounts. The buyer may insist on retaining part of the purchase price as security in case a warranty claim arises. This is appropriate where parties are aware of potential liability arising or where the buyer expects a particular benefit to accrue from the sale, such as continuance of trade with particular debtors and creditors of the target.

A frequently used mechanism in the case where exchange does not occur simultaneously is the creation of an escrow for the holding of the purchase price, or part thereof, or even the title deeds of the shares of the target, as well as instruments of transfers for the shares, until the satisfaction of conditions.

(c) Restriction on Seller's Activities

The buyer will also seek to protect the goodwill of the target by including restrictive covenants to restrict the seller's activities (in regard to competition with the target) after the completion date. This is more widely known as the "non-competition clause". Care should be taken when drafting such a clause, as courts will not enforce a clause barring the seller from setting up a competing business. Only implied undertakings will be enforceable, such as not disclosing confidential information, forbidding the seller from representing itself as the business it has sold, and from soliciting customers from the business. The key in drafting such a provision is that the clause can go no further than necessary from protecting the goodwill of the business or company.

The buyer should be aware that all restraints of trade are prima facie void at common law but the court will not strike down a clause if it considers it reasonable to protect the buyer's legitimate interests. In the case where the clause is disputed, the court will look at the time duration of the restraint (it will usually only be considered reasonable if it spans 1-5 years), the geographical area of the restraint and the activities it seeks to restrain. Finally, the clause should be drafted to keep the restrictions separate from each other, so in case one of them is struck-out, the others will remain unaffected.

(d) Other important clauses

The SPA usually also contains clauses relating to employees and pension funds, insurance, VAT and boilerplate clauses, including an entire agreement clause, a clause excluding the rights of third parties and clauses to provide for notices, variation, severance and choice of law and jurisdiction.

The choice of law and jurisdiction clause has to be considered with care, since it will bind both parties to the full extent of the agreement. In most cases Cypriot Law and the Jurisdiction of the Cypriot courts is chosen, especially where the acquisition does not take an international perspective. The courts in Cyprus have proven to handle disputes from such agreements in a satisfactory way, applying the law and the principles of equity in a just manner.

However, where the parties wish to avoid court proceedings in the case of a dispute, a dispute resolution clause may be negotiated and inserted into the SPA to provide for an alternative form of dispute resolution, such as mediation, alternate dispute resolution (ADR) or arbitration. Such a clause directs parties in dispute to initiate the agreed form of dispute resolution in order to produce a compromised solution without engaging the costly and time-consuming court procedure and would be upheld by a Cyprus court.

2. Warranties, Representations & Indemnities

(a) Warranties

As discussed above, the SPA should include a carefully drafted clause (often accompanied with a detailed schedule) of the warranties granted by the seller to the buyer. The purpose of giving warranties is two-fold; first to provide the buyer with a remedy in case of breach, and second it is a mechanism to elicit information about the target from the seller. As the seller will want to avoid any liability for breach of warranty, it will attempt to disclose all relevant information before the SPA is agreed and signed. Finally, warranties are made about the state of the target at a specific point in time; if completion will not be simultaneous to exchange, then the warranties will be re-confirmed at completion.

(b) Indemnities

Warranties usually go hand in hand with indemnities. The indemnity basis is usually compensation on a "euro for euro" basis for the loss the buyer has suffered. However a threshold and or pre-agreed maximum may be contractually set. The amount recoverable under an indemnity is far more favourable to the buyer, because it is not only the cost of fixing the problem, but also any costs or expenses relating to it that may be indemnified.

The buyer generally wants indemnities wherever they are possible, but the seller is reluctant to give them. The final draft in the SPA is therefore the end result of negotiations between the two parties, based on each side's bargaining power. Therefore, unless the buyer has a particularly strong bargaining position, it is only likely to obtain indemnities for tax liabilities (in a share acquisition) and certain areas where a specific problem has been identified from the Due Diligence process. Some of these areas may be environmental risks, potential litigation for infringement of IP rights, specific book debts, loans of the target and product liability claims.

(c) Relevant issues when drafting warranties and representations

Some consideration must be given to who actually will give the warranties to the buyer. In an asset sale, it is always the seller company. In a share sale, it depends on who the shareholders are. If the target is a wholly owned subsidiary, then the parent company will be giving the warranties. In other situations, it will be the individual shareholders. However, this may be a sensitive issue, especially if there are minority shareholders involved with no active involvement in the company. Such minority shareholders will be reluctant to assume the exposure to liability as they will have limited knowledge. Other shareholders who will be reluctant to give too many warranties (and indemnities), are institutional sellers and trustee shareholders. Since such shareholders are holding shares solely for investment purposes, they will want to limit their liability.

(d) Negotiating Warranties

It is common practice for the buyer's legal advisers to seek that the warranties are drafted as widely as possible, in order to achieve maximum protection for their client. In contrast, the seller's legal advisers aim to keep the warranties as concise and narrow as possible, to restrict the liability of the seller. Since this area will usually be heavily negotiated, the clause is usually drafted by including certain limits, as a sort of compromise between the parties.

Firstly, a time limit on warranty claims may be imposed, as a limitation period for which warranties are actionable. For tax indemnities, this is usually a period of six or seven years from the date of contract. For all other matters, it is usually a period between one and three years after the sale, when the parties would expect any problems to have been identified.

Another solution is to place a financial limit on warranty claims. The limit will cover a minimum limit for individual claims, a minimum limit for aggregate claims, and a maximum overall limit for all claims. The minimum limit will typically be 1% of the (aggregate) consideration price. The maximum limit is often set as the purchase price, respecting the principle that the seller should not pay out more in damages than the consideration it has received. Furthermore, if any of the parties is taking out insurance, a double recovery clause may be inserted, which prevents the buyer from claiming for the same loss twice, and obligates it to seek compensation via the insurance route first.

In general, when acting for the seller, a legal representative seeks to exclude any general warranties (for example, that the buyer has been supplied with all relevant information). In addition to this, any warranties which are forward-looking (and warrant matters about the target's future performance) are also avoided. Finally, the seller's representatives seek to insert the wording *"so far as the seller is aware"* into the warranties clause, so as to limit the warranty by the seller's actual awareness.

(e) Representations

A warranty may also be a representation where it was made by the seller in pre-contract negotiations, and it induced the buyer to enter into the contract. Therefore, if a warranty has induced the buyer to enter into the contract, it will be deemed a representation, and breach will entitle the buyer to rescind the contract, especially in situations where there is a gap between exchange of contracts and completion of the acquisition. The buyer may also be entitled to damages in the case of misrepresentation.

The nature of an acquisition agreement makes it likely that any representations made by the seller in the pre-contract stage, and which have induced the buyer to proceed with the agreement, will be included in the SPA as warranties. In such a situation therefore, the buyer's legal representatives seek to have such representations included in the SPA as warranties. In contrast, the seller's representatives seek to limit this by inserting an acknowledgment in the SPA that the buyer has not relied on any representations, known as a "non-reliance" clause.

A "non-reliance" provision is essentially an acknowledgment by the buyer that he has not relied on any representations which are not contained in the contract. In order to rely on such a clause, the seller must prove that the provision itself if clearly drafted, that the buyer intended for the provision to be acted upon and that the seller belied the statement to be true. In other words, it must be obvious that the buyer was not relying on any other representations except those expressly incorporated into the agreement. If the seller knows this statement to be untrue, then he cannot rely on it against the buyer.

Finally, another way of safeguarding the seller is to include an "entire agreement" clause in the SPA. It should be noted that such a clause can never exclude liability for fraudulent misrepresentation.

3. Disclosure

(a) The Disclosure Letter

The disclosure letter forms an integral part of the acquisition transaction, and is closely linked to the SPA. Its purpose is to disclose matters which have to do with the target, which if they were not disclosed would result in the seller's breach of warranty. The disclosure letter is usually prepared by the seller's legal advisers, who identify and go through each of the warranties in the SPA to ensure that the seller has disclosed all known facts which may give rise to a warranty claim by the buyer.

Disclosure serves a purpose for both parties. For the buyer, it supplements the Due Diligence process, and gives the buyer a fuller picture of the target. The buyer may use the disclosure letter to identify additional risks and re-negotiate the purchase price, ask for further indemnities to cover a specific risk, or even walk away from the transaction. For the seller, disclosure essentially means that the seller is negating its liability under a warranty. In other words, it is in the seller's best interests to disclose as much as possible, to avoid future argument as to whether the buyer knew or not about certain facts which give rise to a breach of warranty. Full disclosure will also provide the seller with a successful defence against a breach of warranty claim.

(b) The Standard of Disclosure

The standard of disclosure required under the warranties is incorporated in the warranties clause of the SPA. The standard will apply to both deemed or general disclosure, as well as specific disclosures. The SPA however often states that disclosure will only be effective if it could reasonably be expected that the buyer will become aware of the relevant breach of warranty from the examination of the documents.

The starting point is that for disclosure to be effective, the buyer must be given specific notice of the particular issue qualifying the warranty. If the parties' legal advisers fail to include a standard of disclosure in the SPA, then the standard to be applied will be that the seller must give specific notice, and that disclosure should be "full and fair". However, this is not common, as the parties negotiate and often reach a compromise to what the standard of disclosure should be.

A standard which is more favourable to the buyer is where the agreement provides that the buyer's "actual or constructive knowledge" does not preclude a claim for breach of warranty. In such a situation, the seller would have to show that the buyer's actual or constructive knowledge affected the consideration price, in order to defend a breach of warranty claim.

Notwithstanding the above, the drafting more frequently used as a compromise between both the seller's and buyer's interests, is that where the buyer has "actual knowledge", then it cannot claim a breach of warranty. By removing the word "constructive", this limits the standard only to information that the buyer actually possesses. The seller's legal representative will always try to negotiate such a standard in order to safeguard his client.

E. Completion

1. Between exchange and completion

Completion of the acquisition transaction will likely occur simultaneously with the signing of the SPA. There are however circumstances in which the parties will agree that completion of the acquisition will occur at a later date. In such a case, additional provisions may be considered, negotiated and included in the SPA, to protect both buyer and seller for this time period.

(a) Conditionality

Before the acquisition is completed, various approvals, consents and clearances may have to be obtained. Such matters may include a clearance from the Cypriot tax authority, a notification from the Cypriot commission for the protection of competition, the provision or transfer of a regulatory licence for the particular industry, confirmation of consent to assign any contracts, consent of a landlord for the change of a tenant, and the shareholders of a corporate buyer passing any necessary resolutions.

(b) Conditions Precedent

As already mentioned with respect to the structure of the SPA, the agreement can contain a clause dedicated to any conditions to be fulfilled and specific terms relating to them. One such important condition precedent is that the buyer will seek the repetition of warranties. A buyer with a strong bargaining position will usually negotiate this into the conditions precedent, giving him the right to withdraw from the acquisition in the event of a breach.

Another important addition would be a material adverse change (MAC) clause, which would give the buyer the right to terminate in the event of a MAC in the business, assets or profits of the target, during this period. Such a provision is intended for the protection of the buyer against the general risk of adverse events that may occur in the period between signing the agreement and completion.

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