

Buying the Business of an Insolvent Company

Introduction

Despite the difficult current economic climate, business opportunities still exist and one of these can be buying a business which is insolvent and in the hands of an insolvency practitioner. This can be an opportunity to acquire market share or valuable assets quickly, and at a bargain price. A prospective purchaser needs however, to approach such acquisitions with an open mind and a keen understanding of the issues likely to be involved and the way in which it will differ from a standard business acquisition. This will enable a purchaser to assess the risks and the potential reward in the short timeframe likely to be available.

Balancing the Risk and the Price

Once appointed, an insolvency practitioner will quickly arrange for the business to be advertised to all potentially interested parties. A sales brochure may be produced but as the insolvency practitioner will not want to disclose information which may damage the value of the business this will often contain only a brief factual description of the business and assets for sale. It is for the purchaser to try and conduct as much due diligence as is possible in the timeframe suggested and from the sources of information available.

The insolvency practitioner may allow the purchaser to visit the premises of the insolvent company to inspect its assets but it is possible that the purchaser will not be able to speak to employees and review accounts, asset registers etc.

The timeframe on such sales is usually very tight. This is because the longer the business remains in the hands of the insolvency practitioner, the greater the risks of its deterioration - debtors become disinclined to pay and creditors may refuse to extend further credit. A purchaser is being expected to complete the acquisition in such a short space of time and without the comfort of even the most basic of due diligence because this is reflected in the price being paid for the business. However, as a purchaser is still assuming a significant amount of risk, it should still fight hard to minimise this risk in anyway possible.

Differences from a Standard Business Purchase

In a standard business purchase on normal commercial terms, the purchaser will look to minimise its risk by ensuring that the seller does not make a clean break from the business it has sold after completion. The purchaser will be willing to pay the asking price based on what it has been told about the business and what it has subsequently found out through due diligence. To back up this information, the purchaser will expect the seller to give representations and warranties about the performance of the business, its assets and liabilities. If these factual statements prove to be incorrect, then the purchaser will be entitled to make a claim for breach of warranty and recover its loss.

Acquiring a business from an insolvency practitioner is somewhat different in that the insolvency practitioner will not want any continuing liability, either personal or on behalf of the insolvent company, after completion. It is likely that the insolvency practitioner will refuse to give any warranties at all in relation to the business and the assets.

Faced with this lack of information and warranty protection, the purchaser may struggle to get comfortable with what it does not know and therefore whether it is in fact getting the bargain advertised.

Getting into the mind of the Insolvency Practitioner

From a negotiation perspective, clearly the insolvency practitioner is the key individual. He has stepped into the shoes of the seller and will assume control of the process. As set out above, an insolvency practitioner will be very keen to conclude any sales process quickly as the value of the business and the assets will be diminishing all the time. Whilst this leads the pressures on the purchaser as set out above, it does also have an impact on the position of the insolvency practitioner. It is important at the outset of a potential transaction for a purchaser to try and assess what the insolvency practitioner is trying to achieve. What are his major considerations? Can he continue to pay the employees for another week? Has he got suppliers or customers on the point of withholding payment or credit? Are there retention of title claims to be dealt with? The answers to such questions will give a purchaser an idea of how keen the insolvency practitioner is to sell and how quickly and therefore may strengthen the bargaining position of a purchaser. What a purchaser is prepared to pay for the business and assets may in reality be more than what the insolvency practitioner is willing to accept to achieve a clean break. The key is asking the questions that are likely to reveal such issues and then of course trying to get the answers to them.

There are some key areas that need to be considered by a purchaser to assist the process of balancing the risk against the reward:

Title to the assets

A purchaser must ensure that the assets it is acquiring are actually owned by the insolvent company. The insolvency practitioner has no title to sell assets which do not belong to the company because either they are held by the company as trust, are subject to retention of title arrangement or are owned by another company in a group which is not subject to the insolvency proceedings. It is very important to include in the sale agreement a list of the assets being sold, and to ensure these are all in the possession of the seller.

If, for instance, the insolvent company has carried on business as a manufacturer or supplier of goods or equipment, there may be assets being sold which include assets delivered to the insolvent company on retention of title or other conditional terms (on terms that title in the goods does not pass to the insolvent company until the goods, or possibly all the goods delivered by that supplier to the insolvent company, have been paid for).

As a matter of practice, an insolvency practitioner will, as soon as possible after his appointment, seek to identify and deal with as many retention of title creditors as possible. However, it is always possible that, at the time the business and assets of the insolvent company are sold, not all retention of title creditors will have been dealt with, in which case, the purchaser may have to deal with them.

It may be that the purchaser can negotiate a reduction in the purchase price based on the value of the assets which are subject to the outstanding claims. The commercial reality is that if such retention of title issues come to light after completion, the purchaser will have to negotiate with the relevant supplier to retain the assets, especially if it is crucial to the ongoing business.

Employees

One of the most difficult issues associated with the purchase of a business of insolvent companies is the application to the purchase of the Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE). If TUPE applies, contracts of employment of employees in the insolvent company (including all liabilities of the company to the employee) are transferred automatically from seller to purchaser. Where the transfer takes place in an insolvency situation, the application of TUPE is varied so that there is more scope for varying terms and calculations of employment after the sale, and in addition the National Insurance fund may pick up some of the liabilities for wages and certain other payments due to employees which would otherwise pass to the purchaser.

In a standard commercial acquisition, a purchaser would protect itself through the insertion of warranties and indemnities. However, as set out above, an insolvency practitioner will rarely, if ever, agree to provide any indemnities against potential liabilities. Indeed, the insolvency practitioner may require purchaser to provide an indemnity in favour of the company and himself in respect of any claims subsequently made by employees against either the company and/or the insolvency practitioner.

Property

There is unlikely to be time for the purchaser to carry out the standard investigation of title and/or review of lease documentation so again it is a question of assessing the risk as accurately as possible always bearing in mind the purchase price and how the purchaser is intending to run the business post completion.

Where property is leasehold very often, the relevant lease will make the assignment of that lease from the insolvent company to the purchaser conditional upon the landlord's consent being forthcoming. A landlord may seek to use the insolvency of his tenant as an excuse to withhold consent to recover arrears. The landlord may however be willing to agree a new lease with a solvent tenant to avoid having an empty unit and a lack rental income.

If the premises in which the purchaser acquires are essential to the conduct of the business post completion, then, pending the receipt of any landlord's consent, then it may be possible to occupy the premises under licence.

VAT

As with a standard commercial acquisition, assets sold on a going concern basis are not subject to value added tax. The sale documentation will customarily state that all consideration stated as being payable is exclusive of VAT and that the insolvent company and the purchaser will use their best endeavours to obtain relief from VAT. The agreement will also provide that if the insolvent company and/or the insolvency practitioner becomes obliged to account for VAT on the consideration, then the purchaser will, upon production of appropriate VAT invoices, make a payment to the insolvency practitioner of an amount equal to that sum demanded by way of VAT from the insolvent company and/or the insolvency practitioners.

Clearly, every business is different and will throw up any number of potential risk areas. A purchaser is essentially trying to make a worthwhile assessment of the risks involved to ensure it does not overpay for assets or take on liabilities he did not intend to. A purchaser does need to come to terms with the fact that it may not get the answers to all of the questions it has but if it takes proper legal advice in the time available hopefully this can help to ensure that the risks are mitigated as much as possible.

If you require any advice in relation to transactions with an insolvent company please contact Jonathan Williamson on 01865 811228 or jwilliamson@darbys.co.uk or Justin Ray on 01865 261154 or JRay@critchleys.co.uk