Share Deal vs. Asset Deal - What to Consider from an Employment/HR and Commercial/Business Perspective!

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Complex cross-border transactions require thorough preparation and comprehensive legal advice. This article will sum up some key insights how to deal with challenges and risks when it comes to cross-border share and asset deal transactions comparing the different legal implications for both types. The following will not only cover the HR perspective but also discuss business and commercial issues and thereby show a multidisciplinary and international approach.

1. **Legal Principles of the Purchase of a Company**

In the context of corporate transactions, which are also described under the term "Mergers and Acquisitions", the provisions of very different sub-areas of law must be observed, which makes such projects complex legal consulting subjects. Possible motives for corporate transactions can be very varied and provide the respective perspective for legal advice. From the buyer's point of view, the motivation for buying a company can be, for example, that companies want to leverage synergistic potential through acquisitions, acquire know-how, and generally realize value creation by merging companies. From the seller's point of view, the concentration on a core competence of the company can be decisive for the sale, or the company - especially in family businesses - can use the sale as a possibility for company succession.

1.1 **Share Deal vs. Asset Deal**

In corporate transactions, a general distinction is made between an asset deal and a share deal, because the sale of a company can technically take place in two different ways. Whether an asset deal or a share deal takes place depends on how the object of purchase "company" is legally defined in the respective purchase contract.

On the one hand, the seller has the possibility to sell all goods and rights of a company or branch of a company as object of purchase. Then all "assets" of the company are sold. The acquirer receives ownership of the individual assets, which is why the individual legal regulations must also be observed for the transfer, in which way the acquirer acquires ownership (e.g. by transfer, by assignment; in Germany, the so-called requirement of certainty under property law also applies, according to
which all objects and rights that are to be transferred must be expressly and unambiguously designated).

On the other hand, the seller may also transfer his shares in the company (depending on the type of company). Then it is a pure legal purchase. The requirements for the purchase contract are based on the respective requirements for the transfer of the share right (in Germany, for example, notarization for the transfer of GmbH shares). In this case, only the shares change ownership. The respective assets of the business remain with the company. The company itself receives a new owner.
The structuring of the company purchase by the parties involved as an asset deal or as a share deal is usually based on tax law aspects. In simple terms, it can be stated that an asset deal has a greater depreciation potential for the buyer, which can be used to refinance the purchase price. The share deal, on the other hand, can reduce the seller's tax burden if a corporation can collect most of the profit from the sale of shares in the corporation tax-free.

1.2 Parties in the Purchase of the Company

1.2.1 Seller

The persons involved on the seller's side differ with regard to share deals and asset deals. In the case of a share deal, a shareholder sells his shares in the company; in the case of an asset deal, the company (sole trader, partnership or corporation) sells the essential assets.

1.2.2 Acquirer

On the acquirer's side, a distinction must often be made between a legal and an economic buyer (such as a group parent company). In some cases, a separate acquiring company ("NewCo") is formed specifically for the transaction, which may have tax and liability reasons.

1.2.3 Third Parties

Often the cooperation of third parties is also required in the case of a company purchase, for example the clearance by the cartel authorities.

In the case of a share deal, third parties may be entitled to first refusal rights in respect of the shares concerned or the consent of the shareholders or the
company may be required for the transfer of shares (in the case of restricted transferability). However, the legal relationships of the Company with outsiders remain unaffected by this form of sale, as a change only takes place in the ranks of the shareholders.

The option rights of third parties can also play a role in an asset deal with regard to individual items. In contrast to the share deal, the transfer of long-term obligations (e.g. rental agreements) to the buyer also requires the consent of the seller's respective contractual partner. For employment contracts, the statutory provisions in the EU provide a transfer of the contracts (as described later in detail).

2. **Warranty for the Purchase of a Company**

According to German law, the general provisions of the law on the sale of goods for warranty of defects would in principle also apply to the purchase of a company. However, the parties often find the statutory provisions for defects in case of the purchase of a company inappropriate - for example, because a purchase of a company once executed can hardly be reversed, as the general right of withdrawal in the purchase law would make it possible in case of not inconsiderable defects. Even if the general provisions for the sale of goods are not applicable - for example under English law - the same problem exists that the parties have an interest in a differentiated, balanced system for liability for defects, indemnification and legal consequences of infringements.

2.1 **Possible Defects in the Asset Deal**

Possible defects may be a deficiency of the enterprise as such, such as when intangible, non-legal assets (e.g. the reputation of the enterprise, the goodwill) are affected. In addition, incorrect financial statement information may also give rise to a defect if the seller provides incorrect information about the company’s current turnover or earnings. In order to create clarity here, it makes sense for the parties to agree that such disclosures, in general which subjective characteristics, are to be used for determining a defect.
However, it is legally controversial whether the defects of individual assets also justify a defect in the object of purchase, the "enterprise", which in the end can only be assumed if the defect is so serious that it affects the entire object of purchase, the enterprise itself.

2.2 Possible Defects in the Share Deal

The object of purchase in a share deal is the right of participation itself. In any case, a defect exists if the participation right itself is defective (e.g. because it is subject to an encumbrance). However, it is more difficult to answer the question whether defects of the business operated by the company itself or individual defective assets of the company can justify a defect within the framework of a share deal. For example, it would be inappropriate, if a shareholder, who acquires only an insignificant number of shares, was able to assert claims for the infringement of warranty rights in respect of the company itself. Rather, it is necessary that the share deal is equivalent to an asset deal from an economic point of view. The acquirer must therefore gain some sort of "control" over the company. The amount of shares, from which this can be said, is to be assessed with a view to the individual case.

3. Procedure and Elements of the Company Acquisition

Since a company takeover is legally and technically very complex, the parties must structure the necessary steps well. Roughly speaking, a distinction can be made between the analysis and conception phase for the preparation of the deal, the transaction phase and the post-acquisition integration phase. How an M&A process is further subdivided in detail depends on the individual takeover conditions, in particular on whether the initiative is taken by prospective buyers or by the seller. In the case of public takeover offers for listed companies, the takeover process is significantly influenced by the statutory provisions of the respective Takeover Act.

3.1 Letter of Intent

During the search for a potential buyer or seller for a corporate transaction, very little information is usually exchanged because it is confidential and should not be made available to a larger circle of interested parties. Once a potential buyer has been
found for the company to be sold, the parties have an interest in recording their intentions and partial results before a final, binding agreement is reached. Such a statement is commonly referred to as a "letter of intent" (although there are many terminological differences and inconsistencies). The effect of such a "LOI" is often said to lie primarily in the field of negotiation psychology. In fact, it records agreements that have already been reached and forms the basis for future measures by the parties. However, as a rule of thumb a declaration of intent is not legally binding, which is often expressly stated by the negotiating parties. At most, individual "preliminary agreements" have binding effect, for example on the provision of information (above all within a due diligence), the bearing of costs or exclusivity in negotiations.

However, liability may arise from the violation of pre-contractual duties of protection, diligence or clarification. Whether and when this is the case depends above all on the concrete form of the declaration of intent. A party may, for example, be liable for damages if it breaks off negotiations without a valid reason, even though the other party has been given a legitimate expectation that the contract will be concluded and has thus been induced to incur concrete expenses.

3.2 Due Diligence

In such company takeover processes, the information about the target company is usually distributed unequally between buyer and seller. In order to compensate for this asymmetry of information, a company audit, the so-called "Due Diligence", is carried out in practice. In a Due Diligence the prospective buyer is enabled to inspect essential information about the target company for a limited time in a data room. The data room increasingly consists of electronically available documents and is often created purely virtually. The buyers regularly submit a list in advance in which they list the desired documents. In addition, the seller is required to submit certain statements, in particular a statement that all relevant information has been provided in full and accurately.

The scope and the topics to be examined vary considerably from transaction to transaction. In the legal due diligence, lawyers determine the legal risks hidden in the company (articles of association, raising and maintaining capital, contracts with
customers and suppliers, collective and individual employment contracts, etc.). In order to ensure that nothing relevant is overlooked in a due diligence, standardized checklists are processed, which are adapted to the individual case in advance. The due diligence is concluded in a "report" by the advisors for the prospective buyer.

In addition to the buyer, the seller also has an interest in carrying out a due diligence. The due diligence can reveal concrete problem areas which the buyer would like to see taken into account by means of a corresponding purchase price reduction or guarantees. However, if the information were not made available to him, he would hardly be able to calculate the risks associated with the transaction and would therefore be forced to make a larger risk deduction from the purchase price from the outset. Due diligence thus also serves to achieve the highest possible purchase price. In addition, a due diligence by the buyer is interesting for the seller because it may exclude warranty rights under sales law or entitle the seller to demand that such warranty rights are to be excluded for information available to the buyer. Finally, the results of the tax due diligence can be used to design a transaction structure that is optimal for both parties under tax law.

If the target company is a stock company, the executive board often faces difficult legal problems. The management has to decide whether it is allowed to publish the corresponding information in a due diligence at all, because in principle, the Management Board is bound to secrecy. On the other hand, conducting a due diligence may be in the interest of the company. The Management Board must therefore decide at its dutiful discretion whether and when a due diligence can be carried out, depending on the interests of the company. Factors to be considered include, among others, the guarantee of confidentiality, the seriousness of the purchase intention of the prospective buyer and the interest of the company in stabilizing the circle of its shareholders. On the other hand, the managing director of a private limited company is usually bound by instructions of the shareholders' meeting anyway, so that he is legally protected by a corresponding shareholders' resolution.
4. **Key Aspects of a Company Purchase Agreement**

Although the company purchase agreement is essentially a purchase agreement, it usually regulates the rights and obligations of the parties comprehensively and conclusively. The statutory legal regulations are to be consulted then only with gaps in the contract. This approach can be explained by the fact that the law on sales does not contain any completely usable legal provisions for company acquisitions and that there is hardly any established case law on company acquisitions, since disputes arising from these transactions are predominantly settled before arbitration courts. Furthermore, M&A transactions often have an international component, which is why the parties wish to be independent of the respective state law.

Before the actual contract text, there is often a preamble summarizing the (economic) background of the transaction. Although the meaning and purpose of the contract must be taken into account in the interpretation anyway, this introduction facilitates such a teleological interpretation for third parties. Furthermore, the preamble may also contain the basis of the contract (which may be relevant in the case of force majeure). At the beginning of the actual contract, the parties are listed and the object of purchase is defined, whereby the more detailed form of asset deal and share deal differs.

There is considerable room for manoeuvre with regard to the nature and amount of the consideration to be paid. For example, the purchase price may be payable in cash or in shares. A company valuation is an important indicator of the purchase price, but the buyer's strategic considerations and risks can also have an influence. The final amount of the consideration is often left open in the purchase contract and is made dependent on the development of the target company up to the actual transfer of ownership at a later date. Furthermore, it is also possible to link this to the success of the company in the period after the transfer ("earn-out clauses"), in which case it must be ensured through information rights for the seller that the buyer does not intentionally keep the proceeds low by manipulation in order to reduce the purchase price.

Furthermore, key aspects of the regulation of the purchase agreement are warranties and indemnities. The agreements made in this regard can in turn have an effect on
the purchase price. As a rule of thumb, it can be said, that the lower the seller's liability is in the respective agreement, the lower is also the purchase price. To secure warranty claims, it is sometimes also agreed that the purchase price is to be paid in installments, or partial amounts are initially paid into a trust account.

The execution of the company purchase agreement is referred to as "closing". Since there is usually a certain period of time between the agreement on the purchase agreement ("signing") and the closing, it is advisable to make provisions for this interim period. Typically, the seller undertakes not to enter into any extraordinary transactions without the consent of the buyer until the closing date. In addition, conditions are formulated for the execution (such as the consent of third parties). The fact that circumstances outside the target company can also change can be taken into account by contractual rights of withdrawal (material adverse change clauses).

The buyer often insists that the seller does not compete with the transferred company for the foreseeable future. This can be ensured by non-compete obligations. However, the German legal system, for example, places various requirements on the content of such non-compete obligations so that they are not ineffective. The seller is regularly remunerated for the non-compete obligation, while he undertakes to pay a contractual penalty in the event of an infringement.

5. Transfer of Employees

When a company is acquired, the question arises as to the fate of the existing employment contracts. On the one hand, the buyer may be burdened if he has to take over employees; on the other hand, he may have a great interest in the continuation of employment contracts with key employees. In this respect, the focus in Europe is on the national regulations on the transfer of employment relationships in transfers of undertakings (in the UK this law is called “TUPE”), which originate from the Directive 2001/23/EC. However, in case of a share deal the regulations from the Directive usually don't apply.

5.1 Transfer of Employees in a Share Deal
In the case of a share deal, generally speaking the existing contracts of the sold company remain unaffected. This is because only the ownership behind the legal entity changes. As a legal entity, the company itself is usually the contracting party for any agreements with third parties. Only in exceptional cases, there are change-of-control clauses under which contracts can be affected (e.g. trigger a right for termination for one party, which must be examined within a legal due diligence), for example, if the ownership structure of the legal entity changes. However, this is usually not the case in employment contracts.

Thus, with regard to employees, the general rule applies that the contracts remain in force. The employment relationships therefore remain with the company, which - and thus also its new owners - continues to be liable for all past, present and future liabilities arising from these relationships. For this reason, it is particularly important in a share deal to closely examine the employment relationships within the framework of a legal due diligence and also to investigate whether there are still claims from employment relationships from the past which the company has not yet fulfilled.

If the new owner wishes to part with some or all of the employees in the course of the takeover of the Company, the general provisions on how employment relationships can be terminated apply. They are governed by the law to which the employment contract is subject. In this context, the provisions on protection against dismissal in the respective member states of the EU must also be taken into account.

5.2 Transfer of Employees in an Asset Deal

In the case of an asset deal, the fate of the employment relationships depends on the regulations of the nation states with which they implement the Directive 2001/23/EC. The idea behind the directive is that employment relationships are transferred by law to the buyer of a business or a part of a business, even if the buyer does not purchases the employment contracts at all, but the seller would retain them in accordance with the provisions of the company purchase agreement.

The problem with the provisions of the Directive 2001/23/EC is that it contains some common rules, but at the same time leaves room for manoeuvre for the implementation of the Directive in the respective Member States of the EU. Because
of the obligation of nation states to transpose the Directive into national law, different rules in the Member States apply, some of which differ considerably from each other. This is based on the fundamental problem of legislation in the EU.

5.2.1 Basic Principles of EU Legislation

The provisions on the transfer of employment relationships in the case of transfers of undertakings thus fall within the scope of harmonizing legislation within the states of the European Union. Legislative harmonization has been and continues to be a key element of the EU's community action. This objective is generally achieved in the EU through different legislative instruments. As such, there are in particular regulations and directives.

- A regulation is a binding legal act that all EU countries must implement in full.
- A directive is a legal act that defines an objective to be achieved by all EU countries. However, it is up to each country to adopt its own legislation to achieve this objective.

The Directive 2001/23/EC is one such legal act. In the following, therefore, the key points which the nation states within the EU had to implement in order to harmonize the law on the transfer of an undertaking will be presented. Therefore, where the legal requirements of individual provisions of the Directive are reproduced below, this always includes the requirement that they have been transposed into national law, which is in essence the case. Besides, there are basically many options for the respective national legislator, so that the laws of the nation states concerned must always be reviewed for the details.

5.2.2 Requirement of a Transfer of an Undertaking

The Directive is subject to the transfer of a (part of an) undertaking. According to Art. 1 No. 1 lit. b of Directive 2001/23/EC, a transfer within the meaning of the Directive is the transfer of an “economic unit” which preserves its identity in the sense of an organizational grouping of resources for the pursuit of an economic main and secondary activity. The provisions are therefore only
relevant in the case of an asset deal, since in the case of a share deal only the participation in the continuing legal entity is transferred to the purchaser. Since the Directive requires a change of ownership, it does not apply to the purchase of a business if the transaction is structured in such a way that the legal entity of the business (or part of it) is retained.

Furthermore, the transfer of an economic unit which preserves its identity must be required, i.e. a permanent, organized group of persons and property for the purpose of carrying out an economic activity with its own objective. Whether these conditions are met can only be assessed on a case-by-case basis on the basis of the applicable national provisions and must take into account the respective case law, which has developed further criteria.

5.2.3 Scope of the Directive

The personal scope of the Directive covers public and private undertakings engaged in an economic activity, whether for profit or not. It is territorially applicable when the undertaking is within the scope of Union law. As an exception, it does not apply to seagoing vessels.


5.2.4 Transfer of Contractual Obligations

If the aforementioned conditions are met, the purchaser shall become a party to the employment relationship in place of the former holder in accordance with Article 3 (1) of the Directive, irrespective of the will of the parties involved,
and shall fully assume the latter's rights and obligations. The new owner thus also becomes the debtor of outstanding salary claims.

For the protection of employees, the national states can furthermore stipulate in accordance with Art. 3 (1) sentence 2 that the former employer is jointly and severally liable - but only pro rata temporis for obligations that arose before the transfer of the business and become due within one year thereafter.

According to Art. 3 para. 4 lit. b, the member states are obliged to protect the interests of employees by corresponding statutory regulations who are entitled to old-age, invalidity or survivors' benefits from supplementary company or inter-company pension schemes. It is in this area in particular that there are major differences between the individual national regulations.

In addition, according to Art. 3 para. 2, the member states may provide for regulations according to which the selling employer is obliged to inform the employer promptly of the sale of the part of the business.

5.2.5 Effects on Collective Labour Law Provisions

The effects of a transfer of an undertaking on existing collective bargaining arrangements are laid down in Article 3 (3), which provides that until the termination or expiry of the collective agreement or until the entry into force or application of another collective agreement, the working conditions agreed in a collective agreement shall continue to apply to the same extent as they were provided for the transferor in the collective agreement. Member States may limit the period during which working conditions may be maintained, but not less than one year.

5.2.6 Prohibition on Termination of Employment

Article 4 provides that neither the former owner nor the person acquiring the undertaking may terminate the employment of an employee by reason of the transfer of the undertaking. Violation of this provision will, in principle, result in
the termination being null and void. According to Art. 4 para. 1 sentence 2, however, this provision does not preclude possible dismissals under the general national provisions (for example for economic, technical or organizational reasons), which leads to delimitation difficulties. For example, under German law for the termination restriction to take effect, the transfer of the business must not merely be an occasion, but "a fundamental reason" for the termination. The prohibition therefore does not apply if there is another reason which alone could justify the termination.

5.3 Possible Risks Arising from the Transfer of Employees for Company Acquisitions

The fact that the purchaser of a company, irrespective of the legal structure by which he acquires the company, also takes over the employees carries corresponding risks for the parties to a company purchase agreement. For example, the purchase price is often set lower due to the assumption of pension obligations by the acquirer. In order to prevent such problems, company sellers and purchasers can reach agreements on risk distribution, such as indemnity agreements, and must exercise the greatest care in formulating the information, which is often difficult.
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1. The sale of a company or significant part of a company can be legally structured as a share deal or asset deal.
2. There are considerable differences between the two alternatives with regard to the legal structure and, in principle, also the legal consequences.
3. Which of the alternatives should be chosen, can only be judged on the basis of the individual case and must take into account the interests of the parties (e.g. saving taxes, etc.).
4. Since the object of purchase often entails far-reaching obligations for the purchaser, not only extensive investigations but also provisions on guarantees and indemnities should be made.
5. The conditions under which this is the case and the further obligations of the acquirer are determined by the different provisions of the jurisdictions whose employment contracts are affected by the purchase.