



MBO A better deal?

Each year the Company Commercial Team at Ellis Jones completes numerous management buy-outs for its clients. Notable MBO deals recently completed include the buy-out of Alfatronix Limited and Enhanced Computer Solutions Limited for their management teams. For those clients who are thinking of buying a business or selling a business, we thought we'd raise the interesting topic of the pros and cons of an "MBO" as compared with a conventional trade sale to or from a third party.

The positives of a management buyout often outweigh the negatives. Selling to your senior management, if you are an owner manager, or buying a business from your boss, is very often a more attractive option than a trade sale to a third party or an acquisition from a third party.

In an MBO transaction due diligence is often less intense than in a trade sale. The MBO team should, due to the nature of the positions they hold, already have a good general knowledge of the business that they are targeting and hence can afford to select specific key areas of the Company for due diligence. Limiting the extent of due diligence means limiting the costs, which is always a positive!

From a seller's perspective, the fact that the MBO team already has a working knowledge

of the business is useful when it comes to negotiating warranties and indemnities – the argument being that the MBO team already knows much of what it is buying, whereas a third party in a conventional trade sale would be more inclined to push harder for warranty cover as protection for undisclosed problems. This means that, following an MBO, the seller often carries less risk.

I have also noticed the relative ease that MBO teams have in talking to lenders. Banks are comfortable dealing with those who can demonstrate a working knowledge of their target business and this helps when it comes to raising finance. Business plans are easier to prepare and to sell to lenders when you already know the state of the business that you are buying and what future plans are achievable.

The process of an MBO as opposed to a third party trade sale is, in my experience, less adversarial. The buyer and seller appear to work closer in achieving the aim of closing the deal. Perhaps this is down to the fact that they know each other well and there is often a feeling that the owner would rather pass the business on to those with whom he has shared part of his working life, rather than to a complete stranger. This means that negotiating

hard points is often easier in an MBO as the parties know each other well; while they are both seeking the best deal, there is often a quicker closing of the harder points.

Beware though if you fail in an MBO attempt. If you are a seller and subsequently seek to sell to a third party, the fact that you have had a failed MBO attempt is arguably a matter that should be disclosed to the third party in a later trade sale. If you don't, then the third party buyer will possibly inherit an unmotivated workforce and could look to hold the seller accountable under an appropriate warranty.

A failed MBO attempt could also lead to friction between owner and staff, or even between the staff themselves.

On the other hand, if handled properly, the MBO route could lead to an extremely energised and excited management team and a happy seller who has a sense of achievement knowing he has left a legacy behind.

If you require any further advice on MBO's or on buying or selling a business contact Grant Esterhuizen on 01202 414000.

HIGHLIGHTS IN THIS ISSUE:



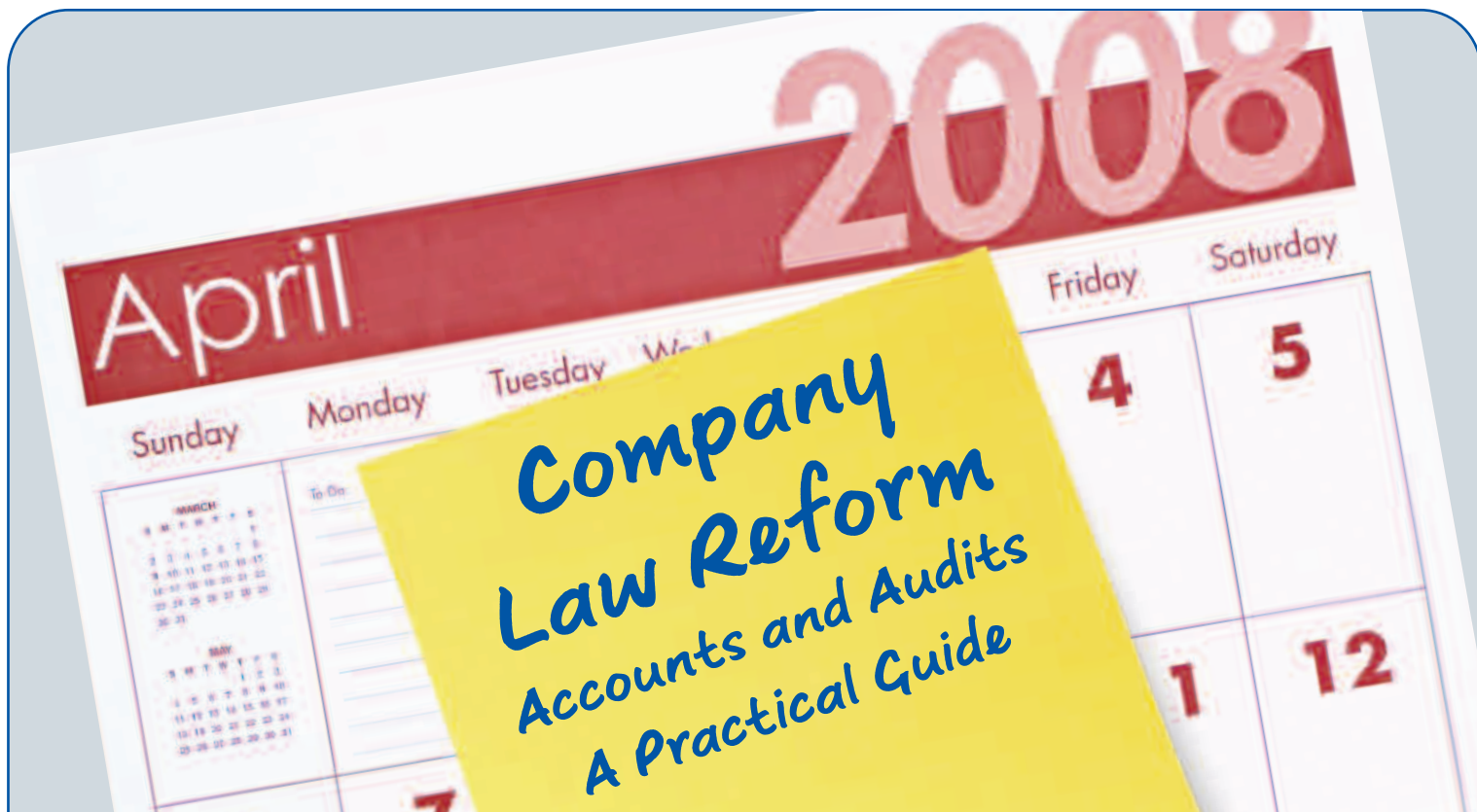
ACCOUNTS
AND AUDITS
A PRACTICAL
GUIDE



DESIGN
PROTECTION



WHERE DIRECTORS
STAND ON LENDING
MONEY TO THEIR
COMPANY



Most directors engage an accountant to deal with the accounting obligations of their companies but all directors should be aware of the responsibilities placed on both themselves and their companies by the law.

These responsibilities are among the many duties to have been modified by the recent Companies Act ('the Act').

Most of the changes relating to accounts and audit are scheduled to come into effect in April 2008.

This note focuses on the main changes affecting private limited companies.

Time for filing accounts at Companies House

The time limit for filing accounts will be reduced from 10 months to 9 months. If accounts are filed late the company faces an automatic fine of between £100 to £1,000.

Directors approval of company's accounts

Under the new Act, directors will be under an obligation to approve the accounts only if they give a true and fair view of the financial position of the company.

Directors take responsibility not accountants.

Distribution of accounts

Companies will still be required to send copies of the annual accounts to all shareholders, although the new Act provides that they do not need to send accounts to shareholders if the company no longer has a current address for the shareholder. Companies will no longer be required to lay annual accounts before a general meeting and the time limit for distribution of the accounts will be the earlier

of the date of delivery of the accounts to the registrar or the expiry of the nine month deadline for filing the accounts.

Medium sized groups

The current exemption for parent companies heading medium sized groups from the requirement to prepare group accounts will be abolished.

Appointing Auditors

The provisions relating to the appointment of auditors are scheduled to come into force in October 2007. The new Act provides that where there is a change of auditor, the appointment of the new auditor will not take effect until the end of the previous auditor's term i.e. the end of the company's financial year.

An auditor, once appointed will automatically be re-appointed unless one of the following applies:

- (i) The articles state that auditors must be re-appointed on an annual basis;
- (ii) The original appointment was made by directors;
- (iii) Shareholders with at least 5% of the voting rights have given notice to the directors that in their opinion the auditor should not be automatically re-appointed; or
- (iv) The directors have decided that auditors are not needed for the following year.

The effect of this change is to remove the obligation currently placed on private limited companies to pass a shareholders elective resolution to dispense with the obligation to appoint auditors annually.

Auditors' liability

The new legislation imposes criminal liability on auditors if they knowingly or recklessly either include something in the auditors report which is misleading, false or deceptive, or if they

neglect to include certain information required by statute in the auditors report when one or more of the following problems have been encountered:

- (i) the accounts do not agree with the companies accounting records and returns;
- (ii) necessary information or explanations in relation to the accounts have not been obtained; or
- (iii) directors have wrongly taken advantage of the exemption to prepare group accounts.

Another change introduced by the new Act is that companies will no longer be permitted to buy liability insurance in order to protect auditors against the costs of successfully defending a claim against them. This approach proved to be ineffective as auditors still faced the threat of being wiped out by catastrophic claims, which they could be obliged to pay, even if others were to blame for the company's collapse.

From 6 April 2008, auditors will be able to enter into a new 'liability limitation agreement' which limits the liability of the auditor as specified in the agreement. Such agreements are only permitted to last one year and must be authorised by an ordinary resolution passed by shareholders holding at least 50% of the shares in a general meeting, although companies are permitted to pass an ordinary resolution removing the need for such approval.

In practice, the main concern for directors is likely to be the new liability limitation agreement which many auditors will soon be requiring companies to sign. If you have been asked to sign one of these agreements or are asked to sign one in the future, we would be able to advise you on the effect and enforceability of its provisions.

Service with a (conditional) smile?

Anti-discrimination laws could soon be extended to give protection against discrimination in the provision of goods, facilities and services and could impact greatly on a variety of businesses.

It will be unlawful for a person who provides goods, facilities or services to the public to discriminate on the grounds of:

- (1) religion or belief; or
- (2) sexual orientation,

against another who wishes to obtain or use those goods, facilities or services, by refusing to provide them in the same manner in which they would normally be provided.

In particular, the provisions will apply to:

- access to/use of a place that the public are allowed to enter;
- accommodation in a hotel (B&B, campsite etc);
- banking/insurance facilities;
- facilities for entertainment / recreation / refreshment;
- travel/transport; and
- services of a trade or profession.

1. Religion or Belief

Includes any religion or philosophical belief. In providing goods or services, you must ensure that you are not responsible for:

Direct Discrimination – treating a customer less favourably on the grounds of that customer's religion or belief;

Indirect Discrimination – applying a general practice which disadvantages a customer and

cannot be reasonably justified other than by reference to that customer's religion or belief; or *Victimisation* – treating a customer less favourably because of a complaint he has made of discrimination, or has helped someone else to claim that they have been discriminated against.

Exceptions

There are a number of general exceptions that will allow for the restriction of the provision of goods, facilities or services, or the use or disposal of premises that will extend to:

- Organisations which relate to religion or belief;
- Charities relating to religion or belief;
- Faith Schools; and
- Care within the Family.

2. Sexual Orientation

This can include a person's sexual orientation towards people of the same sex, the opposite sex or both sexes.

Provisions will apply specifically to housing, education, advertising and clubs whose activities are not covered by the general goods, facilities and services provisions. Offences will include:

Direct Discrimination – adopting a policy that excludes a person because of their sexual orientation;

Discrimination against Civil Partners – adopting a policy which is exclusive to married couples and does not extend to civil partners;

Discrimination by Association – refusing a service to someone because of the sexual orientation of a person they are with;

Discriminatory Practices – actions which would be likely to result in discrimination against a person/group because of their sexual orientation;

Discriminatory Advertisements – publishing or causing to be published an advert that contains (either expressly or by implication), an intention to discriminate on the grounds of sexual orientation.

Exceptions

Organisations providing activities targeted at customers on the basis of their sexual orientation are not guilty of discrimination if they can show that those goods/services are available to people of any orientation. Further limited relief from the provisions (dependent on meeting specified criteria), maybe available to:

- Single sex clubs;
- Clubs providing a genuine benefit to people;
- Accommodation in a private home.

Liability

Knowingly helping another person to do something unlawful under the Act is also an offence. Employers will be held liable for anything done by employees in the course of their employment, unless they can show they took steps to prevent the employee from committing the act.

The courts can award damages/compensation, to a successful victim.

These provisions are due to come into force later this year, please contact Ellis Jones Corporate Team for further details.



Design Protection An Under Used Form of Protection for Valuable IPR

One of the less well-understood and therefore under used forms of intellectual property protection is that relating to the protection of designs. The protection of designs exists in two forms:

(1) firstly, there is design right protection that, like copyright, is automatic and no formal application process is necessary;

(2) secondly there is a "registered design right" which, must be applied for and registered.

The first type of design right applies to three-dimensional objects only and lasts until either ten years after the object is first marketed or fifteen years after the creation of the design, whichever is earlier. The design can be purely functional (i.e. it does not depend on what it looks like) but it must be original and "not commonplace". This type of design right is most appropriate for functional items although a design whose shape is determined by the fact that it must match or fit with another item is not eligible for protection.

The second type of design right, that is, registered design right, offers a greater degree of protection than the unregistered design right and the registration costs are quite modest. Design registration is obtained

by application to the UK Intellectual Property Office. A registration will only be granted if the design is novel and sufficiently unique. It lasts for five years, but is renewable for up to 25 years. This type of design right depends on the appearance of the design – the design must have 'individual character' meaning that it must create a different overall impression on the user as compared with any previous design.

It is possible to register both 2D and 3D designs including such things as logos and even computer desktop icons. Designs which are dictated purely by their technical function cannot be registered

A business which values its designs should seriously consider what protection is available and take steps to secure such protection. In the case of functional items that cannot be registered, it is important to have and retain proof of the date of creation of the design and its origin.

RECENT CASE LAW SHOWS WHERE DIRECTORS STAND ON LENDING MONEY TO THEIR COMPANY

Directors often advance their own money into the companies they direct, either as seed-corn capital or to tide the company over cash flow shortages. Where the company subsequently becomes insolvent, such cash injections normally rank equally with other creditors and in that case should receive the same treatment as the debts due to creditors in general.

In such circumstances, a director who reimburses money they have advanced is creating a 'preference' over other creditors

and may be ordered to repay the amounts withdrawn from the company.

Recently, a director of a pub company was ordered to repay £28,000, which he had loaned to the company when it was unprofitable and in financial difficulties and then taken out again when the pub was subsequently sold.

He had also authorised a payment of £5,000 to his co-director. Three months later, the pub company commenced a company voluntary arrangement (CVA). The administrator



supervising the CVA entered into negotiations to recover the amounts and discussions were held between the administrator and the director at which the director was asked if he would be prepared to settle the claim against him for between £5,000 and £10,000. He made an offer to repay £5,000, but no formal agreement was made. In the absence of an agreement, the administrator was given leave by the court to claim the entire sum that had been paid to the director in preference to the other creditors plus the £5,000 paid preferentially to his co-director.

To avoid such a situation, a director could take a charge over the company's assets to secure the money lent to the company which charge would then have to be registered at Companies House. This charge would have to be approved by the board of the company and the director concerned would have to declare his interest in the transaction. The director would then have the status of a secured creditor and would be able to obtain repayment in priority to other creditors.

Company Commercial Team *Tel: 01202 414000*



Grant Esterhuizen

Partner
Head of Company Commercial
grant.esterhuizen@ellisjones.co.uk



Elizabeth Gilmour

Associate
elizabeth.gilmour@ellisjones.co.uk



Sarah Hopcroft

Solicitor
sarah.hopcroft@ellisjones.co.uk



Lyn Tucker

Legal Executive
lyn.tucker@ellisjones.co.uk



William Fox Bregman

Trainee Solicitor
william.foxbregman@ellisjones.co.uk



Danielle Cheal

Associate
Head of Employment
danielle.cheal@ellisjones.co.uk



Lesley Walford

Solicitor
lesley.walford@ellisjones.co.uk

www.ellisjones.co.uk

302 Charminster Road,
Bournemouth, BH8 9RU
Tel: 01202 525333
bournemouth@ellisjones.co.uk

99 Holdenhurst Road,
Bournemouth, BH8 8DY
Tel: 01202 414000
business@ellisjones.co.uk

14a Haven Road
Canford Cliffs, BH13 7LP
Tel: 01202 709898
canford@ellisjones.co.uk

4 Monmouth Court
Ringwood, BH24 1HE
Tel: 01425 484848
ringwood@ellisjones.co.uk

55 High Street
Swanage, BH19 2LT
Tel: 01929 422233
swanage@ellisjones.co.uk