

Adams & Remers

A&R. Selling Your Pharmacy

What To Expect



Selling a pharmacy is likely to be the culmination of a considerable amount of time and effort over many years to develop a successful business.

Most sellers will not have been through the process before and therefore may be unsure what to expect. This guide provides an overview of what to expect from the legal process.

Understanding the Sale Process

Before explaining the legal process that follows once a potential buyer has been found, it is important to understand what the process is seeking to achieve.

Business sales and purchases are one of the few areas of law where the rule “caveat emptor” still retains almost all its old force. The effect is that, under the law, almost all of the risk is placed on the buyer.

This is in direct contrast to other areas of the law where the rule has been limited by legislation – consumer law being a good example. Unlike a consumer, who has a raft of legislation to fall back on, a buyer of a business has very little statutory protection. A prudent buyer will therefore want to undertake extensive investigations as part of the sale and purchase process to satisfy himself that the pharmacy is worth the price he is expecting to pay for it. This process is known as due diligence and a buyer will normally concentrate on financial, legal and commercial investigations.

A buyer will also be keen to diminish the effect of the caveat emptor rule by ensuring that the seller takes on some of the risk that would otherwise be assumed by the buyer. The usual way of achieving this is in the form of warranties and indemnities which the seller will be asked to give to the buyer. More about this later.

A seller will naturally try to resist this, but if he wishes to maximise the purchase price he will invariably have to accept some shift in the balance of risk. A large part of the negotiation of the legal documentation will therefore be debating the extent of the warranties and indemnities and agreeing how the risk is to be apportioned between the parties.

There are various other mechanisms that the parties can use to manage the issue of risk. For example, instead of paying all of the purchase price to the seller on completion, the buyer may require part of the price to be held as a retention. Any such sum is typically paid into a separate joint account and held for a period of time (1-2 years is normal).

The purpose of the retention is to give the buyer comfort that a pool of money is available in case there are any claims against the seller. In the event there are no claims, the retention can be released to the seller at the end of the retention period.



Structure of a Sale

A fundamental issue at the outset of any proposed sale is whether it will proceed as an acquisition of the shares in the company operating the pharmacy or whether there are reasons why it would be an advantage to sell the business and assets and leave the company under the continued ownership of its existing shareholders.

Each method has its advantages and disadvantages, depending on whether the transaction is being viewed from the buyer's or the seller's perspective.

An advantage to a buyer of acquiring the business and assets is that it allows him to be selective as to which of the assets he wishes to acquire. The liabilities of the business (except those relating to employees) will usually be left behind with the company, and this could also be very attractive for a buyer.

One downside, however, is that the consent from NHS England will be needed in order to transfer the NHS contract from the seller to the buyer. No such consent is needed when the shares in a company are being sold as the NHS contract will remain with the company both before and after the sale completes.

Many sellers prefer to sell the shares in their pharmacy company rather than the underlying assets as it is often more tax-advantageous to do so. It is therefore important to take tax advice before settling on a proposed sale structure.

Finding a Buyer

Occasionally a buyer may make the initial approach to the seller, either directly or through an intermediary. This is most likely to happen where the buyer and the seller already know each other – for example, the parties may be competitors.

Whilst an unsolicited offer can save the seller time and money, it does come with its downside. Often sellers who receive such offers are not well prepared for the process. For example, the seller may not have taken some of the pre-sale steps that he would otherwise have done to make the pharmacy more attractive to a buyer. The result is often that the purchase price might not be as high as it otherwise could be.

In other cases, though, the seller will have to actively seek out a buyer. The usual way of advertising for a buyer is to prepare what is known as an "Information Memorandum" on the pharmacy. This document will usually contain information about the pharmacy's services, its market and certain financial information, all presented to show the business in the best possible light. Sensitive information is usually excluded until much later in the negotiation process.

Sellers will often engage the services of a specialist pharmacy agent to prepare the Information Memorandum and market the business. Such advisors will use their extensive databases and market knowledge to identify and contact potential buyers.

At such an early stage, only limited information is provided to potential buyers and sometimes the name of the business is excluded. However, it is important to include sufficient information to arouse the interest of potential buyers.

If a potential buyer wishes to take matters further, they should first be asked to sign a confidentiality agreement. This places the potential buyer under an obligation to keep confidential all information provided to them about the pharmacy.

This obligation should extend to the fact that the seller is contemplating a sale as even this could be sensitive information which could adversely impact on the pharmacy's business if it was widely known in the marketplace. News of a potential sale can unsettle employees, and customers and suppliers may interpret the move as a sign that the pharmacy is in difficulties.

If the Information Memorandum generates sufficient interest in the pharmacy, there are likely to be a number of interested buyers.

There are a number of ways of dealing with multiple interested parties, but the most common is for the seller (perhaps in conjunction with the pharmacy agent) to identify a preferred buyer.

The seller will then negotiate exclusively with this preferred bidder for a period of time to see if an agreement can be concluded. Some buyers may actually insist on this, as they may be reluctant to invest the time and incur the expense of investigating the pharmacy if the seller is negotiating with other parties at the same time.

The buyer may therefore require a period of "exclusivity" during which the seller agrees not to negotiate with any other party. The period of exclusivity will be a matter for negotiation, but generally it is a reasonable period of time for the due diligence to be undertaken and the legal documentation to be prepared and agreed.

Heads of Agreement

If the seller and the preferred buyer come to an agreement on the fundamental commercial terms of the sale, they will usually enter into "Heads of Agreement" (also known as "Heads of Terms"). This is not always necessary, but it helps to document both parties' understanding of the terms of the sale and serves as a useful reference document for other interested parties, such as legal and financial advisors.

Due Diligence

Once the Heads of Agreement have been signed, the due diligence process will start in earnest. This usually begins by the buyer's legal advisors submitting a lengthy list of questions and request for documents.



The seller will need to spend time answering these questions and sourcing the necessary supporting documents. If the seller wishes to keep the sale confidential from employees, this can often present a challenge as it can be difficult to obtain copies of all the required documents without alerting staff that something out of the ordinary is taking place.

The initial request for information is usually followed by one or more much shorter requests, usually focussing on the seller's initial replies.

Sale and Purchase Documentation

As a general rule, the buyer will be responsible for preparing the sale and purchase documentation. He will, therefore, have a significant degree of control over this from the outset.

The buyer will usually prepare the documentation after the due diligence process has commenced. The core document is known as a "Share Purchase Agreement" or an "Asset Purchase Agreement", depending on the structure of the sale. This is a lengthy document which will be heavily negotiated as part of the sale process.

The Agreement will usually contain details of the following:

- sale and purchase of the shares/assets
- purchase price
- mechanics of completing the sale
- retentions (if any)
- any post-completion adjustment to the purchase price
- warranties and indemnities

Warranties and Indemnities

If a seller wishes to achieve the highest purchase price possible for his pharmacy, he will have to accept some of the risk that would otherwise fall on the buyer under the caveat emptor rule.

The balance of risk between the buyer and the seller is achieved through the buyer giving certain warranties and indemnities to the seller, and these are the main source of risk for a seller under the sale and purchase documentation.

If a warranty given by the sellers is subsequently found to be incorrect, or the buyer has reason to call on an indemnity, the seller may be required to repay part or all of the purchase price to the buyer.

Reducing the Risk of a Claim

In order for a seller to reduce the risk of a claim under a warranty or indemnity, a seller will first seek to limit the ambit of the warranties and indemnities. This is a matter of negotiation between the parties and their legal advisors.

There are also other provisions that a seller can insert into the sale and purchase documentation to help minimise his liability. The first is to provide that the buyer must bring a claim against the seller with a specified period of time. The time limits will differ depending on the nature of the claim, but as a general rule, claims relating to tax can be made within seven years after the sale and most other claims can be made in a period ranging from 18 months to three years after the sale.

It is also accepted practice that the seller should be allowed to impose monetary caps on his liability. In the majority of cases, this is set at the price paid for the pharmacy.

A financial threshold for each claim is also agreed, such that the buyer cannot bring a claim unless it is worth over a certain amount. This is usually acceptable to a buyer as he has little to gain from pursuing claims with a low value where the costs incurred in doing so are likely to exceed the amount in dispute.

However, the most effective means for a seller to minimise his risk under the warranties is to undertake a thorough disclosure exercise. If the seller discloses to a buyer that a warranty is untrue and explains in what way it is untrue, the buyer will not be able to claim at a later date that the facts disclosed amount to a breach of warranty. All the disclosures are collected together in what is known as a "Disclosure Letter" which will be prepared by the seller's legal advisors and negotiated with the buyer.

Buyers will not normally accept disclosures against indemnities and therefore the Disclosure Letter will only minimise a seller's risk under the warranties.

Completing the Sale

The run up to completing the sale can be very pressurised, but preparation is important to ensure that completion runs smoothly. If there is a lack of preparation, or if issues are still being negotiated and discussed immediately prior to completion, then this is likely to lead to a prolonged completion process.

Completion can be effected through a physical meeting between the buyer and the seller and their professional advisors. However, these days completion often takes place via a series of e-mails and telephone calls between the parties' legal advisors. Bear in mind that if the buyer is relying on bank finance to fund the purchase, the bank and their professional advisors will need to be included within the completion process.

Completion takes place once all the transaction documents have been signed and any other pre-completion tasks have been finalised. At this point, the buyer will release the purchase monies to the seller and the buyer will become the new owner of the pharmacy.

For further advice on buying or selling a retail pharmacy, please contact us.

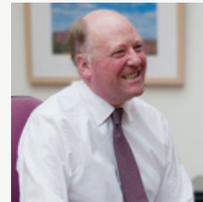
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