

BUSINESS TURNAROUND PROGRAM

LEGAL KIT

BUSINESS DUE DILIGENCE CHECK LIST

This due diligence recognises that every business is different and every industry is different. In Part 1 we define the business' activities and assets. This sets the scope of the due diligence. In Part 2 we examine the business' paperwork and records for those activities and assets, looking for any apparent legal flaws. No business is perfect, all have their challenges.

PART 1 – WHAT ARE THE BUSINESS' ACTIVITIES AND ASSETS?

1. In which of the following activities is the business engaged:

- Supplying services
- Supplying goods
- Using goods or equipment belonging to others
- Selling on a retail basis
- Selling on a wholesale basis
- Selling online
- Operating from premises
- Providing credit to customers (for example for the sale of goods or services)
- Lending money to customers

2. Which of the business activities are included in the sale?

3. Which of the business activities are excluded from the sale?

4. The next step is to identify the nature of the goodwill – is it basically:

- Location goodwill
- Customer goodwill
- Name goodwill (eg Trade Mark) or intellectual property
- Monopoly goodwill

This is important, because the nature of the goodwill gives you vital clues as to which assets are commercially important, and these assets are the 'must haves' for a buyer.

5. We then identify the assets that are used in the operation of the business. These assets very much depend on the answers above. The assets could include:

- lease or ownership of premises (maybe an option to buy the premises)
business name or company name logos, trade mark, product names, patents, copyright, licences & other Intellectual Property
- Social media (Facebook, etc)
- Telephone, email, website, PO box
- Stock in trade
- Work in progress

- Book debts
- Equipment
- Customer agreements
- Supplier agreements
- Credit sales, gift vouchers, lay-buys
- Credit and discount policies
- Plant and equipment
- Hire purchase, finance & operating leases, rental agreements
- Staff (names, start dates, awards, leave, superannuation, redundancy & entitlements)
- Independent contractors - contracts
- Motor vehicle
- Licence to operate the business (Council DA, statutory licence)
- Computer software agreements
- Creditors (sometimes important for goodwill of business)
- Other agreements: distributorships, retailer, franchising, agency, manufacturing, transportation, sub-contractors, joint venture, partnership & government agreements
- Insurance policies and claims
- Environmental licences, approvals, registrations, permits & site reports
- Tuition by the seller
- Restraint by seller and important operatives within the current operator (eg the directors)

PART 2 – EXAMINING THE BUSINESS’ ACTIVITIES AND ASSETS

DGI’s summaries of main points are set out below for the following aspects of the Business:

- Property used by the Business
- The marketing conducted by the Business
- Brands, names and intellectual property used by the Business
- Pricing of goods and services
- Franchise agreement
- Customer agreements
- Supplier agreements
- Hire purchase, finance & operating leases, rental agreements
- Independent contractors
- Joint venture
- Partnership
- Distributorship
- Computer software agreement
- Privacy
- Credit Reports on Customers
- Employees

- Stamp duty
- Company structure and shareholdings
- Insurances
- Legal Compliance
- Finance
- Asset Valuations

PROPERTY

- Addresses of any real estate owned or occupied by the Business
- Copy certificates of title for real estate owned
- For real estate leased
- Copies of the current lease(s)
- A site plan
- The term
- Any options to renew for a further term,
- Current rent
- Future rent variations
- Estimated current and future outgoings
- Estimated ongoing repair costs
- Annual insurance costs
- Bank guarantees provided
- Personal guarantees
- Estimated 'make good' costs at lease end
- Any disputes with landlord
- Procedure for landlord consent to a change of tenant or shareholding

MARKETING

- What marketing does the business conduct? Include all the business' channels of marketing such as material sent out to customers, standard sales spiels, product packaging and social media, as well as advertising.
- Are any of the claims made in as material sent out to customers, standard sales spiels, product packaging, social media or advertising incorrect or likely to create a false impression?
- Does the business conduct any electronic marketing?
- Does the electronic marketing include a functioning unsubscribe facility?
- Is any of that electronic marketing sent out without the recipient's prior consent?

BRANDS, NAMES – INTELLECTUAL PROPERTY

- Which brands or names are important to the Business?
- Does the business own those brands or are they licensed from another party?
- How are the brands protected? Is there a registered trade mark? If so, whose name is it registered in, what categories of activities does it cover and when is it due for renewal?

- Is a name registered as a business name or company name? If a business name, what is the name of the proprietor of that registered business name and when is it due for renewal?
- If a brand is licensed from another party, please review the licensing agreement as to the duration, activities, geographical scope and special conditions of that licence.
- Does the business have copyright in any published documents which are important to its activities?
- Does the business own or licence any patents or registered designs?
- Details of company's use of its intellectual property on social media (Facebook etc)
- Any claims against the Business for infringement of the intellectual property of others?
- Any claims by the Business against others for infringement of the Business' intellectual property?
- Any non-disclosure agreements signed for the Business?

PRICING

- Are any statements around the pricing of goods or services incorrect or likely to create a false impression?
- If the business makes statements about comparative pricing, are they correct? Comparative pricing is where the business compares the sale price of a product or service to a former price, as in 'the RRP is \$x, but our sale price is \$....'
- Do prices to customers state the total price of the goods or services as a single figure, which is the minimum total cost that is able to be calculated? Does this single figure include any tax, duty, fee, levy or other additional charges (e.g. GST or airport tax). This rule generally does not apply in business-to-business transactions.
- Does the business supply goods to a reseller? If so, does the business quote a recommended retail price (RRP) and is it truly just recommended? Ensure there is no evidence of any compulsion or pressure applied on the retailer to keep its prices at the RRP (that is, no discounting below the RRP).
- Does the business have a policy of ensuring that there is no discussions with competitors about prices of goods or services?

FRANCHISE AGREEMENT

- Period – does the business (as franchisee) have right of renewal? If so, on what conditions?
- Which goods or services are covered by the franchise? Does the franchisor limit the scope of goods or services in which the business can trade?
- Territory: is there a defined area? Is it exclusive? Are the franchisee's activities limited inside or outside that area?
- What royalties are payable by the business? Is the rate fixed or variable? How are royalties accounted for and calculated? When payable?
- Are there any minimum turnover or performance standards to be met by the Business?
- Who owns the goodwill?
- Can the franchisor access the customer list of the business?
- Is there any post termination restraint on the business (as franchisee)? Does the Business have any first refusal rights on a new franchise?

- Does the Business have marketing or advertising obligations? Does the franchisor dictate the content and spend amount by the Business on marketing or advertising?
- Is any named person required to be personally present in the Business?
- Security for payment of money to the franchisor - personal guarantees, other?
- Does the franchisor supply goods or services to the Business?
- Is the franchise saleable by the Business? Is franchisor approval needed for a sale? Is any money payable by the Business to the franchisor on sale of the franchise? Does the franchisor have first refusal rights on a sale of the franchise? Does a sale of shares in the franchisee company activate anything by the franchisor?
- Does the franchisor provide any support services to the Business?
- Franchisor's power to end the franchise and the consequences of ending the franchise
- Any franchise manual?

CUSTOMER AGREEMENTS

- CUSTOMER AGREEMENTS
- Does the Business enter into written contracts with the customers?
- Does the Business have a separate set of standard terms and conditions for supplies to customers?
- How and when are the standard terms and conditions communicated to customers? (eg rear of invoice, docusign, other)
- For the standard terms and conditions, please review as to the following issues:
- Period of the agreement
- Goods or services supplied
- Price – fixed or variable
- Time for payment by customer
- Security for payment by customer: personal guarantees,
- Credit protection against customer overdues – interest on overdues, power to suspend supply for overdues, retention of title for goods, cash on delivery
- If retention of title for goods, does the business make an online PPSR registration? force majeure if the Business can't supply goods or services
- Time for delivery of goods or services
- Risk and ownership passing to customer
- Warranty & liability issues; consumer sale?
- Any unfair clauses
- Termination of contract
- Consequences of termination of contract
- Transferrable to buyer?

- Any equipment lent to customer?
- Gift vouchers, discounts, layby, door to door sales?
- Any particular industry issues
- Any disputes with customers

SUPPLIER AGREEMENTS

As for Customer Agreements above, plus:

- Any automatic renewal of the term
- Supplier control over price
- Currency exchange rate price impact
- Transport issues
- Insurance, indemnities
- Any international standard conditions used

HIRE PURCHASE, FINANCE & OPERATING LEASES, RENTAL AGREEMENTS

- Type of legal instrument - hire purchase, finance lease, operating lease or rental
- Any residual amount payable
- Period of agreement
- Any automatic renewal of the period
- Goods or equipment supplied
- Amount of rent or lease payments – are these amounts fixed or variable
- Time for payment of rent or lease payments
- Security for payment: personal guarantees, bank guarantee, other
- Credit protection – interest on overdues, right to terminate and repossess equipment
- Force majeure
- Risk and ownership passing to customer
- Warranty & liability issues; is it a consumer credit transaction?
- Insurance, indemnities
- Any unfair clauses
- Termination of contract
- Consequences of termination of contract
- Transferrable to buyer?

INDEPENDENT CONTRACTORS

- Type of arrangement – normal contract or labour hire
- Qualifications of contractor
- Must an individual be personally present and providing services?
- Preparatory work by Principal
- Other things to be provided by Principal
- Site access
- Period
- Any automatic renewal of the term
- Goods or equipment supplied
- May the principal require extra services or goods?
- Continuing obligations (eg to be proactive)
- Response times for services
- Amount of payments – fixed or variable
- Are superannuation and gst included in amounts payable?
- Time for payment
- Any right to withhold payment for breach of contract
- Protection against poor performance, drugs, corruption – right to terminate, right to audit, right to bar unsafe or poor performers
- Force majeure
- Safety & risk issues – insurance by contractor
- Ownership of inventions passing to principal
- Warranty & liability issues
- Insurance, indemnities
- Records
- Rights to publicity
- Any unfair clauses
- Termination of contract
- Consequences of termination of contract
- Restraint and confidentiality
- Transferrable to buyer?
- Does contractor provide its own equipment?

JOINT VENTURES

- Nature of the project & activities
- Any conditions precedent, such as provision of assets, funds, regulatory approvals, consents of third parties
- Who is to apply for approvals or consents
- Period for termination if conditions precedent not met
- Earn-in requirements: What are the proposed interests of the parties and how are these to be earned? Is the relevant interest to be transferred 'upfront' or when conditions are met (e.g. expenditure requirements)
- Warranties to be given by asset holder: Good title, no breach of lease (if a lessee), payment of rent, rates & taxes; no rights of third parties to intervene; no pending litigation.
- Decision making: Quorum; Calculation of voting rights; Mechanism for breaking deadlock; meetings, powers over which issues; records
- Contracting out to others
- Financial administration: budgets, cash calls, authority to exceed approved budget
- Share of profits and losses
- Will separate entities be established for such matters as the acquisition of land and marketing of product?
- Any feasibility study required
- Whether a party may proceed separately on basis of feasibility study if other party is unwilling
- Events of default
- Possible remedies for default, such as option to purchase interest of defaulter, forfeiture of interest, interest on outstanding amounts, loss of voting rights & access to information, compulsory sale
- Force majeure - party's obligation to remove the cause of force majeure?
- First refusal rights: Mechanism for offering interest to other parties; Mechanism for acceptance;
- Must offer be for a cash price? Will a change in control of a party trigger the pre-emptive rights?
- Circumstances in which mortgages may be created, if any.
- Confidentiality e.g. disclosure to banks, but not others
- Restraint on competition with the JV activities

PARTNERSHIPS

- The business activities of the partnership
- The assets of the partnership; who owns these assets
- How are the partnership decisions made? Meetings of partners; voting; veto by partner
- How are the income and expenses of the partnership divided?

- Partner's duties as to loyalty, devote time to the Business
- Liability of the partners, insurance cover
- Voluntary and involuntary withdrawal of partner
- Dissolution of partnership; Dissolution calculation of moneys due
- Any trauma /disability insurance to pay out the departing partner?

DISTRIBUTORSHIPS

- Product and area scope of distributorship
- Term & expiry date
- Option period
- Goodwill ownership
- Time for delivery of product to distributor
- Distributors right re any new product range of supplier
- Product price – fixed or variable
- Time for payment
- Security for payment: personal guarantees,
- Credit protection – interest on overdues, power to suspend supply for overdues, retention of title for goods, cash on delivery
- Force majeure
- May distributor handle competitive product?
- Brand/trademark protection for supplier
- First refusal on sale by distributor; transfer of shares in distributor company
- Director of distributor to be personally present
- Ownership of key items – website, telephone/po box, customer list
- Access to distributor's customer list
- Any ancillary goods or services supplied (for example, is equipment lent to distributor for storage of product?)
- Flexibility of directions by supplier
- Confidentiality (esp. if access to supplier's computer system)
- Restraint on distributor
- Risk and ownership passing to distributor
- Warranty & liability issues;
- Insurance and indemnity
- Any unfair clauses
- Termination of contract
- Period of notice fair?
- Consequences of termination of contract
- Transferrable to buyer?
- Repossession of product; whether PPSR registration effected?

COMPUTER SOFTWARE AGREEMENTS

- Does the Business use any custom built software or is it subscription software?
- Who owns the software?
- Extent of the licence to use the software
- Services by software supplier (for example to modify the software, install the software, continuing to maintain or support (help desk) the software, update the software)
- Period of services
- Any automatic renewal of the period
- If custom built software, what are the obligations of the Business (eg to assist and instruct in software development, not modify software, use updates)
- Time for payment for ongoing services
- Security for payment: personal guarantees
- Main points credit protection – interest on overdues, power to suspend supply for overdues, cash on delivery
- Force majeure
- Warranty & liability issues
- Any unfair clauses
- Termination of contract
- Consequences of termination of contract
- Are the software rights transferrable to a buyer of the Business?

PRIVACY

- Is the Business' annual turnover more than \$3m? If so, it's subject to Privacy laws, for which the following points apply.
- Does the business collect and store personal information from its customers?
- Does the business collect and store sensitive personal information about its customers?
- Does the business issue a privacy policy statement?
- Does the business' privacy policy statement state that customer consents to a sale of the customer's personal information?
- Does the business' privacy policy statement prominently state that customer may easily object to being sent direct marketing material?
- Does the business' direct marketing have a simple and easy to use opt-out procedure?
- Does the business store the customer's personal information on an overseas data facility (eg the cloud)?
- Are there any claims against the company for infringement of privacy law?

CREDIT REPORTS ABOUT CUSTOMERS

- Does the business receive credit reports about its customers from a credit reporting agency (eg Aveda)?
- Does the business send credit information about its customers to a credit reporting agency (eg Aveda)?
- Does the business have a credit reporting statement on its website?

- Does the business' credit reporting statement deal with customers' access to the credit information and allow the customer to correct that credit information?
- Does the business have an account application form? If so, does it comply with the business' credit reporting statement?
- If the business refuses a customer's application for credit, does the business provide a notice of refusal that customer?
- Which sorts of credit overdues does the business tell its credit reporting agency about?
- How much does the business tell its credit reporting agency about a customer's credit overdues?

EMPLOYMENT CONTRACTS

- Does the business have written employment contracts or letters with the employees?
- Do the employee contracts or letters contain confidentiality clauses with a limited period of operation after they cease to be employees?
- Do these employee contracts or letters contain restraint clauses with a limited scope and period of operation after they cease to be employees?
- Are there any casual employees in the Business, who are employed regularly or systematically? If so, they may be legally permanent employees.
- Which awards apply the employees?
- What redundancy, long service leave and other leave rights do the employees have?

STAMP DUTY

- Would the purchase of business assets attract stamp duty in the state where the business is conducted?
- Is the seller company a land rich company, such that a purchase of shares in the seller company would attract stamp duty liability?

COMPANY STRUCTURE AND SHAREHOLDINGS

- The shareholders agreement
- Any buy/sell share agreements
- The share capital of the Company, including classes of shares
- Names and addresses of all shareholders, showing number and classes of shares of each shareholder
- Any trustee notifications for any of the shareholders
- Any PPSR entries for any of the shares

INSURANCE

- Any outstanding claims made under insurance policies
- Schedule of current insurance policies

LEGAL COMPLIANCE

- Licences, authorisations, approvals, and consents held by the business
- Any pending prosecutions, litigation or other disputes
- Any material breach or default by the Company under the terms of any agreement, arrangement or licence

FINANCE

- Most recent accounts of the business
- Any outstanding loan agreement
- Any bank, invoice discounting, factoring and other financing facilities, including currency hedging arrangement.
- Director's guarantees and bank guarantees
- Intra-group arrangements
- Loans made to or by the Company, including director's loans and indebtedness
- Mortgages, charges or other security over assets
- Any security held by the Company over the assets of a third party
- Material off-balance sheet finance commitments

ASSET VALUATIONS

- Any valuations of assets

HEADS OF AGREEMENT

THIS HEADS OF AGREEMENT (the “Document”) made on the ____ day of _____,

_____ (the “Execution Date”),

BETWEEN:

[insert name of proposed purchaser] of [insert address of purchaser]

(the “Purchaser”)

- AND -

[insert name of seller] of [insert address of seller]

(the “Seller”).

BACKGROUND:

The Seller is the owner of all the issued and outstanding shares (the “Shares”) of [insert name of seller] of [insert address of seller] (the “Company”) which carries on the business of [insert details of type of business] in the State of [insert state].

The Seller desires to sell the Shares to the Purchaser, and the Purchaser desires to buy the Shares.

It is the intention of the parties that this Document sets out the terms to be used in a future business purchase agreement between the Seller and the Purchaser. The terms contained in this Document are not comprehensive and it is expected that additional terms may be added, and existing terms may be changed or deleted. The parties do wish however to have a framework for their final agreement and to record the basic terms of their mutual understanding to date which are as follows:

NON-BINDING

1. This Document does not create a binding legal agreement between the Purchaser and the Seller and will not be enforceable. The parties agree that they will sign a binding legal agreement in the future and acknowledge that purpose of this document is to record those matters which the parties propose to include in their final agreement.

TRANSACTION DESCRIPTION

2. The Business is located at: [insert address of business]
3. The Business is described as: [insert brief description of business]

PURCHASE PRICE

- 4. The Purchaser will pay the Seller the sum of \$ XXX AUD [or insert such other details or purchasing terms or consideration that the parties have agreed upon] on or before the [insert end date after which heads of agreement will no longer apply – the scarcity invoked by a “sunset” date will provide a line in the sand or deadline for a seller to commit] (the “Closing Date”) as payment in full for the Shares [or whatever terms are being proposed eg. In return for 50% of the issued shares in the company – or to achieve certain targets or milestones – these should be set out here eg extinguish or negotiate all debt. In an earn out situation the targets and payments should be set out here. If payments are deferred this should be specified with dates and amounts if known. It does not have to be legalese and plain English will suffice. What is important is the intention and the “in principle” agreement].

REPRESENTATIONS

- 5. The Seller represents and warrants that the Shares are free and clear of any liens, charges, encumbrances or rights of others apart from those that have been disclosed to the Purchaser. [List these here as relevant – this will arise more so with a distressed business and will appear on an ASIC or Equifax search] If the representations of the Seller are untrue upon the Closing Date, the Purchaser may terminate any future agreement without penalty and any monies paid will be refunded. [As this is not a binding legal agreement, this clause is of no force but it does formalise things and achieve some commitment in relation to the proposed sale and the seller’s situation as disclosed to the purchaser].

This Document accurately reflects the understanding between the Seller and the Purchaser, signed on this _____ day of _____, _____.

Purchaser

Seller

SAMPLE NON-DISCLOSURE AGREEMENT

Made the _____ day of _____ 20____

PARTIES:

[insert name of owner] of [insert address of owner] (the Owner)

AND [insert name of proposed purchaser] of [insert address of purchaser] (the Interested Party)

BACKGROUND:

- A. The Owner is the proprietor a business (the Business). The Owner has invited the Interested Party to conduct a due diligence of the Business (the Due Diligence).
- B. In the course of the Due Diligence the Owner will disclose certain confidential information in respect of the Business to the Interested Party (the Confidential Information) for the purpose of enabling the Interested Party to submit an offer to acquire an interest in the Business from the Owner (the Approved Purpose).
- C. The Interested Party gives the undertakings in this agreement to the Owner in consideration of the disclosure of the Confidential Information.

IT IS AGREED:

1. OBLIGATION OF CONFIDENCE

1.1 The Interested Party must:

- a. take all action necessary to maintain the confidential nature of the Confidential Information; and
- b. not, without the prior written consent of the Owner, or an order of a Court, disclose any of the Confidential Information to any person other than as approved by the Owner in its discretion; and
- c. not use or reproduce any of the Confidential Information for any purpose other than the Approved Purpose. In particular, the Interested Party must not use any of the Confidential Information in a manner which might prejudice the business of the Owner.

1.2 The Interested Party may without the Owner's consent make such a disclosure:

- a. to its legal advisers who require such information for the Approved Purpose and who have duly completed, executed and sent to the Owner an undertaking in the same form as this agreement;
- b. if such information is generally publicly available;
- c. if required by law; or
- d. for the purposes of legal proceedings arising out of this agreement.

2. DESTRUCTION OF CONFIDENTIAL INFORMATION

The Interested Party shall, on demand by the Owner, destroy all records of the Confidential Information, whether held in written or electronic form (including computer, cloud storage, tape, disk, film and microfiche). Destruction of the Confidential Information does not release Interested Party from its obligations under this agreement.

3. APPLICABLE LAW AND DURATION

3.1 This agreement is governed by the law of law of the State or Territory in which the business is predominantly carried on.

3.2 The obligations of the Interested Party under this agreement will cease four (4) years after the date of this agreement.

SIGNED BY THE INTERESTED PARTY PURSUANT TO S127 CORPORATIONS ACT

.....
Director/Secretary

.....
Director

SIGNED BY THE OWNER PURSUANT TO S127 CORPORATIONS ACT

.....
Director/Secretary

.....
Director



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