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SMALL BUSINESS **BIG RISKS**

AN LPLC PRACTICE RISK GUIDE

LPLC LEGAL PRACTITIONERS' LIABILITY COMMITTEE

lplc.com.au

Contents

Introduction

Since LPLC published the first edition of *Small business – big risk* there have been some changes in the legal landscape which are particularly relevant to transactions for the sale of small businesses including the introduction of:

1. the Estate Agents (General, Accounts and Audit) Regulations 2018, which has made substantial changes to both the form and content of the section 52 statement and increased the definition of businesses requiring a section 52 statement
2. Personal Property Securities reforms. This has had a very important impact on how practitioners can and should protect their client's interests in various transactions, particularly in relation to the sale of a business.

While this guide has been updated to reflect legal developments and LPLC's recent claims experience, the underlying issues and challenges have remained the same. The claims scenarios often arise from exuberant purchasers who have just signed up to buy their own business, full of hope and enthusiasm. They cannot wait to get into the business, want settlement in just a few days, and only need the practitioner to check the contract and make sure there are no major problems.

Alternatively, it is the desperate vendor who cannot wait to sell and will do whatever it takes to just get settlement through cheaply and in the least amount of time.

The information in this guide is designed to help you recognise the trouble areas and manage your clients in a way that best protects the client's interests and your position. While we are unable to provide legal advice, we can discuss danger areas, how claims may arise and direct you to relevant resources.

To discuss any concerns you may have contact LPLC on (03) 9672 3800 or lplc@lplc.com.au.

The challenges

The recurring problems in small business transactions usually result from practitioners failing to:

- manage the client relationship
- clarify the limits of the retainer
- document what has been said and done.

The challenge for practitioners is to ensure clients take responsibility for properly protecting their own interests. Where clients want to take shortcuts, your role is to ensure the client makes an informed choice about those risks and consequently bears the resultant risk.

In the course of their small business transactions, practitioners run into difficulty if they:

- fail to manage over-anxious purchasers wanting to take possession before settlement
- act for both vendor and purchaser
- act on a limited retainer without confirming it in writing
- fail to create a useable trail.

Failing to manage over-anxious purchasers wanting to take possession before settlement

It is not uncommon for small business purchasers to present practitioners with signed documents and one week to settle.

This situation creates the potential for mistakes to be made. When faced with such clients, practitioners can sometimes fail to take into account a number of issues, especially those relating to the section 52 statement under the *Estate Agents Act 1980* (Vic) (the Act) which relates to the sale of a small business.

The requirement to provide a section 52 statement applies to businesses up to the value of $450,000 or any interest therein.

Failing to provide a section 52 statement or providing a defective one in respect of a business to which the Act applies, gives the purchaser the right to avoid the sale agreement:

- three months after the purchaser first signs any contract, agreement or document in respect of the sale
- before taking possession of the business.

Taking possession of a small business before settlement means that a purchaser relinquishes the right to avoid the contract later if the section 52 statement is defective.

Early possession has little to recommend it, even when you are acting for a vendor. It gives the purchaser ample opportunity to find fault with everything before the balance of the money is due.

You should also be wary of the client who says 'I'm not going to worry about a section 52' because 'I worked in the business' or 'I trust the vendor'. We strongly recommend you advise the client to insist on a section 52 statement and that you review it to see if it complies with the Estate Agents (General, Accounts and Audit) Regulations 2018 (Vic)).

Our recommendations

- ☑ Explain the consequences of early possession to your client so they can make an informed choice about the course they wish to adopt.
- ☑ If your client is not interested in your advice or does not accept it, confirm this in writing, noting the risk the client has elected to take. Suggested letters to the purchaser are attached as Appendix One and to the vendor as Appendix Two.

Acting for both vendor and purchaser

LPLC has always recommended that you should not act for more than one party in any transaction, notwithstanding Rule 11 of the Legal Profession Uniform Law Australian Solicitors' Conduct Rules 2015. As a deterrent for practitioners tempted to act for both parties, remember that in the event of a claim you will have to pay a 'deterrent excess'. That is double the normal excess.

Irrespective of whether the Rule 11 consent is obtained, the fact is that conflict will often be pleaded against a practitioner who has acted for both sides. The courts have also consistently taken a harsh view of the practice.

> 'It was accepted by all parties that there existed no ethical or legal prohibition against a practitioner acting for more than one party in a conveyancing transaction. Argument was presented on the basis that the legal duty of the practitioner is to be measured by their compliance or not with Rule 10 [in rules applicable at the time]. This is, in my view, a serious misunderstanding of the true position. How many cases like this need to come before the Courts before practitioners appreciate the folly of acting for more than one party in the most innocent appearing of transactions? Judges for almost a century have inveighed against the practice.'

Byrne J, *Pyramid Building Society (in liq) & Anor v Rick Nominees Pty Ltd & Ors* 23/08/94 unrep VSC 2162/92, p69).

Typically, in cases where the practitioner has acted for both parties, the clients begin by trusting each other implicitly, come to the practitioner with a 'done deal' and see no reason to duplicate time and expense. The practitioner is lulled into a false sense of security and often fails to see the looming problems that would be apparent to a practitioner acting in a more adversarial role. Practitioners in these circumstances leave themselves open to the allegation that they preferred the interest of one client over the other.

Many practitioners who agree to act for both parties later find themselves having to answer allegations of conflict. When a practitioner is asked to act for both parties, they will rarely have considered all contractual terms and further negotiations are then necessary. For example, parties often do not turn their minds to restraints of trade or the GST implications of stock before consulting a practitioner.

It is impossible for a practitioner to conduct arm's length negotiations for both sides and protect their respective interests at the same time.

Conflicts can arise even before the practitioner realises. A practitioner is required to divulge all relevant information to a client but that obligation can conflict with the obligation to keep another client's information confidential when acting for more than one client in a transaction. By the time confidential information about one client that should be given to the other client is received, a conflict has occurred.

Any practitioner who chooses to act for both vendor and purchaser, notwithstanding the inherent risks, should take special care to document the scope and any limits to the retainer as well as maintain a useable trail of detailed file notes and written advice.

EXAMPLE:

Practitioner previously acted for a vendor in the vendor's purchase of the business

A client purchased a transfer of lease and various chattels for a café business for $31,000, and shortly after sold the café business to a purchaser for $210,000. The practitioner was aware of the prior purchase of the chattels and lease because he had acted for the client. The practitioner then acted for both the vendor and purchaser in the sale of the business. The purchaser subsequently found out about the earlier transaction and brought proceedings against both the vendor and the practitioner.

It was inadequate for the practitioner to say he was prevented by obligations of confidentiality from disclosing to the purchaser the information about the earlier sale. By not disclosing the information, there was an immediate conflict between the interests of the vendor and the interests of the purchaser in relation to the price. If the practitioner could not obtain instructions from the vendor to disclose the information to the purchaser, then the practitioner should not have agreed to act for both parties in the first place, or should have ceased to act in the matter.

We also see situations where the practitioner thought they were only acting for one client but it was later alleged that the practitioner acted for other parties to the transaction. The other parties were unrepresented but thought the practitioner was looking after their interests as well.

Other awkward situations occur where the practitioner has a vendor as a client and the vendor's landlord as a client or the practitioner acts for the landlord and then obtains instructions to act for a purchaser. This leads to an uncomfortable conflict, especially where the landlord doubts the ability of the purchaser to take on the business and is reluctant to consent to the transfer of the lease. It also seriously undermines the ability of the practitioner to properly advise the landlord.

Acting on a limited retainer

We frequently see claims where the clients are in a hurry, want to cut costs and want to do some or most of the work themselves. However, when something goes wrong, they complain, 'but I went to you to protect me'. These clients put the practitioner on a limited retainer. There is nothing inherently wrong with this but you need to manage the process carefully.

Our recommendations

- ☑ The best strategy is to be direct and honest with your client in establishing the limits of your retainer.
- ☑ Provide clear advice as to how the transaction should be handled to ensure your client's interests are protected.
- ☑ Obtain clear instructions as to the basis on which you are to proceed and if the client wishes to limit your retainer, warn your client of the risks.
- ☑ Confirm your retainer and your advice in writing, include any aspects of your work the client has expressly removed from the retainer and set out any areas where the client has chosen not to take your advice.

Failing to create a useable trail

Making file notes and writing letters is as much the job of the practitioner as providing advice. We have seen many claims where, although the practitioner has kept some file notes, they do not contain the relevant advice given or contain a cryptic 'note to self' which could be interpreted very differently by someone else at a later date.

The importance of creating and keeping a useable trail is critical when the client is not accepting the advice of the practitioner. In such circumstances, the absence of a file note or written correspondence may be relied on by a court to draw an adverse inference against the practitioner and lead to a preference for the evidence of the client over the evidence of the practitioner.

Our recommendations

- ☑ Keep file notes and confirm advice in writing.
- ☑ Ensure your file notes:
  - » are dated
  - » record the duration of the attendance
  - » record who was present or on the telephone
  - » record the author of the note
  - » are legible
  - » record the substance of the advice given and the client's response/ instructions
  - » are a note to the file rather than to yourself.
- ☑ Consider other ways of recording what advice was given including audio or video recording the conference. One of the benefits is the client can be given a copy to listen to again later.

The most common mistakes

1 Defective section 52 statements

Section 52 statements can get both purchaser and vendor practitioners in trouble.

We have seen practitioners for purchasers sued for failing to advise:

- a section 52 statement should be obtained from the vendor
- that the vendor's failure to provide a section 52 statement entitles the client to rescind the contract
- that the purchaser should have their accountant check the financials in the section 52 statement
- there was a defect in the section 52 statement that could have been used to avoid the sale.

We have seen practitioners acting for vendors sued for failing to advise the vendor that a section 52 statement must be provided before the purchaser signs the contract or pays a deposit.

Many vendors will have their accountants prepare the business operating report which forms part of the section 52 statement. The remaining part of the section 52 statement is sometimes overlooked because the practitioner does not clarify with the client who is to complete it. Where possible, the practitioner should insist on completing the section 52 statement or at least checking it before it is given to the prospective purchaser.

Practitioners have also made the mistake of assuming that a section 52 statement is not required where there is no stated goodwill being sold in the contract.

Practitioners should also be aware that:

- in order to come within the definition of 'small business' in the Act, not all of the 'goodwill, plant, equipment and fittings' must be sold to deem the transaction subject to section 52 (see, for example, Todoran v Timotic, 23/10/95 unrep VSC Byrne J, 7751/92)
- the requirement to provide a section 52 statement applies to businesses up to the value of $450,000 or any interest therein (instead of the previous limit of $350,000)
- if the business has and is required by law to have a liquor licence, then section 52 does not apply and the vendor is not obliged to provide a section 52 statement – see subsection 52(8).

Our recommendations

When acting for the purchaser:

- ☑ check that your client has received a section 52 statement
- ☑ advise your client to have the figures reviewed by an accountant
- ☑ have the client check the remainder of the section 52 statement or offer to do it for the client
- ☑ explain that the absence of a section 52 statement or a defect in it may entitle your client to avoid the contract before taking possession of the business or within three months of signing the contract, whichever occurs sooner.

When acting for the vendor:

- ☑ explain that the failure to give the purchaser a section 52 statement before the purchaser signs the contract or pays the deposit may allow the purchaser to avoid the contract. Confirm this advice in writing (see Appendix Two for suggested letter)
- ☑ explain that the business operating report in the section 52 statement must be prepared by an accountant and must be accurate
- ☑ explain that the remainder of the section 52 statement also needs to be prepared and accurate, and confirm whether you are to prepare this
- ☑ confirm that your client's accountant is preparing the business operating report and request that the accountant or the client send the business operating report to you for inclusion in the section 52 statement
- ☑ do not make any marketing-type representations or statements about the desirability or profitability of the business, especially under your letterhead.

2 Failing to adequately consider planning issues

Planning permits are crucial for anyone purchasing a business, especially a food business. Practitioners get into trouble for failing to advise clients about the need to check planning schemes and permits to ensure the premises can lawfully be occupied for the required purpose, usually in the context of a limited retainer.

LPLC has received claims when the business sold did not have the necessary permits. Claims in those circumstances have been made against:

- practitioners acting for the vendor for allegedly failing to advise the vendor of their obligations under the contract to ensure the business premises can be lawfully used
- practitioners acting for the purchaser for allegedly failing to advise the purchaser to check planning schemes and permits, and advise the purchaser of the risk that the vendor may not comply with condition 2.7.

EXAMPLES:

Practitioner on limited retainer did not consider planning permission

A client purchased a restaurant/hotel business. The business had a courtyard area with a bar, a function room upstairs as well as a main restaurant and bar downstairs. The client arranged the liquor licensing himself but delivered the application to the practitioner to witness the statutory declaration and lodge the liquor licensing document.

After the sale, the client discovered that the room upstairs was not permitted to be used as a function room because it was not included in the planning permit. The practitioner had not advised on the planning issues as he assumed the client was dealing with planning because he was also dealing with the liquor licensing. The practitioner's retainer had not been clearly defined with the client.

No advice about operating business from home

The client purchased a home business from a good friend which she intended to operate from her own home. When the practitioner asked if the client had made enquiries of the local council, the client responded that she knew she could not put up signs outside her house. The inevitable happened and the council issued a notice to cease trading from a residential premise. The client alleged she did not know she could not operate a business from home. The practitioner said he thought she did know she could not operate the business from home because she knew that she could not erect a sign outside her house. The issue had not been clearly spelt out by the practitioner.

Our recommendations

When instructed to act on a limited retainer:

- ☑ confirm instructions and any limit of the retainer in writing regardless of whether you are acting for vendor or purchaser
- ☑ advise your client to check with the local council:
  - » about the current and proposed use of the premises
  - » about any planning issues affecting such use
  - » if non-conforming use rights are alleged to apply, what limitations apply and whether council has a view on the precise nature of the non-conforming use
  - » about any existing orders affecting the premises
  - » about existing planning permits and ensure that any permit conditions have been complied with
- ☑ if the contract contains an obligation on the vendor to ensure the premises can be lawfully used by the business, advise the vendors of their obligations and/or advise the purchaser of the risk that the vendors will not comply with their obligations.

3 Failing to advise about security (or adequate security) for terms purchases

When a small business is sold on terms or with vendor finance, security needs to be addressed. The usual forms of security to be considered are mortgages over real estate and/or chattels, mortgages of leases, indemnities, charges and circulating assets agreements/general security agreements. Guarantees can also be sought although not constituting security *per se*.

In these claims, mistakes have included the following actions.

- Failing to address the issue of security at all. This usually occurs because the practitioner believes they are not retained to consider the issue or simply does not think about it. Sometimes it occurs because the deal changes at the last minute. For example, where the parties cannot agree on the value of the stock before settlement they agree to settle and do a stocktake later. No one thinks to take security for that later payment, the purchaser is a $2 company and no directors' guarantees are in place.
- Failing to canvass the issue with the vendor client who is desperate to sell or, alternatively, giving the advice orally but not confirming the advice in writing or making a file note of the conversation and the client's response.
- Failing to ensure that property in the chattels of the business does not pass until the last payment is made.
- Failing to prepare, follow-up or register security documents. Sometimes the security documents are done in such a hurry without a proper title search that the practitioner fails to realise that there is more than one party on title and does not get the co-owner's signature.
- Failing to discover the existence or the value of a first mortgage. A second mortgage is executed and sometimes even registered but it is in fact worthless.
- Failing to recommend that a priority agreement be entered into with a first mortgagee or that the first mortgage liability be capped at a specified amount.
- Failing to advise the client of the need to register a debenture charge within 45 days of execution – the client then fails to return the signed documents to the practitioner within time to register the charge. (The equivalent now will be failing to advise the client of the need to register a general security document in relation to a security interest on the PPS Register within time.)
- Failing to discover a pre-existing debenture charge over the assets of the purchaser (now a security interest on the PPS Register) and/or that stock could be subject to a retention of title clause.
- Obtaining guarantees that were subsequently challenged as being unenforceable due to both defects in form and Amadio-style claims.
- Failing to obtain guarantees (or other security) when there were last-minute changes from cash purchase to terms purchase and/or from individual purchasers to a corporate purchaser.

Our recommendations

- ☑ Advise your vendor client not to advance vendor finance in any form.
- ☑ Remind your client that if vendor finance is agreed to, your client may have to go back into the business under the security provided, often to a business that is in bad shape.
- ☑ If your client still wants to proceed, advise your client on the various forms of security available and the risks associated with them.
- ☑ Take file notes of client conferences where advice is given about the risks in proceeding at all and the need for security.
- ☑ Confirm your advice and your client's response in writing.
- ☑ Familiarise yourself with the new PPS regime including what property it covers and excludes as well as how the security interests are enforced.
- ☑ Make sure all the vendor's security interests in the business, chattels of the business or other personal property are promptly and properly registered in the Personal Property Securities Register.
- ☑ Make sure that any mortgage over real property is registered if possible. Alternatively, lodge caveats on title to protect any other interests in real property.
- ☑ If the purchaser is a corporate entity, advise the vendor of the importance of obtaining personal guarantees from directors or third parties.
- ☑ Insist that any third-party guarantors provide a practitioner's certificate confirming that they have been provided with independent legal advice.

4 No or inadequate advice on the contract documentation

Practitioners as well as vendors are often blamed by purchasers when a business does not turn out to be the 'goldmine' expected. Allegations frequently arise that the practitioner failed to 'advise us about the contract'. Here are some examples of the types of claims we have seen against purchasers' practitioners.

EXAMPLES:

Contract not conditional on a two-week trial period

The purchasers alleged that the practitioner failed to ensure the contract was conditional on a two-week trial period. In fact, the practitioner had recommended to the clients that a two-week trial period be included in the contract but the vendor's practitioner had refused to allow it. The practitioner had not kept a file note of his conversation with the vendor's practitioner about the issue. The practitioner had told the clients of the vendor's response and the clients elected to proceed with the purchase. The practitioner did keep a file note of this conversation although he did not confirm it in writing. The file note assisted in settling the claim early.

Blank warranty not picked up

The purchasers had signed a contract and paid a deposit for a business interstate when they came to see their lawyer. They said they had received advice from their accountant in relation to the figures. After settlement, it became apparent that the vendor's warranty relating to the figures was worthless as the warranty referred to figures in certain parts of the sale of business contract, which were blank. The practitioner was blamed for not advising on this issue. In fact, the practitioner said he had only been asked to arrange a new lease for the client but unfortunately had not confirmed this in writing.

Failing to advise the client that long service leave and annual leave would not be paid by the vendor

The contract contained a definition of 'employee entitlements' that excluded long service leave and annual leave. The body of the contract said the vendor would be responsible for employee entitlements. The practitioner failed to read the definition and then was distracted leading up to settlement in arranging for the necessary DHS licence and forgot to look further at the employee entitlement issue. As a result, the client was unexpectedly saddled with liability for long service and annual leave.

Practitioners acting for vendors can also get into trouble in relation to the contract documentation.

EXAMPLES:

Non-refundable deposit clause removed

The practitioner removed a non-refundable deposit clause from the contract on instructions from his vendor client during negotiations. The sale did not go ahead and the purchaser recovered his deposit. The vendor complained the non-refundable deposit clause should not have been removed. The practitioner had not kept a file note of the instructions or confirmed them in writing to the client.

Mistakes in the schedule of plant and equipment

A practitioner acted for a client in the proposed purchase of a business. Shortly afterwards, the client sold the business to a third party. The client instructed the practitioner to draw a sale contract excluding certain equipment which the client intended to take with him. The practitioner drew the contract on behalf of the vendor in the same terms as the previous contract and left in the excluded equipment.

Failure to advise client to get accounting advice on allocation between goodwill, and plant and equipment

The contract of sale allocated $1 for goodwill and $90,000 for plant and equipment. The written down value of the plant and equipment was approximately $5,000. The client subsequently received a large tax bill. It was alleged the practitioner should have referred the client to an accountant to determine the appropriate allocation.

Our recommendations

- ☑ To protect yourself and your client, always confirm advice in writing, particularly when you have concerns about the transaction. A legible file note setting out the substance of the advice given, made at the time of the attendance can also make the difference between a claim proceeding or not proceeding.
- ☑ Pay careful attention to:
  - » schedules – have your client confirm they are accurate, particularly in relation to plant and equipment, intellectual property and financial data
  - » definitions – particularly employee entitlements and give careful consideration to who is responsible for long service leave, annual leave, sick leave and termination payments
  - » advising on the default mechanism and the consequences if default occurs
  - » formula – particularly retention amount and test the formula to ensure it works mathematically.

5 Failing to obtain liquor licences or secure them in the event of a re-entry

A common problem seen by LPLC is the failure to apply for or transfer a liquor licence. It often arises because of a limited retainer. The practitioner says the client was going to do it, but the client subsequently denies that this was the case.

A letter at the beginning of the retainer setting out the arrangement would have put the matter beyond doubt.

Other common problems arise when:

- there is confusion as to the type of licence required
- the sale is on terms and the vendor's practitioner fails to include a power of attorney in the lease. The vendor needs to be entitled to automatically apply to have the liquor licence reissued in their name on re-entry into the premises. Without the power of attorney this cannot be done without delay or the co-operation of the purchaser.

Our recommendations

- ☑ Clarify in writing who is to make the liquor licensing application and what type of licence is required.
- ☑ If the client is to apply for the licence, advise the client of the specific risks in failing to obtain the licence within any relevant deadlines.
- ☑ Consider the need to include a power of attorney in a vendor terms contract in the event that the purchaser defaults and the vendor needs to take possession and obtain a liquor licence. It may be necessary for the purchaser to sign blank transfer forms to be held in escrow as security.

6 Failing to undertake necessary searches

The searches required in small business transactions vary widely depending on the type of business involved.

The safest course of action is to obtain as much relevant information as possible, such as:

- company name search
- business name search
- trademarks, designs, copyright and patents
- motor vehicle registration
- local council health department – health orders
- certificate of title
- liquor licence search
- planning certificates
- usual conveyancing searches, whether the freehold is being purchased or not
- usual lease searches, if leasing land. Also remember to obtain a copy of the lease as it is essential you check its terms, especially the remaining period of the lease, whether there are any options and the termination rights
- bankruptcy search for individuals
- PPS Register searches (See the section on PPS on page 34)
- any other relevant permissions or information related to regulatory matters necessary to conduct the specific business, such as regulation by Consumer Affairs Victoria, licensing of aged care facilities, pharmacies, post office outlets and newsagencies, food handling and product safety standards and regulations, the *Firearms Act 1996* (Vic) and the *Control of Weapons Act 1990* (Vic).

Practitioners who undertake inadequate searches usually say that the client 'wanted to save money', 'just wanted me to document the deal' or 'was in a hurry'. These are hallmarks of the practitioner being put on a limited retainer. In these circumstances, the practitioner needs to confirm this in writing along with the consequences of the client's instructions.

We have also seen cases where practitioners have been caught out by relying on:

- statutory declarations when a company search would have shown the correct information
- a signed change of business name form when a business name search would have shown that the business name was not (and could not be) registered
- a tax invoice and a statutory declaration that the vendor was registered for GST when an ABN search would have shown that the vendor was not registered for GST
- answers to requisitions when a planning permit would have shown that no valid permit was issued
- what the vendor told the purchaser when a liquor licence search would have shown the contrary.

Secondary sources are no substitute for the public record searches which will independently confirm the matter.

Our recommendations

- ☑ When asked to advise just on the contract documentation before the purchaser signs the contract, recommend that all relevant searches be done before the contract is signed.
- ☑ Explain to your client why searches are necessary and the useful information that searches will provide.
- ☑ Where your client does not want you to undertake some or all of the necessary searches, confirm in writing the client's instructions and the specific risks of not obtaining the searches.
- ☑ When searching the PPS Register, advise on the outcome of searches including the limitations of the searches and the PPS Register.

7 Incorrect handling of restraint of trade clauses

Given that most businesses have a personal element, a restraint of trade provision is usually required to restrain action by the vendor that might damage the goodwill of the business. To be enforceable, the provision must be reasonable in every respect. We have seen practitioners caught out by:

- failing to draw an effective restraint of trade clause, for example, one that is too wide and is found to be unenforceable
- failing to advise purchaser clients to include a condition that the vendor, or where the vendor is a corporate entity, the individuals behind the vendor, enter restraint of trade agreements
- failing to warn the purchaser client that key employees, not connected to the vendor, cannot be restrained from setting up business or working nearby.

Our recommendations

When acting for the purchaser:

- ☑ where your client wants a wide restraint of trade clause:
  - advise your client in writing of the risks of the clause being unenforceable
  - provide 'stepping down' clauses in the agreement, so that if the widest restraint is found to be unenforceable the contract provides a less onerous restraint
- ☑ ensure that any directors of corporate vendors are bound by restraint of trade clauses
- ☑ include a non-poaching clause in respect of employees and customers even though the vendor's next competing business is outside the area of restraint
- ☑ if the vendor refuses to agree to a restraint of trade clause, document the position and advise the purchaser of the risks of proceeding.

8 Failing to obtain assignments or mortgagee consents to leases

Where the business is run from leased premises, remember that the purchaser will require the lessor's consent and, if the property is mortgaged, the mortgagee's consent, to occupy the premises. Failing to obtain a mortgagee's consent to a lease is a trap that can have disastrous consequences for a tenant client if the mortgagee takes possession of the premises mid-lease as a result of the landlord's default. These claims often arise in the context of limited retainers.

We have seen cases where the practitioner relied on verbal assurances that the mortgagee had consented, only to find out after settlement that the mortgagee had not given written consent and was now refusing to do so.

Our recommendations

- ☑ Refer to LPLC's practice risk guide *Looking after leases* which provides a full discussion on why these claims occur and how they can be avoided.
- ☑ When acting for the purchaser, undertake a title search to check whether the property is mortgaged. If so, ensure that the mortgagee has consented to the lease in writing.
- ☑ Advise your vendor client that it is the party who must satisfy the landlord about any assignment requirements and obtain the landlord's permission for assignment. It is not the purchaser's role to do this, even though the purchaser has an interest in receiving the assignment.
- ☑ Advise your client on who is meeting the costs of obtaining the consent of the landlord and its mortgagee.
- ☑ Advise your purchaser client that business references and financials need to be prepared to give to the vendor in order to obtain the mortgagee's consent.

9 Failing to protect the vendor from ongoing liabilities

Since the introduction of the *Retail Leases Act 2003* (Vic) (the RL Act) there has been a trap for vendors' practitioners regarding disclosure and ongoing liability. Section 62 of the RL Act provides that if the assignor of a lease has given the required disclosure statement, the assignor or any guarantor of the lease will no longer be liable. Practitioners have failed to give that extra disclosure and left their vendor clients exposed to ongoing liability.

The Retail Leases Regulations 2013, which commenced on 22 April 2013, sets out a prescribed form of disclosure in schedule 4 which is to be provided on the assignment of the lease under section 61(5A) of the RL Act. Practitioners should read schedule 4 carefully, however there is still no prescribed time for providing the disclosure statement for assignments other than before requesting the landlord's consent.

In relation to vendor guarantees to other parties, in some instances the vendor's practitioner fails to obtain a release from one of several guarantees because it was overlooked by either the practitioner or the vendor.

There can sometimes be a tricky timing issue in obtaining releases from guarantees given to suppliers because suppliers are not willing to give a release until new replacement guarantors have signed up. LPLC has even had a claim where the supplier indicated in writing that it would give a release but a formal written release was not obtained before settlement. The supplier then purported to renege on their agreement and refused to execute the formal release. If there are risks in proceeding with the transaction, the practitioner should warn the client in writing and seek further instructions in order to avoid taking such risks on themselves.

Occasionally the vendor is so desperate to sell that they agree to accept indemnities rather than delay the sale while releases are obtained and the indemnities later prove to be worthless. In extreme cases, we have even seen desperate vendors willing to provide guarantees to the purchaser's financiers. In other cases, indemnities for guarantees are not obtained because the guarantees were left out of the schedules in the sale of business contract.

EXAMPLE:

Vendor failed to realise he had given guarantees to suppliers

The vendors were selling their half-share interest in a grocery store to the remaining owners. The vendor clients instructed their practitioner that the only guarantees they had given were bank guarantees. After the sale, the purchasers went into liquidation and prior trade guarantees, given to suppliers by the vendors when in the business, were called on. One guarantee was simply a paragraph in a credit application while another was a separate deed. The practitioner was criticised for not specifically asking about these types of guarantees as it was usual practice for such guarantees to be required by suppliers.

Our recommendations

- ☑ Where your vendor client is assigning a retail lease, ensure you use the disclosure statement in schedule 4 of the Retail Leases Regulations 2013. It should be provided before requesting a landlord's consent. Practitioners should review the legislation and regulations each time to ensure they are using the current form in the appropriate way in order to give their client the protection available.
- ☑ Seek written instructions from your client about any guarantees given in connection with the business.
- ☑ Seek specific instructions about guarantees given to suppliers and advise clients to check with suppliers to confirm the position.
- ☑ Confirm in writing your client's instructions to proceed by way of an indemnity and the possible consequences of taking this course.
- ☑ Ensure guarantees are obtained from directors where the purchaser is a company.
- ☑ If the vendors are so desperate to sell that they are willing to settle without executed releases from guarantees, or will accept indemnities or even provide additional guarantees to third parties, make sure you advise the vendors of the risks and confirm that advice in writing.

10 Failing to document variations to a contract in the course of the transaction

We have seen several claims that arise as a result of failing to document variations to a contract in the course of the transaction. Sometimes, the parties will agree on variations between themselves, however due to communication breakdowns, the written agreement will not be varied at all or will not be varied correctly.

Problems can subsequently arise when:

- it turns out the vendor and purchaser may not have agreed or their agreement is not sufficiently certain
- the vendor and purchaser think they have agreed but they each give different versions of what was agreed
- practitioners take it upon themselves to simply amend contracts, for example, by removing and replacing pages or making handwritten amendments, and do not have the client re-execute the documents
- practitioners do not change the documents and fail to exchange correspondence with the other side confirming the terms of the apparent variation.

Often variations are made shortly before settlement. This results in there being limited time for the practitioners to think through the implications and consider whether additional clauses should be added or ensure that other conflicting clauses are removed.

EXAMPLE:

Practitioner failed to consider need for guarantees due to late variations

When the contract was initially drawn up, the purchase price was payable in full on settlement and the purchaser was an individual. However just before settlement, the parties agreed to a terms purchase and a corporate vehicle was substituted as purchaser. The settlement proceeded without the vendor obtaining guarantees from the individuals behind the purchaser. When the purchaser company defaulted on payments and went into liquidation, the practitioner was blamed for not obtaining guarantees.

11 Allowing a conditional contract to become unconditional

Mistakes relating to 'subject to finance' clauses have increased and here are some of the common errors.

- In order to assess the client's finance application, the financial institution requires a valuation of the business. When obtained, the valuation is too low for the purchaser's needs (and possibly indicates the sale price is too high), however by then the contract has become unconditional.
- The client is not given sufficient warning by their practitioner of the requirement to notify the vendor in writing by the specified time if finance cannot be obtained and the consequences of not doing so. This sometimes happens because the clause is badly drafted and unclear. Other times it occurs because the practitioner assumes the client knows what is required.
- The client who receives no or inadequate advice about the 'subject to finance' clause takes it literally and assumes that if finance is not approved the contract is void.
- Failing to obtain an extension of time for finance approval possibly because:
  - the purchaser arranges the extension directly with the vendor. Purchasers sometimes assume that a vendor has agreed to a request for extension of time without having clear written evidence of such agreement
  - there is some oversight or administrative error in the practitioner's office such as failing to follow up requests for an extension prior to the relevant deadline.

If the purchaser seeks to terminate the contract pursuant to a 'subject to finance' clause, it is imperative the purchaser or their practitioner sends a written notification to the vendor in clear and unambiguous language. This notice should be '*such that a reasonable person, having given it fair and proper consideration, would be left in no doubt as to its meaning*'.

In *Umbers v Kelson* [2010] VSCA 227, the purchaser of a business sent a letter to the vendor in the following terms:

'Our client has not had finance approved at this stage.

We seek an extension of one month to 17 August 2005.

We understand the delay relates to the actual distribution to our client of shares under an estate, which will form security for the borrowings.

Should you have any queries, please contact [the purchaser's practitioner].

In the event that an extension is not agreed to, you may treat this letter as written notice ending the contract.'

The Victorian Court of Appeal found that this notice was not a 'written notice ending the contract'. Instead it gave the vendors 'the option of treating the letter as a written notice ending the contract, in the event the extension was not agreed to'. While the decision may seem harsh (and may have been influenced by other subsequent and inconsistent conduct on behalf of the purchaser), it graphically demonstrates how direct and unambiguous a practitioner must be in drafting a letter that terminates a contract.

Our recommendations

- ☑ When you receive a contract immediately check for any conditional clauses.
- ☑ When a contract has a 'subject to finance' clause:
  - » diarise the relevant date
  - » write to the purchaser client immediately setting out clearly the date by which finance must be obtained. Spell out the consequences if finance is not obtained and the vendor is not notified in time that finance has not been obtained
  - » confirm with the client that any approval they receive is in writing is final and not conditional, and is for an amount sufficient for their needs
  - » make a diary note to check with the client a few days before the relevant date as to whether finance has been obtained and if not, obtain instructions whether to terminate the contract or attempt to negotiate an extension of time
  - » do not leave requests for extensions of time for finance approval unanswered and chase up the answer before the time expires
  - » confirm any oral agreement to extend time in writing
  - » if instructed to terminate a contract for lack of finance, document the instructions and ensure correspondence to the other party is sent to the right place. Make sure that any written notification of termination is clear and unambiguous.

12 GST

One of the issues that needs to be considered when acting in the sale or purchase of a business is whether the sale will qualify as the supply of a going concern under section 38-325 of *A New Tax System (Goods and Services Tax) Act 1999* (Cwlth).

In order for the supply of a going concern to be GST-free under section 38-325:

- the supply must be for consideration
- the purchaser must be registered or required to be registered for GST
- the vendor and the purchaser must have agreed in writing that the supply is of a going concern
- the vendor must supply to the purchaser all of the things that are necessary for the continued operation of the enterprise
- the vendor must carry on the enterprise until the day of supply.

The ATO ruling *GSTR 2002/5 Goods and Services Tax: when is a 'supply of a going concern' GST-free?* provides guidance on the application of the supply of going concern provisions.

Although this area is notoriously technical, mistakes made by practitioners have been surprisingly simple. The two most common mistakes made by practitioners acting for vendors are:

- failing to ensure that the parties have agreed in writing that the supply is of a going concern (either by way of a condition in the contract of sale or by an exchange of letters prior to settlement)
- failing to check or require confirmation from the purchaser prior to settlement that the purchaser is registered for GST.

Vendors' practitioners are exposed in these circumstances if there is no GST exclusive 'claw back' clause in the contract. In the absence of such a clause, the risk for any GST liability falls on the vendor who must remit 1/11th of the purchase price to the ATO. Conversely, a purchaser required to pay GST pursuant to a 'claw back' clause will at least be able to claim the GST as an input tax credit, provided receipt of the supply is a 'creditable acquisition'.

Another danger in this area is the tendency for vendors and their practitioners to go to extraordinary lengths to accommodate purchaser requests to structure transactions as supplies of going concerns, even where there is significant risk that they will not qualify. If you are acting for a vendor client in circumstances where there is doubt that the sale will qualify, it may be better to treat the supply as taxable at the outset.

The most complex aspect of whether a sale of business will qualify as the supply of a going concern is the requirement that the vendor supplies to the purchaser all the things that are necessary for the continued operation of an enterprise.

ATO ruling GSTR 2002/5 provides the following.

- Where the freehold from which a business is conducted is owned by one entity and the business by another, the sale of both to a single purchaser may qualify if the contracts are interdependent and settle simultaneously (paragraphs 137-140).
- Where the freehold from which a business is conducted and the business are owned by one entity, the sale of both to two separate purchasers may qualify if a lease of the freehold is granted to the purchaser of the business by the date of settlement and the sale of the business settles at least the day before the sale of the freehold (paragraphs 133-136).
- Where a business is conducted from premises which are not owned by the vendor, the right to occupy the premises must be supplied for the sale to qualify:
  - if there is a lease, the vendor may supply the lease either by way of assignment or by surrendering the lease and facilitating the entry by the purchaser into a lease or agreement for lease of the same premises by the date of supply (paragraphs 58-63)
  - the absence of a written lease will not be fatal. A periodic tenancy which is capable of assignment is considered sufficient (eg. overholding under an expired lease), however a mere tenancy at will, which is not capable of assignment, will not qualify (paragraphs 64-70)
  - if particular premises are not required, the supply of alternative suitable premises will be sufficient, however if premises are necessary but are not supplied because the purchaser has some already, the sale will not qualify (paragraphs 90-99).
- Where a vendor is selling a business but retaining the freehold from which it is conducted, the vendor will need to grant a lease to the purchaser effective from the date of settlement for the sale to qualify (paragraph 100).
- Sometimes it will not be possible for the vendor to supply a thing necessary for the continued operation of the enterprise such as the benefit of a franchise agreement or a statutory liquor licence. The sale may still qualify if a third party supplies the thing instead in the following limited circumstances.
  - The thing must be incapable of assignment because of a statutory or legal impediment
  - The vendor must use all reasonable efforts to have the thing supplied to the purchaser
  - The supply must be by a statutory authority or other party to the contract with the vendor
  - The thing must actually be supplied to the purchaser (paragraphs 53-57).
- If there is no statutory or legal impediment to the assignment, it will still be permissible for a third party to supply the thing if:
  - normal commercial practice dictates the supply can only be effected in this way
  - the vendor conditionally surrenders or terminates the right to the thing and facilitates entry into a new arrangement between the purchaser and the statutory authority or other party to the contract
  - the thing is actually supplied to the purchaser (paragraphs 53-57).

- If the enterprise is a business, goodwill must be supplied as one of the things necessary for the continued operation of the enterprise (paragraph 111).
- The vendor must take all reasonable steps to facilitate the transfer of the skills and knowledge of key personnel for the sale to qualify (paragraphs 125-128).
- Admitting a new partner, assignment of a partnership interest or sale of a partnership interest will not qualify (paragraphs 190-192).
- Where the sale of a business which has been carried on by a company is structured as the sale of shares in the operating company, it will not qualify (paragraph 196).

The other difficult issue is the requirement that the vendor must carry on the business until the day of supply. The ATO ruling GSTR 2002/5 identifies the day of supply as occurring when the vendor has done everything to satisfy the obligations under the contract and the purchaser has assumed effective control and possession of all the things which are necessary for the continued operation of the enterprise. Paragraphs 161-165 of GSTR 2002/5 has examples of when the day of supply occurs.

Lastly, even if the sale is a GST-free transaction, it is still necessary for the vendor to quote their ABN or tax file number. If the vendor fails to do so, the purchaser has an obligation to withhold 46.5 per cent of the purchase price and remit that amount to the ATO. See section 12-190 of schedule 1 of the *Taxation Administration Act 1953* (Cwlth) and ruling TR 2002/9 for further details. The failure to withhold a payment is an offence under section 16-25 of schedule 1 of that Act and the purchaser could be liable to a penalty equal to the amount that it did not withhold.

It is therefore essential to ensure that parties to your transactions quote ABNs at or before the time of payment. In particular, caution should be exercised in transactions where there is no requirement for a tax invoice. The simplest way of ensuring compliance is to insert the vendor's ABN into the business sale agreement.

For additional information refer to the:

- LPLC Key Risk Checklist: GST
- GST FAQs on the LPLC website.

Our recommendations

- ☑ If acting for a vendor client in circumstances where there is doubt that the sale will qualify, either:
  - » apply for a private ruling from the ATO to clarify the position before settlement or
  - » treat the sale as taxable from the outset.
- ☑ Always use a GST-exclusive 'claw back' provision in the contract as a safety net in the event the sale does not qualify and, if acting for a vendor client, consider expanding the GST definition to include penalties and interest.
- ☑ Be conscious of the timing issues where you are acting for separate vendors selling both freehold and business to a single purchaser or for a single vendor selling both freehold and business to separate purchasers.
- ☑ Be wary of sales where assets are excluded or the right to occupy premises is not supplied.
- ☑ Ensure the parties have agreed in writing that the supply is of a going concern prior to settlement.
- ☑ Require evidence that the purchaser is registered for GST prior to settlement.
- ☑ Be aware that the date a purchaser enters into early occupation may or may not be treated as the day of supply. As a broad rule of thumb, the greater the number of sale conditions outstanding at the time the purchaser enters into early occupation, the less likely it is that the entry date will be regarded as the day of supply.
- ☑ Ensure the vendor's ABN is inserted into the business sale agreement.

13 Failing to deal with employment liabilities

The liability for employees' entitlements and the payment of those entitlements are matters that can catch out purchasers' practitioners if not dealt with carefully.

In many claims the purchaser's practitioner has not insisted that the vendor's liability to pay out the employees' long service leave and annual leave be adjusted at settlement. Instead, the vendor is left to make those payments, either before or after settlement, but those payments are never made. While the purchaser may have some recourse against the vendor for breach of warranty, the vendor is often bankrupted, has gone into liquidation or has moved overseas by the time the problem is discovered. The purchaser is then left having to make those payments.

This mistake can happen when the purchaser says they will deal with the vendor themselves regarding the employee entitlements, often in order to save legal costs. The purchaser later complains that the practitioner should have advised them 'how to deal with the issue' or failed to advise them that the entitlements should have been adjusted at settlement and the consequences of not doing so.

Our recommendations

When acting for the purchaser:

- ☑ if you are instructed before the contract is signed, ensure there is a clause requiring the employee entitlements are adjusted at settlement
- ☑ insist that full details be provided of the employee entitlements
- ☑ advise your client in writing that they need to have their accountant verify the employee entitlement figures and what adjustment should be made at settlement
- ☑ if you are not experienced in advising on employment law, advise your client that this is not part of your retainer and they should obtain separate advice on how to manage the transferring employees
- ☑ if the client insists on dealing with the vendor personally in relation to employee entitlements, set out in writing what should be done and the consequences of not doing so.

Personal Property Security

The *Personal Property Securities Act 2009* (Cwlth) (PPS Act) introduced a single national register of security interests for personal property and a new rule-based system to determine priorities between competing security interests. The register commenced on 30 January 2012.

Practitioners acting in the sale and purchase of small businesses need to understand how the register works, what property is likely to have security interests registered on it and how best to advise and protect their clients.

LPLC has written several bulletins describing the basics of how the PPS Register works and what to consider when acting in the sale of a business or real estate and leasing land.

The bulletins can be accessed at www.lplc.com.au/category/bulletins and are:

Personal Property Securities Act 2009 (Cwlth) Background and Key Concepts (March 2012 – updated July 2017)

Sale of Business and the PPS Act (September 2013)

Land Leases and the PPS Act (September 2013)

Sale of Land and the PPS Act (September 2013)

LPLC Small Business Checklist

This is not a comprehensive checklist but it will help you avoid most of the mistakes made by practitioners in small business transactions. The checklist can be photocopied for ongoing use.

CLIENT:

MATTER:

When acting for the purchaser

- ☐ When asked to advise just on the contract documentation before the purchaser signs the contract, recommend that all relevant searches be done before the contract is signed.
- ☐ Check that your client has a section 52 statement and has had the figures reviewed by an accountant.
- ☐ Advise your client that the absence of a section 52 statement or a defect in the statement may give your client the right to rescind the contract.
- ☐ When instructed to act on a limited retainer, confirm the limits of the retainer in writing.
- ☐ When you receive a contract, immediately check for any conditional clauses. If there is a 'subject to finance' clause, follow the recommendations set out in chapter 7 above.
- ☐ Clearly explain the issues associated with early possession (see the suggested form of letter in Appendix One: Early possession – acting for the purchaser).
- ☐ Advise your client of the need for comprehensive searches and the risks if particular searches are not obtained.
- ☐ Consider whether the following searches are necessary:
  - » company name search
  - » business name search
  - » ABN search
  - » search of the Personal Property Securities Register
  - » trade marks
  - » motor vehicle registration
  - » local council health department – health orders
  - » certificate of title
  - » liquor licensing
  - » planning certificates
  - » usual conveyancing searches
  - » usual lease searches if leasing land.

- ☐ Do not rely on secondary sources instead of the standard searches and enquiries.
- ☐ Advise your client to check with the relevant planning authority as to whether there are restrictions in the planning permit or scheme that will inhibit the operation of the intended business. Confirm this advice in writing (see the suggested form of letter in Appendix One: Possession at settlement).
- ☐ Confirm in writing with your client who is to apply for the liquor licence (if applicable) and what type of licence is required.
- ☐ Consider the need for a restraint of trade clause and check that it adequately protects your client's position.
- ☐ Where your client wants a wide restraint of trade clause, use a 'stepping down' clause.
- ☐ Check whether the property is mortgaged. If so, ensure the mortgagee has consented to the assignment of the lease in writing (see LPLC's practice risk guide *Looking after leases*).
- ☐ Advise your client of the need to obtain independent financial advice on the viability of the business. Do not give that advice yourself (see suggested form of letter in Appendix One: Possession at settlement).
- ☐ If you are instructed before the contract is signed, ensure there is a clause requiring the employee entitlements are adjusted at settlement.
- ☐ If you are instructed after the contract is signed, check the contract accurately reflects who is responsible for all employee entitlements and any necessary adjustment is made to the purchase price.
- ☐ Insist that full details be provided of the employee entitlements.
- ☐ Advise your client in writing that they need to have their accountant verify the employee entitlement figures and what adjustment should be made at settlement.
- ☐ If you are not experienced in advising on employment law, advise your client that this is not part of your retainer and they should obtain separate advice on how to manage the transferring employees.
- ☐ If the client insists on dealing with the vendor personally in relation to employee entitlements, set out in writing what should be done and the consequences of not doing so.
- ☐ Make sure the vendor quotes their ABN or tax file number. The simplest way this can be satisfied is by quoting the vendor's ABN on the business sale agreement. Note: this is essential for a purchaser to comply with its withholding tax requirements and the requirement applies regardless of whether the transaction is subject to GST.
- ☐ Pay careful attention to:
  - » schedules – have your client confirm they are accurate, particularly for plant and equipment, intellectual property and financial data
  - » definitions – particularly employee entitlements andn give careful consideration to who is responsible for long service leave, annual leave, sick leave and termination payments

- advising on the default mechanism and the consequences if default occurs
- formula – particularly retention amounts and test the formula to ensure it works mathematically.

When acting for the vendor

- ☐ Advise your client that the failure to give the purchaser a section 52 statement may allow the purchaser to avoid the contract. Confirm this advice in writing (see Appendix Two for suggested letter: Initial letter before contract is signed).
- ☐ Explain that the business operating report in the section 52 statement must be prepared by an accountant and must be accurate.
- ☐ Confirm that your client's accountant is preparing the business operating report for the section 52 statement and request that the accountant or the client send the business operating report to you for inclusion in the section 52 statement.
- ☐ Have the client confirm all schedules are accurate.
- ☐ Explain the issues associated with early possession (see the suggested form of letter in Appendix Two: Early possession – acting for the vendor).
- ☐ Advise your client not to provide vendor finance.
- ☐ If your client still wants to proceed on vendor terms:
  - advise your client on the various forms of security and the attendant risks, confirming your advice and the client's decision in writing
  - ensure the title to chattels does not pass in a terms contract until final payment is made and register the vendor's security interest in the Personal Property Securities Register
  - consider the need to include a power of attorney in a vendor terms contract in the event that the purchaser defaults and the vendor needs to take possession and obtain a liquor licence.
- ☐ Where your vendor client is assigning a retail lease, ensure you use the disclosure statement in schedule 4 of the Retail Leases Regulations 2013. It should be provided before requesting a landlord's consent. Practitioners should review the legislation and regulations each time to ensure they are using the current form in the appropriate way in order to give their client the protection available.
- ☐ Seek written instructions from your client about any guarantees given in connection with the business.
- ☐ Seek specific instructions about guarantees given to suppliers and advise clients to check with suppliers to confirm the position.
- ☐ Confirm in writing your client's instructions to proceed by way of an indemnity and the possible consequences of taking this course.
- ☐ Ensure guarantees are obtained from directors where the purchaser is a company.

- ☐ If the vendors are so desperate to sell that they are willing to settle without executed releases from guarantees or will accept indemnities or even provide additional guarantees to third parties, make sure you advise the vendors of the risks and confirm that advice in writing.
- ☐ Advise your client that it is the party who must satisfy the landlord about any assignment of lease requirements and obtain the landlord's consent.
- ☐ If there is doubt that the sale will qualify as the supply of a going concern, treat the sale as taxable.
- ☐ Always use a GST-exclusive 'claw back' clause in the contract as a safety net.
- ☐ Be aware of the timing issues when acting for separate vendors selling both freehold and business to a single purchaser or for a single vendor selling both freehold and business to separate purchasers.
- ☐ Ensure the parties have agreed in writing that the supply is of a going concern.
- ☐ Conduct an ABN search to ensure that the purchaser is registered for GST prior to settlement.
- ☐ Advise your client of the need to give to the purchaser details of employee entitlements together with employment records.
- ☐ Pay careful attention to:
  - » schedules – have your client confirm they are accurate, particularly for plant and equipment, intellectual property and financial data
  - » definitions – particularly employee entitlements and give careful consideration to who is responsible for long service leave, annual leave, sick leave and termination payments
  - » advising on the default mechanism and the consequences if default occurs
  - » formula – particularly retention amount and test the formula to ensure it works mathematically.

Generally

- ☐ Make a comprehensive file note of the initial conference with your client.
- ☐ Document all attendances and meetings with your client and others.
- ☐ Check that your file notes:
  - » are dated
  - » record the duration of the attendance
  - » record who was present or on the telephone
  - » record the name of the author
  - » are legible to you and someone else
  - » record the substance of the advice given and the client's response/instructions
  - » are a note to the file rather than a note to yourself.

- ☐ Provide clear advice on how the transaction should be handled to ensure your client's interests are protected.
- ☐ Obtain clear instructions as to the basis on which you are to proceed, particularly where the client seeks to limit your retainer.
- ☐ Warn your client of the risks they are taking by reason of their decision about the way the transaction will be handled, for example early possession, limited retainer or limited searches (see suggested letters in Appendices One or Two).
- ☐ Confirm your retainer and your advice in writing, particularly where the retainer is limited, setting out any areas where your client has chosen not to take your advice and has elected to accept the resultant risks.
- ☐ Be aware of conflicting and divergent interests and do not act for both parties or for a party and the landlord.

Appendix One

A. Early possession – acting for the purchaser

'You have instructed me to act for you in relation to the purchase by you of the business currently known as _____. You have told me that you intend to take possession of the business on _____, this is only ___ days from today.

You have provided me with a copy of the section 52 statement prepared on behalf of the vendor. – **OR** – You have not yet received a written statement from the vendor setting out the financial and other details of the business. This statement is often called a section 52 statement.

I confirm my advice to you that taking early possession of the business is hazardous and should not be done. I say this because there are many aspects to a business that require investigation before you take possession. I am unable to complete those investigations in the time available before you intend to take possession. It is also important that your accountant carefully review the section 52 statement before you take possession.

If you or your accountant find a defect in the section 52 statement (or no section 52 statement is given to you) within three months from the date you signed the contract you can avoid the sale provided you have not taken possession of the business before you wish to avoid. You will lose this right as soon as you take possession of the business. You have instructed me that despite my advice you intend to take possession on _____.'

B. Possession at settlement – acting for the purchaser

'You have instructed me to act for you in relation to the purchase by you of the business currently known as _____. You have told me that you intend to take possession of the business on _____'.

I confirm my advice to you in conference that:

1. You should arrange for your accountant to carefully review the financial statements given to you by the vendor. We also recommend you instruct us to check and advise you on the other aspects of the vendor's statement. The financial and other aspects of the vendor's statement that have been or should have been given to you is often called a section 52 statement. If a defect is found in the section 52 statement within three months from the date you signed the contract you are entitled to avoid the contract, provided you have not taken possession of the business. It is therefore important that your accountant reviews the financial statement as soon as possible. Please confirm that you want us to review the other aspects of the section 52 statement.
2. You should look to your accountant for advice on the financial viability of the business as I cannot make any comment in relation to financial matters.
3. Before final settlement it is important we make enquiries and perform searches, including company, business name and trademark searches as well as searches relevant to your occupancy of the premises [add any other relevant searches]. I confirm that you have authorised us to make these searches.
4. It is important that you speak to the [relevant planning authority] about the existence of any restrictions in the planning permit or scheme which may affect your intended running of the business.
5. [where a liquor licence is necessary] The liquor licence will have to be transferred into your name. I will make this application on your behalf. – **OR** – You have agreed to make this application yourself.
6. [comment about any restraint of trade provision or issues with the lease that may have been discussed].

I will contact you when I receive the results of my searches.

Appendix Two

A. Initial letter before the contract is signed – acting for the vendor

'You have instructed me to act for you in relation to the sale of your business known as _____'.

I enclose a blank copy of a 'Form 2'. This form outlines what must be included to adequately prepare what is commonly known as a 'section 52 statement'.

I confirm my advice to you that:

1. You must arrange for your accountant to prepare the business operating report set out in the Form 2.
2. The other part of the form will need to be completed. Let me know whether you require my assistance in completing this part of the form. If you do not require my assistance, then I suggest you allow me to check the form before it is completed.
3. A fully completed and accurate Form 2 must be given to the purchaser before they sign the contract of sale or you accept the deposit. If you do not give the purchaser such a statement or it is defective in some way, the purchaser is entitled to avoid the contract at any time up until possession or three months after signing the contract, whichever happens first.
4. You will need to provide me with a list of all guarantees you have given in relation to the business. These may include guarantees for leases of equipment, for the property or guarantees in supply agreements. It may be difficult to obtain a release from these guarantees from the various entities. We can attempt to do so once a purchaser is found. The usual course is for the purchaser to provide you with an indemnity for each guarantee. This means that if you are pursued in relation to any of the guarantees you will be entitled to be reimbursed by the purchaser. However, you should note that the amount you will ultimately be paid by the purchaser will depend on whether the purchaser has any assets to meet the indemnity at the time you seek to enforce it.'

B. Early possession – acting for the vendor

'You have instructed me to act for you in relation to the sale of your business known as _____ to
[name of purchaser]. Final settlement of the sale is due on _____'.

You have told me that you intend to allow the purchaser into possession prior to settlement.

I confirm my advice to you that while early possession takes away the purchaser's right to avoid the contract in the event that they find a defect in the section 52 statement, it does also give the purchaser an opportunity to find fault with the business.

As you will appreciate, there is often a drop in takings when a business is first under new management. If, for example, the purchaser is disappointed with the takings before settlement they may try to avoid the contract.

Furthermore, if the settlement does not occur for any reason and it is necessary for you to re-take possession, there is a risk that the business may have deteriorated in the meantime. You have instructed me that you understand my advice that early possession carries various risks but you intend to allow the purchaser into early possession.'

LEGAL
PRACTITIONERS'
LIABILITY
COMMITTEE