MULLINS business

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HOW DO YOU GET VALUE FOR YOUR BUSINESS?

DAVID WILLIAMS

Is your business a licence to earn an income or a valuable asset?

Post the Global Financial Crisis (GFC) as the recovery strengthens; owners of business may ask the questions:

- *"Where can I take my business?"*
- *"Is there any value in my business?"*
- *"If my business is valuable, how and when do I exit?"*

When an owner wishes to exit their business, what is the value of the business and who is the buyer? I recall a comment made by a renowned property valuer, Sir Frank Moore, who said "*… Valuation is easy. The hard part is putting a date on it*". A similar comment can also be made with regard to the value of a business.

It is not uncommon for owners of businesses to ascribe little or no value to their business other than it gives them a licence to earn an income for as long as they wish to conduct that business. This seriously undermines the intrinsic value of a business that has historically generated significant income. If owners wished to or wanted to sell their business no options may be available other than simply running down the business. There are professions where this scenario is quite true; such as Barristers who operate on their own as individual traders, when they come to retire there is essentially nothing to sell because their clients will simply go elsewhere for their services.

As the economy recovers from the GFC, value will return to businesses that are well run and are profitable. You must plan for your exit well before you wish to exit your business. When you come to sell your home, you do not simply put it on the market and hope for the best. You undertake a freshening up program, seek advice from appropriate professionals and present your home in its best light in order for you to maximise and achieve the best price.

The sale of a business is no different. The more effort you put into making your business attractive and profitable gives you the best chance to maximise your exit price. It is then up to you, to put a date on when you wish to sell.

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How much authority do your managers or employees have?

NIGEL INGLIS & CHRIS HARGREAVES


The extent to which managers and employees are authorised to bind the owner of a business to a contract with third parties is one that frequently arises in many business day-to-day operations. Business owners must be able to rely on staff to order stock, other purchases and services.

Third Parties

Business owners need to be able to trust their employees, in particular managers, to make rational decisions about entering contracts for goods and services. Whether a director of the business entity (or a partner) has the time and inclination to personally review, negotiate and agree to all contracts for goods and services is something that will vary. However, in many cases these kinds of decisions are delegated to employees, and those employees are expected to make appropriate decisions.

The question, ultimately, is one of 'actual or ostensible authority'.

The situation does arise, however, where an employee has stepped outside the bounds of their authority and entered into a contract with a third party for the acquisition of goods or services for which they were not authorised. Whether or not the third party will be entitled to rely on that agreement is a complicated question.

One relevant consideration is whether that employee or manager has any previous dealings with the service provider in question, and whether the service provider is accustomed to dealing with that particular employee for contracts. If there is an established track record of that employee making decisions in respect of that particular provider, the business might be hard pressed to convince a Court that it should not be bound by the contract when it has allowed an employee to deal with that situation on previous occasions.

If, however, it is well known to the supplier that the business insists on reviewing every single agreement, there is a reasonable argument to suggest that the supplier should have known that the employee had no authority to bind the business/employer and, therefore, the supplier cannot hold the business to the agreement.

The question, ultimately, is one of 'actual or ostensible authority'. If you have given an employee actual authority to do what they did, then you are unlikely to be able to wriggle out of the agreement (at least on this particular ground).

If, however, the employee has held themselves to be in a more lofty position than what they actually hold, or has represented to a supplier that they did have authority to enter into the agreement then the question will be much harder. Whether the supplier was entitled to, or could reasonably have, relied upon such a representation will vary depending on the facts.

If you wish to avoid this situation, you should ensure that the appropriate levels of authority and the necessary sign offs are made clear to all of your frequent or habitual suppliers, and you should confirm who the authorised representatives are in writing so there is no confusion as to who they are to deal with when the time comes to make a deal.

Employees

Employees have the authority to do all things necessary to carry out their role including duties or tasks specified in an employment contract or position description. Additionally, any lawful and reasonable direction given by an employer to an employee will fall within that scope. However, a number of factors impact on the scope of this authority including the employee's skill and knowledge, and seniority.

An employee's authority will either be express (in a contract or policy), implied (from the nature of the role or seniority of the employee) or ostensible (apparent authority).

Ostensible authority generally involves some act or omission by the employee that suggests to a third party that the employee has the authority to bind the employer. This may be through previous dealings, where a third party has dealt with the particular employee before and based on those dealings, believes the employee continues to have the authority (which they may have legitimately had previously) to bind the employer.

Because of the issues with third parties set out above, it is best practice, and a sound risk management tool, to clearly define the authority of the employee. This can be through a limit on the value of any contract an employee may be allowed to enter on behalf of the employer. If the contract is a "one off", then this should be clear.

The next practical step is to ensure that the scope of authority granted to the employee is clearly communicated to the employee. Regardless of what any contract may say, if the employee does not understand the limits of their authority, then costly questions may arise about whether, or to what extent, the employee had authority to bind their employer to a third party.

Consequences that can arise where an employee acts outside the scope of their authority and enters a third party contract on behalf of their employer that they shouldn't have include:

The employer may be bound to the contract and need to carry out what the contract provides. If not, the employer may be in breach of that contract and be exposed to a claim for damages.

The employer may terminate the employee.

The employer may be able to recover directly from the employee any losses arising from the contract, depending on what the employment contracts provides.

In summary, the extent to which your employees are authorised to negotiate or contract on your behalf should be clearly communicated, in writing, to both your employees and to your common suppliers. This type of risk management can help to avoid serious issues in the future.

NOT MORE FRANCHISING CHANGES?!

DAVID WILLIAMS

Amendments to the *Trade Practices Act 1974* (Cth) and the *Franchising Code of Conduct* ('the Code') will be made during 2010 with draft legislation to be released shortly.
Some of the unexpected changes are discussed here. Other changes will be discussed in future articles.

There may be even more changes to The Trade Practice Act after the expert panel, appointed by the government, reports on the need to introduce further provisions to prevent specific behaviours that are inappropriate in a franchising arrangement.

UNCONSCIONABLE CONDUCT

The expected amendments will include fines of up to $1.1m for corporations and $220,000 for individuals that engage in unconscionable conduct or make false or misleading representations:

- During the negotiation process;
- By way of the actual terms and conditions in the franchise agreement; and
- Whilst the franchise arrangement is in place (and perhaps even when that arrangement ends).

ACCC'S AUDIT POWERS

In response to untested claims by franchisees that any reporting by franchisees to the ACCC of improper behaviour by franchisors is met with 'retribution', the ACCC is expected to receive expanded powers including the power to:

- Randomly audit franchisors' behaviour including compliance with the Code;
- 'Name and shame' non-compliant franchisors; and
- Seek court orders against franchisors on behalf of all franchisees of a particular franchise even though not all franchisees are parties to the legal proceeding.

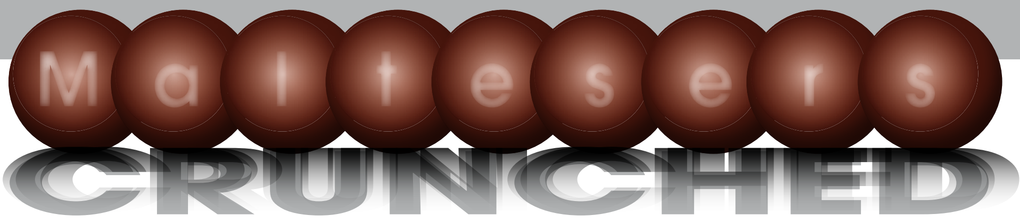
YET MORE CHANGES TO FRANCHISORS' DOCUMENTS

The expected changes will require Franchisors to amend and update (once again):

- Standard franchise agreements; and
- Disclosure documents.

WHAT HAPPENS NEXT? WHAT DO I DO?

Whilst the proposed changes have not yet come into effect, they will shortly and all franchisors should take steps to ensure that their documents, and their processes, are fully compliant with the changes to avoid court fines and adverse publicity (with the potential loss of business).



ANDREW NICHOLSON

Traders must consider the apparent popularity or reputation of their brand in assessing whether their rights have been infringed.

In a recent appeal, the Federal Court had to consider the alleged infringement of Mars' reputation in its 'Maltesers' product. The trial judge earlier held that "*it is highly unlikely that any ordinary consumer of chocolate confectionary could mistake something which is not a Malteser for a Malteser. … In that sense, Mars is a victim of its own success*".

The competing product was marketed under the name 'Delfi' and packaged in plastic jars which had a red background, the word Delfi, a logo containing a picture of a skier, images of malt balls (some shown in cross-section) and the words 'Malt Balls'. It was accepted that the label was not an identical copy of Maltesers' trademark. Accordingly, to succeed in its claim for trademark infringement, Mars needed to show that the marks were deceptively similar – which is generally established by considering whether there may be confusion amongst consumers between the two products.

It was suggested by the trial judge that "*consumers are so familiar with Maltesers that they could not possibly be confused by the label*". However, the Appeal Court found that the overall impression left by Mars' product is the word 'Maltesers', whereas the main (distinguishing) feature of the other product was the word 'Delfi'.

The Court also took into account other elements of the packaging and the overall look and feel of the products. In this case, there were a number of features of the packaging of both products which were similar and which are commonly used in confectionary packaging. Those included the primary colours used in the background (red), the representation of the product, including cross-section and stylised writing from the bottom left corner to the top right. As both products followed that 'standard formulae' it was more difficult for Mars to establish that there had been any intention to infringe.

Of course, trademarks can become so well known that they become part of the product description (such as the recent conjecture over ugg boots). However, that is a difficult area to agree and there are many shades of grey.

Summary and Recommendations

Market advantage and reputation must be monitored. Traders must be vigilant about their branding, consider the position of their product in the market, the currency of their trademarks and those seeking to infringe the rights which they have established by benefiting from leveraging off their reputation.

It is essential to review your branding strategy regularly to ensure that you are up to date and competitive in the market.

The trade-off between creativity and following tried and tested marketing patterns must be considered. The more unusual the mark, (including industry 'norms') and the greater the distinguishing features which are incorporated in the mark the greater the prospect of registration and protection in the case of infringement.

ADVISOR **Caution**

CHRIS HARGREAVES

Insolvency practitioners, solicitors and accountants are frequently called upon to advise companies in varying states of financial decline. The *Corporations Act 2001* (the Act) contains a minefield of traps for the unwary advisor. These include the duties placed upon directors, officers and employees of companies, with which all advisors should be familiar if they are to properly advise their clients as well as protect their own interests.

From a director's point of view, you can take it that the following basic principles should be known:

1. If a company is insolvent or at risk of insolvency, then the interests of creditors must be considered in preference to the interests of shareholders.
2. Any conduct by a director to utilise knowledge of a company's failing financial situation in order to protect himself, profit him or his relatives or any other similar goal to the detriment of creditors will not be conduct for a 'proper purpose' within the meaning of the Act.
3. Transferring assets out of a company while leaving creditors stranded to pursue an assetless company in administration or liquidation is not a 'proper purpose' within the meaning of the Act.

Importantly, you should be aware that counselling, aiding, abetting or procuring a breach of the Act could render a third party liable for penalties by virtue of section 79 of the Act. This 'catch-all' can apply to friends or family, financial planners, business brokers, accountants and even solicitors.

The dangers of improperly advising or assisting defunct companies or opportunistic directors were highlighted in a recent decision in the Supreme Court of New South Wales involving a solicitor who advised directors of various companies to enter into what are commonly known as 'phoenix operations'.

The scheme set up by the solicitor involved selling all the profitable assets of the companies to a new entity, leaving the majority of creditors in the old company. Those creditors would then, supposedly, be paid by way of share dividends from the new entity. Unfortunately, the director of the old company was the one who made the decisions in relation to whether the dividends were ever paid. Not surprisingly, no dividends ever made their way back to the old company. The Court found that the schemes contravened the Act.

The solicitor had devised the concept for the companies, encouraged the directors to implement it, drafted the necessary documents and completed the transactions. He was, therefore, found to have aided, abetted, counselled and procured breaches of a number of sections of the Act.

ASIC's successful prosecution in this case should serve as a warning to advisors to ensure they understand the wider implications of any transactions for which their advice is sought.

DAVID WILLIAMS

EDITORIAL

Welcome to 2010. This will be a very challenging year, but it will also be a time where opportunities will be available to expand and improve your business.

Critical to any resurgence in business confidence is the ability for business to access cash, either through equity in the investment market or from financial institutions. The equity market currently is an unpredictable source of funding at this early stage in the recovery and therefore your options may well be limited to only the financial institutions.

The Mullins Business Services Group has more recently been involved in some transactions where the purchasers involved in the acquisition of the businesses did not need the support of financial institutions as they had their own cash resources to purchase the businesses.

The financial institutions are still maintaining tight reins on their lending criteria in regard to funding business. The financial institutions were the only segment of the business community given financial support during the GFC by the Federal Government but anecdotal evidence suggests that they are making it difficult for business to borrow money in order to invest in expanding and growing your business. The Government guarantee is currently in the process of being withdrawn and hopefully this will not further impact this funding issue.

Unless business owners have substantial security in the form of property to support the funding they may be forced to limit their aspirations to expand. Hopefully as the recovery gathers greater strength this cycle will be broken and funding from financial institutions will be freed up for business owners and operators.

We trust that as 2010 unfolds each of you will have an opportunity to enhance the value of your business with the support of your financial institution of choice and we look forward to working with you in the near future.

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