

# Top Ten issues arising in Due Diligence

By Philip Wild, Kidd Rapinet, Solicitors, London

In our corporate acquisitions work, we conduct due diligence on many companies and businesses, and we see the same issues time and again. We are also often asked to advise on problems which could have been resolved if these issues had been properly dealt with. Here is a "Top Ten" of some of the most common of these issues.

## 1. Written particulars of employment

It has been a statutory requirement for over 40 years (now contained in Section 1 of the Employment Rights Act 1996) that an employer give to his employees a written statement of certain particulars of their employment. However, this is still one of the most widely ignored legal requirements on businesses. Directors of small owner-managed companies often overlook this for their own employment. The opportunity should be taken to draw up proper contracts of employment for all employees, dealing with the various issues that can arise in an employment relationship, and to produce disciplinary procedures to assist in avoiding unfair dismissal claims and policies on matters such as email and internet usage. For more senior employees, non-competition clauses are advisable. It is also vital to make sure the employees actually sign the contracts.

## 2. Terms of business

Many businesses do not have standard contract terms, or simply copy those of competitors. Disputes with customers or suppliers often turn on what was agreed in writing, and having properly drawn up contract terms and ensuring they are incorporated into your contracts can be a big advantage here. Care needs to be taken to comply with the Unfair Contract Terms Act 1977, and businesses dealing with consumers will also have to comply with the Unfair Terms in Consumer Contracts Regulations 1999 and in appropriate cases the Consumer Protection (Distance Selling) Regulations 2000.

## 3. Stakeholder Pensions

Since 1 October 2000 most employers with 5 or more employees who do not already provide a pension scheme have been obliged to provide their employees with access to a stakeholder pension scheme. This can easily be arranged through a financial adviser, but many employers still fail to comply.

## 4. Data Protection Act notification

The scope of the Data Protection Act 1988 is much wider than many businesses appreciate. Any business which processes personal data other than for certain limited exceptions for internal record keeping will need to notify the Information Commissioner under the Act. It is often overlooked that "personal data" includes anything by which a living individual can be identified, including for example the names of individual contacts at companies and most email addresses. Notification should always be made direct to the Information Commissioner - there are a number of unscrupulous companies with official-sounding names who mailshot companies to register through them at an inflated fee.

## 5. Website compliance

There is an increasing amount of legislation with which websites must comply: in particular the Consumer Protection (Distance Selling) Regulations 2000 and the Electronic Commerce (EC Directive) Regulations 2002. The Companies Act also requires a company to provide on its website the full corporate details that must appear on its notepaper, but many websites fail to state these details in an "About Us" or similar section, and it is often impossible to ascertain the correct identity of the owner of a business from its website. Failure to make websites accessible to those with disabilities is a breach of the Disability Discrimination Act 1995.

## 6. Intellectual Property Rights not owned

IPR created by an employee in the course of his employment will belong to the employer, but many IPR are created by independent contractors or third party designers. Whether it is copyright in computer software or the design of a logo or website, the intellectual property will belong to the contractor unless assigned in writing to the company commissioning the work. In the case of domain names, website designers often register them in their own names, rather than those of their clients.

## 7. Letterheads

Letterheads and certain other stationery must comply with the Business Names Act 1985 (or in the case of companies the Companies Act 1985). The essential requirement is to state the name(s) of the proprietor(s) of the business and an address for service. For companies the full corporate name, including "Limited" must be stated on letterheads, cheques, and any order or promise to pay, or the signatory will be personally liable if the company does not pay. Many directors expose themselves to potential personal liability by simply omitting the word "Limited" on notepaper. As from 1 January 2007 this requirement has been extended to company emails.

### **8. Unsatisfied charges**

The Companies Act 1985 Section 395 requires charges given by a company to be registered at Companies House within 21 days or they will be void. Unsurprisingly, banks are diligent about registering their charges. But they are less so about registering their discharge, and companies often overlook this. This can cause problems with future lenders or for a purchaser of the assets of the business. The Charges Register can easily be checked at Companies House and Form 403a (the memorandum of satisfaction) sworn by an officer of the company and filed.

### **9. Directors' loans**

Under the Companies Act 2006 Section 197 shareholder approval is required for a company to lend more than £10,000 to one of its directors. But many directors, particularly of small companies, have loan accounts which go into debit by more than this figure without any such approval being minuted. The director is liable to account to the company for the money - and liquidators are well aware of this. If the "drawings" are in fact salary, then there are PAYE and NIC implications.

### **10. Failure to write up statutory registers and minute books**

Companies are required by law to maintain certain statutory registers of directors and shareholdings and to keep minute books of meetings of directors and shareholders. Sometimes a diligent auditor will require to see these, but otherwise they are only checked on a sale of the company or an insolvent liquidation. In the former case, writing them up from scratch can be a difficult and expensive task. In the latter case, failure to comply can be a factor leading to disqualification of a director.

This is not a complete list of the legal issues with which a business is required by law or well advised to comply, but simply some examples where consulting a solicitor can help avoid future legal problems, or if the business is ever sold can make due diligence a much easier process.