



**Before You Sign -
Do Your Due Diligence**
who are you *really* contracting
with?

Useful for: Business/Government/Non Govt Organisations/Local Government
Article looks at: Pre contractual relationships

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BEFORE YOU SIGN – DO YOUR DUE DILIGENCE

In Brief

- Do at least basic due diligence before every deal, even if you know the party well.
- Due Diligence enables you to understand who you are really contracting with, as opposed to what their marketing information may say.
- Depending on the type of contract and your position the financial/commercial stability of the other party may matter more or less to you.
- Basic due diligence on a company you are contracting with is cheap and easy to do through online services.
- **Always** search the company (or other legal entity) you are dealing with. If nothing else a company search will tell you that the company is properly incorporated and not under external administration or in liquidation.
- Be wary of dealing with Trust entities – it is usually the Trustee that is the legal entity you should be contracting with, not the Trust itself.
- Partnerships and Joint Ventures are not legal entities by themselves (unless they are incorporated).

Do You Really Know Who you are Contracting With?

What is due diligence?

- It is the process of carrying out enquiries that will give you the information you need to understand the risks of dealing with the other party.
- The elements of a contract can be categorised like this:
 - WHO (parties)
 - WHAT (the goods and/or services),
 - WHEN (the parties will carry out their obligations),
 - WHERE (will the contract be carried out)
 - HOW (will the parties carry out their obligations)

Why do you need to do it?

Simple answer - to ensure as far as practicable that you are getting what you think you are getting out of the contract.

UPFRONT DUE DILIGENCE ANSWERS THE “WHO” QUESTION

- Who am I really depending on to get this contract completed?
- Is the name on the contract a legal entity?
- Is this the right entity to contract with?
- Can this entity deliver what I want?
- If this entity doesn't deliver what it agrees to and I suffer loss, what back-up does it give me in this contract?

The types of enquiries you will make will always depend to some (or a large) degree on the nature of the contract you wish to enter into. However, there are a range of searches that will **always** be relevant.

Search that Company!

The best example of a search you should always start with and NEVER go without is a company search. These can be done either through the ASIC website www.asic.gov.au, or through an organisation like Equifax. For under \$10.00 you can get basic information on a company you are thinking about dealing with, including:

- Correct name, Australian Company Number and Australian Business Number;
- Paid up capital
- Date of first registration of the company
- Directors and Shareholders basic information
- Documents lodged (including by an external administrator or liquidator of the company and by financiers that have loaned or hold an interest in the company or its assets).

While this information is very basic and doesn't give detail about the actual financial or commercial practices of the company (Equifax or a report from a credit agency will give you more), it will assure you:

- That the company is properly incorporated and no liquidator or external administrator is currently appointed (note this is not a guarantee that the company is not insolvent);
- Exactly who manages and takes the profits of the company (and who has authority to execute documents on behalf of the company);
- How long the company has been operating;
- Whether it is of “substance” (is the paid up capital nominal? Doesn't mean the company is worth nothing, but further enquiries should be made if it is important to your deal that the company has a certain level of financial resources).

Other handy information

Examples of other useful searches that are cheap and easy to do online are:

- A bankruptcy search on any individuals that are relevant (for eg individuals giving guarantees for the deal, whether they are directors or not);
- Company director disqualification search (easy to do on the ASIC website);
- Litigation search to obtain details of any court action the company is involved in.

Further due diligence might involve:

- an in-depth report by a credit agency such as Dun & Bradstreet or Equifax,
- provision of financial reports of the company for the past 1-5 years (depending on the type and scope of the matter). The financials of the company will give full details of the assets and liabilities, cash management etc and can provide either comfort that the company is trading well and is likely to be able to meet its commitments or, confirm that any reservations raised by initial due diligence are valid.
- Security for the price and/or the undertakings of the other party/s - eg bank guarantee, personal guarantees of directors or other relevant individual, guarantee by holding/parent or other related company of substance. All searches carried out on a contracting party should also be carried out on a guarantor.
- Requiring a bankers reference (a letter from the bank confirming that the individual's/company financial position is adequate for the purposes of the deal).

Timing is Everything

There is not much point finding out that you don't want to contract with this party after all once you've signed on the dotted line.

Basic due diligence (company searches on all relevant entities at the very least) should always be conducted at the commencement of negotiations. However, depending on the type of contract you are dealing with, often the contract itself may provide opportunity for due diligence to be carried out at various stages before execution of formal documents.

Examples of this include:

1. The seller of property providing (and sometimes warranting the correctness of) due diligence material (eg building/plumbing/electrical reports, title search, copies of registered documents and the like, whether in accordance with vendor disclosure legislation, or otherwise);
2. Where the contract provides for a period within which the buyer can undertake investigations and decide whether or not to proceed on the basis of whether the due diligence results are satisfactory to them or not, again usually found in major contracts for acquisition of property.

Joint Ventures, Trusts and Partnerships

Dealings with any unincorporated body, including joint ventures, partnerships or trusts require further due diligence and caution as these structures can hide a multitude of sins.

These entities do not usually appear on public registers. In these circumstances you should always ask for a copy of the partnership or joint venture documentation, or trust deed, and then seek legal advice as to exactly the type and capacity of legal entity you are dealing with and also what form or forms of security should be obtained before entering into an agreement with such entity (if at all). It is worth noting that with some very limited statutory exceptions, the trustee of a trust is the legal entity you are dealing with, not the Trust itself, so it is always important to know exactly who the trustee is and carry out all the same due diligence on that entity that you would on any other, in addition to obtaining separate advice on the trust deed.

Important Note: This information is general and is not intended to be a substitute for specific legal advice in relation to your particular contract. If a contract is important enough to you to ensure it is right, seek legal advice.