

“Strategies with Deposits in Business and Equity Sales Transactions”

Presented by:

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Tom has over 25 years' legal and business experience including:

- Being an owner and Director of his former firm, Murfett Legal;
- Previously working for major local and international law firms;
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- Previously being the WA Legal Technology Group Manager for a National Law Firm;
- Owning and managing an IT Consultancy Business; and
- Being a Director and In-house Counsel for a Public company.

He is also a regular publisher of articles and is one of Australia's leading presenters of legal seminars to and for various professional bodies, associations and government authorities on a wide range of business law and professional development-training topics including:

WA Department of Commerce • Chartered Accountants Australia and New Zealand • Law Society of WA • Innovation Centre of WA • LegalWise CLE • The Tax Institute • Institute of Public Accountants • Governance Institute of Australia • National Electrical & Communications Association (WA) • Australian Hotels Association (WA) • Small Business Development Corporation • Australian Institute of Conveyancers (WA) • CPA Australia • Mortgage & Finance Association of Australia • Australian Institute of Business Brokers • Pharmacy Guild of Australia Group • City Insolvency Discussion Group • Forum for Directors of Indigenous Organisations (FDIO) • Stirling Business Centre • Institute of Certified Bookkeepers • Western Suburbs Business Association • Business Foundations Inc. • WA Business Assist • WA Reckon Partners • WA Indian Docs Inc.



Disclaimer

This seminar is not legal advice and must not be relied on as such.

The information presented in this seminar is intended only as a guide, as to the topic and the matters discussed.

If you have a matter which relates to this seminar or you require legal advice, careful review and analysis of your matter's particular facts, information, documents and the applicable laws are required before proper legal advice can be given or applied to that matter.





What is a Deposit?

- A deposit is a pre-agreed instalment towards the purchase price in a sale contract.
- The Courts have held that the 2 functions of a deposit are to be:
 - ✓ *an earnest commitment to bind the bargain, which means a deposit acts as an indication the Buyer is serious in carrying out the bargain; and*
 - ✓ *a guarantee of due performance, that is security of the performance.*
- A deposit is usually paid at or upon shortly upon the buyer's signing of the contract.
- Usually, a deposit should be *no more than 10% of the total purchase price*, and commonly may be less. Note: there is no specific laws on that deposit percentage amount per se*.

Why a Deposit? *continued*



- The other practical, commercial and financial reasons for why a deposit is useful:
 - ❖ Often the **seller will incur not-insignificant fees and expenses** (e.g. sale preparatory work and undergoing due diligence, applying to lessor for consent to assignment of lease etc), *independent of whether the actual contract proceeds to settlement or completion*. So may be also used to partially-compensate for some of those costs incurred if the buyer ultimately walks away”.
 - ❖ **Loss of potential, other sale opportunities** during the express or implied exclusivity period during the conditions precedent of sale contract. This could be months or longer
 - ❖ It's good to have the **buyer show it has “skin in the game”** by having such "hurt money" put upfront on & the table.
 - ❖ Tip: Even with the best of Confidentiality Deeds/NDAs , the **deposit helps reinforce the value and proprietary nature of the seller’s business or entity**.
 - ❖ Not uncommonly, the Buyer entity may be newly-established . Therefore, if there is default or repudiation, even if they are subsequently pursued by the seller, **the Buyer may not have any actual capitalisation to be realised against!**
 - ❖ Lastly, **if a buyer or won’t (or can’t!?) put up even** the deposit, then you should have **serious concerns about their financial capacity** to commit all the way through the transaction.

What's the difference between a “deposit” and a “penalty” (and why is that relevant)?



- Most people think they are protected if they have contracts which contain clauses that outline the consequences if a party defaults on their obligations.
- However, they may be using contracts which contain unenforceable “penalty clauses”.
- An often-litigated issue is whether the clauses dealing with the default payments create a penalty? If this clause is found to be a penalty, then this provision is unenforceable and the consequences can be significant.
- Also watch for ‘reduced deposit’ clauses. That is:
 - 5% upfront; and
 - if the buyer defaults,
 - the seller can demand the balance of the 10% deposit and
 - then buyer forfeits the full 10% deposit.

Differences between a “deposit” and “penalty” *continued*



- The Courts have recently confirmed the following are the issues they consider when determining whether a clause is a penalty:
 - *"a contractual term will not be a penalty if it protects the legitimate commercial interests of the non-defaulting party."; and*
 - *whether it is:*
 - *a "genuine pre-estimate of the [innocent party's] probable or possible interest in the due performance of the principal obligation; or*
 - *a penalty inserted 'merely to secure the enjoyment of a collateral object'?"*
- Deposits are usually not considered a penalty.
- This is because the purchaser is not limited to recovering the deposit – they are entitled to also recover any short fall on the sale (less the deposit).

Practical other tips with Deposits

▪ Deposits and ‘refundability’.

- Note: under some 'standard form' contracts and their general terms & conditions the deposit is always refundable. Unless:
 - the matter completely proceeds to settlement; or
 - there is repudiation of the contract by the buyer...



▪ Conditional or "phased deposits"

- e.g. pre-agreed mechanism for Buyer to subsequently adjust the (initially) offered purchase price and to continue to ‘contractually retain’ the Seller.
- Once preliminary due diligence has been completed and it is been reasonably ascertained that some of the relevant asset values’ asking-price are not entirely accurate or correct.

Practical other tips with Deposits *continued*

■ Interest-bearing Deposits

- If the deposit:
 - is a significant amount (i.e. over the \$20,000); and
 - the matter will not settle within at least 2 months,
then those deposit monies, if so directed by the Buyer, may be put into an appropriate interest-bearing trust account.
- Particularly useful for foreseeably lengthy or drawn-out transactions, and of course it with hindsight, any of those that become contentious or show to have a ‘fluid’ settlement date (see below).



■ Settlement Dates:

- Outright fixed or incentivised e.g. *“upon the later of:*
 - *the parties’ desired specific Settlement Date ; and*
 - *last of the conditions precedent met (or waived) plus 2 business days”* (with ‘acceleration’ provisions).

Thank You!

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