

# Strategic Issues in Due Diligence

*Expert knowledge means success*

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**Note:** This publication has not been updated since it was last published. Some of the hyperlinks may have changed and may need updating. In addition, some of the information in this publication may be out of date.

## Introduction

Due Diligence has many meanings. In this publication, it describes the process whereby the parties to a joint venture or an acquisition assess the risks they are taking.

Risk itself has many interpretations. In Russia there is an old saying *"If you don't take risk, you don't drink champagne"*. By way of contrast, American General George Patton, was more prosaic, saying, *"Take calculated risks, that is quite different from being rash"*.

These notes<sup>1</sup> consider the balance between these two attitudes and focus on three points:

1. Due diligence is about managing risk
2. In order to minimise their risk and get the best terms, both the vendor and the purchaser need to take a proactive strategic approach to Due Diligence
3. Project management and new technologies can be used to improve the Due Diligence process

## Due Diligence is about Managing Risk

### Risks in joint ventures/acquisitions

For the purchaser and his financiers, a range of risks exist, such as:

- The political risk associated with the countries in which the Target is based
- The accuracy of the past financial accounts of the Target
- Whether the Target's key personnel, suppliers and customers will remain
- Whether the Target has good title to its assets
- Whether those assets are worth the value the Target attributes to them
- Whether there are any existing liabilities that may manifest themselves in the future to disrupt the operation or financial performance of the Target

One or both of the parties will carry these risks, some properly being the sole responsibility of the purchaser to assess, for example political risk. Others are conventionally considered the responsibility

of the vendor, for example the accuracy of the past financial accounts. However, once identified, the majority of the risks are negotiable and the bargaining between a vendor and a purchaser will relate predominantly to the apportionment of these risks between them.

In conducting those negotiations, the purchaser is at a disadvantage since he does not have the data to identify and assess those risks accurately. Accordingly, one of the most important decisions that every purchaser has to make at the earliest stage of any transaction is the degree to which he wishes to redress the knowledge imbalance between himself and the vendor. Conversely, unless the vendor conducts his own Due Diligence in advance of selling the business, it is possible that the well-advised purchaser will eventually achieve information superiority over him.

## Increased risk when investing abroad

Where the transaction takes place outside the home country, the purchaser's risks are increased as the entire political, economic, social and business environment differs from the one he is familiar with. Not surprisingly, purchasers investing in foreign countries are much more cautious than when they are doing business in their own country.

## The purpose of Due Diligence

The purchaser will wish to check that:

- The assets have the value the vendor is giving them
- The vendor has good title to those assets
- There are no risks that reduce the value or use of those assets, e.g. another party having a right to use them
- There are no other liabilities that may adversely affect the Target, e.g. taxation liabilities

Although the vendor may provide warranties which give assurances on these issues, the purchaser will nevertheless wish to check them. This is not dissimilar from the 'Trust but verify' attitude adopted by the Soviet Union during the Strategic Arms Limitation



Talks with the United States in the 1980's.

The verification approach also reduces the potential for conflict because problems are identified early on. All too often, the vendor is not even aware of its own problems, until the purchaser discovers them during Due Diligence.

Purchasers also recognise that warranties and indemnities given by vendors:

- Last only for a few years
- Are limited by amount
- Can be disputed
- Can be difficult to enforce

Accordingly, the Due Diligence process that has developed in many capitalist countries requires the vendor to disclose all relevant information. This enables the purchaser to evaluate properly the Target and negotiate terms on a reasonably even playing field.

## Outline of the Conventional Due Diligence Process

### Typical transaction procedures

There are two basic types of transaction procedure regarding Due Diligence in the UK:

1. Pre-determined data
2. Data provided in response to the purchaser's enquiries and warranties

Each of these is summarised in the Table below:

Method	Aspects	Advantages for vendor	Disadvantages for vendor
Pre-determined data	Vendor collates all data to be disclosed to purchaser in advance of negotiations and makes it available for inspection, usually in a data room. Particularly applies to bid situations.	Maximum control for vendor enabling it to centralise release of data.	Often higher cost and discipline required to collate all data in advance.
		Advantages for purchaser	Disadvantages for purchaser
		Minimum level of quality data available compared with potentially poor quality data under other method.	Limited opportunity to acquire further data. Copying of data often prohibited, hampering analysis process.
Response to purchaser's enquiries and to warranties	Vendor responds to purchaser and to warranties. May have 'groomed' Target in advance to improve negotiation position.	Advantages for vendor	Disadvantages for vendor
		Advantages for purchaser	Disadvantages for purchaser
		Greater ability to reduce adverse factors disclosed.	Permits purchaser greater scope for obtaining negative data.
		Greater scope to collect higher quality data. Ability to copy data, which improves the analysis process.	Possibility of poorer quality data than data room.

## Pre-determined Due Diligence data

Here, the vendor makes available no information at all for Due Diligence or limited information collated by the vendor in advance. Where data is made available, this is either delivered to the purchaser or, where the data is more extensive, at a data room (usually at the offices of the vendor's solicitors) where the purchaser can access it.

## Typical transaction

The sequence of events in this, the most common situation, tends to follow the following general pattern:

- Where a merchant bank is involved, some initial Due Diligence is undertaken, particularly covering such areas as political risk, compatibility of organisational cultures.
- The purchaser may undertake some basic Due Diligence, usually by way of oral discussion with the vendor. The purchaser may also involve its accountants in some preliminary analysis of the vendor's financial accounts.
- The purchaser negotiates basic heads of terms with the vendor.
- The purchaser sends in its in-house Due Diligence team.
- The purchaser instructs its accountants to commence Due Diligence.
- The purchaser and vendor instruct their solicitors. In addition to the commencement of preparation of documentation, the purchaser's solicitors forward a set of Preliminary Enquiries to the vendor's solicitors. Normally, the vendor will warrant the accuracy and completeness of the written responses provided via the vendor's solicitors.
- The vendor's solicitors pass the Preliminary Enquiries on to the vendor's nominee for handling enquiries, who will arrange for the documentation requested to be collated and the questions answered. These will be returned to the vendor's solicitors who will vet the responses and filter and qualify them, where considered appropriate, before restating the responses in their own terminology and forwarding them to the purchaser's solicitors. Those documents that the vendor has collected will usually be indexed and ordered in a separate set of folders called the Disclosure Bundle. The written responses will refer to the appropriate documents by their index number in the Disclosure Bundle.

- The purchaser's solicitors prepare further enquiries from time to time, based on the answers to the Preliminary Enquiries and earlier Further Enquiries.
- Gaps in the written responses by the vendor's solicitors and Disclosure Bundle are filled from time to time with additional written responses and deliveries of documents as the vendor continues to collate these.
- The purchaser's Due Diligence Team prepares their Due Diligence reports.
- The purchaser's accountants prepared their draft Due Diligence report.
- The purchaser's solicitors may provide a Due Diligence report.
- The negotiations concerning the warranties, which have been ongoing for some time, are finalised close to Exchange of the Sale Agreement.
- The vendor's solicitors produce a draft Disclosure Letter, disclosing facts and documents against the warranties.

## Benefits of a Proactive Strategy

### Analogy of the transaction with warfare

The Due Diligence exercise is in many respects analogous to a military campaign. The purchaser is similar to the attacking army. He is on the offensive, trying to obtain as much data as possible on the Target (i.e. gain territory) in order to enter negotiations (the various battles) to gain the most favourable terms (i.e. win the war).

The negotiation sessions between the parties will deal with a range of issues (i.e. dispositions on the fields of battle). As most of these issues deal with the business of the Target, the party commanding superior knowledge of the Target will hold the advantage (i.e. better battlefield positions).

## Benefits of thorough Due Diligence for both sides

Therefore, the Due Diligence process is more effective when each party pre-determines its strategic objective. The party that plans its strategy to gain superior knowledge on the Target usually achieves negotiation advantage because he is able to:

- Measure with greater accuracy the cost of each risk
- Determine with more precision those risks which he is willing to assume
- Play up or down (as appropriate) the perceived cost (as opposed to its real cost) of the risks during negotiations
- Obtain more favourable terms by:-
- Assuming a particular risk in exchange for securing a concession from the opposition which is more valuable than the real cost of the risk
- Persuading the other side to assume those risks which are likely to be more costly
- Make specific arrangements regarding risks he does not wish to carry e.g. by excluding affected assets. This has particular importance when drafting warranties and indemnities for, without specificity, a warranty may not cover a particular liability.

## Establishing the purchaser's strategy

The purchaser is on the offensive. Consequently his strategy should seek to secure relevant and more detailed data on the Target which will allow him to control the negotiations.

Even though the purchaser takes the initiative, he does not have all the advantage. The vendor has natural advantage by virtue of his superior information on the Target. The purchaser must overcome this in order to be, at least, on an equal footing in negotiations. He may wish to go further and use this data to improve the terms of the original transaction, by identifying real or perceived factors, which may reduce the value of the Target. His choice of action should be determined according to a pre-

determined strategy.

The typical range of the purchaser's strategic objectives is set out in the Table below:

Permutation	Description
1. Maximum offensive and defensive strategy	To secure better terms by identifying any factors that might reduce the value of the assets or increase the liabilities being acquired
2. Maximum offensive strategy with limited defensive strategy	To secure better terms by identifying negative factors in the hope that the improved terms will cover any undisclosed liabilities. This may apply where limited time prevents a thorough due diligence
3. Maximum defensive strategy only	To check that there are no undisclosed liabilities. Not to seek better terms actively
4. Selective defensive strategy	To check that the value of certain key assets is secure and/or to check certain key areas of liability e.g. deal breakers. Not to seek better terms actively
5. Minimal defensive strategy	To rely on warranties to protect against any future diminution in the value of assets or an increase in liabilities. Little or no investigation of any undisclosed liabilities. Not to seek better terms actively

Strategy 1 above inevitably produces the best results. To determine the right strategy, two major factors *inter alia* have to be considered:

- The key assets the purchaser wishes to secure
- The key risks to which the Target is exposed

### What are the key assets?

The key assets that the purchaser wishes to secure through the acquisition are at the heart of the development of its strategic objective. They are equally important to the vendor when setting its strategy.

Typical key assets include:

- Client or customer base
- Suppliers
- Management or technical expertise
- Brand name(s)
- Technology
- Production capacity
- Distribution network
- Land and buildings

## What are the key risks?

The implication of the key risks to the Target is also of prime importance to both parties, not least because the range of potential risks to which the Target is exposed can be extensive. Their relative weighting will vary from country to country. The range of potential risks is:

Risk	Some potential consequences
Environmental	Criminal penalties for Target and its personnel Civil liabilities
Health & safety	Criminal penalties for Target and its personnel Civil liabilities
Legislative changes	Restrictions on the Target's operation
Negligent advice	Civil liabilities
Political and social instability	Many
Product liability	Criminal penalties for Target and its personnel Civil liabilities
Property damage and loss, Unpaid taxation, Unpaid suppliers	Reduction in value of assets

The multitude of potential risks to which every business is exposed will usually make it impractical for the purchaser to assess all of them. Accordingly, a profile can be developed of the *key risks* and their consequences, made up of the following elements:

- The relevant industrial sector(s)
- The geographical area(s)
- The Target's own activities

## Setting the vendor's strategy

The vendor has the defensive role. He tries to protect his position as defined by the Heads of Agreement. This means ensuring that the purchaser's investigation does not reveal adverse factors which will result in less favourable terms to the vendor or in the vendor having to bear the risks of those adverse factors.

Quoting General Baron de Jomini, "*A defensive war is not without its advantages, when wisely conducted. It may be passive or active, taking the offensive at times. The passive defence is always pernicious; the active may accomplish great successes. The object of a defensive war being to protect, as long as possible, the country threatened by the enemy, all operations should be designed to retard his progress, to annoy him in his enterprises by multiplying obstacles and difficulties... he desires delay until his adversary is weakened ...*".

In a Due Diligence exercise, the vendor can apply this strategy to erect barriers to the purchaser attaining adverse information on the Target. The author disagrees with this strategy because it is at odds with the concept of disclosure and is ultimately counterproductive to successful negotiations. Nevertheless, major international corporations and respected law firms do adopt it.

Taking a wider view, the vendor can adopt:

- A Defensive - Offensive strategy, with the purpose of securing better terms; and/or
- A Defensive - Defensive strategy, with the purpose of reducing his contingent liabilities after the transaction has completed. This involves providing minimal warranties and indemnities to the purchaser, thereby transferring liabilities to the purchaser

The following Table sets out the range of strategies for vendors, which are often combined in varying degrees:

	Permutation	Objective
	<b>ACTIVE STRATEGIES (involving positive action, including before negotiations commence)</b>	
1	Defensive - Offensive	To secure better terms by identifying in advance of purchaser's Due Diligence any factors that might decrease the value of the assets or increase the liabilities of the Target
2	Defensive - Defensive	To provide minimal warranties and indemnities through justification
	<b>PASSIVE STRATEGIES (responding to purchaser's actions)</b>	
3	Defensive - Offensive	To negotiate terms in the Heads of Agreement based on the Target being 'clean' and endeavour to maintain those terms during the Due Diligence process
4	Defensive - Defensive	To provide minimal warranties and indemnities to purchaser by: - - negotiation using whatever justification he can - reducing the amount of adverse factors disclosed to the purchaser

A combination of Strategies 1 and 2 invariably produce the best results.

## Tactics for dealing with adverse factors

If the vendor's advance Due Diligence reveals adverse factors, the vendor needs to consider the purchaser's likely reaction to them in order to determine his tactics. The range of options may include:

1	Remedying the defects ahead of Completion
2	Offering the purchaser better terms to account for the adverse factors
3	Disclosing the problems to the vendor and potentially paying the cost later under indemnities
4	Ignoring the problems in the hope the purchaser will not spot them or that they will not be caught by warranties, although this can be a high risk tactic

Wherever possible, the transaction will run smoother where the defect has been remedied before the purchaser commences his Due Diligence. However, this must be subject to a cost-benefit analysis.

## Rules of Engagement

### Avoid Misunderstanding

Much of the conflict that arises during the acquisition process relates to issues concerning Due Diligence, largely because of the close contact that it involves between the Target's personnel and the purchaser's Due Diligence teams.

Much of this conflict can be avoided if the parties discuss and agree the format of the Due Diligence process in advance. Ideally, this is then documented and communicated to all relevant personnel on both sides. Some of the more important points also benefit from being encapsulated in a formal understanding between the parties, such as any Heads of Agreement.

A few of the key initial due diligence issues to be considered for discussion are set out in the following Table:

	Issue	Explanation
1.	Access to data	How much access is to be given? - Unlimited access - Limited access
2.	Form of access	What is the form of access? - Direct contact with Target - Pre-packaged data
3.	Warranties and Indemnities	Extent of them in broad outline i.e. is the starting point to be the conventional list of warranties or a more limited approach?  What disclosed data is to be warranted? - Written responses to Preliminary Enquiries and Further Enquiries - Disclosure Bundle - Other data
4.	Effect of due diligence on warranties and indemnities	Will the fact that the purchaser is undertaking extensive Due Diligence restrict the extent of the warranties and indemnities?
5.	Scope for re-negotiating terms	Will there be scope to negotiate different terms in the light of problems arising from Due Diligence, e.g. price, specific warranties and indemnities?
6.	Timetable	For preparation of documentation For visits to each site by purchaser, its accountants, its solicitors - For Exchange - For Completion

## Using Project Management to Improve the Process

### The general plan

Timing is inevitably one of the key drivers in every transaction. Accordingly, the importance of managing the project is vital. There will be a range of tasks that will need to be co-ordinated in relation to the transaction, including those referred to in the next Table. This will need to cover both the Due Diligence exercise and the wider issues affecting the transaction as a whole.

### Tasks to be co-ordinated

- Appointment of personnel
- Preparation and negotiation of legal documentation
- Establishment of data Room or Data Centre
- Visits to Target
- Cessation date for Due Diligence exercise
- Due date for disclosure letter
- Date for finalising transaction documentation
- Exchange
- Period for preparation of Completion accounts
- Completion
- Post-Completion action

With this large number of 'moving parts', it can be seen that, without careful and constant co-ordination and communication, vital time can be lost and issues mishandled. Accordingly, it is recommended that professional project management techniques be applied to the management process, including the use of Gantt charts.



The importance of well organised personnel  
Each side will need to select and engage  
personnel to conduct or defend the Due  
Diligence exercise. This is likely to comprise  
some or all of the specialists described in the  
following Table:

PERSONNEL	SPHERE OF RESPONSIBILITY
<b>PROJECT MANAGEMENT TEAM</b> In-house and/or external personnel	<b>PROJECT MANAGEMENT</b> - Strategic direction - Co-ordination and communication
<b>DATA MANAGEMENT TEAM</b> In-house or external personnel	<b>MANAGEMENT OF DATA</b> - Logging and storage of data centrally - Distribution of data - Directing the co-operation of different Due Diligence teams in relation to the data - Assisting in the retrieval of data by Due Diligence team members
<b>CORE DUE DILIGENCE TEAM</b> In-house personnel Accounting Merchant bank Risk managers Lawyers	Operational areas Finance and operations Strategy and integrating mechanism Risk analysis and remedy Legal affairs
<b>SUPPORT TEAM</b> Actuaries Environmental consultants Health & Safety advisers Personnel benefit advisers Product liability analysis Surveyors and valuers Others	Value of pension scheme Environmental management Health & safety issues Personnel benefits issues Product liability issues Property issues Other matters

## Terms of Reference guide the teams

With such a wide range of personnel working  
on various areas of a Due Diligence exercise,  
there is often considerable scope for gaps and  
overlaps. In order to minimise the problems  
these may cause, the personnel and their  
activities should be co-ordinated. Terms of  
Reference can be prepared by each Due  
Diligence team so that the purchaser or  
vendor can compare the various teams'  
responsibilities to ensure they dovetail.

Ideally, the Terms of Reference should be  
used to determine the questions and  
documents each team will use when  
conducting its investigation. These  
Preliminary Enquiries should also be  
compared to ensure they do not overlap or  
have gaps. One of the most cited complaints  
by Targets is that they are repeatedly asked  
for the same documentation by different  
teams.

## Application to international Due Diligence

In international Due Diligence exercises,  
local in-house and external personnel will  
also be required. The activities of the local  
personnel can be standardised using the  
original Terms of Reference agreed by the  
main advisers and the purchaser but  
conformed to the local conditions.

Similarly, the Preliminary Enquiries of each  
adviser can be based on the main set of  
Preliminary Enquiries and then conformed to  
local conditions.

In this way, a Target with operations in many  
different countries can be investigated in a  
standardised fashion.

## The Importance of Managing Data

### Use of technology

Data is the lifeblood of every acquisition. Without it, the purchaser cannot assess the Target. So why is it that the collection, distribution and storage of data is so frequently handled in a haphazard manner? Each side should establish a system for carefully managing the various stages through which the data will pass, these stages normally being:

Vendor's process	Purchaser's process
Acquisition	Acquisition
Vetting	Logging and storage
Indexing	Distribution
Storage	Collaboration
Distribution	Retrieval
Retrieval	Analysis
	Reporting

Typically, data in Due Diligence exercises is stored in paper form. With the ready availability of imaging technology, data can now be stored and transmitted electronically, offering a range of advantages such as those highlighted in the next Table.

Advantages of storing data in electronic form	
Advantage	Benefit
Portability of data	Data can be stored on laptop for use at remote locations e.g. meetings, a different office, browsing while travelling
Ability to transfer data	Data can be transferred to, or be accessed from, remote locations more quickly, in better quality, with ability to be manipulated, at lower cost. Is particularly helpful for international transactions
Single access	All parties can access the same data on-line, ensuring their activities are properly co-ordinated and producing greater synergy

In spite of the availability of technology to deliver such systems, advisers have been slow to develop them.

### Indexing the data

The system for logging and indexing data must be determined at the earliest stage in order to avoid problems with the collation of the Disclosure Bundle which forms part of the formal legal process.

The Disclosure Bundle is the agreed bundle of data which the vendor warrants the accuracy and completeness of. At the date of Exchange, when the vendor and the purchaser exchange the signed legal documentation, they will also exchange a copy of the Disclosure Bundle. These must be in identical form. Accordingly, it is important that the purchaser and vendor agree on an indexing system for all data disclosed during the Due Diligence process and to be inserted into the Disclosure Bundle.

## Areas of Investigation

The areas covered during a legal Due Diligence exercise will largely be determined by the industry sector, but typically will cover:

- (a) General information / corporate structure
- (b) Company secretarial
- (c) Corporate acquisitions & disposals
- (d) Voidable transactions / reconstructions
- (e) Trading activities
- (f) Competition law
- (g) Personnel
- (h) Health & safety liabilities
- (i) Pension schemes
- (j) Land & buildings
- (k) Environmental management
- (l) Plant, equipment & other fixed assets
- (m) Computer software
- (n) Intellectual property
- (o) Investments
- (p) Lending to third parties
- (q) Banking facilities / borrowing from third parties, financial grants
- (r) Guarantees / indemnities / letters of credit
- (s) Product liability
- (t) Investigations, litigation, disputes
- (u) Insurance
- (v) Taxation

The following is an outline of some of the more major factors that can be considered in relation to the above topics.

**(a) Corporate structure**

- To report on the corporate structure of the Target's group of companies.
- To review any agreements or other documentation relating to any joint venture, partnership, consortium or other profit sharing arrangement.

**(b) Company secretarial**

- To check the information contained in the Target's Statutory Books.
- To provide details of any outstanding share options, share conversion rights, and any agreements or commitments to create, issue or transfer shares (including loan capital).

**(c) Corporate acquisitions & disposals**

- To identify any outstanding obligations owed under any previous agreements for the sale and purchase of any company or business.

**(d) Voidable Transactions/Reconstructions**

- To identify any voidable transactions involving the Target.

**(e) Trading activities**

- To review all licences, consents, permits, and authorities (public and private) required to carry on the business of the Target.
- To review all trading agreements and report on them.
- To list the major customers of the Target

**(f) Competition law**

- To report on any activities in breach of competition legislation.

**(g) Personnel**

- To provide an outline of the method by which the Target documents its arrangements with personnel and consider whether the above comply with legislative requirements.
- To identify whether the personnel practices have created criminal or civil liabilities including in relation to incentive schemes, termination practices or policies or undertakings, discrimination .
- To report on any trade union activities and relations.

**(h) Health & Safety liabilities**

- To report on the Target's compliance with its Health & Safety obligations.

**(i) Pension schemes**

- To analyse and report upon any pension schemes, particularly so that the purchaser can:
  - compare the terms and obligations thereunder in comparison with other purchaser group schemes
  - identify any fund surplus or deficit

**(j) Land & buildings**

- To check the Target's title to its land and buildings
- To identify ongoing obligations and any other parties with rights in relation to them

**(k) Environmental management**

- To make preliminary enquiries regarding any potential environmental liabilities and, where necessary, to advise the purchaser regarding commissioning an environmental audit.

**(l) Plant, equipment & other fixed assets**

- To provide a copy of any schedule provided by the Target, identifying any asset which is held subject to any hire, rental, lease, hire purchase, conditional sale and similar agreements.
- To check the Target's title to the assets.
- To provide a review of any hire, rental, lease, hire purchase, conditional sale and similar agreements.
- To identify any warranties covering any plant or equipment and to provide a review of any maintenance or servicing contracts.

**(m) Computer software**

- To list all software and to check the Target's title to it.
- To check whether any other party has any rights over the software.

**(n) Intellectual property**

- To identify all patents, trademarks, copyright, design rights, registered designs and all other forms of registered and unregistered intellectual proprietary rights or other forms of monopoly or proprietary rights used or owned by the Target and related applications pending.
- To consider whether they have been protected.
- To consider whether any other party has any rights over such intellectual property.

**(o) Investments**

- To provide details of any investments and check the Target's rights to them.

## (p) Lending to third parties

- To identify any loans made by the Target to third parties.
- To provide details of all security given in respect of such loans.
- To review any letters of credit of which the Target is the named beneficiary.

## (q) Banking facilities/borrowing from third parties, financial grants

- To provide details of all bank facilities and security given and the obligations and rights thereunder.
- To provide details of all financial grants obtained.

## (r) Guarantees / indemnities/letters of credit

- To provide a review of any guarantees, sureties, indemnities, or Letters of Comfort.

## (s) Product liability

- To identify and report on the Target's compliance with its product liability obligations.

## (t) Investigations, litigation, disputes

- To provide details of all investigations, litigation and disputes (whether current or foreseeable).
- To provide details of all regulatory action.

## (u) Insurance

- To provide a schedule of all past period and current insurance cover relating to assets of the Target, including details of the type of insurance policy.
- To review the extent of coverage of the Target's insurance cover in respect of any areas of trading activity from which a substantial liability may arise in the future.

## (v) Taxation

- To review the Target's taxation affairs, particularly to identify any liabilities.

## Difference between share acquisitions and asset purchases

Generally, a purchaser will prefer to acquire a company's assets rather than the company itself in order to avoid acquiring unforeseen liabilities. This however necessitates transferring the assets and rights of the company to the purchaser, a task that is often large enough to outweigh the benefits of avoiding liabilities.

## Change of control and non-assignability clauses

It is important, when acting for the purchaser, to ensure that the purchaser will indeed take the benefit of the Target's contracts. In the case of share acquisitions, the purchaser's solicitor should check whether the agreements contain any "change of control" clauses. These clauses provide that the other party will be entitled to terminate the agreement in the event that the majority beneficial ownership or control of the Target changes, or similar provisions.

In the case of asset acquisitions, the situation is different, as the Target needs to effect a transfer of the contracts to the purchaser. Therefore, the purchaser's solicitor will need to determine whether the Target's contracts can be assigned or whether they need to be novated. This can also be relevant to the vendor, as most asset acquisition agreements (and share acquisition agreements) contain a warranty that all of the Target's agreements are assignable without the consent of the other party, thereby obliging the vendor to prepare a list of those agreements which are not so assignable (this therefore being a warranted item).

## Conclusion

First and foremost, the parties involved in the Due Diligence exercise should determine their objectives, and clear strategies for fulfilling them. All too often, lack of strategy can be the Achilles Heel, leading to an unsuccessful result.

Traditionally, many vendors and purchasers have treated Due Diligence as a defensive exercise, offering limited scope for improving the terms of the transaction. Accordingly, the investigation or disclosure is often handled with limited dynamism, particularly by vendors. However, a well managed Due Diligence exercise, including the use of technology to facilitate communication and the distribution of data, can reward both the vendor and the purchaser handsomely, by improving their terms in negotiations, reducing risk and by smoothing and speeding the transaction process.

## Further Information

This guide is for general interest - it is always essential to take advice on specific issues. We believe that the facts are correct as at the date of publication, but there may be certain errors and omissions for which we cannot be responsible.

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