ENGLISH FOR LAW STUDENTS

Legal Due Diligence

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LEGAL DUE DILIGENCE

Pre the event
Post the event
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Pre the event:
- buying an asset
- buying a business
- buying a company
- entering into a joint venture
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Post the event:

➤ Investigation or inquiry
  (granskning)
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- No two buyers, no two sellers, no two targets are the same

- Understanding the business of as well as the buyer’s plan for the target group is key

- Consider, target’s risk exposure, materiality thresholds, negotiation strategy, expected level of representations, warranties and indemnifications

- Customised process

Handout 1: example of a due diligence request list
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- Overall purpose of legal due diligence is almost always the same: to identify and handle actual and potential legal liabilities and obstacles in the target group or asset

- Due diligence findings (legal, commercial, financial or tax) transform into the right form of risk allocation
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The majority of all findings made during due diligence (deal breakers not included) should have one or more of the following consequences:

- Reduction of the purchase price
- Specific indemnities, representations or warranties
- Closing conditions or closing delivery
- Post-closing implementation
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Important issues to be addressed before and during a legal due diligence are:

- Scope
- Mission & Strategy
- The Team
- Interaction between advisors
- Vendor due diligence
- Form of the due diligence report
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- A due diligence report should be a clear report of the most important findings, comments thereto and recommendations on how to deal with the findings.

- Basically, the report should be a tool for the potential buyer to make the legal and commercial decisions.
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What to typically look for - examples:

- Change of control
- Rights to terminate or renegotiate
- Guarantees
- Live warranties/indemnities
- Consents
- Material liabilities
THE DATA ROOM

- Documents provided by pdf
- Physical data room
- Virtual data room
DISCLOSURE
Disclosure

- English style of disclosure is in the form of a **disclosure letter** (US style incorporates into sale/purchase agreement)
- A key document or schedule
- Insufficient disclosure can = warranty claims against seller, or nasty surprises for buyer
- Negotiated
- Warranties and disclosures should be dealt with together
Purpose of due diligence/warranties/disclosure

- To flush out information
- To provide a way to adjust afterwards if disclosures are wrong
- To avoid breach of warranty claims (for the seller)
- Disclosure is the seller’s “shield” not buyer’s “sword”
- The warranties written as absolute statements but are qualified by the disclosures, and knowledge
Form of disclosure

- A letter from seller to buyer (or from seller’s lawyers to buyer’s lawyers - English way; not normal in Norway)
- General part
- Specific part
- In a schedule
- In the text
- Documents on a CD
How should a seller prepare disclosure?

- Seller prepares
- Golden rule – even if seller knows that buyers is aware of something – include it
- Involve the business team
- Keep an index of documents – keep track
How should a seller prepare disclosure?

- Cast knowledge net wide
- Include all relevant staff
How should a seller prepare disclosure?

- Give complete disclosure
- But be careful about disclosing documents giving legal privilege (or it may be lost), or confidential documents
- Black Box concept
How should a buyer review disclosure?

- Ask for the disclosures as early as possible
- Involve the business team
- Don’t accept last minute disclosures
- Ask questions to clarify anything unclear uncertain, “flush out” problems
How to respond to general disclosures

- Searches at public registries
- Resist deemed knowledge
- Corporate records
How to respond to general disclosures

- Inspect of assets (e.g. real estate/vessel)
- Get experts report (e.g. surveyor’s report)
- Check communications (letters, emails, etc.)
How to respond to general disclosures

- Watch out for matters referred to in other documents
- Results of the buyer’s own due diligence
How to respond to general disclosures

- Matters buyer *should* be aware of affecting similar businesses - resist this one

- Public domain - very wide – e.g. anything that was in the local press
Disclosure

- Buyer’s knowledge
- Seller’s knowledge
Warranting the disclosures

➢ “Nothing in the disclosure letter [schedule] is misleading and it is true and accurate in all respects”
The “fully and fairly disclosed” discussion

- Is information fully and fairly disclosed
WARRANTIES
Typical English/American: 50 pages or more

- Close to 50 for a public listed company
- For a private company average 16-20 pages
- 6 – 10 pages for a sale of business
Disclosure and warranties

- English concept of *caveat emptor* “Let the Buyer beware” – property law doctrine in England
- Moving away from that in consumer deals
Practical points to note:

- Long warranties are not necessary for new company
- Go through the warranties with the client – know what the objectives are – what can safely be left out
- Over long warranties can kill a deal
- Show the warranties to the auditors
Basic warranties for share sale

- Compliance with legal requirements
- Accounts accurate and provide for material liabilities
- Tax returns up to date
- Ownership of assets
- No material litigation or arbitration
Purpose of warranties

- To put the other side on notice that food faith is expected
- General assurance that the business is legal and clean – no skeletons in the cupboard
- Specific points
- Establish the problems so purchaser can take a view
- Obtain information
For a seller

➢ The “catch all” warranty
  “All information relating to the Company and to the Vendor which is known or which would on reasonable enquiry be known to the Vendor and which would materially affect a purchaser for value of shares of the Company has been disclosed to the Purchaser”.

➢ Be specific instead – ask the Buyer what it is concerned about having done its DD
Warranties and disclosure

- Use of “material”/“substantial”
- De minimis clause is to avoid arguments as to materiality
- Warranties as to the future
For a Buyer

- If a disclosed matter is of major concern, consider an indemnity
Indemnities

- General rule – not reasonable to seek an indemnity where a warranty provides adequate protection
- Taxation indemnity is traditional in UK
Advantages of indemnities

- Warranties are personal to the buyer – indemnities can be in favour of the target company
- Claim under indemnity – establish loss within scope of indemnity
- Claim under warranty – must establish that the loss arose from the breach and was not too remote
- Duty to mitigate loss in breach of warranty – not always so for indemnity
- Right of set-off and counterclaim do not normally affect indemnities – might affect a breach of warranty claim
- Quantifying loss
Disadvantages of indemnities

- Duplication – hard to argue against
Seller protection – limitations on liability

- Time limits
- De minimis amounts
- Overall caps
- Other limitations