

Before agreeing to acquire a company, the buyer should conduct a thorough investigation of the target. This “due diligence” process serves to determine the value of the target, identify any problems, and assist with structuring the deal. The buyer should examine the target’s business operations, financial information, and legal documentation. Due diligence in the United States is often more extensive than comparable investigations performed in other jurisdictions.

Assembling the Team

Begin by identifying your company’s internal personnel who will be involved in the diligence process. This group should include representatives from management and internal legal staff. Your external advisors—accountants, financial advisors, and lawyers—will also play a role. Additional third-party advisors, such as pension or environmental specialists, may also be required.

Establish at the outset who will oversee the diligence process and ensure that proper communication channels are in place so that the team works together efficiently. Team members should be kept apprised of any changes in deal structure because such changes can have an impact on what they look for during the diligence review. Often, as reviewing insignificant materials can be a waste of time and money, it’s helpful to establish a minimum value for the assets, contracts or liabilities that will be reviewed.

Document Requests

The buyer will usually need to submit a diligence request list to the seller in order to conduct a thorough review. The due diligence request list is an extensive list of documents and information covering the seller’s operations, finances, and legal matters. Your document request list should be tailored to fit the company and the transaction.

Maintaining an organized due diligence process will help maximize the benefits of the review. Where possible, try to establish a single contact between the diligence team and the target company. Duplicate requests from multiple sources will slow down the process and could create ill will.

If you have the opportunity to visit the target or meet with the target’s management as part of the due diligence process, gather as much information as possible in advance and prepare questions or an issues list for the meeting.

Data Room

Most buyers use online data rooms to gather due diligence materials in a central location. Although less popular, physical data rooms are sometimes still used. When

using an online data room, be sure to clarify who is in charge of maintaining and updating the room. Determine who will need access and how access will be granted. Materials should be uploaded to the online data room promptly upon receipt and the entire team should be alerted when new materials are added.

Confidentiality

Maintaining confidentiality is important in any transaction. The buyer and the seller should enter into a confidentiality agreement that covers the due diligence process. All parties should be aware of their legal obligations under any such agreement.

Important Areas for Review

The following is a list of areas that should be covered in a thorough legal due diligence examination:

- Corporate structure: Verify the target company's form, capitalization, outstanding options, subsidiaries, etc.
- Assets/liabilities: Confirm that the target actually owns its assets. Identify all material liabilities.
- Key contracts: Determine which contracts are material to the business. Identify contracts with assignment or change of control provisions.
- Permits and licenses: Identify any permits or licenses that are necessary for the business. Confirm whether any permits or licenses will need to be transferred and the timing/procedure involved.

Other areas of importance (depending on the transaction) include real estate, pension liabilities, intellectual property, employee benefits, and environmental liabilities.

Diligence Reporting

Clarify with your outside advisors at the beginning of the process the type of due diligence report you expect. Identify whether you would prefer a detailed report or a summary of the issues, or both. Let your advisors know if you have a preferred diligence report format. Consider scheduling regular updates or conference calls. This will help any potential problems with the target company as early as possible in the due diligence process. Make sure that the deal negotiators and the parties conducting the diligence communicate regularly. The knowledge gathered by the diligence review can affect the transaction structure and can give you leverage when negotiating the terms of the deal.

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