Preparing Your Client for Corporate Due Diligence

OBA Professional Development
The Ultimate Due Diligence Review
Monday, December 8, 2008
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Overview

What is Due Diligence?

- Process by which a party (purchaser, investor, lender) gathers and reviews information about another party (vendor, investee, borrower) and/or its business in furtherance of a transaction (asset/share purchase, equity investment, loan arrangement).

Purpose of Due Diligence

- To allow purchaser to make a well-informed assessment of the value of the business being acquired.

- To identify risks to be managed and allocated between purchaser and vendor pursuant to the representations, warranties, conditions and covenants in the purchase agreement and the related provisions dealing with indemnities, holdbacks, escrow arrangements, etc.

Overview

Due Diligence Process

- Non-Disclosure Agreement
- Determine scope of review taking into account (i) client's goals and objectives, (ii) transaction size, (iii) cost limitations, (iv) time constraints, (v) client's knowledge of industry, (vi) client's risk tolerance, (vii) vendor's status (operating business vs. receiver/trustee in bankruptcy).
- Identify due diligence team: (i) primary contact for purchaser, (ii) primary contact for vendor, (iii) purchaser's counsel, (iv) vendor's counsel, (v) purchaser's accountant, (v) vendor's accountant, (vi) other experts.
- Approach will depend on complexity of transaction and sophistication of vendor – ad hoc productions of due diligence material vs. data room (virtual or actual).

Basic Areas of Due Diligence

- Corporate
- Financing
- Real Property and Environmental *
- Personal Property
- Intellectual Property *
- Material Contracts
- Regulatory
- Employment and Labour *
- Financial and Tax
- Litigation
- Insurance
- Health and Safety
- Customers and Suppliers
- Corporate and Public Searches *
- Extra-jurisdictional

* *Subject of separate presentation*

Asset Purchase vs. Share Purchase

Asset Purchase Transaction

- Description of assets being acquired and assets being excluded
- Allocation of purchase price
- Assumed and excluded liabilities
- Material Contracts – Assignment
- *Bulk Sales Act* compliance

Share Purchase Transaction

- Minute book review – target and subsidiaries – title to shares, identification of deficiencies, securities and corporate law compliance
- Banking and indebtedness
- Tax (income, GST, RST)
- Material Contracts – Change of control
- Litigation

Third Party Investors

Investment Transaction

- Shareholders agreement, articles of incorporations, by-laws
- Detailed capitalization table
- Key Person insurance, Directors' and Officers' insurance and director indemnity provisions
- Details of senior management compensation
- Non-arm's length arrangements
- Business Plan, Budget, Liquidity Position

Business Specific Due Diligence

Regulatory Compliance

- Licenses, registrations and permits (i.e. nursing homes, investment dealers, insurance brokerages, funeral homes)

Extra-jurisdictional

- Registration to carry on business
- Import/Export
- Immigration

Human Resources

- Licenses, registrations, security clearances, bonding
- Unions

Research and Development

- SRED tax credits

Intellectual Property

- Patent, trademark, source code escrow

Reporting Results of Due Diligence

- Confirm scope of review, procedures employed, materiality threshold used and assumptions made.
- Note requests for additional disclosure based on preliminary findings.
- Summarize findings in executive summary format for client.
- Identify outstanding issues and deficiencies.
- Summarize recommended course of action to address outstanding issues and deficiencies.
- Keep track of disclosure which will be included in disclosure schedules to purchase agreement.

Summary

- Due diligence can be an expensive, time consuming, disruptive and tedious process.
- Counsel is relied upon to ask the right questions.
- Purchaser has to know what it is getting itself into.
- Vendor has to know what, if anything, it will continue to be on the hook for.
- Due diligence is a proactive means of mitigating risk from the perspective of the purchaser, the vendor and their respective counsel.


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