

Episode 80: Summary

Episode name: Careful What You Wish For: Limiting or Waiving Due Diligence in Private Mergers and Acquisitions

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What area(s) of law does this episode consider?

Due diligence in private M&A.

Why is this topic relevant?

Due diligence is a vital commercial step in the process of a merger or acquisition. The process allows the parties to discover information about each other which may not otherwise be readily available.

A particularly notorious M&A transaction occurred at the end of 2022, Elon Musk's acquisition of Twitter. In that transaction, Musk offered to buy the platform and waived due diligence. Musk then faced litigation when seeking to renege on the deal over what he said was an unsatisfactory amount of bots on the platform - something that he would have discovered had he done due diligence.

Legal practitioners undertaking due diligence are entrusted with identifying legal risks. Understanding how those legal risks interact with the structure of a deal - and when to drill down into or let something go - is vital for any practitioner.

What are the main points?

- As a very basic proposition, due diligence is just looking for and understanding risk.
- The two things you are looking for when conducting due diligence are, firstly, understanding the asset being acquired and how the business operates.
- The second is understanding the transaction itself, which involves determining what is required to transfer the business to the purchaser.
- In distressed acquisitions, parties will sometimes waive due diligence as insolvency practitioners are often required to sell businesses in an accelerated time frame - the "*best in the time we've got approach*".
- Where a founder, owner, or shareholder puts their business into a formal insolvency process where there is a valuable underlying business, if it's sold back to the relevant party there will often be a limited due diligence process.
- Typically, this is because that person already knows the business having worked with it closely during its operation.
- Waiver of or otherwise limited due diligence is far less common in a typical M&A transaction where someone *outside* the business or target is looking to acquire the economic benefit of the business.
- There are roughly four phases to a typical transaction; the first phase is the term sheet. At that point, you've got an interested vendor and an interested

purchaser. For larger transactions, you might have a very motivated vendor running a sale process with a bunch of prospective purchasers.

- And then the second phase is really your due diligence phase. A phase where parties can jump into a data room and understand a little bit about the business and the asset before they sign their life away and acquire it.
- The third phase is the transaction documents phase - aka signing.
- The fourth phase is completion; or satisfying the conditions precedent in the binding legal agreement and getting to completion.
- Despite personnel being one of the most important aspects of a business, how the employees of both businesses might interact is often considered a post-transaction integration issue. This means many mergers erode rather than create value.
- There is often tension between lawyers and business people because business people are trying to close the deal as quickly as possible whereas lawyers are attempting to be as thorough as possible in doing their legal due diligence.
- Lawyers should view their role as aiding the transaction by quantifying the risks involved in acquiring or merging businesses. Lawyers should also remember that advisors will have evaluated the business from a financial, a regulatory and a governance perspective.
- Where a risk is identified but cannot be closed off to your satisfaction, ensure the client is aware of this risk involved in proceeding. Where a risk is identified but you do not know the extent of it or are unable to quantify it, ensure you flag the risk in your due diligence report and attempt to quantify it to the best of your ability in the time you have. Where you have influence on the transaction timetable, raise this risk to your client and determine the extent of the risk appropriately.
- If professional services firms are merging, or one is acquiring the other, have the people who will be affected by the issue manage that issue.
- As lawyers completing due diligence, consider your role not only identifying risks to allow a transaction to happen, but identifying risks to allow that transaction to flourish.
- Identify risks that may make your client hesitant to complete prior to the companies exchanging agreements, that way they are not bound to complete.
- Currently, cybersecurity and data management is a very important risk to consider when completing due diligence. When conducting due diligence, lawyers should review the business' systems and processes, understand where the data that they hold on behalf of their customers sits, how secure it is and how comfortable they are with that. Businesses should only be holding data that is necessary.

What are the practical takeaways?

- Practitioners should always look for technological tools to help them practice more effectively in the real world.

Show notes:

[*The Big Idea: The New M&A Playbook*](#) (Harvard Business Review 2011)