

DUE DILIGENCE



A Comprehensive
Assessment

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Introduction



WHAT IS LEGAL DUE DILIGENCE

A legal due diligence is a comprehensive assessment of the possible legal risks related to the corporate status, assets, contracts, securities, intellectual property etc. of the target company concerned.

Legal due diligence is a precautionary operation through which one can know the strengths and weaknesses of the company through the maximum possible information available. This process reduces future problems and ensures safety.

TRANSACTION THAT REQUIRE LEGAL DUE DILIGENCE



Following Transaction are generally covered under Legal Due Diligence

- Mergers/Acquisitions
- Corporate Restructuring
- Corporate Governance related matters
- IPOs/FPOs /QIPs
- Joint Ventures etc
- Private Equity
- General Compliance requirement.
- Commercial agreements
- Leveraged buy-outs

OBJECTIVES OF LEGAL DUE DILIGENCE



The objectives of a legal due diligence exercise may vary from case to case. However some of the common objectives in most of the cases would be as follows:

- To take an Informed decision on the Proposed transaction
- Assessing the risk and liability.
- Mapping of compliance requirements
- Conduct a SWOT and to uncover threats and weaknesses
- Improving the bargaining position.

SCOPE OF LEGAL DUE DILIGENCE



Depending on the nature of transaction, the terms and extent/scope of Due Diligence shall be agreed between the parties.

For Eg: While providing the corporate credit facilities by the Banks and Financial Institutions, the scope of due diligence would be limited to financial performance, statutory and secretarial compliances and title diligence with respect to the property offered for security.

SCOPE OF LEGAL DUE DILIGENCE



Regulatory compliance

It would include assessment of compliance requirements of the company under various laws such

- Companies Act,
- Income Tax Act,
- SEBI Act rules and regulations,
- employee related laws,
- other applicable laws.(RERA, RBI, Insurance etc)

SCOPE OF LEGAL DUE DILIGENCE



Contractual compliance

It would include the compliance by the company under various material contracts like:

- Shareholders/Investment Agreement
- Suppliers Contract
- Customer Agreement

SCOPE OF LEGAL DUE DILIGENCE



Compliance of the Constitutional Documents

It would include the compliance by the company under the intra company documents such as

- Memorandum of Association
- Articles of Association
- Corporate policies
- Procedures, code of conduct etc.

SCOPE OF LEGAL DUE DILIGENCE



Financial aspects

It includes thorough reading of the balance sheet to identify the financial obligations of the company, penalties paid for violations of laws in the past etc.

Non financial aspects

It includes analysis/examination of aspects such as reputation and goodwill of the company.

SCOPE OF LEGAL DUE DILIGENCE



The following aspects covered as scope of due diligence in general. However, the list provided herein is not an exhaustive list and the scope would vary according to the

Under Companies Act

- Compliance with provision of Articles of Association
- Related parties transaction
- Appointment of and remuneration to Directors
- Contracts with director
- Loans to Director
- Borrowings by the Company
- Matters such as disclosure, prospectus, minimum subscription compliance with listing agreement etc. in case of listed company.

SCOPE OF LEGAL DUE DILIGENCE



- Fixed deposits accepted and its repayments
- Distribution of dividend
- Maintenance of statutory registers, minutes books etc.
- Filing of necessary returns nature of business decision.

Under Tax Laws

- Status of tax assessments
- Identification of potential tax liabilities
- Pending notices and demands
- Impact of business agreements on potential tax demands
- Aspects relating to double-taxation.

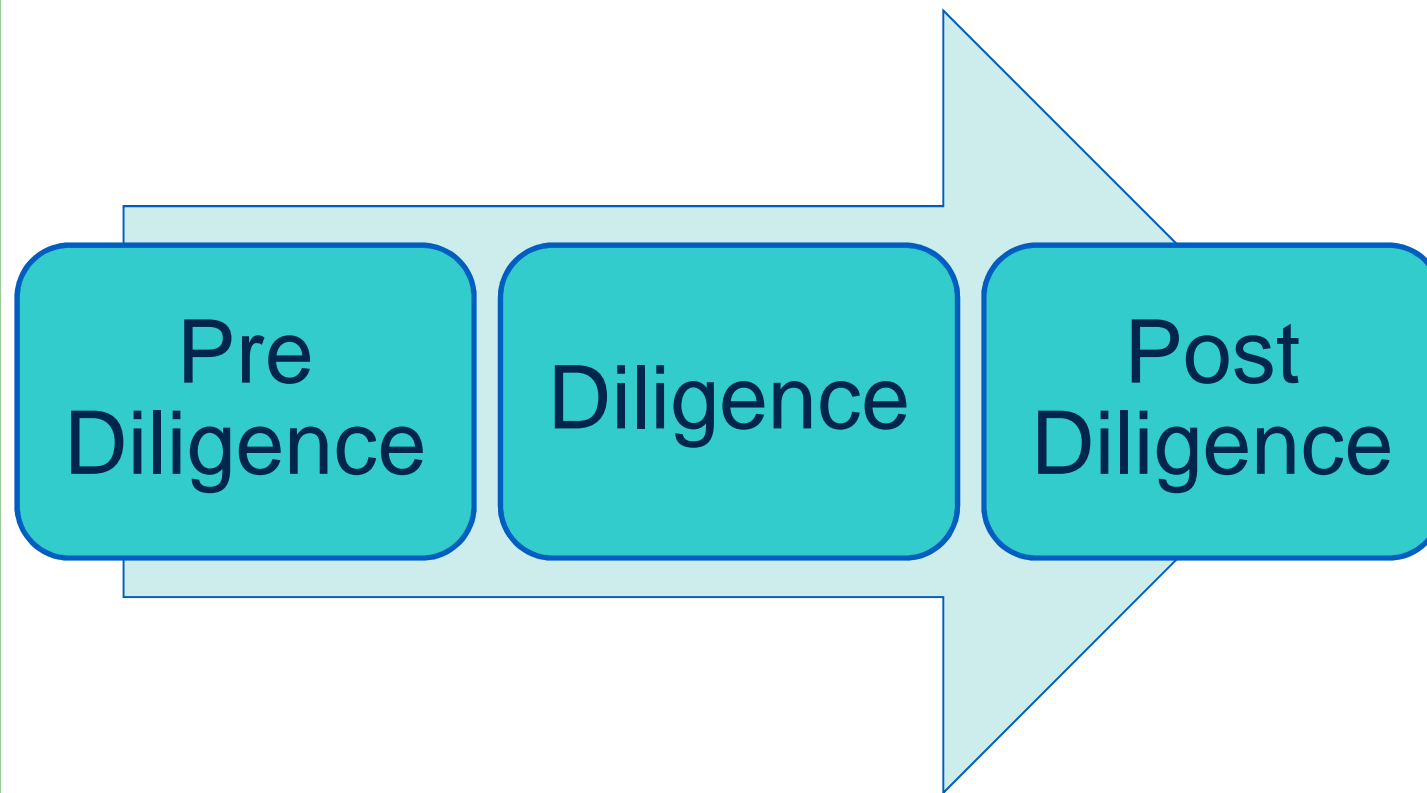
SCOPE OF LEGAL DUE DILIGENCE



Under other business laws

- Registrations and approvals from various statutory authorities
- Compliance under pollution control laws
- IPR related matters
- Issues relating to immovable properties, title deeds etc.
- Compliance under FEMA, insurance laws etc.

LEGAL DUE DILIGENCE PROCESS



LEGAL DUE DILIGENCE PROCESS



There are three stages of Diligence:

➤ Pre diligence

- Entering of MOUs and NDAs
- Determination of scope of Legal Due Diligence
- Calculation of time frame
- Drafting of various questionnaire and checklists

➤ Diligence

- Obtaining of access to records and data room agreement
- Interaction with management and KMPs with the questionnaires and checklists and for other material information

LEGAL DUE DILIGENCE PROCESS



- Checking of regulatory and contractual compliance
 - Analysis of financial and non financial information
 - Collation with financial due diligence for confirmation of representations, warranties and liabilities
 - Investigation of material issues
- **Post Diligence**
- Drafting of preliminary report
 - Discussions with the management of the target company
 - Finalisation of the Report
 - Determination of strategy

DOCUMENTS/ASPECTS TO BE COVERED



The following aspects would give a rough figure on the aspects/documents to be looked into in the process of legal due diligence. However, this is not an exhaustive list.

- ❑ **Organizational and internal Aspects**
 - Memorandum and Articles of Association of the Company
 - Details of Directors
 - Minutes of all meetings
 - Organisational chart
 - Statutory Registers
 - Returns filed with MCA and other regulatory authorities.
 - Search/status report if any.
 - Details of branches and subsidiaries
 - Registrations documents under various laws
 - Documents/reports filed with stock exchanges

DOCUMENTS/ASPECTS TO BE COVERED



□ **Financial Aspects**

- Financial Statements for the last five years
- Qualifications in Audit Reports and Internal Audit Reports
- Details of various financial reports published under listed agreement
- Capital Budgets and projections and Cash flows
- Details of fixed and variable expenses
- Details of internal control procedures.
- Unrecorded liabilities
- Commitments, contingencies
- Accounting policies
- Reliance on debt funds and usage of debt
- Debt repayment and potential debt trap
- Working capital lock up

Material Contracts



- Partnership
- Joint venture Greements
- Copies of Related Party Agreements
- Loan agreements, letter of credit, or promissory notes etc
- Security agreements, mortgages etc
- Any distribution/ marketing/ sales Represntative agreements,
- All nondisclosure or non competition agreements
- Other Material Agreement

IPR/Patent/R&D Details



- Schedule of trade marks/copyrights
- Details of Indian and international patents with the company
- Details of pending patent applications
- A schedule and copies of all consulting agreements, agreements regarding inventions, licenses, or assignments of intellectual property to or from the Company
- Details of threatened claims if any etc.

Human Resource Aspects



- List of employees, their positions and salaries
- Details of options given/vested under ESOP scheme
- Bio-data of key managerial personnel
- Employee litigations
- Employee harassment reports if any.
- Cultural issues in case of cross border transactions.

Environmental aspects



- Environmental audits reports if any
- Details of environmental permits and licenses
- Hazardous substances used in the Company's operations
- Copies of all correspondence with environment authorities
- Litigation or investigations if any on environmental issues
- Contingent environmental liabilities or continuing indemnification obligations if any

Other aspects



- Copies of any governmental licenses, permits, or consents
- Any correspondence or documents relating to any proceedings of any regulatory agency
- A list of all existing products or services and products or services under development
- Company's purchase policy/credit policy
- Details of largest customers
- Details of company's competitors — Press releases relating to the Company.

POSSIBLE HURDLES



Hurdles

- Non availability of information
- Unwillingness of target company to part with Information
- Providing of incorrect or part information
- Complex tax policies and hidden liabilities
- Multiple Regulations and its applicability
- Absence of proper MIS

REMEDIAL ACTIONS



Actions to break hurdles in due diligence The following actions may break the afore said hurdles

- Focus follow up questions.
- Ask several people the same questions and utilise appropriate professional scepticism.
- Polite persistence may help to overcome this attitude.
- Independent check with regulatory authorities.
- Considering this hurdles, it is advisable to insert the necessary disclaimer clauses in the due diligence report.



*Thank
you*

