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Purpose and scope of due diligence

Vijaya Sampath, Senior Partner,
Lakshmikumaran and Sridharan

What is due diligence?

- **Research, evaluation, analysis of**
  - **All relevant/ material data, information or details of a corporation or group**
  - **Of its business, operations, conduct, promoters, compliance, profitability and reputation**
- **Purpose**
  - **obtain a realistic & holistic picture of the subject**
  - **Evaluate investing/partnering in it including risks**
  - **Use reports in negotiating agreements**
  - **Decide its value or "price" or at least a range**

Where and when is it required?

- Investment: Asset deal or company acquisition
- Joint venture with another partner
- Franchise arrangements
- Business agreements: project collaboration
- Supply of goods, equipment
- Service provider
- Investigation and litigation

Raison d' etre

- Access to markets : extending global foot print
  - Existing products in new markets
  - New products in existing markets
  - Become a global player
  - Regulatory requirements for market access
- Acquisition of manufacturing/ service base
- Aggregation: horizontal and vertical integration
- Assimilate intellectual property
- Additional synergies: Leveraging existing strengths
- Assess strength and weakness of potential partners

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Relevant laws for India

- Companies Act and Contract Act
- Foreign Exchange Management Act and Reserve Bank of India Master Circular
- Foreign direct investment (FDI) and FII(Foreign Institutional Investors) policy
- Sector specific laws and regulations, local and municipal laws
- Competition Act
- Stamp duty – Central and State
- Income and Service tax
- Other Indirect taxes
- Tax treaties and free trade agreements
- Dispute resolution mechanism: courts and arbitration

Objective

- Detailed analytics of subject
- Decision on “go ahead’
- Derive price and valuation
- Finalize the terms of the agreement
- Discovering and marking “red flags”
- Risk assessment
- Timing and completion
- Planning for integration

Scope

- Financial: accounts, policies, standards, inventories, tax
- Legal: Contracts, approvals, licenses, litigation, IP
- Compliances: HR, secretarial, regulatory, supply chain
- Technical: IT systems, equipment, R&D, technology
- Commercial: supply arrangements, service provisions, licensing , rentals, lease arrangements, ownership of assets
- Real estate and immovable property: title, insurance, ownership and possession, mining rights
- Intangibles: reputation, market, promoters, good will, brand value and recognition

Evaluation metrics

- Impact of material commercial agreements
- Shareholder agreements: rights & restrictions
- Control and management issues
- Lender and creditor agreements & arrangements
- Evaluation of assets: Title, value, insurance
- Financial numbers and strength of company
- Markets and global reach
- Human Resources: Employee contracts, ESOP
- Intellectual Property
- Litigation
- Regulatory issues and compliances (anti trust, sector regulator)
- Governance
- Tax : deal structure

Transaction process

- Initial expression of interest
- Appointment of advisors: Legal, Investment bankers, consultants
- Non disclosure agreement
- Information memorandum and non binding offer
- Negotiations and term sheet
- **Due diligence: Legal, technical, commercial, financial, HR**
- Documentation: Agreements, disclosures
- Filing & approvals: Internal and external
- Closing: Completion of transaction and post closing adjustment
- Integration and contract management

Role in agreements

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- Definitions
- Transaction Ownership & Control provisions
- Representation, Warranties , Covenants, Indemnities
- Rights and Obligations of parties
- Exit Mechanisms
- Conditions for Closing
- Capital contributions dilutions
- Intellectual property
- Default and remedial provisions

Transaction documents

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- Valuation reports: Big risk areas to be valued and discounted
- Shareholder / subscription agreements: control and management
- Financing arrangements for acquisition: covenants, cross defaults
- Transition arrangements: scope, length, fill in gaps
- Intellectual property, HR, service contracts: gaps, litigation scope
- Open offer, anti -trust, SEC: filings and information, data
- Court related documents: mergers, bankruptcy, settlement: disclosure
- Closing and post closing obligations: seller's obligations and duties
- Regulatory approvals: filing for transfer of licenses, permits
- Contract management : post closure adjustments, process management

Mitigating risks

- Winners curse : Price for prize
- Political and regulatory uncertainties
- Overestimating markets, management capabilities
- Technological obsolescence : the next wave has arrived
- Synergy mismatch : Cost savings, products / services, markets
- Hidden dangers : Undisclosed or understated liabilities
  - existence and quality of assets
- Integration : People, systems, culture

Effective use of reports

- **Disclosure schedule**: **New and excessive information in last stage for exclusion from indemnity**
- **Reps and warranties**: **validity, stickiness, linkage to breach**
- **Indemnities**: **De minimis, basket, must Vs nice to have, overall limits for claims**
- **Adjustment in price**: **Post closing, escrow, termination as alternative**
- **Claims and process**: **control and management of litigation, governing law, arbitration venue and process**
- **Tax**: **statutory period of limitations, extent of coverage**

Delhi, Mumbai, Bengaluru, Chennai, Hyderabad, Ahmedabad, Pune

Thank you

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