DUE DILIGENCE AND BUSINESS INTELLIGENCE – THE ART AND STRATEGY FOR ENHANCING DEAL SUCCESS

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Introduction

Imagine that you are a car enthusiast, and you take interest in reading about the German brand of cars – Mercedes, BMW and Volks Wagen. When you want to purchase your next car, your choice of which car to buy will very likely have been narrowed down to any 2 or 3 of the cars you have frequently read of. This could be because you have sufficient information about them to enable you make a decision. However, to take a final decision, you want more information on things such as warranty, after sales service, financing and payment options, etcetera. So, you proceed to a car dealership to make your findings and hopefully make a decision. At the dealership, you ask questions to confirm the warranty available on the cars you have in mind (including their scope of coverage and duration). You also enquire about the after sales services and the responsiveness of the dealership to service requests. Essentially, you make all the enquiries and if possible, request documentation to enable you make a decision as to whether to buy a car, and which car to settle for.

In the scenario above, you have gathered intelligence by periodically reading about these cars. The intelligence enabled you to ponder over just 2 or 3 cars instead of a hundred of them. Then, by going to the dealership to make all the enquiries, you have done due diligence (DD) which enables you to make a final decision. You will agree that if you had not gathered intelligence before going to the dealership, you will be undecided on which car to purchase and will invariably enquire about the wrong things at the dealership, which in turn may lead to a wrong buy decision.

DD and business intelligence are the bedrock of any commercial transaction, especially for mergers and acquisitions (M&A) deals. Every deal ought to be preceded by business intelligence gathering and DD. The purpose of this paper is to do a deep dive into DD both as a concept and as a process. Most writers and authors address DD as a stand-alone subject. However, we believe that because business intelligence and DD are two sides of the same coin, it is best to discuss them side by side in this one paper.

In this paper we will introduce both concepts, discuss business intelligence in depth and do a deep dive into the world of DD. We shall also discuss the different issues to be considered in the DD process, including the relationship between DD and other parts of an M&A Deal, as well as the importance of site visits as part of the DD process. Finally, we will discuss the process of conducting Integrity DD on counterparties – an added advantage for DD practitioners.

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The need for Business Intelligence

Business intelligence is often viewed as a subject for business consultants and strategists, not a lawyerly affair. However, we believe that a grasp of the business intelligence function will enable the lawyer to render more in-depth and strategic due diligence and other legal services to clients. Discussing business intelligence is important for two reasons. First, the importance of business intelligence in the M&A context cannot be overstated. It should be (even though sometimes it is not) the basis for making crucial decisions in the deal. Secondly, business intelligence is increasingly important for normal day-to-day business transactions outside the M&A sphere. Hence it is important to discuss business intelligence within the normal life of a business, and in the context of M&A deals.

But what is business intelligence? In his 2008 paper published on Forrester Research, Boris Evelson defined business intelligence as *a set of methodologies, processes, architectures, and technologies that transform raw data into meaningful and useful information which allows business users to make informed business decisions with real-time data that can put a company ahead of its competitors*. A simpler and more appreciable definition is offered by Moeller & Brady in the second edition of their 'Intelligent M&A' textbook where they defined the function of business intelligence to be, *to act as the eyes and ears of the organization, to gather and, more importantly, analyse information that provides a competitive advantage*.

The key points that emerge from these definitions are that business intelligence (a) requires collection of data, (b) involves the analyses and transformation of data into meaningful information, and (c) gives the business some competitive advantage over its peers. In these days of ICT and artificial intelligence, it is commonplace to find that business intelligence is defined as a set of applications and software that mine, collect, process and analyse data. Irrespective of how it is defined, business intelligence, at its core is about collecting, storing and analysing data in order to gain competitive advantage. Today, there are several business intelligence firms and software applications, and the business intelligence industry is a multi-billion dollar industry (according to Cision PR Newswire). This underscores its growing importance.

Therefore, as long as businesses continue to compete for market share and dominance, they will continue to rely on accurate and properly analysed data to make sound decisions that will put them ahead of competitors. This creates the never-ending need for business intelligence, both for the everyday business and the M&A participant.

Who should collect and store business intelligence, and should collection be done internally or outsourced?

Recall that we had set out to look at business intelligence from 2 broad spectrums of (a) the everyday business and (b) M&A deals. Hence, there is often the temptation to treat the question of who should collect, and to what extent, along the lines of 'everyday business' and 'M&A'. However, it is our position that the divide should not matter.

Any business looking to compete should cultivate a business intelligence habit and should cover such scope as its resources allows. A company may have no intentions to acquire or merge with another company, but intelligence about an impending merger of two rivals, or a new entrant, or the unlocking of a new geographical market, may spur it to make quick acquisitions to ensure

it remains competitive. In order to make such quick and successful acquisition(s), it will rely on previously accumulated business intelligence to decide on the most suitable acquisition targets. Thus, we see that a normal everyday company would have avoided losing market share by relying on business intelligence, and more importantly, it will have engaged in 'unplanned' M&A by relying on business intelligence.

The intelligence should as much as possible be collected and analysed internally (this requires that an intelligence desk/department be created within the organisation) to aid quicker decision making. Also, for businesses in highly competitive industries such as tech and FMCG, it may be desirable to hire external intelligence firms to provide intelligence on happenings across the industry and even outside the industry in so far as they have implications for the industry. This external intelligence need not be sent via emails daily, the business may simply be connected via API to the intelligence Firm, in order to get direct access to intelligence on its database.

In the M&A context strictly speaking, business intelligence is as useful to the seller as it is to the buyer. The reason is simple as has been shown above that a buy-decision may be spurred by the intelligence available to a party. Further, deciding who to buy is a decision which rests almost solely on the intelligence function. It is intelligence that aids a party in drawing up a list of possible targets based on the strategy of the buyer and the reason driving the acquisition. When communication has been established with possible targets, the buyer will rely on intelligence for every step of the deal from the preliminary stage (letter of intent/heads of agreement, confidentiality agreement, etcetera) to the due diligence stage (to be discussed later in this paper), the documentation stage, closing and most importantly, the post-closing integration.

On the other hand, a seller should rely on the business intelligence available to it in order to choose which suitor to sell its business to. Whether the seller is a strategic seller or a financial seller (to understand the different types of sellers, read our paper titled '*Before you sell your business, think like a buyer*') business intelligence will help the seller to decide which buyer best suits the seller's strategic needs. Businesses that have been on the wrong selling end of an acquisition will attest to the fact that if they had intelligence on the particular buyer, they would not have sold to that buyer. In *Airborne v. Squid Soap*, a 2009 decision of the Court of Delaware, United States of America, Squid Soap (the seller) was a growth company and had lots of suitors looking to acquire it. It however opted for Airborne based on the false representations and assurances of Airborne. This proved disastrous and the company failed to obtain adequate value from the sale. The intelligence function would have revealed the different litigations and the Federal Trade Commission investigations which Airborne had pending while negotiating to purchase Squid Soap. Of course, these issues impacted on the post completion success of the deal, and resulted in loss to the seller.

Developing the intelligence function should be strategic

In order to maximise the intelligence function, it is important to think of the unique features of your organisation and how best to deploy the intelligence function to gain competitive advantage. A good way to start may be to perform a basic SWOT and PESTLE analysis. This will give you an idea of your internal and external environment. Knowledge of your environment, capabilities and limitations should serve as a pointer to what intelligence you may require in order to better compete.

It is important that the intelligence function is engendered as a culture in your organisation. Else, the intelligence unit may act in isolation from the other business units. Imagine the amount of intelligence that the human resources department receives each time they interview an applicant who works or worked with a competitor; or the intelligence that could be available to the sales department, from interacting daily with customers. Having an intelligence culture that encourages cooperation and information sharing may enable your organisation spot important game-changing information which would have otherwise had less significance if the intelligence function was isolated.

Moeller and Brady (2014) identify the different types of intelligence that should be collected and the need for scenario planning to be done based on available intelligence. They mention the need for immediate (on-demand) intelligence, continuing intelligence, technical and analytical intelligence. In the writer's view, a business looking to compete should definitely deploy continuing intelligence since this will provide the database for immediate and analytical intelligence. The intelligence available to the organisation should be used for scenario planning in order to simulate possible outcomes based on available intel. This is especially important for the post-integration phase of M&A transactions. Where deployed strategically, the intelligence function may enable the organisation to foresee multiple futures and by so doing gain competitive edge.

Due Diligence

If business intelligence means acting as the ears and eyes of the company in order to gather information on which decision-making will be based, then what is DD and why do we need to discuss it separately from business intelligence? DD is a fact-finding exercise through which a party (call this party 'Thomas'), will x-ray the information available on another party (call this other party 'Peter') in other to discover if there are hidden liabilities that will aid Thomas' decision on whether to –

a. Proceed on a transaction with Peter;
b. Negotiate further and get better terms in the transaction with Peter; or
c. Not proceed on the transaction with Peter.

It is important to understand why DD is necessary outside the M&A context and especially for M&A deals. Contracting Peter to construct a food processing plant is not the same thing as buying orange over the counter. There is a lot more at stake for Thomas and should things go wrong, Thomas could lose a lot of money and may be locked in legal battle with Peter. In the M&A context where Thomas is seeking to acquire or merge with Peter, a wrong move may actually spell doom for Thomas as a company or may cause severe loss of value for Thomas' shareholders. Therefore, to avoid these losses or difficulties, it is important to look beyond the information provided by Peter in order to find out if there are other facts which Thomas should be aware of before deciding whether to proceed or how to proceed on the transaction. Thus, as long as you contemplate engaging in business with another party, you should become a Thomas and conduct DD on the counterparty, Peter.

Generally speaking, the function of DD is to enable a party to ascertain the veracity of disclosed/available information and/or unearth information not provided or previously not available in order to aid decision making. For M&A deals, DD has more prominence in the way it dictates other deal processes as seen bellow:

a. DD helps parties to determine whether to proceed with a deal or not to proceed with same;

b. DD enables parties to set/adjust the price of an acquisition target or to determine the price at which parties should merge their respective businesses;
c. DD sets the tone for negotiating representations and warranties;
d. Knowledge obtained from DD will enable a purchasing party to request indemnities for potential/unmaterialised liabilities;
e. Findings from DD may show the need to warehouse some of the purchase price in an escrow account to limit the exposure of the purchaser to liabilities from indemnified events or ascertained but unmaterialised liabilities; and
f. Very importantly, DD serves to prepare the purchaser or the merging parties for the post acquisition/merger integration – an often-overlooked part of the deal process.

It is important to note that the aforementioned functions will not be realised if DD is done haphazardly or merely as a scientific part of the deal (by ticking the box). It is the writer's view that for DD to unlock value, it must be developed as a core part of the deal strategy (which must align with the corporate strategy and vision of the business), and not an after-thought. Usually, the business plan serves as the strategic base case. Thus, the DD will answer the question whether the business plan can be realised based on the status of the target as revealed by the DD.

What areas should be investigated?

The point to note here is that DD is a process that can and should be segmented according to different expert areas. However, the question as to which areas should be investigated will depend on the nature of business of the Company and the nature of the specific transaction as well as (as I am sure you must be used to by now) the strategy underlying the deal. The following areas may be the subject of a DD especially within the M&A context:

a. Financial/Accounting: Here, the DD will focus on analysing the financial statements of the party being investigated. This is critical because the valuation of the deal will be based on, among other things, the financial statements. Also, the financial statements will often be the starting point for the business plan which serves as the base case for the deal. Hence, if not properly verified, the entire deal may be hinged on faulty financial assumptions. The HP and Autonomy deal (discussed below) is a good case study. Accountants are best suited for this DD.

b. Legal: This goes without saying. Virtually every part of the business being purchased will have legal connotations. It is important to ascertain that the relevant laws are being complied with and that there are no potential exposures from non-compliance with laws or any disputes (whether existing or potential). For existing disputes, it may be important to ascertain whether they are potential liabilities and if this has been properly reflected in the financial statements. Intellectual property ownership and use rights should also form part of legal DD as well as data protection and privacy issues.

c. Insurance: In certain deals involving high risk businesses, it may be necessary to conduct separate insurance DD to ascertain the level of insurance required to operate the business and whether they are in place and premiums fully paid up. An insurance broker may be best for this DD. Alternatively, and for less risky businesses, it may suffice to get a certificate from the seller's insurer stating that all relevant insurance is in place and

premium fully paid. Risk of sufficiency will then rest on the insurer.

d. Tax: Tax is a complex issue especially for multijurisdictional deals. Hence, it may be necessary to engage an accountant or tax consultant to conduct DD on the tax obligations of the seller and whether there are any existing or potential tax exposures. Also important is an investigation into the tax implications of the deal. This will go a long way in determining the structure to be adopted in closing the deal in order to reduce tax exposures which may arise especially for multijurisdictional deals.

e. Real Estate: Where the party being purchased owns a chain of businesses in different locations such as food retail chains (Chicken Republic, KFC, Macdonalds), it may be necessary to investigate the nature of title to properties which they occupy, especially where the properties form part of the deal valuation.

f. Environmental: Environmental concerns are increasingly becoming slippery slopes for businesses. Hence it is important to conduct environmental DD to ascertain the level of compliance and existing/potential exposure especially for businesses in the energy, textile, food retail, FMCG and other such sectors.

g. Cultural/Social: This aspect of DD may be overlooked but its importance is far reaching. The Daimler-Chrysler merger in the late 90's billed as the 'merger of equals made in heaven' failed largely due to cultural/social differences which were not properly understood before the merger was completed. Hence, it is important to study and understand the culture of the organisation as well as the social environment in which it conducts business. The culture of a Nigerian business may be similar to that of a Swedish business. But the social environments in which they both exist may mean that cultural synergies may not be achieved. An understanding of these issues through DD will enable parties plan for post deal integration.

h. Brand: In today's world of social media, brand visibility is very important, but even more important is brand credibility. It is important to conduct DD on the underlying parameters of a business' brand especially, since the brand will often form part of the intangible asset of the business and will be factored into its valuation. The case of Airborne v. Squid Soap should serve as a reminder on the frailty of big brands and the need to investigate them. Additionally, the business' social media handles, posts and comments should be scanned for potentially damaging content or hard-line positions which may have damning future implications.

i. Pension: For businesses which have numerous employees, pension costs are often large and, in some cases, may be unremitted. It is important to investigate the pension scheme in use by the business as well as the remittance levels. Pension DD may form part of the legal or accounting DD or may be commissioned separately to pension experts in multijurisdictional deals.

j. Commercial/Market: This DD requires an investigation of the commercial position or market environment of the target. It may help to start off this DD by conducting a SWOT analysis, Five Forces analysis, Ansoff Matrix analysis and PESTEL analysis for the target using information provided by the Target and available from business intelligence. This will give insights as to the true market position and

competitive constraints of the target. Quaker Oats' acquisition of Snapple in USA, in 1994, for $1.7 billion failed partly because Quaker Oats failed to realise the competitive constraints facing Snapple at the time especially from Coca-Cola and Pepsi. This failure resulted in a $1.4 billion loss to Quaker Oats.

k. Ethical: In today's world of #MeeToo and other ethical scandals, ethical DD cannot be overlooked. It may be necessary to x-ray the ethical happenings in the business as well as outside it. For instance, if its suppliers or agents provide it services using child or forced labour, then it may face potential backlash, fines and loss of goodwill. These matters should be investigated. An extensive discussion on process of integrity DD is found in part C.

l. Management DD: The management of the business should be investigated to ensure that their personal lives will not cause loss of value or reputational damage to the target in future. For instance, if the CEO of a tech giant is found to be involved in funding or supporting terrorism, regulatory authorities will sanction the business and users will shun the business' services for fear of their personal data being made available to terrorists. The recent social media backlash against a Nigerian Bank whose former CEO was alleged to have been involved in workplace romance with a staff and which allegedly contributed to the death of the staff's husband is a case in point and underscores how the activities of top management can impact on the image of the business and possibly its valuation. Another reason why management should be investigated, especially in a sponsor-led Management Buy-Out, is that the realisation of the business plan rests on the management. Hence, it is important to properly investigate them and ascertain their ability to deliver the business plan.

The understated importance of site visits in the DD process

Many advisers and business executives have reduced the DD process to a document verification exercise whereby all that is required is to read through a host of available documents in order to ascertain the existence of value or liabilities. Hence, the role of site visits, especially for professional advisers, are somewhat understated. Site here refers to the physical place of business of your proposed business partner or target (in the M&A context). Site visits are important and may be a great source of insight for the deal parties. Tom Speechley, in the 2nd edition of his *Acquisition Finance* book, noted 2 major importance of site visits in the M&A context.

First is that site visits provide an opportunity for the purchaser to meet and interact with the management team of the target/seller. This is important because it could be that the purchaser contemplates executing a Key Employee Retention (KER) Agreement as part of the transaction documents. This visit provides a window to assess the key employees' capabilities and whether they can execute the business plan underlying the deal.

The second reason why site visit is important is that it enables the purchaser or parties in a merger, to observe first-hand, the operation of the business they are seeking to buy/merge with. To maximise the importance of this second reason, it is important to ensure that persons who go on the visit are skilled enough to understand the operations of the business being visited, and ask relevant questions that will enhance the understanding of the business. To this end, professional advisers and/or consultants may be

hired to join the visit team. Where the business being sold is a unit of a larger business (for instance, the acquisition of Dangote Flour Mills in Nigeria by Olam Industries on 1st November 2019 for $331 million), site visit will enable the purchaser, in this case Olam, to see how much of the Flour Mill's business/operations is tied to the main entity, Dangote Group and whether there are shared services. This will enable Olam to plan for the post-acquisition integration of the business unit which was hitherto reliant on the holding company.

Another reason why site visits are important is that it affords you an opportunity to observe the culture of the business organisation by chatting with employees (within allowable parameters of course) and observing their relationship with the management and peers.

Who should conduct DD?

The question of who should conduct DD sounds simplistic. Of course, it is the party acquiring the company or in the non-M&A context, the party looking to engage another party for a contract. But this is not entirely correct. It is the position of the writer that both parties should conduct DD both for general commercial transactions and for M&A Deals. Using our pseudonyms (Thomas and Peter), let us create different scenarios to drive home the point.

a. Thomas seeks to acquire Peter: Thomas conducts DD on Peter and Peter should also conduct DD on Thomas in order to ensure that Thomas is a credible buyer and a sale to it will not result in loss of value.
b. Thomas and Peter are contemplating a merger: both parties will conduct DD on each other to ensure that they are satisfied with each other's state of affairs and business prospects before agreeing to the merger.
c. Thomas is an FMCG company and desires to retain the services of Peter, a logistics company: Thomas will conduct DD on Peter to know whether it is able to move its products through its supply-chain. Peter should also conduct DD on Thomas to ensure that by delivering the products, it will not be unintentionally aiding the distribution of prohibited substances hidden in the products or even aiding a money laundering scheme.

From these scenarios, we can agree that DD should be a two-way process. However, because of the cost of conducting DD, one side of the transaction may elect not to expend resources and conduct DD – a potentially regrettable decision. In *Airborne v. Squid Soap,* Squid Soap's failure to conduct DD on Airborne affected its ability to request sufficient reps and warranties which it would have relied on when the combined business began to plummet. In this case, Squid Soap's reason for agreeing to sell to Airborne (who it considered a strategic partner) was mainly the brand strength of Airborne. However, it failed to conduct DD on the brand strength. A good DD on brand strength would have served as a pointer to Squid Soap to extract brand-related reps and warranties which in turn would have led Airborne to make disclosures, and those disclosures will either lead to a renegotiation of the deal or the use of indemnities and escrow accounts to cushion any potential liabilities. Squid Soap only had general reps and warranties in its favour against Airborne, and the Court held that they were not specific as nothing was warranted as to brand strength, the focal point of parties' discussions.

In *Am. Capital v. LPL Holdings*, a 2014 matter decided in Delaware, United States, the seller expected that the adaptation of its systems with the buyer's computers will result in more sales to its existing customers and enable it onboard new customers. The seller received assurances from

the buyer and relied on them without conducting at the very least, a technical DD on the buyer to verify its assumptions on technological synergies. This failure to avert its mind to conducting DD on the buyer meant that it also failed to obtain specific reps and warranties that on the suitability and adaptability of the buyer's technology. After the deal was closed, the technologies were not adapted, and the anticipated synergies plus improved sales vanished. The seller paid the price for failing to diligence the buyer.

Another way to look at the question of who should conduct DD is from the point of view of whether same should be done internally or by professional advisers. DD should start internally, and then professional advisers should be retained in areas where there is insufficient internal expertise.

Is there a duty to disclose information not requested at DD?

Imagine that (continuing with our pseudonyms) Thomas, being desirous of acquiring Peter, requests for registration documents from Peter showing Peter's ownership over its intellectual property, and Peter provides the documents to the satisfaction of Thomas. But, unknown to Thomas at the time, Peter's ownership over the IP rights to one of its products is being challenged, and because Thomas did not ask any questions or request warranties that the IP rights are not being challenged, Peter keeps quiet and refuses to disclose. The transaction has now been completed and Thomas is crying foul. The question is, was there a duty on Peter to disclose information not requested for at DD?

The scenario above is somewhat similar to that of HP's acquisition of Autonomy in 2011 (a U.K. deal). In that acquisition, HP was swayed by the impressive numbers posted by Autonomy but Autonomy on its part did not reveal the engineering behind the numbers. The issue was that Autonomy's flagship product IDOL (Intelligent Data Operating Layer) was somewhat outdated and was bundled with other commoditized products thereby allowing IDOL to appear more economically successful than it was. HP was seduced by the numbers from IDOL and acquired the company for $10.2 billion. A year after the acquisition, HP discovered the accounting improprieties and wrote down the value of the deal by $8.8 billion. While the HP-Autonomy case may border on fraud, the question from a purely transaction perspective is whether there was a duty on Autonomy to disclose its accounting procedure to HP if it already provided access to its books and HP asked no questions?

The answer to the question whether there is a duty to disclose will depend on whether the transaction is governed by common law or civil law. In civil law jurisdictions (e.g., France), the doctrine of good faith is applicable and will impose a duty on parties to disclose any facts which they are aware could be material for the other party's decision to proceed with or withdraw from the contract. Indeed, Article 1104 of the French Civil Law Code provides that contracts must be negotiated, formed and performed in good faith. And Article 1112-1 mandates a party to a negotiation, say Peter, who is aware of information the importance of which would be determinative for the consent of the other party, say Thomas, to inform Thomas of such information if Thomas is legitimately unaware or relies on Peter for such information.

The position in common law countries is different. English common law has no good faith requirement which imposes a duty to disclose. In fact, there is the principle of caveat emptor (meaning 'buyer beware') which imposes a duty on the purchaser to make independent verification before committing to a purchase. So, a party may not be bound to disclose unless the other party

specifically requests such disclosure. (Duty to disclose will be discussed in-depth in a subsequent paper.)

Relationship between DD and other areas of the M&A deal

The centrality of DD to the M&A process is not up for discussion here. It can be said to be the pivot of the transaction because the decision of whether to proceed and/or how to proceed ought to rest on the outcome of DD. Indeed, DD shares a special relationship with several critical areas of the deal. For instance, based on the outcome of DD, a purchaser will be able to determine what specific Reps &Warranties to request for. These Reps & Warranties will in turn induce the vendor to make further disclosure in order to reduce the reach of the Reps & Warranties. Where time permits, the disclosure may lead to further DD. Also, the DD will show the purchaser the areas where there may be impending liability to enable the purchaser to negotiate for indemnity and escrow account clauses in the purchase agreement. Barring any tax considerations, DD may also be instrumental in a decision as to whether to use a locked-box price setting mechanism or a completion account mechanism. This is in view of the fact that risk in the target is transferred either at the locked box date or at the completion date respectively for the mechanisms. Indeed, where time is of the essence and parties envisage a high-level DD, the purchaser will likely prefer the completion account such that risk is transferred at closing. However, where the purchaser is afforded time for an extensive DD, it may be confident to accept a locked-box price. (Locked-box and completion account mechanisms will be discussed in a subsequent paper.)

Another part of the M&A process that shares a special relationship with DD is the post integration stage. DD, if properly done, sets the stage for the actual combination/integration of the parties post-deal. DD will provide insight into cultural peculiarities, leadership patterns and other soft issues that are usually ignored but could be fundamental for the success of the deal post-completion.

Finally, where earnout is deployed as part of the deal, DD will enable parties to properly negotiate the terms of the earnout to ensure that post competition disputes which are often associated with earnouts are greatly minimized. Where earnout is contemplated, it is important that parties conduct DD on each other so that the earnout provision is properly negotiated. (For a full anti-dispute discussion on earnout, see my paper on *'Why Earnouts Lead to Post-Closing Disputes'.*)

Conducting DD in multiple jurisdictions and dealing with language barriers

In multijurisdictional transactions, the target's assets may be in multiple jurisdictions. The question in this case borders on how to centrally coordinate DD in multiple jurisdictions with different legal regimes and how to address language barriers if the transaction language is different from that of the jurisdictions where DD should be conducted.

To centrally coordinate DD in multiple jurisdictions, the coordinating solicitor may either elect to appoint local counsel in the different foreign jurisdictions to conduct/oversee DD on specific areas and furnish it with reports on those areas. Alternatively, purchaser's solicitor may request the seller's solicitor/general counsel to furnish it with a report on specific areas in that foreign jurisdiction. Seller's solicitor/general counsel will then authorise its local coordinating counsel to provide such report which will be sent to purchaser's solicitor. However, to ensure completeness of such report, purchaser's solicitor

will often request an affidavit from seller's solicitor attesting to the completeness of the report and its sufficiency for the subject under investigation. The effect of this affidavit is to transfer the risk of inaccuracy or incompleteness of the report from the foreign jurisdiction to the seller's solicitor or local counsel who is knowledgeable in the local law.

Where the report or documents is/are provided by seller's solicitor in a foreign language, purchaser's solicitor should request that seller's solicitor translates or makes arrangement for the translation of the report/documents to the deal language. This translation should be backed by an affidavit by the seller's solicitor stating that the translation is accurate and complete. Again, the purpose of the affidavit here is to transfer risk of inaccurate translation to the seller's solicitor.

Liability of professional advisers for flawed DD reports

Generally, the reason why parties rely on professional advisers for DD reports is because parties lack internally, the expertise which professional advisers represent to possess. And given that far reaching decisions will be made relying on the expert report of such professional advisers, is there liability on the professional adviser for a flawed/negligent DD? The answer will depend on the letter of engagement/contract underlying the instruction to conduct DD.

Generally speaking, professional advisers are liable where they have been negligent in conducting DD which results in damages to a party. However, this liability can only be established based on the specific provisions of the engagement letter for that instruction. Thus, professional advisers should be careful to agree on the specific scope to be covered by the DD both in terms of areas of coverage and how far back the investigations should reach for. Liability can also be contractually limited by placing a monetary cap on the party's recourse to liability. However, where the negligence or flaw falls squarely within the agreed scope and the documents which contained the error were provided but overlooked by the professional adviser, it is our opinion that the adviser may be found liable for damages, albeit within the contracted cap.

Business Intelligence and DD – Two Sides of the same coin.

Is DD different from business intelligence? Which should come first, business intelligence or DD? In simple and clear terms, while DD is target specific, business intelligence is usually not, although it could be depending on how it is deployed. Also, it is our position that business intelligence should normally precede DD in order to provide insight into what areas should be investigated thereby enhancing the DD process for deal success. Imagine that HP had accumulated business intelligence on Autonomy, its different products and their market performance. Its advisers would have taken a more cautious look at Autonomy's financial statements and formed a better opinion as to its revenue generating products, and the false assumption on the viability of its IDOL product would have been avoided.

On the relationship between business intelligence and DD, it is our position that they share a symbiotic relationship. Thus, while DD relies on business intelligence for insight and direction, business intelligence is enhanced by DD. Put differently, information provided by business intelligence analysis ensures a better and more deal enhancing DD. On the other side of the coin, information realised in the course of DD is stored back in the intelligence archives of the investigating party thereby enriching it for future analysis and transactions.

The scope of a comprehensive integrity DD

It is typical for potential business partners to enquire into the affairs of one another, usually prior to the start of the business relationship. In practice, the more *strategically placed* party performs DD procedures on the other party (or parties, as the case may be). *Strategically placed* in this context could be in terms of financial strength, country/region, reputation and goodwill, industry, and/or extent of regulation.

Integrity DD, otherwise known as reputational DD, is one of the most important aspects of DD to be considered when deciding on whether to commence (or continue) a business relationship. This is necessary for many reasons. Firstly, integrity DD would show the *nature* of the target by disclosing prior instances of fraud or illicit activities (if any) by the target and/or its officers. Every business wants to avoid preventable financial losses, including losses due to fraud perpetrated by business partners. So, unearthing information on fraud by an officer of a proposed business partner would be valuable intelligence. For instance, a party to an oil mining joint venture would be genuinely concerned if the Managing Director of the operator of the joint venture was a previously convicted fraudster, wouldn't it?

Again, and perhaps more importantly, local and international laws ascribe liability on businesses for certain unlawful actions of their business partners, especially where the business failed to adequately ascertain the reputation of the affected business partner before the commencement of the business relationship. Under the US Foreign Corrupt Practices Act and the UK Bribery Act, for instance, a company may be held liable for certain unethical payments made by their subsidiaries and agents, even where the payments were made outside the USA and the UK respectively. Similarly, Nigeria's anti-money laundering law imposes strict liability on financial institutions that fail to undertake proportionate DD procedures on their customers, especially where such customers are found to engage in money laundering activities.

Furthermore, it is increasingly fashionable for businesses to present themselves as ethical corporate citizens. Such businesses would expectedly want to partner with other entities that share similar values, so as avoid erosion of values within their operations. Thus, a business would likely not consummate a business relationship with another entity, if that entity or its key stakeholders has had recent ethical infractions or have been recently sanctioned for offences relating to moral turpitude.

What should an integrity DD cover?

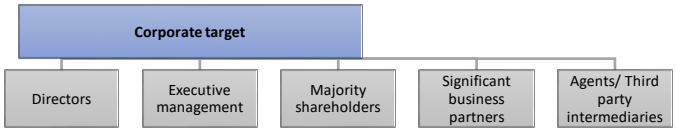
It is typical for the *principal* (the business commissioning the DD) to use internal staff to perform limited DD procedures on the target(s) for less significant business relationships, and to engage external professionals and forensic experts for more significant relationships. In any event, the DD procedures should cover the following areas, minimally: background checks, tone at the top, tone from the top, and transaction testing. Each area will be discussed presently.

Background checks

A background check is a quasi-investigation into the affairs of a target, usually undertaken with a view to uncover information in the public domain about the target. Such investigations inquire into the identity, experience, business dealings, associates, criminal history, regulatory sanctions, litigation history, etc. of the target. Reported instances of criminal or ethical breaches (bribery and corruption, money laundering, fraud, etc.) by the target, its officers and/or associates will be relevant, in addition to other incidental

information that the principal might be interested in.

Background checks usually rely on data from public sources, but it is not uncommon to access non-public information, especially where the consent of the target has been obtained. For a corporate target, background checks should be conducted on the stakeholders shown below, in addition to the target:



It is important to consider the privacy and data protection rights of the targets, when conducting background checks. Liability may attach to the investigator and/or the principal where it is established that the personal data of data targets who are natural persons were accessed or processed in contravention of extant data protection laws (like Europe's *General Data Protection Regulations*, *Nigeria Data Protection Regulation*, South Africa's *Protection of Personal Information Act*, etc.). For this reason, it is highly recommended that the express consent of the target should be obtained prior to commencement of the DD.

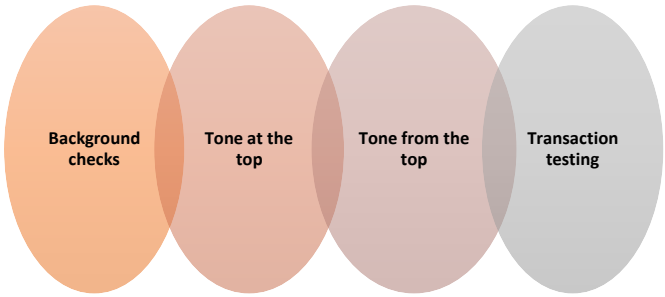
Restrictions on cross border transfer of information is another consideration to be had when conducting background checks. This usually applies to instances where the DD is conducted on a target outside the home country of the principal. Some jurisdictions require that state approval must be obtained before personal data and other important data obtained within their territories can be moved/transmitted outside. Investigators and principals are advised to seek legal counsel in this regard.

Tone at the top

Tone at the top refers to the internal regulatory framework guiding ethical behaviour within a target's operations. This includes policies (Finance Policy, Anti-bribery Policy, Code of Business Conduct, Gift and Hospitality Policy, Staff Manual, and so on), documented procedures (regulating payment, interaction with government officials, employee discipline, use of cash, etc), and other policy documentation developed by the target to regulate its business operations. It also refers to official communications and trainings provided to staff, agents, and other stakeholders in relation to the culture of the target and the standard of ethical behaviour expected of every stakeholder.

A thorough DD should cover an assessment of the documented policy framework of the target, to determine whether the right ethical principles are entrenched therein. Where the target does not have or maintain expected policies, it may be a red flag. In addition, there have been instances in the past where organisational policies permitted the payment of bribes to government officials in order to avoid liability, or permitted the payment of "Presentation fee" to government during promotion of products.

The policies should be assessed in line with extant laws and regulations, as well as leading business practices. A gap analysis (a comparison between *what is* and *what ought to be*) is usually undertaken to identify the shortfalls of the target's internal framework, as well as areas of strength identified. Lastly, it goes without saying that policies and procedures ought to be approved by the appropriate levels of authority, and updated to reflect changes in laws and regulations.



Tone from the top (and from the bottom)

Tone from the top analyses the *mind* of the alter egos of a given target. While it is important for a target to have approved policies regulating ethical behaviour within its operations, it is also necessary to ascertain to what extent those policies are inculcated into the target's stakeholders. It is possible that a target has good policies (on paper only) which are not *living* in practice. This means that the policies are not followed in the target's organisation, are not communicated to staff, or worse still, that the target's personnel and stakeholders do not necessarily agree with the principles contained in those policies.

Interviews are highly effective in gleaning information about the actual practices at a target's organisation. Such interviews are usually targeted at the management team of the target and/or the heads of the various units. Discussions around past experiences, trainings attended, knowledge of existing policies, and interactions with external stakeholders, etc. can reveal a great deal of information about the relevant personnel, and ultimately, about the culture of the target. In addition, the interview session presents an avenue to corroborate information obtained during background checks.

One may be surprised at the amount of intelligence that can be obtained during an interview. Someone at a conference once shared a story of how a client's Head of Logistics engaged her in a heated argument about the propriety of paying non-approved fees to factory inspectors (who were government employees) to "speed up the inspection process". There was another discussion where a Head of Finance disagreed with the fact that facilitation payments could expose the client to liability. In both stories, the clients had top-notch approved anti-bribery policies!

Sometimes, the management may have *ready-made* answers for the investigator, in which case the investigator may not get the true picture of things within the target's organisation just from discussing with management. In such circumstances, the investigator can also have discussions with some relevant field staff, especially those in charge of payments and external interactions, about their experience in the target's organisation. From experience, such discussions may throw up information that the investigator can further explore during testing of transactions.

Transaction testing

Transaction testing is the final phase of an integrity DD. It refers to the review of financial and other relevant records of the target, and analysis of specific transactions, to further understand the general nature of the target's day-to-day transactions. There may not be a need to undertake transaction testing where the principal considers the intelligence gathered by the investigator during the earlier phases sufficient to take a decision. However, transaction testing may disclose information not earlier provided, as well as corroborate intelligence previously gathered.

Typically, the general ledger, trial balance and other financial books of the target are reviewed by the investigator (this may also be covered during financial DD). Thereafter, a number of transactions are selected (depending on the scope agreed by the principal and the investigator), and the supporting documentation maintained for

those transactions analysed to understand the nature and purpose of each transaction. There might be a need to have further discussions with personnel in relation to some selected transactions, or to undertake further background check procedures, during transaction testing.

Transaction testing is usually *exception-based*. This means that the investigator is specifically looking for one or more instances of non-compliance, rather than trying to assess the overall level of compliance of the target. While objectivity and fairness are key qualities every investigator should possess, it is important to point out that even one case of non-compliance may be enough to impose legal liability. The investigator's samples should be informed by its experience in other forensic engagements as well as specific intelligence that had already been disclosed during the present integrity DD exercise.

Lessons and Conclusion

Having discussed business intelligence and DD extensively in this paper, the takeaway in our view is simple.

- Business intelligence should be instilled as a function in any business looking to compete in today's complex and shrinking business environment.

- Due Diligence should be done not as a mere tick-box requirement of a deal, but as a core part of the deal and aligned to the business plan, corporate vision and deal strategy. DD should also be commissioned for general commercial transactions in order to minimise risks.

- It is advisable to retain the services of a solicitor with commercial awareness and who understands the role of strategy in DD, to coordinate the DD process. This solicitor will among other things oversee the retention of other professional advisers as well as review their engagement letters in order to agree on scope and liability. The solicitor will also liaise with other professional advisers to ensure that the central strategy underlying the deal is at the focal point of investigations and addressed in the reports.

About Niccom LLP

At Niccom LLP, we advise on due diligence, Mergers and Acquisitions, and we understand the intricacies of deal making and structuring. We are happy to advise you on structuring and negotiating that deal irrespective of the side of the deal you are negotiating from, be it the buy-side or sell-side or even a merger properly so-called.

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