

## The Importance of Due Diligence Investigations: Failed Mergers and Acquisitions of the United States' Companies

■ by *Wendy B. E. Davis\**

Mergers and acquisitions have become a favored method for expanding a business, both nationally and internationally. Companies compete globally for the opportunity to acquire or merge with other businesses. This frenzy of activity includes multi-billion dollar transactions, like HCA or AOL and Time Warner, as well as smaller mid-market acquisitions.

In this highly competitive market, it is common to overlook the careful investigation that should preclude any acquisition decision. Ideally, acquiring corporations should carefully investigate all information pertaining to the business to be acquired before either party discusses the possibility of an acquisition. In the real world, many deals are sealed, with signed letters of intent<sup>1</sup> or term sheets, with buyers having only limited knowledge of the seller, often based on public information. In these cases, the buyer expects the lawyers, accountants, and other investigators to gather information to confirm the buyer's expectations of value and potential synergies as quickly as possible so the deal can be finalized.

Whether the investigation occurs before the preliminary handshake, or after the offering price and significant terms have already been agreed to, the buyer should use due diligence to investigate the company to be acquired before the transaction is consummated and documented.<sup>2</sup> This investigatory process is similar regardless of whether the structure chosen

---

\* Associate Professor at Albany Law School, New York, U.S.A. She can be contacted at "wdavi@albanylaw.edu".

<sup>1</sup> A letter of intent is generally a non-binding proposal to agree, with no liability incurred by either party if the transaction is not consummated. See, e.g., *Apex Equity Partners Inc. v. Murray*, 18 Misc. 3d 1137, 2008 WL 498468, No. 111623/2006, N.

<sup>2</sup> The term "due diligence" originated in the Securities Act of 1933, 15 U.S.C. § 77 k, in reference to the duties of a director to make disclosures in public offerings. Although the term is not defined by statute, it is generally viewed as an assessment of the legal risk, evaluation of the viability of the target, and a review of disclosure obligations. See David A. Katz, "Due Diligence in Acquisition Transactions", PLI Course Handbook 2003 at 581.

is an asset purchase, stock acquisition, or merger. The term ‘seller’ as used herein is intended to indicate any target of such a transaction. The process is also necessary regardless of whether the seller and buyer operate exclusively in one country, or if foreign entities and laws will be implicated. Buyers who neglect this process, or who are less than diligent in their investigations, may hope to rely on the seller’s representations and warranties. Courts have found such reliance to be unreasonable, and therefore denied a buyer’s claim of harm as a result of a breach of those representations and warranties, where the buyer did not sufficiently investigate to discover the seller’s problems, as will be discussed in Section II, below.

### **I. THE PURPOSES OF A DUE DILIGENCE INVESTIGATION**

When a company is considering the acquisition of a target, the purposes of a due diligence investigation include:

1. To ascertain the appropriate purchase price to be paid by the buyer, and the method of payment, including earn outs;
2. To determine details that may be relevant to the drafting of the acquisition agreement, including the substance, extent, and limitations of representations and warranties and any relevant escrow or hold-back agreement for a breach of the same;
3. To evaluate the legal and financial risks of the transaction;
4. To evaluate the condition of the physical plant and equipment; as well as other tangible and intangible property to be included in the transaction;
5. To analyze any potential antitrust issues that may prohibit the proposed merger or acquisition;
6. To determine compliance with relevant laws and disclose any regulatory restrictions on the proposed transaction; and
7. To discover liabilities or risks that may be deal-breakers.

Appointing appropriately skilled members of the due diligence team is critical to ensure the information is adequately understood and its impact accurately evaluated. Time and costs will, of course, play a role in the identification of team members, but buyers should avoid a situation where potentially significant information is disclosed to a representative of the buyer who is not sufficiently skilled or qualified to recognize the risk. Buyers need to keep an open mind, so that risks and liabilities will not be underestimated in the enthusiasm of the transaction.<sup>3</sup>

---

<sup>3</sup> See, generally, the HA2003 Liquidating Trust v. Credit Suisse Securities (USA) LLC, 517 F.3d 454 (7<sup>th</sup> Cir. 2008) (illustrating the dangers of ignoring negative information).

After the due diligence investigation has been completed, two important steps remain. The first is to create a detailed written report of the investigation results. This report can be an important tool for both parties, as evidence of the disclosures made by the seller and knowledge of the buyer.<sup>4</sup> This tool may be important in developing a plan to incorporate the information into the transaction agreement, as well as in any subsequent litigation.<sup>5</sup>

The second step, which is equally as important as the investigation but is often overlooked, is analyzing the information and determining the impact such information should have on the proposed transaction. An action plan should be developed to strategize what to do with the information disclosed, including what additional information is necessary or what additional actions, investigations, or warranties by the seller should be pursued. A buyer that determines that information disclosed by the seller is not significant, such as potential liabilities, may be precluded from a subsequent claim for recovery based on those liabilities.<sup>6</sup>

## II. PROBLEMS RESULTING FROM LESS-THAN-DILIGENT REVIEW

Courts are hesitant to provide a remedy to a purchaser that neglects the due diligence process, either by failing to adequately investigate or by ignoring the information discovered.<sup>7</sup> In 2000, a manufacturer of promotional products acquired a start-up company with electronic commerce experience for \$240 million.<sup>8</sup> The start-up had never made a sale, and was “burning through venture capital at \$3 million a month.”<sup>9</sup> The business consultant hired to do the due diligence informed the buyer’s chief executive officer that the start-up’s revenue projections were “wholly speculative exercises.”<sup>10</sup> The buyer decided to acquire the start-up notwithstanding this warning, causing the buyer to file for bankruptcy protection just one year later.<sup>11</sup> In a suit attempting to shift the blame to the investment banker that issued a fairness opinion, the court denied recovery, finding that the investment banker was contractually obligated to rely on the start-up’s projections, even though the buyer had knowledge that these projections were unrealistic.<sup>12</sup> The court also refused to blame the investment banker for not foreseeing the end of the dot-com boom,

---

4 For a case where the knowledge of the buyer was harmful to the buyer’s claims, see *U.S. Lubes, LLC v. Consolidated Motor Oils, Inc.*, 2008 WL 140798 (N.J. Super. Jan. 16, 2008) (finding buyer breached a duty of good faith and fair dealing by setting an unrealistic sales goal that determined the price paid to seller, when buyer’s actions prevented seller from achieving the sales goal and buyer knew of the lower profit margins of those sales.)

5 See, e.g., *Boston Edison Co. v. U.S.*, 80 Fed. Cl. 468, 492 (Fed. Cl. 2008) (citing the buyer’s due diligence field notes as evidence).

6 See, e.g., *Via Christi Regional Medical Center, Inc. v. Leavitt*, 509 F.3d 1259, 1277 (10<sup>th</sup> Cir. 2007) (“the consolidating parties’ due diligence before the consolidation revealed that the risk from these contingent liabilities was acceptably low[...] [the buyer] cannot now make a mountain out of what it previously determined to be a molehill.”)

7 See generally, Wendy B. Davis, *The Importance of Due Diligence Investigations in Mergers and Acquisitions*, 11 N.Y. Business Law Journal 24 (Spring 2007).

8 *The HA2003 Liquidating Trust v. Credit Suisse Securities (USA) LLC*, 517 F.3d 454, 455 (7<sup>th</sup> Cir. 2008).

9 *Id.* at 455.

10 *Id.* at 456.

11 *Id.* at 456.

12 *Id.*

when the buyer had failed to request an update of the opinion.<sup>13</sup> As this case shows, buyers may become emotionally involved in the enthusiasm for the merger, causing them to ignore negative information when it is discovered, which can lead to disastrous results.

In a recent District of Maryland case, *Sherwood Brands v. Levie*,<sup>14</sup> the court denied recovery to a buyer who alleged fraud and misrepresentation by a seller. The buyer paid \$2 million for the stock of a candy cane manufacturer, following a 21-day due diligence review.<sup>15</sup> The buyer did not receive all of the information it requested in its due diligence checklist, but decided to close notwithstanding the omission. The buyer alleged reliance on projections of future income prepared by the seller. After the closing, the buyer discovered that the seller was not as valuable as the buyer had hoped, in part because numerous liabilities were not disclosed, including a failure to fully fund employees' 401K pension plans and unpaid unemployment taxes. The court found that the buyer could have discovered these liabilities and did not have a right to rely on income predictions made by the seller, as such were mere puffery.<sup>16</sup> The buyer assessed the risk associated with the deal and made a calculated decision about the level of due diligence it wanted to conduct prior to closing the merger transaction.<sup>17</sup>

In accord with the *Sherwood Brands* case, other courts have not been sympathetic to buyers who complete acquisitions without adequate due diligence, denying recovery to "sophisticated businessmen" who make "errors in judgment."<sup>18</sup> In a 1995 Southern District of New York case, the court denied recovery for fraud<sup>19</sup> alleged by the purchaser in a \$400 million deal, where the purchaser had agreed to a due diligence period limited to 17 days, even though the seller's key personnel made themselves unavailable for much of the 17-day period.<sup>20</sup> The court found that the buyer had waived its right to terminate the agreement based on the results of their investigation, and therefore could not complain that it reasonably relied on the seller's representations as to projected future income which did not materialize. The court did not make a determination as to recklessness, instead analyzing the buyer's actions as lacking reasonable reliance.

13 Id. at 458; see also *Joyce v. Morgan Stanley & Co. Inc.*, \_\_\_ F.3d \_\_\_, 2008 WL 3844111 (7th Cir. 2008) (finding no liability in issuer of fairness opinion); Tariq Mundiya, "Fairness Opinions: Courts Scrutinize Role of Investment Banks", 239 N.Y.L.J. 5 (2008).

14 *Sherwood Brands, Inc. v. Levie*, No. Civ. RDB 03-1544, 2006 WL 827371 (D. Md. March 24, 2006), aff'd 2007 WL 4622915 (4th Cir. Dec. 28, 2007).

15 Id.

16 Id. at \*13 ("to the extent that Leonard Levie made any projections about Asher's future performance, such as projecting a profit for Asher for 2002, or expressed general opinions concerning potential synergies that may result from a merger between the two companies, it was unreasonable for Sherwood to rely on such predictions.").

17 Id. at \*13 ("the securities fraud laws cannot be an insurance policy for cases where a sophisticated business entity comes to believe, post-closing, that it has paid to much for another company.").

18 *Manufacturers Hanover Trust Co. v. Drysdale Sec. Corp.*, 801 F.2d 13 (2d Cir. 1986); *Harsco Corp. v. Bowden*, No. 94 Civ. 6191 (LMM), 1995 WL 152523 at \*7 (S.D.N.Y. Apr. 5, 1995); *Silva Run Worldwide Ltd. v. Gaming Lottery Corp.*, No. 96 Civ. 3231 (RPP), 1998 WL 167330 (S.D.N.Y. 1998) ("Having agreed in writing that it had only relied on publicly available information ..., and its own investigation of these companies, in deciding to participate in these offerings, plaintiff, run by sophisticated investors involved in a multimillion deal, cannot now, faced with an investment gone bad, claim that it relied on material misrepresentations and omissions as to material facts by [the seller].").

19 Based on the antifraud provisions of the Securities Exchange Act of 1934, § 10(b), as amended, 15 U.S.C.A. § 78j(b).

20 *Harsco*, 1995 WL 152523 at \*7.

Although most courts now agree that the buyer's reckless conduct, rather than simple negligence, will preclude a buyer's recovery for a seller's fraudulent failure to disclose, recent decisions have denied recovery based on a finding that the buyer's reliance on the seller's statements or projections was not reasonable, because the buyer was given the opportunity to discover the accurate information. A leading case illustrating this principal is *IBP v. Tyson Foods*.<sup>21</sup> Tyson Foods had agreed to buy IBP for \$4.7 billion in 2001, after a 25-day due diligence investigation. Four months later, Tyson brought suit to terminate the merger, claiming it relied on oral representations made by IBP officers that were misleading.<sup>22</sup> The Delaware Chancery Court granted specific performance to IBP, refusing to allow the buyer to rescind the merger agreement, finding that the buyer could not reasonably rely on oral representations when the written contract stated that only representations expressly included in the written agreement were part of the bargain. The court noted that *caveat emptor* (buyer beware) was still the rule, especially when sophisticated business entities were involved. Because the court found no duty in the seller to disclose, buyers must be cautious and comprehensive in asking the relevant questions.

A more recent Delaware Court likewise denied a buyer's claim of fraud where the buyer failed to demand accurate financial information, and failed to understand the information provided by the seller.<sup>23</sup> The court ultimately determined that the buyer's lack of business skill caused the failure of the business post-acquisition.<sup>24</sup>

In a ruling contrary to the *IBP* decision, the same Delaware court found that a buyer was not precluded from alleging fraud by a buyer in *Cobalt Operating, LLC v. James Crystal Ent. LLC*.<sup>25</sup> The court recognized that a due diligence investigation is expensive, and therefore buyers may negotiate for representations in the contract to alleviate the need to verify minute details of the seller's business.<sup>26</sup> Because the seller made representations regarding the accuracy of its financial statements, the court found the buyer's reliance on such representations to be reasonable, and the buyer's failure to discover the fraud was reasonable because it was intentionally hidden by the seller.<sup>27</sup> This decision should be a warning to sellers to use caution when making representations, but buyers should remain cautious in relying on representations as a substitute for due diligence, as the previously discussed cases show.

Sellers should exercise caution when stating an opinion as to the quality of the product or service sold or the potential for future profits. Such

---

21 *IBP, Inc. v. Tyson Foods, Inc.*, 789 A.2d 14 (Del. Ch. 2001).

22 *Id.* at 73.

23 *Homan v. Turoczy*, No. Civ. A. 19220, 2005 WL 2000756 (Del. Ch. Aug. 12, 2005).

24 *Id.*

25 *Cobalt Operating, LLC v. James Crystal Ent. LLC*, NO. Civ. A. 714 – VCS, 2007 WL 2142926 (Del. Ch. July 20, 2007).

26 *Id.* at \*28.

27 *Id.*

statements are generally referred to as “puffery,” and usually do not result in liability under traditional common law. Notwithstanding this tradition, a District of Kansas court found that statements could amount to fraud where the statements were made by an insider and related to actual past or present facts and not merely predictions, and where such statements resulted in an increase in the market price of the security purchased.<sup>28</sup> The court was considering the 1999 proposed acquisition of Sprint by WorldCom for \$129 Billion. The merger eventually was blocked by the Department of Justice because of antitrust concerns.

Buyers of manufacturing companies also need to be aware of successor liability for potential product liability claims. A buyer that fails to conduct an adequate due diligence investigation of the seller’s product defects, and potential future liability for past wrongdoing, may be liable for punitive damages for its own direct misconduct in failing to warn others of dangers that could have been discovered in an adequate due diligence investigation.<sup>29</sup>

Buyers considering an acquisition should be skeptical and tenacious in their investigations of the seller and the seller’s business. Sellers should avoid making unrealistic predictions as to future profits, and exercise caution in their promises to potential buyers. Careful drafting of the agreement, including disclaimers, representations, warranties, and remedies, will benefit both parties.

### III. THE SCOPE OF A DUE DILIGENCE INVESTIGATION

Many experienced buyers, and the attorneys who represent them, will use checklists to remind them of issues to review in their due diligence investigation. Sample checklists are available on-line, in most M&A treatises, and in the archives of law firms; however, the value of such forms is limited and attorneys should use them with skepticism. It is critical to customize any checklist to reflect the specific issues of each deal, and to think creatively rather than rely on a form. For example, one transaction was rolling along smoothly with the buyer in the final stages of a due diligence review, when a representative of the buyer did an internet search of a key employee of the seller and learned the employee had changed his name several years ago. Although there was no evidence that the name change was for fraudulent purposes, there was sufficient suspicion that the venture capitalists financing the deal immediately backed out and the deal fell apart.<sup>30</sup> Checklists should be only a starting point to your investigation. The following are some of the broad topics that should be reviewed.

#### A. Organizational Status

<sup>28</sup> *In re Sprint Corporation Securities Litigation*, 232 F. Supp. 2d 1193, 1216-1217 (D. Kan. 2002).

<sup>29</sup> See Douglas R. Richmond, *Product Liability: Corporate Successors and the Duty to Warn*, 45 *Baylor L. Rev.* 535, 583-84 (Summer 1993).

<sup>30</sup> Confidentiality requirements prevent disclosure of the identity of the transaction.

The buyer will need to confirm that the seller has filed all necessary documents of incorporation, as well as current annual reports, to ensure it is duly organized as a corporation, limited partnership, LLC, or other entity. Corporate Articles of Organization or Certificates of Limited Partnerships are filed in the offices of the Secretary of State, and such records are open to the public. Corporations that do business in more than one state will need to register to do business as a foreign corporation in each state in which they operate. The failure to register in each state may result in invalidity of contracts or penalties. The determination of what actions of the corporation will qualify as doing business in each state depends on the laws of each state, but owning real estate, maintaining an office, and employing local employees will require registration in most states.

The buyer will also want to confirm the identity of the officers and directors of the seller, as well as their authority, to ensure that all transaction documents are properly executed and authorized. Minutes, notices, and votes of shareholder and director meetings should be reviewed to ensure appropriate approval of the intended transaction.

Any defensive measures adopted by the seller, such as shareholders' rights to purchase additional shares, or limitations on directors' terms or authority, should be investigated and evaluated for their impact on the intended transaction.

### **B. Contractual Obligations**

The buyer should review all contractual obligations of the seller, including supplier agreements, joint venture agreements, leases, licenses, employment agreements, and financial obligations. The buyer will need to determine which contractual obligations it will assume, and whether the proposed sale to the buyer will result in a default or other consequences under any contract, based on change-in-control provisions. Exclusive dealing arrangements will need to be analyzed to disclose any conflicts with the buyer's existing contracts. Accounts payable to vendors, as well as debts owed to banks and others, should be confirmed and considered in any calculations of value of the acquisition.

### **C. Labor**

The buyer may want to retain key employees of the seller, either temporarily to facilitate the change in control or to continue as long-term employees. Employment contracts with such employees should be reviewed to determine obligations for salary, bonuses, and benefits, and whether the sale will trigger any additional compensation, as well as covenants not to compete should the employees decide to leave. Union contracts should also be reviewed, as well as grievance logs or complaints.

The status of any non-citizen employees should be reviewed. Visas and

other immigration permits are often dependent on an employer/sponsor, and if the name or identity of the employer will be different after the merger, this may have significant consequences for the employee. If the U.S. Citizenship and Immigration Services (USCIS) determine that a visa has become invalid as the result of a merger, a key employee may be prohibited from re-entering the country. Even more damaging, if an employee whose visa has been invalidated has traveled outside the U.S. and returned without informing the USCIS of the change in status, she may be deemed to have committed entry fraud, which is a lifetime bar from ever entering the U.S.<sup>31</sup>

Criminal background checks and employment histories of the key employees, founders, and officers should be considered. An internet search may also be revealing.

#### **D. Insurance**

Insurance contracts should be reviewed for sufficiency of coverage, conflicts with buyer's insurance agreements, and compliance by seller. Insurers should be notified of the change of ownership.

#### **E. Tax**

Tax returns for several prior years should be reviewed and the IRS and local taxing authorities should confirm payment of all taxes owed, including payroll, excise, real estate, and income taxes.

#### **F. Accounting**

In 2002, Congress enacted the Sarbanes-Oxley Act, Pub. L. No. 107-204, 116 Stat. 745 (2002), 15 U.S.C. § 78 et seq. (2000). This act requires the managers of publicly owned corporations to certify that the financial statements of the corporation fairly represent the financial affairs of the corporation. As soon as the acquisition is completed, the managers of the buyer must make these representations as to the seller. The buyer must be certain that the seller, who may be a non-publicly traded corporation and therefore exempt from compliance with Sarbanes-Oxley, has used proper accounting standards in preparing accurate and complete financial statements. Many sellers are hesitant to represent such compliance to the buyer, because their accounting practices may not be as detailed or rigorous as required, and in fact this may be one reason the seller has chosen to sell rather than go through the process of an initial public offering to become publicly traded.

#### **G. Employee Benefits**

Employee benefits such as retirement and disability plans should be reviewed to determine compliance with IRS regulations. Funding of such

31 See Mark Ivener, "Stopped at the Border", HR Magazine, Vol. 51, No. 6, June 2006.

benefits should be reviewed by experts. The buyer will want to know if any benefits or compensation will be triggered by the proposed sale. The impact of the transaction on any employee stock option plan (ESOP) should be evaluated.

## **H. Litigation and Product Liability**

Outstanding lawsuits should be reviewed to determine potential liability that may be assumed by the buyer, as well as threatened litigation. Consider the case of Bristol-Myers acquiring Medical Engineering Corporation (MEC) in 1982. MEC manufactured silicone breast implants which had not been FDA approved. Such approval was not required, because the U.S. Food and Drug Administration (FDA) provided that implants could be sold without approval, but safety and effectiveness data could be required at some unspecified future date.<sup>32</sup> When the FDA demanded the data in 1988, the FDA deemed the data submitted by Bristol-Myers and other implant manufacturers to be inadequate and called for a voluntary moratorium on the sale of the implants. Even though the FDA never stated that the implants were not safe, but merely that the information relating to their safety was inadequate, a panic was caused by the announcement, resulting in a flood of lawsuits. The cases against Bristol-Myers, Dow Corning, 3M, and other manufacturers of breast implants resulted in a \$4.25 billion settlement.<sup>33</sup> Predicting potential liability can be challenging. Although Bristol-Myers may have conducted an extensive due diligence review, and MEC was not lacking any required approvals, the results were devastating. A more thorough review should have revealed the potential for a future demand by the FDA for statistics, as well as MEC's lack of preparedness for such a demand.

## **I. Environmental Liability**

Hazardous waste site assessments may be appropriate for all real estate owned or occupied by the seller. Because the contaminator may be liable for clean-up costs even after the property is sold, buyers may also need to assess properties that have been sold by the seller. Buyers may be liable for clean-up costs as operators or owners of the acquired real estate.

## **J. Valuation of Acquisition**

Financial projections, which are the only reasonable indicator of the worth of the acquisition to the buyer, are merely an educated guess as to future performance. The buyer will need to study the market and customer base of the seller and predict the influence of the transaction on those customers. Customers of the seller should be contacted to determine any quality control issues or other product inadequacies, as well as to verify accounts receivable. Competitors should also be considered, to determine

<sup>32</sup> 21 U.S.C. § 360 (c); see also William M. Brown, "Grandfathering Can Seriously Damage Your Wealth: Due Diligence in Mergers and Acquisitions of Medical Device Companies", 36 *Gonz. L. Rev.* 315 (2000-01).

<sup>33</sup> William M. Brown, *supra* note 33, at 324.

how the seller performs relative to the competition and the competitors' future predictions regarding the market.

### **K. Antitrust**

If either the buyer or seller has a significant market share or few competitors, the Hart Scott Rodino Act, 15 U.S.C. § 18a, may require an advance notice of the merger to be sent to the Federal Trade Commission. If the industry is heavily regulated, then the regulating authority may require notification or approval, for example the Federal Communications Commission, Federal Aviation Administration, or Food and Drug Administration.

### **L. Foreign Regulations**

Many U.S. companies are acquiring businesses in China, Brazil, and other emerging economies. Local counsel should be retained early in the process to analyze local laws to determine the permissibility of the transaction, and to provide a more in-depth determination of any additional legal consequences of the transaction.

### **M. Intellectual Property**

All patents, copyrights, trademarks and trade secrets owned by the seller need to be identified and cataloged. The level of review will depend on the value assigned by the buyer to such assets. If the buyer's primary purpose in making this acquisition is to acquire a key product to enhance its product line, then the patent or copyright protecting rights in that product will become much more important. The buyer will need to ensure that the patent is owned by the seller corporation, and that the employee who invented or created the product is not claiming individual rights. Any licensing of the patent will need to be reviewed. The claims of the patent will determine exactly what rights the company has to exclude others from manufacturing or marketing similar products. If the patent was not artfully drafted in the first place, a buyer may find that his most valuable asset is worthless because competitors can reverse engineer or work around it.

### **N. Document Retention**

The buyer will need to learn the location of all documents, including financial and tax records, human resources records, and government compliance evidence. The buyer will need to be satisfied that the seller has retained adequate records for an appropriate period of time to meet the standards set forth in relevant federal and state regulations, as well as to comply with the buyer's internal policies.

## **IV. CONCLUSION**

Companies that are planning an acquisition or merger should plan to

devote sufficient time and resources to discover potential problems with the seller. A failure to carefully review may result in a determination that the buyer is not reasonable in relying on the statements of the seller, and the buyer may be precluded from bringing an action against the seller if fraud is discovered after the sale is consummated. Undisclosed potential liabilities may negate any value of the acquisition and result in financial ruin for the acquirer.

---

## A SAMPLE DUE DILIGENCE CHECKLIST

### 1. Organization

- Obtain copies of the articles of incorporation and confirm the identity of officers, corporate name, and business.
- Confirm filing of all required annual reports.
- Review states where the seller is doing business and confirm registration.
- Review by-laws for authority of officers to sign transaction documents.

### 2. Contractual Obligations

- Obtain copies of all contracts with suppliers and determine penalties and potential liability for failure to continue contract post-acquisition. Determine any exclusivity provisions that may conflict with exclusive deals of the buyer.
- Obtain copies of all contracts with customers and determine whether terms can be complied with post-acquisition. Determine if contract will be valid if identity of target as seller changes.
- Review all contracts for existing and potential default by the seller.
- Review all leases and other administrative contracts.

### 3. Labor

- Obtain list of all employees who are non-citizens and visa details.
- Review union agreements.
- Review any employment agreements.
- Order criminal record checks on all key employees and officers.

### 4. Insurance

- Review all insurance policies, confirm effective dates and payment of all required premiums, and notify insurers of change

of ownership.

#### 5. Tax

- Confirm with IRS and state and local taxing authorities that all income and payroll taxes are current.
- Review tax returns and compare to financial statements.
- Confirm with town and county that real estate taxes are current.

#### 6. Accounting

- Review all financial records for Sarbanes-Oxley compliance.
- Discuss revenue recognition policies and practices with accounting manager.

#### 7. Employee Benefits

- Confirm funding of pension plans.
- Review health insurance contracts.
- Develop integration plan for employee benefits to ensure consistency.

#### 8. Litigation

- Review all complaint or dispute correspondence.
- Review all litigation, including Westlaw, Lexis, and internet searches.
- Discuss potential liability with legal counsel.
- Review all required approvals from regulating agencies.

##### Environmental

- Obtain hazardous waste site assessment on all real estate owned or occupied by seller within the past 5 years.
- Check with local authorities for reports of underground storage tanks.
- Confirm with U.S. DEP and state agencies for compliance.

##### Valuation of Acquisition

- Determine the seller's market size, share, and projected potential.
- Analyze how any anticipated new regulations will affect the market.
- Research whether any new technologies could impact the market.
- Identify the seller's largest customers and evaluate the likelihood that such customers will remain after the merger.
- Determine what new products, services, or innovations are currently being developed by competitors.
- Analyze how the seller compares to its competition in terms of service, customer loyalty, and quality.
- Predict necessary future capital expenditures.
- If the seller is to be carved out of its parent, determine what new stand-alone costs may be required for services formerly performed by the parent.
- Evaluate the potential for future cost reduction synergies as a

result of the merger.

- Identify any product quality issues by reviewing returns or customer complaints.

#### 9. Antitrust

- Analyze market share to determine violations of antitrust regulations.
- Determine whether notification to Federal Trade Commission will be required.

#### 10. Foreign Regulations

- Establish relationships with local counsel to determine any additional local laws that will impact the proposed transaction.

#### 11. Intellectual Property

- Identify and catalog all patents, trademarks, and copyrights claimed by the seller, the date, location, and number of registration, and the registered owner.
- Review any license agreements, whether seller is the licensor or licensee.
- Review patent applications and claims to ensure that technology is appropriately covered.
- Review procedures for protection of trade secrets.