From Due Diligence to Share Purchase Agreement: How to Turn a Multi-Jurisdictional Due Diligence Report into a Top Notch Stock Purchase Agreement

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Goals of Due Diligence in M&A

• Seller
  – Avoid discounts, particularly for adverse selection (market for lemons)
  – Push risk onto purchaser by disclosure
• Purchaser
  – Leverage to negotiate price and terms
  – Making sure it gets what it pays for
Tools for dealing with Due Diligence Issues

• Adjusting price and terms
  – Normally, the “great equalizer”, which will work where all other methods fail.
  – Very low added transactions cost
  – Possibly sub-optimal for problems valued differently by buyer and Seller

Tools for dealing with Due Diligence Issues

• The General Law
  – Mostly only considered by Civil Law lawyers
  – Not justified, the law is not usually an “ass”
  – Very low transaction costs, gets the problem off the negotiating table
  – Particularly appropriate for thorny issues with a low probability of occurring (empty box)
Tools for dealing with Due Diligence Issues

• **Representation and warranties**
  – Depending on “knowledge qualifiers” and remedies, can eliminate or reduce a problem or just provide protection against bad faith of the seller, which itself helps to eliminate adverse selection.
  – Typically with baskets to prevent uneconomic claims and caps to protect a seller’s reservation price.
  – **Schematic approach** often is value-destructive; consider your business case (perhaps as a seller you might exceptionally prefer rescission to damages).

Tools for dealing with Due Diligence Issues

• **Conditions**
  – **Checklist** function
  – For *essentialia negotii*, e.g. delivery of shares, the only possible solution
  – Can result in an **option**, so need to consider economics (Black Scholes valuation, etc.)
Tools for dealing with Due Diligence Issues

• **Indemnification**
  – A tool to avoid a discount for a particular problem
  – Creditworthiness of seller and any security or
    holdbacks are key
  – From the seller’s standpoint, consider the risk of
tactical use of such tools, since
  * Possession is 9/10 of the law and
  * Such tools can result in transaction / enforcement costs

Tools for dealing with Due Diligence Issues

• Changing Deal Structure
  – Changing ***Share Deal to Asset Deal*** may leave liabilities
    with seller, where no successor liability applies or the
    seller indemnifies the purchaser.
  – Changing an ***Asset Deal to a Share Deal*** may preserve
    contracts, concessions, tax losses, etc. that otherwise
    would be lost.
  – A ***split Share/Asset Deal*** across countries is possible.
  – In some cases, creditworthiness or practicality (numerous
    shareholders) will mandate a ***holdback or escrow***
    arrangement.
Unconventional Tools

• Earn-Outs
  – Not usually considered a tool for due diligence issues but can work that way depending on formula.
  – Indeed, sometimes there is overcompensation

• Repurchase Obligations
  – Often used for current assets, i.e. debtors, inventory
  – Can be used for any assets (e.g. real property)