

Introduction

The Manual on Acquisition Review has been prepared to provide examples of the factual and legal issues to be considered by the attorney for the purchaser of a business in advising his or her client regarding the negotiation of the terms of the transaction and, more particularly, the consummation of the acquisition. This introduction describes the basic orientation and expectations for its usefulness in the myriad of acquisition situations business lawyers may encounter.

The acquisition review procedures contained in the Manual were drafted with reference to the same prototype transaction reflected in the Model Stock Purchase Agreement, namely, an acquisition of all of the stock of a privately held corporation (frequently referred to as the "target") from a small number of individual shareholders (frequently referred to collectively as the "seller"). The Manual necessarily contains references to certain inquiries that are applicable to asset acquisitions or to acquisitions of divisions of other corporations, both public and private; but analysis of acquisition review procedures designed exclusively for those transactions has been excluded from this volume.

The Manual generally adopts the viewpoint of counsel for the purchaser, although it is expected that counsel for the seller will find use for these materials in assisting his or her client in avoiding liability for inaccurate representations. For the purchaser's counsel, education regarding the target is an evolving process, in which counsel generally will have rather superficial information regarding the target at the time the drafting of the acquisition agreement commences and an abundance of detail at the time the transaction is ready to close. Because there is such a great variety of circumstances under which a lawyer will be called upon to draft an acquisition agreement, no attempt has been made to identify lines of inquiry particularly applicable to the drafting stage. Substantially all of the procedures described in this volume contemplate an intensive inquiry into the affairs of the target designed to give the purchaser, at the time of closing, a high level of confidence as to the accuracy and completeness of the seller's representations.

The user of the Manual should have in mind that the following chapters deal only with the condition of the target and do not address other important issues arising under laws of general applicability that the purchaser's counsel must consider, such as the effect of federal or state antitrust laws on the transaction, or compliance with regulatory requirements (e.g., Public Utility Holding Company Act). Similarly, the Manual does not deal directly with other matters that generally are of concern to the purchaser's counsel, such as negotiations with the purchaser's sources of financing, the accuracy of the purchaser's warranties in the transaction, and information about the principals of the target where it is contemplated that they will become principals of the purchaser. The Committee believes, however, that the techniques and results of a properly conducted acquisition review are relevant to such matters.

It is not expected that lawyers will undertake, in any particular transaction, each of the investigations and procedures described in this volume, and no inference is intended that a failure to conduct all such investigations is a breach of professional standards. The Committee has attempted to be comprehensive in its description of review procedures; but it should be emphasized that, first, the Committee makes no recommendation that any inquiry described in the Manual is essential in all transactions and, second, that the Committee expects that certain inquiries that have not been included here will be appropriate in particular situations. It is for the client to determine the scope of the investigation, taking into account the lawyer's advice regarding the possible benefits and the costs and risks of alternative approaches. Among the factors that may influence the breadth and depth of inquiry are the following:

- a. Much depends on the business being acquired: intellectual property is the essence of some businesses, and of no consequence in others; some enterprises may have significant exposure to defective product, environmental, or employee benefit liabilities, and others do not. The purchaser's counsel may approach a target company that has a law department and an internal auditor and that has audited financial statements quite differently from a company that does not have well established routines and systems of internal and independent reviews.
- b. The purchaser's judgment regarding the benefit of certain review procedures, or time constraints resulting from business needs, may preclude the sort of investigation the lawyer would prefer. A client may choose to close by year-end, even if that means curtailing the scope of the pre-purchase review.
- c. The lawyer's role may expand or contract, depending on what other advisers are assisting the client. If the client has retained an investment banking firm, accountants, an industrial hygienist, an actuary, an insurance consultant, special patent counsel, and two or three other specialized advisors, the transaction lawyer may have less to do than if he or she is the client's sole adviser.
- d. The cost-benefit analysis may result in a less-extensive review if the purchaser has confidence in the practical effectiveness of its right to recover for any misrepresentation made by the seller, including self-executing remedies such as an escrow or a right of offset.
- e. The scope of the review may depend on what the seller will tolerate. If the target is a competitor of the purchaser, it is likely that the scope of the investigation will be negotiated between the parties and will be limited to certain documents.

If the client chooses a less extensive review than the lawyer believes may be warranted in the circumstances, the lawyer, for the sake of the client and for his or her own sake, should advise the client of the attendant risks. In addition, it often is prudent to reassess the scope of review as the client learns more about the target, either through the review or through statements made in the course of negotiating the acquisition agreement. Chapter 1 of this Manual offers suggestions on educating and coming to an understanding with the client regarding the work to be done.

The pre-closing review conducted by counsel for the purchaser in an acquisition often is compared to the "due diligence investigation" conducted by an underwriter and its counsel in a securities offering. That investigation is intended to preserve the defense for certain participants in the offering stated in Section 11(b)(3) of the Securities Act of 1933 that such participants "had, after reasonable investigation, reasonable ground to believe and did believe" that the offering materials were accurate and were free of material omissions. Although there are many similarities in the procedures that would be followed by counsel in both the securities-offering and the acquisition contexts, there are fundamental differences in the purpose and scope of those engagements that should not be confused.

The standards applicable in a "due diligence" investigation have been shaped essentially as a result of litigation in which the courts have been sensitive to the position of the often unsophisticated securities purchaser having no access to direct negotiations with the issuer. The conduct required of a person seeking to assert the due diligence defense against the defrauded securities purchaser, and hence the responsibilities of the counsel for the person seeking to preserve that defense, reflect considerations that may not be applicable to the infinite variety of acquisition transactions. In particular, as this introduction emphasizes, the responsibilities of the purchaser's counsel will be shaped in each case by the client's perception of its actual needs; and those responsibilities may be reassessed during the course of the transaction as a result of numerous factors, including the purchaser's perception of risk and the safety of its contractual

protections. Although the bibliography to this volume includes references to materials relating to the Section 11(b)(3) due diligence defense, the standards recommended in those materials, while helpful in formulating an approach to pre-acquisition review, should not be viewed as establishing requirements for the purchaser's counsel in acquisition engagements.

A frequent question in acquisition review is whether a particular issue relating to the target company should be referred to a specialist in that field of law. There is no universal answer to that question; its resolution depends, like most other issues of the scope of review, upon the client's cost-benefit determination in light of all of the circumstances. When the purchaser's counsel is a large, full-service firm, the lawyer in charge of the acquisition review usually refers certain issues to his or her colleagues who are specialists in relevant areas, at least for preliminary advice whether further analysis is required. In situations in which the firm representing the purchaser does not have broad expertise, the client, having been advised by the lawyer of the limits of the lawyer's knowledge and experience, may nonetheless wish the lawyer to take a first look at particular issues, deferring a decision on the employment of a specialist until the transaction lawyer has made an assessment of the risks. In a smaller transaction the client may not wish to assemble a team of specialists from each area mentioned in the following chapters and may not be able to find a single lawyer who has mastered all of these areas. The client may choose to take the risks attendant to its lawyer's limited competence and to agree with the lawyer that it will not look to the lawyer for advice on specific matters beyond the lawyer's competence. In such situations the lawyer will wish to be satisfied that the client has been fully informed and that there is no misunderstanding as to the scope of the lawyer's engagement. The materials in this volume attempt to point out areas and signs of danger and to help the generalist better advise the client on the hiring of specialists.

The conduct and scope of an acquisition review also inevitably is shaped by the dynamics between the parties in each case, and the lawyer may be required to exercise the same skills in the completion of an acquisition review as are required in the negotiation of an agreement. In some cases, the seller takes the position that it will warrant as little as possible and disclose no more than is necessary to get the purchaser to complete the transaction. In such situations, the seller generally is uncooperative with the purchaser's counsel's efforts to uncover potential commercial liabilities or violations of law, and counsel is forced to spend time and effort to probe for information. On the other hand, a seller may be willing to be candid about its problems, but anxious not to do anything that might make them worse. Counsel for the purchaser can be sensitive to the seller's concerns while at the same time protecting the purchaser's interests. For example, counsel should not needlessly require that a document be created that might be discoverable in pending or subsequent litigation; it is doubtful whether there is an attorney-client, work product, or joint-defense privilege for acquisition disclosure documents. Similarly, purchaser and seller may agree that it is appropriate for purchaser's counsel, rather than seller, to engage consultants for certain purposes; in certain cases it may be unwise to have a formal environmental assessment if the parties are not prepared immediately to remedy any condition that may be reported.

The acquisition of a business is as challenging a transaction as the practice of business law can offer. The stakes generally are high, both in financial and personal terms, and the path from signing an acquisition agreement to closing the transaction is never free from the unexpected disclosure and never without anxieties and uncertainties. The Committee on Negotiated Acquisitions, in this Manual and in its companion Model Stock Purchase Agreement, has attempted to identify and organize the issues that arise in acquisitions in a way that will give the practicing lawyer confidence in representing clients in acquisition transactions..