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SECTION 1

INTRODUCTION

INTRODUCTION

1.1 The concept of due diligence originated in the US Securities Act 1933. This included a defence which could be used by brokers or dealers when accused of inadequate disclosure to investors of material information about shares being brokered. Effectively, as long as the brokers or dealers conducted a 'due diligence' investigation into the company whose equity they were selling, and disclosed to the investor what they found, they would not be held liable for non-disclosure of information that failed to be covered in the process of that investigation. It did not take long before it became standard practice to conduct due diligence investigations, initially in relation to public offerings, but over time with private mergers and acquisitions as well.

1.2 The concept of 'due diligence' was therefore born. Today a working definition of due diligence would be: the process of investigation through which a potential purchaser gains a complete understanding of the target business or its assets for acquisition, evaluating both the strengths and the weaknesses of the business and reaching conclusions as to whether to proceed with a purchase, reduce the price or restructure the transaction.

1.3 The difficult economic conditions in recent years have lifted due diligence to higher prominence. Somewhat ironically, perhaps in response to their own failings, the banks now place much greater significance on due diligence. This is not just in the context of corporate lending, but in their general business banking criteria. Businesses also are taking a much more vigilant approach to all their significant contracts and are evaluating suppliers on the stability of their corporate structure as well as on price. Due diligence is no longer the preserve of large-scale corporate transactions. It is a living breathing part of daily business life. There is no better time to understand its potential as a powerful business tool both in gaining competitive advantage and in minimising business risk.

OBJECTIVE OF THE GUIDE

1.4 The objective of this Guide is to provide business owners, entrepreneurs, investors, business angels, early stage and general practice

lawyers and accountants with an understanding of the purpose of legal due diligence and the tools required to undertake the process. The Guide deals with due diligence in the context of private companies both in day-to-day business and more particularly in corporate transactions whether asset purchases or share purchases. It does not include reference to public companies, neither does it offer any detailed advice on tax and financial matters which would normally be covered by accountants involved in the transaction.

1.5 The text is supplemented by a series of Sample Documents which form the principal documents required in a due diligence process. They are accompanied by notes on their applicability and use.

1.6 The intention is to give straightforward practical advice in plain English. With the aim of keeping the text of this manual concise, a directory of useful links is included in this introduction at **1.11**.

STRUCTURE

1.7 Following this introductory section, the book is split into six further sections as follows:

- **Section 2** covers the purpose of due diligence and the impact it may have on the structure of the proposed transaction.
- **Section 3** reviews the process of disclosing information to the buyer and issues of confidentiality.
- **Section 4** deals with obtaining and reviewing the information to be gathered through a due diligence process.
- **Section 5** looks at some specific areas where issues commonly arise in more detail.
- **Section 6** considers the process of post-completion integration.
- **Section 7** contains Sample Documents with explanatory notes and guidance, which are both also included on the accompanying CD-ROM.

LIMITATIONS OF ADVICE AND HEALTH WARNING

1.8 The advice is intended to be readable and intelligible at the same time as being accurate. However, some of the issues are complex and there is only scope within this Guide to provide an overview. Consequently, if

any advice or suggested Sample Document does not fit the particular facts, specific advice from a specialist lawyer should be obtained.

1.9 Although every care has been taken in the preparation of this Guide, neither the author nor the publisher shall be liable for any misstatement or inaccuracy, nor any indirect damage including loss of profit. The law stated is accurate at December 2012.

1.10 Reference to any organisation or body or the provision of any website address does not constitute a recommendation by the author or the publisher, nor does it imply that any of these parties has verified the accuracy of any information provided by that organisation or body.

DIRECTORY OF USEFUL LINKS

1.11 Public registers can be found on the following websites:

- Companies House
www.companieshouse.gov.uk
- Intellectual Property Office
www.ipo.gov.uk
- Land Registry/Land Registry Charges
www.landregistry.gov.uk
- Insolvency Service
www.bis.gov.uk/insolvency/personal-insolvency/individual-insolvency-register
- Companies Court
www.justice.gov.uk/courts/rcj-rolls-building/bankruptcy-and-companies-court
- Trade Marks Registry/Patent Office/Designs Registry
www.ipo.gov.uk/tm.htm
- Press searches
<http://news.bbc.co.uk>
- Agency searches
www.dnb.co.uk
www.lexisnexis.co.uk

particularly so if this results in a data room being used (see 2.31–2.38). The buyer will need to weigh all of these factors when instructing external advisers and be prepared to adjust the approach should matters emerge which require more detailed enquiries. The box below summarises these considerations.

Scoping due diligence

- (1) What is known already about the target business?
- (2) What is known already about the industry and any inherent risks?
- (3) Balance the financial commitment and associated risk in proceeding with the transaction against the cost of an extensive review.
- (4) Are there time constraints such as imminent changes in tax regimes or tax deadlines to consider?
- (5) Is the seller unwilling to release sensitive information?

RELATIONSHIP BETWEEN BUYER AND SELLER

2.12 Some of the most successful due diligence exercises result when there is a good working relationship established between the seller and the buyer. The basis for this is the establishment of trust between the parties which is supported by a legal framework.

2.13 From the seller's perspective confidentiality is a key issue. The seller will be providing detailed information about its operations with no certainty that the deal will proceed. The seller therefore needs to be comfortable that in releasing such confidential information the business will not be jeopardised in future should the transaction fail. Agreeing a Confidentiality Agreement from the outset is therefore vital (see **Sample Document 2**).

2.14 Meanwhile, the buyer wants to know that there is a realistic prospect of the seller selling the business before committing significant resources to undertaking a thorough due diligence review. Therefore, the buyer would usually seek to have a period of exclusivity during which the seller agrees not to negotiate with any other potential buyers. This is often contained within a set of Heads of Terms which set out the key terms on which the buyer will make the acquisition, provided that the due diligence review supports the assumptions that were made in putting the terms together.

2.15 Even with these legal parameters having been set, there remain a lot of tensions in this information-gathering phase between the seller and the buyer. Confidentiality Agreements can be difficult to enforce in

practice and therefore the seller may often be reluctant to give free access to the buyer to all information about the business. In particular, where the buyer is a competitor, the seller may be concerned about releasing sensitive information until there is a high certainty of the deal proceeding. The seller will want to do all it can to ensure that its customers, suppliers and key staff are not approached. For some sellers, the very knowledge that the business is for sale can create difficulties, for example, customers and staff may become unsettled and move elsewhere, which can be hugely damaging to the ongoing business. Therefore, the seller will often only include key senior managers in the due diligence process and keep knowledge of the potential sale confidential from all other staff. This will often require meetings to be conducted off-site.

2.16 Whilst this provides comfort for the seller, it can restrict the amount of information that the buyer can access. It is not uncommon for the buyer to want to have access to the target business's premises, which can perhaps be managed by out-of-hours visits or meetings being arranged as part of a routine inspection so as not to arouse suspicions. Senior staff will often be more candid than the seller about their hopes and fears for the business, having an incentive to impress potential new owners and therefore the buyer will want to have some opportunity to meet with them. Where there are large key customers, the buyer may want to meet with them too to ensure that the sale will not prejudice any ongoing key relationship.

2.17 There is, therefore, a key role for the professional advisers in balancing these conflicting interests and ensuring that sufficient information is available to allow decisions to be made as to whether or not a deal can proceed. The box below suggests some practical means to deal with this.

The confidentiality versus clarity conundrum

- (1) Build a trusting relationship between principals.
- (2) Sign a Confidentiality Agreement.
- (3) Grant a period of exclusivity for the buyer.
- (4) Release information in tranches, leaving sensitive information until there is greater certainty of the deal proceeding.
- (5) Consider practical steps to reduce the risk of confidentiality breaches such as reducing the number of people with access to the data.

ACCESSING INFORMATION

2.18 The key tool in soliciting information about the target business is the Due Diligence Questionnaire. This forms the basis of the enquiries

Arguably the main purpose of warranties is to extract information before the purchase is concluded. When the seller is faced with real liability there is a greater incentive to make frank disclosure. The buyer is then in a position to decide whether to adjust the price, withdraw from the purchase or seek some specific indemnities. The disclosure letter is therefore a key document in an acquisition. This is even more so in an auction sale where limited time to conduct due diligence is available. In these circumstances, the disclosure letter may be the main source of information on the target.

HINTS AND TIPS FOR SELLERS IN PREPARING THE DISCLOSURE LETTER

3.5 The following box provides some useful hints and tips for the seller in preparing the disclosure letter:

Hints and tips for seller in compiling the disclosure letter

- (1) Disclose everything relevant even if the buyer is already aware.
- (2) If in doubt as to relevance, it is better to include reference to a matter and explain why it has been included.
- (3) Retain copies and index documents provided as due diligence responses. Use these as the basis of the disclosure bundle.
- (4) Update information up to completion as the business continues to operate.
- (5) Make enquiries of all relevant personnel.

HINTS AND TIPS FOR BUYERS IN REVIEWING THE DISCLOSURE LETTER

3.6 The following box provides some useful hints and tips for the buyer in reviewing the disclosure letter:

Hints and tips for buyer in reviewing disclosure letter

- (1) Obtain a first draft as early as possible to give time to seek further information.
- (2) Index copies of due diligence documents as received and distribute for review with all relevant advisers.
- (3) Investigate fully late disclosures or refuse to accept them.
- (4) Ensure the impact of a disclosure is fully understood.
- (5) Flush out problems rather than leaving them until after completion to resolve.

BUYER'S KNOWLEDGE

3.7 Most purchase agreements contain a provision that completion of the transaction does not amount to a waiver by the buyer of any breach of the agreement (including breach of warranty) by the seller, whether or not known to the buyer at the date of completion. Further, buyers often include wording to the effect that warranties are only qualified by matters 'fully, fairly and specifically' disclosed in the disclosure letter. This is because it is not always possible for the buyer to appreciate the implications of a disclosure with its limited knowledge of the target business. Sellers often seek to resist this type of wording.

3.8 There is some doubt as to the legal ability for a buyer to rely on such a clause where it does in fact have actual knowledge. Accordingly, if a buyer becomes aware of an undisclosed issue which is of concern, it should not rely on the courts treating the knowledge as irrelevant. The prudent buyer will seek specific indemnification from the seller or a reduction in the purchase price.

FULL, COMPLETE AND FAIR DISCLOSURE

3.9 It is in both parties interests for disclosures to be fair and complete; the buyer wants to obtain full knowledge and the seller wants to avoid liability for a warranty claim. If disclosure is inadequate then it may be insufficient to preclude a claim for breach of warranty.

3.10 There have been numerous cases determining what amounts to a 'fair' or 'complete' disclosure. The safest approach is to be clear in the purchase contract what the parties have agreed in this regard. A buyer should therefore seek to include a general principle that for a warranty to be qualified '*there must be fair disclosure of facts and circumstances in sufficient detail to identify the nature and scope of the matter disclosed and to enable the buyer to form a view*'. Sellers may try to preclude any complaint that disclosure has been insufficient by including the following wording in the disclosure letter:

'Where brief particulars only of a matter set out or referred to in this letter, or a document is referred to but not attached, or a reference is made to a particular part only of such a document, full particulars of the matter and the full contents of the document are deemed to be disclosed and it is assumed that the buyer does not require any further particulars.'

Buyers should resist such a provision on the basis that it should have a right of action unless a fair disclosure has been made. It is arguable that the onus should be on the seller to determine what disclosures are required by the warranties, not the buyer.

4.4 The Articles of Association of the target business should be inspected for any pre-emption rights that exist in relation to the transfer of the shares on a share purchase. On the basis that in most cases the entire issued share capital of the target business is being sold, this is not normally a problem as in the sale and purchase agreement each seller can agree to waive any pre-emption rights attaching to their shares. However, if only a proportion of shares are being sold, the buyer will need a written waiver of pre-emption rights from those shareholders who are retaining their shares.

4.5 In both a share purchase and an asset purchase the buyer will need to be sure that the seller has the ability to enter into the sale and purchase agreement and to sell the shares or assets concerned. This can be checked in a number of ways:

- Where the seller is a company, the Memorandum and Articles of Association should first be checked to establish that they contain power for the company to sell the shares or assets concerned and to ensure that the directors are authorised to exercise that power without any restriction. The buyer should also request a copy of the minutes of the board meeting authorising the sale. When checking these minutes the buyer should make sure that the meeting has been held in accordance with the company's articles (for example, was it quorate, was proper notice given, were any other special requirements met?), that directors' interests have been properly declared and that those individuals proposing to sign the sale agreement have been duly authorised to do so by the board. It is also prudent for the buyer to check at Companies House whether the company is in receivership, administration or liquidation as different procedures will then apply for authorising the transaction.
- Where the seller is an individual the buyer must first make sure that the seller is not a minor as contracts made by a minor can in some instances be set aside. A bankruptcy search in the Land Charges Registry should then be carried out and if there is any outstanding bankruptcy order or a bankruptcy petition then the consent of the trustee in bankruptcy or the court respectively will be required for the sale to proceed.

4.6 In both a share and asset purchase the buyer should investigate the corporate structure of the seller. It is also worth checking the certificate of incorporation and any certificates of incorporation on change of name of the target business or of the seller as appropriate just to make sure that the target business is the correct entity. The Memorandum and Articles of Association of the target business will then reveal whether the target business is currently operating within its constitution. In a share purchase the buyer will also want to check that there are no unreasonable restrictions on the directors and their ability to manage the target

business's affairs and that the objects clause is wide enough to cover all the activities that the buyer has planned for the future of the business. The buyer will also want to know about the wider group, particularly any companies in which the target business holds shares and all the due diligence enquiries will need to be made also against those subsidiaries.

4.7 If there have been any recent sales or acquisitions within the target business, then there may be ongoing warranties and indemnities in relation to which the buyer may either need the benefit or be subject to the burden. An assessment of risk would need to be made as to the impact of these on the buyer.

ACCOUNTS

4.8 The buyer's in-house or externally appointed accountants would normally undertake the majority of the financial investigations. It is, however, usual for some enquiries also to be made within the legal due diligence process. These would normally focus on obtaining copies of the annual audited accounts for the last 3 years and in the case of a share purchase, the management reports and accounts of the target business going back a similar period of time. Copies of bank statements would also usually be obtained in both a share and asset purchase as would an analysis of the fixed asset balances, the capital expenditures and the working capital balances. The debtor's position should be reviewed, together with any extended credit terms agreed with any customer.

BORROWING/FINANCE

4.9 The comments in this section will on the whole apply more to a share purchase than an asset purchase. However, for an asset purchase it will be important for the buyer to ensure that all assets are transferred free from any charges.

4.10 The buyer will need details of all loans, borrowings or other facilities made available to the target business. These will often terminate on a change of control and therefore a buyer in a share purchase will need to negotiate with the lender if it wishes to maintain the facilities. In an asset purchase, if the facilities relate to the business that is transferring, the buyer will need to understand what needs to be done in order to close down the facilities and ensure that there is no early repayment or other penalty for closing the account.

4.11 Copies of all debentures, mortgages and charges will need to be obtained, particularly those that are secured over the assets of the target business. These will often be repaid or discharged at completion and therefore the buyer will need to obtain all necessary releases and discharges at the point of completion.

ELI

- (1) Identity and age (but not addresses).
- (2) Information contained in the employees' written particulars of employment as prescribed by s 1 of the Employment Rights Act 1996.
- (3) Details of any collective agreements.
- (4) Details of any disciplinary proceedings or grievances in the previous 2 years where the Acas Code of Practice on Disciplinary and Grievance Procedures (Acas Code) applied.
- (5) Details of any legal action taken against the seller in the previous 2 years or where the seller has reasonable grounds to believe that such action might occur.

5.4 The above information must be provided in writing or in 'other forms which are accessible to the transferee' which might include computer data files or even in the case of a small business with few employees, over the telephone. There is no obligation to provide original documents and a summary of the information would seem to be sufficient.

5.5 The ELI must be provided not less than 14 days before the transfer, or as soon as reasonably practicable if for some reason this is not possible.

5.6 If anything changes in the information provided, the seller must provide written notification of this to the buyer.

5.7 If the seller does not provide the relevant employee information, the buyer can bring a claim in the employment tribunal within 3 months of the date of the transfer. The employment tribunal will assess the amount of damages that is just and equitable having regard to the buyer's loss and the contractual terms agreed between the seller and the buyer. There is a minimum payment (currently £500) for each employee in respect of whom defective or no information was provided.

5.8 In some instances identifying which employees are transferring can be more complicated, for example where individual staff work across the business and not just in the part that is being sold. Unfortunately, there is no set test regarding the proportion of an employee's time spent in each part of the business to determine whether an individual will transfer or not. The courts have tended to look at the facts in each particular circumstance. It is therefore important for both the buyer and the seller to identify and seek advice in relation to any of these 'split duties' employees.

Consultants, contractors and agency workers

5.9 In a share sale the target company will remain bound by the terms of any contracts with consultants and contractors, so the main issue for a buyer in this instance is to understand the commitments that will be taken over.

5.10 For a buyer in an asset purchase, TUPE will only transfer employees working 'under a contract of service' to the buyer. This does not include consultants and contractors who 'provide services under a contract for services'. To the extent that any consultants or contractors are supplying essential services, the buyer will need to enter into a separate agreement with them.

5.11 With regard to temporary workers who are engaged through agencies, in an asset purchase it is unlikely that these will transfer with the business under TUPE as they are not employed by the seller. Even in a share purchase, such workers can have their working arrangements terminated without any liability on the part of the target company (subject to any claims under the Agency Workers Regulations 2010 (SI 2010/93)).

Employee share incentive scheme and pensions

5.12 Employee share incentive schemes (ESISs) and pensions can cause particular complications in a transaction and are often a cause of any significant adjustment to the price. The following table summarises the issues:

Common issues with ESISs and pensions

- (1) An ESIS may include shares that the buyer will want to acquire as part of the transaction.
- (2) Obligations to account for income tax and national insurance contributions through PAYE can arise after completion of the transaction.
- (3) Corporation tax relief in relation to ESISs may be lost on completion.
- (4) The buyer may be required to put in place similar arrangements post-completion.
- (5) In recent years under-funding of pension schemes has become a significant issue.
- (6) Historic pensions commitments may pass to a buyer.

5.52 The last of these is perhaps the most difficult to control as it includes people over whom the organisation has little control such as agents, subcontractors and other intermediaries as well as employees, contractors and suppliers. To be guilty of this offence the organisation does not need to be aware of the corrupt conduct. Individual senior officers can also be convicted for giving their consent or conniving to give or receive a bribe.

5.53 A commercial organisation will have a defence if it can demonstrate that it had in place 'adequate procedures' to prevent bribery.

Risks for a buyer

5.54 The Bribery Act does not include a concept of successor liability and therefore the buyer itself will not be liable for acts of the target company. However, there are still risks for a buyer acquiring a business which may have been involved in corrupt practices. The following box sets out the potential for these in both the context of an asset and share sale:

Risks for a buyer

Share purchase

- Target company could be prosecuted for corrupt acts that took place prior to the acquisition resulting in loss of revenues though unlimited fines
- Future revenues may depend on continued corrupt practices and contracts obtained through improper payments may be lost
- Gross revenue from any contract or asset obtained as a result of corrupt conduct could be confiscated by the Serious Organised Crime Agency as proceeds of a crime
- Reputational damage through association with target company
- Loss of key senior employees who are prosecuted or personally liable for corrupt conduct of target company
- Loss of public sector contracts
- Remedial costs of implementing new procedures

Asset purchase

- Senior employees whose contracts transfer under TUPE may be prosecuted or face personal liability for corrupt conduct in the target business
- Gross revenue from any contract or asset obtained as a result of corrupt conduct could be confiscated by the Serious Organised Crime Agency as proceeds of a crime

- Future revenues may depend on continued corrupt practices and contracts obtained through improper payments may be lost
- Gross revenue from any contract or asset obtained as a result of corrupt conduct could be confiscated by the Serious Organised Crime Agency as proceeds of a crime
- Damage to goodwill of target business
- Reputational damage to buyer through association with target company
- Remedial costs of implementing new procedures

If corruption continues to take place after completion the buyer could also be liable for failure to prevent bribery if no new adequate procedures have been implemented.

Risk indicators

5.55 Initial information that can be obtained publicly that might indicate a corrupt practices risk in a potential target are as follows:

High level risk indicators

- (1) **Sector or industry:** some sectors such as oil and gas and construction are considered more prone to corruption
- (2) **Jurisdictions in which target operates:** in some jurisdictions corruption is perceived to be higher than others
- (3) **Large involvement of third parties:** if business has been conducted through many intermediaries the risks could be higher

5.56 The Serious Fraud Office identify the following as corruption indicators:

Corruption indicators

- (1) Unusual payment patterns
- (2) Lavish gifts being received
- (3) Payment of unusually high commissions
- (4) Abnormal cash payments made
- (5) Missing documents or records

5.57 The above areas should therefore be considered as part of a due diligence exercise in addition to the questions on bribery set out in the due diligence questionnaires at **Sample Documents 3 and 4** in **Section 7**.

SELLER(S)

Lawyers

Firm address:
Switchboard:
Facsimile:

Partner:
Email:
Direct Dial:

Assistant:
Email:
Direct Dial:

Secretary:
Email:
Direct Dial:

Accountants

Firm address:
Switchboard:
Facsimile:

Partner:
Email:
Direct Dial:

Assistant:
Email:
Direct Dial:

Secretary:
Email:
Direct Dial:

Foreign lawyers

Firm address:
Switchboard:
Facsimile:

Partner:

Email:
Direct Dial:

Assistant:
Email:
Direct Dial:

Secretary:
Email:
Direct Dial:

<http://www.tbbookshop.com>

- 9.6 If any court or administrative body of competent jurisdiction finds any provision of this Agreement to be invalid, unenforceable or illegal, the other provisions of this agreement shall remain in force.
- 9.7 If any invalid, unenforceable or illegal provision would be valid, enforceable or legal if some part of it were deleted, the provision shall apply with whatever modification is necessary to make it valid, enforceable and legal.
- 9.8 A variation of this Agreement or waiver of any right under this Agreement shall be in writing and signed by or on behalf of all parties.
- 9.8 No failure to exercise or delay in exercising any right or remedy provided under this Agreement or by law constitutes a waiver of such right or remedy or will prevent any future exercise in whole or in part thereof.
- 9.10 This Agreement and any disputes or claims arising out of, or in connection with, its subject matter are governed by and construed in accordance with English law and the parties irrevocably agree that the courts of England and Wales have exclusive jurisdiction to settle any dispute or claim that arises out of or in connection with this Agreement.

This Agreement has been entered into on the date stated at the beginning of it.

Schedule**Particulars of Sellers**

Name of Seller	Address	Fax number

Signed by [Name of Individual Seller]

Signed by [Name of Individual Seller]

Signed by [Name of Director] for and
on behalf of [Name of Seller] Director

Signed by [Name of Director] for and
on behalf of [Name of Buyer] Director

Signed by [Name of Director] for and
on behalf of [Name of Target] Director

<http://www.tbocshop.com>

3.7	Provide schedules breaking down the fixed asset balances annually for the last [three] years for each asset with an original cost exceeding £[amount] and showing original cost, additions and replacements, maintenance costs incurred, depreciation, net book value, revaluations and appraised values (if any), and currency of payment.	
3.8	Provide schedules of capital expenditures in excess of £[amount], committed or contemplated, showing quarterly estimated expenditure and basis of estimate, currency of expenditure, proposed funding, start date and completion date and anticipated future benefit for the business.	
3.9	Provide schedules breaking down working capital balances on a quarterly basis for the last three years showing major categories of current assets and liabilities. Show losses/provisions made or contemplated with respect to working capital items and the identity, where applicable, of the defaulting counterparty. Provide details of any stocks of more than £[amount] which are damaged or which are regarded as obsolete.	
3.10	Details of the following systems in respect of the Target [and the consolidated Target Group] business corporate planning, budgetary control, internal control, costing, stock recording and control, evaluation of stock and WIP, sales order and invoicing system, purchase order, debtor and creditor control, payroll, electronic data processing (EDP) controls and treasury management and foreign exchange management, including any procedural manuals relating to the same.	
3.11	Details of debtors including:	
3.11.1	an up-to-date list of aged debtors;	
3.11.2	details of any debtors included in the most recent audited accounts which have not been paid in full and for which provision has not been made in full in such accounts;	

3.11.3	details of any debt which has become due in the current accounting year which has been waived or disputed and has been or is expected to be unpaid in full within [60] days of the date of the invoice; and	
3.11.4	any extended credit terms agreed with any customer.	
4.	Borrowings/Finance	Document Number
4.1	List of all bank accounts in which the Target has an interest and details of highs and lows for those accounts over the last year.	
4.2	Details of all loans, borrowings or other facilities (whether or not currently drawn down) existing on [date] made to the Target by a third party or by the Target to a third party specifying whether or not such loans or facilities provide for payment of interest and, if so, the rate.	
4.3	Copies of all debentures , debt factoring agreements, mortgages, charges, letters of credit or other documents relating to any financial facilities of any type made available to or by the Target including hire purchase, credit sale agreements and loans to employees and details of any other arrangements having the commercial effect of borrowing or lending or which are not completely covered by the copy documents above.	
4.4	Details of any guarantee, security , indemnity, suretyship or comfort given by or for the benefit of any part of the Target.	
4.5	Is the Target in breach of any obligation or covenant or has it received any notice requiring repayment or discharge of any loan or financing?	
4.6	Details of the Target's loan capital set out as follows:	
4.6.1	the authorised and issued loan capital distinguished by type;	

9. Contractual Arrangements	Document Number
9.1 Details and copies of contracts in relation to the Target which fall into the following categories:	
9.1.1 long-term agreements , being an agreement which either cannot be terminated, in accordance with its terms, on [six] months' notice or less or is unlikely to have been fully performed, in accordance with its terms, more than [six] months after the date on which it was entered into or undertaken or is for a fixed term of more than [six] months;	
9.1.2 contracts which are of an unusual, onerous or abnormal nature or not wholly on an arm's length basis;	
9.1.3 contracts of a loss-making nature ;	
9.1.4 contracts which cannot readily be fulfilled or performed on time without unusual or excessive expenditure of money or effort ;	
9.1.5 contracts which are entered into other than in the ordinary course of business ;	
9.1.6 contracts which require the Seller to pay or receive consideration in excess of £[amount];	
9.1.7 contracts which involve payment by reference to fluctuations in the retail price index or other index or in the rate of exchange of any currency;	
9.1.8 contracts which involve the supply of goods or services the aggregate sales value of which will represent in excess of [percentage] per cent of the anticipated turnover of the Target in the next [12] months;	

9.1.9 any contract which will require notice to be given to the other party, will require the consent of the other party, will relieve any party to the contract of any of its obligations, will become subject to termination by reason of the sale of the Target to the Buyer;	
9.1.10 any contract which involves the Target and another company within the Target Group; and	
9.1.11 any contract which could give rise to a liability or incur costs on the part of the Target in excess of £[amount].	
9.2 A complete list and copies of all marketing, agency, distribution, purchasing, manufacturing or licensing agreements , distinguishing between those agreements under which the Target has been appointed as a distributor or agent and those under which the Target has appointed a third party as its distributor or agent.	
9.3 Description of any subcontracting arrangements , identifying in particular those upon which the Target is dependent for maintenance of production or supply.	
9.4 Copies of any standard terms of purchase or supply on which the Target operates.	
9.5 Description of principal customers of the Target accounting for more than [percentage] per cent of turnover, identifying any arrangement upon which the Target is particularly dependent.	
9.6 Details of any joint venture , consortium, partnership or other unincorporated association of which the Target is, or has agreed to become, a member and any agreement or arrangement for participating with others in any business sharing commissions or other income to which the Target is, or has agreed to become, a party.	
9.7 Details of any material default by any party under the contracts which are referred to in this section.	

14.15	Confirmation that the Target is a trading company for all tax purposes and that the Target is not and never has been a close company.	
14.16	Details of any taxes including social security levies which are payable in non-UK jurisdictions and are equivalent to PAYE and National Insurance contributions in the UK.	
14.17	Details as to the dates of the most recent review of PAYE/NIC or similar arrangements by relevant taxation authorities indicating also the findings of such reviews.	
14.18	Details of any non-cash remuneration elements which are subject to PAYE/NIC or the non-UK equivalent and supply copies of any special dispensations from the relevant tax authorities upon which the Target relies.	
14.19	Confirmation of the Target's status for VAT (or the non-UK equivalent) purposes including details of registration and whether or not the Target is Grouped together with other companies for these purposes and that it has complied with all requirements in relation to VAT.	
14.20	Details of any outstanding liabilities in respect of stamp or capital duty or any other type of transfer or sales or issue taxes payable by the Target either in the UK or in other relevant jurisdictions.	
14.21	Confirmation that the Target has kept adequate records to determine expenditure which is eligible in relation to capital allowances .	
14.22	Details of any pre-sale planning which involves or may involve the Target.	

15.	General Assets	Document Number
15.1	Have there been any material acquisitions or disposals of fixed assets since the date to which the last audited accounts were prepared or have the net assets of the Target been reduced?	

15.2	Details (including age and original cost) of material items of plant and machinery and any other assets which are material in relation to or owned or used by the Target and confirmation of the beneficial ownership of each. Are any to be excluded from the sale?	
15.3	Details (and, where relevant, copies) of any mortgage, charge or other encumbrance over the whole or any part of the assets of the Target.	
15.4	Details of any assets which are the subject of any factoring arrangement, hire-purchase, conditional sale or credit sale agreement , together with copies of the relevant agreements.	
15.5	Details of stocks including items which are damaged or have been written off since the date to which the last audited accounts were prepared.	
15.6	Has the work in progress shown in the management accounts been valued on the same basis as in the last audited financial statement?	
15.7	Does the amount of work in progress which may have to be written off since the date on which the last audited accounts were prepared exceed £[amount]?	

16.	Insurance	Document Number
16.1	Details (including premiums, renewal dates and level of cover) together with policy documents of all insurances maintained in respect of the Target or any of its assets.	
16.2	Please specify by category the numbers of claims made under its insurance policies by the Target over the past [three] years excluding road traffic claims. Please include details of any claims over £[amount].	
16.3	Details of any circumstances that may give rise to a claim under an insurance policy in the future.	

Section

1. Preliminary

Where the target business consists of more than one company or where the target business or group holds significant interests in other companies or entities, a separate Due Diligence Questionnaire should be completed for each such company or entity. Questions may also need to be raised and answered in relation to any other company in which the target business holds an interest (whether directly or indirectly).

Although the Share Purchase Agreement will contain numerous warranties covering much the same ground as answers to the Due Diligence Questionnaire, the buyer will normally expect the answers to the Due Diligence Questionnaire themselves to be warranted as true and not misleading as at the date on which the Share Purchase Agreement is entered into. The buyer may also want them to be warranted as 'complete' but the seller(s) will endeavour to avoid such a wide expression.

Answers to the Due Diligence Questionnaire will inform the warranties requested by the buyer and may also give rise to the need for additional specific warranties or indemnities to be included in the Share Purchase Agreement.

2. Constitutional/
Structural
Information

This section of the Due Diligence Questionnaire is normally quite straightforward. The Articles of Association will need to be reviewed for specific provisions such as any pre-emption rights which will need to be waived. Where there is a minority who may not wish to sell (or which the buyer may not wish to purchase) the position will need to be considered more carefully.

Often the Articles give shareholders holding a specified majority of the equity the right to compel the minority to sell their share and, equally, if there is a change of control a minority shareholder often has the right to insist on being bought out on the same terms.

Where shareholders are willing to sell shares carrying 90 per cent of the votes or value of all the shares in issue, the buyer may be able to compulsorily acquire the remaining 10 per cent under sections 979–982 of the Companies Act 2006. Alternatively the minority may be able to force the buyer to purchase their shares under sections 983–984 of that Act.

It is crucial to discover at this stage whether there are any rights under which third parties may be able to acquire shares. If, for instance, the Target itself has issued options, or granted rights which may result in third parties being entitled to subscribe for shares in the future, these may survive completion with the result that the buyer's interest would be liable to dilution.

The statutory books should always be inspected. The share register is the best evidence of legal title to shares, but the details of allotments and original share transfers should be checked to ensure a clean chain of title. The books will also contain minutes of meetings of directors and members. The former particularly may reveal commitments entered into of which the buyer may not be aware.

The buyer's solicitors should carry out the usual searches and enquiries of public registers, particularly at Companies House, where much of the material requested in this section should be filed. Any discrepancies between the public records, statutory books and the answers to the Due Diligence Questionnaire should be followed up.

On the day on which the Share Purchase Agreement is entered into, the buyer's solicitors need to check at Companies House for any late filings against the target business. They also need to check with the High Court that no winding-up petition has been filed.

2.11.4	any administrator appointed in respect of the Seller by any person entitled to appoint such an administrator pursuant to Schedule B1 to the Insolvency Act 1986 , any documents filed with the court for the appointment of such an administrator and any notice of intention to appoint such an administrator given by any such person;	
2.11.5	any composition in satisfaction of the debts of the Seller , scheme of arrangement of its affairs or compromise or arrangement between it and any of its creditors or its members or both, or any class of any of its creditors or members or both, which has been proposed, sanctioned or approved;	
2.11.6	any distress , distraint, charging order, garnishee order, execution or other process that has been levied or applied for in respect of the whole or any part of the Business or the Assets;	
2.11.7	any event that has occurred causing or which, on intervention or notice by any third party, may cause any floating charge created by the Seller to crystallise over the Business or the Assets or any of them, or any charge created by it to become enforceable over the Business or the Assets or any of them, or details of any such crystallisation that has occurred and any such enforcement that is in process;	
2.11.8	any transactions entered into by the Seller in connection with the Business which may be set aside , stayed, reversed or avoided or affected in part or whole in connection with any insolvency proceedings; and	
2.11.9	any circumstances which have given or may give rise to any of the above insolvency proceedings against the Seller, the Business or Assets.	

2.12	A full description of the Business and whether it has at all times been carried on as a going concern by the Seller.	
3.	Accounts	Document Number
3.1	Copies of the annual audited accounts for the business (including balance sheet, income statement and cash flow statement) for the last [three] years and copies of all other relevant financial information, including non-audited accounts, management accounts, financial statements and auditors reports, notes and certificates for the last [three] years.	
3.2	The accounting reference date for the business.	
3.3	Copies of the Business's bank statements from [date] to [date] and details of the Business's bankers.	
3.4	Provide schedules breaking down the fixed asset balances annually for the last [three] years for each of the Assets with an original cost exceeding £[amount] and showing original cost, additions and replacements, maintenance costs incurred, and revaluations and appraised values (if any).	
3.5	Provide details of current committed capital expenditures under contracts binding on the Business in excess of £[amount].	
3.6	Provide schedules breaking down working capital balances in relation to the Business on a quarterly basis for the last [three] years showing major categories of current assets and liabilities, losses/provisions made or contemplated with respect to working capital items and the identity, where applicable, of the defaulting counterparty. Provide details of any stocks of more than £[amount] which are damaged or which are regarded as obsolete.	
3.7	Have any extended credit terms beyond [30] days been agreed with any customer of the business?	

9. Contractual Arrangements	Document Number
9.1 Details and copies of contracts in relation to the Business which fall into the following categories:	
9.1.1 long-term agreements , being an agreement which either cannot be terminated, in accordance with its terms, on [six] months' notice or less or is unlikely to have been fully performed, in accordance with its terms, more than [six] months after the date on which it was entered into or undertaken or is for a fixed term of more than [six] months;	
9.1.2 contracts which are of an unusual, onerous or abnormal nature or not wholly on an arm's length basis;	
9.1.3 contracts of a loss-making nature ;	
9.1.4 contracts which cannot readily be fulfilled or performed on time without unusual or excessive expenditure of money or effort ;	
9.1.5 contracts which are entered into other than in the ordinary course of business ;	
9.1.6 contracts which require the Business to pay or receive consideration in excess of £[amount];	
9.1.7 contracts which involve payment by reference to fluctuations in the retail price index or other index or in the rate of exchange of any currency;	
9.1.8 contracts which involve the supply of goods or services the aggregate sales value of which will represent in excess of [percentage] per cent of the anticipated turnover of the Business in the next [12] months;	

9.1.9 any outstanding material quotations or tenders or any negotiations of material importance to the Business that are currently in progress;	
9.1.10 any contract which will require notice to be given to the other party, will require the consent of the other party, will relieve any party to the contract of any of its obligations, will become subject to termination by reason of the sale of the Business or the Assets or is not capable of assignment to the Buyer;	
9.1.11 any contract which involves the Business and another member of the Seller's group;	
9.1.12 any contract which could give rise to a liability or incur costs on the part of the Business in excess of £[amount]; and	
9.2 Description of the principal sources of supply to the Business (accounting for more than [percentage] per cent of goods supplied).	
9.3 A complete list and copies of all marketing, agency, distribution, purchasing, manufacturing or licensing agreements which are significant to the operation of the Business.	
9.4 Description of any subcontracting arrangements of the Seller identifying in particular those upon which the Business is dependent for maintenance of production or supply.	
9.5 Copies of any standard terms of purchase or supply on which the Seller operates the Business.	
9.6 Description of principal customers of the Business (accounting for more than [percentage] per cent of turnover), identifying any arrangement upon which the Business is particularly dependent and any arrangements which are significant in relation to the Business.	
9.7 Details of any material default by any party under the contracts which are referred to in this section.	

16. Insurance	Document Number
16.1 Details (including premiums, renewal dates and level of cover) together with policy documents of all insurances maintained in respect of the Business or Assets.	
16.2 Please specify by category the numbers of claims made under its insurance policies by the Seller over the past [three] years relating to the Business or Assets. Please include details of any claims over £[amount].	
16.3 Details of any circumstances that may give rise to a claim in relation to the Business or Assets under an insurance policy in the future. Has anything occurred which may make any insurance policy void or invalid or its renewal be refused or its premium increased?	
16.4 Confirmation that the Assets are, and have at all material times been, insured to their full replacement or reinstatement value in accordance with generally accepted practice.	
16.5 Does the Seller have in place, and has it had in place at all material times, insurance giving adequate cover against accident, damage, injury, third party loss (including product liability) and all other risks normally insured against by persons carrying on a similar business to the Business?	
16.6 Are any of the policies of insurance taken out by the Seller in relation to the Business or Assets subject to any special or unusual terms or restrictions , or to the payment of any premium in excess of the normal rate?	
16.7 Is the assignment of any insurance policy for the Business or Assets subject to the consent of any person other than the relevant insurance company?	

17. Intellectual Property	Document Number
17.1 Details of all patents used in the Business or pending patent applications of which the Seller is proprietor or applicant or joint proprietor or applicant, set out as follows:	
17.1.1 the registration number(s), registration dates or application number;	
17.1.2 product or process covered;	
17.1.3 date of expiry or estimated date of grant;	
17.1.4 countries in which patent is registered or in which applications have been made;	
17.1.5 whether any objections or challenges to validity or scope have been made and, if so, how likely it is that they will succeed;	
17.1.6 name of registration proprietors or applicants; and	
17.1.7 any infringements or suspected infringements.	
17.2 Details of patents used or required by the Business but which are not owned by the Seller, set out as follows:	
17.2.1 registration number, registration date and countries of registration;	
17.2.2 product or process covered;	
17.2.3 date of expiry;	
17.2.4 owner of the patent; and	
17.2.5 copy of the licence pursuant to which it is used.	
17.3 Please give complete details or supply copies of any licences or other arrangements whereby the Seller in relation to the Business is entitled to do an act in relation to a patented product or process, which would otherwise be an infringement.	