

The image features a dark blue background with a complex, geometric architectural structure of white lines and beams, creating a sense of depth and perspective. A vertical yellow bar is positioned on the left side. The text is overlaid on this background.

MAYER | BROWN

Due Diligence in M&A Transactions

June 2023

Due Diligence Objectives

- Due Diligence is:
 - Investigation of the target business or assets
 - Evaluation of factors that may have a future impact on the business or assets
 - Known issues and emerging challenges
 - Confirmation of information provided by the seller and its advisors

Objectives - Identify Risks and Confirm Assumptions

- Determine or confirm valuation
- Identify risks and potential liability exposure
- Confirm Seller/Target has title/rights to key assets
- Identify any obstacles to effecting the transaction (such as required consents or problematic exclusivity clauses)
- Confirm information provided by Seller and its advisors in management presentations or in general discussion
- Identify steps necessary to integrate the business/assets into Buyer's operations

Types of Due Diligence

- Different types of due diligence
 - Legal due diligence
 - Business due diligence
 - Accounting/financial due diligence
 - Tax due diligence
 - IT due diligence/Privacy due diligence
 - HR due diligence (covered in Part 1 of this series)
 - Other
- Due diligence varies based on the particular transaction, company, industry, etc. Due diligence applies to several types of transactions.
- Common aspects: Any due diligence exercise will include an assessment of risks and issues relating to the transaction using methods such as document review, site visits and questions posed to management and others.



General Considerations

- Deal terms (including representations and warranties and indemnification provisions) and purchase price can be materially affected by issues identified during due diligence review
- Due diligence may entail more than document review; may also include site visits, talking to customers, suppliers and key employees, management presentations, and asking follow-up questions

Importance of Effective Due Diligence

- Reduces risk (and related costs) of a failed deal
- For Buyer, contractual protections may be insufficient
 - Seller may not be willing (or able) to provide sufficient post-closing indemnification to cover all losses
 - Certain issues cannot be cured with dollars
 - Acquisition agreement may limit recovery
 - Contractual recovery likely requires formal proceeding (lawsuit/arbitration), which may be undesirable from an ongoing relationship perspective

Buyer's Due Diligence Responsibilities

- Due diligence report may be prepared
 - Summarize documents reviewed and discussions with Seller and its representatives
 - Identify and quantify any problems or opportunities and propose solutions/alternatives
 - If representation and warranty insurance is being obtained, often required by underwriter/insurer
- Identify areas where further due diligence may be warranted or desirable
- Confirm information contained in disclosure schedules
- Take due diligence findings into consideration when drafting and negotiating transaction documents

Seller's Due Diligence Responsibilities

- Data Room Preparation
 - Gather, organize and index documents obtained from appropriate business units and specialty teams
 - May be necessary to redact documents due to contractual confidentiality restrictions, “political” implications of disclosure or sensitive terms (e.g., customers, pricing, margins)
 - May be appropriate to withhold certain documents until later in the process
- Prepare Management Presentation

Seller's Due Diligence Responsibilities

- Identify any issues that need to be “fixed”
- Preparation of Disclosure Schedules
 - Seller will prepare schedules to the definitive agreement based on its own due diligence review
 - Some of the schedules will be based on information contained in the data room. Other schedules will be based on information obtained from inquiries of the relevant individuals who are responsible for the business being sold

Diligence in Asset Deals

- Identify potential liabilities that should be expressly retained by Seller or assumed by Buyer
- Contracts
 - Anti-assignment provisions
 - Default, acceleration or termination rights (e.g., in debt instruments, equity incentive arrangements)
 - Restrictions on the business, such as non-compete, exclusivity and MFN provisions
- Permits/Licenses
- Employment/Benefits matters (unique consequences in asset deals: CBAs? Pension liabilities?)
- Litigation
- Environmental matters
- IP registrations
- Other third-party consents

Diligence in Equity/Merger Deals

- Identify potential liabilities that should be subject to a “specific indemnity” right
- Contracts
 - Change of control provisions (real property leases)
 - Default, acceleration or termination rights (e.g., in debt instruments, equity incentive arrangements)
 - Restrictions on the business, such as non-compete, exclusivity and MFN provisions
- Permits/Licenses
- Employment/Benefits matters (simpler than asset deals; employment agreements)
- Environmental matters
- Other third party consents; why do third-party consents matter?
 - Key consents should be made conditions to closing
 - If consents are less important, may try and get consent post-closing or let associated contract lapse/terminate

Diligence in Minority Investments

- More limited than in acquisition of 100% of a Target
 - Primarily to support valuation and confirm Buyer is acquiring the type and amount of equity they are expecting
 - If the plan is to ultimately acquire 100% of the target, it may make sense to do more robust diligence as the Target may be less willing to go through a full diligence process for an existing investor
- Capitalization
 - Existing preemptive rights
 - Anti-dilution in favor of existing equity holders
- Confirm
 - Title to key assets (such as unique IP)
 - Key customers/suppliers will remain in place past closing

Managing the Due Diligence Process

- Organization
 - Team leader/point person
 - Allocation of responsibilities (document requests, submission of follow-up questions)
- Distribution and Tracking Plan
- Communication Plan
 - Confidentiality requirements
 - Process and timing
 - Up the chain
 - Between due diligence team and drafting team
 - Between Buyer and Seller/Target

Managing the Due Diligence Process – Scope

- Factors affecting the appropriate scope of review include:
 - Deal structure and size
 - Industry of the Target business/assets
 - Location of operations
 - Value drivers
 - Cost and time constraints
 - Identity of the Target
 - Competition
 - Robustness/detail of representations expected to be in ultimate agreement

Special Issues - Competitors

- Legal Restrictions
 - Antitrust laws may prohibit competitors from exchanging certain information prior to consummation of the transaction (*e.g.*, pricing)
- Seller/Target Imposed Limits
- Solutions
 - Redact (pricing, customer information, etc.)
 - Clean Team

IT Due Diligence in M&A Transactions

1. Proprietary Software
2. Open Source
3. Data
4. Cybersecurity
5. Other Technology

Proprietary Software

```
mirror_mod = modifier_ob.  
get mirror object to mirror  
mirror_mod.mirror_object  
operation == "MIRROR_X":  
mirror_mod.use_x = True  
mirror_mod.use_y = False  
mirror_mod.use_z = False  
operation == "MIRROR_Y":  
mirror_mod.use_x = False  
mirror_mod.use_y = True  
mirror_mod.use_z = False  
operation == "MIRROR_Z":  
mirror_mod.use_x = False  
mirror_mod.use_y = False  
mirror_mod.use_z = True
```

```
selection at the end -add  
mirror_ob.select= 1  
modifier_ob.select=1  
context.scene.objects.active  
("Selected" + str(modifier_ob))  
mirror_ob.select = 0  
= bpy.context.selected_objects  
data.objects[one.name].select  
print("please select exactly  
one mirror")
```

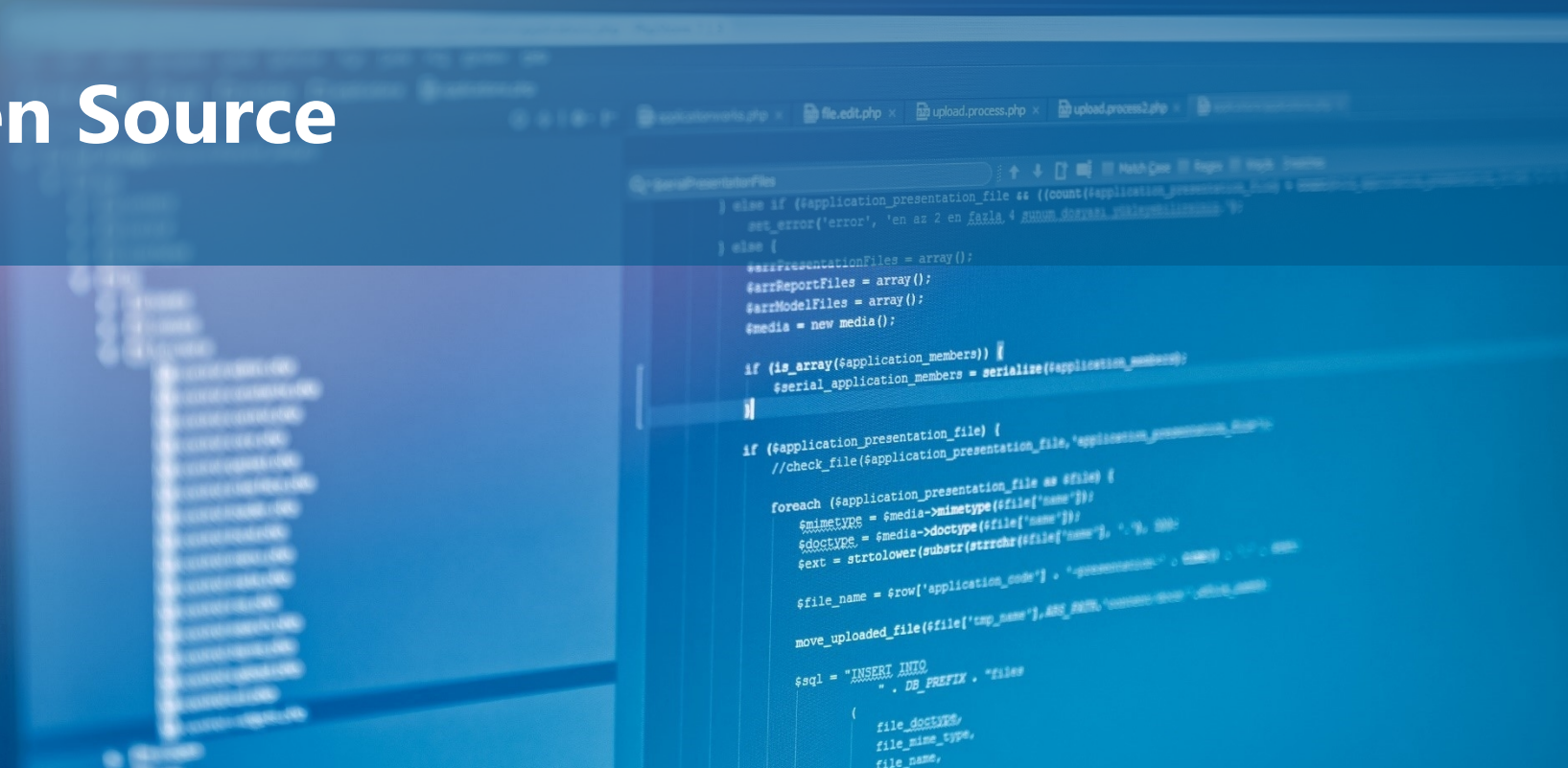
OPERATOR CLASSES -----

```
types.Operator):  
X mirror to the selected  
object.mirror_mirror_x"
```

Likely Due Diligence Areas Related to Proprietary Software Include:

- Which software is proprietary?
- How was proprietary software acquired?
 - If software was by employees, did they sign intellectual property assignment agreements?
 - Are there any gaps in the chain of title to technology that the Seller should try to address now?
- Prior disputes and particularly third-party infringement claims
- Copies of “license out” agreements
- Material disruptions or interruptions due to technology issues

Open Source



What Is Open Source?



Commercial (Closed)

Open Source

Public Domain

- No precise definition of “open source,” but understood to refer to software licensed under an “open source license”
- OSS licenses generally provide:
 - Source code availability
 - Modification rights
 - Redistribution rights
 - No license fees
 - Unlimited use

Differentiator in OSS Categories

PERMISSIVE



COPYLEFT

- Key differentiator – Reciprocal / Copyleft / Viral
 - “Copyleft” – using copyrights to keep code “free” and require distribution of source code
 - Usually triggered by “distribution,” but SaaS may also trigger
 - Code changes must be made available in source code form under the same license as the base OSS code
 - May prohibit license fees on distributed OSS code
- Permissive (no copyleft) – minimal license requirements (e.g., attribution)

Copyleft Strength

Permissive

No copyleft – e.g., Berkeley Software Distribution License (BSD); no reciprocal effect; minimal license requirements (e.g., attribution); covers file-level code changes

Weak
Copyleft

Weak copyleft—e.g., Mozilla Public License (MPL)

Strong
Copyleft

Strong copyleft—e.g., GNU General Public License (GPL); covers OSS code **changes** and **works that contain or are based upon** OSS code

Ultra-Strong
Copyleft
(AGPL)

Strongest copyleft—e.g., Affero GPL (AGPL); strong copyleft + SaaS is a type of distribution

Why Worry about OSS in M&A Transactions?

A. Key Concerns:

1. May materially undermine the value of the target company AND of the acquirer (post-close)
 - Especially important if the target company is distributing software
2. Remediation time and costs
3. Security vulnerabilities

B. Other Concerns:

1. Noncompliance
2. Infringement claims
3. Breach claims
4. Impact on licensee IP enforcement (patent retaliation clauses)
5. Failure to protect trade secrets

Due Diligence Questions Related to OSS

- Can the target company provide an accurate, real-time inventory of the open source components in use?
- What are the company's policies for use of open source, including with respect to:
 - Compliance with open-source licenses
 - Identification and remediation of known open-source security vulnerabilities and monitoring for new vulnerabilities
 - Training developers on the importance of managing open source
- Are such policies up to date and in compliance with industry standards?
 - ISO/IEC 5230:2020: International process management standard for open-source license compliance

Synopsys/Black Duck Scan

- Engage experts to review the scan, including for “false positives” or undisclosed issues
 - Technical/security review
 - Legal review
- Categorize risks and alternatives
 - Evaluate remediation alternatives
 - If on sell side, prepare a thoughtful disclosure
- Negotiate reps and warranties based on disclosed risks
- The acquirer should require rescanning of the code



Data & Data Rights

```
mirror_mod = modifier_ob.  
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operation == "MIRROR_X":  
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mirror_mod.use_y = False  
mirror_mod.use_z = False  
operation == "MIRROR_Y":  
mirror_mod.use_x = False  
mirror_mod.use_y = True  
mirror_mod.us  
mirror_mod.use_x = False  
mirror_mod.use_y = False  
mirror_mod.use_z = True
```

```
selection at the end -add  
mirror_ob.select= 1  
modifier_ob.select=1  
context.scene.objects.active  
("Selected" + str(modifier_ob.  
mirror_ob.select = 0  
= bpy.context.selected_object  
data.objects[one.name].select  
print("please select exactly
```

OPERATOR CLASSES -----

```
types.Operator):  
X mirror to the selected  
object.mirror_mirror_x"
```

Likely Due Diligence Areas Related to Data & Data Rights Include:

- What are the relevant data sets, and the sources of those data sets (e.g., generated internally, collected from customers, licensed from third-party vendors, derived from other data sets)?
 - **CAUTION:** Market data (e.g., S&P, Moody's) requires particularly close scrutiny.
- What are the rights in each data set, and the basis for such determination (e.g., relevant contracts, IP laws)?
 - What are the protections regarding quality, non-infringement, and compliance with laws?
- How is the data used currently? Is such use consistent with the corresponding rights?
 - Will Buyer continue such use post-acquisition?
 - Will the nature of use change by virtue of acquisition (e.g., based on financial services regulatory requirements)?
- Can the data be transferred as part of the transaction and, if so, on what basis?
- How will such data be used post-closing (e.g., acquisition or investment)? Is such use consistent with corresponding rights?

Cybersecurity

```
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```

Introduction: Cybersecurity

- What is cybersecurity?
 - Cybersecurity concerns the protection of electronic data and systems to prevent unauthorized access (e.g., unauthorized use by insiders or data breaches by hackers)
 - Overlaps with privacy
 - Privacy concerns the use and disclosure of personal information
- Why worry about cybersecurity in M&A transactions?
 - Key assets of the target company may include IP or other non-public data, including know-how, customer lists, personal data or other corporate assets in electronic form
 - Data breaches and cybersecurity leaks can materially undermine the value of a target company, the viability of a transaction or the productivity or goodwill of the organization
 - Risks of noncompliance, fines and lawsuits
 - Special considerations when acquiring start-ups

Likely Due Diligence Areas Related to Cybersecurity Include:

- Perform a cybersecurity scan (can be conducted as part of the Synopsys/Black Duck open-source scan)
- Ask whether there is a written information security policy (WISP)
- Determine whether the policy is up to date and consistent with current industry practice
- Does the company have a chief information security officer or similar function?
- Does the target company carry cybersecurity insurance?
- Does the target's supply chain present its own cyber risk?
- Do the target's customer agreements present risks?



Other Technologies

```
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operation == "MIRROR_X":  
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mirror_mod.use_z = False  
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mirror_mod.use_x = False  
mirror_mod.use_y = True  
mirror_mod.use_z = False  
mirror_mod.use_x = False  
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```

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```
types.Operator):  
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```

Likely Due Diligence Areas Related to Other Technology Include:

- What third-party software does the company use?
 - Copies of relevant “license in” agreements
- What third-party services does the company use (e.g., hosting agreements, outsourcing agreements, services agreements, software distribution agreements)?
 - Copies of relevant services agreements
- Review of the company’s third-party contracts
 - Compliance with financial services regulatory requirements, including cybersecurity requirements
 - Rights to use data for the acquirer’s intended purposes
- Any material performance issues with technology vendors (e.g., missed service levels, excessive downtime)
- Business continuity and disaster recovery plans

Conclusion





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