TRADITIONAL DUE DILIGENCE NEEDS UPDATING - BAKER & MCKENZIE

Posted on 26/06/2014

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Due to the incremental liabilities companies now face, the traditional method for reviewing, negotiating and protecting a purchaser in an M&A transaction has needed to be updated, according to Cecilia Pastor, partner at Baker & McKenzie Madrid and head of the corporate compliance department. These potential liabilities include fines, enforcement actions, the cost of clean-up actions, the risk of substantial loss of turnover and the ensuing loss of reputation.

"The traditional system of due diligence based on documents, and their subsequent review, is not enough from a compliance standpoint," says Pastor. "A review of documents is not likely to identify criminal or irregular behaviour – traditional due diligence checklists are geared towards the detection of legal issues and not towards the detection of irregular business practices."
Pastor adds that compliance risks should be addressed through a risk assessment exercise that should take into consideration issues including: the target's industry and nature of business; the geographic areas of operation, for example whether the target operates in high risk markets; the way

the target conducts business, that is whether it uses agents or intermediaries; whether the target´s customers include government entities; whether there is a reliance on critical permits or licences; and whether major suppliers or customers are owned by government officials.

“The answers to these questions should then enable the purchasing company to establish how far the compliance due diligence should extend and the right level of review,” Pastor says. “This will usually go beyond document review and may include management interviews, employee interviews, cash flow analysis and even an internal investigation.”

What should a savvy purchaser be worried about? Pastor says: “Concerns should include the applicability of ´successor liability´, the existence of tainted assets,and the adverse reputational impact that may bring the price of the purchasing company down.”