MALAYSIA

A business case for legal due diligence in M&A transactions

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Often in a merger and acquisition (M&A) transaction, whether with respect to the sale and purchase of shares in a company or its assets or business, the buyer will most likely insist on the right to carry out a due diligence audit over the target company (in a share acquisition) or its assets or business, as part of the condition to purchase. It is quite common for the buyer to carry out legal, financial and technical due diligence, although commercial due diligence is increasingly becoming more important.

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Practical tips for buyers

When conducting due diligence, it is important that the potential buyer requests full access to documents and information pertaining to the target company, including the right to make copies of materials or documents and the right to take such materials away from the premises of the target company for further review if necessary. Buyers should also request they be provided with exclusivity of negotiations whilst the due diligence is being carried out, particularly when the transactional agreement has not been signed by the parties.

It is also beneficial if the potential buyer requests that the seller identify one or two contact people that the buyer can liaise with, who will be able to answer questions about the target company. Preferably officers from the target company who know the company well, these people will also direct the potential buyer and its advisors to any other appropriate personnel to talk to in order to obtain the required information.

Due diligence issues

In the firm's experience of conducting legal due diligence we have encountered many issues, some of which have resulted in the buyer deciding not to proceed with the M&A transaction. Some of these issues have included:

- Irregular passing of resolutions by the Board of Directors, whereby directors have authorised transactions to enrich themselves;
- Instances where the target company has not been contributing to the Employee Provident Fund for its employees;
- Instances where the target company's contracts of employment with employees contain terms which contravene labour laws;
- Instances where the target company's conduct of business contravenes relevant and applicable laws – for example, operating in premises where a certificate of completion and compliance was never issued, or operating under expired/revoked licenses or permits;
- Instances where the target company's conduct of business breaches existing agreements with third parties.

Whilst some issues might not be 'deal-breakers' in their own right, they are often dealt with by the parties as part of the conditions for completion of the transaction. A potential buyer might request for a reduction of the purchase price, seek to set aside a portion of the purchase price in escrow to cater for issues uncovered post-completion, or seek to include stronger indemnity provisions in favour of the purchaser.

The principle of *caveat emptor* (let the buyer beware) should influence the purchaser to act prudently in an M&A transaction. Due diligence is a good step preceding an acquisition exercise which enables a buyer to make informed decisions vis-à-vis the target company or its assets/business.

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