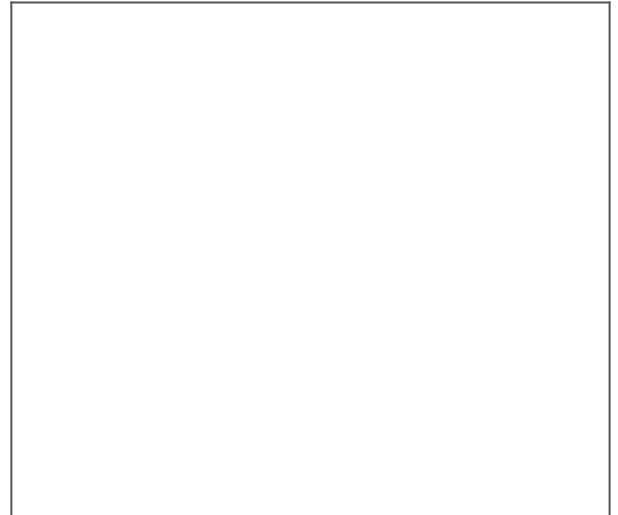


The Importance of Due Diligence

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The due diligence stage is an essential element to a successful commercial transaction.

When purchasing a business the due diligence stage allows the buyer to assess the value of the business and to verify the information pertaining to the business in order to determine whether to proceed with the purchase. The due diligence period also permits the buyer to determine if there are any barriers or risks associated with the transaction. Accordingly, the transaction is usually conditional upon the due diligence stage being completed.



The due diligence period is typically two weeks to one month in length, but can vary depending on the complexity of the transaction and can also be extended in some circumstances. Often the buyer and the seller will enter into confidentiality agreements prior to commencing the due diligence so that the seller can be certain that the information the buyer receives and reviews will be subject to confidentiality restrictions. The majority of the information for completing due diligence is obtained directly from the seller.

Due diligence generally falls into two categories: legal due diligence and business due diligence. There is however occasionally overlap between these two categories.

Legal Due Diligence

Legal due diligence involves reviews of corporate organizational documents, searches involving the corporation, reviews of leases, reviews of material contracts, etc.. The most basic form of due diligence is determining whether the seller is actually the owner of the business or assets that he, she or the corporation proposes to sell. Another common search that ought to be conducted, with respect to equipment or assets, is a search to determine whether there are any mortgages, liens or other claims against the equipment or assets. Due diligence searches can become very complex depending on the nature of the transaction. The physical assets are not the only area that is subject to due diligence, the intellectual property of the seller must also be reviewed. The buyer will want to know what licenses are held by the seller and whether or not they are transferable. Often lawyers will involve specialists for key areas of risk. For example, the buyer's accountant may be engaged to

review the tax filings and/or balance sheets of the business being sold.

Business Due Diligence

Business due diligence involves a review and understanding of the customer and supplier contacts, work in progress, status of receivables, employee relations, banking relations, etc.

Typically the due diligence searches are performed by the buyer, but in certain circumstances the seller will also conduct searches on the buyer. For instance, if the seller is taking back debt or receiving shares as part of the purchase price he or she may wish to conduct his or her own due diligence.

The due diligence stage also provides the buyer with information to assist with the negotiation of the main agreement. The results of the due diligence may show that specific consents are required, or may cause the buyer to request that specific representations and warranties be set out in the definitive agreement, or that certain additional indemnities be given by the seller.

If you are purchasing a property or a business, it critical to ensure that the due diligence associated with the purchase is conducted in a complete and thorough manner. The due diligence stage, if conducted properly, should provide the buyer with a complete understanding of what he or she is buying and an analysis of any risks associated with what is being purchase, so that the transaction may be completed without any unpleasant surprises.

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