
DUE DILIGENCE IN CROSS-BORDER ACQUISITION DEALS

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A Due Diligence process is one of the most remarkable characteristic of the modern counseling. As complex transactions enlarged the boundaries of global businesses, corporate creativity is bound only to the legal possibilities of its creators, where legal counseling erupts its original limits to become another active partner in drawing the very basic aspects of any deals.

We at Almeida Advogados believe that the full role of the best practice of law is played by being at both sides of creativity and consciousness: the art of outlining the environment for the business free flow, alongside the duty to evaluate all risks involved: to assist and to foresee.

We know for sure that there are multiple perspectives involving both of these commitments, nonetheless the Due Diligence process as a whole must be held as a keystone in the perspective of consciousness.

Due Diligence process is an art per se to evaluate all the legal aspects involving a certain company, to determine whether or not each business practices are susceptible to eventualities, to be able to understand how fragile or strong certain corporate relations may be and still, never loose track of the players' interests and needs. To master a Due Diligence is somehow to master the very outline of the corporate life.

In the present global business scenery, it is not possible to conceive the execution of an acquisition deal without conducting a Due Diligence process, both in order to verify all potential or effective contingencies and liabilities of a target company, as well as to accurately evaluate its assets and worthiness.

From this second standpoint, the seller has a great interest in proving the real value of the target company, among all areas a company must be evaluated from. Undoubtedly, the solidity of the evaluation of a target company is a strong bottom limit in negotiating prices, alongside good evaluation results.

From the other standpoint, and amongst the most important criteria for the buyer, there are the need of plainly understand the target company and to correctly evaluate the risks involved, and only a Due Diligence process is capable of such analysis and capable of avoiding exterior or cosmetic aspects of a certain company.

Due Diligence Concept

The Due Diligence process is a collective term for a number of procedures and standards involving the investigation or audit of a certain company, all directed towards its most accurate evaluation.

The term has its origins probably in the Securities Act of 1933, by the U.S. Securities and Exchange Commission, which had as basic objectives to require that investors receive financial and other significant information concerning securities being offered for public sale, and to prohibit deceit, misrepresentations, and other fraud in the sale of securities. Such liabilities would be avoided once dealers have disclosed to the investors the information gathered as a result of the exercise of a “reasonable diligence”.

The term spread out through the broker-dealer community and was quickly adopted to identify the efforts of analysis and evaluation of any investment, becoming the conducting of due diligence investigations a standard practice throughout the business environment worldwide.

Interestingly, the due diligence process may be conducted by both parties in order enable both to verify the risk and value of a certain investment, as well as to verify the investor's capability to purchase and to comply with the obligations and liabilities arising from the investment itself.

Due Diligence Scopes

The primal scope of a Due Diligence is to evaluate a certain target of an investment by analyzing any aspects that can be revealed or to harm its value. Since the Due Diligence is majorly a risk management activity, the activities conducted in Due Diligence processes are mainly oriented to reveal the liabilities, contingencies, problems and exposure to damages or losses arising from the regular performance of the target's business.

In view of such risk analysis and evaluations, the Due Diligence process varies for different transactions, in example, the acquisition of an Information Technology company may not require the analysis for possible environmental damages.

The most relevant areas of concern may include the financial, legal, labor, tax, intellectual property, environment, real and personal property, market or commercial situation, IT, as well as insurance and liability coverage, debt instruments review, immigration, international transactions among many others.

Nevertheless, the crucial aspect of an accurate analysis exceeds the simple verification of the actual status of any aspect, relying on the ability of foreseeing any arising, potential or collateral contingencies that such aspect may generate and being able to evaluate the probability of damages or loss in the future. Therefore, the analysis of each area of concern should be performed by experienced and specialized consultants.

Due Diligence Structure

A Due Diligence process mainly comprises the review and analysis of documents, contracts, archives, accounting records and any other type of information required for the analysis of the chosen aspects. Therefore it is a process that can take place in either investor or investee location and that nowadays can be conducted even virtually, by using digital data rooms in which the scanned documents are stored and using computers to have access to it.

Depending of the particularities of each transaction, it may be necessary to conduct field researches, interviewing officers and employees, gathering information of the target's sites and locations, and to include the analysis of proceedings where the target is involved within each court office.

A Due Diligence process is usually conducted by lawyers, but it can include accountants, engineers, financial advisors and any other expert professionals who may be able to understand and more accurately evaluate each proposed aspect.

Although it is widely recommended that the Due Diligence wideness be as comprehensive as possible, analyzing every aspect of the intended investment, it is possible to reasonably adequate its range for the most sensible aspects involved in a certain transaction, decreasing the time-frame needs of the project as well.

Once a Due Diligence process is majorly conducted over an entire company or group of companies, another important aspect of such process is to clearly identify the documents flow and to set the confidentiality among the parties and agents involved in the transaction, as well as the responsibilities arising from delivering or supplying of documents, the control over the access to the documents, and the duties and tasks of each party, each consultant, each agent, etc.

The period of time a Due Diligence requests is often connected to its wideness, and such time-frame, as described above, usually contributes for its definition. Along with the available time-frame, the resources dedicated to the Due Diligence are another usual limitation to its range, nevertheless, as each transaction may present more relevant issues to evaluate, a more adequate Due Diligence may result in an acceptable safety margin, where other losses and damages may not compromise the whole investment to be done.

Due Diligence Result

The result of a Due Diligence is mainly a report and an opinion.

The report is a summary of all information gathered throughout the Due Diligence process, concentrating all evaluated areas and all aspects involved, as it acquire its form from a relation of all documents and information in which the analysis is based on, a description of the scope and limits of the Due Diligence process, all aspects involved, the selected areas of concern and a full brief of all gathered data such as numbers, dates, names, main aspects, main exposure, prices, risks, margins as well as any other information deemed to be relevant of each analyzed document or information. Nonetheless, the true value of a Due Diligence process is the opinion arising thereto.

Once all analyzed aspects have been evaluated specifically by the professionals involved in each area of a Due Diligence process, the most important task is performed, to understand the very outline of the proposed business, to perceive all interests involved in the transactions, to evaluate and foresee the gathered risks, to comprehend the investment as whole and to, finally, judge from a legal and commercial standpoint whether the proposed investment may prosper.

The opinion expressed as result of a Due Diligence process is one of the most important instruments for the corporate players to evaluate, to judge and to decide any transaction.

Cross Border Due Diligence

In respect of the above, it is within cross border transactions where a Due Diligence process finds its higher importance.

Since every country has its own legal system, it is almost impossible for a foreigner to correctly evaluate all aspects of a company such as financial, legal, labor, tax, intellectual property, environment, real property, insurance coverage, among many others aspects.

Furthermore, to evaluate certain aspects of an investment relying solely upon the rules and standards of another legal system and culture, can usually lead to misconceptions, distortions and imprecise conclusions, turning a highly non recommended investment in a attractive one or vice-versa.

Being absolutely aware that each country has its own particularities, its own requirements and concerns, a short brief of Brazilian legal system and most common singularities are presented below.

Due Diligence in Brazil

Considering the diversity of legal and administrative particularities of each country, especially in a continent size and federatively structured country such as Brazil, it is essential that a Due Diligence process be conduct by local legal consultants, whose expertise may comprise all the territory involved in a certain transaction.

It must be taken into consideration that Brazil has a Federative System comprised by three different government spheres, at federal, state and municipal levels, all capable to legislate in autonomous ways over many areas, according to the limits set forth in the Brazilian Federal Constitution.

In order to perceive the extension of such system, Brazil has today five thousand, five hundred and sixty two cities, divided into twenty six States and a Federal District, which legislates at both state and municipal levels, resulting in an enormously extent legislative

production, filled with uncountable particularities and, very often, pierced by concurring standing for enacting legal rules among the three spheres.

In respect of such concurring standing, it should be further considered that there is a hierarchy between the federal, state and municipal instances, in reason of which the federal legislation outstand state and municipal ones and the state legislation govern the municipal one. Meanwhile, conflicts amongst such different legislations is very often found, which may lead to a great impact in the transaction, if not correctly observed, and alerted.

With regards to the environmental legislation, for example, the federal government may legislate in concurrence with states and the Federal District, enacting general rules as well as requiring a supplementary legislation by the second group. The main concerns in such case arises from the interpretation of the constitutional outlines, in connection to state legislations, and invariably generates a triple inspection by the environmental bodies and agencies from each governmental entity.

Nevertheless, not only entities of the Legislative Power are entitled to legislate in Brazil, but other executive federal, state and municipal agencies are also capable of enacting rules and Standards with full autonomy, thus regulating markets and setting specific policies to be fulfilled by companies and corporations in the performance of regular business.

Along the same path there are the regulatory agencies, entities connected to the indirect administration and which main scope are to rule activities under the infrastructure sector, previously executed by the state and now transferred to privately held companies.

In view of the above matters, a Due Diligence conducted exclusively under federal legislation or disregarding the particularities of the region involved in the transaction, or additionally, the standards and policies from state agencies shall inevitably hold distortions that may compromise the whole transaction.

This is one of the reasons why foreign firms and companies are recommended to procure a local partner and consultant, who may offer the commitment and capacity to precise and accurate analysis of the aspects of a certain investment within Brazilian jurisdiction.

Almeida Advogados' Cross Border Experience

Almeida Advogados is a law firm focused on the corporate business environment, having as a major premise the pursuit to understand each of its clients' markets, the nuances of each industry and the corporate culture and goals of each company. From a legal standpoint, such an approach permits us to structure and afford our clients operations in a more secure and economical way.

Born out of a union of competent professionals committed to the Law practice, whose activities are focused on providing legal services for both Brazilian and foreign companies in the areas of corporate legal counseling, litigation avoidance and litigation counseling in general, Almeida Advogados plays an important role in a wide range of mergers and acquisitions operations, providing full legal aid for buyers and sellers, both counseling and conducting due diligence processes, risk analysis, drafting and negotiation of contracts, corporate restructuring, drafting of shareholders' agreements and at any other stages required in such operations.

With the goal to participate and assist in the implementation of new businesses, minimizing the risks involved, Almeida Advogados have conducted many investment operations in Brazilian Information Technology companies, especially for North and South American investors, as well as many acquisitions involving the agricultural-industry business both investing in Brazilian companies, and investing in companies abroad.

We have also conducted and managed an acquisition of an agribusiness group of companies with industries in Brazil, Argentina, Uruguay, Paraguay, and holding structures both in United States and in Austria.

Please, do not hesitate in contacting us for any further clarification.