LIABILITY ISSUES IN LEGAL DUE DILIGENCE

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I hereby declare that the work submitted is mine and that where I have made use of another's work, I have attributed the source(s) according to the Regulations set in the Student's Handbook.

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ABSTRACT

This dissertation was written as part of the Master of Laws program in Transnational and European Commercial Law, Banking Law, Arbitration / Mediation at the International Hellenic University.

Due diligence, in the process of mergers and acquisitions, will be examined in a more general way with the purpose of making every reader understand the way that the investigation or exercise of care of a reasonable business takes place, before entering and finally concluding a transaction.

Focusing on legal due diligence, the buyer's legal team will try to obtain a legal opinion on the target firm through the examination of its “checklist”. The last one, includes the sectors and the matters that are about to be examined and cannot constitute an exhaustive catalogue, once it is possible to be enlarged depending on the needs and the demands of the potential investor. For conducting due diligence with success, both the buyer and the seller need to cooperate. A faster, lower cost and more effective process can only be conducted with the disclosure of all the necessary information and data by the seller and the examination and assessment of them by the buyer’s team.

The last ascertainment raises doubts and questions in every transaction, related to the credibility of this information and the protection in case of doubtful and finally failed deal. Solution to this problem seems to be easy, in case appropriate “clauses” are included from the early beginning of the transaction.

This dissertation topic will delve into liability issues from both the buyer’s and seller’s part and derive its importance from trends related to the globalization of the markets. The enlarged risks and the adverse effects that would enjoy both parties (and especially the buyer) in case of a defective conduct, makes a comprehensive, fully and well-timed due diligence process more urgent than ever before.

Whether from a business or legal aspect, pursuing this topic will make the reader appreciate the legal requirements of a business, as well as the impact of these rules on the way in which the business functions. Besides, business acumen backed by legal prowess is bound to be a winning combination for any youngster venturing into the competitive business environment.

Keywords: due diligence, transaction, checklist, liability clauses

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INTRODUCTION

As the world economy continues its effort to emerge from financial downturns, Mergers and Acquisitions (M&A) consist a vital part of this effort enabling weak companies to grow and the already strong ones to expand. Such kinds of transactions have been proved to be of great complexity, as the various issues that may arise can be broad and obstruct the conclusion of the deal. A variety of key issues need to be examined, actions need to be taken and all these with the maximum speed, integrity and value. [1]

History has shown that an M&A can result in a disaster. To be more specific, can cause irretrievable damage to shareholders' wealth in the acquiring companies. Talking with numbers, a study by the National Bureau of Economic Research (NBER,2014) proved that of the total 12,023 transactions have taken place over a twenty – year period, U.S. takeover bids converted shareholders' profits to losses of more than $200 billion. Also, according to research conducted by KPMG, 83 percent of the above-mentioned deals were not profitable for shareholders. Besides, the failure rate of an M&A estimated between 50 to 85 percent, a percentage that sounds quite tremendous. [2]

There are many ways that an M&A transaction can finally take place, such as by absorption, by consolidation, related to an asset or a share deal, but in any case, before making the deal there is a whole process of examination and assessment of the anticipated transaction. The initial stage consists of, not only the negotiations but also the "check level" in which the interested party, along with his team, makes its own investigation in order to assess whether or not the deal is truly desirable and also for preventing unexpected failures and costs.

Poor M&A results, may be attributed to false investigation, inadequate assessment, poor strategy, lack of a strong negotiation phase and of course poor due diligence process. The last one process not only allows the interested party to observe the internal control of the business but also to assess the potential risks. And it is important to comprehend the risks because with this way they can be prevented at all or at least be calculated at the final price, giving the transaction a great value from the early beginning. As today a typical M&A is more operational than ever before, groups of experts start working at the desirable deal after negotiations, but still at a preliminary stage, with the assessment of the deal from a commercial, financial and legal point of view. Normally, issues that are found in the due diligence process will not automatically cancel the deal, but experts will try to find solutions and overcome them, in

[1] Stanley Foster Reed, Alexandra Reed Lajoux, H. Peter Nesvold, *The Art of M&A (A Merger Acquisition Buyout Guide),* Fourth Edition, p.2-3

[2] Timothy J. Galpin, Mark Herndon, *The Complete Guide to Mergers & Acquisitions (Process tools to support M&A integration at every level),* Third Edition, p.2

order to reach the deal. Features like negotiations, willingness by both parties, and of course luck, play a leading role.[3]

The two most important facts that need to be taken into consideration when dealing with the purchase of a business (asset and share deals are both included in this term) are:
A) The asymmetry of knowledge that the two main participants have in the deal and
B) The willingness of the participants to put aside the "soft law" by providing priority to their private autonomy[4]. These facts force the parties to make special predictions and agreements concerning all issues around the knowledge acquired through the due diligence process as well as the consequences in case of liability of each party.

The most well-known tool for the seller to prove his knowledge is the so-called "*Disclosure Letter*". This document is delivered by the buyer at the early beginning of the assessment process in order to be the guide for the due diligence team. As will be examined below in chapters 3 and 4 with great detail, the seller usually undertakes the obligation to make his "*best effort*" about the conclusion of the deal and also provide the buyer with "*Representations and Warranties*" around different issues that may influence the transaction. Special clauses for liability issues cannot be omitted at this preliminary stage and for this reason, in almost every transaction, will be found *"indemnities", "sandbagging", "non-reliance"* clauses etc.[5]

The frequency of such transactions has already resulted in a plenty of cases that led to courts because of the use of the above liability clauses. International, but mostly case-law provided by English courts, makes more comprehensive the liability clauses and help the parties make *a priori* some written predictions and find solutions to their most important concerns that may arise from a transaction, based mostly on their private autonomy and ignoring the application of the "soft law" that seems to provide guidance only if the parties cannot reach an agreement on their own.

For this dissertation purposes, the participating parties in a Merger or an Acquisition process will be called "the seller" and "the buyer". The last one will indicate the party that undertakes the target business, conducts due diligence procedure and makes exhaustive negotiations, while the seller will depict the party that transfers his business and all the assets and liabilities raised by this transaction.

[3] Peter Howson, Due Diligence – *The Critical Stage in Mergers and Acquisitions* (2003), p.3
[4] George T. Papachristou, *Ο Προσυμβατικός Έλεγχος της Πωλούμενης Επιχείρησης – Due Diligence*, First Edition 2021, p.21-26
[5] George T. Papachristou, *Ο Προσυμβατικός Έλεγχος της Πωλούμενης Επιχείρησης – Due Diligence*, First Edition 2021, p.316-317

CHAPTER 1: DUE DILIGENCE IN MERGERS AND ACQUISITIONS

Every integration begins with the Due Diligence procedure. Questions such as why do this deal, how much will the buyer pay, how long will the process last, what will happen with employees and customers of the purchased company and countless more are only an indicative list of the issues that the due diligence team has to solve and find answers.

EXPLAINING THE MEANING OF DUE DILIGENCE

Before starting with the explanation of the term Due Diligence, it is important to mention what exactly the words 'mergers' and 'acquisitions' [6] mean[7] in order to further elaborate in the pre-dealing procedure. A *merger* takes place when two or more companies are combined and both the assets and liabilities of the selling company (target firm) are actually absorbed by the buying company (merger by absorption). There is also the possibility to have a totally new formed company for the purpose of the merger (merger by consolidation). When it comes to *acquisition,* the term is used in order to describe the purchase of a stock or assets of a corporation by a specific buyer.[8]

The difference of these terms is detected at the results of transformations. A merger is a narrower term which is mainly related with the legal procedure and may or may not result in an acquisition, while an acquisition is a generic term for the description of an ownership transport[9]. In fact, the distinction between these two closely related terms is of less importance, since the result is usually the same: two or more companies that used to operate separately, now function under the same company having adopted one strategy and lots of privileges.

At the time the negotiations for a desirable transformation start, the preliminary phase is activated. During this pre-dealing phase every conscious businessman tries to aggregate groups of experts with the purpose of initiating a scrutinised investigation for the target firm.

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[6] Broc Romanek and Cynthia M.Krus, *Mergers and Acquisitions,* 2002, Chapter 5, p.35-38:
Nowadays, all types of companies, including the big and the small ones, are thinking of global competition and have already adopted a global perspective in their transactional relationships. For this reason, it is correct to talk mostly about cross-border mergers and acquisitions.

[7] Look at Directive 2005/56/EC on cross-border mergers of limited liability companies, codified in the Directive 2017/1132 and amended by the Directive 2019/2121.
Dirk Van Gerven, *Cross-Border Mergers in Europe – Volume I,* General Editor, Cambridge, p.6-7: The main target of the Directive is to authorize cross-border mergers without liquidation and the automatic transfer of assets and liabilities enabling the transactions.

[8] Andrew J. Sherman, *Mergers Acquisitions From A to Z*, Third Edition, Chapter I p.2-3

[9] Stanley Foster Reed, Alexandra Reed Lajoux, H. Peter Nesvold, *The Art of M&A (A Merger Acquisition Buyout Guide),* Fourth Edition, p.4

This is the time when the due diligence process begins[10]. The last one has been characterized as both an art and science because it requires a deep knowledge of the history, values, and intangible assets of the target firm. So, goes a step further from the formalistic review of documents and contracts. [11]

Searching for a more dictionary definition of the term, it is said that due diligence is a procedure of examination and development of four main factors with the purpose of understanding the business transaction. These four factors mainly include: the understanding of the company's strategy and its business operation, the investigation of the products, services and assets of the company, the determination of the company's value and finally the personnel of the company. Easily can be deduced that the four mentioned factors of main examination in a transaction, consist of every business cornerstone.

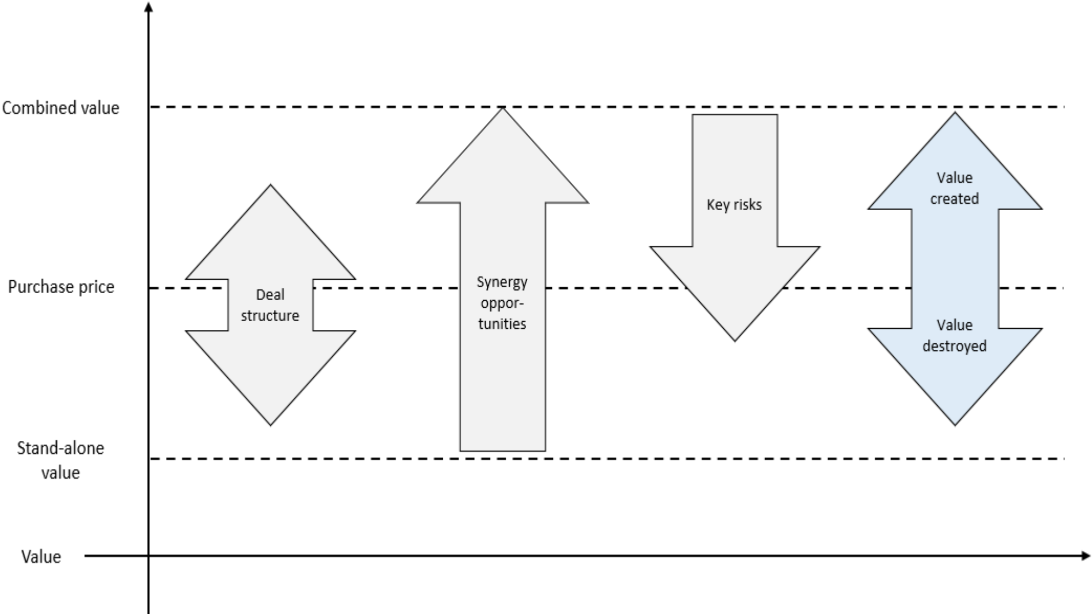
During the examination of the cornerstones of the target firm, the interested party is expected to gain knowledge about the legal and financial structure of the company with the target to identify potential risks and handle them. Also, believes that it could be possible to understand the data, nature, assets and generally services of the target company from a financial and legal point of view. The way that the due diligence process progresses and finally its results, will be a crucial point in the valuation of the desired transaction because the price is mutually reliant with the sustainability of the company and the risks that may be undertaken. The bigger the risk for the transaction, the more negotiable the value of the company. Last but not least, it is important in every transaction to care about the personnel of the existing business. Actually, there is the need to identify the key personnel and consider whether the existing workers for the firm could be capable of operating the potential business. If the due diligence process indicates that they are, the operation of the new business seems to be easier as experienced and reliable persons will provide their services from the early beginning of the transaction. [12]

So, the due diligence process lays the foundation to reach the "*plan to create value*" that every businessman has in mind even when negotiations start. The main purpose of the potential buyer of a company is to ensure that his plan can be achieved with the conclusion of a specific transaction after the prosecution of the due diligence process. In practice, three key aspects exist that will determine if the value will be created: a) the strategy of the firm, including the rationale that already exists and the value expected to be acquired by the transaction, b) the value sources, meaning all these aspects that can increase value and can be spot in due

[10] Donald DePamphilis, *Mergers and Acquisitions Basics*, ELSEVIER, 2011, Chapter 8, p.173-174: Due diligence process is essential in post-negotiation phase too, while provides the buyer with additional information and enable him understand the liabilities and the value of the business is going to acquire.
[11] Robert Mack, Michael Gerrard and Ned Frey, *An IS Perspective on Mergers and Acquisitions: A Six Stage Handbook*, Stamford, April 17,2002
[12] Jefrey W. Berkman, *Getting a Deal Done - Due Diligence and the Business Transaction*, Apress, p.11-13

diligence process and last, c) the determination of risks, not only those that already exist but also the potential ones. [13]

The combination of these elements is represented with the following way:



From the above depiction, it is concluded that during the examination of the deal lots of opportunities or risks can be discovered and these are which finally will influence and determine the final purchase price. As the plan is always to create value, the due diligence process seems to be the most important stage for taking the appropriate decision and avoiding a failed future transaction.

Due diligence process is not simple. Requires time, money and great attention. The whole mechanism is ranked among the exchange of information between the parties and the determination, in advance, of the potential liability issues. Nowadays, the due diligence process appears in a standard format for the experts, as its repeated practice has made it more typical than ever before. Of course, the more complicated a transaction is, the more time and caution is dedicated by both parties. The due diligence mechanism is usually activated by the buyer's side, who has the necessity to organise teams of experts for examining every issue included in their "checklist". The results will finally determine whether or not the initial plan can create value to the purchaser.

PURCHASER'S DUE DILIGENCE "CHECKLIST"

Depending on the field of examination, due diligence can take various forms. The most significant forms are the "financial due diligence" and the "legal due diligence". Further fields

[13] William J. Gole, Paul J. Hilger, *Due Diligence – An M&A Value Creation Approach*, Wiley Finance, 2009, p.17-24

of assessment can lead to "tax due diligence", "commercial due diligence", "human resources due diligence", "environmental due diligence", "technical due diligence" etc. All the above areas seem to be interesting for examination when a whole business is about to be bought but the interested party needs to choose those areas that are closely related with the main activity of the business and also those that will make him take his final decision.

One of the greatest steps when starting due diligence procedure is to instruct economists, auditors, lawyers, accountants and other experts. Mistakes made by the purchaser can obstacle the process and increase the time and the costs. The most common ones that meet in practice are the lack of communication or misunderstanding between the team of experts of the two participant parties in the transaction, the complexity of financial statements and misunderstanding of numbers, the inadequate time and space for buyer's due diligence team and surely the lack of planning and stuck on the preparation of due diligence process[14]. Every deal has its own peculiarities and finally it is the short time and the pressure for making the transaction or at least deciding if this transaction is beneficial, which make due diligence in need to be concluded as soon as possible. For this reason, due diligence must be structured *a priori* in a balanced position between cost and perceived risk. This technique reduces the uncertainty of the deal and helps investing significant time and monetary expenses[15].

Assignments such as the areas that need to be covered and the extent of investigation should be answered in advance. There are no right or wrong answers when it comes to the question which areas to cover. As already mentioned, the areas that need to be covered depend on the deal. Influence seems to exist by custom and practice, meaning that it would be almost impossible to conduct due diligence without some form of financial and legal one. Where due diligence will focus, depends on the different types of M&A.

Factors such as the speed of the planned implementation, the key exposures of the firm and the greatest risks arising from the transaction are decisive for creating the "check list". Following the question "how much investigation to do", obviously there is no specific question. At the end of the due diligence process, almost all experts are going to feel like they have not done enough due diligence, even though actually they would have conducted a detailed examination and assessment. It is theoretically supported that 'the more extensive the contractual protection is, the less the need for due diligence'.[16]

Below will be presented shortly some of the most important areas that constitute expert's "checklist" in every transaction:

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[14] Andrew J. Sherman, *Mergers Acquisitions From A to Z*, Third Edition, p.73

[15] Patrick A. Gaughan, *Mergers, Acquisitions and Corporate Restrictions*, WILEY, Fifth Edition, Introduction, p.21-24

[16] Peter Howson, Due Diligence – *The Critical Stage in Mergers and Acquisitions* (2003), p.16-17

i) Financial Due Diligence

The widest known form of due diligence is financial. At this stage of the company's examination and from a first point of view, somebody could think that accounting policies and financial statements will only be examined. But such a restrictive financial due diligence would be characterized as insufficient and dangerous for the final decision. Except for the obvious examination that the same the term indicates, meaning the statements, the company's expenses and incomes, firm's assets and its general financial situation, this type of due diligence must not stay focus on the past statements and facts but should go a step forward and make predictions about the future based on the existing evidence[17]. Financial due diligence will finally determine every decision and the general business plan.

Until the purchase is completed, the buyer will have specific information provided by the seller and his team. The group of experts that conducts financial due diligence will have made several assumptions based on the providing information. In order for the purchaser to be convinced that the deal is worthy, his financial team needs to assume that the future operation, profits and performance will be at least similar to the past or even better. The buyer wants to ensure that the relationships with the existing big customers will be continued and as a result, sooner or later, the transaction will be profitable.

The difficult role of economists, in this phase, is to be able to understand false numbers and identify any deal breaker factor. They need to understand the business so as the profit emerges. Their role has no relationship with an audit. Generally speaking, financial due diligence must be completely distinguished, as it differs in aim, scope, access and evidence[18]. The main difference is that audit confirms results, having an unrestricted access to systems and information of the company, presenting a true picture of the company' s financial situation which focuses on the past, in comparison to financial due diligence in which it is possible "black holes" to be covered and lots of issues to be negotiated, based on past and future facts.[19]

ii) Legal Due Diligence

While the financial due diligence is about assessing the deal from an economic point of view and finally deducting whether the transaction is worth the risk, the legal due diligence is about reaching the same result through the legal examination. The legal due diligence is complicated

[17] George T. Papachristou, *Ο Προσυμβατικός Έλεγχος της Πωλούμενης Επιχείρησης – Due Diligence*, First Edition 2021, p.44-45

[18] Usually, accountants include a clause in their financial due diligence review having the following content: "*Our procedures in preparing the presentation and report will not comprise an audit and will not be in position to express a formal opinion on the financial information which we will be reviewing*".

[19] Peter Howson, Due Diligence – *The Critical Stage in Mergers and Acquisitions* (2003), Chapter 4, p.45-49

as not only assesses the existing and potential risks but also the legal team must predict which impediments may arise and secure the transaction from a possible inversion. This can be achieved with the incorporation of a plenty of 'contractual clauses' that are about to protect both the seller and the buyer to the greatest extent. [20]

Legal advisors work closely with the other experts in the due diligence process, as their work is related to other due diligence fields of investigation. The legal due diligence, as more general from the other forms of due diligence that will be examined below, has *three main objectives*: to reveal potential liabilities, to discover obstacles arising from the contractual relationships of the business and to create the foundations for the final agreement. [21]

To begin with liabilities issues, these need to be uncovered for the present and the future. And the issue around liabilities emerges mostly in share deals, as in asset deals the purchasers usually do not take over liabilities. It is not easy to be discovered while statistically it will be behind another emerging issue. The most worrying area for potential liabilities is the tax area because, as history has proved, purchasers who have undertaken such liabilities would be more vulnerable to bankruptcy.

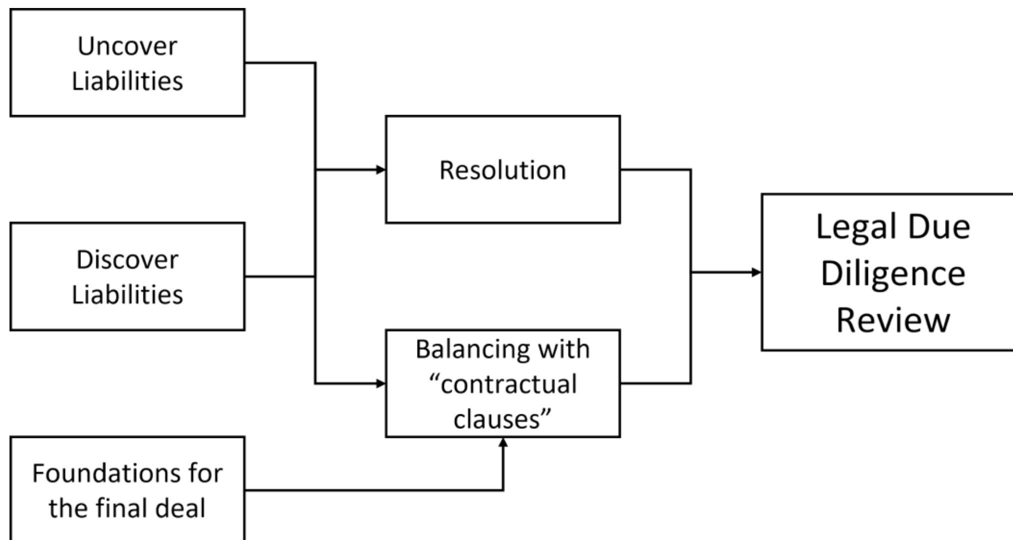
Continuing with overcoming the legal obstacles, the research needs to focus on the shares or the assets that the potential purchaser is going to acquire. Facts such as the owner of shares and assets, the way that have been owned, regulatory issues about the way that the above will be acquired, about licences, permits, orders and reports are in the spotlight[22]. And after the attainment of the above targets, the legal team will make a document in order to record the legal understanding of the transaction and guide the process until the conclusion. Usually, such kind of documents bind both parties with the purpose to complete the transaction, mainly because the parties have already agreed upon the way that potential arising problems or liabilities issues will be solved. The examined obstacles can either be resolved at all or can be balanced with the use of 'contractual clauses' which are going to determine the burden of responsibility for each party. After the accomplishment of these objectives, the legal due diligence team is ready to make a review.

The way that the legal team will make the due diligence review is represented at the diagram as follows:

[20] For more details about the so-called 'Contractual Clauses' look at Chapters 3 and 4 below.

[21] Peter Howson, Due Diligence – *The Critical Stage in Mergers and Acquisitions* (2003), Chapter 5, p.68

[22] For example, in the UK any company carrying on financial services, needs permission, authorization and registration from the Authorities in order to conclude a lawful transaction of the target company's business.



To reach its objectives, the legal due diligence team should make a scrutinised legal check which ranged between *four large areas*.[23]

a) Firstly, the legal team will check the corporate records and the articles of the association of the target company. There will be certified from official documents the incorporation and all the amendments of the company, will learn about all directors' and shareholders' meetings as well as the current shareholder list and members of the firm [24]. The legal team will find answers to questions such as, whether the company was created lawfully, whether amended according to the law, whether the parent company has subsidiaries or branches to deal with and, of course, whether the company follows the disclosure regulations.

b) Secondly, legal advisors will examine the assets of the seller. Here, included both tangible and intangible assets. The legal team will acquire a list of real property and material assets owned or rented by the firm and additionally a list of all issues related to intellectual property rights ranging from patents, trademarks, copyright, licences to registration numbers, policies and threats of all related intellectual property rights.

c) Thirdly, always in the spotlight, is the examination of the company's relationships with third parties. Indicatively, in the category of third parties are included company's clients, suppliers, employees and creditors. The main target is to assess if the contractual relationships are properly fulfilled and if they will survive between the third party and the buyer after the transaction.

d) Finally, litigation issues are examined. A list of material litigation or claims for more than 5,000€, a list of settlement agreements, compromises, orders, arbitral awards or court decisions are only a few of the litigation issues under examination[25]. The fact that the target

[23] George T. Papachristou, *Ο Προσυμβατικός Έλεγχος της Πωλούμενης Επιχείρησης – Due Diligence*, First Edition 2021, p.45-46

[24] Andrew J. Sherman, *Mergers Acquisitions From A to Z*, Third Edition, p.74-75

[25] Andrew J. Sherman, *Mergers Acquisitions From A to Z*, Third Edition, p.81

company has future trials which potentially going to cause financial damage and harm the company's reputation, may be an admonitory factor for concluding the deal.[26]

The list of the examined areas under the legal due diligence procedure seems endless. As already have been underlined, it is impossible for a transaction to be examined from every possible point of view. The examination and assessment depend on the objectives of each transaction and of the targets that every potential investor will set. The general idea is that in every transaction the legal team will try to investigate, even in a shorter way the main four areas that briefly represented above.

More specific fields which are incorporated in the general legal due diligence concept, are examined in detail below.

iii) Tax Due Diligence

Tax due diligence ranging from two levels. At the first level, tax professionals try to construct and secure the deal with the most profitable tax system for each specific transaction. After this, experts pay their attention to overdue payments of the target company and try to evaluate if the conclusion of the transaction is worth the risk.

A tax investigation focuses on the purchaser's ability to control his investment through proper tax planning strategies and also through similar tax opportunities. In order to reach it, the tax due diligence team has to answer the following questions: "Has the seller paid all his tax liabilities?", "Is there a possibility of tax penalties emerging by tax authorities?", "Can the buyer continue to have a similar beneficial tax system?". Areas that need further investigation are the corporate structure of the firm, the federal tax returns and workpapers, state and local taxes, accounting periods, methods and so on.[27]

At the time that tax investigation is concluded, experts organise their tax review in a way to secure the interests of both parties. It is essential to be included, one part regarding the allocation of tax liabilities with respect to pre-dealing period and also, another part which allocates the liability of the seller, in case an unexpected taxation emerges due to breaking of law at the pre-dealing stage. Obviously, the existence of tax responsibilities, either present or potential, will affect the pricing of the transaction and will be a decisive factor for the purchaser to diminish the price, as a compensation for the risks undertaken.

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[26] Additional value to the reputation's harm of the company exists when the target company is a listed company. After the company's conviction, it is expected that the share's price will fall dramatically. The loss of confidence to the firm can cause excessive financial damage.

[27] E. Daniel Leightman, *Tax Due Diligence*, article, p.5-10

iv) Commercial Due Diligence

Along with the above forms of due diligence process, commercial due diligence is a supplementary and one of the most traditional and significant forms of investigation. This kind of investigation focuses on the historic performance of the company and on its potential improvements. The target firm will be acquired for its ability to generate profits in the future, but in order for experts to deduct that the company is finally profitable, its past performance is in need of scrutinised examination and assessment.[28]

Initially, the term of commercial due diligence should be defined because it is not so easy to understand exactly what professionals investigate. Actually, what experts do, is a *mini-strategy review* at the commercial profile of the business in the pre-acquisition period in order to confirm that the target company has the potentials and commercial prospects which the interested purchaser considered and also, in order to find ways to reduce the risks and help the integration of the desired company.

Because of the limited available time that professionals have and concentrating on the resources of each business judgment, their review mainly centred on the competitive position of the firm, the seller's power in the market and the relation with his customers. The experts have to find answers around the topics 'what is the size, structure and potentials of the business', 'who are the customers of the firm and which are their needs', 'who are the competitors, their strengths and weaknesses and the power that they have in the market'.

More specifically, commercial due diligence experts are going to carry out research on all the documents and industry reports of the company as well as interview managers, experts and other staff to collect information. Through this process the current market situation of the company will be established and professionals will be able to make predictions about the expected growth after the transaction. Furthermore, the team will try to approach the customers of the firm. The main target here is to identify their needs, acquiring an overview of their strengths and weaknesses and their intentions to continue being customers in the post-acquisition stage. Last but not least, the commercial due diligence team will examine the competitive position of the firm and the way of managing it. An ambitious purchaser is expected from the target firm to be part of an open competition community where there are always incentives to be better, to modify prices and to attract customers with clever ways. [29]

The capabilities of the target company and the identification of its strengths and weaknesses at the marketplace, will finally determine the risks that need to be balanced and the price of

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[28] Peter Howson, *Due Diligence – The Critical Stage in Mergers and Acquisitions* (2003), Chapter 6, p.77

[29] Peter Howson, *Commercial Due Diligence – The Key to Understanding Value in an Acquisition, Gower*, 2006, Part 1, p.20-22

the final transaction. The way that the final decision will be taken, depends to a great extent on statistics and predictions deducted from the comparative analysis between the historic performance of the company and its potential improvements as part of an M&A process.

v) Human Resources and Employees Due Diligence

A potential investor will want to know the number of employees of the target firm, their qualifications and their providing services to the company. The policy that every business applies around its "people" and whether the target company complies with the law and other regulations, is a matter always in need of investigation before a transaction takes place. Practice has proved that although in all workplaces challenges and difficulties exist, the majority of them are normal and under control. Only a few of them could be "deal killers". These aspects should not be underestimated but have to be seriously considered for the commitment of human resources and employee's due diligence process.

Every country has its own regulations around employment and human resources issues. The European Union's law tends to be the stricter one for the employer who needs to provide specific privileges to his employees and adopt a regulated behaviour for providing their 'acquired rights'[30]. Due diligence checklist in this area of investigation, focuses on issues arising across various jurisdictions and then on issues determined by the specific law of target's country. [31]

First of all, the due diligence team has to comply with data protection law when gathering information about target's employees and human resources. May this require employees' consent signed. If this happens, then the experts can start their investigation about the staff and its working situation. Information can be gathered from the managers, from the public domain and from the employees. The number of employees, their contractual relationship (full time or part time employees, temporary employees, salary, layoffs, compensation etc), their standard or advanced terms and conditions, any specific agreement that they had with the target company have to be known to the buyer's due diligence team. Copies of personnel, employees' manual and other related documentation should be obtained by the buyer's team.

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[30] It is important to mention the Directive 2001/21/EC on the approximation of the laws of the Member States relating to the safeguarding of employees' rights in the event of transfers of undertakings, businesses or parts of undertakings or businesses. According to the par.1 of art.3 of the Directive: *"The transferor's rights and obligations arising from a contract of employment or from an employment relationship existing on the date of a transfer shall, by reason of such transfer, be transferred to the transferee".* This is the general rule, while more favorable predictions by the Member States are welcomed. The Directive was incorporated in the Greek Legislation by the Presidential Decree 178/2002.

[31] Henry H. Perritt, Jr, *2015 Employment Law Update*, Wolters Kluwer, Chapter 8

It would be a good idea for the seller to discuss with the due diligence team and determine the way that employees had been recruited and selected at all levels as well as whether employees had been trained at the beginning or continue to be trained at all levels. The existence of review system and the way that their work is assessed are also, under investigation[32]. All the above are factors that will be examined in each transaction and may not impede the conclusion of the deal.

The final deal may be suspended or cancelled at all, if the due diligence team finds out that important obstacles exist for the conclusion of the deal. More specifically, should be investigated if the seller is subject to any pending or if is threatened to any claims, lawsuits, appeals by its employees. The administration charges and fees in this labour sector should also be examined. The seller's compliance with the policies and law along with the internal ethics code of conduct will be a determinative factor for expert's assessment and for the final choice. Other issues such as the providing compensation and benefits to the employees, their insurance coverage and specific agreements for salary increase or bonuses may act as impediments for the purchaser. [33]

Generally speaking, every transaction's concept and buyer's desire is to keep untouched the vast majority of the human resources and employees' relationships and agreements. Even though may the law and other regulations force the buyer not to end such working relationships, the same buyer will want to acquire a "full staffed" company where the employees will know, at least at the beginning, better the way that the company functions. The purchaser's main target is to feel confident and forceful, and a trained and well-organised staff can contribute to achieve this aim.

After all the above analysis, the most crucial information to keep in mind is that *due diligence is not only about ticking boxes on a prepared checklist,* but something much bigger. The team should be focus on its target, meet regularly and share the results of the investigation[34]. The interested parties, on their turn, must focus on the issues that may arise during the process of due diligence or that potentially will arise in the future and either decide to negotiate the price or to terminate the deal or make their best efforts to decide and implement a post implementation plan based on warranties and indemnities for both the parties. [35]

[32] Gordon Bing, *DUE DILIGENCE – Planning, Questions, Issues*, Praeger, 2008, Chapter 17, p.71-76
[33] Henry H. Perritt, Jr, *2015 Employment Law Update*, Wolters Kluwer, Chapter 8
[34] Steven M. Bragg*, Mergers and Acquisitions- A Condensed Practitioner's Guide,* WILEY, 2009, Chapter 5, p.93-95
[35] Peter Howson, *Due Diligence – The Critical Stage in Mergers and Acquisitions*, 2003, Chapter 1, p.17

CHAPTER 2: STRUCTURING DUE DILIGENCE PROCESS

Having explained what exactly the due diligence process is and which are the areas of investigation that due diligence teams focus on, it is time to go a step back and examine the way that the due diligence procedure actually takes place. The goal for every potential investor is to create a less complex structure, which can reflect his objectives and can make the examination of due diligence "checklist" easier. As expected, not all the targets and goals can be met, but there is always a need for negotiations and compromise between the two participant parties and their teams, in the transaction process.

FINDING INFORMATION

During a due diligence process that has been initiated by the purchaser, the main source of collecting data and information about the business and its operation is the seller. The last one, along with its personnel and the official documents of the target firm related to the business's function contribute to the collection of all the essential information.

i) First Source of Information

To begin with, every business has specific representation in the public eye, so information about the company can be found in *news and web media*, including newspapers, magazines, trade publications etc. But as there is a possibility all this information in public media to be false or distorted the interested party has to find information from *the company's public data and reports*. Documents such as the creation of the company, its articles of association or any amendment of them, information about the management of the company, its representation by members, its employees, clients and suppliers and their contractual relationship with the target firm are significant for the buyer's due diligence process. Certain peculiarities exist on capital markets for issuers of securities traded on the regulated markets in the European Union. They are obliged by the law[36] to make their activities transparent by publishing certain information such as financial reports, major changes of the voting rights and other inside information.

When collecting data with the above way, the seller, in order to help the purchaser, usually creates a *'virtual data room'* in which data about its business and its operation are gathered all together. Besides, the seller has a main duty during the due diligence process: to enlighten

[36] Look at Transparency Directive 2004/109/EC, as amended by the Directive 2013/50/EC, which aims to provide information to all the potential investors in order to benefit them equally across Europe, when it comes to listed companies.

the buyer and provide him with all the necessary information that every potential investor would like to be informed before the final deal.[37]

ii) Second Source of Information

Furthermore, a second significant source of information for the potential buyer is the *contact with the managers and other superior employees of the target company.* This is what, in practice, is called *'management representations'.* During these meetings between the buyer's team and superiors of the business additional information is given to the purchaser and his team as well as clarifications for issues arising from the presented documents. These kinds of meetings are ultimately the most reliable source, having in mind that the managers of the company will not only provide the buyer with an insightful view of the company and its prospective, but will additionally persuade the buyer to continue with the transaction, increasing the possibilities of achieving a higher price[38]. The fact that the managers and other superiors of the company will have direct contact, makes the buyer more confident and hopeful that they will have spontaneous reactions when it comes to more deliberated issues about the company.

iii) Third Source of Information

Last but not least, the buyer and his team *organise a visit at the firm*, in order to have a first contact with employees. There, meet the company's equipment and facilities and shape an opinion about their appropriateness for the new business' purposes. From his view about the working force, the culture and working conditions, the purchaser can deduct whether the situation of the company is the desirable one or the transaction would be unprofitable[39].

DUE DILIGENCE IN PRACTICE

The plan and strategy that will be followed during the due diligence process is diverse, depending on every transaction's specific characteristics. Repeated practice has developed a more typical process which is followed by the parties. The most common element in every due diligence preparation is that lots of working hours are expected to be dedicated and lots of professionals in different fields to participate.

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[37] George T. Papachristou, *Ο Προσυμβατικός Έλεγχος της Πωλούμενης Επιχείρησης – Due Diligence*, First Edition 2021, p.49-50

[38] However, it is supported the opposite position too, meaning that in the fear of future dismissal, if the transaction is finally concluded, the managers and other personnel are reluctant to participate in such meeting or in case they participate they try to emerge on purpose, all the problems and negative aspects of the target firm, aiming to deter the final deal.

[39] George T. Papachristou, *Ο Προσυμβατικός Έλεγχος της Πωλούμενης Επιχείρησης – Due Diligence*, First Edition 2021, p.52-53

More specifically, the potential investor should detect the major dangers of the transaction, so that determine on which areas his investigation will focus. Due to the fact that the due diligence process will need to be conducted as soon as possible, purchaser's first step is to gather and organise his Corporate Development due diligence team rapidly but carefully as well[40]. Significant care should be given to the classification of everyone's role and responsibilities. People from staff functions and line management are selected by the buyer and need to be integrated in a due diligence team depending on their qualifications and knowledge.

The size of the transaction, the nature and the complexity of the arising issues in the due diligence process, in combination with the need for making the final report soon and under time pressure, require the appointment of external experts and professionals who will be part of each due diligence team[41]. It would be costly and time consuming for the interested investor to train his team in order to acquire knowledge for a specific area of examination under due diligence[42]. As a result, the due diligence process requires not only legal and financial advisors but also other professional advisors (for instance if there are environmental concerns to the target company an environmental consultant needs to join the team). [43]

Having gathered the experts needed for the specific transaction, then it follows the above already analysed "*due diligence checklist*" process. With the target to save time and money, professionals of every field will participate in a due diligence team, specifically created for the assessment of the specific area of the transaction. The results of each due diligence process will be compiled in the so-called "*due diligence report*". The last one is a useful means of organisation, like a system, in order to gather the findings of every due diligence team. This report will be given to the buyer in order to acquire some codified information about the target company and have in mind some conclusions of the experts when it comes to the final transaction. Every next step of the interested party will be assessed once again after these reports.

Usually, the report is divided into two parties. The first one which refers very briefly to the deductions of the report, also known as "*executive summary*", in practice. There, the experts write down in a codified way the basic facts and arising problems of the target firm (known as "red flags"). The second one, constitutes the *main corpus* of the report, in which all the

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[40] Michael E.S. Frankel, *Mergers and Acquisitions Basics,* WILEY INC., 2005, Chapter 7, p.154-155

[41] Steven M. Bragg*, Mergers and Acquisitions- A Condensed Practitioner's Guide,* WILEY, 2009, Chapter 5, p.93-95: Other alternatives are to perform all the work with the existing staff, in case of a small integration, or to form an acquisition analysis group that will evaluate the potential "candidates" on a constant basis.

[42] It is widely supported that a successful due diligence process results from a scrutinised due diligence investigation in many areas, with the participation of third and external professionals to be inevitable.

[43] Jefrey W. Berkman, *Getting a Deal Done - Due Diligence and the Business Transaction*, Apress, p.216-217

covered areas by examination are referred[44]. Despite its obvious practical use, the "*due diligence report*" plays an important role as evidence as well, if a potential liability issue arises. The report facilitates the process and makes it easier to prove if the purchaser had knowledge in advance about an issue.

At this point, it is important to mention that the writer of each "*due diligence report*" will be liable for all the information and conclusions included in the report in case an unexpected event or liability issue arises. For this reason and with the target to avoid such a liability, it is common in practice, at the precise moment that the writer gives the report to the purchaser, to provide him with the so-called "*release letter*". With the last one, excludes his liability of arising issues, once the writer declares that cannot guarantee the accuracy of the information included in the report[45]. In rare cases, the writer of the report decides to undertake his responsibility related to the content of his report. This is something that is clearly stated between the parties, this time with the so-called "*reliance letter"* [46]*.* This kind of declaration can make the expert liable and obligate him to face charges because of his inadequate and / or incorrect information included in the report.[47]

THE SELLER'S DUTY OF ENLIGHTENMENT

Defining what exactly the term "*Duty of Enlightenment*" means, is the act of the spontaneous and without previous demand provision of information to the purchaser, related to the potential investment. More specifically, the buyer and his due diligence team anticipate an access and enlightenment by the seller, when it comes to different issues related to the business[48]. The investor expects to be informed *ad hoc* about specific issues of great importance for the transaction. But obviously, the extent of the providing information cannot

[44] George T. Papachristou, *Ο Προσυμβατικός Έλεγχος της Πωλούμενης Επιχείρησης – Due Diligence*, First Edition 2021, p.56-58

[45] The *"release letter",* addressed to investor, has often the following content: "*A) You acknowledge and confirm that in connection with or arising from the disclosure of our Report we have no obligation, responsibility or duty of care towards you and any other third party to whom our Report is disclosed or into whose hands it may come. It is your sole responsibility to decide whether our Report may possibly serve your purposes. Any use of our Report and any reliance thereupon is entirely at your own risk. B) You accept that in providing you with a copy of the Report and otherwise communicating with you and / or your advisers concerning the Report we have no responsibility or liability to you, whether in contract, tort (including negligence) or otherwise*".

[46] On the contrary, the *"reliance letter"* has often the following typical content: *"We acknowledge that the Addressee may rely on the Report, in its final written form as of the date indicated above, in connection with the Transaction, subject to (i) limitations, reservations, assumptions and qualifications set out in the Report, (ii) limitations, reservations, assumptions and qualifications and terms and conditions set forth below and (iii) the payment of the Fee"*.

[47] Simmons & Simmons, Online Presentation, *Reliance Letters – Appreciate the value and consider the risks,* 23 May 2019

[48] This duty arises from the article 197 of the Greek Civil Code, referring to the liabilities of the parties, at the stage of negotiations, as follows: "*At the stage of negotiations, the parties have to act in accordance with good faith and honest practices*".

be unlimited by the seller. Otherwise, it would be an unfair practice for the seller, while more liability issues could be raised.

Various opinions have been supported, as far as the extent of seller' s responsibility to provide information to the buyer is concerned. The most acceptable one is the '*objective one'*, according to which the seller is obliged to enlighten the buyer about issues *in an objective way* and *in accordance with the good faith*. The information should be restricted only to those issues that are capable of influencing (positively / negatively) the expected purpose and finally the purchase of the business. Practice has proved that this information mainly relates with sustainability and the general "clear" business's situation. Indicated examples are the relationship with the suppliers and the existence of debts, threat or already existence of execution measures by company's lenders, break of contracts etc. This kind of information is the cornerstone for the buyer's decision to continue or stop the transaction and is of utmost significance in every merger or acquisition.

A significant arising issue under examination is whether the seller could be liable for "*contributory negligence*". According to article 300 of the Greek Civil Code, if the damaged party contributed with his actions to the damage, then the court can reduce the compensation paid by the other party or exclude it at all. The question around this article, in case of a due diligence process, is whether the defective due diligence conduct or the incorrect assessment of the answers given by the seller, could be capable of establishing contributory seller's liability.

This matter has already been solved by case law. Based mostly on the flow of information transferred by the seller, the limited time in which the buyer has to assess it and the potential investor's experience, could be deducted that is almost impossible for the seller to make an assessment *a priori* around the issue of whether the data transferred were sufficient or the buyer was in need of further information, excluding with this way the application of art. 300 of Greek Civil Code. [49]

Last but not least, it is worth mentioning the Board of Director's Duty of Confidentiality. Target company' s Board of Directors (BoD), as the major and superior organ of the firm, plays a crucial role in providing information and enlightening the potential investor. As has already been explained above, the contact with the BoD is maybe the most essential source of information. But the authority to provide information is not unlimited. Restrictions exist to the Greek Law 4548/2018[50]. The article 97 par.1 establishes an obligation for the company's

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[49] George T. Papachristou, *Ο Προσυμβατικός Έλεγχος της Πωλούμενης Επιχείρησης – Due Diligence*, First Edition 2021, p.75-102

[50] Law 4548/2018 (Official Government Gazette Bulletin A' 104/13.06.2018) "*Reform of the Law on Sociétés Anonymes*"

directors, not to reveal the company's "confidential", known to them due to their high position in the firm. The question arising here is whether the flow of information to the potential investor and his team, because of their interest to make a transaction, is competent with the director's duty of confidentiality.

It would be wrong to accept *a priori* an unlimited application of the above-mentioned rule, as would raise important problems in every transaction for the company. Unanimously supported that the director's duty is restricted for the sake of the company's interest. Of course, limitations continue to exist as widely accepted that the BoD has to balance the interests of the company from the expected merger and is liable for the protection of company's secrets. So, directors should assess in every single time, which of the above prevails, based on specific transaction's characteristics. The decision is not necessary to range among "all or nothing", while a balanced procedure seems to give the best results for both parties.

Once the BoD decides that confidential information should be given then has to choose the less burdensome measure. The most suitable measure that has been adopted in practice, seems to be the conduct of a "*confidentiality agreement*" between the members of the BoD of the target company and the receiver of information by the purchaser's side. The buyer and his team are obliged to keep confidential all the material gathered related to the target company through the due diligence procedure[51]. It is generally suggested the target company to be a contracting party to the above "*confidentiality agreement*" along with its directors and the potential investor. With this way the company can raise claims against the investor and any other receiver of the information[52]. The agreement will, also, determine the extent of compensation and other penalty clauses in case a party violates the terms of the "*confidentiality agreement*". So, the "*confidentiality agreement*" is assessed as an adequate measure for avoiding the arbitrary disclosure of information by the BoD and for complying with their duty of enlightenment in the most effective way.[53]

[51] In most cases, confidential is not only the information transferred to the purchaser but the transaction as well. The parties may decide to keep secret their intention to have a merger or an acquisition (the so-called "business secret") and even the whole stage of negotiations may be conducted under privacy and secrecy.
[52] A typical writing is the following: "*The Company may enforce the terms of this Confidentiality Agreement as if it was a party to this Confidentiality Agreement, pursuant to articles 410 et seq. of the Greek Civil Code*".
[53] George T. Papachristou, *Ο Προσυμβατικός Έλεγχος της Πωλούμενης Επιχείρησης – Due Diligence*, First Edition 2021, p.104-113

CHAPTER 3: SELLER'S GUARANTEES AND LIABILITY ADJUSTMENT

Having examined the way that the due diligence process is taking place, it seems of utmost importance, in the following chapters, to focus on the pre-contractual treatment of the potential arising liability issues. Even though the transaction is actually a purchase, as one business buys another, the enforcement of the general rules of law is almost always set aside. The reasons are that, firstly these rules are considered "soft law", giving priority to the private autonomy of the parties and secondly, special particularities exist in such kinds of transactions. In any case, if the parties decide not to define their own rules to their final contract, rules of law are activated any time a liability issue arises.

Before elaborating more on the liability clauses that parties usually agree upon, it is important to begin from the seller's provided guarantees as the foundation for the continuity of the process and finally the conclusion of the deal. These are presented with the form of "*Representations and Warranties"* and are incorporated in the *"Disclosure Letter".* More specifically these two forms of guarantees have the following form and content in an agreement:

"REPRESENTATIONS AND WARRANTIES"

Trying to define the term "*Representations and Warranties*", they are considered as statements of fact which are provided by the seller to the buyer and the seller confirms as being true[54]. Automatically, the seller excludes his liability for all the issues disclosed, so the purchaser is not capable of raising claims against him. But if the buyer proves that a representation or warranty was dishonest, then may support claims in tort and for breach of implied warranties[55].

i) The general concept of "*Representations and Warranties*"

The technical difference between these two terms is that representations are presenting existing or last facts, while warranties are actually promises with which the seller declares that existing or future facts are or will be true[56]. The distinction of these two terms seems unimportant and superfluous in practice.

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[54] Peter Howson, *Due Diligence – The Critical Stage in Mergers and Acquisitions*, 2003, Chapter 2, p.27

[55] Donald DePamphilis, *"Mergers and Acquisitions Basics*", ELSEVIER, 2011, Chapter 8, p.176-177: Such declarations abbreviate the due diligence period based on the theory that the buyer will be protected by a well-written agreement between the parties, focusing on agreed contractual clauses.

[56] American Bar Association, *Model Asset Purchase Agreement*, 2001, Chapter 3: Representations and Warranties of Seller and Shareholders, p.69

The above declarations determine the 'proper situation' in which the business is, when the transaction is taking place. If deviations are located, then liability issues rise. There are many purposes that aim to be served with the above declarations. To begin with, the buyer acquires knowledge and obtains disclosure about important facts for the company, before the final transaction takes place. Also, the seller's representations put the foundation for the buyer's right to decide whether to continue or to terminate the deal. Finally, such declarations provide the buyer with the opportunity to raise claims against the seller and other involved parties in the transaction, on a potential subsequent discovery of adverse facts. In fact, the most important target of representations is that they act as an allocation of risks, a mechanism between the seller and the purchaser[57]. It is not easy for the parties to reach an agreement about the content and the extent of providing representations and warranties, but it is all about negotiations and good faith.

There is always a connection between the "Representations and Warranties" clauses and the pricing of the transaction. The negotiation of the final price is taking place under the so-called "*locked box mechanism*". The last one indicates that specific financial statements will be known and will be considered by the buyer in order to conclude the deal. Both advantages and dangers which will follow the date being considered as a reference point, will be either compounding or beneficial for the purchaser. [58]

Another important aspect is that these representations differ from the warranty under the Greek Civil Code, as it is coordinated under the purchase law. Firstly, because the adoption of the contractual clause of "Representations and Warranties" bases on the private autonomy and on the principle of freedom of contracts[59]. And secondly, because warranties under the purchase law are closely related with the agreed properties of the business which can only be referred to the current period of time. On the contrary, "Representations and Warranties", as contractual clauses, can refer also to the future situations. Finally, the issue whether a providing warranty can be examined under the scope of Civil Code or the assessment is totally left to parties' autonomy is a matter of interpretation. For this reason, it is suggested that the contractual parties prefer to clearly define whether the warranty has been included as an autonomous term or is related to the agreed properties. [60]

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[57] American Bar Association, *Model Asset Purchase Agreement*, 2001, Chapter 3: Representations and Warranties of Seller and Shareholders, p.70-71

[58] This method is completed by the term "*no leakage*". According to this one, a date is determined as a reference point, after which the purchaser is obliged not to take advantage or create financial obstacles in the company, with the purpose to diminish its value.

[59] Article 361 of the Greek Civil Code

[60] George T. Papachristou, *Ο Προσυμβατικός Έλεγχος της Πωλούμενης Επιχείρησης – Due Diligence*, First Edition 2021, p.227-228

At this point, it is essential to make the following distinction: the "*Representations and Warranties"* can either be "*Strict"* or "*Mild"* ones. This distinction determines the extent of seller's liability in case one of his provided warranties were defective or false. In the occasion that the parties have agreed upon "Strict Representations and Warranties", then the liability is unlimited. The seller will be liable for every result, independently of his knowledge or culpable ignorance, when it comes to the accuracy or the rightness of the matters upon which have guaranteed. Obviously, such a prediction would be favourable for the purchaser, because the seller's liability is totally disconnected from subjective criteria, having achieved with this way his total recovery and protection. Regarding the burden of proof, things are easy for the buyer who has only to prove that the company's situation deviates from the seller's representations and warranties. Then the road for claim compensation is open.

On the contrary, "*Mild Representations and Warranties*" indicate that the objective criteria for raising liability charges to the seller have been excluded by the parties. If their agreement was based on subjective ones, then this means that the seller depends his guarantee and his potential liability on his knowledge. Usually, the seller declares that guarantees and undertakes the liability for matters "*to the best of his knowledge*". Significant discrepancies are incorporated, in order to prevent the buyer from raising claims against him. The main advantage of this type of representation is located in the burden of proof. Here, the purchaser has the burden to prove that the seller was aware of his false representations and defective warranties.

The determination of which 'model' will be adopted at the end, is dependent on the bargaining power of the parties. A seller with the bargaining power will try to impede the "Mild" model, while a buyer with the bargaining power will make his best effort to incorporate the "Strict" one[61]. There is, also, the possibility the parties neglect to make clear which model they have adopted for their contractual relationship. Then, it is again a matter of interpretation.[62]

With the purpose to diminish the risks and dangers undertaken by the seller, various solutions have been adopted, in practice. A first one is the incorporation of the phrase "*to the best of his knowledge*" when a warranty is provided by the seller. The so called "*best knowledge clauses*" restrict the seller's liability only to these issues that had real knowledge about and guaranteed for their correctness and accuracy. Another adopted solution is to write down the names of all the engaged persons in the transaction that could have knowledge about the

[61] However, there are some cases in which the liability is, in natura, objective. For example, this happens in case of a share deal. The seller ensures that the shares exist and not have legal defects, irrespective of the knowledge that might not have for the shares of other shareholders.
[62] George T. Papachristou, *Ο Προσυμβατικός Έλεγχος της Πωλούμενης Επιχείρησης – Due Diligence*, First Edition 2021, p.234-237

issues and the seller guaranteed with the "Representation and Warranty" clause for them. With this way, the seller's liability is delimited and the seller has the chance to estimate the extent of dangers and risks that are undertaken with the above clauses. Another aim is to restrict the number of persons that could be liable, to these persons enjoying managerial positions in the company.

A typical wording of the a "Representation and Warranty" clause would be the following: "*In determining whether the Seller has the knowledge referred to in a Warranty, it shall be treated as knowing: a) anything which is known to any of its directors; and b) anything which is known to the persons listed in Schedule(..) but, in respect of each of the individuals named, only in relation to those of the Warranties which are specified against his name in that Schedule*". With this content the above clause would be considered as a "risk clause" [63], with which the purchaser recognizes that it is not possible for the seller to have been aware of all the information disclosed by the participating, in the transaction, persons, but only of those that can be considered "*representatives of knowledge*" in the company, meaning the persons on managerial positions.[64]

After the above analysis, it could be easily deduced that "Representations and Warranties" are supported by the private autonomy, the principle of freedom of contracts and of course the good faith. These clauses are present at every transaction and can solve potential issues between the parties more effectively than the law.

ii) Issues related to compensation

Once it is proved that a "Representation and Warranty" was false or defective, then liability issues are emerged. The purchaser will demand to return to the position that would be if the defect did not exist and the seller is obliged to pay compensation to the buyer. As a rule, monetary compensation is preferable than an 'in natura' one [65]. The monetary compensation includes the coverage of the positive difference, meaning that the purchaser should be in such a position, if he knew the real facts and had made different negotiations with the seller.

The calculation of the compensation is another controversial issue. The reference point in this case, seems to be the objective characteristics of each specific transaction, such as the buyer's

[63] This clause should be distinguished by "non-reliance" clauses, according to which the seller's liability for information disclosed by other participating parties can be excluded. For more details, see below at Chapter 4, pages 34-35

[64] George T. Papachristou, *Ο Προσυμβατικός Έλεγχος της Πωλούμενης Επιχείρησης – Due Diligence*, First Edition 2021, p.237-242

[65] Both theory and courts have been concerned about whether an 'in natura' compensation could be effective. As there are no clear answers to this question, it is suggested that the parties determine what exactly the compensation would be (monetary or 'in natura') in case of a violation of the clause.

aims, the designation of the deal, the price etc, in order to restore the balance in the parties' relationship. But in the majority of cases, the parties conclude on some restrictions to the compensation, on their own and *a priori*. These restrictions can be both quantitative and temporal. In the category of quantitative restrictions are included: **a)** The exclusion of seller's liability for damages that have significantly fallen short the price of the deal *("de minimis")*. The main aim is to avoid raising claims against the seller for minor damages of less importance. **b)** The adoption of the so-called "*basket*" deal [66]. Here, there is a prediction by the parties that the claims raised against the seller need to be superior to the *de minimis* level as well as to the *basket* level, in order to be covered [67]. There are two possibilities: according to the first one, the parties predict that the liability of the seller is restricted only to the superior amount of the *basket* ("*excess only – principle*"), while the second one covers the whole amount, irrespectively of the basket ("*first dollar – principle*").

It is important to mention that for specific representations and warranties, related to the core issues of the company (such as the ownership of the shares) the liability is always unlimited. When it comes to the temporal restriction, it is always a matter of negotiations, until which period of time, following the transaction, the seller will be liable for his "Representations and Warranties". The tendency, in practice, ranked between one to two years after the conclusion of the deal. Of course, there are specific exceptions for important issues in which either temporal restrictions are not predicted at all or the time limit is expanded. The above-mentioned restrictions are mainly beneficial for the seller. Every seller wants to be dispelled by the purchased company and aims to restrict his liability, in order to ensure that can continue his action to the business world without the eternal fair of possible raising claims by the purchaser.[68]

The last significant issue that can arise, in respect of the compensation, is the liability of third parties participating in the business transaction and mainly in the due diligence procedure. As the seller is not capable of knowing all the information that are disclosed to the purchaser by the directors of the company and other employees, it is common for the seller to receive the so-called "*management letter*" by the directors of the company, in which the last persons provide guarantees about the accuracy and rightness of the information disclosed to the potential purchaser. The main purpose is to boost the seller's confidence by being ensured that all the information given was accurate and will not be a possible violation of "Representations and Warranties".

[66] In practice, the "basket" level usually ranked between 1-3% of the total price of the transaction.

[67] American Bar Association, *Model Asset Purchase Agreement*, 2001, Chapter 3: Representations and Warranties of Seller and Shareholders, p.72

[68] George T. Papachristou, *Ο Προσυμβατικός Έλεγχος της Πωλούμενης Επιχείρησης – Due Diligence*, First Edition 2021, p.228-231

Furthermore, cannot be excluded the occasion in which the purchaser asks directly from the directors of the company guarantees for the disclosed information. The "*management representation letter*" gives the buyer the chance to raise an autonomous claim against the managers and also to avoid the participation of the managers as witnesses, in a potential future trial, between the seller and the buyer.

"DISCLOSURE LETTER"

In addition to "*Representations and Warranties*" the transactional practice has emerged the so-called "*Disclosure Letter*" as a measure of proof, in order to calculate each party's liability.

i) Nature and content

More specifically, the "*Disclosure Letter*" exists with the purpose to prove that the buyer had knowledge about some facts which have been written down to a list and for this reason no liability issues are raised against the seller.

The form that the "*Disclosure Letter*" usually has, is to be a *separate document* given to the buyer and his due diligence team, the time before the conclusion of the transaction. In this document, there is a catalogue numerating different facts and issues, already known during the due diligence process [69]. In the main content of the final contract, there always exists a reference to the disclosure's letter list. This adopted technique presents a lot of advantages. The majors are, firstly, the fact that the contract is simplified, as all these facts and issues are included in a catalogue and there is no need for it to be incorporated as separate documents in the main contract. And secondly, the existence of a list makes the letter flexible, meaning that it is easier to make amendments and additions at almost every stage of the transaction[70], from the negotiations stage to an advanced, and close to the transaction one. Lots of professionals have underlined the need of being composed and assessed by both the contractual parties cautionary.

A typical detailed wording of the *"Disclosure Letter"* mentioning in the content of the party's agreement is the following: *"The disclosures in the Disclosure Letter, and those in any Supplement thereto, must relate only to the representations and warranties in the Section of the Agreement to which they expressly relate and not to any other representation or warranty*

[69] Robert Thompson, *Sinclair on Warranties and Indemnities on share and asset deals*, 11th Edition 2020, par. 9-07

[70] Need to be careful here, as if the seller makes additions at an advanced stage of the transaction which are considered substantial for the buyer, the transaction may be suspended or cancelled at all.

in this Agreement" [71]*.* It is important to be mentioned that specific references can also exist relating to potential updates or amendments of the *"Disclosure Letter".*

From the first look, the "*Representations and Warranties*" clauses and the "*Disclosure Letter*" seem to have a lot of similarities. Their main difference is that, as has already been explained above, the "*Representations and Warranties*" clauses aim to ensure a reasonable relationship between the purchased business and the offered price. All these events and issues under the guarantee of a "*Representation and Warranty*" clause describe the *status quo* of the business, including all the possible and already acceptable by the buyer danger. Similarly, the "*Disclosure Letter*" aims to make known to the buyer all these facts that are important for the transaction and can exclude the seller's liability.

ii) Forms of the "*Disclosure Letter"*

As far as the forms that the "*Disclosure Letter*" can take is concerned, these are divided into two categories: the "*Specific Disclosure*" and the "*General Disclosure*". It is also possible, those two forms to be combined in the same letter. In both cases, the "*Disclosure Letter*" will have attached copies of the documents, providing all the disclosed information to the buyer. The last one practice consists a key-element in the whole process, and is known as the *"Disclosure Bundle".*[72]

To begin with, the "General Disclosures" will be as general as possible. As they apply in every transaction are usually standard disclosures with standard content and way of drafting. The seller will make references to the database from which the buyer had taken information and will try to avoid any connection of a disclosure with the "Representation and Warranty". To name just a few examples, a typical general disclosure would be the reference to public records and all this available information in the public registers [73] (ex. articles of associations, minutes of the meeting, financial statements). The idea is that by reference to all this general and open accessible information the buyer will be treated as cognizant of the seller's disclosures and the last one will not be accused of any liability. On the contrary, "*Specific Disclosures*" are the seller's opportunity to specifically disclose some matters, with the purpose to connect this disclosure with a specific given *"Representation and Warranty".* If this disclosure was not made, then it would constitute a breach of warranty. To be more precise, for instance, if the seller has guaranteed that the target company is not subject to any litigation, he needs to disclose all these documents which prove that no current litigation affecting the company.

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[71] Law Insider, *Disclosure Letter Sample Clauses*, online database

[72] Legal Vision, *"What is a disclosure letter"*, online website

[73] Morgan Lewis, *"Practice Guide: M&A Transactions",* law works, p.9

When it comes to the above mentioned *"Disclosure Bundle"*, it contains documents which have been disclosed in the letter and generally are attached as annexes to the "Disclosure Letter". This technique is beneficial for both the contracting parties. The seller ensures that has provided a full and honest disclosure and the buyer is aware of any relevant documentation associated with the disclosures feeling more confident. The form that these annexes usually take, is the exchange of a hard drive or a USB stick or other electronic files between the parties, as it is expected the quantity of documents to be massive.[74]

As expected, the "General Disclosures" are those that raise problems. The main issue that parties have to face is to determine *a priori* to what extent the presentation of some documents can be considered as declarations of all the facts and information contained or resulted from them. In other words, to what extent the seller disclosed facts in a comprehensible way in order to let the buyer understand for which issues the seller excludes his liability. This issue is commonly solved with the "*fair disclosure"* treatment.[75]

Aiming to avoid misunderstandings and liability issues and mainly in order to protect buyer's interests, the transactional practice has introduced the *"Fair disclosure*" clause. According to the last one, the seller undertakes the obligation to disclose information and to provide the appropriate documents to the buyer, in such a reasonable, absolute and sufficient way for avoiding to pass on the comprehensive risk to the buyer [76]. The disclosure can be agreed with the form of "*fair disclosure"* or *"full, fair and specific disclosure"*. Each of the clauses that the parties decide to adopt and finally include in their agreement is important to depict their clear intention. Then, the assessment and interpretation of the clause, in a possible litigation, would be easier.

[74] Morgan Lewis, *Practice Guide: M&A Transactions,* law works, p.9-10

[75] George T. Papachristou, *Ο Προσυμβατικός Έλεγχος της Πωλούμενης Επιχείρησης – Due Diligence*, First Edition 2021, p.263

[76] Bismarck, *Corporate acquisitions and mergers*, 2018, par.179

CHAPTER 4: DEFINING AND EXPLAINING PARTIES' CONTRACTUAL LIABILITY

The way and the extent of the information that will be disclosed by the seller are important factors for the determination of his responsibility. An obvious matter is that the two contractual parties have *conflicted interests*. Meaning that the seller's main target is to expand as much as possible the general concept of the information revealed for each specific matter. But usually, the parties want to find a balance in their relationship. Otherwise, the buyer will be in a disadvantageous position, as in case a problem is disregarded and it is accepted that has the proper knowledge, will not have the chance to put the blame on the seller.

The more danger is eager to undertake the seller, the less the liability for the purchaser, in case of a failed transaction. The information that has been collected by the buyer through the due diligence process constitutes the foundation for the negotiations and finally the inclusion of contractual terms when it comes to liability issues.

A) SELLER'S CONTRACTUAL CLAUSES

"EFFORTS"

Another important measure of protection that a seller usually undertakes is the connection of his liability with a specific duty of care. This connection is accomplished by the so-called "*Efforts"* clauses. According to these clauses, the buyer and the seller agree that the last one is going to show off a special behaviour and make some efforts in order to comply with the contract's expectations[77].

i) Defining and Classifying "*Efforts"* clauses

The transactional practice has developed a wide range of such clauses. Often, these "Efforts" clauses are classified according to their "heaviness" in contractual relationships. To be more specific, the two most well-known categories are the "*Best Efforts*", which defines the maximum possible effort and the "*Reasonable Effort*s", indicating the effort expected to be taken. Other variations are the *"Good Efforts*", "*Diligent Efforts*", "*Commercially Reasonable Efforts*" and "*Reasonable Best Efforts*".

It is not easy to understand just from the name of each clause and its meaning. For this reason, the use of such clauses in contracts has raised lots of issues. Their physical ambiguity raises questions around the specific content and meaning. And such issues can be disastrous when

[77] In order to define the meaning of these clauses, the traders in the USA use the word "*Efforts*" while in England the term "*Endeavors"*

it comes to discovering parties' liability. In plenty of cases, practice has proved that even when the parties have concluded on their own such an "*Effort*" clause, they did not know how to interpret it when an issue emerged. Because of the use of standard samples, the clause is usually transferred to the new contract without even having been examined by the parties its suitability for the specific transaction.[78]

For the purpose of overcoming the difficulties and the vagueness of these clauses, professionals tried to classify the clauses as follows[79]:

- *Best Efforts*: the highest standard, requiring a party to do essentially everything in his power to fulfill his obligation [80] (for example, by expending significant amounts or management time to obtain consents).
- *Reasonable Best Efforts*: somewhat lesser standard, not requiring any action beyond what is typical under the circumstances.
- *Reasonable Efforts*: still weaker standard, not requiring any action beyond what is typical under the circumstances.
- *Commercially Reasonable Efforts*: not requiring a party to take any action that would be commercially detrimental, including the expenditure of material unanticipated amounts of money or management time.
- *Good Faith Efforts*: the lowest standard, which requires honesty in fact and the observance of reasonable commercial standards of fair dealing. Good faith efforts are implied as a matter of law[81].

Obviously the "Best Efforts" clause belongs to the top of the classification pyramid, highlighting its binding nature for the seller, while the "Good Faith Efforts" clause declares a very relaxed tie with the seller's liability. This kind of sorting indicates clauses ranked from assuring the maximum protection to the buyer and the maximum duty of care to the seller, to the minimum protection to the buyer and the minimum duty of care to the seller.

The above classification is important and worth mentioning. Despite the fact that there are professionals who support the hierarchy of "*Efforts*" clauses, the majority of experts today is against the distinction and the different explanations of these clauses. Actually, they support that all these clauses need to be determined and applied under the same scope, defining the criterion of *"Reasonable Effort"* as the single evaluation one. On the opposite side, it is suggested that when the parties include in their contract different types of "*Efforts*" clauses,

[78] Adams, *Business Law 74*, 2019, p. 721

[79] The effort was made by the American's Bar Association (ABA) Committee on Mergers and Acquisitions.

[80] But this does not mean every conceivable effort. The promisor is not expected to ignore its own interests or incur substantial losses. The party needs to make such efforts in the way that are reasonable and according to its liabilities.

[81] Apposition as presented at Adams, *Business Law* 74, 2019, p.681

then the classification cannot be ignored because it seems that the parties' true intention was to distinguish each of the used clauses.[82]

As have already been mentioned, most contracts adopt some standard samples in order to incorporate a desired "*Effort*" clause. It is important to stress the particularities that exist in the Greek language when it comes to the adjustment of pre-written terms and whole sentences from English to Greek. The way that these terms are interpreted in English, it is almost impossible to be translated with great accuracy to the Greek language. The translation usually has failures and the real meaning of the term cannot be presented [83]. Having this aspect in mind, it is preferable not to accept totally the classification of the "*Efforts*" clauses, unless the parties can make clear on their contract which is their real intention, after including a specific "*Effort*" clause.

ii) Interpreting "*Efforts"* through the international case law

The "Best Efforts" clause has been already considered as the most onerous of "Efforts" standards and for this reason the courts, at an international level, tried to interpret this stricter form through case law. To begin with, a first opinion that emerged at the case *Triple-A Baseball v. Northeastern Baseball* [84], was the identification of best effort to the general duty of good faith. As the US court was mentioned[85] : "*We have been unable to find any case in which a court found…that a party acted in good faith but did not use its best efforts*" [86].

This base of interpretation can, also, be examined under the scope of Art. 288 of the Greek Civil Code. According to this article "*The debtor has the obligation to fulfill the benefits as required by good faith, after taking into account the transactional manners*". Making a try to identify the terms "Best Efforts" and "Good Faith", can conclude that when a person acts in good faith then results in making his best effort to fulfill the agreed terms. On the contrary, some experts support that every time parties decide to incorporate a specific clause in their transaction there is always a reason. Their real intention is not just to repeat the rules of law but to go a step further and deviate from their content. As the parties have spent a lot of time negotiating and also money in order to reach an agreement, maybe their true intention is not

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[82] Adams, *Business Law 74*, 2019, p. 704-709

[83] George T. Papachristou, *Ο Προσυμβατικός Έλεγχος της Πωλούμενης Επιχείρησης – Due Diligence*, First Edition 2021, p.245-246

[84] In this case, the plaintiff 'triple A-Baseball' and the defendant 'double-A Baseball', both team owners, entered into a series of agreements whereby each of them would sell the baseball team to the other. The transaction was subject to consent of the Eastern League, as the governing League. The parties agreed to make their "*Best Efforts*" in order to obtain the League's approval of the sale. The last one refused to approve the sale of the double-A team, unless relinquishment of the rights in the team to the Eastern League was given.

[85] Similarly, the case *Soroof Trading Development Co v. Ge Fuel Cell Systems LLC: "…a best efforts clause imposes an obligation to act with good faith in light of one's own capabilities"*.

[86] Casetext, Analyses of this case by attorneys, online website

to confirm the law but to diverge from it, reaching a clause consciously and agreed on highest standards of seller's duty of care[87]. Continuing with a second approach emerged from case law, some courts have adopted the opinion that every "*Effort*" clause is subject to a reasonableness test, in order not to impose the seller make everything possible for fulfilling the contractual obligations, but only those actions reasonably necessary for the deal [88].

In conclusion, elaborating more the above facts in the due diligence process, the parties need to put the foundations for their agreement and clarify their real intentions in their contract. So, if they decide to let the law aside and include a specific *"Effort"* clause, to be ready to interpret it once a liability issue emerges[89]. It is suggested the incorporation and use of only one of the "*Effort"* clauses, in order to avoid interpretive difficulties[90].

"INDEMNITIES"

In every transaction, the seller recognizes that future arising issues, related to his activity in the company, are going to emerge. With the target to protect the buyer, the parties usually agree on specific compensation clauses, the so-called "*Indemnities*" [91]. These kinds of compensation clauses mainly protect the buyer from unknown to him, but expected for the seller, dangers. A contractual indemnity is often expressed as a promise to secure the other party against loss or to save and keep the other party harmless from loss. Actually, it is the only essential method according to which the indemnifier (seller) will protect and compensate for the loss the indemnified party (buyer). And this is why issues known to the seller that are going to occur with relative certainty are in need of further prediction in order to protect the buyer and exclude the possibility of a failed transaction.

A frequent form and structure of a contractual indemnity consists of the description of the indemnifier, of a set of expressions and wordings according to which the one party gives a promise to compensate the other party and offers a statement of the general scope and concept of the providing protection[92]. Referring to a typical wording of an "*Indemnity*" clause, has the following content: "*Buyer shall defend, protect, indemnify and hold harmless Seller, Seller's Affiliates and their respective partners, shareholders, members, officers, directors, employees and agents, as applicable, and the Property Manager from and against all Losses*

[87] George T. Papachristou, *Ο Προσυμβατικός Έλεγχος της Πωλούμενης Επιχείρησης – Due Diligence*, First Edition 2021, p.246-247

[88] For more details, look at case *Coady Corp v. Toyota Motor Distributors*

[89] George T. Papachristou, *Ο Προσυμβατικός Έλεγχος της Πωλούμενης Επιχείρησης – Due Diligence*, First Edition 2021, p.248-250

[90] Adams, *Business Law 74*, 2019, p. 716

[91] It is possible the same issue be subject of a "*Representations and Warranties*" and of "*Indemnities*" clauses, at the same time.

[92] Wayne Courtney, *Contractual Indemnities*, HART Publishing, January 2014, Introduction – Contractual Indemnities

(whether arising out of injury or death to persons or damage to the Property or otherwise) including, but not limited to, costs of remediation, restoration and other similar activities, mechanic's and materialmen's liens and attorneys' fees, arising out of or in connection with Buyer's Due Diligence, Buyer's breach of its obligations or Buyer's or any Licensee Parties' entry upon the Property; provided, however, that Buyer shall have no obligations under this Section to the extent the Losses are caused solely by the negligence or wilful misconduct of Seller, Seller's Affiliates, Seller's partners, shareholders, members, officers, directors, employees and agents, as applicable, and/or the Property Manager or result from the mere discovery by Buyer of pre-existing conditions at the Property and the Buyer promptly notifies Seller in writing of such discovery. The provisions of this Section shall survive the Closing or, if the purchase and sale is not consummated, any termination of this Agreement" [93].

The clause has to be more concrete when it comes to a purchased business. Typical examples of the matters that usually refer to, are the existence of past tax debts or/and violations of the legislation due to specific events and actions that had been taken place by the seller. In these cases, the seller expects that, sooner or later, the purchased business will be examined by tax authorities or be subject to litigation and as a result the firm will be responsible for paying a tremendous (administrative) fine. With the purpose of complying with his contractual obligations and acting in good faith, the seller has to reveal this information to the buyer and undertake his responsibility. This happens through a concrete "*Indemnity*" clause, as presented above, according to which the seller undertakes the responsibility to pay to the buyer the total amount of money that the purchased company will be obliged to pay because of the seller's damaging event. There is no obligation for the buyer to prove that the damaged event caused an actual damage to him and his business, as just the occurrence of the event is sufficient. Usually, the clause's content is clear, adopting mutual obligations for the parties. The seller will pay the whole amount and the buyer will be willing to constantly inform the seller about the case and cooperate with him, keeping in mind their common interest.

However, the recognition of such a flat-rate compensation contract with no given right for rebuttal by the seller's part is not generally acceptable as an autonomous position under the Greek Law [94]. The reason is that such a prediction is contrary to the mandatory provision of the article 298 of the Greek Civil Code. According to the last one "*The compensation includes the reduction of the lender's existing property (positive loss), as well as the lost profit*". Despite the fact that the parties are free to conclude whatever they want based on the principle of freedom of contracts[95] and on their private autonomy, there are restrictions to these rights when mandatory provisions exist. The provision of Art.298 of the Greek Civil Code is

[93] Law Insider, *Due Diligence Indemnity Sample Clause*, contract database

[94] According to the Supreme' s Court decision 2049/2017: "*the recognition of a flat-rate compensation contract can raise validity issues…"*

[95] See art.361 of the Greek Civil Code

mandatory for the parties in every transaction, as it encourages the restorative nature of compensation. The main target of the provision is to find the balance between the damage and the amount needed to be paid as compensation and not to make the damaged party rich. The last one needs to return to the situation that was before the damage. The damaged party is exempted from any obligation to prove the facts and the harm as such a prediction can cause only disparity and problems.

B) BUYER'S CONTRACTUAL CLAUSES

The way that the information was disclosed during the due diligence process and if it could be totally understandable by the buyer and his team under the pressure of the deal, have led to the adoption of another essential clause incorporated in almost every agreement: the so-called "*Proper Knowledge Clause*". According to this clause, the parties agree that the seller has provided the buyer with all the information needed in a fully, explicit and detailed manner, related to matters that are already known to the seller or matters that are expected to emerge in the future and are all important for the business's assessment.

Generally, the "*Proper Knowledge Clause*" is similar to the seller's Duty of Enlightenment as has already been presented and analysed at Chapter 2. The main difference between these two is that the Duty of Enlightenment is based on the general principles of law and the duty of good faith, while the *"Proper Knowledge"* is a clause, specifically agreed upon by the parties and additional to the above duty as emerged by the law. The consequences of violating each of the above duties are the same: the seller will be liable in case of an incorrect or defective disclosure of information. It is important to mention that the buyer has the right to establish, in an autonomous way, a claim for compensation because of the infringement of his duties.

"SANDBAGGING"

The "sandbagging" [96] clause is beneficial for the buyer and is included in a final agreement usually after long negotiations with the seller. A typical wording of this clause is the following: *"The right to indemnification, payment, reimbursement, or other remedy based upon any such representation, warranty, covenant or obligation will not be affected by any investigation conducted or any Knowledge acquired at any time, whether before or after the execution and delivery of this Agreement or the Closing Date, with respect to the accuracy or inaccuracy of, or compliance with, such representation, warranty, covenant or obligation".*[97]

[96] The origin of the term has been of great interest. It is believed that the term derives its name from the use of a bag or a sock, full of sand, as a weapon in a surprise attack.

[97] George T. Papachristou, *Ο Προσυμβατικός Έλεγχος της Πωλούμενης Επιχείρησης – Due Diligence*, First Edition 2021, p.273

According to this term, the parties conclude that even though the buyer has knowledge about an incorrect or violated "Representation and Warranty" given by the seller, has the right to start proceedings against the seller and claims compensation for his damage. It is obvious that such a benefit for the buyer's side clause would not be easily acceptable by the seller. There are plenty of reasons that the buyer would like to incorporate such a clause. First of all, the legal safety that the buyer would feel, because during the due diligence process it is difficult for the buyer and his team to notice all the existing problems or potential dangers. Secondly, the buyer is more protected against devious seller's actions. In order for parties to have a balanced relationship the warranties and the information that the seller chooses to disclose are given in a more general and abstract way, with the purpose to make it difficult for the buyer to acquire proper knowledge. Of course, if the parties agree on such a clause this would be taken into account at the price of the purchased business as well.

Need to be mentioned that in American legal systems the use of the *"sandbagging"* clause is more popular and frequent than the European ones. The American courts are in two minds when it comes to the acceptance or not of "*Sandbagging"* clause in an agreement. Those Courts that are in favor of the clause and award compensation are called *"pro-sandbagging"* while those that are against the clause and not make acceptable lawsuits and compensation claims are called *"anti-sandbagging".* Generally, the trend is the "pro-sandbagging" as the *"Sandbagging"* clause is acceptable from the two bigger and most important US States [98], New York and Delaware State.

"NON-RELIANCE"

As has already been explained in detail, one of the most important sources of information for the interested buyer is the contact with the Board of Directors (BoD) of the company and of course the employees. All these parties play an active role in the due diligence process and in the achievement of the seller's duty of enlightenment and disclosure of information. The difficult issue that parties need to solve *a priori* is the following: Will the actions or the omissions (and the arising negative consequences) of seller's representatives be charged to the seller?

The answer is not clear. There are supporters of the opinion that the seller should be accused in any case and others who insist that the responsibility belongs to the "employee" who gave or omitted to give the information. It is preferable not to adopt *a priori* an opinion but to examine every occasion *ad hoc*, having in mind the specific characteristics of the transaction and the "employee's" position in the purchased company [99]. With the addition of such a "*Non*

[98] Charles K. Whitehead, *Sandbagging: Default Rules and Acquisition Agreements*, 2011, p.1090-1100

[99] George T. Papachristou, *Ο Προσυμβατικός Έλεγχος της Πωλούμενης Επιχείρησης – Due Diligence*, First Edition 2021, p.280-282

Reliance" clause, the parties conclude that their Agreement, either for an asset or share deal, constitutes their main and universal agreement, excluding previous written or oral declarations between them.

In order to have an unambiguous relationship, the parties usually define the role and the extent of the responsibility of the seller's team. It is possible for the seller to face charges because of the unreliability or untruth of the seller's team declarations during the due diligence stage. As the seller usually does not know exactly and in great detail, due to time pressure, which information about the business was transferred to the buyer and by whom, it is possible to take on the responsibility of some unpleasant results. Along with the seller's "Representations and Warranties" and all the other facts included in the disclosure letter, the seller desires to exclude his liability for potential negative results of third parties' actions.

This is achieved with the incorporation of the "*Non Reliance"* clause in the contract. With this clause the buyer acknowledges that his opinion for continuing and finally concluding the transaction was based only on the written "Representations and Warranties" as provided by the buyer and his team and not to other references, either oral or written, provided in the pre-contractual stage and not included in the final agreement[100]. The incorporation of such a clause in the Agreement is still subject to intense dialogue. The main thought is to what extent is possible to exclude the seller's liability *a priori* for facts and information provided by his team, at the pre-contractual stage and have finally been proved false and unreliable[101]. There are several arguments in favor of this position, such as the fact that a "Non Reliance*"* clause just confirms what the seller has already disclosed and guaranteed with his "Representations and Warranties*"* or that this clause improves the quality of the provided due diligence process as the seller may provide only those facts, the accuracy of which can be guaranteed.

After all these, a certain conclusion is that the "Non Reliance" clause is subject to negotiation by both parties and in case of adoption in the Agreement is taken into account once the price of the deal is accorded.

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[100] A typical wording of a "Non Reliance" clause has the following content: *"This Agreement and the other Transaction Documents together set out the whole agreement between the parties in respect of the sale and purchase of the Shares and supersede any prior agreement between any of the parties (whether oral or written) relating to the Company and/or the Proposal Transaction. It is agreed that: a) no party will have any claim or remedy in respect of any statement, representation, warranty or undertaking made by or on behalf of any other party (or any of its Affiliates or its or their Connected Persons) in relation to the Proposed Transaction which is not expressly set out as a representation or warranty or undertaking in this Agreement or any other Transaction Document; b) any terms or conditions (including, but not limited to any warranties or representations) implied by law in any jurisdiction in relation to the Proposed Transaction are excluded to the fullest extent permitted by law or, if incapable of exclusion, any light, or remedies in relation to them are irrevocably waived….provided that this Clause will not exclude any liability for (or remedy in respect of) fraud, gross negligence, wilful misconduct or fraudulent misrepresentation".*

[101] The true concept of this clause is to be a permissible risk clause for both parties and not an exculpatory clause for the seller.

CRITICAL ASSESSMENT

The necessity of the due diligence process, in almost every kind of transaction and especially in a merger or an acquisition, is indisputable. The fact that the process has so many fields of examination and lots of professionals need to be involved in a limited available time are matters that need to be overcome. Although, there are no common legislative predictions at a European or International level, it seems that the practice emerged effective solutions to various arising problems. The above-mentioned clauses, could be considered as a form of “soft law” at an international level because are accepted and finally adopted from the general framework of transactional ethics. Having the appropriate clauses, the professionals shield the interests of their customers and both the seller and the buyer are satisfied from the deal.

The difficulties which were surpassed with the adoption of the contractual clauses are more than obvious. So many countries with different legislations and with not even a common direction on due diligence process, would make the conclusion of an international transaction impossible. Obstacles such as which legislation system would govern in case of a conflict or a failure transaction are now solved with the common internationally accepted contractual clauses. Besides, the clauses have been examined in actual practice and lots of transactions reached the courts. So, a plenty of interpretive issues have been already examined and specific directions have been given through case law. The parties respect and apply at their business relations the interpretations of case law, in order to avoid post-litigation.

The way that the due diligence process evolved in the pandemic period of Covid-19 is also worth discussing. The conduct of a whole M&A process is now taking place mostly in a virtual environment. The combination of the governmental restrictions and the need of protection of public health made the due diligence process more virtual than ever before. Visiting the target company can be essential for some transactions, as may acquire official documents and information provided by the employees and directors through a personal contact. But during the current pandemic period, labor hours have become more flexible and professionals work from home. Special groups of experts are created and start working on the due diligence process through a virtual environment where they have contact with the interested business, the persons in charge and their data. It is important to remember that due diligence is a confidential procedure and the data transferred are sensitive. For this reason, the involvement of the right people at the assessment phase is essential, as well as the use of Virtual Data Rooms in a safe cyber environment, allowing data protection and accessing control features. This “new normal” has not “come to stay” but it is essential for professionals to adopt and retain all the positive technological influences from the pandemic period at every due diligence procedure.

CONCLUSIONS

After all the above analysis, it could be easily deduced that the legal due diligence process is essential in every merger and acquisition or any other type of transactional relationship. Despite the fact that does not exist a Global or European legal concept, under which the whole procedure would be structured and conducted, the parties and merely the "buyer" gathers professionals and makes specialized groups in order to examine the interested company and decide if it would be beneficial to conclude or retreat the business deal.

As a transaction can also take place between foreign companies, it is almost impossible to compromise the parties and make them apply the legislation of one of the engaged parties. Taking as an example the Greek Law, in case of purchasing a business (either an asset deal or a share deal) the sales provisions of the Greek Civil Code are applied. According to article 534 of the Greek Civil Code: *"The seller is obliged to deliver the thing (including the business) with the agreed properties and without real defects"*. In case of a violation of this obligation, the buyer has the chance to defend his position and apply some of the alternatives that the articles 540 and 543 of the Greek Civil Code propose, in order to reverse the defects of the deal, if it possible or to be compensated, if does not want to continue with the transaction. At the stage of legal due diligence, as a pre-contractual stage, the application of the above provisions is not so clear, but there is the possibility to apply the articles 197-198 of the Greek Civil Code and ask for compensation, even from the stage of negotiations.[102]

At a European level, on September of 2020 was approved by the European Economic and Social Committee, a proposal for a mandatory due diligence legal framework[103]. The main idea was the following: the European Commission to act and propose legislation to the Member States on mandatory due diligence in order to avoid legal uncertainty[104]. Based on the last common framework, the individuals would know what actions have to be taken by companies throughout the whole due diligence process. A risk analysis, a realisation of agreed standard terms, a consideration of human rights and environmental issues would be the foundations for the creation of quality standards, in a clear and comprehensive language, ensuring legal certainty and practicability. More actions are expected to be taken in order to achieve uniformity in this actually mandatory, in practice, pre-contractual due diligence process.

It is worth mentioning that recently, in March 2021, the European Parliament adopted a legislative initiative and made a proposal to the European Commission to legislate on

[102] George T. Papachristou, *Ο Προσυμβατικός Έλεγχος της Πωλούμενης Επιχείρησης – Due Diligence*, First Edition 2021, p.167
[103] European Economic and Social Committee, opinion about Mandatory due diligence (explanatory opinion), official website of EU
[104] Official Website of European Economic and Social Committee, *"Mandatory due diligence",* Key points

"Corporate Due Diligence" and "Corporate Accountability". The main idea behind this proposal is to achieve progress in protecting human rights and environment and enabling access to justice[105]. A draft directive has already been proposed, but is still expected to be legislated and enforceable. [106]

In conclusion, more actions need to be taken for adopting a common and universal (or even European) legal concept related to the due diligence process that will be applied in every transaction. The existence of lots of different legal frameworks, the uncertainty or disagreement upon the issue which of them would apply in a specific transaction, make the parties agree upon their liability issues on their own and be based on clauses that could be considered a type of "customary law" as they have been applied and examined by courts globally.

[105] ECGI, Commentary: The European Parliament's Draft Directive on Corporate Due Diligence and Corporate Accountability, April 19,2021

[106] European Parliament, "*Legislative Train 11.2021 – An economy that works for people",* Corporate Due Diligence and Corporate Accountability

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