**Form:** Due Diligence Checklist for Acquisition of a Private Company

**Description:** This is a comprehensive legal checklist to consider when reviewing the purchase of a privately held company. Additional issues may be appropriate under the circumstances of a particular deal.
DUE DILIGENCE CHECKLIST

FOR

ACQUISITION

OF A PRIVATE COMPANY
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**Accounting and Financial**

1. Coordinate with internal accounting staff and outside auditors.
2. Address any updates to financial statements.
4. Coordinate investment of proceeds from sale.
5. Assist in developing responses to Buyer requests, if any, for more detailed financials.
6. Carefully review seller’s financial statements.
7. Proper accounting treatment and revenue recognition by seller?
8. Audited financial statements and auditor reports available?
9. Auditor management letters available?
10. Asset review.
11. Liabilities review.
15. Cash position and requirements review.
16. Loan review.
17. Unfunded pension cost review.
18. Contingent liabilities review.
19. Prospective financial information:
   (a) Earnings projection.
   (b) Projection of cash requirements.
   (c) Projected financial statements.
   (d) Underlying assumptions and key factors.
   (e) Capital and operating budgets.
   (f) Long-term plans.
Agreement Preparation

1. Confidentiality Agreements
2. Asset or Merger Agreement
3. Assignment & Assumption Agreements
4. Real Estate Purchase Agreements (if not included in the main Agreement)
5. Environmental Agreement (if not included in the main Sale Agreement)
6. Bills of Sale (and other instruments of transfer)
7. Disclosure Schedule and other Schedules to Agreements
8. Opinions of Counsel
9. Officer’s Certificate
10. Compliance Certificates
11. Develop appropriate purchase price adjustment mechanism, if necessary, such as for working capital adjustments.
12. Determine Position on Key Points:
   (a) Representations and warranties.
   (b) Scope of indemnification: cap/time to assert/basket.
   (c) Liabilities to be retained/assumed by buyer.
   (d) Conditions to closing.
   (e) Damages clause in the event of failure of buyer to close.
   (f) Treatment of employees & benefit plans.
   (g) Pre-closing restrictive covenants of seller.
   (h) Covenants of buyer (such as access to records)
   (i) Post-closing transition.
   (j) As-is sale with all faults? – disclaimers of representations or warranties?
   (k) Assumption by buyer of designated existing contracts (service as well as sales).
   (l) Buyer’s cooperation if seller intends to complete transaction as part of a tax free exchange.
   (m) Risk of loss prior to closing (casualty, condemnation) – materiality standard.
   (n) Consents and approvals of third parties.
   (o) Proration and allocation of closing costs: transfer taxes, escrow fees, title insurance premiums, recording fees.
   (p) Assumption by buyer of various deferred obligations?
   (q) Arbitration clause.
   (r) Non-compete provision.
   (s) Supply agreements.
   (t) Amount if any escrow hold back, exclusivity of escrow for certain claims, time of escrow.
Antitrust and Regulatory

1. Determine permitted scope of disclosure of information to competitors
2. Determine allocation of antitrust risk, including seller positions in the event of 2nd request under HSR Act or injunction. Payment from bidder if anti-trust problem forces cancellation?
3. Analyze scope of any antitrust issues with various bidders
4. Prepare Hart-Scott-Rodino filings if thresholds are met
5. Be prepared to respond to requests for additional information re: Hart-Scott-Rodino filings
6. Review Hart-Scott-Rodino filings from buyers
7. Address Exon-Florio issues if any foreign bidders
8. Address Department of Commerce filings if any foreign bidders.
Asset Schedules

1. Detailed listing of assets vs. descriptive approach?
2. Determine which assets are subject to liens
3. Determine which assets are leased or licensed
4. Coordinate obtaining consents to assignment of leased and licensed assets
5. Determine seller position re: costs of obtaining consents
6. Determine seller position if consents not obtained.
Confidentiality Agreements

1. Prepare form of Confidentiality Agreement
2. Determine which points seller or buyer will be flexible on:
   (a) Term of confidentiality obligations
   (b) Term of agreement
   (c) Non-solicitation of employees
   (d) Venue for disputes
   (e) Changes to standstill
   (f) Oral disclosures
3. Ensure that Confidentiality Agreement fully executed prior to providing information
4. Prepare log of information and documents provided to buyer

Coordination with Customers & Vendors

1. Determine what notices to give to customers
2. Determine what notices to give to vendors
3. Determine whether any new agreements needed

Data Room

If a data room is to be established containing information of the seller, consider the following issues:

1. Determine location of Data Room
2. Establish procedures for bidders reviewing information in the Data Room
3. Establish procedures re: copying of information
4. Determine which documents to include in Data Room
5. Analyze if any documents need to be excluded because of antitrust, confidentiality or attorney-client privilege issues
Due Diligence

In connection with a potential acquisition transaction, the following materials or information relating to the target company and any subsidiaries (together, the "Company") are typically requested.

(A) Corporate Documents of the Company and Subsidiaries

(1) Articles of Incorporation and all amendments thereto.
(2) Bylaws and all amendments thereto.
(3) Minutes of all Board of Directors, committee and shareholders meetings and all consents to actions without meeting.
(4) List of states and jurisdictions in which qualified to do business and in which the Company has offices, holds property or conducts business.
(5) Material information or documents furnished to shareholders and to directors during the last two years.
(6) Most recently obtained good standing certificates for all states and jurisdictions where the Company is qualified to do business.

(B) Previous Issuances of Securities

(1) All applications and permits for issuance/transfer of securities.
(2) Sample copy of stock certificates, warrants and options.
(3) Stockholder information, indicating number of shares held, dates of issuance, and consideration paid.
(4) All stock option, stock purchase and other employee benefit plans and forms of agreements.
(5) List of any outstanding stock options and warrants.
(6) Any voting trust agreements, buy/sell agreements, stockholder agreements, warrant agreements, proxies, or right of first refusal agreements.
(7) Any registration rights or pre-emptive rights agreements.
(8) Powers of attorney on any matter.
(9) Convertible debt instruments.
(10) Other contracts, arrangements, or public or private documents or commitments relating to the stock of the Company.
(11) Any debt arrangements, guarantees or indemnification between officers, directors or the shareholder and the Company.

(C) Material Contracts and Agreements

(1) List of banks or other lenders with whom Company has a financial relationship (briefly describe nature of relationship - lines of credit, equipment lessor, etc.).
(2) Credit agreements, debt instruments, security agreements, mortgages, financial or performance guaranties, indemnifications, liens, equipment leases or other agreements evidencing outstanding loans to which the Company is a party or was a party within the past two years.
(3) All material correspondence with lenders during the last three years, including all compliance reports submitted by the Company or its accountants.
(4) List of major clients and their locations.
(5) Any other material contracts.

(D) Litigation

(1) Copies of any pleadings or correspondence for pending or prior lawsuits involving the Company or the Founders.
(2) Summary of disputes with suppliers, competitors, or customers.
(3) Correspondence with auditor or accountant regarding threatened or pending litigation, assessment or claims.
(4) Decrees, orders or judgments of courts or governmental agencies.
(5) Settlement documentation.

(E) Employees and Related Parties

(1) A management organization chart and biographical information.
(2) Summary of any labor disputes.
(3) Correspondence, memoranda or notes concerning pending or threatened labor stoppage.
(4) List of negotiations with any group seeking to become the bargaining unit for any employees.
(5) All employment and consulting agreements, loan agreements and documents relating to other transactions with officers, directors, key employees and related parties.
(6) Schedule of all compensation paid to officers, directors and key employees for most recent fiscal year showing separately salary, bonuses and non-cash compensation (i.e. use of cars, property, etc.).
(7) Summary of employee benefits and copies of any pension, profit sharing, deferred compensation and retirement plans.
(8) Summary of management incentive or bonus plans not included in (7) above, as well as other non-cash forms of compensation.
(9) Confidentiality agreements with employees.
(10) Description of all related party transactions which have occurred during the last three years (and any currently proposed transaction) and all agreements relating thereto.

(F) Financial Information

(1) Audited financial statements since inception (unaudited if audited financials are unavailable).
(2) Quarterly income statements for the last two years and the current year (to date).
(3) Financial or operating budgets or projections.
(4) Business plan and other documents describing the current and/or expected business of the Company including all material marketing studies, consulting studies or reports prepared by the Company.
(5) A description of all changes in accounting methods or principles during the last three fiscal years.
(6) Any documents relating to material write-downs or write-offs other than in the ordinary course.
(7) Revenue, gross margin and average selling price by product or service.
(8) Management letters or special reports by auditors and any responses thereto for the last three fiscal years.
(9) Letters of counsel to the Company delivered to auditors for the last three fiscal years.
(10) Aging schedules for accounts receivable for the last two years.
(11) Breakdown of G&A expenses for the last two years.
(12) Copies of any valuations of the Company's stock.
(13) Description of all contingent liabilities.

(G) **Property**

(1) List of real and material personal property owned by the Company.
(2) Documents of title, mortgages, deeds of trust and security agreements pertaining to the properties listed in (1) above.
(3) All outstanding leases with an original term greater than one year for real and personal property to which the Company is either a lessor or lessee.
(4) Documents pertaining to proprietary technology developed/owned by the Company, including any copyright or patent filings. This will also include information confirming that the Company's systems, software and technology is owned solely by the Company and does not infringe on any other party's rights.

(H) **Taxation**

(1) Any notice of assessment, revenue agents' reports, etc. from federal or state authorities with respect to any currently "open" years.
(2) Federal and state income tax returns for the last three years.
(3) Evidence of Company being current on sales tax, unemployment, social security, and other tax payments.

(I) **Insurance and Liability**

(1) Schedule or copies of all material insurance policies of the Company covering property, liabilities and operations, including product liabilities.
(2) Schedule of any other insurance policies in force such as "key man" policies or director indemnification policies.
(3) All other relevant documents pertaining to the Company's insurance and liability exposure, including special reserve funds and accounts.

(J) **Acquisition, Partnership or Joint Venture Agreements**

(1) All acquisition, partnership or joint venture agreements.
(2) Documents pertaining to potential acquisitions or alliances.
(3) Any agreements regarding divestiture or assets.

(K) Governmental Regulations And Filings

(1) Summary of OSHA inquiries for past three years.
(2) Summary of federal and state EPA, EEO, or other governmental agency inquiries during the past three years.
(3) Material reports to government agencies for past three years (e.g., OSHA, EPA).
(4) Copies of all permits and licenses necessary to conduct the Company's business.
(5) Summary of applicable federal, state and local laws, rules and regulations.

(L) Miscellaneous

(1) Press releases during the last two years.
(2) Articles and other pertinent marketing studies or reports relating to the Company or the industry.
(3) Information regarding competitors.
(4) Customer satisfaction surveys, if any.
(5) Current brochures and sales materials describing the Company's services.
1. **Employee Hiring**
   (a) Consider whether buyer should be required to hire:
       (i) All employees working at the business;
       (ii) All employees other than those who are out on long term disability or other leave;
       (iii) All employees for at least 60 days; or
       (iv) No employees other than those it wishes to hire.
   (b) With respect to union employees, consider whether buyer should be required to adopt/assume any existing collective bargaining agreements with the seller. If adoption or assumption by buyer is desired, is union consent required? Also what plans will buyer have to adopt or agree to participate in as a result of hiring such union employees and adopting or assuming the relevant collective bargaining agreements?

2. **Retention/Severance Plans**
   (a) Consider whether severance plan should be adopted, revised or clarified.
   (b) Consider whether retention plan should be adopted, and for what group of employees.
   (c) Consider whether the acquisition should be an event causing full vesting of affected employees (i.e., partial termination) under pension plan or 401(k) plan.

3. Consider applicability of WARN Act; prepare WARN Act notices if necessary.


5. Review any employment agreements.

6. Determine whether new employment agreements are appropriate
Employee Benefits

1. Due Diligence Matters/Representations
   (a) Prepare material to provide buyers for due diligence purposes, such as list of all employee plans, employment agreements etc.
   (b) Assemble and copy actual plan documents, summary plan descriptions, IRS Form 500’s and other materials.
   (c) Consider whether there are any ERISA liabilities that may become an issue during the transaction. If there are any, determine what position seller should take, including whether seller is willing to indemnify buyer for such liabilities.
   (d) Begin to consider what representations seller is willing to make with regard to ERISA matters.
   (e) Determine whether any change in control provisions in any employee plans, stock options plans or agreements or employment agreements will be triggered by transaction and what financial effect would be.

2. Single Employer Pension Plans
   (a) Can or should sponsorship of any such plans be transferred to buyer?
   (b) Should assets and liabilities of any such plan be transferred?
      (i) Do such plans have surplus, or are they underfunded?
      (ii) If transfer of assets and liabilities is suggested, need to determine on what basis the amount of transferred assets will be determined, and need to discuss this with plan’s actuary.

3. Multiemployer Pension Plans
   (a) Will transaction trigger withdrawal liability?
   (b) If withdrawal liability would otherwise be triggered by transaction, should purchase agreement require buyer to post bond to prevent withdrawal liability?

4. 401(k)/Savings Plans
   (a) Can or should sponsorship of any such plans be transferred to buyer?
   (b) Should account balances be transferred to plan adopted by buyer?
   (c) Should assets be distributed to employees who will have option to roll accounts over to buyer’s plan? Note: Whether 401(k) assets can be distributed and/or rolled over needs to be determined under 401(k) regulations.

5. Welfare Plans
   (a) Can or should sponsorship of any such plans or their related insurance contracts by transferred to buyer?
   (b) Are any welfare plans funded in a trust (i.e., a VEBA). If so, should assets of that attributable to transferred employees be transferred to buyer?

6. Buyer’s Plans
   (a) Consider what seller should require of buyer in terms of plans. For example, should buyer be required to provide benefits:
      (i) Substantially similar to those provided to employees by seller prior to closing;
Employee Benefits

(ii) Substantially similar benefits to those it provides for its own employees who are similarly situated; or

(iii) Any benefits that the buyer chooses to provide (however, address union issues.).
Environmental

1. Identify Existing Environmental Information/Data
   (a) Environmental site assessments
       (i) Phase I reports (or equivalents)
       (ii) Phase II-III type reports (i.e., subsurface investigation, remediation)
   (b) Regulatory compliance audit (internal or by consultants)
   (c) Agency correspondence
       (i) Inspection reports
       (ii) Notices of violation and/or enforcement actions
   (d) Permittng
       (i) Current permits
       (ii) Pending applications
   (e) Environmental litigation
       (i) Governmental actions
       (ii) Third-party (toxic torts, Prop 65, etc.)

2. Ascertain Environmental Status of Assets (incl. hazardous materials, asbestos, wetlands, endangered species, permitting and compliance)
   (a) Estimation of future costs (if possible)

3. Determine How to Fill in Information Gaps and/or Bidders’ Requirements
   (a) Conduct additional due diligence
       (i) During bidding
       (ii) In response to bidders’ demands
   (b) Consider permitting bidders to conduct own limited due diligence
   (c) Address legal issues: Confidentiality, reporting, access, cost-sharing, etc.

4. Negotiation With Environmental Agencies
   (a) Cleanup agreements
   (b) Resolution of pending notices of violation
   (c) Closure letters, comfort letters, prospective purchaser agreements (i.e., covenants not to sue)

5. Address Contract Provisions/Documents
   (a) Access/inspection agreement
   (b) Schedules
   (c) Cleanup agreements
   (d) Indemnification provisions/releases

6. Investigation of Insurance Products (as supplement to contract)
   (a) First and third-party pollution liability coverage
   (b) “Stop-loss” policies (for overruns in remediation)
   (c) Transfer policies (for lenders)

7. Address issues with transferring or reissuing permits and licenses to buyer
**Existing Contracts Review**

1. Identify and summarize all contracts  
2. Determine whether amendments to contracts are appropriate  
3. Determine what new or transition contracts are necessary  
4. Coordinate obtaining any necessary consents

**Insurance Considerations**

1. Determine any needed changes to insurance policies pre-closing  
2. Determine any needed changes or cancellation effective as of the closing  
3. Modify or eliminate bonds (as appropriate)

**Intellectual Property**

1. Evaluate strength of seller’s intellectual property.  
2. Evaluate whether seller’s products or services infringe on any third party rights  
3. Review patents, if any.  
4. Determine if employees and consultants have executed appropriate Confidentiality and Invention Assignment Agreements.  
5. Review trademarks  
6. Review copyrights.  
7. Review scope of any licenses  
8. Review Web domain names  
9. Review Web site information and IP ownership.

**Internal Policies**

1. Address treatment of old drafts of documents  
2. Discuss preparation of e-mail policy  
3. Establish procedures for maintaining attorney-client privileged communications  
4. Ensure in-house counsel are up-to-date on all matters

**Litigation**

1. Determine what existing litigation will be retained  
2. Anticipate and prepare for new litigation
3. Determine what affect the transaction will have on existing litigation.

**Political/PR**

1. Determine what lobbying may be appropriate
2. Draft and review press releases
3. Establish well understood internal policy for commentary to the press on this transaction

**Real Estate**

If the business includes any real estate owned by the seller, consider the following:

1. Prepare disclosure of condition of property and any problems
2. List personal and real property
3. List any liens, encumbrances and easements
4. Address title issues
   (a) Select nationally recognized title insurance company (obtain bids on title insurance premium costs)
   (b) Provide title company with copies of all legal descriptions and assessor’s parcel numbers
   (c) Confirm current vesting of title and determine if additional transfers are required
   (d) Obtain copies of all underlying title exception documents
   (e) Obtain/update any needed surveys
   (f) Obtain information on any significant bond assessments or special assessment districts
   (g) Ascertain access rights and easements
   (h) Release of existing mortgages, if any
   (i) Resolve any logging/mechanics’ liens, if any
   (j) Obtain pro-forma title commitments
5. Prepare transfer documents
   (a) Grant Deed
      (i) legal description
      (ii) permitted exceptions
      (iii) State Documentary Transfer Tax
      (iv) preliminary change of ownership form
      (v) transfer tax affidavit
      (vi) nonforeign affidavit (IRC 1445)
   (b) Assignment of Leases, Service Contracts and Warranties
      (i) schedule of tenant leases (if any)
      (ii) schedule of service contracts
(iii) schedule of warranties
(iv) schedule of licenses, permits and governmental approvals

6. Address due diligence items: review and make available copies of the following materials to proposed
   (a) Leases (ascertain assignability)
   (b) Service contracts (ascertain assignability)
   (c) Environmental reports
   (d) Building plans, drawings, specifications (for major facilities only)
   (e) Zoning and subdivision map act compliance
   (f) Governmental licenses, permits and development agreements (ascertain assignability)
   (g) Surveys

Sale Process

1. Determine procedures for disseminating Confidentiality Agreements
2. Establish expected timetable
3. Coordinate with investment bankers, if any
4. Assist with negotiation strategy
5. Prepare management scripts
6. Prepare management presentations
7. Assist with Data Room setup
8. Consider separate Data Room for seller competitors who conduct due diligence
9. Prepare definitive agreements to present to bidder (see “Agreement Preparation”)
10. Assist in evaluation of bids and development of seller response
11. Review mark-ups of proposed definitive agreements
12. Multiple negotiations with bidders
Sales

Review sales and marketing matters of seller, including:

1. Description of sales.
2. Number of orders, customers, and names of principal customers.
3. Sales by product for past five years and for past twelve months.
4. Sales backlog, accounts receivable activity, and customer continuity.
5. Sales correspondence, returns, and allowances.
6. Sales policies and method of compensation of sales personnel.
7. Pricing policies and fluctuations in past five years.
8. Credit terms – any special arrangements.
10. Web based sales/Web strategy
11. Revenue recognition issues.
Tax

1. Address state tax issues
   (a) Treatment of disposition income
   (b) Sales tax consequences
   (c) Property tax reassessment to real property interests

2. Address federal tax treatment

3. Determine if tax-free or taxable treatment is expected

4. Address treatment of retained contingent liabilities

5. Address net operating and capital loss utilization techniques

6. Address use of installment sale structure

7. Address Section 338(h)(10) planning

8. Address Section 1060 planning

9. Explore tax-advantaged disposition strategies
   (a) Like-kind exchange
   (b) Partnership mixing bowl
   (c) Spin-Off

10. Address transfer tax issues if real property involved.

11. Address allocation of purchase price issues