

THE IMPORTANCE OF CORRECTLY EXECUTED DUE DILIGENCE

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Why is effective due diligence important?

Essentially due diligence is an investigation and review in order to obtain sufficient information to make an informed decision on whether to proceed with a transaction, and if so, on what terms. Missing key information could greatly affect the validity of your decision.

Conducting due diligence searches – how much is enough?

The nature and extent of due diligence conducted will depend on several factors, primarily the type of transaction. Are you vetting a potential client or advising a client on a deal?

The objective of conducting due diligence searches is to manage and minimize the risk for the client and to increase the knowledge base of your target corporation.

Managing risk is all about communication:

- Let your client understand the risks of:
 - Not completing all recommended searches
 - Not going back far enough into the corporate history
 - Not checking all relevant jurisdictions

Can the due diligence search process be standardized?

To be truly effective, each transaction must be looked at independently due to variances in location, jurisdiction, court level and type of entity.

The type of transaction is also important - some searches may be transaction-specific and relate to the nature of the business or assets to be purchased. (e.g. environmental searches on land adjoining an oil company).

Due diligence for a share purchase can be vastly different than for an asset purchase, as liability around a corporation's activity transfers to the purchaser.

What do you need to look for when conducting due diligence searches?

Effective due diligence will reveal whether:

- The target corporation is active;

- The company's corporate records are up to date or deficient;
- Any undisclosed liens or mortgages exist;
- There are Litigation actions pending;
- There are Environmental orders pending;
- There are Bankruptcy orders;
- Any expired or new business names exist – have any liens been carried over to or from the current names?

It is important to advise the client of potential undisclosed liabilities as the purchaser should generally not be liable for the debts and liabilities.

Conducting effective due diligence searches – Practical Tips

- Due diligence searches should commence as soon as possible and must also be updated before closing to make sure that no changes have occurred;
- No matter what type of institution you are, be aware of variations;
- While the lawyer and client will decide appropriate risk levels for each type of transaction, the following items should be discussed:

Check the profile report for:

- Indications of a business name registration, current or expired.

Check for corporate history:

- Look for indications of predecessors, amalgamations, continuances, revivals
- Look for name changes
- Look for cancellations and default notices
- Confirm officer and director information is current
- Decide how far back you should search
- Consider searching amalgamated and predecessor corporations
- Consider searching officers, directors, shareholders entities (along with variations on names)
- Determine the municipalities and jurisdictions to be searched
- Determine the levels of court searches required –civil, small claims, appeals and beyond

Conducting effective due diligence searches – Practical Tips (continued)

- Determine any intellectual property ownership, including registered and approved patents
- A search of extra-provincial foreign and domestic corporations may be required
- Be alert for discrepancies in officer, director details (spelling, addresses, alternate jurisdictions)
- Check for good standing status and whether they have ever been in default
- Be aware of English/French variations in name and spelling
- Take note of similar names that reveal the same postal code information – it could mean that multiple corporations are operating in the same establishment. Are all these names related to target company?
- Do subsidiary companies exist?
- Consider searching jurisdictions where assets are held in addition to the registered head office address level?

Conducting effective due diligence searches – What other information should I be obtaining?

Consider obtaining the following:

- **Certificate of Existence or Status** along with charter documents, by-laws, initial organization set-up documentation (ledgers and registers) and any resolutions that have taken place after initial set-up.
- **Corporation Profiles**, business names list, document lists on domestic and extra-provincial corporations whether within Canada or foreign.
- **Copies of filings** – initial returns, notices of change, annual returns.
- **PPSA, Execution, Bank Act**, Bankruptcy and Official Receiver, Litigation, Bulk Sales (where applicable) searches
- **Any articles of amendment**, amalgamations and accompanying resolutions
- **Any evidence of discharges** (PPSA etc.), estoppel letters etc.
- **Intellectual Property Searches** – patent, copyright, industrial design, trademark searches
- **Real Estate searches** – where real property is involved, to confirm registered owner and to make sure property is clear of any mortgages, liens and easements
- **Labour and Employment searches** – for outstanding applications or complaints filed
- **Environmental searches** – reveal pending orders, reports of spills, waste disposal sites etc.

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