

CONSILIUM LAW

M&A Due Diligence Guide

Key Legal Considerations for Buy-Side and Sell-Side
Transactions

Prepared by Consilium Law LLC

Section 1: Understanding the Due Diligence Process

What Is Legal Due Diligence?

Legal due diligence is the systematic investigation of a target company's legal affairs conducted before a merger, acquisition, or investment closes. It serves as the foundation for risk assessment, price negotiation, and deal structuring. When done well, diligence protects against surprises that surface after closing, when remedies are limited and costly.

A thorough diligence process does more than verify facts. It identifies contingent liabilities, confirms the enforceability of key contracts, validates intellectual property ownership, and surfaces regulatory risks that could affect the transaction's value or viability.

Why It Matters

Deals fail for many reasons, but inadequate due diligence is among the most preventable. Undisclosed liabilities, defective IP assignments, and regulatory non-compliance are issues that diligence is designed to catch. The cost of thorough pre-closing investigation is modest compared to the cost of post-closing litigation or earnout disputes.

Typical Timeline

For small and mid-market transactions, legal due diligence typically runs two to six weeks. The timeline depends on the complexity of the target's business, the quality of its records, and the responsiveness of its management team. Deals involving regulated industries, international operations, or significant IP portfolios often require additional time.

Key Participants

- **Buyer's Counsel:** Leads the diligence review, drafts the request list, and reports findings to the buyer
- **Seller's Counsel:** Manages the data room, coordinates responses, and prepares disclosure schedules
- **Management Teams:** Provide operational context, participate in management presentations, and respond to follow-up inquiries
- **Accountants and Advisors:** Handle financial, tax, and valuation diligence in parallel with legal review

Confirmatory vs. Full-Scope Diligence

Confirmatory diligence is a narrower review, typically used when the buyer has significant existing knowledge of the target (for example, in a management buyout or a strategic acquisition of a long-time partner). The buyer focuses on verifying specific assumptions rather than conducting a comprehensive review.

Full-scope diligence is the standard for most transactions. It covers every major legal category, from corporate formation through regulatory compliance, and produces a detailed report of findings, risks, and recommendations.

Confidentiality Considerations

Before any substantive information is exchanged, the parties should execute a non-disclosure agreement (NDA). Effective transaction NDAs address several considerations beyond standard confidentiality terms:

- Definition of confidential information broad enough to cover oral disclosures and analyses
- Permitted disclosures to advisors, lenders, and co-investors
- Non-solicitation of the target's employees during and after the process
- Standstill provisions (common in competitive processes)
- Return or destruction of materials if the deal does not close

Section 2: Pre-Diligence Preparation (Sell-Side)

Sellers who invest in diligence preparation before engaging with buyers consistently achieve better outcomes. A well-organized data room signals operational maturity, reduces buyer uncertainty, and accelerates the path to closing.

Virtual Data Room Best Practices

- Use a purpose-built platform (Datasite, Intralinks, or similar) with granular access controls and activity tracking
- Organize documents by category using a standardized index that mirrors typical diligence request lists
- Upload documents in searchable PDF format whenever possible
- Assign a data room administrator to manage access, respond to Q&A, and track completion
- Enable watermarking and restrict downloads for sensitive materials

Documents to Prepare Before Buyer Engagement

- Corporate formation documents (certificate of incorporation, articles of organization) and all amendments
- Capitalization table and equity grant records, including option plans, SAFEs, and convertible instruments
- All material contracts with customers, vendors, and partners
- Employment agreements, offer letters, and benefit plan documents
- IP portfolio summary covering patents, trademarks, copyrights, and trade secrets
- Audited financial statements for the prior three years (or reviewed statements if audited are unavailable)
- Federal and state tax returns and records of any compliance issues
- Litigation history, pending claims, and settlement agreements
- Regulatory filings, licenses, and permits
- Insurance policies (general liability, D&O, cyber, professional liability)

Common Red Flags That Slow or Kill Deals

Watch for these issues during preparation. Addressing them before the buyer's review begins saves time and preserves deal value.

- Missing or unsigned IP assignment agreements from founders, early employees, or contractors
- Cap table discrepancies, missing 83(b) elections, or improperly issued equity
- Key contracts with change-of-control provisions that require third-party consent
- Outstanding or threatened litigation not disclosed in early discussions
- Regulatory non-compliance, particularly in data privacy, employment, or environmental areas
- Revenue concentration where a single customer accounts for more than 20% of total revenue
- Deferred maintenance on corporate governance (missing minutes, lapsed registrations)

Seller Disclosure Schedule Preparation

The disclosure schedules are among the most important documents in any acquisition. They qualify the seller's representations and warranties, and errors or omissions can give rise to post-closing indemnification claims. Best practices include starting disclosure schedule preparation early in the process, assigning responsibility to specific team members for each schedule, and cross-referencing against the data room to ensure consistency.

Section 3: Due Diligence Checklist (Buy-Side)

The following checklist organizes the most common diligence requests by category. Not every item will apply to every transaction. Tailor the request list to the target's industry, size, and the specific risks identified during preliminary review.

3a. Corporate and Organizational

- Certificate of incorporation (or articles of organization) and all amendments
- Bylaws or operating agreement (current and all prior versions)
- Board of directors and shareholder/member meeting minutes for the last three years
- Written consents in lieu of meetings
- List of all subsidiaries, affiliated entities, and joint ventures
- Organizational chart showing all entities and ownership percentages
- Good standing certificates from the state of formation and all foreign qualification jurisdictions
- Shareholder agreements, voting agreements, and registration rights agreements
- Stock ledger and records of all equity issuances, transfers, and cancellations
- Agreements relating to any prior mergers, acquisitions, or dispositions

3b. Financial and Tax

- Audited financial statements for the prior three fiscal years
- Interim (unaudited) financial statements for the current quarter
- Revenue recognition policies and any recent changes
- Accounts receivable aging report (current)
- Accounts payable aging report (current)
- Schedule of all outstanding debt instruments, guarantees, and security interests
- Capital expenditure budgets and projections
- Federal, state, and local tax returns for the prior three years
- Documentation of any tax audits, disputes, or pending assessments
- Transfer pricing documentation and intercompany agreements (if applicable)
- Sales and use tax compliance records
- Net operating loss carryforward schedules

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3c. Contracts and Commercial

- Top 20 customer agreements by revenue
- Top 10 vendor and supplier agreements by spend
- Partnership and joint venture agreements
- Licensing agreements (both in-bound and out-bound)
- Lease agreements for real estate and equipment
- Loan agreements, credit facilities, and related security documents
- Non-compete and non-solicitation agreements
- Government contracts and subcontracts
- Distribution and reseller agreements
- Agreements with related parties or affiliates
- Contracts containing change-of-control, assignment, or consent provisions
- Agreements with most-favored-nation or exclusivity provisions

3d. Intellectual Property

- Patent portfolio: issued patents and pending applications (domestic and foreign)
- Trademark registrations, pending applications, and common-law marks
- Copyright registrations
- Trade secret inventory and documentation of protection measures
- Open-source software usage log and license compliance records
- IP assignment agreements from founders, employees, and contractors
- IP-related litigation, opposition proceedings, or disputes (pending and resolved)
- Technology licensing agreements (both as licensor and licensee)
- Domain name registrations
- Software development agreements and work-for-hire contracts
- Data ownership and data processing agreements

3e. Employment and Benefits

- Employee census including headcount, roles, locations, and compensation
- Employment agreements for key executives and senior management
- Bonus, commission, and incentive compensation structures
- Stock option plans, restricted stock agreements, and schedules of outstanding grants
- 401(k) plan documents, summary plan descriptions, and most recent Form 5500
- Health, dental, vision, and other benefit plan documents
- COBRA compliance documentation
- Worker classification audit results (employee vs. independent contractor)
- Pending or threatened employment claims, EEOC charges, or wage-and-hour disputes
- Employee handbook and workplace policies (current version)
- Severance agreements and change-in-control arrangements
- Immigration and work authorization records (H-1B, L-1, etc.)

3f. Regulatory and Compliance

- Industry-specific licenses, permits, and registrations
- Regulatory filings and correspondence with government agencies
- Environmental assessments, audits, or known liabilities
- Data privacy compliance documentation (CCPA, GDPR, HIPAA as applicable)
- Privacy policies, data processing agreements, and breach notification records
- Anti-corruption and FCPA compliance program (if international operations)
- Government investigations, inquiries, or subpoenas (pending and resolved)
- Consent decrees, regulatory orders, or compliance agreements
- Export control and sanctions compliance records
- Lobbying registrations and political contribution records

3g. Litigation and Disputes

- Schedule of all pending or threatened litigation, arbitration, or administrative proceedings
- Settlement agreements executed within the last five years
- Arbitration proceedings (pending and concluded)
- Product liability claims and warranty disputes

- Insurance coverage analysis for existing and potential claims
- Legal opinions or memoranda related to material risk areas
- Demand letters received or sent within the last three years

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Section 4: Deal Structure Considerations

The choice of deal structure has significant implications for tax treatment, liability exposure, required consents, and operational complexity. The three most common structures for private company acquisitions are asset purchases, stock (or membership interest) purchases, and mergers.

Factor	Asset Purchase	Stock Purchase	Merger
What Transfers	Buyer selects specific assets and assumes specified liabilities	Buyer acquires all equity interests; entity continues with all assets and liabilities	Target merges into buyer (or subsidiary); surviving entity holds all assets and liabilities
Tax Treatment (Buyer)	Generally favorable: buyer gets stepped-up tax basis in acquired assets	No step-up unless Section 338(h)(10) election is made	Varies depending on whether structured as taxable or tax-free reorganization
Tax Treatment (Seller)	May result in double taxation for C-corps (corporate and shareholder level)	Generally favorable: single level of capital gains tax at shareholder level	Tax-free reorganization possible if requirements are met
Successor Liability	Generally limited to assumed liabilities (with exceptions for certain statutory liabilities)	Buyer inherits all liabilities, known and unknown	Surviving entity inherits all liabilities by operation of law
Third-Party Consents	Required for assignment of most contracts	Generally not required unless contracts contain change-of-control triggers	May trigger change-of-control provisions
Complexity	Higher: requires identification and transfer of individual assets	Lower: transfer of equity interests is mechanically simpler	Moderate: requires compliance with state merger statutes

Change of Control Provisions

Buyers should review all material contracts for change-of-control provisions early in the diligence process. Common triggers include direct or indirect changes in ownership exceeding specified thresholds (often 50%), mergers or consolidations, and asset transfers. Contracts with government agencies, key customers, and technology licensors frequently contain these provisions.

HSR Act Filing Requirements

Transactions meeting certain size thresholds must be reported to the Federal Trade Commission and the Department of Justice under the Hart-Scott-Rodino Antitrust Improvements Act. As of 2024, the minimum size-of-transaction threshold is \$111.4 million (adjusted annually). Parties must observe a waiting period (typically 30 days) after filing before closing. Early termination of the waiting period may be available for non-controversial transactions.

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Section 5: Common Pitfalls and How to Avoid Them

The following issues arise frequently in transactions and, when discovered late, can delay closing, reduce purchase price, or cause deals to fall apart entirely.

Undisclosed Liabilities

Representations and warranties in the purchase agreement serve as the buyer's primary contractual protection against undisclosed liabilities. The seller represents the accuracy of specific facts about the business, and breaches of those representations can trigger indemnification obligations. Buyers should negotiate comprehensive representations, appropriate survival periods, and meaningful indemnification caps. Representation and warranty insurance has become a common tool for bridging gaps between buyer and seller expectations on indemnification.

IP Ownership Gaps

One of the most common and damaging diligence findings is the absence of proper IP assignment agreements. If founders developed technology before incorporating the company, or if contractors contributed code without written work-for-hire or assignment agreements, the company may not own its core intellectual property. Remediation before closing is essential and may require tracking down former contractors or employees to obtain retroactive assignments.

Key Person Dependencies

When critical business relationships, technical knowledge, or operational capabilities are concentrated in one or two individuals, the buyer faces significant risk. Retention agreements, employment contracts with non-compete provisions, and earnout structures tied to continued employment are common tools for managing this risk.

Customer Concentration

A target company that derives more than 20% of its revenue from a single customer presents a meaningful risk. If that customer relationship deteriorates post-closing, the impact on the acquired business can be severe. Buyers should diligence the terms of key customer contracts, the history of the relationship, and any indications of dissatisfaction or competitive alternatives.

Regulatory Non-Compliance

Compliance issues discovered late in the process create difficult choices. The buyer must evaluate the cost of remediation, the risk of enforcement, and the potential impact on deal value. In regulated industries (healthcare, financial services, government contracting), compliance diligence should begin early and receive dedicated attention.

Cap Table Errors

Errors in the capitalization table create uncertainty about who owns what, and resolving them can require consent from every equity holder. Common problems include stock options granted without proper board approval, missing Section 83(b) elections for restricted stock, and failure to track exercises, forfeitures, and cancellations accurately.

Outstanding Consent Requirements

Some contracts require third-party consent before they can be assigned or before a change of control occurs. If consent is not obtained, the contract may terminate automatically, or the non-assigning party may be in breach. Identifying consent requirements early gives the parties time to negotiate with counterparties and, if necessary, structure the transaction to avoid triggering consent provisions.

Section 6: Post-Closing Integration Checklist

Closing the transaction is a milestone, not the finish line. Post-closing integration requires careful coordination across legal, operational, and administrative functions. The following checklist covers the most common post-closing tasks.

Corporate and Regulatory

- File amendments to corporate formation documents (if name or structure changes)
- Update state registrations and foreign qualifications
- Transfer or apply for new business licenses and permits
- File required regulatory notifications (industry-specific)
- Update registered agent information in all jurisdictions

Contracts and Commercial

- Execute assignment or novation agreements for key contracts requiring consent
- Send customer notification letters (where required by contract or appropriate for the relationship)
- Send vendor and supplier notification letters
- Update billing and payment information with customers and vendors
- Review and renegotiate contracts approaching renewal

Employees and Benefits

- Distribute employee transition communications and updated offer letters
- Enroll employees in buyer's benefit plans or establish new plans
- Terminate or merge seller's benefit plans (coordinate with ERISA counsel)
- Address outstanding equity awards (acceleration, assumption, or cancellation per deal terms)
- Update payroll systems and employment tax registrations
- Conduct new-hire orientation for transitioning employees

Operations and Technology

- Execute IT systems integration or migration plan
- Transfer domain names, social media accounts, and digital assets
- Migrate data in compliance with data privacy requirements

- Update website, marketing materials, and signage
- Consolidate or transition accounting and ERP systems

Insurance and Risk Management

- Obtain tail coverage under seller's existing policies (if applicable)
- Add acquired operations to buyer's insurance program
- Update D&O insurance to cover the acquired entity's directors and officers
- Review and update cyber liability coverage

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Section 7: Transaction Timeline Template

The following timeline reflects a typical schedule for a small to mid-market acquisition. Actual timelines vary based on deal complexity, regulatory requirements, and the responsiveness of the parties.

Weeks 1 to 2: Initiation

Execute NDA. Negotiate and sign Letter of Intent (LOI). Buyer issues initial diligence request list. Seller begins populating the data room. Engage advisors (legal, financial, tax).

Weeks 2 to 4: Core Diligence

Buyer's counsel reviews data room documents. Conduct management presentations and site visits. Identify key risk areas and follow-up questions. Financial and tax diligence proceeds in parallel. Begin drafting the purchase agreement.

Weeks 3 to 5: Negotiation

Circulate and negotiate the purchase agreement. Negotiate representations, warranties, indemnification, and closing conditions. Address identified diligence issues through deal terms or price adjustments. Begin preparation of disclosure schedules. Seek required third-party consents.

Weeks 4 to 6: Finalization

Complete diligence review and resolve all open items. Finalize purchase agreement and ancillary documents. Obtain board approvals and any required shareholder consents. Prepare closing checklists and signature pages. Coordinate funds flow and escrow arrangements.

Week 6 and Beyond: Closing and Post-Closing

Execute the purchase agreement and deliver closing deliverables. File HSR notification (if required) and observe the waiting period. Close the transaction. Begin post-closing integration. File post-closing regulatory notifications.

Planning Tip: Build buffer time into the schedule. Deals rarely close on the originally anticipated timeline. Common causes of delay include third-party consent negotiations, regulatory filings, lender approvals, and resolution of diligence findings. Setting realistic expectations from the outset helps maintain momentum and trust between the parties.

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Planning a Transaction?

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