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Long Live the Term Sheet — When Term Sheet Provisions Survive the Execution of Definitive Agreements

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Deal parties may be surprised to learn that a term sheet signed as part of early negotiations can, in some circumstances, continue to be binding after the execution of a definitive transaction agreement contemplated by the term sheet. This is true even when the definitive agreement includes an integration clause, and Delaware case law offers several examples where a party successfully asserted rights found only in a previously executed term sheet. This article reviews recent Delaware opinions and offers guidance on how parties can avoid surprises from old term sheets through clear and unambiguous drafting at both the term sheet stage and in definitive documentation that is intended to fully supersede a previously executed term sheet.

Background

Term Sheets: Parties to a proposed transaction often use a term sheet in the early stages of negotiation to agree to key deal terms at a high level before committing additional time and resources to due diligence and the negotiation of definitive documents. The terms outlined in a term sheet are typically intended to be non-binding and for discussion purposes, without committing the parties to enter into a transaction. However, in some cases, parties may agree that specific provisions in the term sheet are binding. These are often ancillary terms relating to confidentiality, exclusivity, choice of law, and treatment of expenses. In some cases, parties might agree to binding provisions that have a more substantive effect on the transaction; we discuss examples of these below.

Superseding Definitive Agreements: In most cases, a term sheet serves a limited purpose and is replaced by a definitive agreement (or set of agreements) that incorporates the full set of deal terms. With a definitive agreement in place, parties may believe that the binding provisions of the term sheet are no longer in force. However, under Delaware Law, a definitive agreement does not supersede the binding provisions of a term sheet unless one of the following is true:

- The provisions of the definitive agreement contradict the binding provisions of the term sheet, in which case the term sheet will be superseded only to the extent of those contradictions.
- The parties expressly agree that the term sheet is no longer binding. Often, a definitive agreement will accomplish this by including an integration clause (sometimes

referred to as a "merger" or "entire agreement" clause). A standard integration clause states that the definitive agreement supersedes all other agreements between the parties with respect to its subject matter. An integration clause creates a presumption that there are no additional terms outside of the agreement (including a term sheet) that will change the terms of the agreement. However, like any other contractual provision, integration clauses are interpreted according to their plain meaning, and the presumption of integration may be rebutted with evidence (including contractual terms and the parties' course of dealing) that show an intention for the term sheet to remain in force alongside the definitive agreement.

Examples of Surviving Term Sheet Provisions: Numerous Delaware Chancery Court opinions illustrate situations where the binding provisions of a term sheet were found to remain in force and not superseded by a later definitive agreement.

Case 1 — A term sheet covering multiple transactions: In one opinion,[1] a small asset management firm partnered with a well-established seed investor to make investments in a series of companies. The parties signed a term sheet that included binding provisions pursuant to which the seed investor, if it chose to join proposed investments, would receive an equity interest in the asset management firm and a share of management fees for each investment. Over the course of their relationship, the parties appeared to rely on these provisions, including at various points where the asset management firm proposed revising the terms and confirmed to its auditor that the seed investor held an equity interest in the firm.

After identifying investment targets, the parties formed a limited liability company ("LLC") governed by an operating agreement specific to each target. Each operating agreement described the split of ownership interests and investment proceeds, and included a standard integration clause.

When one investment achieved a liquidity event, the seed investor asserted its rights under the term sheet to an equity interest in the asset management firm and a share of the management fees. The asset management firm argued that the term sheet had been superseded by the operating agreement.

The court disagreed, holding that the term sheet had not been superseded for multiple reasons:

1. It held that the plain language of the operating agreement's integration clause only superseded prior agreements that covered the same subject matter as the operating agreement. The subject matter of the operating agreement was limited to the parties' investment in one of many targets. In contrast, the term sheet addressed the parties' overarching business deal across several investments, and was therefore beyond the more narrow subject matter of the operating agreement.
2. The asset management firm's course of dealing demonstrated that it relied on the term sheet. In fact, the court noted it would be an "absurd result" for the operating agreement to supersede the term sheet because the term sheet's provisions formed the basis of the ongoing investment relationship and the firm's access to capital from the seed investor. The court refused to enforce an interpretation of the

[1] *Finger Lakes Capital Partners, LLC v. Honeoye Lake Acquisition, LLC*, C.A. No. 9742-VCL (Del. Ch. October 26, 2015) (Laster, V.C.) (post-trial memorandum opinion), *affirmed in relevant part*, No. 42, 2016, 151 A.3d 450 (Del. 2016).

integration clause that "produces an absurd result or one that no reasonable person would have accepted when entering [into] the contract.

Accordingly, the court held that the term sheet remained in force alongside the operating agreement, entitling the seed investor to an interest in the asset management firm and a share of the management fees.

Case 2 — A definitive agreement with an affiliate: In another opinion,[2] a private equity firm and an investor signed a term sheet with respect to the acquisition of a target company. The term sheet included a binding provision that the target company would reimburse the private equity firm for all expenses incurred in connection with the acquisition.

After closing the acquisition, the acquired company was held through an LLC, which was majority owned by an affiliate of the investor, with the private equity firm and other investors holding smaller interests. The LLC agreement included governance rights and a standard integration clause but was silent on any reimbursement to the private equity firm. When the target company failed to reimburse the private equity firm, the firm sued, alleging that the investor had breached the term sheet by failing to use its control of the LLC to cause the acquired company to pay the reimbursement.

The court held that the term sheet remained in force and was not superseded by the LLC agreement for one reason: although the investor was a party to the term sheet, it was not a party to the LLC agreement. By the terms of its integration clause, the LLC agreement superseded only prior agreements *between the parties to the LLC agreement*. The court concluded that the parties were different because, although the investor was a party to the term sheet, one of its affiliates (and not the investor itself) was a party to the LLC agreement.

Case 3 — A term sheet with unique provisions: In another opinion,[3] an investor planned to invest in an LLC and signed a term sheet with the LLC and its four members. The term sheet included a binding provision titled, "Exclusivity; Restriction on Business," pursuant to which the target company agreed that, for 12 months, neither the LLC nor its members would take certain actions without the prior written consent of the investor. The parties entered into an amended LLC agreement signed by the LLC itself, the four members, and the investor as a new member. The LLC agreement included a standard integration clause.

The LLC later attempted to sell substantially all of its assets without the approval of the investor. The investor argued that (in addition to certain rights under the LLC agreement) the exclusivity provision of the term sheet required the LLC to obtain the investor's prior written consent for the sale. The LLC countered by arguing that the term sheet had been superseded by the LLC agreement. The court held that the exclusivity provision of the term sheet remained in force because:[4]

1. The two agreements addressed different subject matters. The term sheet addressed

[2] *Tygon Peak Capital Management, LLC v. Mobile Investments Investco, LLC*, C.A. No. 2019-0847-MTZ (Del. Ch. January 4, 2022) (Zurn, V.C.) (memorandum opinion regarding motion to dismiss).

[3] *RE: Techno-X USA. Inc. v. Spartan Forge. LLC*, C.A. No. 2024-1313-LWW (Del. Ch. June 9, 2025) (Will, V.C.) (letter opinion regarding cross-motions for summary judgment).

[4] The term sheet was governed by the laws of the Province of Québec, Canada. The court declined to definitively resolve the effect of the term sheet's provisions under those laws. Instead, the court focused its analysis on the LLC agreement, which was governed by Delaware law, and the effect of its integration clause on the term sheet.

the investor's relationship with the LLC as an outside investor, while the LLC agreement governed the internal affairs of the LLC and its members. Most importantly for the court, while the LLC agreement included some provisions from the term sheet, it excluded other binding provisions, including the term sheet's exclusivity/consent provision. Since the investor's rights under the term sheet's exclusivity provision did not appear in the LLC agreement, they were outside the scope of the LLC agreement's subject matter and, therefore, not superseded by it.

2. The term sheet and the LLC agreement involved different parties. The term sheet was signed by the investor (when it was not yet a member of the LLC), the LLC, and the four members of the LLC at that time. Although these same parties signed the LLC agreement, the court noted that the parties to the LLC agreement remained in flux — three new members were later added to the LLC agreement. For the court, this made clear that the term sheet applied to the investor as an outside investor, while the LLC agreement applied to the investor in its more narrow capacity as one of the members of the LLC.

Practical Considerations

These opinions demonstrate that binding provisions of term sheets may not terminate upon the execution of a definitive agreement and that parties must carefully account for them as part of the transaction. Below are some takeaways to keep in mind.

Factors Causing Term Sheets to Survive: Deal parties should be attentive to the following circumstances where it is more likely that the binding provisions of a previously executed term sheet may survive alongside the definitive agreement:

- *The purpose or subject matter of the term sheet differs from that of the definitive agreement.* The subject matter of the term sheet and the definitive agreement are perhaps most obviously different when the term sheet contemplates multiple transactions, and the definitive agreement applies to a single transaction or a component of the transaction.

  Parties should also take care when the definitive agreement is an LLC agreement or other governance document (such as a stockholders agreement or investor rights agreement) that has the narrow purpose of defining the parties' rights as equityholders in an entity. In those cases, a term sheet is more likely to be viewed as an expression of a wider relationship between the parties beyond the limited scope of the governance documents.

- *The term sheet has binding provisions not included in the definitive agreement.* Delaware courts are reluctant to terminate substantive term sheet provisions that can significantly impact the transaction absent language in the definitive agreement that expressly supersedes or terminates them.

- *The parties to the term sheet differ from the parties to the definitive agreement.* While it seems logical that an agreement between party A and party B should not be assumed to supersede an agreement between party A and party C, it is notable that, in Case 2 above, the court refused to look beyond corporate formalities in holding that a term sheet between party A and party B was not superseded by the definitive agreement involving party B's

affiliate. Because it is not uncommon for parties to form transaction-specific affiliates to enter into the definitive agreement, if the parties desire to ensure that the provisions of a binding term sheet are no longer in effect, they should consider having the specific parties to the term sheet execute a termination agreement.

- *The course of dealing of the parties indicates they intended for the term sheet to remain in effect.* Evidence of such a course of dealing can include actions in compliance with the term sheet provisions, communications referencing the provisions, amending or expressing a desire to amend the provisions, and communications to third parties (such as auditors) about the provisions. Particularly, as noted in Case 1 above, if the term sheet provisions play a fundamental role in the transaction such that it would be "absurd" or unreasonable for the parties to have understood them to be superseded, those provisions are likely to remain in force.

Express Termination of Term Sheets: If parties want to ensure that a term sheet is superseded upon entry into a definitive agreement, they should consider the following:

- In the integration clause of the definitive agreement, expressly state that the term sheet has been superseded and is no longer in effect. For example:

  > This Agreement constitutes the entire agreement between the parties hereto concerning the subject matter hereof and supersedes any prior understanding, correspondence, email, term sheet, offer letter, letter of intent, agreement or arrangement, whether written or oral, among the parties and their respective affiliates with respect to such subject matter (the "Prior Agreements"). For the avoidance of doubt, all Prior Agreements (including without limitation the term sheet executed by the parties hereto on [date]) are hereby null and void and deemed to be replaced and superseded in their entirety by this Agreement.

- Include a provision in the term sheet causing it to terminate upon entry into the definitive agreement or other circumstances. For example:

  > This Term Sheet shall terminate automatically and be of no further force and effect upon the earlier to occur of (i) the execution and delivery of a [definitive agreement], or (ii) the mutual written consent of the parties hereto.

- While these examples terminate the term sheet in its entirety, there may be circumstances where parties desire for certain binding provisions to remain in force, such as confidentiality obligations. In such cases, the parties should either incorporate the provisions into the definitive agreement or draft the integration clause as clearly as possible to define which provisions do and do not survive.

Appropriate Scope of Term Sheets: Parties should be thoughtful about their use of term sheets. In many cases, term sheets are helpful tools to agree on high-level deal points in the early stages of negotiations, but they may not be the ideal place to include substantive provisions about an ongoing investment relationship or about rights

and obligations that may continue after a definitive agreement is signed. Parties should consider addressing such substantive provisions in the definitive agreement or, if the parties anticipate a series of related transactions, the terms should be incorporated into a framework agreement applicable to the series of transactions.

Beyond Term Sheets: The Delaware opinions discussed in this update involve term sheets, but their reasoning applies equally to other preliminary agreements, including letters of intent, memoranda of understanding, and confidentiality agreements. When preparing any definitive agreement, counsel should consider identifying and addressing all such preliminary agreements.

Termination Fees: Breaking Up Usually Comes with a Price

By Jillian Mulroy Wright and Lyla Sax, Debevoise & Plimpton LLP

Termination fees, or "break-up fees," are a common tool used to compensate the buyer for the loss of a signed deal as a result of the exercise of the target board's fiduciary duties. Typically, payment of a fee is triggered either when (i) the target board terminates the agreement to accept a superior offer from an interloping bidder or (ii) the buyer terminates the agreement because the target board no longer supports the buyer's deal for any number of reasons, including the occurrence of an "intervening event" that materially increases the value of the target (practitioners often colloquially describe an intervening event as "discovering gold under the company headquarters"). Some agreements limit the payment of a fee to circumstances where the deal is terminated and the target signs or closes a transaction with the interloping bidder or another third party within a negotiated "tail" period after termination. Agreements may also call for termination fees (x) if the target company materially or willfully breaches the "no-shop"[1] covenant, or (y) less commonly, if the target shareholders fail to approve a deal (even in the absence of a superior offer or a failure by the target company to comply with the agreement), also known as a "naked no vote fee." This article provides a brief primer or refresher on the law and practice of termination fees.

The ubiquity of termination fees in public company transactions stems from the tension between a buyer's desire for closing certainty and the target company board's need to retain flexibility to fulfill its fiduciary duties to the target company's stockholders. In Delaware,[2] in a change of control setting directors are meant to obtain the highest value reasonably attainable for the stockholders.[3] Director duties do not end upon the signing of a definitive agreement, and, as the case law has evolved, the target board may need to consider, and ultimately accept, a competing superior offer even after the buyer and the target have signed definitive agreements — until a fully informed, uncoerced stockholder vote approving the deal.

[1] Most public acquisition agreements will include a "no-shop" covenant — a provision that restricts the target and its representatives from soliciting or even engaging in discussions regarding alternative proposals — though targets will commonly negotiate for a fiduciary exception (a "fiduciary out") that would permit it to enter into discussions with another party making an alternative proposal that is, or is reasonably likely to result in, a superior offer.

[2] The specific fiduciary duties of a target's directors requires an analysis of the relevant state corporate law. Since most public companies continue to be organized under Delaware law, Delaware is the focus of this article.

[3] *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986).

From the buyer's perspective, a termination fee somewhat reduces the risk of losing the deal between signing and closing by making competing offers a bit more expensive and provides the buyer with some recompense for the time, expense and opportunity cost it has incurred in connection with the terminated deal. From the target company's perspective, it wants to make sure that any termination fee is not so large as to preclude competing bids, and is not triggered in circumstances where it does not have an actionable competing superior transaction.

There are some lessons to keep in mind when considering the size of a termination fee:

Equity value is the typical metric, though there may be circumstances that warrant looking at enterprise value, too. Relating the size of the break-up fee to equity value is the most common approach. However, the Delaware Court of Chancery in *Lear*[4] and later in *Cogent*[5] acknowledged that relating the fee to enterprise value could also be appropriate for transactions with highly leveraged targets, because most such acquisitions require the buyer to pay for the company's equity and refinance all of its debt.

The typical size of termination fees is in the 2.0% – 3.5% range. Generally speaking, the most common range for termination fees is between 2.0% and 3.5% of equity value though negotiations may result in a termination fee outside of this range. In Houlihan Lokey's most recent termination fee study, the smallest termination fee observed was 0.2% and the largest was 6.0%.[6] The Delaware Court of Chancery has mentioned, while declining to decide the issue of whether a termination fee was coercive, that a 6.3% termination fee "seems to stretch the definition of range of reasonableness."[7] The average termination fee for deals announced in 2024 was 2.4% of equity value, slightly down from 2.5%, 2.7% and 2.9% in 2023, 2022 and 2021, respectively.[8]

But, there is no bright-line test for reasonableness. Delaware courts[9] have been clear that a purely formal, mechanical view based on percentage is not sufficient and there is no percentage that is per se acceptable. The reasonableness of the size of the termination fee will necessarily be informed by the specific deal dynamics. A target company board should take the same approach when assessing a termination fee proposal from a buyer.

The reasonableness of the size of the termination fee needs to be assessed holistically based on the particular facts surrounding the deal. This includes the negotiation history and the parties' relative negotiation strength. Dealmakers should be sure to take account of other deal protection mechanisms, such as expense reimbursement obligations, when assessing the reasonableness of the target's overall break-up costs for a transaction. Timing and other conditions for payment of the fee can also be relevant.

The presence or absence of a robust pre-signing market check may also affect the assessment

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[4] *In re Lear Corp. S'holders Litig.*, 926 A.2d 94, 120 (Del. Ch. 2007).

[5] *In re Cogent, Inc. S'holder Litig.*, 7 A.3d 487, 503 (Del. Ch. 2010).

[6] Approximately 63% of the termination fees expressed as a percentage of equity value were between 2.0% and 3.5% according to the Houlihan Lokey 2024 Transaction Termination Fee Study. https://cdn.hl.com/pdf/2025/2024-transaction-termination-fee-study.pdf

[7] *Phelps Dodge Corp. v. Cyprus Amax Minerals Co.*, 1999 WL 1054255 (Del. Ch. 1999).

[8] https://cdn.hl.com/pdf/2025/2024-transaction-termination-fee-study.pdf

[9] *See, e.g.*, *Cogent* at 503; *La. Mun. Police Employees' Ret. Sys. v. Crawford*, 918 A.2d 1172, 1181 n.10 (Del. Ch. 2007).

of whether the size of the termination fee is reasonable. Where there has been a robust pre-signing market check, regardless of whether it leads to a competitive bidding process, a higher termination fee may be justified on the theory that the target company board has taken pre-signing procedural steps to seek the highest value reasonably attainable. However, the target company board can also use a robust pre-signing market check in the negotiations to put downward pressure on the size of the termination fee by arguing that there should be a lower risk of the deal being topped by a higher offer.

Transactions with fewer restrictions on a target company's ability to entertain and accept competing offers tend to support higher termination fees than deals with more stringent deal-protection mechanisms. Further, if the agreement includes a "go-shop" covenant — a provision that allows the target, for a window of time after signing, to solicit alternative proposals — there will often be bifurcated termination fees.[10] A lower fee typically would be triggered during the "go-shop" period and a higher fee after the "go-shop" period.[11]

The absolute size of the transaction can also be relevant, with mega-deals typically carrying termination fees that are lower when measured on a percentage basis, likely due to the poor optics of outsized dollar amounts when compared to buyer's actual or anticipated expenses in the deal.

A "naked no vote" trigger will generally not support a large termination fee. Boards are sensitive to the fiduciary implications of large termination fees and the effect that they may have on stockholders' ability to freely reject a transaction in the exercise of their voting rights. In *Lear*, while the Delaware Court of Chancery upheld a "naked no vote" termination fee of approximately 0.9% of the equity value, it emphasized that the fee was negotiated in exchange for a post-announcement price increase.

It is worth noting that reverse termination fees ("RTFs"), which are fees payable by the buyer if it fails to consummate the transaction in certain circumstances, do not implicate the same fiduciary duty concerns for buyers as termination fees do for target company boards. Buyers are not undergoing a change of control and so their directors' duties to stockholders are generally subject to the deferential business judgment rule, at least in Delaware. As a result, the size of RTFs are less scrutinized by the courts. The most prevalent types of RTFs are financing RTFs and antitrust RTFs, with antitrust RTFs generally seeing an uptick since 2021, coinciding with increased antitrust regulatory scrutiny and enforcement in M&A transactions. The size of the antitrust RTFs generally are less impacted by what is "market" as compared to financing RTFs (where the risk being allocated relates to macroeconomic conditions that could lead to financing failure, such as rising interest rates and general availability of capital). While antitrust risk exists against the backdrop of a given antitrust enforcement environment, it is specific to the companies involved and can be heavily influenced by the scope of the antitrust efforts covenants that the parties negotiate in their acquisition agreement.

Target company boards and their advisors should be armed with knowledge of the types of termination fees available to allocate completion

[10] "Go-shop" covenants are included in a minority of deals. Approximately 8.5% of deals include this provision according to the ABA 2024 U.S. Public Target Deal Point Study.

[11] https://cdn.hl.com/pdf/2025/2024-transactiontermination-fee-study.pdf

risk between the parties and be prepared to consider and document the target company board's assessment of the use of termination fees in the context of their deal, particularly with a view to appropriately discharging the target company directors' fiduciary duties.

M&A Due Diligence: What You Miss Can Cost You

By Alison McCormick, Fried, Frank, Harris, Shriver & Jacobson LLP, and Jennifer Contegiacomo, QuisLex

Mergers and acquisitions are among the most complex and transformative business endeavors, with due diligence serving as the cornerstone. Conducting due diligence encompasses a thorough, detailed examination of a target company's legal and financial operations. This scrutiny enables buyers, sellers and their advisors to make informed decisions, mitigate risks and lay the groundwork for successful integration.

M&A due diligence involves a diverse group of stakeholders, each contributing critical expertise. Business executives and investment bankers assess the strategic fit and operational and financial viability of the target. Legal professionals examine potential risks and liabilities. Accountants scrutinize the financial health and performance of the organization, while consultants offer cross-functional insights that connect these various domains. Together, they provide a comprehensive picture of the target company, ensuring that nothing essential is overlooked.

Why Due Diligence Matters

At its core, due diligence is about risk management and value creation. For business leaders, this process helps determine whether the target company aligns with their strategic goals and is worth its stated valuation. Legal experts rely on due diligence to uncover past or potential future liabilities, ensure compliance with various regulatory requirements and structure protections through indemnities, carve-outs or other contractual arrangements. Financial teams validate the target's financial metrics and identify synergies, cost optimization or revenue growth opportunities post-acquisition.

Thorough due diligence is also essential for post-merger integration. A well-executed diligence process lays the groundwork for smooth integration, reducing the likelihood of unforeseen challenges. Conversely, inadequate diligence can lead to missteps that undermine the target's value.

Case Study: Overlooked Operational Dependency

In a recent deal, a public company sold a subsidiary to a private equity sponsor. The seller had been providing a specialized service critical to operations that it wouldn't provide post-closing. The sponsor couldn't replicate the service and only realized the gap late in the process. It had to source the service from a third party at significant cost and ultimately negotiated a steep purchase price reduction to reflect the new reality. This type of overlooked operational dependency can erode value quickly.

Three Key Components of M&A Due Diligence

There are several important components of M&A due diligence, including legal, financial and operational, each warranting dedicated attention.

1. Legal Due Diligence

Legal due diligence focuses on understanding the target company's legal structure, identifying risks and ensuring compliance. A strategic "macro-to-micro" approach is particularly effective.

Prioritize business-critical issues that could pose the greatest risks or constitute deal-breakers first. This allows teams to allocate resources efficiently, drilling down to smaller issues only after addressing major concerns.

By understanding the business, teams can determine which legal matters warrant extensive investigation versus those where the potential impact doesn't justify the effort or legal expense. A good place to start is by evaluating key contracts with customers, suppliers and partners. Look for change-of-control, exclusivity and pricing adjustments triggered by the transaction.

Case Study: Buried Supplier Agreement Amendment

In one transaction, a private equity sponsor discovered, midway through diligence, that the seller had quietly uploaded an amended agreement with a critical supplier. The amendment included onerous new terms that significantly altered the deal value. The diligence team caught it just in time.

Subsequent steps should include ensuring the target owns or has adequate rights to its IP and identifying any infringement risks, as well as analyzing current and potential litigations, their financial implications and reputational risks. In addition, legal due diligence should include assessing adherence to any industry-specific regulations and identifying potential liabilities.

Legal diligence also plays a key role in structuring protections. Risks may be addressed through:

- Indemnities (*e.g.*, covering unresolved tax liabilities)
- Carve-outs (*e.g.*, removing problematic assets or business lines)
- Purchase price adjustments
- In extreme cases, walking away entirely

Case Study: Carve-Out Asset Gaps

In carve-out deals, one challenge is determining whether the target holds all the assets necessary to run the business. Critical assets may be legally owned by the parent company, not the subsidiary being sold. Diligence teams must define the business "perimeter" and ensure the buyer receives all required assets and avoids liabilities tied to excluded assets.

In the supplier contract example above, the parties ultimately resolved the risk through negotiated indemnification, ensuring that the buyer would be protected if the new terms created a post-closing exposure.

2. Financial Due Diligence

Financial due diligence is critical for validating the target's performance and identifying red flags that may affect valuation. Key areas of focus include reviewing historical financials — income statements, balance sheets and cash flow statements — to assess profitability, liquidity and financial stability, as well as evaluating the target's tax history, liabilities and potential exposure.

Case Study: Multistate Sales Tax Exposure

A recurring issue in middle-market transactions is the discovery of uncollected sales tax obligations. In one deal, the buyer found that the target had failed to collect sales tax in multiple states. The exposure was material, and the buyer successfully negotiated a purchase price reduction to account for the cleanup process, which included voluntary disclosure procedures and back payments.

It's also vital to understand the sustainability of revenue sources, assess customer concentration and evaluate outstanding obligations and their impact on valuation. Determine if revenues are

diversified or concentrated and which customer contracts are near expiration or have pricing terms that could change post-closing.

Case Study: Hidden Earnout

In another deal, due diligence uncovered a significant earnout obligation that the seller had not emphasized, despite having every reason to believe the targets would be met soon after closing. Surfacing this in diligence allowed the buyer to adjust the economic terms before signing.

Thorough financial due diligence not only informs the valuation of the target but also helps identify opportunities for financial optimization post-acquisition.

3. Operational Due Diligence

Operational diligence connects the dots between legal and financial findings and how the business runs. This involves examining the target's day-to-day operations, identifying strengths, weaknesses and potential synergies. Areas to investigate include core processes, technology and systems, IT infrastructure, cybersecurity measures and supply chain risks.

Operational due diligence also requires a focus on the workforce. Evaluating the capabilities and stability of the leadership team and broader workforce is critical, as is assessing alignment between the acquirer and target's corporate cultures to ensure a seamless integration. A thorough operational review ensures that the acquirer understands the target's core operations and is prepared to address any challenges that may arise during integration.

Case Study: Executive Fraud Uncovered

In one public company transaction, legal and operational diligence revealed that the target's executives had fraudulently misrepresented their business model, claiming customer deployment figures inflated by an order of magnitude. Further review uncovered financial impropriety, including misappropriated investor funds. The executives involved were ultimately convicted and imprisoned. That diligence outcome didn't just protect value — it preserved reputational integrity.

Overcoming Common Due Diligence Challenges

Due diligence can be fraught with challenges. Tight timelines, complex processes and the need for coordination among multiple stakeholders can create bottlenecks. Additionally, integrating diverse systems, people and contracts post-acquisition can be daunting.

To navigate these challenges, effective communication and collaboration among team members are paramount. Clear roles and responsibilities should be established early on to ensure that all aspects of due diligence are covered comprehensively.

Case Study: The Limits of AI Review

A client who outsourced parts of diligence to a third-party provider offering an AI-based tool nearly missed important data. The tool misclassified key documents and overlooked critical risks. With little time left before signing, legal counsel had to rereview the data manually. The client was ultimately reimbursed for the third-party AI tool expenses, but the experience reinforced the wisdom of using technology to augment — rather than replace — human intelligence and judgment. The right tools can streamline review, but only when properly vetted and actively monitored.

The Strategic Value of Due Diligence

While due diligence is often seen as a procedural step, it holds strategic value for all stakeholders.

For buyers, it provides a road map for realizing the full potential of the acquisition. For sellers, thorough preparation for due diligence can enhance their credibility and help maximize transaction value. Sellers who enter diligence with well-organized data rooms, updated contract summaries and clear disclosures often avoid surprises and can command higher valuations with fewer conditional holdbacks.

The diligence process is a critical checkpoint for deal teams to align key objectives and mitigate risks. By fostering collaboration and leveraging the collective expertise of the team, due diligence transforms from a compliance exercise into a strategic opportunity to create value.

For organizations that engage in frequent M&A activity, due diligence represents an opportunity to refine and improve processes over time. By documenting lessons learned about standardization, prioritization or team coordination from each transaction, deal teams can develop best practices that enhance efficiency and effectiveness in future deals.

A Foundation for Long-Term Value

M&A due diligence is a multifaceted process that requires meticulous planning, collaboration and execution. By focusing on the legal, financial and operational dimensions of the target company, deal teams can uncover risks, identify opportunities and set the stage for successful post-merger integration.

Ultimately, the success of any M&A transaction hinges on the quality of due diligence. When approached with precision and foresight, due diligence becomes more than a step in the process — it becomes the foundation for achieving long-term value and sustainable growth. Embracing a comprehensive and strategic approach to due diligence allows organizations and their deal teams to navigate the complexities of M&A with confidence and unlock the full potential of their investments.

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