

*Legal due diligence of oil assets  
in the eyes of outside legal counsel*



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# ***LEGAL DUE DILIGENCE (LDD) ISSUES***

1. What is legal due diligence ?
2. Types of LDD
3. Sections of LDD report
4. Skills needed
5. Using the results

# *What is legal due diligence and why it is necessary ?*



# *Legal due diligence – what is it?*

## Definition:

- Complete or limited scope analyses of legal and/or operational aspects in the context of the planned transaction. E.g. its like checking tomatoes before you buy them on the bazaar.

## Type

### 1. Buyer's LDD

Prior to purchase of the asset

### 2. Presale LDD

Conducted by potential seller prior to commencement of sale process.

### 3. Internal audit

## *Why LDD is necessary?*

- Get data on Transaction Object and to understand the factual legal status.
- Identify potential risks, negative facts, breaches, potential liability of the Transaction Object.
- Determine terms and conditions necessary to conduct and complete the transaction:
  - Economic concentration;
  - Third parties rights (notices, consents, first refusal rights, pre-emption rights и т.д.)
  - Other (covenants, change of control clause, legislative regulation of the activities, existing risks, self test by the management of the company.)

## *Objective of the Buyer's LDD*

- Confirmation the obtained data (e.g. prospectus or information memorandum);
- Confirmation on the interest in the deal
- Obtaining arguments to discuss financial aspects of the transaction
- Drafting representations and warranties (English law concept that is used in Kazakhstan).

# *Objective of presale LDD*

- Identify weak points and risks prior to the sale process;
- Remedying problems, homework;
- To strengthen expected price level and scope of the representations and warranties;
- Limiting volume of the Buyer's LDD and timeframe of access to dataroom (often Virtual Data Rooms);
- Expediting process of the sale transaction.

# *Process of the due diligence*

Conducting in steps



# 4 stages

## Create and manage relations



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## What does the client want law firm to do?

It is a DD to sell out the company (VDD), or it is a DD to clean up a company before going into a bid process (Assistance VDD), or it is a DD to buy a company or a bunch of assets and liabilities, or it is a DD for looking financing a project or to restructure a group of companies. The legal consequences or effect may vary from one transaction to another and this will have a great impact on the methodology and purpose of the DD.

In this phase it is crucial for a successful job to identify the main stakeholders of the project.

The client's interlocutor, does he hold the capacity to make decision? Does he enjoy of legal knowledge?.

Target's representative Who knows the transaction? Confidentiality is a great issue. Who support the project? Shall we have to do some kind of pressure or convince of the needs and purpose of the project? In any case, our work should be tackled somehow to minimise any impact to the day to day work of the Target.

Public bodies: Competition Authorities, Tax Inspectors

Other third parties: any other lawyer involved in the transaction. Think over the coordination of other agents. Foresee if auditor shall allow us to review their working papers.

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## *4 stages*

### **Stage 1: Identify target**

- What does the client need?
- What is the transaction in question?
  - ✓ Know the specifics and industry sector of the Object
  - ✓ Process crystallization
    - ❖ Sequence
    - ❖ Data availability (data room)
    - ❖ Preparation and assisting in presale DD
    - ❖ Virtual data room
  - ✓ Identify potential sources of problem
  - ✓ Define requirements applicable to the Object of the transaction

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## ***4 stages***

### **Stage 2: Identify due diligence scope**

- Scope of work
  - ✓ Availability of documents
  - ✓ Discuss scope change, if necessary
- Format of the report (red flag list and/or complete report either consolidated or in separate sections)
- Client's expectations
  - ✓ Identify specific topics that are vital for the Client
- Expectations of the outside legal counsel (law firm)
  - ✓ Payment in time, professional reputation, new experience...

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## ***4 stages***

### **Stage 2: Identify due diligence scope (continued)**

- **Time frame and team to complete**
  - ✓ Building qualified team for timely completion of report (number and experience)
- **Key milestones**
  - ✓ Commencement and coordinating the questions
  - ✓ Regular communication and report
  - ✓ Providing the draft of the preliminary report
  - ✓ Final report

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## Second Phase: Commitment

In this respect, we should focus on:

Scope shall be in accordance with the volume of the transaction, timing and team, careful in entering into commitments difficult to meet. (top 10 clients). Type of report (red flag report, long report, describing the business)

The benefits that the client expect to receive should be met. Recommendation to cover risk, the specific goals that they have identified to us, for instance, compensation for dismissal of certain employees (liquidation of the target), third parties consent or prohibition to transfer agreement (global transfer of assets and liabilities), cost of terminating agency agreement (clientele compensation)

Benefit of law firm: fees, professional prestige, new experience, public acknowledgement.

From the beginning it is also needed to foresee a calendar in accordance with the team involved.

Identify the main milestones of the project: approval of scope, delivery of status reports, draft and final reports, meeting to advance the issues.

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## *4 стадии*

### **Stage 3: Delivering quality**

- Structuring the team members and clear coordination
  - ✓ Using qualified experts / layers of other jurisdictions when needed
  - ✓ To describe each role clearly
- Begin with general high level overview to confirm the completeness and accuracy based on the original understanding of the Object's matters status (publicly available data, info memo, etc.).
- Controlling the information flow and managing the process

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## Third phase: Deliver

This is the performance of the work, analyse all topic of the scope of the engagement. The main task is Identify risk or contingencies of the transaction at hand, explain the issues out of which those risks arise, quantify the risk is possible, and recommend action to tackle those risks.

Risk could be of different types:

Deal breaker: contingencies that make the buyer to back off the transaction unless a remedy is achieved timely. (Change of control clauses in most of the lease agreements in case of acquisition of a franchise net work)

True facts: contingencies which are affecting the target or shall affect the target in a near future. This contingencies should be taken into account to reduce the prices or have them totally guaranteed. (for instance think in a merger to companies with commercial network of agencies in the same territory)

Uncertain future events: This are events that we are not sure if they will come or not but we may be able to establish a criteria of likelihood Probable, Possible or Remote. This contingencies should be covered by Reps&Wars as much as possible. Our work should help out to quantify and determining statute bar limitation



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## *4 стадии*

### **Stage 3: Delivering quality (continued)**

- Immediate notification of all major issues
- Regular communication with the team members, the client and other counsel
- Following the process of receiving the data
- Identify and describe major issues for the Transaction (dealbreakers, inevitable events, possible events)
- Identify other terms that are significant for entering into the Transaction (e.g. consent of state bodies, third parties, etc.)
- Talking through with the Object's management
- Final report

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## *4 σταδίου*

### **Stage 4: Assessing the results**

- Assessing relations with the client
- Discussing with the team and getting feedback from the members

This is about to ascertain the value of our work and to build relationship with clients and team. Main goal is to improve the quality of our work based on client's view as well as the team's ones; secondly we intend to consolidate the relationship with the client and ascertain if there any other services that we may render to the client.

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## ***Sections of the due diligence report***

- Key items / executive summary;
- Assumptions, qualifications and limitations
- Detailed analyses:
  - corporate issues;
  - main business (e.g. subsoil use contract or major commercial contracts);
  - property/assets (movable and real estate);
    - contracts with suppliers and consumers;
    - labour issues;
    - licenses and permits;
    - IP;
    - environment;
    - litigation.
- Potential liability.

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## *Why is a due diligence required?*

Essentially a due diligence exercise is carried out to ensure that the acquiror or seller is fully aware of all the historic liabilities/exposures of the target/group to be acquired, divested, floated. It follows that the aim is to ensure that there is adequate cover provided for the investor in the form of warranties/indemnities (or that our clients are able to factor in potential liabilities to price negotiation) to ensure that no nasty ‘surprises’ pop up after the transaction.

It should be noted that not only will the investors and or seller, themselves need a due diligence carried out, but the banks that are providing debt finance will want to ensure that are not carrying more risk on the finance that expected.

# *Skills needed*



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## **Communication**

- To communicate with team members (TS) on issues arising during tax and financial DD in order to **detect** if it could have possible impact on legal part.
- To communicate with a Client on business process to **detect** possible legal issues.

## **Experience**

- To use the experience received during the previous projects in order to be able to **detect** the similar issues during the legal DD.

## **Observation**

The consultant needs to be observant in order to **detect** the possible risk.

## **Detailed analysis**

In order to **detect** the possible risk, detailed analysis of supporting data is required.

## **Technical knowledge**

Risk **detection** requires thorough knowledge of legislation as well as regulatory requirements.