The Deal Room Podcast

Episode 176 – Why doing a deal is like "Married at First Sight"

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Transcript

Joanna: Hi, it's Joanna Oakey here and welcome back to The Deal Room Podcast, a podcast proudly brought to you by our commercial legal practice Aspect Legal now we have back on the show, Claire Bibby from our very own Aspect Legal Claire, it's always a pleasure to have you on the show. I feel like you and I then get in a groove. And we just want to keep talking about contract stuff and DD and like buying and selling businesses. But here we go again, for another blockbuster, all about why doing a deal is like Married at First Sight. Okay, you came up with these topics and I love the title and I am sitting on the edge of my seat Claire?

Claire: Well, I know that I had some of my best ideas when I just zone out. Like I find that showering in the morning or in the evening, and I'm just you know, completely zoned out. I'll have a real cracker idea. Last night, I will not admit that I was watching Married at First Sight and I had a cracker idea. I thought we're doing a podcast today. What could we talk about? And I thought well, Married at First Sight. That's an example of people not doing due diligence on their partner, right?

Joanna: That's so true.

Claire: Getting married and then well, some of our listeners are going to know where I'm going. It does not work out.

Joanna: Yes, it suddenly does not work out so well on that show.

Claire: Absolutely. I mean, let's start talking about Dean and Tracy from a couple of seasons ago, because I don't watch this program. So, my children told me about these names, of course. And then, you know, there's Bryce and that lovely young lady the moment Melissa. But anyway, we won't talk about MAFS because well, that could be a whole new episode. Let's talk about due diligence. And what happens when you don't do due diligence? Not necessarily in the Married at First Sight context, but perhaps, in the acquisition space? How does that sound like a topic of today's podcast?

Joanna: I love it. But you know I can absolutely see the similarities. I mean, Well, firstly, I mean, the show is a little bit out there. But the idea, I think when businesses are in that deal phase is some motion of the deal. And we call it in the industry this day on fever that here, everyone gets swept along, of course, other than the lawyers in this deal, fever, where they just want to do the deal. And they want to do the deal fast. But sometimes it's just like, all sensible thoughts about the risk that might be sitting in these transactions sort of flies out the window, you know, as they get caught up in the emotion. So I think that's, you know, certainly we see that on MAFS.

Claire: Yes. I mean, you start, you start off in the honeymoon phase, everything's going really cool, and everything's fine. And then you start to get involved in the nitty gritty, and then the honesty box comes out, because somebody started doing due diligence, they've started poking around or your contracts. And that's generally the lawyers and then we start asking the hard questions. And then it gets a little bit complicated. And then you've got to have the situation on the couch and you've got to answer to the psychologists why everything's going pear shaped. So the law is not that terribly different to Married at First Sight. Now, that is not something you're going to hear many lawyers say, but I'm going to start today's podcast off on that foot. And you know, perhaps we can talk about some of the war stories that I've had over the years.

Joanna: I'd love that. And I think our listeners really love to hear us talk about those stories because of course we are sitting at that age where we see lots and lots of deals. So whilst we do see deals done really well sometimes we see lots of interesting stories along the way. I guess we've recently done a podcast where we're talking about warranties and DD and how that all fits together, but maybe it helps colour it a bit more if we can add a bit of our real life example in this so Claire, you know, looking back what are some things that stuck out to you as examples of DD gone wrong or DD opportunities missed?

Claire: Well, if I go to the DD gone wrong, I remember this deal I did many, many years ago. And this is back in the days and we talked about this on an earlier podcast that we did Jeremy's have physical DD rooms where we used to go in and sit in rooms and have dusty boxes and we used to look on microfiche and stuff like that. I remember doing a deal many years ago with a gentleman and I use that in a loose term because he wasn't really very much a gentleman anyway, he was doing an inspection of our documents, my clients documents, and it was in our offices, and it was in a suit, it was in an office building in the centre of Sydney. And all of a sudden, the alarm went off on the building.

And we thought, oh, what's going on here? What was the alarm going off, the man had stolen due diligence materials, and was actually going out of the fire escape, thinking somehow that he was going to be able to get out of the building, and he got caught? And security said to him, as he's holding all of these papers, you know, why are you running out of a law firm with all these papers? He said, Well, you know, they wouldn't let you photocopy them. I was having to write notes. So I just thought I'd just take everything. Anyway, then that brings us to the stories of the importance of electronic due diligence rooms.

Yeah, and I guess it just, you know, a lesson from that is, it's probably not so dissimilar today in the sense that when you're doing a due diligence deal, make sure that your due diligence room doesn't enable people to remove electronic copies of documents, because when you come to doing warranties, and indemnities, and disclosures, and all of that sort of stuff, they usually done paid to a particular date. And if somebody has removed documents from your due diligence room, either deliberately or accidentally, that could have a problem for your warranties, depending on what side of the transaction you're on. So why do I bring that up, I bring that up because control of a data room is really important. But I find that people often don't give much thought into who is controlling a due diligence room.

And it's very, very important, particularly if it's just even done on Google Docs or something like that, it's very easy to change documents unintentionally. And that can have a flow of effect. So when you're doing due diligence, and you're creating a due diligence room, talk to your lawyers or talk to somebody, please don't just do a Google Docs due diligence room and think that that's going to be enough. It might be, but it comes with risk. And as lawyers, we do this every day. And so we can tell you how to best set up a due diligence room. So that's one little story. Another little story was a deal I did a few years ago where my client was a private company. And they were selling, or they were being bought by a listed company.

And the list of companies was giving them securities in the listed company in exchange for their securities and their unlisted company. And so my clients were thinking happy days, we were never going to be able to flog this as easily as we could a listed company. So let's take shares in the listed company. I remember saying to my clients, do you know anything about this company? And they're like, no, but it'd be alright, they're listed on the stock exchange? I said, Well, yeah, they're a pretty big company. But sometimes companies on the stock exchange, you know, sometimes they do crash. Yeah, and the share price might crash, or the company itself might crash. And you're giving your entire value of your company over in exchange for shares and somebody else, so go and do some DD fellas.

And they looked at me and said, Well, we don't know how to do that. So I then got involved. Some other advisors got tax advisors, I did the legal side, got some financial advisors in to look at the numbers. And just before we exchanged them, the listed company disclosed to us that they had just been hit with a massive piece of litigation, which wasn't quite a class action, but was close to a class action and could have brought their entire company down. And thankfully, my client had by that stage, done an awful lot of DD on them, and so was able to get itself comfortable about the risk.

But I guess the point there as well is, even when you're selling a company, if you're not getting cash back, you know, you could be getting a financial instrument, you could be getting something that's linked to the purchases profitability, or you could be getting shares in a listed company, if you're not getting cash. If you're getting something else that's got some sort of contingency or some sort of test or third party involvement in the valuation, then you just as equally need to do your own due diligence, because what are you getting a you're getting shares and listed company? Okay, fine. That, of course, means you're not going to get a seat on the board, probably if it's a listed company, and then I could go on for hours about this. But there's so much flow on when you're not actually getting cashed out due diligence, as you know, one of my passions, that sounds awful, I'm passionate about due diligence, but it's really important.

Joanna: Hahaha. We have to own it as lawyers.

Claire: I know we have to own it. I watch MAFS listeners and like due diligence. You got to do due diligence properly, because if you don't, what you don't know today could very easily come back and haunt you tomorrow.

Joanna: Yeah, and I think it's a really important point that you make. Because in the past, when we've had our other episodes talking about due diligence, we have been focusing on due diligence from the perspective of a buyer buying, you know, the whole box and dice and realizing that they need to do due diligence and how the buyer and seller navigate that process. But, you know, the last story that you're talking about, I think, exemplifies brilliantly, the fact that a requirement for due diligence can come up in a whole heap of situations that you may not expect from the beginning. So we talked about that instance of well, where you're actually getting a share swap as part of her deal.

And, you know, we've got lots of new transactions coming in right now, where this is actually happening a lot at the moment, this idea of, you know, equity swap. And when we talk about due diligence, right at the beginning, I find commonly that that example that you just gave is a common reaction, which is, I hadn't really thought of doing DD on the other party, because I see them as the buyer. But in fact, you're taking on the risk in the transaction as well, even though you're selling in inverted commas, because you're swapping shares with a larger entity, that doesn't mean in any way that you have less risk. You know, so it's coming from that perspective. But also, I find this occurs as well, when we have people looking at buying a parcel of shares in an existing entity, rather than the whole entity, don't think like quiet. And, you know, buyers in that instance, will come in not really having thought about due diligence as well, because they're just buying a parcel rather than the whole box and dice.

Claire: And you could be buying, as you say, a parcel of shares in a company, where the reason why you're buying that parcel of shares in the company is because of the founder. And what happens if the founder dies or leaves and you've put 100 grand or a million bucks or 10 million bucks into this company? What are your rights? What does the shareholders agreement say? What does the constitution say? There's so many papers that you really poke around and have a look at, does the company have keyman insurance in case the person does get hit by the bus that goes around hitting all of these executives.

There are a lot of questions that you may not necessarily have in front of mind, but which we will have in front of mind. Just when you're speaking and Joanna, I thought of another time when I was doing due diligence for a client, and it was a building that they were buying. And I admit that I don't often go and do physical inspections. But there was something about this building, and I thought, Oh, my gosh, gonna do a physical inspection. So I went and did an inspection with one of the young lawyers in my team, and we got in the lift, and we went down to the basement. And we just had a bad vibe. And the person who was running the, I'm gonna say the premises in the basement, can't really want us to poke around.

The short of it is it was a brothel in the middle of Sydney. It was a basement, but it was also, now this will show how inexperienced I am in illicit drugs. It was also a meth lab. And the meth lab was above all the massage rooms. And there were cameras in every single message room, which were filming people having messages. Well, the reason why I'm telling you this story is it does have a happy ending. That's a terrible choice of language on my part. But anyway, my client bought this building knowing that something dodgy was going on, but we couldn't get rid of the tenant on the basis that they were running a massage joint. So what we did is we actually teamed up with the police and we said we feel that there's something dodgy going on in this basement. And so I caught an arrangement with the police whereby they were able to get into the building and bust certain things happening. And there were dog squads and all this sort of stuff. But still, we still couldn't get rid of the tenant.

Now this sort of information isn't going to come up in due diligence because there was a quite nice looking lease about this being a massage parlour. Like generally a massage parlour. Not every massage parlour is a massage parlour. But anyway, the reason why we got rid of this tenant in the end is the seller had massive amounts of arrears. And so my client bought those arrears and we then use the eviction clause under the lease to get rid of the tenant for not paying their arrears and the couldn't pay their raise, because we had got the dog squad in there to kick them all out. So they couldn't earn any money. I probably shouldn't say much more about the transaction, I guess at this point in time, because I'm just thinking, there were some rather large men with accents there that day who I didn't know who they were. But anyway, leaving that aside, what I'm why I'm telling you this story is just that due diligence is fabulous. And it's so important, and you must do it, and you must look at the documents. But you must go that step further. And you must also apply an enquiring mind and just go and do more than just look up paperwork.

Joanna: I think that's a really good point, because, you know, what you're talking about here is going into actually having a physical inspection. So we're saying, Okay, well, the value was in the premises here. So let's not just look at the paper. Let's also get there in person and look and feel and that helps you assess. Oh sorry, that was incorrect, you know, I think... Well, how do I deal with this now? Hahaha.

Claire: Haha it was a fun acquisition, it what's the most interesting ones I've ever had, but it did teach me a lesson early on in my career, which is look behind the papers.

Joanna: And I think this has two points. It's number one, it's about looking behind, as you say, the papers. But number two, it's also about let's not just use a cookie cutter approach to DD, you know, because what annoys me is when I see these really long, you know, DD request lists that just seem not relevant on the transaction at hand?

Claire: Absolutely no. So let's tick a box.

Joanna: Yeah. And the problem with that fundamentally, other than it just annoys people slows down a deal creates all sorts of issues is also from a buyer's perspective, you risk losing the wood for the trees, because you're not actually focusing on the on the things you need to focus on. And, you know, hilarious story, but the serious point behind what you've been talking about Claire is the importance of working out, you know, what is the value? And how do I interrogate that practically, as well, as you know, stepping back from a legal perspective, and I think, you know, adding to the some, we had an example, in the not too recent past that reminds buyers as well, that sometimes it's important for them to do their own amount of, you know, perhaps a small amount, but some due diligence on potential buyers, we've had a number of transactions, and one stands out more than most, and I don't think I can say too much about it.

Claire: I know exactly where you're going.

Joanna: Other than for a seller, sometimes, you know, there might be buyers out there who ultimately are wasting your time, for whatever reason. And I think it's super important not to just get connected to the idea of any buyer, being the buyer of your business, you need to look at objectively, and you need to at least understand who it is and a bit of the history behind your prospective buyers to allow you to work out A whether or not you're going to release information to them that's confidential during this due diligence process, I think that is such an important one. But B whether the prospective buyers are actually worth you spending your time and money, you know, in advisors on as well. So obviously, we can't talk too much about this transaction, even though we have so much we want to say.

Claire: Haha it was a fun transaction. In so many ways.

Joanna: But I think it's without us, you know, getting into the details, which we may be in one podcast in the future when time has passed. I think it's that point, isn't it. And in fact, you know, this comes up all the time, we were speaking with someone just the other day, who was talking about a sale that fell through and this is quite a you know, it's quite common that a buyer will come and start going through due diligence process and then at some point D day doesn't meet what they what they say they wanted or their finances difficult or whatever they might fall away. But when the potential buyer is someone who is a competitor are somehow involved in your distribution line, you know, that can be where you have to be very careful about what it is that you're that you're making available to the prospective buyers in that correct due diligence process. And what's walking that fine line, isn't it between preserving the protection of not oversharing confidential trade secrets within the business versus providing enough information for a buyer.

And sometimes the way that we can navigate this is actually the timing of due diligence. Because sometimes, you know, we can look at putting in parameters around due diligence and perhaps entering into a contract, subject to the final outcomes of due diligence. But of course, we have to be very careful how that is reflected in the contract as well. So we've been talking about due diligence in relation to the you know, sale on business transactions. And of course, it's just as relevant to smaller transactions. It's relevant to many things. But I guess, Claire, just wrapping up this discussion, where we talking about our case studies, is there any sort of last example you can think of that will help our listeners sort of cement some of these warnings that we're giving them today?

Claire: Totally the last example that I probably give, bless, I had this lovely client who was opening a restaurant on the Central Coast. And they came to me and said, found the perfect restaurant Claire. Got to do the lease in a week. Can you do it for me such a cool secondary way? So I started to prep the lease for them. And then I said, Okay, guys, have you been in there? Have you turned on all the lights? Have you tested the air conditioning? Have you flushed all the toilets? Have you tried all the water? Get away about that clear? Okay, have you checked that oven? And all of this sort of stuff? Yeah. Claire, don't worry about it. It's awesome. So okay, I can give you clauses that require a proper inspection and a proper report to be done. It's probably not going to get done in a week, though. So what do you guys want to do? Don't worry, Claire, she'll be right. Okay.

So I did the lease for them, they started business, say, on Monday, whenever it was, there was no grease trap, and the water was going out into the alleyway behind the shop. These lovely people just hadn't done the most basic DD of checking in a restaurant if there was a grease trap. And you know the lease that we got didn't didn't have any of this in there. And I warned them about it. But they just were so anxious to do this deal as quickly as possible, because they'd found this great premises. And looking back at it in hindsight, now, there was a reason why it was such a great deal at the time, and that it had to be done so quickly. So when you come to us and ask us to do things urgently, we certainly can do them. But if we cut corners, or if you cut corners, obviously I'm not telling people how to suck eggs here, but they can obviously be serious consequences. In doing so because you're limiting the due diligence that you can do. So sometimes that golden egg again, you want to look behind it and find out why it's so golden.

Joanna: It's such a good point. And do you know what that is such a good example of cases that you've seen to wrap up the discussion today, because it demonstrates You know, I think the overarching problem here, which is when lack of full understanding of what you're buying combines with emotion and deal fever, you can be in this situation where you're overlooking some things that are obvious. And due diligence really helps to drive you there without emotion. It's the objective check. Of course, we have the contract, but the contract needs to sit together with sensible due diligence as well. And that's the point I think.

Claire: I agree with you, because let's go back to where we started this conversation. Do you really think any of those couples are Married at First Sight would have got together if they haven't done their due diligence? First, I put to you that the answer is no.

Joanna: Well rounded, thank you so much for joining me again Claire.

Claire: My pleasure Jo.

Joanna: Well, that's it for this episode of the deal room podcast. As a bit of a recap, of course, in this episode, we were talking about pulling doing a deal like Married at First Sight. And of course, the importance of due diligence and where we have actually seen this play out in reality. And actually, as part of our reality here at Aspect Legal we say it day in day out. And the point is that it can be really hard when you're in the middle of a transaction, when you're in the midst of that deal fever to retain that objective sense of what makes sense from a due diligence perspective. And of course, we're here at Aspect Legal. I'm more than happy to help you walk you through your transactions and work out what's relevant in your transactions.

And if you're looking at it from a sell side, how it is that you can manage the due diligence process so that you are most protected. If you'd like more information about this topic, then head over to our website at the dealroompodcast.com where you'll be able to download a transcript of this podcast episode if you want to read it in more detail. Please note however, that it is a auto transcribed audio so it says definitely won't be Word Perfect but it is our attempt at providing you in an efficient way. A vivid transcript of what we talked about today but there at that website you'll also find details of how to contact Claire Bibby and our other legal Eagles at Aspect Legal, if you or your clients would like to discuss any legal aspects of sales or acquisitions, we've got a range of services to help guide businesses through the sales and acquisition process.

And of course, through due diligence, which was the topic of today's discussion, and we work with clients both big and small and have different types of services depending on size and complexity. So just do not hesitate to book an appointment if you'd like to find out how we can assist. Well, that's it if you enjoyed what you heard today, I just love it if you can possibly pop over to iTunes or Apple podcasts or your favourite podcast player and leave us a review. And of course, don't forget to hit that subscribe button. Well thanks again for listening in. You've been listening to Joanna Oakey and The Deal Room podcast, a podcast proudly brought to you by our commercial legal practice, Aspect Legal. See you next time.