

A person in a business suit is seated at a wooden desk, reviewing a document. The desk is cluttered with a computer monitor, a keyboard, a mouse, a pair of glasses, and a telephone. The person's hands are visible, holding a pen and pointing to a section of the document. The background is slightly blurred, focusing attention on the person and their work.

Phase 3: Where Legal Due Diligence Becomes Deal Craft

(Part of the Buyer-Side Legal DD Series)

Where You Actually Earn Your Keep

In any buyer-side M&A, Phase 0 sets the machine, Phase 1 defines the thesis, Phase 2 brings in the information. But Phase 3 is where you actually earn your keep. It's where documents stop being "uploads" and become evidence, risk, and - most importantly - deal leverage.

Many junior lawyers think Phase 3 is "reading everything." That is not diligence; that is document consumption. Phase 3 is a disciplined process: you read with a thesis, extract facts in a repeatable way, evaluate impact, and translate findings into actions the buyer can use in the SPA/APA and the closing plan.

The Purpose is Simple and Non-Negotiable

Create a Defensible Factual Record

What exists, what it says, what's missing

Build a Risk View

Impact and probability

Convert Both Into Deal Actions

Price, CPs, covenants, indemnities, escrows, and integration fixes

If you run Phase 3 properly, you can build a red-flag memo almost directly from your Issue Register. If you run it poorly, you will spend the last week before signing rewriting everything—under pressure, with gaps, and with avoidable mistakes.

The Phase 3 Mindset: You Are Not Summarising, You Are Engineering a Transaction

Your job is not to summarise documents. Your job is to identify what can go wrong and how the buyer can fix it in the deal.

One line should guide your work every day in Phase 3:

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That means every review must connect to at least one of the buyer's Thesis Questions and at least one of the buyer's crown jewels (contracts, licenses, IP, land, data, brand, or key people). When a document does not answer a thesis question, you do not "go deep" by default. You either (i) classify it as lower priority, or (ii) extract only what's needed to confirm it's irrelevant.

A Universal Method: How to Review Any Document in Phase 3

Whether you are reading a facility agreement, a software licence, a labour CBA, or an environmental permit, the method stays the same. Juniors often ask, "How do I know what to look for?" - the answer is: follow the steps and the issues reveal themselves.



Step 1: Identify What the Document Is Doing

Start with the function. Is it creating rights, imposing obligations, restricting transfer, or allocating liability? Capture parties and capacity (who signed and as what), effective date, term, renewal, governing law, and dispute forum. A contract you can't place in context is a contract you can't evaluate.

Step 2: Extract Metadata Into the Schedule (For Anything Material)

This is where Phase 3 becomes professional. You capture: Doc ID and filename, signing entity, counterparty, value, term/renewal/termination, assignment/COC position, any security/lien implications, operational must-dos (SLAs, audits, reporting), and unusual risk clauses (indemnities, penalties, caps, warranties, limitation of liability). If you skip metadata, your "analysis" will never be consistently actionable.

Step 3: Read With a Thesis Question in Mind

Ask yourself, explicitly, what thesis question this document answers. Does it protect or threaten a crown jewel? Does it create a closing blocker (consent, filing, regulatory approval)? Does it create economic drag (hidden rebates, penalties, under-pricing, step-ups)? When you read without a thesis, you miss what matters and over-weight what doesn't.

Step 4: Write the Finding in the Issue Register Immediately

This is the habit that separates strong deal lawyers from "review lawyers." Every issue must contain: (i) the fact (what it says), (ii) why it matters (impact on closing/value/operations), (iii) evidence (Doc ID + clause/page), (iv) a proposed lever (price, CP, covenant, indemnity, escrow, R&W, integration action), and (v) the next step (Q&A, missing doc request, registry check, rewrite request). If you can't propose a lever, you haven't completed the thought.

Step 5: Decide Green / Amber / Red, and Justify It

Green

Standard/no meaningful impact

Amber

Fixable/manageable

Red

Deal-stopper or high-probability/high-impact exposure that you can't fix pre-close at acceptable cost

Green is standard/no meaningful impact. Amber is fixable/manageable. Red is a deal-stopper or a high-probability/high-impact exposure that you can't fix pre-close at acceptable cost. Most mistakes happen when juniors mark everything "Amber" because they fear being wrong. The right standard is not "what looks scary," but "what changes the deal."

Step 6: Escalate Early, Especially Reds

- ☐ **A Red should be escalated within 24 hours with two things: a clear explanation and at least one mitigation path.**

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Workstreams in Phase 3: How to Apply the Method Across the Company

Phase 3 is not one monolith. It is multiple parallel reviews, each with its own outputs, typical traps, and deal levers. A good team runs them consistently, but not identically.

A. Corporate, Cap Table, Governance, Group Structure

Corporate diligence is about one question: can the seller deliver clean title and authority to close?

In Phase 3, you are not "reading charters." You are building a group structure chart, a cap table schedule (equity, options, convertibles, warrants, ESOP), an authority pack (who can sign and what approvals are required), and an encumbrances summary (pledges/charges).

The deeper skill is to hunt for "hidden control" and "leakage"—supermajority reserved matters, veto rights, ROFR/ROFO, drag/tag mechanics, negative covenants, and informal equity promises outside formal plans. Convertibles are a classic DD landmine: maturity, default triggers, conversion mechanics, valuation caps, MFNs, and any rights that change the economics at closing.

Red flags in corporate DD are rarely dramatic—but they are fatal: missing approvals, defective issuances or transfers, unclear beneficial ownership, security over shares blocking transfer, and option acceleration that blows up the buyer's model.

Deal levers are straightforward: CPs for clean-up and releases, special indemnities for title/cap table defects, escrows/holdbacks tied to releases/ratifications, and purchase price adjustments for acceleration and debt-like items.

B. Material Contracts

Contracts diligence answers the question: what is the business actually made of, and can the buyer keep it after closing?

Juniors often start with "what the contract says." Start instead with a structure: business terms, risk allocation, control/exit, and enforceability. For each material contract, produce a schedule and a consent tracker, and extract a "key clauses table": scope, pricing/rebates, exclusivity/MFN, SLAs, warranties, indemnities, limitation of liability, term/renewal, termination (cause and convenience), assignment/COC, audit rights, subcontracting limits, governing law, forum/arbitration, and survival.

What separates high-quality Phase 3 work is spotting the silent killers: termination for convenience, short renewal windows, unilateral price changes, broad audit rights, or customer SOW language that quietly transfers ownership of deliverables to the customer. Combine those with customer concentration and you have a real value risk.

Red flags include major revenue contracts terminable on short notice, COC triggers requiring hostile consents, non-assignability for critical contracts, and cross-defaults in financing triggered by the acquisition.

Deal levers are the classic toolkit: CPs for consents/novations, covenants to preserve relationships and avoid pre-close triggers, price chips or earn-outs where retention is uncertain, and special indemnities for undisclosed rebates, penalties, or audit liabilities.

C. IP, Technology, Software, and Open-Source

This is where many deals win or die silently. The key question is: does the target own what it thinks it owns, and is it free to operate and keep shipping?

Your outputs should be tangible: an IP register with status and owner, a chain-of-title file (assignments from founders/employees/contractors), inbound/outbound licence schedules, and an OSS/SBOM/code scan summary if it's a software business.

The review discipline is to separate four buckets: ownership, inbound rights, outbound monetisation, and open-source compliance. Pay particular attention to contractor-created code and "customer owns deliverables" clauses in SOWs. If AI is in scope, the modern equivalent of chain of title is data provenance and usage rights.

Red flags are clear: missing assignments, copyleft exposure in shipped products without compliance, core IP owned by individuals or affiliates outside the perimeter, and non-transferable inbound licences essential to operations.

Deal levers tend to be surgical and strong: CPs to obtain/record assignments and cure OSS gaps, special IP/OSS indemnities, escrows tied to title perfection, and covenants to implement scanning and governance post-close.

D. Privacy, Data Protection, and Cybersecurity

Privacy/cyber diligence is not a policy review. It answers one question: can the buyer legally use and safely hold what it is buying, especially the data, and what is the incident risk profile?

Your required outputs include a data map summary (types/purposes/locations/transfers), a vendor list with DPAs/security terms, an incident summary (breaches, near misses, ransomware, regulator contacts), and a control-maturity snapshot (policies, IAM, IR plan).

Approach the review in three layers: lawful processing/transparency (does notice match reality?), cross-border transfers (mechanism and localisation constraints), and security posture (controls, IR plan, testing, insurance).

A recurring Phase 3 mistake is ignoring deal intent: if the buyer plans database merging or cross-sell, your review must assess whether that is lawful post-close. That is the difference between "compliance" and "deal viability."

Red flags include material breach history without remediation, missing DPAs for key processors, weak access controls (no MFA, shared accounts), and inability to transfer or repurpose data lawfully.

Deal levers often combine pre-close and post-close actions: CPs or covenants to implement controls and complete audits, holdbacks tied to remediation, special indemnities for known incidents/investigations, and targeted reps with tight disclosure schedules.

E. Employment, Benefits, Labour, Immigration

Employment diligence is not a headcount list, it is an exposure and transfer analysis: what liabilities exist, and can the buyer keep the people and legally transition them?

Your outputs should be structured: headcount schedule by entity/role/location with key persons flagged; CIC/vesting summary for executives and equity plans; benefits/accrued liabilities summary; union/works council consultation plan where applicable.

Review through the lens of classification (employee vs contractor), compensation liabilities (bonus/commission/severance/accruals), collective arrangements (CBAs and consultation obligations), transfer-of-undertakings regimes, and immigration.

Red flags include automatic CIC vesting/severance that changes the economics, unresolved labour disputes, benefits or payroll compliance gaps, and consultation duties ignored that can delay closing or trigger penalties.

Deal levers usually include CPs to complete consultations and secure key-person retention, price adjustments for accruals and CIC costs, indemnities for pre-close employment claims/misclassification, and carefully drafted covenants on pre-close changes (without triggering control/gun-jumping issues).

When Phase 3 Is "Done": The Exit Checklist That Protects You

You can say Phase 3 is complete only when these are true:

- Priority A documents are reviewed and scheduled.
- Consent and filing needs are identified with realistic timelines.
- Issue Register contains RAG and proposed levers for every Amber/Red.
- Missing critical information is clearly listed as "Information Gaps" and requested.
- Senior verification is complete for all Reds.
- A draft red-flag memo outline can be produced from the Issue Register without rewriting facts.

 **If you cannot generate a red-flag memo from your register, you do not have Phase 3 output, you have Phase 3 activity.**

Closing Coaching Cues

Phase 3 is where you build your professional habit set. The best juniors are not those who read fastest; they are those who think in a deal format.

Keep these lines close:

Always answer three questions

What does it say, why does it matter, what do we do about it?

Be precise and boring

Precision beats eloquence in DD.

Separate facts from judgment

First line: what the document says. Second line: why it matters.

Escalate early with options

A Red without a mitigation idea is not a professional escalation.

Write for the SPA

If it cannot become a rep, covenant, CP, indemnity, escrow, or integration action, your finding is incomplete.

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