

A group of four business professionals (two men and two women) are gathered around a conference table in a bright, modern office. They are all dressed in business attire. One woman is standing and pointing at a document, while the others are seated and looking at laptops or documents. The scene is brightly lit, suggesting a large window in the background. The overall atmosphere is professional and collaborative.

# Phase 4: Turning Findings into Deal Power

(Part of the Buyer-Side Legal DD Series)

# Where Legal Due Diligence Becomes Deal-Making

By the time a team reaches Phase 4, the data room no longer feels like a mystery. Contracts have been read. Cap tables have been reconciled. Licenses have been mapped. Issues have been logged. In many deals, this is the moment where the junior team believes the job is largely done: "we've found the risks, now we just report them."

**That is exactly the wrong mindset.**

Phase 4 is where legal due diligence becomes deal-making. A buyer does not pay for a report; the buyer pays for protection, certainty, and leverage. And none of that exists until the diligence findings are converted into terms in the SPA/APA—price mechanics, closing conditions, covenants, reps and warranties, indemnities, escrows, and integration actions that make risks either disappear or become economically acceptable.

If Phase 3 is learning the truth, Phase 4 is deciding what to do with it.

# The Discipline of Phase 4: Every Issue Must End with an "Ask"

The most common failure at this stage is a DD report full of "interesting facts." The second most common failure is a report full of "risks" but no clear instruction on what the buyer should demand.

Phase 4 imposes one rule that changes everything: **each Amber/Red issue must produce an actionable ask.**

A proper Phase 4 entry has a specific structure, and the team should follow it almost mechanically:



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## State the fact

What the document says, or what is missing.



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## State the risk

Why that fact matters for closing, value, compliance, or operations.



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## State the ask

The deal lever(s) that should be used to mitigate or allocate the risk.



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## State the evidence

Data room doc ID + clause/page, Q&A reference, or registry reference.



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## State the owner

Who on the deal team negotiates it (SPA drafter, regulatory counsel, commercial lead).



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## State the deadline

When the buyer needs resolution (often driven by signing or long-stop dates).

This is not bureaucracy. It is the only way to ensure diligence becomes leverage, and that no critical issue ends up as an orphaned paragraph in an appendix that nobody negotiates.

 **A good coaching test for associates:** if you cannot write the ask in one sentence, you have not finished analysing the issue.

# The Phase 4 Toolbox: Choosing the Right Lever for the Right Risk

Once the team understands that every issue needs an ask, the next question becomes: what is the right "ask"?

In buyer-side M&A, Phase 4 is fundamentally about selecting tools, deal levers, and applying them with precision. The best teams do not throw every tool at every problem. They choose the least intrusive mechanism that still provides real protection.

## a) Pricing levers

Price is the cleanest solution when a risk is quantifiable or likely to crystallise soon. This includes purchase price adjustments (working capital, net debt, leakage, capex true-ups), specific deductions for known liabilities, deferred consideration/holdbacks, and sometimes earn-outs where future performance is uncertain.

But the team must be realistic: earn-outs can become litigation factories unless the metrics are defined with clarity and control rights are carefully managed. The coaching point is simple, when price is the lever, make it auditable and objective.

## b) Closing conditions (CPs) and deliverables

If an issue blocks legal ownership or legal operation, the answer is not a clever warranty, it is a condition precedent. Third-party consents/novations, regulatory approvals, license transfers, releases of liens, corporate ratifications, and carve-out mechanics belong here.

A recurring Phase 4 coaching point: CPs must be tight and objective. "Obtain all necessary consents" sounds comprehensive but is often unenforceable and invites argument. "Obtain consent from Counterparty X to the assignment of Agreement Y" is negotiable and provable.

## c) Pre-closing covenants

Between signing and closing, value can drift and risk can worsen. Pre-closing covenants are the guardrails: ordinary course operation, restrictions on new debt or liens, prohibitions on terminating key contracts, and "efforts" obligations to obtain consents and approvals.

However, this is where inexperienced teams accidentally create gun-jumping risk by demanding buyer approval over routine operations. The better practice is to reserve approvals for truly material actions and structure covenants so they protect value without giving the buyer de facto control.

## d) Reps & warranties and disclosure schedules

Reps and warranties exist for two purposes: to reduce unknown risk, and to create clean post-close recourse when reality deviates from what was promised.

But sophisticated Phase 4 work never treats reps as standalone. The actual battlefield is the disclosure schedule. If disclosure schedules are vague, incomplete, or detached from data room evidence, the buyer may end up with "reps on paper" and no practical remedy.

The internal instruction to juniors should be blunt: **the schedule is where truth lives**. In Phase 4, you push for complete lists, detailed exceptions, and references that are traceable to the data room. A warranty without a disciplined schedule is often just a negotiation ornament.

## e) Indemnities: general and special

Indemnities are best when a risk is substantial but not cleanly priced, or when a known issue requires ring-fencing. General indemnities with caps and baskets handle ordinary risk. Special indemnities isolate specific known exposures, tax audits, a named litigation, an identified environmental remediation, a known breach incident.

A Phase 4 team must also align survival periods with risk horizons. It is poor practice to put a one-size survival across all claims when certain risks predictably crystallise later.

## f) Escrows and holdbacks

Even the best indemnity is meaningless if the seller cannot or will not pay. Escrows and holdbacks provide enforcement. The best ones are simple: appropriate size, clear claim mechanics, objective release criteria tied to time or milestones.

Complex release formulas tend to delay closing or create post-close friction. Keep them clean.

## g) R&W insurance

R&W insurance often becomes relevant when sellers demand a clean exit or when the deal is competitive. But it does not replace diligence, and known issues frequently sit outside coverage. The Phase 4 approach is practical: use insurance as a deal architecture tool, and then use special indemnities/escrows for known risks that insurers will exclude.

# The Issue-to-Lever Decision Logic: How to Pick, Not Guess

The professional way to select levers is to classify each issue and follow a decision tree, not instinct.

The Phase 4 team should classify each issue by:

## Category

Title/ownership,  
consents/transferability,  
compliance/regulatory,  
economic liability, operational  
continuity,  
enforcement/reputation

## Timing

Pre-close vs post-close

## Certainty

Known/quantifiable vs  
uncertain

## Fixability

Can the seller fix it pre-close

From that classification, a default lever set typically follows:

### Closing blocker

CP + pre-closing covenant +  
termination/long-stop protection

### Known quantifiable liability

Price reduction or  
escrow/holdback (plus special  
indemnity if needed)

### High-impact uncertain risk

Targeted rep + special indemnity +  
escrow (plus post-close  
covenants/audit rights)

### Information gap

CP to deliver documents + bring-  
down certificate +  
extended/tailored reps (and often a  
holdback if critical)

### Operational integration risk

Remediation covenant + milestone-  
based holdback (and special  
indemnity for known incidents)

- ☐ **A coaching habit that strengthens negotiation outcomes:** always offer two route, a strong protection route and a commercial compromise route. This reduces seller defensiveness and speeds up convergence.

# How to Write the "Ask" So It Can Be Negotiated

In Phase 4, wording matters. Many junior associates write risks as paragraphs that read like academic commentary. That is unusable in negotiation.

The team should write findings in a consistent, deal-ready five-line structure:

- 1 Finding (fact)
- 2 Risk
- 3 Severity with reason (Red/Amber)
- 4 Ask (lever)
- 5 Evidence reference

This format forces clarity and makes your output portable: it can move directly into a red-flag memo, a negotiation tracker, and then into SPA markup instructions.

The deeper lesson for juniors: **do not "describe the issue"; package it for decision and drafting.**

# Drafting Guidance: What Phase 4 Must Instruct the SPA/APA Drafter to Do

Phase 4 is not just "legal DD reporting." It is writing and negotiating instructions for the transaction documents. Even if juniors are not drafting full clauses, they must know what high-quality instructions look like.

## a) CPs: be objective, not poetic

A CP should specify the exact consent, approval, or release and the form of evidence required. Avoid broad language that becomes impossible to prove. Tie CP failures to consequences: termination rights, long-stop extensions, or economic adjustments.

## b) Pre-closing covenants: protect value without controlling operations

Use ordinary course covenants plus a short list of prohibited material actions. Limit buyer consents to big-ticket decisions. This both protects value and reduces gun-jumping risk.

## c) Reps & warranties: tailor to diligence reality and enforce schedule discipline

If your diligence did not deeply verify a topic, don't demand an unrealistically broad rep. Instead, seek a narrower rep plus disclosure schedule completeness and detail. The team should push for schedules that are complete, specific, and referenced to data room documents. Otherwise, reps become hollow.

## d) Indemnities: align with economics and time

Indemnities must define recoverable losses, clarify defense control, and set survival and caps that match the risk. Special indemnities must name the matter precisely and run until final resolution plus a buffer—not an arbitrary one-year period that ignores reality.

## e) Escrow/holdback: keep release mechanics clean

Specify holder, currency, claims process, partial releases, dispute resolution, and objective releases tied to time or milestones. Avoid over-engineering.

## f) Price adjustment mechanics: make them auditable

Define net debt, working capital, leakage, and accounting principles consistently. Provide dispute resolution through an independent accountant with a limited mandate. Undefined "normalised working capital" is an invitation to post-close conflict.

## g) Termination, MAC, and long-stop

Phase 4 must align long-stop dates and termination rights to regulatory approvals, consent processes, and remedy risks (especially antitrust/FDI). Risk allocation provisions should reflect real expected pain points.

# The Red-Flag Memo: The Executive Instrument of Phase 4

A Phase 4 output is only as good as its usability. The red-flag memo is the tool that forces decisions while there is still time to negotiate.

A disciplined structure works best:

1	<b>Deal snapshot (1 page)</b> What is being acquired, timeline, crown jewels
2	<b>Top 10 red flags (2–4 pages)</b> Each with ask + recommended lever
3	<b>Consent/approval critical path (1 page)</b> Who/what/by when
4	<b>Open information gaps (1 page)</b> What's missing, why it matters, deadlines
5	<b>Appendix</b> Issue Register extract (reds/ambers) and key schedule summaries

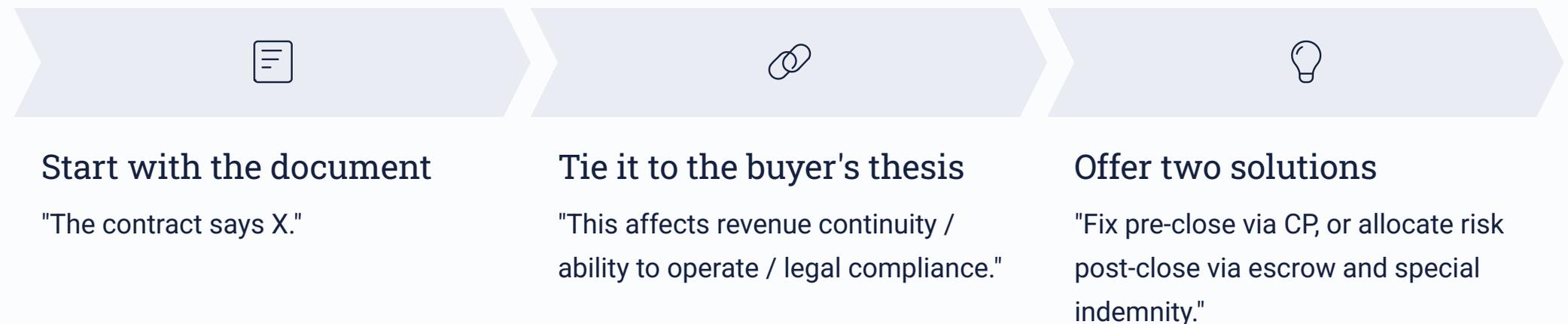
The writing rule is strict: every red flag ends with "Decision required: A/B/C." Evidence references stay tight and traceable.

**If the memo does not trigger decisions, it is not an executive memo, it is a document dump.**

# Negotiation Posture: Credibility, Options, and Predictable Logic

Phase 4 is also the stage where the seller's counsel tests whether the buyer's diligence team is serious. The most persuasive posture is evidence-driven and options-based.

A strong Phase 4 argument is simple:



Handling common seller pushbacks is part of the Phase 4 craft:

**"It's market standard."**

Standard does not mean acceptable in this deal.  
Concentration and context matter.

**"We can't give that rep/indemnity."**

Then the buyer needs economic protection: holdback/price adjustment, or narrower special indemnity.

**"It never happens in practice."**

Then provide a waiver/comfort letter or evidence of non-enforcement.

**"We disclosed it."**

Disclosure prevents surprise, but it does not remove risk. Risk still must be allocated.

What a senior lawyer trains juniors to avoid is emotional escalation. **Phase 4 is not adversarial; it is architectural.** You are building a structure where risk sits in the correct place.

# Closing Phase 4 Properly: What "Done" Looks Like

Phase 4 is complete only when the diligence findings have been translated into the deal documentation plan and the buyer's decision points are locked.

Before moving to Phase 5, the team should be able to say, and prove, all of the following:

- Every Amber/Red issue has at least one proposed lever (usually two options).
- The CP list is finalised, realistic, and tied to deliverables.
- The consent/filing tracker aligns with the long-stop date and regulatory risk.
- The reps and warranties are matched to diligence scope, and disclosure schedule discipline is in place.
- Special indemnities and escrows exist for known big risks.
- The pricing mechanism (PPA/holdback/earn-out) aligns with identified liabilities and uncertainties.
- The red-flag memo has been delivered, and buyer decisions are recorded.
- The issue register shows a status for each key risk: accepted, mitigated, pending, or escalated.

# Coaching Cues for Phase 4

Phase 4 is where juniors learn to stop thinking like document reviewers and start thinking like deal lawyers. The simplest coaching reminders are often the best:

You are not producing a report. You are producing protection.

Never present a risk without at least one solution.

Offer two pathways: "fix pre-close" or "allocate post-close."

Keep asks tight: one issue, one paragraph, one owner, one deadline.

Protect credibility: don't overreach, and don't demand reps for topics you didn't properly diligence.

Remember: the deal documents are the product —DD is only the raw material.

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Phase 4 is where the legal DD team earns its place at the negotiation table. If you do it well, the buyer signs with clarity: knowing what has been fixed, what has been priced, what is insured, what is secured, and what remains as managed risk. If you do it poorly, the buyer signs with a report, and hopes.

# ABOUT US



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