

DIGITAL ISSUES MOST PRESSING AND LEAST ACCOUNTED FOR IN MERGERS AND ACQUISITIONS

How the source company should prepare to integrate the target company's data retention policies and litigation holds, as well as an eDiscovery checklist which can save merged companies time and money down the line.
By Daniel Garrie

INTRODUCTION: DATA DUE DILIGENCE AND EDISCOVERY

A critical, but yet surprisingly overlooked, component of a successful merger or acquisition is the dependability and efficiency of the data due diligence undertaken by the companies involved in the transaction. Companies should be cautioned that post-integration success may hinge on the data due diligence efforts undertaken in the pre-merger and acquisition due diligence phase.

A PRIMER EDISCOVERY CHECKLIST

An unassuming, but effective, tool in the due diligence process is to create an e-discovery checklist. The following items should be included in the checklist, but should by no means be viewed as an exhaustive list:

- The condition of the target company's electronically-stored information, or its ESI;
- Existing and anticipated legal holds; costs of preserving data for existing or anticipated legal holds;
- Verifying that the companies back-up policies, software, processes and systems operate accordingly.

The importance of the condition of the target company's ESI cannot be understated. It is imperative that the acquiring company undertakes a "systems" check to thoroughly review the target company's existing information systems. Moreover, an evaluation of these systems and processes will assist the parties in identifying critical issues related to integration, data loss and data recovery issues. In light of the burden that the acquiring company assumes respective to ensuring that data related to current or anticipated legal disputes is preserved, along with the high cost of losing or improperly storing such data, mandates that the aforesaid steps be undertaken in some fashion to ensure a thorough evaluation of said company's ESI.

THE IMPORTANCE OF ACCOUNTING FOR LEGAL HOLDS

A second item of particular import in any e-discovery checklist is current existing and anticipated legal holds. An acquiring company succeeds its target in ongoing or anticipated legal disputes; therefore, said company is now responsible for preserving and placing litigation relevant data and metadata under legal hold. The sustainability of any post-integration

success will be tested by any number of issues, but arguably none more so than ongoing litigation and the costs associated with such litigation. Companies generally tend to vet current and potential legal disputes of a target company with a "fine-tooth" comb; however, the same critical analysis should also be placed on identifying these litigation or regulatory holds in the pre-acquisition phase.

The cost of preserving data for existing or anticipated legal holds is a significant factor to consider in pre-M&A due diligence. Evaluating the costs of preserving data that is subject to a litigation hold should be accounted for in the pricing of the deal, where appropriate.

Counsel must also consider physically verifying the systems exist and that the systems are operational. An acquiring company should physically verify that the backup tapes operate and contain data. Failing to do so at this phase exposes the acquiring company to unnecessary liabilities and increased costs, because if the data is partially or not at all backed up the acquirer will incur substantial additional costs in order to try and restore the data, which may or may not be possible. Perhaps, even more important, if this issue arises, the acquirer should see it as a red flag because it may indicate possible prior bad acts, senior management is oblivious to the day-to-day operations, existing agreements might be fraudulent, or other possible technology infrastructure issues exist that might not have been identified, which are costly to remedy.

These factors should be integrated into every due diligence/e-discovery checklist. Data due diligence is too critical an issue to be left to ad-hoc construction of methods devised after the companies have merged or the target company acquired.

ENFORCEMENT OF DUE DILIGENCE POLICIES

Although there is not a great deal of information available on the exact number of mergers or acquisitions that fail due to improper data due diligence, one could successfully argue that ineffective data due diligence contributes to the high failure rate of merger and acquisition deals. In light of the increased popularity of the use and storage of electronic data, it behooves companies to invest resources on the front-end in order to avoid costly blunders post-integration. It is inconceivable that in today's digital age, parties contemplating a merger or acquisition would not avail themselves of these tools in order to ensure a comprehensive due diligence phase. The costs associated with a merger or acquisition are no doubt extensive. However, not focusing on a target company's ESI or e-discovery obligations can also prove costly from a pure business standpoint and result in judicial and regulatory penalties.

For example, a court recently found that a U.S. manufacturing company acted negligently in not instituting a company-wide information retention policy and ordered said company to pay about \$200,000 to restore information from backup tapes. However, it is not enough for a company to institute a companywide policy, unless that policy is effectively rolled out

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We work with our clients, whether law firms, corporate organizations or government agencies, to resolve eDiscovery issues, perform electronic forensic examinations and investigations, and help bridge information and communication gaps between technologists and legal professionals.

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to the company's employees through proper training. The company's chief compliance officer, along with the legal department, must ensure that the policy is understood and enforced.

The same can be said about a company's litigation hold policy. As with any policy, the content must have some "teeth" in order to be effective, and failing to do so can be catastrophic. For example, in a wrongful termination case in the Southern District of New York, a company's employees deleted e-mails relevant to the case well after the company was advised of a litigation hold. The result was that the court allowed the jurors to infer the deleted e-mails supported the plaintiff's claims and the jury returned a verdict in favor of the plaintiff to the tune of \$29 million. The fact of the matter is that most if not all companies have similar policies, but the problem lies in the application and enforcement of these policies, and often times their ineffectiveness.

CONCLUSION

Effective data due diligence and applying a high degree of scrutiny to a company's record retention, litigation hold and other related policies will not guarantee post-integration success, but it will eliminate unnecessary risks and liabilities that can be easily avoided.