THE NETHERLANDS BOEKEL DE NERÉE N.V.

Disclosure of your due diligence report

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There is a phrase that you will undoubtedly find at the beginning of every due diligence report: 'This report is addressed to the client. This report may not be relied upon by, transmitted to or filed with any other person, firm, company or institution for any purpose without the express prior written approval of our firm.'

However, two recent court rulings indicate that a due diligence report may not be as confidential as this wording suggests. Through a brief overview of these recent rulings and an explanation of the legal basis for demanding disclosure of a due diligence report, this article outlines the circumstances that may lead to an obligation to disclose a due diligence report to parties other than the addressee.

Legal basis

Under Dutch law, claims under warranties can be barred if the purchaser had, or should have had, knowledge of facts or circumstances that contradicted the warranties. On the other hand, a vendor that fails to disclose the information that it knows, or should have known, to be material to the average vendor, cannot rely on the argument that the purchaser failed to actively perform its duty to investigate and thus avoid liability exposure flowing from a claim under the warranties. As a result, being able to determine the scope and nature of the disclosed information could be considered material to the success or failure of any claims under the warranties. For this purpose, having access to the due diligence report could be vital to a vendor's case once it has been confronted by a claim under the warranties.

Arguably, the legal basis for demanding disclosure of a due diligence report can be found in Article 843a of the Code of Civil Procedure. This Article reads as follows:

> 'He who has a legitimate interest may, at his own expense, demand to inspect, receive a copy of or extract of certain documents regarding a legal relationship to which he or his legal predecessor is a party, from the person that has possession of these documents or has the documents at his disposal. The term documents includes any data contained by electronic sources.'

In two recent cases an attempt has been made to obtain due diligence reports by parties trying to ward off claims under warranties or attempts to nullify sale and purchase agreements (SPAs) on the basis of negligent misrepresentation (*dwaling*).

Disclosure case one

- On 21 October 1997 a vendor and purchaser entered into a letter of intent (LOI) in relation to an envisaged sale and transfer of shares in two entities. In the LOI the vendor and the purchaser agreed that the vendor would issue a guarantee in relation to the profitability of the target companies, should a due diligence investigation fail to reveal any loss-making projects.

- On 6 October 1998 the same vendor and purchaser entered into an SPA that included a warranty in relation to the profitability of the companies. The parties furthermore agreed that the warranty would be effective regardless of the outcome of the due diligence investigation.

- Soon after completion, a project operated by one of the target companies was found to be losing money. The purchaser took the vendor to court, arguing that the vendor had failed to disclose relevant information. The purchaser tried to claim under the warranty in the SPA. The vendor responded by pointing out that the fact that this particular project was losing money should have been anticipated and should have surfaced during the due diligence investigation. To be able to better defend itself against the purchaser's claims and to show that, on the basis of the disclosed information, the fact that this particular project was losing money was foreseeable, the vendor demanded to receive the due diligence report drawn up by the purchaser's accountants.

- On 14 January 2004 the Court in Breda ruled that the due diligence report should be disclosed. The most notable argument laid down in this judgment is probably the fact that a due diligence report, by its nature, reflects the results of an investigation into factual circumstances, leads to the conclusion that such a report cannot be considered to be exclusively of an advisory nature. Moreover, should certain passages of the report be of an advisory nature, the fact that these passages have been included in a report that is meant to display the results of an investigation into the facts, should be for the account of the vendor and, as a result, not form an obstacle for disclosure. As such, the purchaser's interest to defend itself against claims from the vendor is found to outweigh the vendor's and its advisor's interest in maintaining the confidential nature of any passages of an advisory nature included in the due diligence report.

It must be said that under Dutch law the relationship between accountants and their clients is less stringent than confidentiality rules which govern the attorney-client relationship. The fact that this argument may not be sufficient to prevent disclosure of a legal due diligence report is made clear by a recent interim ruling of the Amsterdam Court in *Dexia v Aegon*.

Disclosure case two

In what may turn out to be a landmark case in respect of the sheer magnitude of the consequences of a positive result for the claimant, Dexia's attempt to reverse a €900m takeover of an Aegon subsidiary, Bank Labouchere, sparked an interim ruling from the Amsterdam Court indicating that disclosure of a legal due diligence report should at this time not be ruled out.

A brief summary of the facts

- In 2000 Dexia acquired Aegon's subsidiary after an exhaustive due diligence investigation. In the SPA drawn up for this occasion, it was specifically noted that Dexia would not be entitled to any damages relating to a breach of the warranties that resulted from a fact, circumstance or event that had become known or should have been apparent from the information disclosed in the data room.

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- Since Dexia's acquisition of Bank Labouchere it has been tied up in lawsuits relating to investment schemes developed by Bank Labouchere. These schemes involved investors (consumers) purchasing shares with borrowed funds which would be repaid in part by making monthly payments and – if all went well – part of the profits made from a sale of the shares. The investment schemes turned out to be less than profitable once the markets started to move downwards. Some investors were surprised to learn that years of making monthly payments left them with nothing more than a – sometimes substantial – debt to the bank. Investors have argued that Bank Labouchere misrepresented the potential risks of these investment schemes. A group of investors have also tried to nullify their original agreements, arguing that these types of investment schemes require spouse approval, which had never been requested by Bank Labouchere. Dexia has attempted to settle some claims, but is left with a number of suits (some of which are class-action), which it argues have greatly affected its good name and profitability.

- Dexia is now attempting to claim under the warranties included in the SPA and is also trying to have the original agreement nullified on the basis of negligent misrepresentation. Dexia claims that possible problems in relation to the requirement of spouse approval and misrepresentation of the risks of investors becoming indebted to the bank were known to Aegon, but were not disclosed.

- Aegon has, in turn, argued that it should have access to – among other things – the legal due diligence report Dexia had drawn up, in order to defend itself against Dexia's claims that it failed to disclose certain information.

- On 3 November 2004 the Amsterdam Court ruled that Dexia does have an obligation to disclose additional information, but that the specific scope of information that Dexia had to disclose had to be determined on the basis of the circumstances at hand. Among the relevant factors the Court mentions: (i) the specific agreement between the parties in relation to the purpose and scope of the due diligence investigation, its confidentiality and the steps to be taken after the investigation; (ii) the role of the disclosed information in the negotiations; and (iii) the interpretation of the SPA and its annexes.

Current status and conclusion

The purchaser in the first case has appealed the Court's ruling and a further decision is pending. In *Dexia v Aegon,* the further progress of the underlying procedure will determine if Dexia will have to provide a copy of – among other things – the legal due diligence report it produced.

This does not deter from the fact that both cases indicate that it may be possible for a purchaser to be obliged to provide a vendor with a copy of a due diligence report. The fact that such a due diligence report may also include advice that would normally be subject to the privileged attorney-client relationship, may not be sufficient to prevent a judge from ruling that a report should be disclosed by a purchaser once it tries to claim under the warranties or tries to nullify the SPA on the basis of negligent misrepresentation.

Although any determination as to the effectiveness of any measures to prevent the possibility of disclosure cannot be made at this time, we are advising our clients to take into account the possibility of being obliged to disclose a due diligence report. Further counter-measures could include drawing up separate factual and advisory reports, or having the parties specifically agree that the due diligence report shall not be disclosed. Time and further developments will tell whether these counter-measures are effective and whether other measures should also be put in place.