REVISTA DE DIREITO COMERCIAL

Value for Money - Attorneys' professional duties of care in the context of Due Diligence work

Hermann Knott *

According to the jurisprudence of the German Federal Supreme Court, in principle the scope of duties in a lawyer's mandate is broad[1]. According to the settled case law of the Federal Supreme Court, a lawyer is obliged to provide the client with general, comprehensive and, as far as possible, exhaustive information on all legal risks in connection with the mandate granted.[2] In the case of complex mandates, such as a legal assessment of the company to be acquired on behalf of the prospective buyer (due diligence), this approach leads to far-reaching information obligations.[3] The lawyer's contract for carrying out the due diligence and preparing a

* The author, Dr. jur and LL.M. (University of Pennsylvania), a member of the German and New York Bar, is a partner of Andersen Tax & Legal, Cologne, specializing in international M&A transactions. He is the editor of the standard reference text book 'Unternehmenskauf (business acquisitions)' published by RWS-Verlag, which will shortly be published in its 6th edition and shall also be published in English. The author wishes to express his gratitude to his colleague Dr. Martin Winkler, M.Jur. (Oxford), LL.M. (Cologne/Paris I), for his valuable contributions to this article.

[1] *Hamm*, in: Beck'sches Rechtsanwalts-Handbuch, 11th edition 2016, § 51 No. 21.

[2] Settled case law of the Federal Supreme Court of Justice for civil matters, most recently judgment dated 21.06.2018 (IX ZR 80/17), No. 8.

[3] Detailed information on due diligence reviews *Becker/Voß*, in: Knott, Unternehmenskauf, 5th ed. 2017, No. 32 ff.

due diligence report is to be qualified as a contract for work[4]; the due diligence report is due as a success. Within the scope of his duties, the lawyer must clarify all points which are essential for the legal assessment of the mandate, in particular by questioning his client.[5]

The term “Due Diligence” originates from the Anglo-Saxon legal system, in which the buyer's warranty rights are much weaker than is known in civil law. The principle 'caveat emptor' applies ('the buyer must be careful').[6] The due diligence is therefore aimed at investigating and documenting all risks resulting from the documents submitted to the lawyer and from other information. If required for the assessment of the target company, further information needs to be obtained.[7] The subject of due diligence is typically a company, property or other asset with complex legal relationships. The due diligence may extend to the legal, tax, accounting and commercial circumstances of the object of purchase. The scope of this article is limited to legal due diligence. In most cases, the prospective buyer (natural person or legal entity) is the client. However, it also happens that the seller wants to analyze the company himself before the sales process starts in order to be informed about risks in advance, but also to provide all prospective buyers with the same information at the same time (so-called vendor due diligence[8]). For both forms of due diligence, the

[4] Palandt/Sprau, BGB, 78th ed. 2019, § 675 No. 23 with reference to case law; see text and footnote 38 below.
[5] Hamm, in: Beck'sches Rechtsanwalts-Handbuch, 11th edition 2016, § 51 No. 22.
[6] *Becker/Voß*, in: Knott (above footnote 3), No. 31.
[7] *Becker/Voß*, in: Knott (above footnote 3), No. 40.
[8] *Becker/Voß*, in: Knott (above footnote 3), No. 61 f.

same duties of care apply to the lawyer in principle.

Against this background, the question arises as to how the general principles on the scope of a lawyer's duties should be refined for the purposes of a mandate to prepare a due diligence report given the complexity of engagements (lit. A. below). The next step will be to examine whether the terms of an engagement letter can be drafted to meaningfully define the scope of the lawyer's duties (item B. below). With regard to both issues only a few decisions have been rendered by lower courts so far. We will be analyzing them in detail in this article[9]. In light of these decisions, a practice-oriented approach will be presented which takes into account both the legitimate interests of the client and those of the transactional lawyer (C.). Innovative concepts will also be presented on how lawyers can perform due diligence work efficiently in practice despite the wide range of duties and simultaneous fee pressures.

A. Due diligence obligations without specific stipulations in the engagement letter

Especially for more complex mandates, engagement letters and fee arrangements are common practice today[10]. If the parties have

[9] On the Legal Due Diligence Regional Court Berlin, judgment dated 14.09.2012, 2 O540/11, cited after juris, and Court of Appeal Berlin, judgment of 17.09.2013, cited after juris, and on the so-called Red-Flag Due Diligence Regional Court Düsseldorf, judgment of 15.10.2013, cited after juris.

[10] See below under lit. B.

not concluded such an agreement or if it does not contain any provision regarding the scope of the lawyer's activities and duties, the following applies with regard to the lawyer's duty to clarify the facts: the lawyer does not have to conduct any investigations of his own, but may rather rely on the accuracy and completeness of the information provided to him by the client or the target company or the seller[11]. The lawyer must, however, seek additional clarification by asking further questions if the knowledge of further facts is necessary according to the circumstances for an appropriate legal assessment and if their importance is not immediately obvious to the client.[12]

In the case of a mandate to carry out a legal due diligence, the Berlin Regional Court in its ruling of 14 September 2012 (confirmed by the ruling of the Berlin Court of Appeal of 17 September 2013)[13] modified the general scope of duties described in the introduction of this Article for a mandate with a due diligence. According to these rulings , the lawyer's general scope of duties must be modified in order to take account of the specific situation in which he is mandated to carry out a legal due diligence , 'so that the lawyer is required to draw the client's attention to missing information only

[11] Federal Supreme Court of Justice, judgment dated 13.03.1997, IX ZR 81/96, paragraph 16 (juris) - NJW 1997, 2168, 2169 (paragraph 16 - does not apply to legal facts and legal evaluations).

[12] Federal Supreme Court of Justice s, judgment dated02.04.1998, IX ZR107/97, NJW 1998, 2048, 2049 (para. 25) (Obligation to demand the existence of court judgments in alimony matters - after the client had described an alimony settlement as the 'last judgment' - so that an action for amendment would have been brought instead of an action seeking alimony).

[13] See both judgments above footnote 11 and *Becker/Voß*, in: Knott (above footnote 3), Nos. 112 - 114.

if (1) the final assessment of the issue is of major importance for the transaction in question, and (2) (a) the lawyer does not have the documents which are indispensable to his assessment, or (b) on the basis of the information available there are concrete grounds for believing that there is a real problem'.[14] To justify this limitation of the scope of duties, the Berlin Regional Court points out that otherwise "the lawyer would be faced with the task of generally examining a transaction object which is extremely complex in terms of its legal relations with the environment", and his report would consist "to a large extent of purely abstract information with regard to legal risks".[15]

The decision related to the lawyer's alleged liability in relation to the intended acquisition of a plot of land. At the end of 2006, the later purchaser of the land engaged the defendant law firm (hereinafter the "DD Law Firm") to conduct a due diligence on the legal aspects relating to the land. The DD Law Firm prepared a due diligence report (hereinafter the "DD Report"). The lawyers were aware of the importance of the continued validity of the property leases for the decision of the buyer whether to purchase the land and the price he would be willing to pay. In 2005, the property had been leased to a law firm consisting of four partners, which was run as a civil partnership (hereinafter referred to as the "Tenant Law Firm"). The term was agreed to run until 31. December 2012. A partner had left the Tenant Law Firm at the end of 2005 and had not co-signed the lease. This meant that the written form requirements of Secs 578, 550 sentence 1 German Civil Code were not fulfilled. The Tenant Law Firm had terminated the lease prematurely on 25

[14] Regional Court Berlin, judgment of 14.09.2012, juris Note 20.
[15] Ibid. No. 21.

September 2009.

The DD Law Firm, which had also advised the former partner in the course of her departure from the Tenant Law Firm, was able to successfully invoke the following aspects before the Berlin courts to defend itself against its client's claims based on professional malpractice: In the DD Report, it had pointed out that its investigations only covered the documents and other information made available and only concretely identifiable risks. That information was assumed to be correct and complete, except where it was obvious that further information was necessary. The DD Report contained the reference that the DD Law Firm had assumed that the conclusion of the lease had been made by persons sufficiently authorized to do so. All these assumptions and limitations on the scope of the DD Law Firm's review had been accepted by the purchaser, the DD Law Firm's client, as he had not opposed to them. In the tenancy agreement, the tenant was described as "... lawyers". According to the Berlin courts the DD Law Firm did not have to know that the tenant was a civil partnership. That fact was not apparent from the designation of the lessee as "... lawyers'' in the lease agreement. Even if the DD Law Firm had been aware of this circumstance, it would not have known how many partners the civil partnership had at the time (late 2005) when the lease agreement was concluded. On the basis of the appearance of the lease agreement it could not be recognized, how many persons had actually signed on behalf of the Tenant Law Firm. Therefore, according to the Berlin courts, any reference in the DD Report to compliance of the lease agreement with the afore-mentioned written form requirement would necessarily have remained abstract. Given the premise that abstract references are to be

avoided in the DD Report, such reference was not considered to be part of the DD Law Firm's duty of care. The DD Law Firm therefore did not have to further investigate the problem of the lease agreement complying with the written form requirement. The knowledge of those lawyers from the DD Law Firm who had advised the partner of the tenants' Law Firm who had left that firm at the end of 2005 could not be attributed to the lawyers of the DD Law Firm responsible for the due diligence.

The judgments of the Berlin courts were advisory-friendly with respect to the risk of liability of law firms arising from due diligence work[16]. Should transactional lawyers therefore accept the judgments with satisfaction and move on to the agenda? Or is it appropriate, on the basis of many years of experience in due diligence processes, to define the lawyer's duties of care appropriately, taking into account what the client may expect from its lawyer without overstretching the duties of care? The buyer had hired the DD Law Firm to investigate the legal circumstances of the property, stating that he was interested in the effectiveness of the lease as an essential factor securing the value of the property to be acquired. With the assumptions and limitations regarding the scope of the review articulated in the DD Report, the DD Law Firm ultimately no longer needed to examine whether the lease agreement had been effectively concluded. All relevant aspects were the subject of assumptions (effective signing of the lease agreement – availability of all necessary authorizations) or should not be part of the DD Law Firm's duty of care (legal form of the tenant as civil law partnership).

[16] See also the discussion of the decisions of Chab, AnwBl. 2014, 444.

In our view a transactional lawyer who takes into account the economic interests of his client would behave as follows: He/she sees that the tenant is trading under the name ".... Lawyers". Thereafter, the probability was very high that the Tenant Law Firm was organised as a civil partnership. Then the question arose as to the formal effectiveness of the conclusion of the lease agreement. In this case, the buyer, who was unaware of the legal context, should have been informed, in the sense of an advice that provided the client with added value, that the tenant was likely to be a civil partnership under German law, that all partners had to sign the tenancy agreement in order to comply with the formal requirements, that the number of partners in the Tenant Law Firm was not known to the DD Law Firm, that there was no indication of the number or required signatories in the tenancy agreement[17] and that it was not possible to verify this on the basis of publicly available documents. The DD Law Firm should therefore have advised its client to ask the seller about the tenant's legal form and - if it was a civil partnership - to further ask how many partners the civil partnership had at the time of the conclusion of the lease at the end of 2005 and who had in fact signed the lease. If the DD Law Firm was in contact with one of the seller's lawyers, it could address these questions directly to that lawyer. These requests for information were necessary in order to examine the risk of the tenancy agreement with the tenants' Law Firm being ineffective for formal reasons.

[17] According to the facts communicated by the Berlin courts, neither the signature lines nor the names of the parties at the beginning of the lease agreement (Rubrum) indicated whether the tenant's office was a civil partnership and who its partners were, Court of Appeal Berlin, judgment of 17.09.2013, No. 22.

If these questions could not have been answered in full, the DD Law Firm was obliged to point out in the DD Report that it had not received all the documents requested concerning the validity of the lease agreement. If it had not been possible to determine the legal form of the Tenant Law Firm and if it had not been possible to determine the number or identity of its partners, the DD Law Firm would have had to point out to the buyer that (i) lawyers are traditionally organised as a civil partnership, (ii) all partners of a law firm organized as a civil partnership had to sign the tenancy agreement, and (iii) on the basis of the copy of the tenancy agreement available in the due diligence it could not be confirmed whether this condition was fulfilled. Therefore, the effectiveness of this lease agreement could not be confirmed despite further inquiries made with the client and the seller. Only with these additional requests for information could the buyer's lawyer have been in a position to advise his client, who was not familiar with the formal requirements for rental agreements, with regard to the effectiveness of the rental agreement with the Tenant Law Firm. The client (purchaser of the property) would then have been in a position to introduce these aspects into the negotiations with the seller. Thus, the buyer could have requested that the effectiveness of the lease contract be guaranteed by the seller for a period until 31 December 2012, in the real estate purchase agreement. It appears from the facts of this case that the seller of the property had in fact not given such guarantee. If such guarantee had been given, it would not have been the DD Law Firm which would have been held liable under the terms of the engagement, but rather the seller of the property under a respective independent guarantee

promise in the property purchase agreement[18].

However, any knowledge of the legally relevant details of the Tenant Law Firm that may exist as a result of the advice given to its former partner who left at the end of 2005 should not be taken into account here to the detriment of the DD Law Firm, since it relates to a different client relationship, and confidentiality obligations must therefore be observed. In purely practical terms, this knowledge could of course have been considered in the advice if it had been known to the DD Law Firm's lawyer advising the buyer. An organisational obligation to make this knowledge available, or even an imputation of knowledge in analogous application of Sec. 166 German Civil Code, is should not, however, be taken into consideration, in view of the principles of the law governing the profession of lawyers.

Among lawyers specializing in M&A transactions, due diligence is regarded as an activity which is very prone to liability , and rightly so: In all legal areas covered by legal due diligence work[19], the lawyer is required to examine the legal aspects relevant for the acquisition of the object of purchase and to communicate the results or remaining open issues that cannot be clarified - all related to the legal risks relevant from the client's perspective with regard to his interest in the acquisition of the object of purchase. In the acquisition of a company, aspects of corporate (in case of a share

[18] For the significance of independent guarantee commitments in accordance with Sec. 311 Para. 1 German Civil Code in the case of business acquisitions governed by German law, see *Stamer*, in: Knott (above footnote 3), No. 237.
[19] See on the areas of law potentially covered by legal due diligence *Becker/Voß*, in: Knott (above footnote 3), No. 40.

deal[20]), labour, contract, competition, environmental and other aspects arising under public law as well as the circumstances with regard to legal disputes, financing and possibly other aspects are regularly of importance. In order to carry out a due diligence, the DD Law Firm must therefore cover all necessary specializations or involve appropriately specialized law firms by way of subcontracting.

The Berlin courts restrict the scope of the lawyer's duties in the context of a due diligence by stating that the lawyer did not need to provide 'abstract' information in the DD Report, as they were not useful for the client. This distinction between 'abstract-problematic' and 'actual problem'[21] as described by the Regional Court Berlin (meaning 'actual problem' as opposed to 'abstract problem') is certainly meaningful insofar as the lawyer does not need to abstractly present irrelevant risks to the client. For example, the lawyer does not need to explain the risk of the return of contributions to the target's capital if there are no indications of this in the documents on which the due diligence is based.

The situation is different, however, with regard to the tenancy agreement with the Tenant Law Firm in the case of the Regional Court Berlin. The risk that not all partners of the Tenant Law Firm would have signed the tenancy agreement was concrete, not just abstract. Although the tenancy agreement may not have contained any indications that signatures were missing, the DD Law Firm had to consider the possibility of the tenant being described as ".... Lawyers" would mean that these lawyers were organised in the

[20] *Becker/Voß*, in: Knott (above footnote 3), No. 120.
[21] See Regional Court Berlin, judgment of 14.09.2012, juris No. 20 f.

form of a civil partnership[22]. In this case, the DD Law Firm could not confirm that the signatures of all those who were partners of the Tenant Law Firm at the time of the conclusion of the tenancy agreement were in fact being made. This problem was not abstract, but concrete, because this risk actually existed - and had subsequently realized.

B. Possibilities for limiting the scope of duties in the case of a due diligence

It is today's standard in particular for transactional lawyers to conclude engagement letters with their clients, especially for more complex projects. Therein the scope of the lawyer's activities can be set forth more precisely with considering the particular circumstances of the individual transaction, and a limitation of the lawyer's liability may be agreed. In order to maintain transparency vis-à-vis the client, the arrangement regarding the lawyer's fees must be clearly distinguished from the other provisions of the engagement letter (see Sec 3a (1) sentence 2 Attorneys' Remuneration Act). From the lawyer's perspective the contractual determination of the activities which shall be carry out mean on the other hand that during the due diligence he or she is not obliged to carry out any other activities which he or she may otherwise have expected to perform. In this context, the parties of the engagement letter should assure themselves that the engagement letter is not legally void or ineffective because the client was not sufficiently

[22] Another opinion (accepting the assumptions and restrictions of the Berlin courts) *Beisel*, in Beisel/Klumpp, Der Unternehmenskauf, 7th edition 2016, § 2 (Due Diligence) No. 53.b.

informed about the risks of limiting the scope of the lawyer's activities. In our view this aspect could be relevant in the case constellation discussed here with regard to the assumption made by the DD Law Firm that the tenancy agreement was entered into in a legally valid and binding way. The reason for these doubts is that, as a result of this assumption, the client was not made aware of the special requirements which exist when concluding the lease agreement with a civil partnership (law firm) (namely the requirement of the signature of all partners)[23]. In the opinion of the Berlin courts, however, the client had not to be made aware of this risk because the DD Law Firm did not have to consider that the tenant could be a civil partnership.

In the appeal judgment of September 17, 2013, which confirmed the judgement of the Regional Court, the Berlin Court of Appeal gave a different reasoning than the Berlin Regional Court. The Berlin Regional Court generally emphasizes the limitation of the scope of a lawyer's duties with respect to due diligence work.[24] The Berlin Court of Appeal, on the other hand, assessed the scope of the mandate on the basis of the assumptions and limitations on the scope of review made by the DD Law Firm in the DD Report. These were binding for the buyer, since he had not demanded, for example, that the effective conclusion of the tenancy agreement with the Tenant Law Firm be part of the due diligence review.

[23] In the sense described here for a kind of 'teleologically reduced interpretation' of the assumption in the DD Report that all documents are fully effective and valid, Regional Court Düsseldorf, judgement dated 15.10.2013 (below text and Footnote No. 25), No. 37.

[24] See also the comments in the judgment of the Regional Court Berlin, dated 14.09.2012, juris No. 20 et seq.

According to the Berlin Court of Appeal, the concrete scope of the lawyer's duties depends on the engagement agreed and the circumstances of the individual case[25]. In our view, however, the buyer, who was unfamiliar with the law, had no opportunity to become aware of the problem of whether the tenancy agreement with the Tenant Law Firm had been effectively concluded. He did not even know that a tenancy agreement with a civil partnership must be signed by all partners of the civil partnership.

As a result, in practical terms, two points in time can then be considered for determining the scope of the attorney's duties in the context of due diligence work, the point in time when the mandate is granted (I.) and the point in time at which the DD report is prepared (II.).

I. At the time of engaging the lawyer

As a starting point, a law firm mandated with a due diligence review is in principle entitled to limit its scope of review to the documents provided when the mandate is granted. This is done primarily by stipulating corresponding conditions in the Engagement Letter[26]. The advantage of this approach is that the client is being informed before the start of the work. In principle, these conditions can still be negotiated. The client may ask

[25] Court of Appeal Berlin, judgment of 17.09.2013, juris No. 18 (published in AnwBl 2014, 449) with reference to the case law of the Federal Supreme Court of Justice for civil matters.

[26] Court of Appeal Berlin, judgment of 17.09.2013, juris No. 20.

questions and receive clarification on the risks arising from this limitation of the scope of duties in the due diligence before the start of the review. However, the DD Law Firm must ensure that such provisions limiting the scope of its work do not deprive the due diligence examination of its purpose and objective for which the mandate was concluded. This risk arises if aspects which should be reviewed in the due diligence become part of the assumptions and limitations of scope proposed by the lawyer. In our view, the issue whether the tenancy agreement with the Tenant Law Firm had been effectively concluded is one of those elements of due diligence which the lawyer should not be entitled to negotiate away.

Restrictions of the scope of the examinations during the due diligence process played a role in the case to which the judgement of the Düsseldorf Regional Court of 15 October 2013 was related. This court's judgement had to deal with the scope of the lawyer's duties of care in the context of a so-called "red flag" due diligence. According to the engagement letter, the DD Law Firm should only present so-called 'deal breakers' in the DD Report. This refers to risks that from the client's perspective could be material to the completion of the intended acquisition. In order to assess this risk, however, the DD Law Firm has to carry out comprehensive due diligence review measures.[27] On the one hand, it had to determine the type and amount of damage risks and, on the other hand, to examine their probability of occurrence.[28] A high risk of damage with a low probability of occurrence can also represent a deal

[27] Regional Court Düsseldorf, judgment of 15.10.2013, juris, No. 28

[28] See. on 'red flag' due diligence (in contrast to "full-scope" due diligence) *Becker/Voß*, in: Knott (above footnote 3), No. 115 f.

breaker.

In assessing whether there is a deal breaker, the probability that the risk in question can be expected to materialise is crucial[29]. The higher the damage to be feared, the lower the requirements to be placed on the probability of realisation of the risk in question. Nevertheless, the risk must be realistic and not just abstract[30]. In the case of the Regional Court of Düsseldorf, at the time of the review by the DD Law Firm there was no case law at all on the risk in question[31], and the discussion of the relevant legal question in the literature was still weakly developed[32]. Against this background, the Düsseldorf Regional Court concluded that there was no deal breaker at the time the company purchase agreement was concluded.[33]

II. References in the DD report

References to the limited scope of the review activity, which the DD Law Firm only makes in the DD Report, are first of all of a purely one-sided nature. With regard to the question as to whether a law firm can limit the scope of its review by making reference in the DD report to the fact that it had assumed that the documents entrusted

[29] Regional Court Düsseldorf, judgment of 15.10.2013, juris No. 39.
[30] Regional Court Düsseldorf, judgment of 15.10.2013, juris No. 46.
[31] The issue was the collective bargaining capacity of a trade union and the threat of additional payments being levied upon the target company, in particular of social security contributions, in the event of collective bargaining incapacity.
[32] Regional Court Düsseldorf, judgment of 15.10.2013, juris No. 45 (published in AnwBl 2014, 450)
[33] Regional Court Düsseldorf, judgment of 15.10.2013, juris No. 38 et seq.

to it were valid and complete, the decisions of the Court of Appeal Berlin of 17 September 2013 and the Regional Court Düsseldorf of 15 October 2013 differ from one another[34].

According to the decision of the Regional Court Düsseldorf of 15 October, 2013[35], the assumption expressed in the DD report that all documents are legally valid in the form available to the DD Law Firm , unless explicitly stated otherwise, was not applicable to the review of documents which could contain deal breakers. Otherwise the decision considers it to be effective. In the literature, one view goes even further[36]. Accordingly, a limitation of the scope of duties of the DD Law Firm solely by reference in the DD report should not be permissible. This opinion is supported by the one-sided character of such statements of the DD Law Firm, which are only made in the DD Report after the conditions of the DD Law Firm's terms of engagement had been agreed. In this case, the client may also lack sufficient information.[37]

According to the appeal decision of the Court of Appeal Berlin of 17 September, 2013, the one-sided restrictions articulated by the DD Law Firm in the DD report are decisive for the scope of the DD Law Firm's duty of care. Acceptance of the DD report is regarded as agreement with the statements contained therein concerning the limited scope of review. If the client does not agree, he may reject the restrictions contained in the DD Report in whole or in part and demand subsequent performance with regard to the due diligence

[34] See above footnote. 23.

[35] Regional Court Düsseldorf, judgment of 15.10.2013, juris No. 35 - 37; see *Becker/Voß*, in: Knott, (above footnote 3), No. 115 f.

[36] Semler, in: Festschrift Quack, 1991, p. 439, 440.

[37] See also above at B.I.

work (Sec. 635 German Civil Code). According to the relevant law governing contracts for work, this claim seeking additional performance takes precedence over the right to claim damages.[38] In the opinion of the Berlin Court of Appeal, extended duties to inform only exist if it results from the review of the documents that documents or information are obviously missing for the assessment of material issues to be examined in the due diligence or if there are doubts as to the correctness of the generally expressed assumptions and the appropriateness of the limitations of the scope of the review.[39] It should be noted, however, that the priority of supplementary performance does not apply in those cases in which compensation is claimed for consequential damages caused by a defect[40], as in the circumstances discussed in the Berlin case (compensation for loss of rent due to premature termination of the rental agreement with the tenant's Law Firm).

C. Recommendations for practical (and pragmatic) way of proceeding

It is advisable for the DD lawyer not to confront the client for the first time in the DD report with clauses containing assumptions and other limitations of the scope of the review. The DD lawyer should either already specify these clauses in the engagement letter or in any case provide for an 'opening clause' in the engagement letter, in which it is announced that certain assumptions will be made in the DD Report and that restrictions will be placed on the scope of

[38] See Berlin Court of Appeal, judgment of 15.10.2013, No. 21.
[39] Berlin Court of Appeal, Judgment of 15.10.213, juris No. 22.
[40] Palandt, BGB, 78th edition 2019, § 634 BGB No. 17.

the review. These restrictive conditions shall be binding unless it is obvious to the DD lawyer that further documents or information are required with regard to a question of the due diligence review that is essential for the client. In order to make an informed assessment of what the DD Law Firm is in a position to perform and what the client's interests are, it is quintessential for the DD Law Firm to communicate closely with the client about the scope of work and also of the meaning of the restrictions and limitations the lawyer intends to agree upon.

Assumptions and limitations should under no circumstances reach so far that the lawyer is not required to fully examine the issues relevant to the client's purchase or other decision as far as possible and to point out relevant questions that remain unanswered. The appropriateness of assumptions and limitations of the scope of the review must be closely scrutinised in the specific context. The lawyer must bear in mind what the application of the assumptions and restrictions of the scope of the due diligence in the specific context means for the client, taking into account the client's interests, and apply them accordingly considering the risks involved for the client[41]. The lawyer cannot rely on generally formulated assumptions and limitations of the scope of the review in respect of those matters in the examination of which the client has an interest on the basis of express reference or as a result of the legal and economic environment of the transaction in the reasonable opinion of the transaction lawyer. Only in case such a risk weighing approach is properly applied, does the client get real value for money.

In a red-flag due diligence, the scope of the review is

[41] 'teleologically reduced', see above footnote 23.

substantively not limited, but only those risks are presented in the DD Report which could potentially be deal breakers. Another approach to countering the high cost pressure and simultaneously high risk associated with due diligence mandates is the following: In close coordination with the client, the scope of review should be focused on certain issues that are to be regarded as of a high-risk nature due to the conditions on the market in which the target company operates, the specific circumstances of the target company itself or the plans for the future which the acquirer is pursuing with the acquisition. To the extent that the DD Report also serves to decide on the granting of debt financing or is intended to form the basis of a warranty insurance policy, restrictions on the scope of the due diligence review are, however, difficult to enforce because financing banks and Warranty & Indemnity insurers request full-fledged due diligence reports.

Hermann Knott