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# Due Diligence and the Legal Sector: A Changing Environment

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The nature, role and importance of due diligence has fluctuated over time. Around 500 years ago, when the phrase first entered common use, it was defined only as “requisite effort” in a business transaction, which is very mutable verbiage. Over the centuries, the words took on an increasingly legal dimension before a fact-finding component was codified in the US Securities Act of 1933 as “reasonable investigation”.

Given that the modern corporate regulatory environment demands far more stringent investigative measures than ever before, it is clear that the legal sector must go even further to promote the conduct of appropriate levels of due diligence by top-level practitioners, in order to better mitigate the risks, weaknesses and threats that may result from a partial understanding of the facts.

## A Question of Quality

Due diligence is, to some extent, a question of levels. It is a process, rather than an outcome: a process that must be followed correctly if the “correct” result (what we would term “the big picture”) is to be achieved. Such a process should encompass not only an investigation of specific targets, but also the web or network surrounding them, to identify any hidden connections, interests or relationships that could prejudice an investment, partnership or transaction. It is important to look beyond the surface and to adopt a healthy scepticism towards even persons and entities that were previously believed to be unimpeachable. The cost of a minor delay to facilitate due diligence is usually far less than the cost of getting due diligence wrong, or the financial (and wider) impact of altogether failing to do it.

Proper due diligence means validating information that is readily available or provided in response to queries, while also determining what is not available or what has not been provided and why, as well as using human and cyber assets in addition to corporate records and media reports to ensure the widest possible analysis.

In practical terms, this means that due diligence can neither be confined to a standardised source base (for example, online-discoverable records/reports only), nor can it rely on only routine internal compliance functions (for example, database screening). An open-source-only or otherwise restricted source base focuses only on what is or is not “present” (for example, a hit against an international sanctions list), while internal compliance personnel will often be ill equipped to dig deeper, perhaps possessing neither the resources (both intelligence and cyber) nor the in-country, on-the-ground assets crucial to fulsome due diligence (for example, to determine a hit (mishit) against a sanctions list to truly be a false-positive).

When decisions are needed quickly, a comprehensive and detailed review of a situation may not be possible, yet a light-touch review, conducted by a true investigative/due diligence specialist, will still go beyond standard database screening and other analogous techniques, and should offer up "immediate red flags". While not ideal, this is a valid alternative to conducting due diligence in-house or conducting no due diligence at all, crossing one's fingers and simply hoping for the best.

This is a highly specialised and skilled area, and needs to be treated as such – to be of the highest quality, due diligence cannot be conducted piecemeal or by persons not fully versed in the techniques and analysis necessary to turn **information** into **intelligence**. Certainly, high-quality due diligence is on the rise and there appears to be a greater awareness of the need to transition from internal compliance departments conducting tick-box exercises to the regular engagement of specialist external investigative and intelligence firms.

## A Question of the Environment

The corporate regulatory environment is both a boon and an impediment to the practice of appropriate due diligence. There is a great amount of leeway in what level and nature of due diligence is considered necessary or appropriate. There is no legal requirement that indicates due diligence **must** be done to a certain level, or even in every case. Rather, it will be up to the discretion of individual lawyers, or even their clients, as to whether due diligence is done and to what degree. This can create imbalances or discrepancies even within the same firm: two partners presented with the same facts could adopt different positions with regard to the type and level of due diligence that is required and their resulting advice or decisions could diverge as a result. For some, due diligence may be a necessary evil that should be dealt with in the most bare-bones manner possible, while for others it might be something conducted deliberately and meticulously in order to ensure the correct result.

In the absence of any sectoral or national government ruling imposing certain due diligence standards, it is up to each company to operationalise proper investigative practices and procedures in its own internal charter, built perhaps around a set of well-defined criteria requiring "tiers" of due diligence based on certain facts. For instance, a deal above a particular dollar amount, involvement in a given market or geography, or the presence of an "immediate red flag" would all necessitate predefined due diligence. Triaging due diligence in this manner should keep the process manageable, simultaneously mitigating the risk of "bogging down" a corporate with intense scrutiny over even the smallest issues, while reinforcing the notion that some form and degree of due diligence is always necessary.

There are encouraging signs that the legal sector is moving in this direction. On issues such as employment/equality rights, human rights and modern slavery, firms quite correctly have stringent procedures to ensure legal and moral compliance, and there are moves afoot in Europe to compel mandatory due diligence on human rights and environmental issues.

In recent years, there has been a surge of focus on cyber-compliance, enhancing cyber best standards and putting in place systems to minimise the chances of a compromise and to diminish the severity should a compromise occur. There is no reason why this surge cannot extend to intelligence: indeed, a comment in the Cyber Security Hub's 2020 study "Decreasing Risk Through Enterprise Compliance" indicated that compliance should be viewed as a continual organisational process rather than a reactive response. This is equally as applicable to human-driven intelligence and due diligence as it is to cyber.

## The Impact of COVID-19

In the current climate, it is, of course, impossible to ignore the impact that COVID-19 is having on business. For the most part, COVID-19 scams are focusing on obvious and upfront frauds: an email purporting to be from the government, for example, or a fake appeal for the World Health Organisation. The longer-term consequence is likely to be less noticeable but more damaging: in a climate where business opportunities are fewer in number and more hotly contested, "work at any cost" may become an understandable, but entirely damaging, mantra. In such situations, companies may feel obliged to take work no matter from whom or from where it originates and may, as a result, sacrifice even streamlined due diligence. It is worth emphasising that, even in an era of cost-cutting and thriftiness, proper due diligence, conducted by specialist investigative lawyers, will often ensure the greatest savings of all, both financial and reputational.

## Final Thoughts

It is the legal sector and due diligence by investigative specialists that will continue to protect companies and their interests, by identifying legal, financial and reputational risks, notwithstanding spiralling threats from malicious actors, cybercriminals and state-sponsored actors. To that end, boards of directors and senior management teams must continue allocating resources towards due diligence. The effect will be to empower their external advisors to determine "bigger pictures" and to render the best possible legal advice.

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**Maria Munoz**
Business Development
T + 44 7747 824 109
E mmunoz@kcsgroupeurope.com

**Samuel Whitmey**
2 I/C Lead Intelligence Analyst
T +44 7940 423850
E swhitmey@kcsgroupeurope.com

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**Campbell Steedman**
Partner, Corporate, UAE
T +971 4 447 8760
E campbell.steedman@squirepb.com

**Richard J. Gibbon**
Partner, Government Investigations & White Collar,
UAE T +971 4 447 8715
E richard.gibbon@squirepb.com

**squirepattonboggs.com**