

# AEB event: Real Estate acquisitions in a crisis

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## Legal Due Diligence: Issues in the Crisis

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# Specific Issues in the Crisis

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- Due diligence as usual

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- Some specific crisis-related issues also need to be checked

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- Unusual acquisition methods may require special due diligence procedures (e.g., mortgage enforcement, bankruptcy sale-out)

# Ordinary Due Diligence

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- *DD scope depends*, inter alia, on:
  - investor aims
  - whether facilities under construction or completed
  - whether acquisition structured as share purchase or asset (real estate) purchase
  - time constraints
  - cost constraints
  - cooperativeness of counterparty and target

# Ordinary Due Diligence

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*The most risky or underestimated issues:*

- Non-legal information on the Project often shapes legal due diligence: e.g.
  - ✓ transport access
  - ✓ availability of community facilities
  - ✓ general and architectural planning
  - ✓ environmental parameters, etc.
- Title to land and facilities: how to address hidden risks, e.g. short term leases and other unknown encumbrances, such as rights to dispute title
- Corporate approvals for transaction

# Ordinary Due Diligence

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- For facilities under construction:
  - ✓ how relationships between investor/co-investor and investor/client (technicheskiy zakazchik) are structured
  - ✓ what is the project structure in terms of key participants and how it addresses major project risks (constructability/approvability risk, cost overrun risk, delay risk, quality risk, underfinancing risk)
  - ✓ what is the status with permissive documentation and relationship with state and supervising authorities

# Additional Issues in the Crisis

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- *Stability of the project – issue No. 1* ⇒
  - Check how various agreements:
    - ✓ regulate termination
    - ✓ regulate change of terms and conditions
    - ✓ qualify as arms-length
    - ✓ address security instruments

## New tactics:

- ⇒ amending key agreements and providing security instruments as a special condition precedent to closing
- ⇒ special pricing formula to compensate the purchaser in case of termination / suspension / change of terms and conditions

# Additional Issues in the Crisis

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- Check actual status with lessees and how lease agreements are structured (particular risk area – preliminary lease agreements for facilities under construction)

New tactics:

- ⇒ restructuring lease agreements as special condition precedent to closing
- ⇒ special pricing formula to compensate the purchaser if anchor lessee moves out within x period

# Additional Issues in the Crisis

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- *How deep to dig in due diligence – issue No. 2* ⇒
  - Check actual status, security instruments and exit strategy for sub-contracts (especially for facilities under construction)

## New tactics:

- ⇒ amending key subcontracts and providing security instruments as a special condition precedent to closing
- ⇒ special pricing formula to compensate the purchaser in case of termination / suspension / change of terms and conditions of subcontracts affecting key contracts
- For Joint Ventures - check partner's financial stability and ability to provide financing for the project

# Special Acquisition Procedures

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- *Bankruptcy Sale-Out* ⇒
  - value of pledged/mortgaged assets goes mostly to pledgor
  - very limited room for due diligence (mostly publicly available information)
  - limited opportunity to add special provisions in purchase agreement

# Special Acquisition Procedures

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- *Enforcement of pledge/mortgage* - note recent substantial amendments to pledge/mortgage legislation facilitating enforcement
  - If through tender (rather than direct sale) (e.g. mortgaged land plots) or stock exchange (for publicly traded shares), then limited room for due diligence and limited opportunity to add special provisions in purchase agreement
  - In case of enforcement on pledged LLC shares – note the problem with consent of other LLC participants
- *Joint Ventures (co-investment)* – note the high risk of simple partnership qualification entailing joint and several liability of co-investors