ACQUISITION STRATEGIES

Diligence Gaps That Can Kill a Deal—Or Blow Up Post-Closing

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Most due diligence checklists are built to confirm that documents exist: is there a cap table, are there customer contracts, is there a litigation history. What they don't test is whether those documents actually hold up under the deal you're trying to do. That distinction is where deals die at the eleventh hour — or worse, where they close cleanly and detonate eighteen months later.

The gaps below are grouped by when they hit: before closing, where they can stall or kill a deal outright, and after closing, where they surface as liabilities the buyer didn't price in.

Gaps That Kill the Deal Before You Get There

Change-of-control clauses buried in ordinary contracts. A target company can have every customer and vendor contract on file, present, accounted for — and still blow up the deal if a handful of those contracts require counterparty consent, or give the other side a termination right, the moment ownership changes hands. This rarely shows up on a first-pass review because the contract “exists” and looks standard. It only surfaces when someone actually reads the assignment provisions against the structure of the deal, which is why it tends to get found late — often after the buyer has already committed time and legal spend.

Unassigned IP and informal equity promises. Especially common in earlier-stage companies: code, designs, or trademarks built by a contractor or early advisor who never signed an IP assignment agreement, or equity that was promised verbally and never papered into the cap table. A checklist that just confirms “IP assignment agreements on file” will miss the people who were never asked to sign one in the first place.

Related-party arrangements that were never formalized. Above-market leases to an entity the founder also owns, commingled payroll, loans between the company and its principals that were never documented — these don't always show up as litigation risk, but they distort the financial picture the deal is being priced on, and unwinding them can become a condition to closing once discovered.

Claims that haven't become litigation yet. A standard litigation search turns up filed cases. It won't turn up the demand letter sitting in someone's inbox, the former employee who's been making noise about a wage claim, or the customer dispute that's still “informal.” These are exactly the things that, once found, cause a buyer to either walk or demand a price adjustment — and they're also exactly the things a document-based checklist structurally can't catch, because there's no document yet.

California-specific licensing and permitting gaps. For businesses that touch professional licensing, local permitting, or industry-specific regulatory approval, confirming the license “exists” isn't enough —

confirming it transfers, or that the buyer's structure qualifies to hold it, is a different question entirely, and one that surfaces late if it isn't asked early.

Gaps That Don't Kill the Deal — They Wait

Employment classification exposure. Independent contractors who function like employees, exempt classifications that don't hold up under California's tests — these rarely stop a deal. They're not usually large enough, or visible enough, to be a closing condition. But they become the buyer's liability the moment the deal closes, and California's wage-and-hour exposure in particular can be disproportionate to how small the underlying issue looked in diligence.

Indemnification structures that don't match the actual risk. A purchase agreement can have indemnification provisions that look standard — caps, baskets, survival periods — while being mismatched to the specific risks diligence actually surfaced. If a known-but-unresolved issue has a survival period shorter than the time it typically takes for that type of problem to materialize, the protection is illusory. This is a drafting problem, not a diligence-document problem, which is why it's easy to miss if legal counsel isn't reading diligence findings and deal terms together.

Working capital mechanics left ambiguous. Purchase price adjustments tied to working capital are a common source of post-closing disputes, usually because the definitions and calculation methodology weren't pinned down precisely enough pre-signing. The gap isn't in the diligence findings — it's in translating them into unambiguous contract language.

No enforceable retention mechanism for key people. A target's value can be concentrated in two or three people who were never asked to sign an enforceable non-compete, non-solicit, or retention agreement. The deal closes, and within months the people who made the business worth buying are gone — a risk that's easy to see in diligence and easy to leave unaddressed in the documents.

Real property issues that don't block closing but should change the price. Title defects, unpermitted improvements, or zoning nonconformities often aren't severe enough to stop a real estate-linked deal from closing, but they represent real future cost or restricted use that should be priced in or specifically allocated — not just noted and carried forward.

Final Thoughts

Every item above would technically “pass” a checklist that only confirms whether a document exists. What separates a deal that closes cleanly from one that stalls — or one that closes and quietly costs the buyer money a year later — is whether someone is reading those documents against the actual structure of the transaction, not just cataloging them.

That's a legal diligence function specifically, distinct from the financial and accounting review most buyers already have covered. If your diligence process ends at “confirm the documents are there,” it's built to catch the wrong things.

About the Author

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