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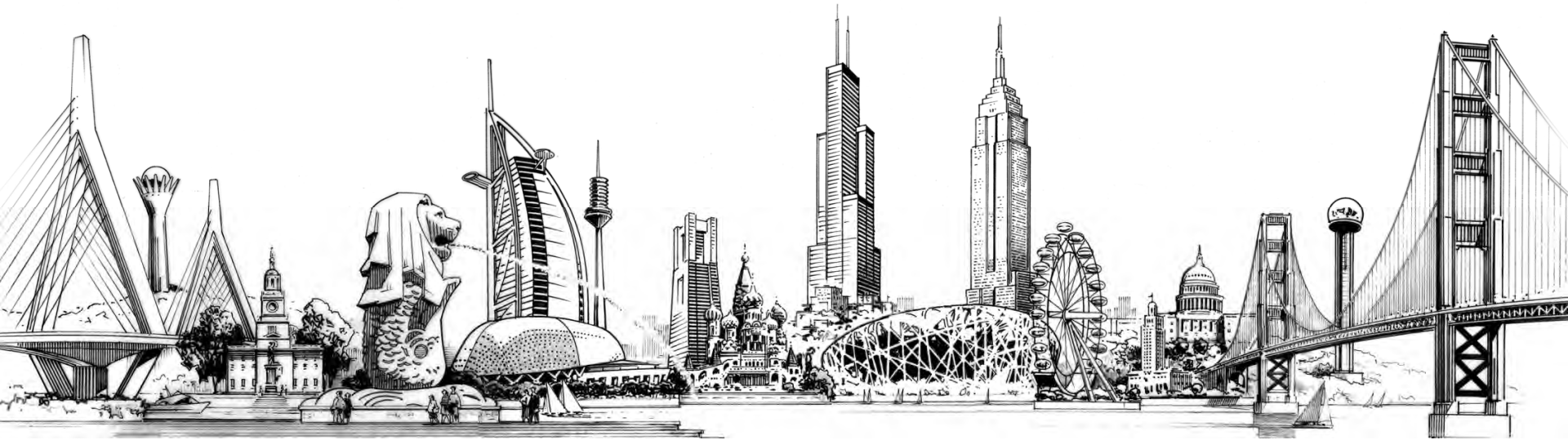
M&A ACADEMY

CONFIDENTIALITY AGREEMENTS AND LETTERS OF INTENT



Confidentiality Agreements

Topics Covered

- Initial Considerations
- Contents of a Confidentiality Agreement
- Sample Provisions

Confidentiality Agreements

Initial Considerations – Topics to Cover

- Why have a written confidentiality agreement?
- Are you more likely to receive or disclose information?
- Unilateral vs. mutual?
- When to enter into a confidentiality agreement?
- Separate agreement or part of the term sheet?
- Is the disclosing party a public company?
- Limitations

Confidentiality Agreements

Why Have a Written Confidentiality Agreement?

- Confidentiality agreements are standard and an expected part of most negotiated deals
- Protection of trade secrets under state law can be lost (deemed waived) if they are disclosed without a written agreement
- Written contracts are typically easier to enforce
- Written confidentiality agreements are often required under prior agreements with third parties
- They avoid confusion over what the parties consider to be confidential
- The parties have more flexibility in defining what is confidential
- The parties can specify what they expect from each other
- Confidentiality agreements often cover issues unrelated to confidentiality, such as nonsolicitation, exclusivity, and absence of binding commitments to complete a transaction

Confidentiality Agreements

Are You More Likely to Receive or Disclose Information?

- A simple question with big implications
- Whether you are primarily disclosing confidential information or receiving confidential information will drive some of your strategy for the structure of the confidentiality agreement
- A Buyer's interest is different from a Seller's interest
- Buyer's Interest:
  - A Buyer typically wants the exclusions from confidential information to be as broad as possible and permission to disclose all confidential information to Buyer's advisors and representatives and any financing sources
- Seller's Interest:
  - A Seller typically wants the Buyer's exclusions to be as narrow as possible, and to the extent possible, to exert control over the sale process through confidentiality provisions

Confidentiality Agreements

Unilateral vs. Mutual

Positive:

- Restricts the disclosing party only

Challenges:

- Does not protect confidential information of the other party that may be disclosed later
- Does not protect nonbusiness information (such as deal terms or deal process) that both parties will likely want to keep confidential

Positives:

- Protects confidential information of both parties
- Protects nonbusiness information about the actual deal
- Provides a more balanced form that typically results in a faster review and signing process

Challenge:

- Imposes restrictions on both parties to the transaction, regardless of which party has more leverage in the deal

Confidentiality Agreements

When to Enter into a Confidentiality Agreement?

- As soon as possible
- Prior to disclosure of any confidential information

Practice Tip

If disclosures of confidential information have been made prior to entering into a confidentiality agreement, make sure that the confidentiality agreement specifically covers all prior disclosures

Confidentiality Agreements

Separate Agreement or Part of the Term Sheet?

Having a separate confidentiality agreement:

- Gives the parties the flexibility to conduct due diligence of certain nonpublic information before negotiating a term sheet or letter of intent
- Is typically easier to negotiate
- Provides the parties with written protection in the event of disclosure of confidential information prior to entering into a term sheet or letter of intent

Practice Tips

- Confidentiality provisions included in a term sheet or letter of intent should be binding on the parties
- A separate confidentiality agreement should be incorporated by reference in the term sheet or letter of intent

Confidentiality Agreements

Is the Disclosing Party a Public Company?

If you answer "**YES**" to this question, then consider the following:

- include a standstill agreement in the confidentiality agreement restricting Buyer's unsolicited bids for the Seller

- obtain a representation that the recipient and its representatives are in compliance with securities laws (or, at a minimum, are aware of their obligations under securities laws)

- determine whether the terms of the confidentiality agreement qualify for Regulation FD under the Securities Exchange Act of 1934, as amended (should qualify in most circumstances)

Confidentiality Agreements

Limitations

- The disclosing party cannot "undisclose" confidential information that has been wrongfully disclosed and has become part of the public domain
- The disclosing party's remedy for wrongful disclosure of confidential information is limited and damages for breach of contract may be the only legal remedy
- The disclosing party has the burden of proof with respect to proving that a breach has occurred
- The disclosing party may not be able to effectively prevent the recipient of confidential information from inevitably taking the confidential information into account in its own commercial plans

Practice Tip

To protect confidential information, the disclosing party should carefully manage the disclosure process, consider additional confidentiality procedures for extremely secretive information and have a contingency plan for dealing with leaks

Confidentiality Agreements

Contents of a Confidentiality Agreement – Topics to Cover

- Parties to the confidentiality agreement
- Definition of confidential information
- Exceptions to confidentiality
- Permitted use and restrictions on disclosure
- Issues with direct competitors
- Term
- Return of confidential information
- Remedies
- Other covenants
- Miscellaneous provisions

Confidentiality Agreements

Parties to the Confidentiality Agreement

- The principal parties to the transaction are the Buyer and Seller/Target. Occasionally investment banks will enter into the confidentiality agreement on behalf of a Seller
- Representatives of the principal parties usually have access to the confidential information
- Most confidentiality agreements limit disclosures to third parties but permit disclosures on some basis to affiliates and representatives
- The disclosing party typically asks that the recipient be responsible for unauthorized disclosures by its representatives. For example, the disclosing party can include a general provision holding the recipient responsible for its representatives or it can require that the representatives sign an acknowledgement to be bound by the confidentiality agreement
- If the recipient is a holding company or part of a larger corporate structure, these provisions often make it clear that the recipient is responsible for the acts of its subsidiaries and affiliates

Confidentiality Agreements

Parties to the Confidentiality Agreement

- Many recipients resist requiring their representatives to sign confidentiality documents and instead prefer to be directly responsible for their actions
- Requiring attorneys, accountants, and other professionals to enter into separate written agreements can be time consuming and delay the due diligence process
- Trend:
  - Financial buyers prefer to have their financing sources enter into confidentiality agreements directly with the Seller so that the Buyer is not responsible for any breach by those financing sources

Practice Tips

- Even when not required by agreement to do so, Buyers and Sellers often have their representatives enter into separate confidentiality agreements as a matter of practice
- Note that certain representatives (such as lenders, investment bankers, and law firms) may not wish to be bound by certain sections of the Buyer's or Seller's confidentiality agreement, such as the standstill or nonhire provisions

Confidentiality Agreements

Definition of Confidential Information

- Defining what is confidential is central to any confidentiality agreement
- The types of matters that are typically categorized as confidential include:
  - Business information (including trade secrets)
  - Derivatives of business information
  - The contemplated transaction itself, including any terms
  - Labeling disclosed information as "Confidential" or not labeling disclosed information?

Practice Tips

- The confidentiality agreement should make it clear when confidential information is being disclosed
- If the confidentiality agreement requires certain steps to be taken for information to be protected, such as marking the information as confidential, must be very careful that this process is followed
- Disclosing parties must also be careful not to disclose information that is restricted by other confidentiality agreements

Confidentiality Agreements

Exceptions to Confidentiality

- Almost all confidentiality agreements provide certain exclusions to the confidentiality obligations
- Many of these exclusions are fairly customary and include information that:
  - Is or becomes public other than through a breach of the confidentiality agreement by the recipient
  - Was available to the recipient on a nonconfidential basis before disclosure
  - Was already in the recipient's possession
  - Becomes available through a third party not bound by a confidentiality agreement or obligation
  - Is independently developed by the recipient without using the confidential information
  - Buyers usually require that all of these exclusions apply to the ”Confidential Information” definition generally and not just to the “nondisclosure” provisions

Confidentiality Agreements

Other Common Exceptions to Confidentiality

- Disclosing the existence and terms of the deal to a bank or other lending source to secure financing
- Disclosures required by law
  - Confidentiality agreements usually allow the recipient to disclose confidential information if required to do so by court order or other legal process
  - The recipient usually has to notify the disclosing party of any such order and cooperate with the disclosing party to obtain a protective order

Confidentiality Agreements

Permitted Use and Restrictions on Disclosures

- The disclosing party should:
  - Clarify how the information can be used, and who may see it
  - Make it clear that the information can only be used for a specific purpose, such as the evaluation of the current transaction
  - Sellers will try to narrowly define the nature of the proposed transaction — for example, a "negotiated acquisition"
  - The recipient of the information must make sure that the scope of the permitted recipients is sufficient to conduct due diligence and obtain financing commitments (if applicable)
- Backdoor Standstill
  - *Martin Marietta Materials, Inc. v. Vulcan Materials Co.*, 56 A.3d 1072 (May 4, 2012) (highlighting the fact that a failure to clearly define how a recipient may use or not use the target's confidential information received during the course of a deal could effectively create a backdoor standstill, prohibiting the recipient from pursuing a hostile deal while the confidentiality agreement is in effect)
- Clarify who is permitted to access and use the information
- Include the recipient's affirmative duty to keep the information confidential. This duty is often tied to a certain standard of care

Confidentiality Agreements

- Anticlubbing and lock-ups
  - More common in deals with one or more private equity Buyers
  - Prohibit the practice of consortium bidding or "clubbing," which is the acquisition strategy of forming a group of bidders to collectively participate in an acquisition
  - The Seller may request that the Buyer make a representation that it is not a party to any exclusivity (or lock-up) arrangement with a potential source of financing

Confidentiality Agreements

Issues with Direct Competitors

- What level of information should the parties disclose if they are direct competitors?
  - Consider business and legal (antitrust) risks
- Direct competitors should consider the following when contemplating the terms of a confidentiality agreement:
  - Disclosures may be limited to aggregated information or sensitive information may otherwise be masked
  - For sensitive information, consider signing a separate NDA and a "clean team" approach with much more specific provisions and controls regarding the disclosure of such information
  - Avoid reviewing any documents that may lead to a claim of misappropriation of information
  - Be sure to check whether sharing certain information with a competitor violates any antitrust laws; a violation could kill the deal or result in regulatory action

Confidentiality Agreements

Term

- Indefinite or termination upon a certain date or event
- Depends on the type of information involved and how fast such information changes
- Disclosing parties typically prefer an indefinite period
- Recipients typically prefer a set term

Practice Tip

Be sure to set specific expiration dates for those provisions that are not related to confidentiality obligations (i.e., standstill agreements or nonsolicitation clauses)

Confidentiality Agreements

Return of Confidential Information

- Confidentiality agreements typically provide for the return of confidential information in the following circumstances:
  - on the termination of negotiations between the parties
  - at the end of the term of the agreement
  - at any time upon the disclosing party's request
- Recipients often want:
  - the option to destroy the confidential information instead of returning it to the disclosing party
  - to include language that allows them to keep copies of the confidential information for archival or evidentiary purposes or if required to do so under law or professional standards

Practice Tip

Disclosing parties should make sure they have rights to the return of their confidential information or an adequate process to confirm destruction or archival under satisfactory procedures

Confidentiality Agreements

Remedies

- Injunctive relief in addition to monetary damages
- Indemnification provision holding the recipient responsible for all costs relating to the enforcement of the agreement
  - Recipients will resist including the indemnification provision
  - A typical compromise is to have the losing side to a dispute pay the fees and expenses (including legal fees)

Confidentiality Agreements

Other Covenants

- No Representations or Warranties
  - The disclosing party may clarify that it makes no representations or warranties with respect to any of the disclosed information. If the recipient claims that the information is incomplete or inaccurate in any way the disclosing party points to this clause to avoid liability
- Nonsolicitation
  - Restricts the recipient from hiring the disclosing party's employees for a certain period of time (one year is common)
  - Restricts the recipient from soliciting the disclosing party's customers and suppliers
- Standstill Agreement
  - May be included in the Confidentiality Agreement when the Seller is a public company
  - Helps the Seller to control the sale process
  - Prevents the prospective Buyer from making a hostile takeover attempt after the parties fail to complete a friendly deal when the Buyer has had access to the Seller's confidential information
  - Often limits the Buyer's ability to buy and sell the Seller's stock
  - Buyers often seek to limit the term of the standstill to a period typically ranging from 6 months to 18 months
  - Sometimes includes a "don't ask, don't waive" provision limiting a Buyer from requesting a waiver of the standstill. This may raise issues about the adequacy of the sale process and the Seller board's fulfillment of its fiduciary duties and should be reviewed carefully
  - The Buyer may also seek to have the standstill "fall away" in certain circumstances, such as once the Seller signs up a deal with another party, or if the Seller becomes subject to a "hostile" bid, to preserve the Buyer's options

Confidentiality Agreements

Other Covenants

- Trading in Securities
  - Use when the disclosing party is a public company
  - Reminds the parties of their obligations under securities laws
- Announcements
  - Prohibits the parties from making a public announcement about the deal unless agreed to in advance by both sides
- Exclusivity
  - Sometimes referred to as a no-shop clause, this provision requires the Seller to deal exclusively with the Buyer for a certain period of time
  - Exclusivity agreements are usually separate agreements or sometimes included in the term sheet for a deal
  - Can be problematic for a public seller, depending on the length of the exclusivity period and size of the deal

Confidentiality Agreements

Other Covenants

- No license granted
- Obligation to inform of unauthorized disclosure
- No further obligations
- Residual rights
  - Residual rights clauses allow the recipient's employees to use any confidential information retained in their memories
  - Sellers often strongly object to residual rights clauses and have concerns over abuse

Practice Tip

To limit potential abuse, some residual rights provisions state that employees cannot "intentionally" remember information to sidestep confidentiality obligations

Confidentiality Agreements

Miscellaneous Provisions

- Often viewed as “standard” or “boilerplate” but may have unintended consequences, restricting the Buyer’s activities in the industry and the Buyer’s options as the negotiation progresses, even if a transaction never materializes
- Terms may prove very consequential in the event of a subsequent dispute between the parties
- Topics Include
  - Entire agreement
  - Assignment
  - Choice of law and jurisdiction
  - Waiver of jury trials
  - Availability of equitable relief
  - Notice provisions
  - Amendments and waivers
  - Override of other confidentiality agreements (for example, in data rooms)

Practice Tip

Parties often switch governing law as part of the negotiations. Don’t select a governing law unless someone knowledgeable about that law has confirmed that it raises no issues

Letters of Intent

Topics Covered

- Preliminary Considerations
- Why Sign a Letter of Intent?
- Why Not Sign a Letter of Intent?
- Contents of a Letter of Intent

Letters of Intent

Preliminary Considerations

- Watch out for unintended binding contracts
- Context is very important
  - Indication of interest
  - Standalone “working” term sheet
  - “LOI,” “MOA,” “MOU,” “heads of agreement”
  - “straight to definitives”
- Bilateral negotiations
- Auction process

Letters of Intent

Why Sign a Letter of Intent?

- Key considerations
  - Level of detail
  - Either party's desire to confront certain issues at certain points in the negotiation before incurring substantial deal expenses or devoting significant time dealing with this counterparty
  - Required disclosure
  - Presigning binding covenants
  - Develop a "road map" for the transaction
  - The Seller sees a level of commitment before disclosing confidential information
  - The Buyer can obtain exclusivity, break-up fee, expense reimbursement provisions

Letters of Intent

Why Not sign a Letter of Intent?

- Time to negotiate — could spend this time on negotiating definitive documents
- Enforceability considerations
- Obligation to negotiate in good faith
- Creates inflexibility

Private vs. Public Company Issues

- Possible disclosure issues if a public company signs a letter of intent for a material transaction
- As a way to address disclosure issues, parties may use an exclusivity letter with a separate unexecuted term sheet

Practice Tip

The most important item in any letter of intent is making sure that the description of which items are binding and which are not accurately matches the parties' intent. Also, confirm that the language about waiving or amending the letter of intent terms is appropriate (for example, no oral waivers or waivers by course of conduct).

Letters of Intent

Contents of a Letter of Intent

- Parties to letter of intent
  - Consider execution by significant shareholders, especially if the Buyer is a shell
- Level of detail varies a lot from deal to deal, depending on the parties' desire to document deal terms in detail up front
- Description of transaction
  - Stock/asset/merger
  - Price
  - Buyer financing, seller financing, holdbacks, earn-outs
  - Purchase price adjustments
    - Net working capital, net worth
    - EBITDA
  - Noncompetition agreements

Letters of Intent

Contents of a Letter of Intent

- Conditions to transaction
  - Standard
    - execution of definitive documentation
    - third party consents, completion of diligence
  - Deal-specific
    - special accounting, environmental issues
    - financing
    - employment arrangements
- Lists of representations/warranties, indemnification, survival

Letters of Intent

Contents of a Letter of Intent

- Exclusivity
  - Binding
  - Fiduciary out
  - Break-up fee, reverse break-up fee, expense reimbursement, and related issues
- Other binding letter of intent provisions
  - Conduct of business after execution of letter
  - Access
  - Expenses
  - Publicity
- Termination
- Binding and nonbinding provisions
- Implied duty to negotiate in good faith

Questions & Answers?

Biography

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John Utzschneider focuses primarily on mergers and acquisitions, securities offerings and corporate governance and finance, including debt restructurings. He represents both private and public companies, equity and debt financing sources and underwriters in mergers and acquisitions, leveraged buyouts, joint ventures, private and public offerings, and restructurings. *Chambers USA 2014* describes him as extremely bright and responsive and able to deliver "top-notch and efficient legal services." John has been listed for many years to various peer-reviewed best lawyer lists in various categories, including *Chambers USA, Best Lawyers in America*, and *Legal 500*.

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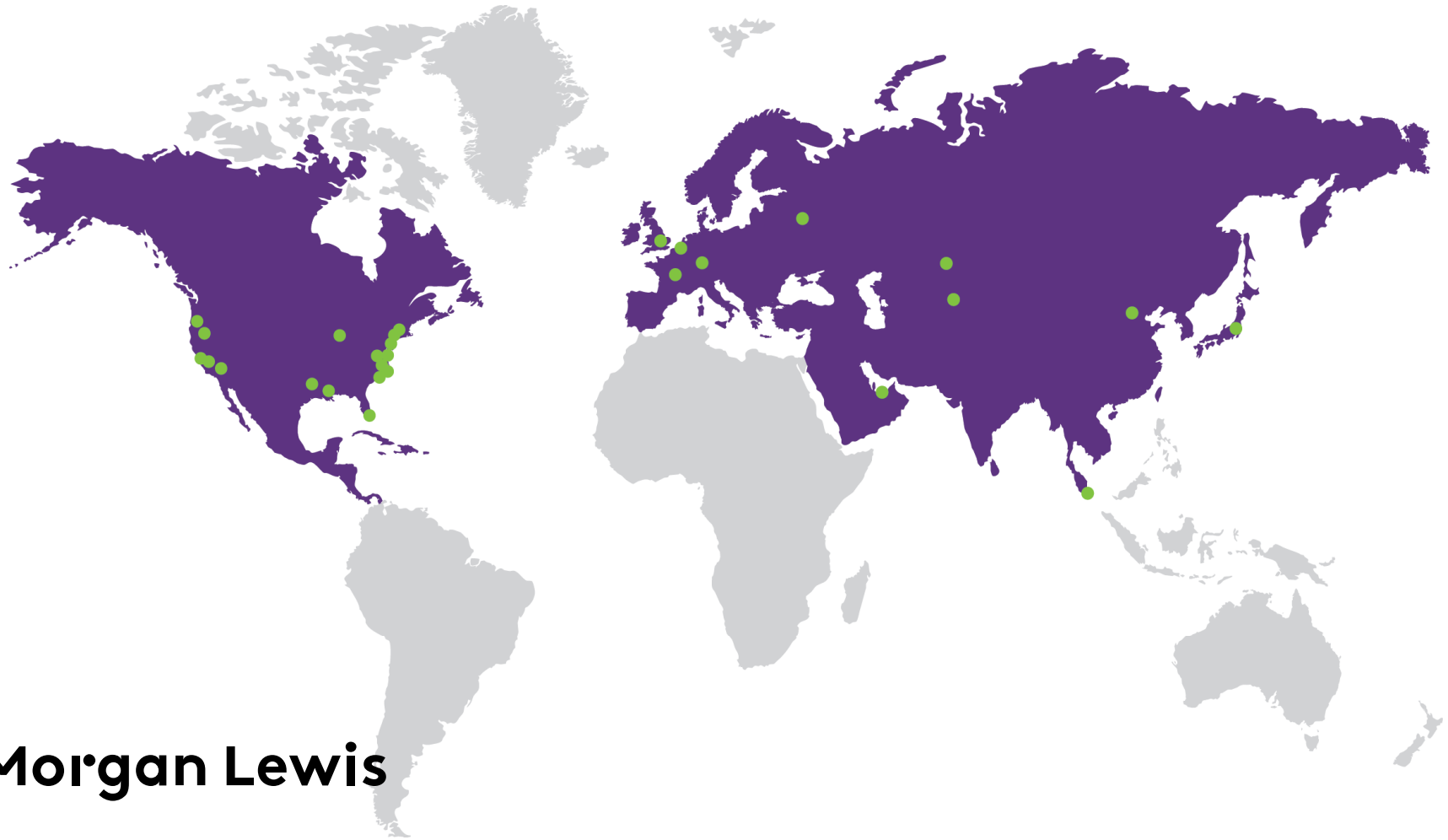

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