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Setting precedent.

**PRELIMINARY AGREEMENTS  
IN NEGOTIATED ACQUISITIONS  
- Letters of Intent and  
Confidentiality Agreements**

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# Preliminary Agreements In Negotiated Acquisitions

## Three Types of Negotiated Acquisitions:

- Merger (including Subsidiary Mergers, Reverse Triangular Mergers, etc.)
- Purchase of Assets
- Purchase of Stock

## All types of Negotiated Acquisitions Require:

- Confidential Disclosure and Evaluation of Confidential Information about the Target to the Buyer, so the Buyer can Evaluate the Target, and Establish a Price.
- Preliminary Agreement To Go Forward with the Deal, Often Through a Term Sheet or Letter of Intent.

# CONFIDENTIALITY IS KEY

- *The Confidentiality Agreement* is usually the first document in the acquisition process, signed by the Recipient before the Discloser provides any confidential information to be Recipient.
- *Letter of Intent* (if there is one), the definitive acquisition agreement, and Noncompetition, Nondisclosure, and Nonsolicitation Agreements signed by sellers or key management usually have their own confidentiality provisions - each should be coordinated with the Confidentiality Agreement.

# CONFIDENTIALITY AGREEMENTS

## *COUNSELING THE CLIENT*

### A. Client is the Disclosing Party/Target

- Client must identify the types of information requested to be disclosed (Buyer's attorneys often provide comprehensive due diligence checklist to send to target).
- Client must be aware of risks of disclosure of highly sensitive information (formulas, technical specifications, customer lists, litigation, etc.).
  - *Misuse may cause irreparable damage.*
  - *May have "two tier" disclosure – most sensitive information disclosed only after definitive agreement is signed.*
- Client often needs a "Team" and a Game Plan to handle massive disclosures.

# CONFIDENTIALITY AGREEMENTS

## *COUNSELING THE CLIENT*

### B. Client is the Receiving Party/Buyer

- Risks of Confidentiality Agreement (“CA”) between competitors – if deal doesn’t close, disclosing party may claim that the receiving party (*its competitor*) has misused the confidential information to compete with the disclosing party.
  - *Don’t enter into CA prematurely*
  - *Don’t receive highly sensitive information until it’s likely that “we have a deal”*
  - *Carefully define “Confidential Information”*

# *Definition of Confidential Information*

Typically Use A Broad Definition –  
An example of a *Disclosing Party* – oriented definition is:

The Disclosing Party will furnish to the Receiving Party certain information concerning the business and affairs of the Disclosing Party that is either nonpublic, confidential or proprietary in nature. This information, whether disclosed orally, in writing or in any other form or medium (including without limitation electronic or computer-based data), and including without limitation information obtained by meeting with representatives of the Disclosing Party, together with all notes, analyses, compilations, forecasts, studies or other materials (in whatever form, whether documentary, computer storage or otherwise) prepared by the Receiving Party or the Receiving Party's representatives that contain or otherwise reflect such information, is referred to herein as "Confidential Information."

# CONFIDENTIALITY AGREEMENTS

## *Differing Perspectives on Disclosure of Confidential Information*

### *A. Disclosing Party:*

- Establish presumption that all information about discloser received by the receiving party is subject to CA restrictions.
- Include receiver's due diligence reports and notes, financial models, etc.

### *B. Receiving Party:*

- Limit presumption that all information about discloser is confidential (e.g., only cover that which is marked "confidential" when disclosed),
- Limit to information that is "non-public, confidential, or proprietary in nature."

# CONFIDENTIALITY AGREEMENTS

## *What is "Confidential Information?"*

"Confidential Information" – as defined, with exceptions for:

- "Public" Information – "in the public domain" (Disclosing Party) versus "publicly available" (Receiving Party).
- Information already possessed by the Receiving Party (requiring prior possession to be "lawful" and "evidenced by the Receiving Party's written records" favors the Disclosing Party).
- Information disclosed by a third party (who, to the Receiving Party's knowledge, is not prohibited from disclosing by any obligation of confidentiality).
- Information required to be disclosed by law (e.g., compelled by deposition, subpoena, or other court or governmental action).

# CONFIDENTIALITY AGREEMENTS

## *Restrictions On Use and Disclosure of Confidential Information*

- *Keep Confidential Information Confidential*
  - Only disclose to those who need to know, often defined as "Representatives," including officers, directors, attorneys, accountants, bankers, and financing parties.
  - Use the Confidential Information only in connection with the Receiving Party's evaluation of the proposed transaction.
  - May require a copy of CA to be furnished to each Representative of Receiving Party, or get them to sign a CA. (*Hard To Do?*)
  - Receiving Party is responsible for breach of CA by it's Representatives.

# CONFIDENTIALITY AGREEMENTS

## *Other Confidentiality Agreement Provisions*

- ❖ *Return of Confidential Information and Destruction by Recipient of its Notes, Analysis, Memoranda, Etc.*
  - Recipient doesn't want materials showing its analysis and other Recipient - prepared information to go to Disclosing Party, who could use it in pursuing claims against the Recipient.
  
- ❖ *Disclaimer of Accuracy and Completeness of Confidential Information*
  - Any representations and warranties should be contained in the definitive Acquisition Agreement.
    - No obligation to proceed with the proposed transaction, unless and until definitive Acquisition Agreement is signed.

# CONFIDENTIALITY AGREEMENTS

## “Standstill” Provisions

- ❖ Disclosing Party (if it is a public company) may be concerned that a proposed “friendly” negotiated acquisition will turn into a Hostile Takeover – and may want to limit the Receiving Party’s ability to undertake an unsolicited tender offer or proxy contest by including “Standstill” provisions in the CA; standstill may include limits on:
  - Purchasing or acquiring securities of disclosing party.
  - Forming or participating in a “Group”
    - *As defined in Section 13(d)(iii) of the Exchange Act.*
  - Proposing to disclosing parties’ shareholders, or making any announcement regarding, a tender offer or other transaction.
  - Seeking to control or influence management.

# Letters of Intent

- *There is dispute among practitioners as to whether a letter of intent (“LOI”) is a desirable document in an acquisition transaction –*
  - There is no universal or “correct” answer to this question.
- *LOI Often Used*
  - Buyer and Target enter into a letter expressing their “intent” to engage in a proposed transaction, as a result of successful completion of the initial phase of negotiations.
  - Generally (but not always), LOI describes the purchase price (or formula to determine), and other key terms, to be used as a basis for further negotiations.

# Letters Of Intent Are Mostly Non-Binding

## ❖ *Most provisions of a LOI are Non-Binding*

- The parties use the LOI to express their intentions, and provide a framework for further negotiations
  - An “agreement to agree” is unenforceable

## ❖ *Some LOI Terms May Be Binding*

- Who bears costs, attorney’s fees, etc.
- Indemnification against certain liabilities.
  - Shareholder Suits?
- “Exclusive dealing” or other “lock-up” provisions (may include a “break-up” or “topping” fee).

# Reasons To Use A Letter of Intent

- ❖ *“Test the Waters”*
  - Determine prospects for a definitive agreement, before incurring costs of negotiating a definitive agreement, and before performing extensive due diligence
- ❖ *Create consistent expectations of Buyer and Target*
- ❖ *Buyer Hopes to Create a “Moral Obligation” of Target*
- ❖ *Facilitate Compliance with Regulatory Requirements (H-S-R, etc)*
- ❖ *Useful with Lenders and Others in Evaluating Whether to Provide Acquisition Financing*
- ❖ *Use as a Basis for Drafting the Definitive Agreement*
- ❖ *Regulate Conduct of Parties During Negotiations*
  - “No Shop,” Preliminary Due Diligence, etc.

# Reasons Not To Use A Letter of Intent

- ❖ *Many Lawyers Believe LOL's are generally more favorable to the Buyer than the Target*
  - Possible negotiating disadvantage because of expectations of Target's employees, vendors, customers, lenders and investors of a sale to Buyer.
  - Buyer's due diligence may disclose information which can be used competitively by Buyer if the deal falls through.
  - "No Shop" limits Target's ability to introduce other interested acquirers to the transaction.

# Reasons Not To Use A Letter of Intent

- ❑ Concern that LOI provisions intended to be non-binding will be found by a court to be binding (and result in unanticipated and unintended consequences).
- ❑ Negotiation of the LOI sometimes becomes bogged down in detailed discussions that are generally reserved to the negotiation of the definitive agreement.
- ❑ Because of these concerns, lawyers often advise their clients to forego an LOI and commence negotiations with respect to a definitive agreement.

# Binding vs. Non-Binding LOI Provisions

## ❖ *Care must be taken to avoid unintentionally binding LOI provisions.*

- A Buyer or Target could be unintentionally obligated to buy or sell, leading to problems and unexpected results if they later are unable to agree on the terms of a definitive agreement.

## ❖ *Legal Principles of Non-Binding/Binding Provisions of LOI.*

- Clear expression of parties' intent not to be bound will be upheld.
- If parties intend to be bound, courts will find provisions binding, even if LOI is to be replaced with a definitive agreement.
  - Courts will supply commercially reasonable terms if there are certain unresolved issues.

# "Long Form" versus "Short Form" LOI

- ❖ *Advantages of Comprehensive, or "Long Form" LOI*
  - Identify "deal breakers" before lots of money is spent on due diligence and drafting of a definitive agreement (and related disclosure schedules)
  - Thorny issues can be resolved upfront, allowing Buyer more time and energy to prepare for transition of its ownership of the company
  
- ❖ *Disadvantage of Long Form LOI*
  - It may burden the negotiations with too many detailed issues too early in the process
    - This can result in loss of deal momentum, or even a breakdown in negotiations

# Determining Whether LOI Terms Are Binding

- ❑ In determining whether parties intend to be bound, courts generally examine the following factors:
  - The actual words of the document (most important factor)
  - The context of the negotiations
  - Whether either or both parties have partially performed their obligations
  - Whether there are issues left to negotiate
  - Whether the subject matter concerns complex business matters that customarily involve definitive written agreements
- ❑ *Most LOIs are intended to be partially binding (“no shop,” expenses, etc.)*

# "SHORT FORM" LOI

- ❑ Shorter and more informal LOI can be effective
  - Avoid hitting snags or deal breakers early on
  - Allow more time to focus on negotiation of definitive agreement at an early stage in the process
  - Allows more time for preliminary due diligence
  - Keeps the process moving – don't lose deal momentum, and less chance of a breakdown in negotiations

# Approach To Drafting the LOI

- ❑ By custom, the Buyer or its counsel usually prepares the first draft of the LOI
- ❑ There is no “right” or even “customary” form of LOI – broad range of what may be considered reasonable
- ❑ Non-binding provisions usually consist of “deal points,” such as purchase price, form of and major terms of the transaction
- ❑ Binding provisions focus on regulation of the negotiation process, such as
  - Access for Buyer to conduct its acquisition review (“due diligence”)
  - No-Shop restrictions and break-up fees
  - Nondisclosure/public announcements (may already be included in Confidentiality Agreement)

# LOI

## Golden Rule: "Be Flexible"

- ❑ Virtually everything in an LOI is subject to variation based upon the particular context of the proposed acquisition
- ❑ There is no such thing as a "standard" letter of intent applicable to all acquisitions
- ❑ The golden rule of LOI drafting and negotiation is "BE FLEXIBLE"

# Use Of A Term Sheet (Versus a Letter of Intent)

- ❑ Term Sheet is usually not signed, so it helps with disclosure issues
- ❑ Term sheet performs many of the same functions as an LOI, by identifying major terms, and setting forth a basis for negotiating the definitive agreement