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PERSPECTIVE

Why it's important to manage confidentiality in M&A deals

By Zachary Turke and Edward Xia

Once you have taken the important step of deciding to sell your company, a business owner must face the reality that the inner workings of your business will be divulged to potential buyers during the sale process. In order to achieve your ultimate goal of receiving the highest purchase price and getting the best deal terms, potential buyers will need to conduct a thorough due diligence process in order to evaluate your company. Keeping confidentiality during this process is a necessary part of any successful transaction.

Why Confidentiality Is Important

Maintaining confidentiality of any information you disclose, including that a potential transaction may occur at all, is of the utmost importance. This is true for any company, not just companies that have proprietary technology or intellectual property. Every business would not want its customer lists, internal financial information or potential future expansion plans to be in the hands of competitors, nor would it want its customers to see what its other customers are paying.

Public disclosure of the fact that your business is being sold may also have severe consequences. Employees become uneasy about their jobs, causing retention issues and loss of productivity. Customers become concerned about disruption. Competitors become emboldened to poach customers and employees. Vendors may seek to renegotiate the current business relationship. Public disclosure may also harm the deal itself, as potential buyers may consider the business to be de-valued if customers leave or proprietary information is leaked.

How Information Leaks

It is important to remember that in a sale process, particularly one with multiple po-

tential buyers, there may be tens — if not hundreds — of people who learn about the transaction or receive confidential information about your company.

Your first concern may be about potential buyers and their advisors. You will have each potential buyer sign a confidentiality agreement (as discussed below). However, do not forget about people on your side of the table as well as they can also be the source of a potential leak. Certain of your employees will need to be brought into the deal process in order to facilitate the transaction. If you are not careful, other employees may find out. You will also likely hire lawyers, investment bankers and accountants to help you with the transaction.

But no deal can get done without the buyer doing due diligence or key employees at your company being involved. So how do you protect confidentiality given these realities? Your investment banker and M&A attorney will help you through this process, but this article outlines some considerations you should be aware of.

Keeping Confidentiality Among Your Team

To prevent disclosure from your team, you should think carefully about the people who you involve in the transaction process. Your team should be limited to a select group of key executives who are essential in responding to due diligence questions and ensuring a smooth sale process. This typically includes, but may not be limited to, your chief executive officer (if that is not you), chief financial officer, head of human resources and general counsel (if you have one), among others.

It is advisable to keep this group very limited at the beginning stages when there is no certainty of a transaction. After the purchase price is agreed upon and the purchase agreement is getting closer to being signed, you may consider bringing other senior em-

ployees into the fold to answer more detailed diligence questions the buyer may ask or to allow the buyer to negotiate employment arrangements to retain these employees after the deal closes.

Even if the circle of people who are aware of the transaction is limited, information may still slip out. Administrative staff who are asked to schedule calls or meetings with investment bankers or potential buyers may figure out the purpose of these calls or meetings. In-person meetings at your office may raise suspicion from employees who notice the arrivals. Documents left on printers or out in the open may also result in employees becoming aware of the transaction.

To prevent this, it is advisable to use an email account other than your work account for transaction communications, have all transaction-related mail sent to your home instead of office, use code names to refer to the transaction whenever possible, use your attorney's office for in-person meetings and schedule meetings yourself. There is a time and place to communicate the change in ownership to your employees, but that is generally after a binding agreement has been signed via a communication plan has been developed with the buyer.

Lastly, remember that your advisors have access to confidential information as well. Your lawyers are bound by a duty of confidentiality under state laws and ethics rules, and the consequences for violations are severe. However, an investment banker is not bound by similar legal obligations and therefore you must have a confidentiality agreement signed with them before they commence work. Your M&A attorney can help you negotiate these agreements.

The Confidentiality Agreement

As you release confidential information to potential buyers, having a confidentiality

Maintaining confidentiality during M&A deals

agreement in place that prevents the disclosure and misuse of confidential information by such potential buyers is essential.

Ultimately, a piece of paper cannot, by itself, prevent confidential information from being leaked. Nevertheless, it establishes a set of guidelines for the parties to follow, and gives you contractual remedies in case of breach. The overwhelming majority of buyers, both strategic buyers and private equity funds, are sophisticated parties that take the confidentiality agreement seriously.

A good confidentiality agreement will set guidelines regarding a number of issues. What information is protected and what is not? With whom may information be shared? What happens if the buyer has to legally disclose certain information? What happens if there is a breach? How long do the protections last? What happens if discussions cease and you want to get information back? What about the buyer's record-keeping requirements? These are just some of the pressing questions that become clarified once there is a written confidentiality agreement in place.

Some confidentiality agreements also restrict the potential buyer from hiring your employees for some period of time. This is particularly important if the potential buyer is a competitor and begins to have contact with your key employees as part of the sale process.

The process of negotiating these agreements is complex, particularly in a competitive sale process where there may be many confidentiality agreements being

negotiated at once. The initial form of agreement is typically prepared by your M&A attorney, and negotiations are done by either counsel or your investment banker.

Controlling the Flow of Information

While the confidentiality agreement provides contractual protection with potential buyers, the other major tool in your arsenal is your ability to control the flow of information.

Almost every transaction is conducted through an online virtual "data room" where you will post documents. There are a number of professional vendors who provide these services. These data rooms allow for customizable security features (e.g., watermarks on documents, restrictions on downloading or printing) and user options (e.g., different access options for different people). While there are free services available that cost less than the professionally managed services, they generally do not have these advanced functionalities. Accordingly, the cost savings often do not outweigh the potential lack of security.

Providing information to potential buyers is typically done in stages. Early in the process, when multiple potential buyers are still involved, the amount of information provided is fairly limited. Once you begin detailed negotiations with a single buyer, you will provide them more information. Buyers will generally push for as much information as possible in this confirmatory diligence, and you may receive an extensive request list asking for

everything on a buyer's wish list. You can consider holding particularly sensitive information until you are closer to signing the purchase agreement if there is concern about the deal breaking. This is especially true in case of buyers that are also competitors.

Your advisors can also review any information before it is disclosed, which may help prevent accidentally sharing something that is sensitive and may also uncover issues that need to be addressed before disclosure to potential buyers. Another tool available to you is to redact sensitive information such as customer names and board meeting minutes discussing other potential buyers. You can also designate that certain information may only be reviewed under strict conditions, such as permitting review by buyer's attorneys only or only permitting review of a physical copy of a document at a designated location.

How to Handle Leaks

Even if you are taking the utmost precaution, information

about the transaction or other confidential information may still leak before you want it to. At that point, you need to be prepared with what you will say to your employees, customers and vendors. In certain cases, you may be able to keep things vague and just mention you are considering a strategic partnership. In others, you may have to acknowledge that you are considering a change of control transaction and explain the reasons why.

It is important if this happens to work with your advisors who have been through this before. Your M&A attorneys may also be able to bring in litigators to help you enforce your rights if someone has breached a confidentiality agreement.

Keeping confidentiality is an important part of any sale process, but the risk of confidential information being leaked should not scare you away from a transaction if that is the right business decision for your company. With the help of your advisors, you can navigate these challenges and achieve a successful transaction.

Zachary Turke is a partner and **Edward Xia** is an associate in the Corporate Practice Group of Sheppard Mullin Richter & Hampton LLP .



ZACHARY TURKE



EDWARD XIA