The Nondisclosure Agreement or Confidentiality Agreement

With respect to a buyer, often the first document signed after the engagement agreement is a nondisclosure or confidentiality agreement provided by an intermediary or attorney for the seller. The seller does not want to reveal financial and other confidential information regarding the business to a potential buyer without the protection of a nondisclosure agreement. This agreement will provide that the buyer is to hold confidential all information provided to the buyer about the business, for the buyer to not use any such information other than for the proposed purchase of the business, and for the buyer to return all information to the seller if the sale does not close.

When representing the buyer, first begin by thinking whether the buyer has confidential information the buyer will want to have protected? If so, the buyer should ask for an agreement from the intermediary and the seller requiring them to hold the buyer's information confidential.

The definition of what is considered protected information is something that should be looked at closely by each party. The seller will generally want a very expansive definition of what is considered to be protected information. The buyer on the other hand will desire a more narrow definition. Oftentimes the buyer and seller will agree to create exceptions for information previously known to the buyer as well as common industry and public knowledge. A common form is to exclude certain information from the definition of Information in the agreement:

> The term "Information" will not, however, include information which (i) at the time of disclosure or thereafter is generally available to and known by the public (other than as a result of a disclosure directly or indirectly by either party or their respective Representatives in violation of this Agreement), (ii) at the time of disclosure was available on a non-confidential basis from a source other than Seller, or (iii) was known by the Company prior to receiving the Information from Seller or has been independently acquired or developed by the Company without violating any of its respective obligations under this Agreement.

If the purchaser is already involved with the company and has company knowledge, e.g. a current employee, vendor, or customer - then the term "information" should exclude the knowledge which has already been acquired by the purchaser as a result of his or her connection with the company - otherwise, it could lead to the employee signing the equivalent of a non-competition agreement or the vendor not being allowed to start a new business. If a vendor desires to purchase a business within a certain industry and has information which could be considered confidential to the seller, there needs to be a special carve out within the nondisclosure agreement to prevent the seller from enjoining the vendor from purchasing a competitor of the seller.

A seller may want a specific list of people to whom the information can be released, whereas the purchaser will want it to apply to all of the purchaser's agents. The latter provision is preferable so there is no inadvertent disclosure to an agent who was not specifically named in the nondisclosure agreement. The receiving party of any confidential information, usually the buyer, will be responsible for any improper dissemination of the information to a third-party by its agents. However, a purchaser will generally want to add language which provides that it is not liable if the purchaser or its representatives used the same degree of care in protecting the information as the seller uses in protecting the information.

Another issue is the level of protection the purchaser needs to provide if the information is sought by a third-party. It is common practice for the purchaser to have to notify the seller of any attempt by a third party to seek disclosure of the confidential information pursuant to law. The question arises whether the purchaser is required to use its best efforts to obtain reliable assurances that the information will continue to be treated confidentially. For example, a purchaser will not want to pay attorneys' fees to defend the confidentiality of the seller's information. To address this situation, the confidentiality agreement can provide for the purchaser to make "reasonable" efforts to obtain an assurance the information will be treated as confidential by the third-party or the seller will provide for the costs of negotiating the disclosure and providing payment for the buyer's legal fees.

Generally, the nondisclosure agreement will provide for the return of all protected information if a letter of intent is not signed by a certain date, if a party decides that it does not wish to proceed with the proposed acquisition, or if the acquisition is not consummated. It may also provide for a time in the future when the protected information will no longer be treated as confidential and the agreement will not be enforceable after that date. This is typically two to five years in the future although trade secrets will generally be kept secret forever.

With respect to enforcement, there should be language in the agreement which provides for injunctive relief without proof of damages. This clause should provide for the recovery of attorney's fees by the prevailing party and that no bond is required as some states, including Illinois, require a bond to sue for injunctive relief unless waived. If the purchaser is an entity, the individual owners may be required to sign a confidentiality agreement in order to obtain personal compliance with the agreement as well as corporate compliance.

Regarding actual disclosure of the information, because of the critical nature of the information and a person's ability to use such information to the detriment of the seller, even with a signed confidentiality agreement, the seller will be very careful with respect to what information is provided to the prospective purchaser at what time. The disclosure of information will often be given in different stages during the purchase process with the more sensitive information being provided later in the process. For example, the purchaser will often receive customer lists and key vendor and supplier lists shortly before the closing date.

The Investment Banker – Business Broker - Intermediary Agreement

For purposes of this paper, investment bankers, business brokers and intermediaries (collectively "intermediary" hereafter) all play the same role of representing the seller or buyer of a business in exchange for a fee. This may include listing a business for sale or helping a potential buyer find a business. Each intermediary has the client sign an agreement documenting the terms of the agreement. Obviously the price and services are of paramount importance, however the remaining terms are of great importance as well and the general terms and what to negotiate and not negotiate are discussed below.

These days it is common to see both seller and buyer intermediaries. Some seller listing agreements provide that a commission is earned when the intermediary presents a willing buyer to the seller as opposed to when the deal actually closes. From the intermediary's viewpoint, the intermediary has done a lot of work in finding the right buyer and wants to avoid losing a fee because the deal does not close due to circumstances outside the intermediary's control. However, from the seller's point of view, the seller only wants to be responsible for one intermediary fee and should not have to pay a fee if the deal does not close. Most intermediaries will agree to change this provision.

One of an intermediary's biggest fears is that after having introduced a buyer and seller, the parties cancel the deal in order to avoid paying the intermediary and then later close on the deal. Most listing agreements therefore require for the intermediary to be paid its fee if the seller sells the business to a buyer introduced to the seller by an intermediary. The intermediary should be allowed this protection. However, if the listing agreement does not provide a reasonable time period, the attorney or other party negotiating the agreement should request one so that if the buyer purchases the business at a much later date, the intermediary would not be entitled to a fee. The length of this time period is negotiable and 12 to 18 months is typical. In order to avoid disputes, it is recommended that the intermediary provide a list of prospects that were contacted to the buyer or seller at the termination of the engagement. This should normally be limited to prospects with whom the intermediary had material contacts.

Another issue is whether the client wishes to sign an exclusive listing agreement. Most sell-side investment banking letters provide for an exclusive arrangement. If the seller agrees to exclusivity, the seller should then focus on the termination and tail provisions in the agreement and think about the consequences if the seller is dissatisfied with the intermediary's performance. If the client wishes to have more than one intermediary listing the business, the client also needs to be ready to either pay an hourly rate to compensate the intermediary for the intermediary's time and costs, or pay a larger than normal percentage of the selling price as a commission. Unless the intermediary is compensated for the intermediary's time, the intermediary will be unlikely to spend time listing a business where it is not an exclusive intermediary.

The term of the agreement will vary and typically be one year for a midmarket sized deal and shorter for a smaller deal. If the client desires to have an option to terminate the agreement prior to the term expiration, this needs to be specifically set forth in the agreement.

Often an investment banking agreement may provide that the banker will provide a large number of services. These should be carefully reviewed and if a service is not desired, it should be removed. For example the sale of stock to the company or any of its affiliates may be excluded from the types of activities which would result in a commission to an investment banking firm.

Sometimes a seller or buyer may have previously contacted prospects before engaging an intermediary. In those instances the parties should specifically address whether those prospects are covered by the agreement and what the payment should be to the intermediary with respect to any transaction that includes those prospects.

Another topic to address in the intermediary agreement has to do with communication between the buyer and the seller. Early on in the process, the intermediary will often want to avoid having the clients interact with each other because the intermediary does not want the deal to sour at an early stage. However, if the listing agreement prevents communications between the buyer and the seller at later stages in the sales process this should be modified. The buyer and the seller will typically be interacting during the due diligence process after a letter of intent has been signed. Further, if the buyer or seller previously negotiated with, or made contact with, a prospect, communications with the prospect should be excluded from the communication restrictions in the agreement.

With respect to fee structures, these vary widely among different brokers. Most have some sort of a commission based upon a percentage fee structure, often with a minimum dollar amount. Some intermediaries may request interim contingency fee payments upon hitting a certain milestone, e.g. upon signing of a letter of intent. However, this is usually resisted or offset by a reduced upfront fee. The commission is usually based upon the actual sales price that is finally paid. If part of the sales price is deferred, as with an earnout, the client may wish to negotiate a portion of the intermediary fee being paid out over time as well. The intermediary however may want to be paid everything at the time of closing because the future collectability from the buyer is not something over which the intermediary has control. If the agreement is silent on this up front, the parties may negotiate a discounted commission at the time of closing to replace the speculative future payments. The intermediary’s commission will also typically be paid on any amounts allocated to an employment agreement, non-compete agreement or any other form of agreement providing compensation to the seller. This prevents the buyer and seller from, for example, allocating part of the purchase price to an employment agreement in order to avoid paying part of the commission. Thought should also be given as to whether the commission should also be based upon any debts which are assumed by the purchaser. For example, if a company is sold for a $5 million purchase price, plus the assumption of $2 million in debt, this is clearly a different situation than a company which is sold for $5 million with no assumption of debt. An intermediary would argue that in the first situation the purchase price upon which commission is based should actually be the $7 million in value provided by the purchaser to the seller.

The Letter of Intent

A letter of intent or term sheet is used by the parties to determine whether or not there is an agreement sufficient between the parties in order for them to proceed forward with the transaction and the expense of drafting a comprehensive transaction agreement. It is a document used to help the parties document their basic tentative agreement on certain points in order to push the deal forward. Sometimes a term sheet is first drafted which sets forth the basic terms of the proposed deal and then a more comprehensive letter of intent is used to set forth more of the details related to the transaction. A letter of intent is not necessary to close a deal; however, it is frequently used to narrow down the parties' agreement on some of the major issues related to the proposed transaction. By using a letter of intent, the parties can limit the amount of expense and time in determining whether a proposed transaction is even feasible between the parties. After the letter of intent is signed, the buyer usually enters into a due diligence period where significant time and expense is spent investigating the operations of the seller. By putting "deal killer" or "must have" points in a letter of intent, a party can determine if a deal is even feasible without incurring the more substantial expenses associated with due diligence and comprehensive purchase agreements. Typically, the purchaser creates the first draft of the letter of intent.

Letters of intent can be relatively simple documents which basically set forth the purchase price and what is being purchased or they can be much more complex documents which really set forth the structure of the proposed transaction. From a buyer's perspective, a shorter letter of intent is advantageous in that the seller is more likely to not be overwhelmed by a lengthy document and may allow the buyer to begin performing due diligence on the company. Additionally, psychologically a seller will become more invested in the transaction after a letter of intent is signed because they switch into a "sell mode." For these reasons, plus the lower cost of a short form that just addresses the major issues, some buyers prefer to use a relatively simple letter of intent.

The advantages of a longer form letter of intent are that if the deal is going to fall apart because of deal structure or other details which are important to the buyer but are not agreeable to the seller, (1) the buyer will hopefully be able to discover the problem areas prior to spending significant amounts of time and expense in due diligence, and (2) the seller can keep the business on the market and not be as committed to the sale. The parties can then negotiate some of these "hot button" areas before incurring other expenses. Once these issues have been negotiated the longer form letter of intent will often be used by the parties as the blueprint for creating the final transaction agreement even if the letter of intent provides that its terms are nonbinding. Therefore a more comprehensive letter of intent can actually save the parties considerable expense on the back end when negotiating the final purchase agreement. Seller's attorneys will generally prefer a more detailed letter of intent so their client is fairly comfortable with the proposed sale before taking the business off the market. Of course there is the disadvantage of greater upfront legal fees being incurred.

A letter of intent should be carefully drafted by the purchaser to provide that the seller will provide the purchaser with the exclusive right to purchase the business for a certain period of time after the letter of intent is executed. This should also provide that the seller ceases the active marketing of the business. If the purchaser does not have such an exclusive right, the purchaser will bear the risk of entering into an expensive due diligence process only to find that the seller has sold the business to another buyer. A seller may be hesitant to provide exclusivity because of a desire to maximize the sales price and to shop the business to other potential sellers. Additionally, a seller's board of directors may have a fiduciary duty to present to the shareholders all potential deals and the seller's attorney may only be able to negotiate a limitation on the active marketing of the business. The purchaser will usually desire a longer period of exclusivity; whereas, the seller may only want to provide for a 30 day period which can be extended if the negotiations with the purchaser are progressing well.

In order to provide exclusivity, some sellers will ask for the purchaser to provide earnest money. This can be a hotly negotiated issue both as to amount and the conditions upon which the earnest money should be returned. Some attorneys advise their clients to not request earnest money as it often increases the amount of legal fees spent negotiating and ultimately may lead to more expensive litigation when the buyer tries to get the earnest money back if the transaction does not close.

Most experienced attorneys require that the letter of intent be nonbinding other than for certain provisions such as exclusivity, confidentiality of seller's information, nonsolicitation of seller's employees and customers, and enforcement. The provision making the letter of intent nonbinding should be carefully drafted or the parties may very well find themselves in expensive litigation trying to sue for or defend against damages for breach of a binding sales agreement.

A detailed letter of intent typically lists some conditions which need to be met prior to proceeding with the transaction such as obtaining adequate purchaser financing, satisfactory lease or other contractual negotiations, and obtaining required third-party approvals from franchisors or regulators.

Though the letter of intent is technically nonbinding, as mentioned previously, the letter of intent is often used as a blueprint for the final purchase agreement. Just as blueprints often change during the construction process, the due diligence process may result in a modification of the terms of the deal (e.g. a reduction in purchase price). Due diligence may also result in a deal structure change. For example what begins as an asset purchase deal may turn into a stock purchase deal. So long as the parties are negotiating in good faith and solid reasons are given for proposed changes to the final deal structure, variations from the letter of intent should not be fatal to the transaction.

Unless the letter of intent specifically renounces a duty to negotiate in good faith, Illinois courts, enforcing Illinois law, may find that there is a duty to negotiate a deal in good faith after a letter of intent is signed. It is probably not feasible, from a party relationship standpoint, to provide that the parties have no obligation to negotiate in good faith. Therefore if a party decides it would like to have a little more flexibility, the parties may wish to include a binding termination provision that provides that either party may terminate the letter of intent for any reason, or for no reason, at a party's sole discretion. Note that some states laws may differ with respect to the enforceability of letters of intent and a party should be careful in this regard.

Midwest Business Brokers and Intermediaries

PRE-ACQUISITION AGREEMENTS

- **Confidentiality Agreements**
- **Investment Banker/Broker Agreements**
- **Letters of Intent**

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Markus May is the principal attorney of May Law Firm Ltd. serving business clients throughout Illinois and other states. As a mergers and acquisitions attorney he has represented numerous clients with respect to business sales and purchases. Mr. May also acts as general outside business counsel to small midmarket companies where he helps them solve business related legal problems. As a transactional attorney he often drafts shareholder agreements, operating agreements, distribution and manufacturing agreements, leases, supplier agreements, customer agreements, and numerous other documents.

Mr. May currently serves or has served as Chairman of the Illinois State Bar Business & Securities Law Section, Chairman of the Chicago Bar Business Law Committee, Chairman of the Chicago Bar Mergers and Acquisitions Sub-Committee, Chairman of the DuPage County Bar Business Law Committee and as a member or the American Bar's Business Law Committee. As a member of the Institute of Illinois Business Law he helps draft Illinois statutes that impact businesses. Mr. May served on the Midwest Business Brokers and Intermediaries board of directors and chaired the Meetings Committee for years. An accomplished author and speaker, Mr. May has published numerous legal and newspaper articles related to business law, including protecting business owners from personal liability, mergers and acquisitions, drag-along rights, and other topics. He appeared on two Illinois State Bar television programs where he taught viewers about finding a business to buy and the business buying process. He speaks frequently at seminars on business topics and graduated from the University of Colorado where he was a member of the law review.

In addition to skiing, racquetball, date nights with his wife, and church activities, Markus enjoys working with, and helping out, other attorneys and professionals.