

Polsinelli's Health Care Private Equity Basic Training: Digital Health M+A

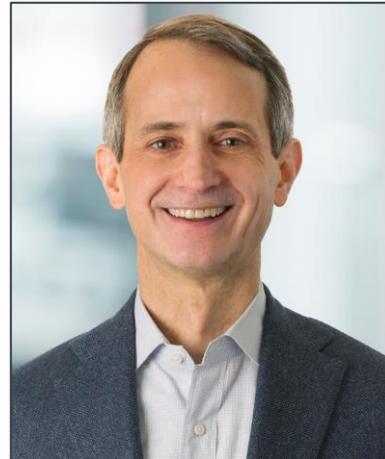
Session 1 - NDA and LOI Terms: Keeping Momentum at the Beginning of a Deal

Health Care M+A

Polsinelli has long prioritized two of its leading integrated practice areas – mergers and acquisitions and health care regulatory. In meeting client needs, we have built a deeply experienced, market-leading industry niche Health Care M+A practice.

- The deal lawyers in our practice provide our health care industry clients with complex transactional advice regarding:
 - Mergers and acquisitions
 - Investments
 - Majority and minority recapitalizations
 - Joint ventures and strategic alliances

Speakers



- **Oliver Davis**, Associate, Polsinelli
- **Michael Dolan**, Shareholder, Polsinelli
- **Jessica Norris**, Shareholder, Polsinelli
- **Jonathan Henderson**, Shareholder | Practice Chair, Polsinelli
- **Joshua Reynolds**, Shareholder, Polsinelli

Hypothetical

- Big Name Capital is looking to expand its presence in the digital health sector and is looking at many telehealth companies in order to acquire a majority ownership.
- One potential target, Need to See a Doc, LLC, a technology-based video platform, has sent over a non-disclosure agreement that includes a non-solicit provision.
- Need to See a Doc, LLC's capitalization table includes multiple founders and venture capital investors, and a large pool of current and former employees with vested restricted stock.
- Big Name Capital wants the founders and venture capital investors to jointly and severally indemnify all indemnity obligations (i.e. no chasing down former employees)
- Big Name Capital wants to sign the purchase agreement as fast as possible after signing the letter of intent and they know that other private equity shops are also interested in Need to See a Doc, LLC.

Part I: Nondisclosure Agreements (“NDA”)

What are the key areas of a Nondisclosure Agreement to discuss with your attorneys?

What is a Nondisclosure Agreement?

- Also referred to as a “Confidentiality Agreement” or the acronym “NDA”
- First step in the M&A process
- Protects the disclosing party’s confidential and proprietary information
- In M&A transactions, NDAs are typically a one-way agreement (vs. mutual) designed to protect the target
- Binding agreement

Elements of a Nondisclosure Agreement

- Parties & Scope
- Definition and use of “Confidential Information”
- Term
- Other Provisions

Parties & Scope

- Identifies the parties bound by the NDA
 - Defines “Representatives” to limit access to Confidential Information
- If one-way NDA, identifies the “disclosing party” and the “receiving party”
- Provides a mechanism for recipient to share Confidential Information with third parties and to have such third party bound by the NDA and recipient responsible for a third party’s breach
- Scope of NDA should be limited to the disclosure of Confidential Information and is provided on an “as is” basis without warranty

Definition and Use of “Confidential Information”

- Defines what constitutes “Confidential Information”
- Limits use of Confidential Information for the sole purpose of evaluating and negotiating the proposed transaction
- Requires recipient to maintain confidentiality using the same degree of care used to protect its own confidential information, but not less than a reasonable degree of care
- Expressly provides for disclosing party’s right to seek injunctive relief in addition to monetary damages for breach by recipient or third parties

Definition and Use of “Confidential Information” (cont’d)

- Exclusions:
 - Previously known to the recipient and not subject to confidentiality
 - Publicly known
 - Independently developed by the recipient
 - Disclosed to the recipient by a third party who had no duty of confidentiality to the disclosing party
 - Court order or securities law disclosure
- Obligation of recipient to return or destroy Confidential Information if transaction is not consummated
 - Retention for evidentiary purposes

Term & Other Provisions

- Term is typically one to five years, depending on the industry
 - Agreement should expressly state that even after expiration of the term, no disclosure of intellectual property and trade secrets
- Nonsolicitation of disclosing party's employees
 - Term
 - Scope
 - Customary carve outs
- No obligation to consummate a transaction
- Governing law and jurisdiction

Application to Hypothetical

- Nondisclosure Agreement should be entered into before any information of the potential target is disclosed to Big Name Capital
- Nondisclosure Agreement should address affiliates and portfolio companies of Big-Name Capital
- Nonsolicitation provision should be carefully crafted to address length of term and define exactly which employees are subject to the restriction, as well as include customary carve outs

Part II: Overview of NDAs in the Auction Process and Polsinelli's SmartNDA Service

How does the NDA process work in an auction setting?

Considerations in Buyside NDA Auction Process

- Speed
 - Engage counsel
 - Notify counsel of target name for clearing conflicts
 - Discuss parameters of acceptable terms with counsel
 - Use target's form
 - For optics, and to facilitate target's quicker review, keep immaterial changes (syntax, nitpicks, etc.) to a minimum
- Compliance
 - Destruction or return of information
 - Retention of materials on email servers, for litigation, etc.
 - Non-solicitation

Polsinelli's SmartNDA Service for Buyside NDAs for Serial Acquirors

- After initial engagement for SmartNDA Service
 - **Step 1:** Polsinelli provides Buyer with matrix of commonly negotiated NDA terms
 - **Step 2:** For each commonly negotiated term, Buyer identifies both its optimal outcome and its minimally acceptable outcome
- As Buyer receives target NDAs
 - **Step 3:** Buyer sends Polsinelli the NDA provided by the target
 - **Step 4:** Polsinelli marks up the NDA to align with Buyer's optimal outcome
 - Assumes all conflicts checks processes have been completed satisfactorily
 - **Step 5:** If and as necessary, Polsinelli and target's counsel negotiate further revisions
 - Polsinelli will not agree to terms less favorable than Buyer's minimally acceptable outcome without Buyer's express consent
- Steps 3-5 are repeated for each target NDA received by Buyer

Polsinelli's SmartNDA Service for Sellside NDAs in an Auction Process

- After initial engagement for SmartNDA Service (prior to auction process beginning)
 - **Step 1:** Seller provides Polsinelli with a list of potential buyers so Polsinelli can run conflicts checks
 - If there are any conflicts, the corresponding NDAs are usually handled by Seller directly or by another law firm
 - **Step 2:** Polsinelli provides Seller with a form NDA
 - **Step 3:** Seller and Polsinelli discuss certain business-oriented terms in the form NDA to ensure it matches Seller's expectations (e.g., duration of confidentiality, non-solicitation terms) and so that Polsinelli knows Seller's range of acceptable outcomes
 - **Step 4:** (Optional): Polsinelli annotates form NDA, identifying a range of acceptable outcomes for commonly negotiated terms
 - This step is optional and is most useful if Seller is handling review of certain NDAs itself
 - **Step 5:** NDAs are sent to prospective buyers
- As Seller receives NDA mark-ups from potential buyers
 - **Step 6:** Seller sends Polsinelli the NDA mark-up provided by the potential buyer
 - **Step 7:** Polsinelli revises the NDA and, if and as necessary, Polsinelli and potential buyer's counsel negotiate further revisions
 - Polsinelli will not agree to terms less favorable than Seller's minimally acceptable outcome without Seller's express consent
- Steps 6 and 7 are repeated for each NDA mark-up received by seller

Part III: Transaction Structure

What are the key transaction structures to discuss with your attorneys?

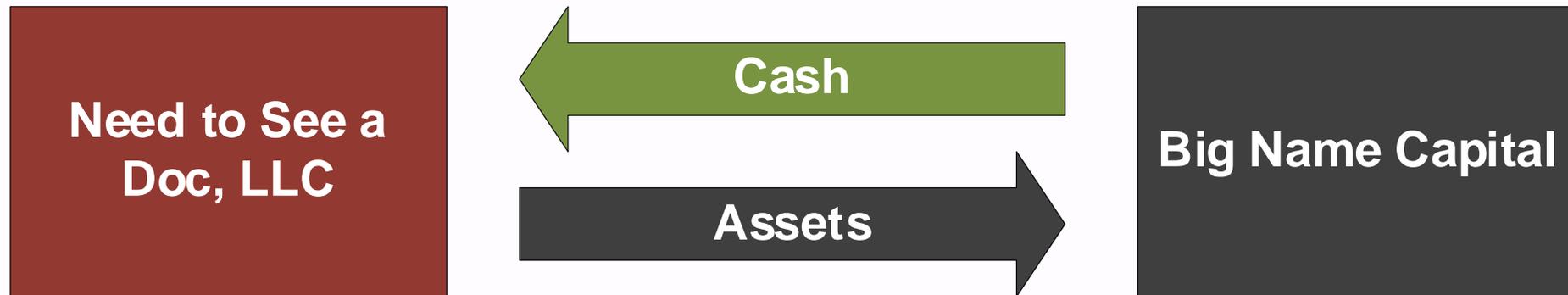
The Three Types of Deal Structures

- What determines the type of deal structure?
 - Tax
 - Liabilities
 - Logistics (internal governance and third-party consents)
- What are the three types of deal structures?
 - Asset Purchase
 - Equity Purchase
 - Merger

Asset Purchase

- Structure Pros
 - Tax benefits for Buyer (stepped up basis)
 - Buyer only purchases assets and assumes liabilities it wants
 - Buyer protected from successor liability
- Structure Cons
 - Not buying all the assets needed to run business post-closing
 - Inefficient logistics – assignment of contracts
 - Disfavored by Sellers

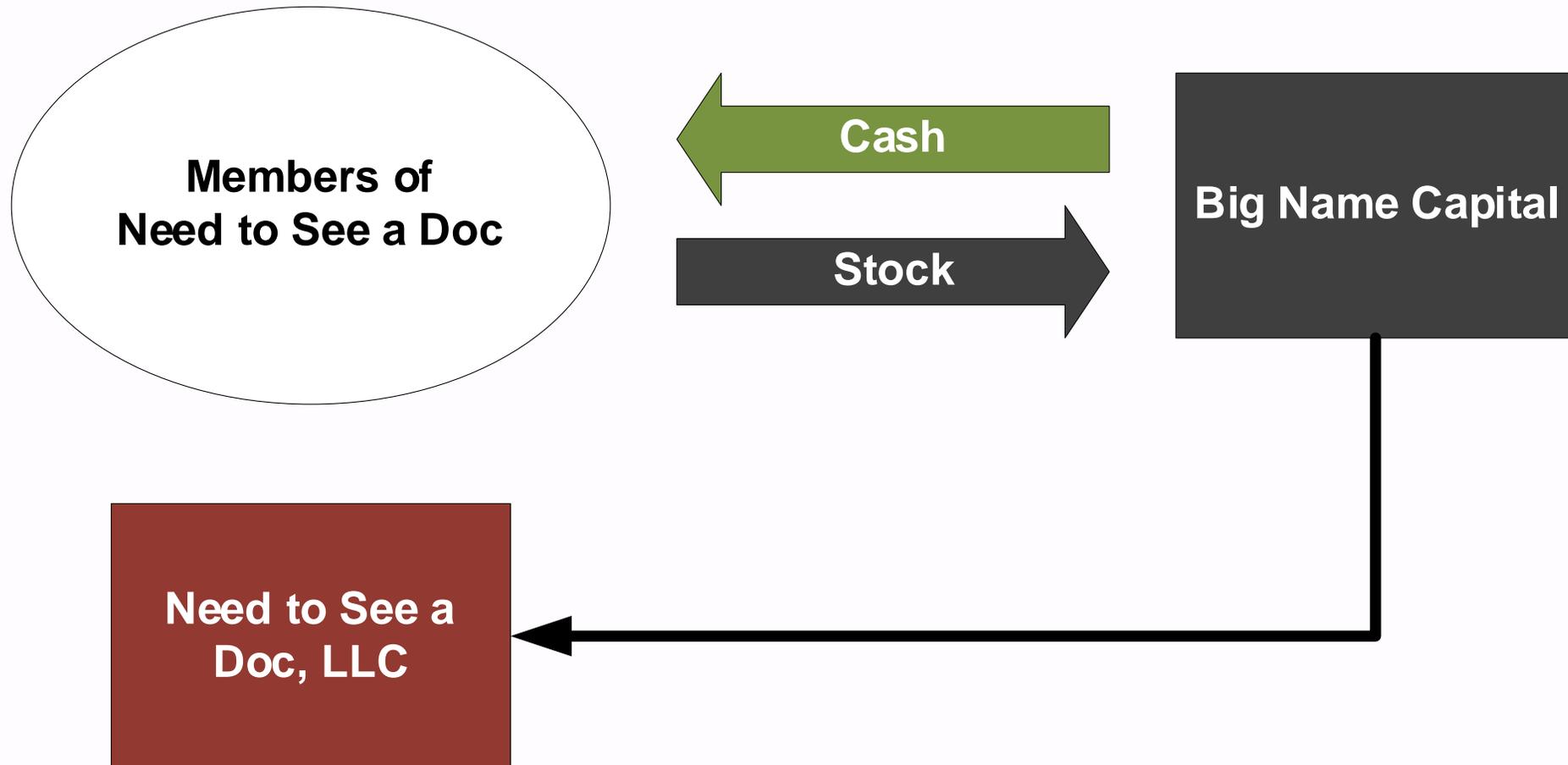
Asset Purchase



Equity Purchase

- Structure Pros
 - Tax benefits for Sellers (capital gains)
 - Efficient logistics with regards to third-party contracts
- Structure Cons
 - Pre-closing liabilities stay with target
 - Holdout seller risk—more equity holders, greater the risk

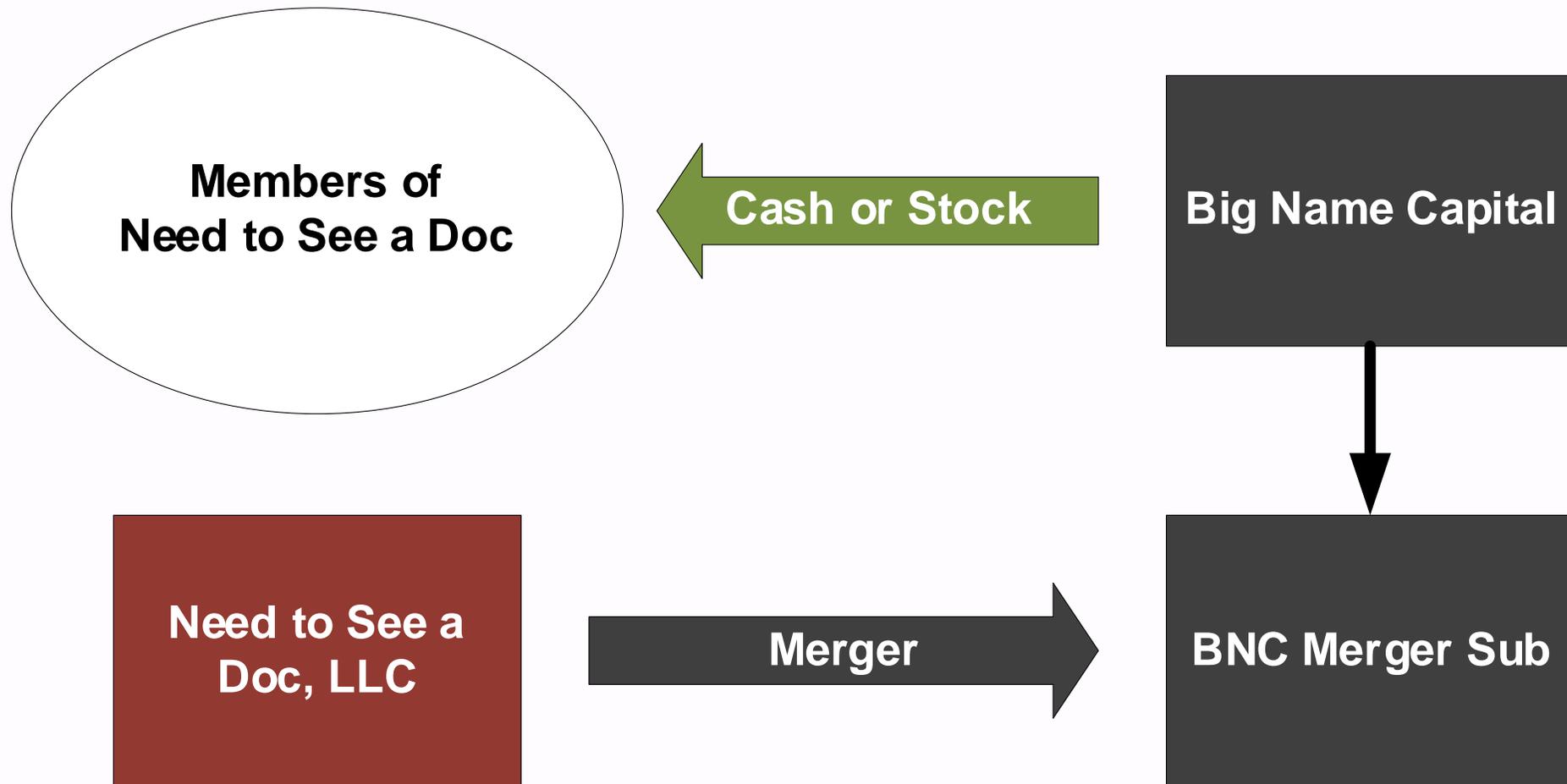
Stock Purchase



Merger

- Structure Pros
 - Potential for tax benefits for Buyer or Seller dependent on structure (potential for no tax if done right)
 - Potential for efficient logistics
 - Potential solution to equity owner holdout problem
 - Fewer third-party consents (assuming reverse triangular merger)
- Structure Cons
 - Liabilities stay with target after closing

Merger



Initial Transaction Structure Considerations

- What are the assets of the target that generate the value?
- What is the tax structure of the target?
- How many equity holders does the target have?
- How quickly do we need to get to closing?
- How much leverage does the Seller have?

Application to Hypothetical

- How many members does Need to See a Doc, LLC have?
- Do we want all the assets or a smaller sub-set of the assets?
- Are we concerned about pre-closing liabilities?
- Are there any contracts/third-party relationships that we can't lose?
Any permits or licenses that would be difficult to get for Big Name Capital?
- What are the tax considerations for the structure?

Part IV: Letters of Intent

What are the key areas of a Letter of Intent to discuss with your attorneys?

What is in a Letter of Intent?

- Description of transaction
- Transaction timeline
- Preliminary statement of basic deal terms
- Scope of due diligence
- Exclusivity
- Allocation of fees and expenses

What are advantages and disadvantages of negotiating a Letter of Intent?

■ Advantages

- Identify Material Deal Terms (and deal breakers) in the beginning
- May reduce time and cost of completing definitive agreements
- Resource and time expenditure signal commitment
- Means to establish expectation and exclusivity

■ Disadvantages

- Cost and resource expenditure required
- Hamstring future negotiating positions

What provisions should be binding?

- Substantive deal terms are generally non-binding
- Process rules for the negotiation process are generally binding
- Some examples of binding provisions:
 - Confidentiality;
 - Exclusivity;
 - Break up fee; and
 - Governing law

Deal Terms

- Vague vs. Specific
 - Beware of the use of the word customary
 - Use vague terms to set expectations (i.e. tax treatment of sellers)
- Certain deal terms (especially if off-market) are easier to negotiate during the negotiation of the LOI
- Use an attorney to negotiate deal points or have an attorney reviewed form
 - Even if deal terms are non-binding, it is difficult to horse trade deal terms that have been agreed to in the LOI.

Exclusivity

- Agreement by one party (usually the seller) to not negotiate with anyone other than the other party (usually the buyer) for a set period of time
- Duration usually to cover until a definitive agreement can be negotiated (30 - 60 days)
- Restricted parties usually include Seller and its affiliates and representatives
- Duty to continue to negotiate in good faith
- Extensions are usually automatic unless seller provides notice

Application to Hypothetical

- Outline closing timeline in the LOI
- Introduce indemnity provision in LOI.
- Layout other deal terms with reasonable specificity
- Include diligence access to employees and records
- Negotiate a tight exclusivity provision (binding target's affiliates)
 - Even introduce break up fee

Polsinelli PC provides this material for informational purposes only. The material provided herein is general and is not intended to be legal advice. Nothing herein should be relied upon or used without consulting a lawyer to consider your specific circumstances, possible changes to applicable laws, rules and regulations and other legal issues. Receipt of this material does not establish an attorney-client relationship.

Polsinelli is very proud of the results we obtain for our clients, but you should know that past results do not guarantee future results; that every case is different and must be judged on its own merits; and that the choice of a lawyer is an important decision and should not be based solely upon advertisements.

© 2021 Polsinelli® is a registered trademark of Polsinelli PC. Polsinelli LLP in California. Polsinelli PC (Inc.) in Florida.

[polsinelli.com](https://www.polsinelli.com)