

# PRE-ACQUISITION DILIGENCE: HOW TO GET AND STAY READY FOR ACQUISITION

Currently, the merger and acquisition (M&A) market in the United States is on a record-setting pace with transactions happening across many industries and company profiles.<sup>1</sup> While there are many reasons for the uptick in M&A transactions in the United States, effects stemming from the COVID-19 pandemic—such as, efficiencies through remote operations and increased confidence in sustaining growth as the economy has continued to open—have played a significant role in the booming M&A market.<sup>2</sup> Anecdotally, we have also seen this bear out here in our own practice, as we have assisted numerous healthcare providers (i.e., physician practices, ambulatory surgical centers, and assisted living facilities, among others) who found themselves swept up by the hot M&A marketplace, regardless of whether these healthcare providers were looking to sell.

This article provides an overview of the steps that companies, including healthcare providers, can take now to be prepared for an acquisition which can save time and costs during the due diligence phase of the acquisition. However, even if your company has no plans to sell, taking stock of and implementing the processes outlined in this article is still part of good corporate hygiene, and will likely prove valuable in other significant company transactions.

## Compiling and Organizing Material Documents

Perhaps the most important function of due diligence is providing the buyer the means to assess the risk associated with the selling company. One main factor in determining a company's risk profile is the company's material agreements and documents, which allow both the buyer and seller to assess the tail of such documents and whether certain restrictive provisions in those documents may be triggered by the acquisition. While the agreements and documents requested by a particular buyer will vary depending on a multitude of factors—including the value and type of the M&A transaction (i.e., asset purchase, change of control, etc.), the industry in which the seller sits, and the seller's representations and warranties as negotiated between the parties—the seller will likely need to provide the buyer with the following general categories of agreements and documents:

- governing organizational documents;
- client/customer contracts;
- vendor contracts;

- employment agreements;
- contracts with governmental or quasi-governmental entities
- lease agreements (i.e., real property or equipment)
- licenses and permits necessary to operate the seller's business;
- insurance policies;
- tax returns;
- financial statements (typically, balance sheets, income statements, cash flow statements);
- loan documents; and
- documents pertaining to seller's capitalization (such, any options or warrants granted, or equity transfers).

Taking an inventory of these documents now and having them compiled and at the ready can save significant time (and cost) during due diligence, as sellers can find themselves inundated with checklists and emails from the buyer and the seller's own legal counsel requesting to review such information.

## Staying Aware of Risks

Being aware of the general and specific risks associated with the seller's business is an important aspect of setting the tone for due diligence. The demanding nature of running the selling entity's business can understandably lead to certain blind spots on the part of administrators and executives when assessing the entity's risk profile. To guard against these blind spots administrators and executives should periodically assess the company's risk profile by determining whether any of the following "G-L-I-D-E-R" categories apply to the company. Doing so now, prior to an acquisition, can reduce the likelihood that closing is delayed due to late major surprises during due diligence.

- **Governmental Notices:** Has the entity received any notices from governmental entities (i.e., the Internal Revenue Services, state agencies, etc.)? This is meant to be a broad category so as to spur thought and discussion amongst the company's executive team. The key here is determining from which governmental agency the notice is from (federal, state, local) and the nature of the notice (whether that be a future deadline or non-compliance with law).
- **Litigation or Other Threats/Claims:** Has the company been part of any litigation, or is the company aware of any claims or threatened claims that may lead to litigation? This is an important category of risk and one in which

the buyer will push to have indemnified post-closing.

- **Insurance Issues:** Has the company paid all premiums on time? Have there been any lapses in coverage with respect to material insurance policies? Here, sellers can typically look to their insurance brokers to provide detailed information regarding insurance issues. Still, administrators should be sure to maintain information from previous insurance providers, because this information may not be in the broker's possession.
- **Data Incidents:** Has any of the company's data been accessed or possessed by an unauthorized party? Has any service provider of the company been the subject of any data incident? With the constant updating of data privacy and security laws in various states, it is important that companies ensure that they and their service providers maintain best practices to keep data secure.
- **Encumbrances:** If the company has obtained a loan or has leased equipment, the company's assets may be subject to certain lender/lessor liens.
- **Related-Party Transactions:** The Company should document and ensure that any related-party transactions (i.e., between the company and officers/family of officers, between the company and owners/family of owners) remain at arm's length.

## Conclusion

Whether or not your company is currently contemplating an acquisition, the foregoing recommendations provide practical steps that your company can take as a matter of corporate governance. Moreover, taking these steps now will streamline the due diligence process and may save needed time in the event the company finds itself in the throes of an acquisition.



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<sup>1</sup> *M&A Trends in the Opportunity Economy*, National Law Review, Volume XI, Number 252, dated September 9, 2021.

<sup>2</sup> *Id.*