

## The “Dos” and “Don’ts” of Due Diligence

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Due diligence refers to the investigation that takes place whenever one party, either an individual or an entity (the “buyer”) commences discussions to acquire, merge, or enter into a significant business relationship with another party (the “seller”). Both buyers and sellers must be well prepared for the due diligence process, as it may have a significant impact on the proposed transaction’s completion.

### Getting Started

The due diligence process may begin before the parties formally enter into official negotiations, i.e., when a party first considers an acquisition, pursuing a new partnership, or expanding current business relationships. If initial intelligence suggests the possibility of a successful outcome, the parties should enter into a confidentiality agreement. Entering into such an agreement before a term sheet is finalized and executed, allows the parties the freedom to release information to each other without the concern that the information will be disclosed or used to the advantage of the other party if the transaction is

not consummated. (A term sheet outlines the main terms of the purchase agreement between the buyer and seller, and is usually negotiated during the first phase of the due diligence process, with changes made during the later phase of the process to reflect relevant diligence findings.)

### The Buyer’s Role

The buyer should submit to the seller a diligence request listing the specifics of the information it wants to review. In a complex transaction, the list can be a dozen pages long. In a simple transaction, particularly one that does not involve publicly traded companies, the diligence request tends to be shorter. These areas address the fundamental aspects of a business and apply to any transaction, regardless of the dollar value. The buyer should not enter into any transaction without having a clear understanding of the scope and nature of the potential financial and legal liabilities. Table 1 is a list of information generally covered in a diligence request.

The buyer should submit its diligence request list as early as possible as it will take the seller some

time to pull together and organize the documentation. While the seller should make an effort to provide as much information as possible in its initial response to the buyer’s request, sellers generally provide the documentation that they can quickly pull together, and then provide supplements (or updates) to the initial diligence. This approach gives the buyer more time to review and follow up on requests for additional information, rather than face a daunting stack of documents close to the time when the transaction will be finalized. Although a seller may be tempted to provide a buyer with a “dump” of documents, providing information in an organized manner that corresponds to the diligence request list is to the seller’s advantage.

### The Role of the Seller and Counsel

At first glance, buyers appear to be the primary beneficiary of the diligence process; however, sellers also benefit as the process facilitates the successful closing of the transaction. For example, the diligence process is an opportunity for the seller to

**Table 1: Information Found in Most Diligence Requests**

#### *Corporate Information*

- Equity owners
- Formation documents
- Board meeting minutes
- Stock register
- Management structure

#### *Employee and Benefits Information*

- A list of employees and independent contractors
- Evidence of applicable employee licenses/certificates
- Employee benefits
- Human resources policies and procedures

#### *Contracts*

- Equipment leases
- Vendor agreements
- Payer contracts

#### *Financial Information*

- Balance sheets
- Financial statements
- Tax returns
- Loan agreements

#### *Regulatory Compliance—federal, state, and local*

- Licenses
- Permits
- Certificates

#### *Legal*

- Threatened or pending litigation
- Government investigations and/or audits

#### *Insurance*

- General and professional liability coverage
- Workers’ compensation
- Loss run reports

#### *Real Estate*

- Deeds
- Leases
- Condominium documents

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organize its documentation and present the most attractive package to the buyer. The seller's timely and thorough response to requests for information reassure the buyer, as it suggests that the business it is acquiring has been run in a professional manner. Finally, due diligence helps sellers quickly locate and identify any documents related to carve-outs to representations and warranties in the purchase agreement.

While the diligence process can be coordinated between the seller and buyer, the legal counsel for both parties should be copied on all requests for information, as well as the documents that are provided. The buyer will determine how much of the diligence it will review internally and how much will be done by its counsel. Counsel will then use information uncovered in diligence to draft representations and warranties that the seller will be required to

make, as well as negotiate any hold-backs or escrows needed to address potential liabilities. On the other side of the equation, the seller's counsel should have access to the documents in order to specify any exceptions.

## Tips for Oncology Practices

Due diligence takes time and resources. Typically, the process is ongoing even as a term sheet is negotiated and operative documents are drafted. In fact, it is not uncommon to have due diligence continue up through the final negotiations of the documents. An oncology practice that plans to put its practice on the market for sale or merger should anticipate the types of information potential buyers will request for diligence review and start to collect the necessary information as soon as possible. The practice should also designate a specific individual as the contact person for all diligence

requests and ask the buyer to do the same. Selecting these key contacts can ease the relationship between the parties, ensure that requests do not slip through the cracks, and help keep details of the transaction more private—particularly if few staff are aware of the proposed transaction.

Under HIPAA, the oncology practice may disclose protected health information to the buyer in connection with the sale or transfer of assets, including any diligence required, without having to obtain any additional consents or waivers. Both the practice and its buyer would be bound under all applicable privacy and security rules in handling the protected health information.

Remember, the diligence process runs more smoothly if both parties keep in mind that they have a common objective—the successful outcome of the transaction—and if they are reasonable in their expectations throughout the diligence process. 📌

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