M&A Non-Disclosure Agreements

Drafting Considerations for Buyers and Sellers

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Selling a company can be a long and winding road with an inevitable exchange of confidential information between presumptive buyers and the selling company occurring throughout the course of a M&A transaction. Typically, the first document signed between a buyer and seller is a non-disclosure agreement (a "NDA") which is designed to place restrictions on what each party may do with confidential information shared by the other party during the course of the buyer's due diligence review of the seller. This article, while not exhaustive, will discuss important precautions and drafting considerations that buyers and sellers should bear in mind when negotiating a NDA.

What information is protected by the NDA?

In an effort to better understand the seller's business and the liabilities that the buyer will inherit in connection with its acquisition of the seller, the buyer typically delivers an extensive due diligence request list to the seller covering a wide array of areas including but not limited to financial information, intellectual property, customer contracts, human resources and pending litigation. Before delivering such confidential information or even engaging in a more informal dialogue with a presumptive buyer regarding the seller's business, it is important for the seller to confirm that the definition of "confidential information" in the NDA includes all such information, whether provided by the seller in written form or verbally in the course of meetings/conversations between the parties. Sellers should resist any effort by the buyer to require that information be specifically legended or identified as confidential in order for the information to be protected by the terms of the NDA; such an approach can be time consuming and inefficient and, depending on the care taken by the seller, may lead to the unintended disclosure of confidential information. Buyers should exclude from the definition of confidential information any information that they have independently developed or that is in the public domain. Sellers may consider the disclosure of particularly sensitive information (such as customer lists, trade secrets or source code) until later in the course of negotiations with the buyer and may also consider implementing special procedures and controls surrounding the sharing of this subset of confidential information.

What restrictions apply to protected information?

Once the universe of confidential information has been properly defined in writing, buyers and sellers next need to determine what restrictions will be placed on this shared information.

A seller will first and foremost want to ensure that the buyer will use the confidential information solely for the purpose of evaluating the acquisition opportunity and not for any other unrelated purpose. This restriction is particularly important in a situation where the buyer is a competitor of the seller; in such a case, a seller may consider implementing additional controls or procedures regarding the confidential information (such as limiting access to the confidential information to certain designated parties, redacting portions of the confidential information or allowing the buyer to view but not download/print confidential information). In

addition, the NDA should make it clear that the seller is not providing the buyer or its representatives with a license to the confidential information or any of seller's intellectual property and that the seller makes no representation or warranty as to the accuracy or completeness of the shared confidential information.

In addition to placing restrictions on how shared confidential information may be used, a seller should also ensure that the buyer is prohibited from disclosing or revealing confidential information to any third party. Buyers and sellers alike should also take care to ensure that the very fact that they are engaged in discussions regarding a corporate transaction is confidential and shall similarly not be disclosed to third parties; this is particularly important in situations where one or both of the buyer and seller is a publicly traded company. Typically, an exception is made for disclosures to representatives of the parties (such as legal advisors or financial sponsors) who have a need to review the confidential information for purposes of evaluating the acquisition opportunity. Exceptions for court-ordered disclosures are also common although a seller is well advised to request the buyer's cooperation in seeking a protective order to limit any such compelled disclosure.

For how long do the restrictions survive?

A seller may argue that the non-disclosure agreement should not expire and, as a consequence, the buyer's non-use and non-disclosure restrictions should survive indefinitely, the rationale being that the confidentiality of certain shared information will not dissipate over time. In practice, however, buyers typically insist on limiting the term of the non-disclosure agreement; a survival period of 2-3 years is fairly typical although parties often agree to an extended survival period for trade secrets.

Who is subject to the restrictions?

It is important for sellers and buyers to specify which individuals and entities are subject to the aforementioned non-use and non-disclosure restrictions. Often, a seller will attempt to have the restrictions apply to not only the buyer but the buyer's affiliates and representatives as well; this is particularly important in a situation where the buyer is an investment fund with one or more portfolio companies that may be direct or indirect competitors of the seller. Buyers will typically resist this approach and ask that only representatives/affiliates with which confidential information is actually shared be subject to the restrictions; of course, it is difficult for sellers to verify this and so a safer approach is to insist on a more widespread application of the restrictions. Regardless of how this issue is ultimately resolved, a seller should insist that the buyer be held liable for any breaches of the restrictions by the buyer's affiliates/representatives.

What remedies does a seller have if agreed upon restrictions are breached?

An impermissible disclosure of confidential information by a buyer can have dire consequences for a seller that often cannot be remedied by monetary damages alone. Accordingly, a seller will typically request an acknowledgement from the buyer that the seller shall be entitled to equitable relief (by way of an injunction or otherwise) in situations where the buyer breaches or threatens to breach provisions of the NDA.

Solicitation/employment of seller's employees

An area of particular concern for sellers is the solicitation of seller's employees by the buyer. In the course of the due diligence process, presumptive buyers will invariably be introduced to key personnel of the seller. Particularly in the case where a presumptive buyer is a competitor of the seller, sellers will understandably want assurances from the buyer that it shall not subsequently solicit the employment of these individuals (or otherwise contact these individuals) for a defined period of time that typically ranges from 1-2 years after the signing of the NDA. Buyers that are large organizations will often resist such a prohibition, citing the difficulty in tracking the organization's hiring activities. A typical compromise is to limit the prohibition to senior, management employees of the seller or to employees that were specifically introduced to the buyer or with whom the buyer otherwise had contact in the course of negotiations. In addition,

buyers will typically seek to carve out indirect solicitations of the seller's employees that occur by virtue of general online or newspaper advertisements or via the use of a third-party search firm.

What happens if a deal is not consummated with a potential buyer?

Despite overtures to multiple interested parties, a presumptive seller may be unsuccessful in attracting a buyer on terms deemed acceptable to the seller. In addition, busted deals happen; parties may sign a letter of intent and start down the road to a potential acquisition only for the buyer or seller to get cold feet and discontinue discussions with the other party. In either of these situations, a seller will find itself in the situation of having disclosed sensitive, private information to one or more third parties with which the seller has not ultimately entered into a corporate transaction. To better protect disclosed confidential information, sellers will typically require a party that is no longer interested in an acquisition to return any shared confidential information or, alternatively, to certify that it and its representatives have destroyed such information. Presumptive buyers may request that they be able to retain a copy of shared confidential information for record keeping purposes; however, sellers may be leery of such an accommodation (and rightfully so in cases where confidential information was shared with a competitor) and may insist that any retained copies be kept in a secure file in the office of the presumptive buyer's legal counsel. Copies of confidential information that are made by way of routine technology backup pursuant to compliance, document retention or disaster recovery policies and procedures are typically excepted from the general rule that confidential information must be returned/destroyed.

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