AN A.S. PRATT PUBLICATION
JULY/AUGUST 2021
VOL. 7 NO. 6

PRATT'S PRIVACY & CYBERSECURITY LAW REPORT

LexisNexis

Pratt's Privacy & Cybersecurity Law Report

VOLUME 7 **NUMBER 6** **July/August 2021**

LexisNexis®

QUESTIONS ABOUT THIS PUBLICATION?

For questions about the **Editorial Content** appearing in these volumes or reprint permission, please contact:
Deneil C. Targowski at 908-673-3380
Email: ..... Deneil.C.Targowski@lexisnexis.com
For assistance with replacement pages, shipments, billing or other customer service matters, please call:

Customer Services Department at ..... (800) 833-9844
Outside the United States and Canada, please call ..... (518) 487-3385
Fax Number ..... (800) 828-8341
Customer Service Web site ..... http://www.lexisnexis.com/custserv/
For information on other Matthew Bender publications, please call

Your account manager or ..... (800) 223-1940
Outside the United States and Canada, please call ..... (937) 247-0293

ISBN: 978-1-6328-3362-4 (print)
ISBN: 978-1-6328-3363-1 (eBook)

ISSN: 2380-4785 (Print)
ISSN: 2380-4823 (Online)

Cite this publication as:
[author name], [*article title*], [vol. no.] PRATT'S PRIVACY &CYBERSECURITY LAW REPORT [page number] (LexisNexis A.S. Pratt);
Laura Clark Fey and Jeff Johnson, *Shielding Personal Information in eDiscovery*, [7] PRATT'S PRIVACY & CYBERSECURITY LAW REPORT [179] (LexisNexis A.S. Pratt)

An A.S. Pratt Publication
Editorial

Editorial Offices
630 Central Ave., New Providence, NJ 07974 (908) 464-6800
201 Mission St., San Francisco, CA 94105-1831 (415) 908-3200
www.lexisnexis.com

MATTHEW BENDER

(2021–Pub. 4939)

Editor-in-Chief, Editor & Board of Editors

Pratt's Privacy & Cybersecurity Law Report is published nine times a year by Matthew Bender & Company, Inc. Periodicals Postage Paid at Washington, D.C., and at additional mailing offices. For customer support, please contact LexisNexis Matthew Bender, 1275 Broadway, Albany, NY 12204 or e-mail Customer.Support@lexisnexis.com. Direct any editorial inquires and send any material for publication to Steven A. Meyerowitz, Editor-in-Chief, Meyerowitz Communications Inc., 26910 Grand Central Parkway Suite 18R, Floral Park, New York 11005, smeyerowitz@meyerowitzcommunications.com, 646.539.8300. Material for publication is welcomed—articles, decisions, or other items of interest to lawyers and law firms, in-house counsel, government lawyers, senior business executives, and anyone interested in privacy and cybersecurity related issues and legal developments. This publication is designed to be accurate and authoritative, but neither the publisher nor the authors are rendering legal, accounting, or other professional services in this publication. If legal or other expert advice is desired, retain the services of an appropriate professional. The articles and columns reflect only the present considerations and views of the authors and do not necessarily reflect those of the firms or organizations with which they are affiliated, any of the former or present clients of the authors or their firms or organizations, or the editors or publisher.

POSTMASTER: Send address changes to *Pratt's Privacy & Cybersecurity Law Report*, LexisNexis Matthew Bender, 630 Central Ave., New Providence, NJ 07974.

Negotiating Confidentiality Agreements in a Competitive Bid Scenario

By J. David Washburn and Soden Abraham*

The authors discuss the issues that a private equity buyer should keep in mind when negotiating a non-disclosure agreement.

This article identifies select issues that a private equity buyer ("PE Buyer") may wish to consider when negotiating a confidentiality agreement ("NDA") with a seller or its investment banker in a competitive bid process. The following is not an exhaustive list of all issues requiring the PE Buyer's consideration, and not all issues must be addressed in each case. Generally, it behooves the PE Buyer to be judicious when revising the NDA as this represents the seller's first impression of what a negotiation with the PE Buyer may look like during the remainder of the process. As a result, PE Buyers typically avoid whole-cloth revisions and focus on only the most pertinent issues to their business and the transaction as a whole.

UNILATERAL VERSUS MUTUAL NDAS

When receiving a seller's unilateral NDA, the PE Buyer's initial reaction may be to make it mutual. However, typically, mutual NDAs should be reserved for mergers and acquisitions ("M&A") transactions involving issuances of buyer equity or scenarios likely to require disclosure of the buyer's strategic plans. In most cases, cash will be used as consideration and the PE Buyer will not be providing any substantive confidential information. Keep in mind that sellers do not want to burden the company with unnecessary contractual commitments to numerous third parties – some of which may be competitors – as doing so could be viewed negatively by the yet-to-be-identified buyer.

In the event that the PE Buyer moves forward in the auction process and a legitimate need for a mutual NDA exists, the parties can easily enter into a separate amendment. With that said, the PE Buyer should always ensure that the NDA requires the seller and its representatives to keep the fact of the discussions between the parties, as well as any terms, conditions, or negotiations, confidential.

* J. David Washburn, a partner in the Dallas office of Katten Muchin Rosenman LLP, is co-chair of the firm's Mergers & Acquisitions and Private Equity practices. Soden T. Abraham is an associate in the firm's Dallas office. The authors may be contacted at david.washburn@katten.com and soden.abraham@katten.com, respectively.

A PURPOSE CLAUSE WITH A PURPOSE

NDAs usually limit the disclosure of confidential information to use in connection with evaluating the potential M&A transaction. Whenever possible, the PE Buyer should expand the permitted purpose clause to include the "negotiation, documentation, and consummation" of the M&A transaction. In the event that the PE Buyer successfully avoids the anti-reliance clause in the definitive agreement, this provision in the NDA can later be used to establish the reasonableness of its reliance on any extra-contractual representations received.

PERMITTED RECIPIENTS

The PE Buyer will obviously need to share confidential information with its representatives, including officers, directors, employees, legal counsel, accountants, financial and tax advisors, and agents. The PE Buyer will likely also want to ensure that potential sources of financing (whether debt or equity) are included in the list of persons entitled to receive confidential information. Sometimes, the seller may require the PE Buyer to reveal the identity of the financing source prior to the time that confidential information is disclosed (in order to maintain some control over the information or to preclude exclusive deals). Although NDAs typically hold the recipient responsible for unauthorized disclosures by its representatives, the PE Buyer may prefer to have its financing source enter into a separate NDA with the seller so that the PE Buyer avoids liability for any breach by a non-controlled party.

The PE Buyer may have numerous subsidiaries, portfolio companies, and affiliates with their own respective representatives. Since the PE Buyer could be liable for the breach of the NDA by one of those representatives (even if uninvolved in the transaction), the PE Buyer may consider defining its "representatives" as only those that actually receive the confidential information. Consider a scenario where an affiliate of the PE Buyer that has nothing to do with the transaction violates (knowingly or otherwise) the non-solicitation provision in the NDA. Many PE Buyers take the position that they should only be responsible for breaches of the disclosure and nonuse obligations of representatives that are recipients of the confidential information.

TERM

Keep in mind that the purchase agreement will normally include a confidentiality provision that would supersede the NDA. As a result, the term is probably best stated as the shorter of the agreed duration or the execution of the definitive agreement. It should also be noted that the PE Buyer would typically not agree to treat as confidential any information furnished by the seller before entering into the NDA.

RETENTION OF CONFIDENTIAL INFORMATION

Should negotiations break down, the PE Buyer will likely be required to return or destroy the confidential information received during the M&A transaction process. Traditionally, the decision to return or destroy the confidential information is at the PE Buyer's sole option as this minimizes the burden on the PE Buyer and ensures that its "work product" need not be provided to the seller. Of course, the PE Buyer's obligation to return or destroy the confidential information should only be triggered by the written request of the seller. In any event, the PE Buyer should ensure that it has the ability to retain the confidential information under specific circumstances.

For instance, the PE Buyer may:

(a) Be required to furnish the confidential information to a governmental authority as part of a routine examination, audit, investigation or other required regulatory inquiry;

(b) Need to retain the confidential information pursuant to its *bona fide* document retention policies or archived back-up procedures; and

(c) Want to retain the confidential information for "legal purposes" if litigation is a possibility.

In connection with (a) above, the PE Buyer should consider including a legal process exception so that it is not required to notify the seller of any disclosure of confidential information made as part of such routine examination, audit, investigation or other required regulatory inquiry.

NON-SOLICITATION

A standard form NDA for a sale process will virtually always contain a non-solicitation clause that restricts the PE Buyer or its representatives from soliciting or hiring any of the seller's employees for some period of time. PE Buyers, particularly those with investments in the industry, tend to request that this be limited to senior management or key employees of the seller introduced to the PE Buyer as part of the transaction (given the difficulty in "policing" the hiring procedures of portfolio companies for lower level employees). In this case, the seller will likely argue that the restriction must apply to all employees because it has a more important need to protect the value of the business for the benefit of the ultimate purchaser. The PE Buyer may have more success negotiating exceptions for general solicitations through advertisements or recruiting agencies, the solicitation of former employees of the seller, or the hiring of any person that contacts the PE Buyer or its affiliates on his or her own initiative.

DUAL ROLE CARVE-OUT

The PE Buyer may have representatives that are involved in the management of various portfolio companies or affiliates. If so, the PE Buyer may wish to provide that its portfolio companies and affiliates will not be deemed to have received confidential information of the seller solely due to the dual role of the PE Buyer's employees, partners or executive advisors as directors and officers of such portfolio companies and affiliates (so long as such employee, partner or executive advisor does not use or disclose the confidential information in his or her capacity as a director or officer of any portfolio company or affiliate of the PE Buyer).

ORDINARY COURSE INVESTMENTS AND THE USE RESTRICTION

The PE Buyer may wish to include a provision in the NDA permitting ordinary course investments. Specifically, it may be prudent for the PE Buyer to require the seller to acknowledge that the PE Buyer is in the business of providing equity financing and management advice to companies in the same industry as the seller and therefore the PE Buyer may evaluate, invest in, do business with or provide advice to companies that are competitors or potential competitors of the seller or its affiliates.

Moreover, the PE Buyer may ask the seller to agree that receipt of confidential information will not restrict or preclude the PE Buyer or its affiliates from investing in any business or entity that competes (or may compete) with the seller. In this manner, if the PE Buyer and the seller find themselves pursuing the same acquisition opportunity, the NDA's non-use restriction will not prevent the PE Buyer from continuing its pursuit.

RESIDUAL KNOWLEDGE QUALIFIER

The PE Buyer may wish to consider adding a "residual knowledge" or "enhanced knowledge" qualifier which provides that:

(a) The PE Buyer or its representatives may gain some general industry knowledge from reviewing seller's confidential information;

(b) Such new information cannot be separated from their overall knowledge; and

(c) The PE Buyer or its representatives will be permitted to use this general knowledge (or general knowledge enhancement) without restriction under the NDA.

Although these types of provisions were historically not included in M&A NDAs, they appear to be gaining traction and are now often included.

THE LEGEND TRAP

Virtual data rooms are commonly used by sellers to share diligence materials and often include a legend or "click wrap" acknowledgement that attempts to impose additional restrictions on users. The PE Buyer will therefore benefit from including a provision that states neither the PE Buyer nor its representatives will be subject to any such additional restrictions and that the terms and provisions of the NDA will exclusively control the exchange and treatment of the confidential information.

ATTORNEYS' FEES

The PE Buyer should consider requiring that the losing party in any dispute between the seller and the PE Buyer will be responsible for the fees and expenses (including legal fees) of the prevailing party. This is especially important because in some states (e.g., Texas) the PE Buyer, as the likely defendant in the case, may not be entitled to attorneys' fees even if it prevails in a dispute due to the absence of an explicit agreement providing for such fees.[1]

The PE Buyer must also be wary if the seller is a limited liability company in a state such as Texas where, in the absence of a mutual fees provision, the PE Buyer may not be able to recover attorney's fees even if it should win on a breach of contract claim.[2] The mutual fees provision would also guard against this potential pitfall.

TRADE SECRETS

In the event that the seller wishes to extend protection beyond the agreed term for any confidential information that also constitutes a trade secret, the PE Buyer may wish to (a) require that the trade secret not only be labeled as such on the cover of the confidential information but that it also meets the applicable state law definition, or (b) exclude the concept altogether on the theory that a separate trade secret agreement will be negotiated if the PE Buyer stays in the bid process. The PE Buyer may also wish to require advance notice that trade secrets will be revealed so that the parties can deal with the issue at the appropriate time.

---

[1] Chapter 38 of the Texas Civil Practice and Remedies Code, as amended (the "Texas Fee Statute"), permits a plaintiff to recover reasonable attorney's fees if the claim is based on breach of contract, but it does not permit a defendant who prevails to recover such fees. *See* Tex. Civ. Prac. & Rem. Code 38.001.

[2] The Texas Fee Statute only permits fees if authorized by statute or agreed to by contract, and a person may only recover from "an individual or corporation." *See* Tex. Civ. Prac. & Rem. Code 38.001. Due to this wording, Texas courts have held that a successful contract breach plaintiff cannot recover fees against a limited liability company where the fee claim is based on the statute. *See*, *e.g.*, *Dixie Carpet Installations, Inc. v. Residences at Riverdale, LP*, 599 S.W.3d 618 (Tex. App. Dallas 2020).

CONCLUSION

As discussed above, this article does not cover every issue that PE Buyers should consider when entering into a confidentiality agreement for an auction sale process. Care should be exercised to ensure that the most pertinent issues are properly addressed in the NDA to protect and minimize any risks to the PE Buyer.