

Confidentiality Agreements, Standstill Agreements, Letters of Intent and Exclusivity Agreements

PLI Presentation
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January 11, 2023

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When playing as a slideshow, this slide will display live content

Poll: 1. Have you negotiated a confidentiality agreement before?

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Poll: 2. Have you negotiated one in an M&A context?

Confidentiality Agreements

Overview

- Governs external examination and use of company information
- Precursor to exchange of information
 - Typically initiates M&A transaction
 - First draft is negotiable, but be practical
 - Guards against inappropriate disclosure and/or misuse of information

Confidentiality Agreements

Preliminary Considerations

- Will disclosure be unilateral or mutual?
- Is the target a public company?
- Are the parties competitors?
- Why will information be disclosed and how sensitive is it?
- Which representatives should have access to the information?

Confidentiality Agreements

Basic Framework: Definition of Confidential Information



- **When Representing the Disclosing Party**
 - Seek a broad definition, including:
 - Derivative materials (e.g., notes, summaries)
 - Prior and future disclosures
 - Information not explicitly marked as confidential
 - All manners of disclosure (e.g., oral, written, electronic)
 - Be sensitive to upstream confidentiality obligations
 - Be aware of obligations with respect to deal information

Confidentiality Agreements

Basic Framework: Definition of Confidential Information



- **When Representing the Receiving Party**
 - Seek a narrow definition
 - Resist including prior disclosures in definition
 - Include derivative materials only “to the extent” they contain confidential information and make sure such information need not be returned to the Disclosing Party
 - Ensure standard exclusions are included

Confidentiality Agreements

Basic Framework: Non-Disclosure and Non-Use



■ When Representing the Disclosing Party

- Limit use to evaluation of the “Proposed Transaction”
- Limit recipients to only those with a “need to know”
- For any permitted disclosures, require representatives to be bound by equally restrictive duties or substantially the same agreement and have the counterparty be responsible for any breaches by such representatives

Confidentiality Agreements

Basic Framework: Non-Disclosure and Non-Use



■ When Representing the Receiving Party

- Expressly include intended recipients and any financing sources as persons who can receive/use information
 - But recognize that recipient is typically liable for breaches by representatives, so a broader list may increase potential liability
 - May seek for certain representatives (e.g., financing sources) to sign a joinder and be directly liable for any breaches
 - Ensure agreement terms are complied with prior to disclosure to representatives
- Expand permitted uses to include all stages of the deal (e.g., negotiation, consummation and implementation)

Confidentiality Agreements

Basic Framework: Permitted Disclosures



■ When Representing the Receiving Party

- Include standard exceptions for disclosure required by law and governmental proceedings
- Companies subject to regulatory oversight (e.g., banks, investment funds) often seek an exception for ordinary course regulatory reviews

Confidentiality Agreements

Basic Framework: Permitted Disclosures



■ When Representing the Disclosing Party

- Consider requiring:
 - Advance notice/input on response
 - Efforts to avoid/minimize disclosure
 - Protective orders

Confidentiality Agreements

Basic Framework: Term

- Disclosing Party will want extended duration, while the Receiving Party will seek limited duration
- Term depends on the sensitivity and nature of the information involved
- 2-5 years is typical
- Trade secrets sometime subject to longer period

Confidentiality Agreements

Basic Framework: Return of Confidential Information



■ When Representing the Disclosing Party

- Confidential information remains property of the Disclosing Party; no implied license to the Receiving Party
- If there is a “return or destroy” option, requiring certification of destruction may provide additional comfort

Confidentiality Agreements

Basic Framework: Return of Confidential Information



■ When Representing the Receiving Party

- Insist on destroy option
- Provide for retention of copies made:
 - Pursuant to standard electronic backup procedures
 - To monitor compliance with the agreement
 - As required by law
- Avoid “automatic trigger”
 - Agree to return/destroy materials upon request

Confidentiality Agreements

Basic Framework: Liability/Remedies



■ When Representing the Disclosing Party

- Impose on Receiving Party affirmative obligation to take action to remedy breach or unauthorized use
- Provide for specific performance/injunctive relief
- Disclaim liability for quality of information



■ When Representing the Receiving Party

- Try to resist obligation to notify Disclosing Party of violations
- Be mindful of breadth of liability
 - Often includes responsibility for any breach or unauthorized disclosure, including those by representatives

Confidentiality Agreements

Basic Framework: Non-solicitation



■ When Representing the Disclosing Party

- May reach employees, customers, clients and/or vendors
- May be unenforceable if overbroad, so accept some limitations (e.g., protected persons, time period, exclusions for general advertisements and former employees)



■ When Representing the Receiving Party

- If the Disclosing Party is in the same industry, non-solicit could be equivalent of non-compete clause
- Carve out contacts made in the ordinary course of business and customary items such as general advertisements for employment

Confidentiality Agreements

Basic Framework: Other Common Provisions



■ **When Representing the Disclosing Party**

Consider including provisions relating to:

- No obligation to provide information or continue discussions
- Assignability of Disclosing Party's rights to enforce confidentiality agreement
- No access to or communications with Disclosing Party employees regarding proposed transaction (for orderly process)

Confidentiality Agreements

Big Picture Issues

- Antitrust issues may require separate “clean team” agreement
 - Consider limiting scope of disclosure and permitted recipients and creating “clean rooms”
- For public companies, insider trading and Regulation FD may be of concern
 - Consider including an acknowledgement of securities law obligations
- Receiving Party may want to protect against the *receipt* of too much confidential information

Standstill Agreements

Overview

- Commonly included in confidentiality agreements for M&A transactions if target is a public company; delete if target is not a public company
- Prohibits bidder from taking certain actions, including:
 - Acquiring target's securities
 - Commencing a tender offer
 - Otherwise trying to gain control of the target without board or management approval
- Requires bidder to negotiate directly with target for a certain period of time

Standstill Agreements



■ **When Representing Target**

- Resist overbroad termination provisions
- Resist most favored nation (“MFN”) clauses

Standstill Agreements



■ When Representing Buyer

- Limit coverage to affiliates and representatives under Buyer's control
- Consider including exception for acquisitions below a de minimus threshold
- Consider requesting MFN clause
- Provide for standard “fall-aways”:
 - Target signs “friendly” deal or fails to recommend against a tender offer
- Consider other, more aggressive “fall-aways”:
 - Hostile bid by third party
 - Target announces exploration of sale

Letters of Intent

Overview

- Description of Transaction
- Preliminary statement of basic deal terms
 - Structure, consideration, purchase price, adjustment, conditions to closing, employment issues, antitrust notification, indemnification, arbitration/governing law
- Generally non-binding, except for limited terms
- Allocation of fees and expenses
- Confidentiality provisions (if there is no separate confidentiality agreement); restrictions on public announcement
- Exclusivity

Letters of Intent

Advantages

- Identifies material deal terms (and deal breakers) at an early stage
- May reduce time and cost of completing definitive agreements
- Can facilitate regulatory compliance (e.g., HSR pre-merger notification filing can be submitted with LOI)
- Resource and time expenditure signals commitment
- Means to establish consistent expectations and exclusivity

Letters of Intent

Disadvantages

- Cost and resource expenditures required
- Can result in unexpected outcomes
 - Inadvertent creation of binding commitments
 - Inadvertent creation of duty to negotiate in good faith
- Hamstring future negotiating positions
- May trigger disclosure obligations for public companies

Letters of Intent

Binding Obligations

- Typically, substantive deal terms are non-binding, but process rules for the negotiation period are binding (e.g., confidentiality, exclusivity, fees and expenses, governing law)
- Rare to make entire term sheet binding
 - May arise in a highly competitive transaction or in a transaction in which the parties are comfortable moving ahead with a simplified agreement (but this comes with significant risk)
 - An LOI that purports to be binding is likely to give rise to a dispute regarding scope of the binding obligations

Letters of Intent

Binding Obligations

- Factors upon which courts may impute binding obligations:
 - Express language of the term sheet
 - Context of the negotiations between the parties
 - Whether the terms are sufficiently definite to be enforceable
 - Partial performance by one or both parties
 - Whether the subject matter is normally addressed in definitive written agreements

Letters of Intent

Binding Obligations

- To minimize risk that the LOI will be deemed to be a binding obligation:
 - Expressly provide that performance under the LOI is at the party's own risk and does not change the non-binding nature of the agreement
 - Avoid language expressing or implying "agreement"
 - Separate LOI into binding and non-binding sections
 - Characterize definitive agreement as condition precedent to any binding obligations other than expressly set forth in LOI

Letters of Intent

Duty to Negotiate

- Avoid inadvertent creation of a duty to negotiate in good faith
 - Expressly state the parties' intent to disclaim any such duty
- In some states (including CA, NY and IL), courts may recognize an implied good faith duty of negotiation even if the LOI itself does not constitute a contract

Letters of Intent

Duty to Negotiate

- If the parties intend for a duty to negotiate to attach:
 - Clearly state circumstances under which the parties may terminate and/or delineate what constitutes “bad faith”
 - Include expiration date for the LOI and any binding obligation (but be careful of behavior following such expiration)

Exclusivity Agreements

Overview

- Agreement by one party (usually the Seller) not to negotiate with anyone other than the other party (Buyer) for a set period of time
- Simple agreement, usually included within LOI or another preliminary transaction document
- Greater benefits to Buyer than Seller:
 - Allows conduct of diligence and negotiations without pressure from other buyers
 - Validates time and expense of due diligence
 - Provides window to obtain financing
 - Shifts leverage – Seller loses ability to create competitive tension with other buyers

Exclusivity Agreements

Basic Framework: No-Shop

■ Basics

- Negative covenant restricting Seller from “shopping” the business to other buyers
- Restricted parties may include Seller, its representatives and affiliates
 - Major shareholders typically not parties to the agreement, and there is a risk that they could “go shopping”
- “Alternative transaction” definition identifies activities that constitute breach

Exclusivity Agreements

Basic Framework: No-Shop



■ When Representing Buyer

- Be sure definitions of “representatives” and “affiliates” are sufficiently broad
- Require Seller to terminate existing discussions with other potential buyers
- Consider an automatic extension of the exclusivity period if negotiations are continuing

Exclusivity Agreements

Basic Framework: No-Shop



■ When Representing Seller

- Public companies should consider expressly including a fiduciary out because it will not be implied
- Resist automatic extensions of exclusivity period
- Consider terminating exclusivity period if Buyer is no longer willing to proceed with transaction at agreed price

Exclusivity Agreements

Basic Framework: Other Common Provisions

- Duty to Notify
 - Generally requires Seller to notify Buyer of the receipt of an offer or indication of interest
- Duration
 - Generally intended to cover the time period between an indication of interest or offer and the execution of the acquisition agreement
 - Commonly 20-30 days
 - If the exclusive negotiation covenant is very short, fiduciary out may not be necessary
 - Should terminate if Buyer declines to proceed before expiration