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Services

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Nondisclosure Agreements in Merger and Acquisition Transactions

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The disclosure of confidential information is unavoidable if you are selling your company, but public disclosure of your company's confidential information, such as financial information, intellectual property, and customer lists, could dull your competitive advantage and make it easier for companies to compete with you. If you are the seller in such a transaction, then the mere disclosure of the sale transaction could jeopardize your relationships with your employees, customers, and vendors. For these reasons, it is crucial that you take steps to protect your company's confidential information in a sale (mergers and acquisition or "**M&A**") transaction.

A well-drafted nondisclosure agreement ("**NDA**") will protect your company's confidential, proprietary, and otherwise nonpublic information. NDAs set clear expectations regarding the handling of confidential information by defining the scope of confidential information, setting out procedures for handling confidential information, and providing a legal cause of action against a party who violates the agreement.

What Type of NDA is Right for You?

The ideal type of NDA for you depends on the details of your transaction. There are two types of NDAs: mutual agreements and unilateral agreements. A mutual agreement prohibits both the seller and prospective purchaser from disclosing confidential information. A unilateral agreement binds only one party, usually the prospective purchaser, from disclosing confidential information.

Unilateral agreements binding the prospective purchaser are the most common type of nondisclosure agreement in M&A transactions. While a seller generally must disclose confidential information to the prospective purchaser to enable them to evaluate their prospective purchase, it is often unnecessary for a prospective purchaser to disclose confidential information to the seller. Note, however, that both parties will want to keep the potential M&A deal terms confidential, as well as the identity of the buyer and seller, and a mutual NDA may make sense for that reason.

If a prospective purchaser must disclose confidential information to the seller, then a mutual agreement is probably more appropriate for the transaction.

What Should Your NDA Say?

The provisions of your NDA will vary depending on the details of your transaction. This section presumes the use of a unilateral NDA, where the seller is the only disclosing party. Generally, your unilateral NDA should:

1. *Identify the parties to be covered by the NDA* – Make clear reference to the parties that will be bound by the NDA. In addition to the seller or prospective purchaser, this list may include third parties such as affiliates, subsidiaries, and advisors. Disclosure of information by the buyer to accountants, attorneys, bankers and the like will be permitted so long as they have a "need to know" the information and are bound by adequate confidentiality obligations. The buyer should be responsible for any breach of confidentiality by its representatives.

2. *Define confidential information* – Define what "confidential information" means. This definition may include information disclosed prior to the parties' entry into the NDA, information marked confidential, oral information, information derived from confidential information, and the prospective purchaser's interest in the transaction. As the party that carries the burden of proof in court to prove a violation of an NDA, the seller will desire a broad definition of confidential information. In contrast, the prospective purchaser will seek to narrow the definition of confidential information in order to limit their legal exposure. The seller should beware of requirements that information be stamped "confidential," because they may have already shared sensitive information that was not stamped in such manner. Also, pay attention to the exceptions to confidential information, such as information previously known to or independently developed by the buyer, which exceptions should impose the burden of proof and documentary evidence requirement on the buyer.

3. *Explain the permitted uses or restrictions on use* – Explain how the prospective purchaser may use confidential information. Generally, the seller should permit the prospective purchaser to use confidential information to evaluate the purchase but restrict use so that the prospective purchaser may not use such information to compete against the seller or for other purposes that are not related to the proposed transaction.

4. *Provide the standard of care* – Provide the standard of care that the prospective purchaser must adhere to in order to protect the seller's confidential information. For example, your agreement may provide that the prospective purchaser must protect the seller's confidential information using the same efforts that it uses to protect its own confidential information, but not less than a reasonable degree of care. Alternatively, the agreement may provide for specific measures, such as password protection.

5. *Create obligation to return or destroy information* – Create clear expectations as to what the prospective purchaser should do with information when negotiations terminate, whether because of the closing of the sale or the deal failing.

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6. *Set the term of the agreement* – Set the length of time that the NDA binds the parties. Time limitations for NDAs may vary, and the proper time limitation will depend on the nature of the confidential information that may be disclosed. Some courts will only enforce an NDA that contains reasonable time limitations. Three to five years is typical, but trade secret protection and source code should have indefinite protection.

7. *No representations by the seller; ownership of intellectual property; no obligation to enter into an agreement* – The seller should clearly state that no representations or warranties are being made to the buyer as to the disclosed information and that the seller retains ownership of all its intellectual property rights in the disclosed information. Neither party is obligated to enter into any kind of transaction as a result of the NDA.

8. *Other issues* – These include choice of law and jurisdictional provisions to benefit you in the event of litigation, the right to ask the court for an injunction if the buyer breaches the NDA, and possibly non-solicitation provisions to prevent a prospective purchaser from poaching the seller's employees, customers or vendors.

Conclusion

Protecting your confidential information in an M&A transaction is crucial to continued business success. In contemplation of such a transaction, you should limit the shared information and limit the number of people involved in the disclosure process. A well-drafted NDA is an indispensable tool that can put such limits in place and protect your business interests in an M&A transaction. A Kutak Rock attorney can prepare an effective NDA tailored to your specific needs.

If you have questions, please contact a member of Kutak Rock's Scottsdale Corporate & Securities Group. You may also visit us at www.kutakrock.com.

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