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Confidentiality Agreements Matter – Three Recent Cases Impacting Private Equity Transactions

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SUMMARY OF THE CASES

A confidentiality agreement ("CA") is typically the first negotiated document in a purchase transaction. These agreements are often negotiated by junior members of the transaction team prior to one (or both) parties engaging outside legal counsel. CAs set the stage for a transaction and, as recent cases have shown, can define the playing field in the event that a deal falls apart. Three cases decided in the last 70 days highlight the significant effect a CA can have after the parties have decided not to pursue a transaction.

On May 4, 2012, the Delaware Court of Chancery issued an opinion in *Martin Marietta Materials, Inc. v. Vulcan Materials Co.* enjoining Martin Marietta's hostile takeover attempt of Vulcan for four months. The decision was affirmed by the Delaware Supreme Court on July 10, 2012. Martin Marietta and Vulcan signed two CAs in connection with discussions regarding a possible merger. While neither of the CAs included an express standstill, the court found that the definition of transaction and the CAs' restrictions on the use and disclosure of confidential information effectively prevented Martin Marietta from using the confidential information it received from Vulcan in a hostile takeover. In addition, the court found that Martin Marietta breached its non-disclosure obligations in the CAs by disclosing some of Vulcan's information and information regarding the transaction discussions in Martin Marietta's SEC filings and that such disclosure was not permitted by the CAs' exceptions for "legal requirements " Thus, in certain situations where a party may not even use the confidential information about a target, a subsequent event which requires comprehensive disclosure may require a party to disclose references to discussions regarding the potential transaction and cause the disclosing party to potentially be in breach of the CA.

On May 18, 2012, the Delaware Supreme Court issued an opinion in *RAA Management, LLC v. Savage Sports Holdings, Inc.*, finding that a provision in the CA which stated that Savage, the target, was not making any representations with respect to its information, together with RAA waiving any claims with respect to the potential transaction, shielded Savage from liability related to potentially fraudulent misrepresentation. RAA alleged that Savage fraudulently stated that it did not have any "significant unrecorded liabilities" and RAA relied on this representation when it incurred expenses negotiating the deal and performing due diligence. The court held that extra-contractual fraud claims are barred by carefully worded non-reliance provisions.

TAKE-AWAYS

1. CAs will likely be more heavily negotiated in light of recent decisions.
2. Beware of unintended consequences when entering into CAs (e.g., certain language in a CA could have the same effect as a standstill agreement).
3. Different provisions, with slight variances in defined terms, could significantly impact your bargained-for protections (e.g., certain "non-use provisions" might prevent a sponsor from pursuing an unrelated transaction with a different target that operates in the same industry vertical as the target with which the sponsor is negotiating the CA).

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On June 25, 2012, the United States District Court for the Southern District of New York, applying New York law, issued an opinion in *Goodrich Capital, LLC, et al. v. Vector Capital Corporation* that did not dismiss a breach of contract claim that was based on an alleged violation of a provision in the CA which limited the use of confidential information. Broadly construed, a non-use provision under this ruling could prevent potential buyers from pursuing an unrelated transaction with a different target in the same industry vertical. Goodrich alleged that Vector used information provided by Goodrich to evaluate a target in the same industry (which resulted in a transaction that was actually consummated). The court found that since Goodrich had provided Vector with the name of its ultimate target, Goodrich's claim for breach of the CA's non-use provision could survive Vector's motion to dismiss.

While each of these cases relates to different facts, a common thread is that after each potential transaction died, a party sued on a theory of a breach of the underlying CA. Based on these recent cases, we expect CAs to be more heavily negotiated. Like all negotiated documents, parties should carefully parse the language of the CA and consider potential unintended consequences of the language used.

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