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Top Issues in Non-disclosure Agreements

A non-disclosure or confidentiality agreement is often the first binding agreement entered into in contemplation of an acquisition. This article focuses on some of the typical provisions found in a non-disclosure agreement in the context of an acquisition, which we refer to here as the “proposed transaction.”

Generally, at the early stages of a proposed transaction, potential buyers desire specific information about the target company in order to evaluate the proposed transaction and to determine the value of such target company for purposes of making a bid. A non-disclosure agreement is essential to protect the target company’s confidential and proprietary information and trade secrets from misuse subsequent to disclosure to a potential buyer. Set forth below is an overview describing each of the provisions that should be considered when entering into any non-disclosure agreement for a proposed transaction.

Definition of Confidential Information

The definition of “confidential information” identifies the information that is subject to the non-disclosure agreement. In order to best protect its business interests, the target company will want a broad definition of confidential information, which often will include all written, electronic and oral information, along with any notes, interpretations, analyses or other documents created by the potential buyer which were derived from the information provided by the target. Additionally, the target company should consider including the fact that the proposed transaction is being contemplated in the definition of confidential information.

Potential buyers will want to limit the definition of confidential information in order to limit their exposure under the non-disclosure agreement. In furtherance of this goal, the following information is generally carved out as exceptions to confidential information:

- i. information which is generally available to the public;
- ii. information which was available to the potential buyer prior to entering into the non-disclosure agreement;
- iii. information received from a third party that is not bound by confidentiality restrictions; and
- iv. information independently developed by the potential buyer without the use of confidential information.

Permitted Recipients

Any non-disclosure agreement should clearly establish which of the potential buyer’s representatives will be permitted to receive access to the target company’s confidential information. Typically, permitted recipients include directors, officers, employees, agents, partners, attorneys, accountants, bankers and financial advisors of the potential buyer. In certain situations, permitted recipients may also include portfolio companies, financing sources, subsidiaries and affiliates. In either case, it is standard to require, at a minimum, that the potential buyer inform all recipients of the terms and conditions of the non-disclosure agreement. In some cases, there is an explicit requirement that the representatives agree to be bound by the terms of the non-disclosure agreement prior to receiving any confidential information.

It is common for the potential buyer to negotiate a broad definition of permitted recipients which allows a wide variety of persons to have access to the confidential information. This may be a double-edged sword, however, because the potential buyer is typically liable for unauthorized disclosures of the confidential information by its representatives.

Permitted Disclosures

Although the goal of the target company is to protect its confidential information from disclosure, at some point a potential buyer may be required to disclose confidential information. For example, a subpoena or other legal proceeding may require that the potential buyer disclose such information. Typically, such disclosures are permitted in the non-disclosure agreement, provided that the potential buyer provides the target company with prior notice that such disclosure will be made.

Non-Solicitation of Target Company Employees

The non-solicitation provision prohibits the potential buyer (and sometimes its representatives) from soliciting or otherwise inducing target company employees to terminate their employment in order to work for the potential buyer (and its representatives). Often, the non-solicitation provision is the most heavily negotiated provision within a non-disclosure agreement. With that in mind, the length of such provision must be reasonable or it will be difficult to enforce. A reasonable non-solicitation provision typically has a term of eighteen months to two years.

In most cases, the target company wants broad non-solicitation language that covers all employees and contractors. The potential buyer, on the other hand, will request that the non-solicitation provision be limited to only those employees that they were introduced to or made aware of through evaluating the proposed transaction. A compromise is often reached that covers high-level employees and all employees that they were introduced to, made aware of or received confidential information about. Typically, exceptions are carved out for general solicitation through advertising or search firms.

Return or Destruction of Confidential Information

A provision dealing with the return or destruction of confidential information becomes important if the proposed transaction is not consummated. A target company generally requests that the potential buyer return all disclosed confidential information along with any derivative information generated by the potential buyer. This can become burdensome on the potential buyer, which typically wants the option to either return or destroy confidential information. Generally, exceptions are carved out to allow the potential buyer to retain electronically stored data and one copy of the confidential information in order to comply with laws or its own internal retention policies, as long as such information is not used in any manner.

Term

Most non-disclosure agreements for a proposed acquisition terminate at some point, usually after two years. Depending on the nature of the confidential information, a target company may consider bifurcated termination provisions for information that is particularly valuable to its business, such as long-term government contracts or intellectual property. It is worth noting that some non-disclosure agreements are perpetual, but at some point a majority of the disclosed information becomes stale and useless.

If you have any questions about non-disclosure agreements, please contact a member of our [Corporate Practice Group](#) or one of the authors of this alert.

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