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M&A Confidentiality Agreements

Strategies for Sellers and Buyers Negotiating Non-Disclosure Provisions

WEDNESDAY, MAY 18, 2011

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

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Confidentiality Agreements in the M&A Transaction

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Overview

❑ Confidentiality Agreements:

- Arise in various contexts, including M&A, employment, sharing of intellectual property, joint ventures and other business relationships
- Protect sensitive information and transaction details from disclosure
- Prevent improper use of Information
- May give Seller control over process

❑ Significance:

- Often viewed as “standard” or “boilerplate” but may have unintended consequences, restricting Buyer’s activities in the industry and Buyer’s options as the negotiations progress, even if a transaction never materializes
- Terms may prove very consequential in the event of a subsequent dispute between the parties

❑ Mutuality: One-Way or Two-Way?

- Sellers often “hold the pen” on the CA, resulting in Buyers receiving proposed CAs that are “one-way,” serving only to restrict Buyer’s activity.
- Buyers often modify the CA to restrict Seller if Buyer will be disclosing information to the Seller.
- Other provisions often made “symmetrical” include: restrictions on disclosing deal info and identities of parties, forum selection, “No Deal Until There’s a Deal” provisions, and remedies.

Selected Issues

- ❑ Definition of Confidential Information
- ❑ Definition of Representatives and Responsibility for Breach
- ❑ Permitted Uses of Confidential Information
- ❑ Keeping Quiet About the Deal and “Stalking Horse” Risk
- ❑ Disclosures Required by Law
- ❑ Non-Solicitation of Employees & Standstills
- ❑ Financing and Clubbing Provisions
- ❑ Return or Destruction of Materials
- ❑ “No Deal Until There’s a Deal”
- ❑ Disclaimer of Accuracy of Confidential Information
- ❑ Term
- ❑ Enforcement and Remedies
- ❑ Applicable Law & Forum/Where Lawsuits May Be Brought
- ❑ Indemnification and Legal Costs

Definition of Confidential Information

“Confidential Information” is usually defined broadly to include:

“any information concerning the Seller (whether prepared by the Seller, its Representatives or otherwise and irrespective of the form, manner or nature of communication) which is furnished to Buyer [before the date hereof,] now or in the future [by or on behalf of the Seller] ... and any notes, analyses, compilations, studies, interpretations or other documents prepared by Buyer **to the extent** that they contain, reflect or are based upon, in whole or in part, the information furnished to Buyer pursuant hereto.”

- ❑ Buyers often include “to the extent” language for derivative materials to prevent entire documents from being tainted by a single piece of Confidential Information. Buyers may also add that information is included to the extent connected to the proposed transaction.
- ❑ Certain kinds of information may be particularly sensitive (e.g., privileged information; trade secrets). Disclosures to competitors may implicate antitrust or other laws.
- ❑ Broad definition of Confidential Information makes it important to focus on exclusions to the definition.

Competitively Sensitive Information / Antitrust

- ❑ Transactions and business relationships involving competitors pose special concerns
 - Sensitivity about sharing pricing, marketing and other competitive commercial information
 - Antitrust laws and business implications

- ❑ Varied approaches
 - Sellers may exclude sensitive information from disclosure or defer disclosure until later in the process
 - Disclosure may be limited to outside advisors or selected individuals
 - Disclosures may be limited to aggregated information or sensitive information may be otherwise masked
 - Mutual exchange of competitively sensitive information often avoided

Exclusions from Confidential Information

Buyers also seek to add the following common exclusions to the definition of “Confidential Information”:

“Confidential Information shall not include:

- (i) information that is or becomes **generally** available to the public [**other than through the fault of the receiving party**] [**other than through a breach of this Agreement**];
- (ii) information that was within Buyer’s possession prior to its being furnished to Buyer by or on behalf of the Seller pursuant hereto or becomes available to Buyer from a source that was not [**known by Buyer** [after due inquiry] **to be**] **bound by** an obligation of confidentiality [prohibiting disclosure of such information to Buyer] [with respect to such information]; or
- (iii) information that is **independently developed by Buyer** or its Representatives without the use of any Confidential Information.”

- ❑ Buyers usually require that all of these exclusions apply to the “Confidential Information” definition and not only to the “non-use” or “non-disclosure” provisions.
- ❑ By applying these exclusions to the **definition** of “Confidential Information,” information that falls within the exclusions is excluded from the CA’s restrictions.

Definition of Representatives

The definition of “Representatives” determines with whom the Buyer may share Confidential Information:

“Representatives shall include the directors, officers, partners, employees, agents, **affiliates** (as such term is defined under the Securities Exchange Act of 1934, as amended), **financing sources**, or advisors of such party **and those of its subsidiaries, affiliates and/or divisions** (including, without limitation, attorneys, accountants, consultants, bankers and financial advisors).”

- ❑ Buyers often prefer an expansive definition (this could be a double-edged sword as Buyer is often responsible for breaches by Representatives)
- ❑ Sellers may subject Representatives to other restrictions in the CA (e.g., disclosure/use; standstill; non-solicit).
 - Buyers often seek to have other provisions of the CA apply only to Representatives “acting on Buyer’s behalf” and should pay careful attention to which provisions apply to Representatives, particularly if affiliates are included.
- ❑ “Affiliates” is usually defined by reference to the U.S. securities laws.
- ❑ If financing may be required, Buyers may seek to include “financing sources” or “potential financing sources” in the definition. Sellers may propose additional constraints on information sharing with financing sources, especially equity financing sources who could be competing bidders.

Responsibility for Representatives

Sellers usually seek to have Buyer liable for breaches by its Representatives:

“Buyer will [cause] [direct] its Representatives to observe the terms of this agreement, and will be responsible for any breach of this agreement by any of its Representatives.”

□ Variations:

- limited to responsibility for breaches by its “officers, directors and employees”;
- provide Representatives with a copy of the CA and direct Representatives to comply with the CA’s confidentiality provisions; and
- to have Representatives sign a “joinder” to provide Seller with a direct remedy against Representatives.

“... the Confidential Information may be disclosed to [Buyer’s] Representatives ... **who have agreed to be bound by the confidentiality provisions hereof in a separate writing for the benefit of the Company; [provided that this requirement shall not apply to [Buyer's] employees, officers and directors (for whom [Buyer] agrees to be responsible in the next sentence) or to attorneys (who are already bound by a duty of confidentiality).]** [In any event, [Buyer] shall be responsible for any breach of this agreement by [Buyer's] [Representatives] [employees, officers or directors.]”

Permitted Uses of Information and Use Restrictions

Seller will try to limit the permitted uses of the Confidential Information:

“Buyer [**will not disclose**] [**will keep confidential**] the Confidential Information to any person and will not use the Confidential Information either for any purpose other than to evaluate, [**negotiate, finance and/or consummate**] a **possible [negotiated] Transaction [or in any way detrimental to the Company]**; [provided, however, that **Buyer may disclose Confidential Information to its Representatives ...**].”

- ❑ “Will not disclose” vs. “Will keep confidential”
- ❑ Buyers generally seek to ensure that they may disclose information to their Representatives, raising issues concerning the definition of Representatives and responsibility for breaches by Representatives.
- ❑ While not common, Buyers may also seek to expand the permitted uses of Confidential Information beyond “evaluating” a potential Transaction but also to negotiating, financing and consummating it.
- ❑ Buyers tend to resist vague limits on use of Confidential Information:
 - Prohibitions on “detrimental” usage may expose Buyer to unknown liabilities and restrictions (e.g., backdoor non-solicit or non-compete?).
 - Being permitted to use the information only to pursue a “negotiated” transaction may serve as a “backdoor” standstill.

Financing and Clubbing Provisions

Sellers may impose restrictions regarding financing sources in order to better manage the auction process:

“Buyer shall not disclose any Confidential Information to any actual or potential financing source (debt, equity or otherwise) or coventurer without the prior written consent of the Seller [such consent not to be unreasonably withheld, conditioned or delayed].”

“Buyer agrees that, without the prior written consent of the Seller, Buyer will not restrict the ability of any of its potential financing sources to provide financing to any other party with respect to a transaction.”

- ❑ The size of the transaction and likelihood of needing to partner with others will influence the importance of these provisions.
- ❑ When these types of restrictions are imposed (and cannot be deleted), Buyers often seek to:
 - Provide Seller with notice, rather than consent, rights;
 - Limit discretion of Seller in refusing to give consent;
 - Where appropriate, bifurcate treatment of debt and equity financing sources;
 - Resist restrictions on exclusivity arrangements with financing sources.

Keeping Quiet about the Deal & “Stalking Horse” Risk

- ❑ Sellers frequently prohibit Buyers from disclosing information concerning on-going negotiations or other transaction details.
- ❑ Buyers often seek to prevent the Seller from disclosing the terms or conditions of Buyer’s proposals or Buyer’s identity/involvement to other bidders or to the public.
 - Hinders the Seller from “shopping” Buyer’s bids.
 - Reduces premature publicity and disclosure risks.
- ❑ Where Seller has proposed limiting Buyer’s ability to disclose transaction details, easiest approach is often to make provision mutual/two-way.

“In addition, **each party agrees** that, without the prior written consent of the other party, it will not disclose to any person (other than its Representatives), the fact that the Confidential Information has been made available to you, that discussions or negotiations are taking place concerning a Possible Transaction **or any of the terms, conditions or other facts with respect thereto, including the status thereof and the identity of the parties thereto** (collectively, the “Discussion Information”).”

Disclosures Required by Law

Buyers typically seek to preserve their right to make legally required disclosures and share information with regulators and courts:

“In the event that either party or such party’s Representatives is **requested or required (by law**, oral questions, interrogatories, requests for information or documents in legal proceedings, subpoena, civil investigative demand or other similar process) to disclose any of the Discussion Information or Confidential Information, such party shall, **to the extent permitted by law**, provide the other party with prompt written notice (**and, to the extent practicable, prior notice**) of any such request or requirement ... and **may make such disclosures without liability hereunder.**”

- ❑ “requested or required”
 - Buyers may propose that disclosures may be made if “requested” pursuant to judicial process or by a governmental entity since Buyer may want the option of disclosing even without a court order or subpoena.
- ❑ “to the extent permitted by law” and “to the extent practicable”
 - Buyers often clarify that they have no obligation to notify if notifying would be illegal.
 - Sellers generally prefer “prior” notice (this may be burdensome to Buyer).

Non-Solicitation of Employees

Seller will often seek to limit Buyer's ability to solicit employees:

“Buyer agrees that, until the **[third]** anniversary of this Agreement, without the prior written consent of the Seller, **Buyer** will not solicit to hire [or hire] any **[officer or management-level]** employee of the Seller [to whom Buyer is [first] introduced in connection with the evaluation of a Transaction] ...”

- ❑ Non-Solicit vs. No-Hire
- ❑ When the Seller is in the same business/industry as the Buyer, both parties are likely to have heightened sensitivity – Buyers may seek to have the non-solicit be “two-way,” also restricting Seller’s activity
- ❑ Buyers generally seek to limit the non-solicit to solicitations by “Buyer” (and not also to Representatives).
 - Consider implications for the scope and drafting of any joinder agreements with Representatives
 - Buyer may want to limit to those within its organization that have access to confidential information (especially if far-flung operation, or many affiliates)
- ❑ Term: Buyers generally seek to limit the term of the non-solicit to one year, depending on business needs.
- ❑ Scope: Buyers may seek to limit the scope of the non-solicit to minimize substantive restrictions and lessen the administrative burden. Alternatives include:
 - Limiting scope to “officers or management-level” employees
 - Limiting scope to employees (first) introduced to Buyer in connection with evaluating the Transaction

Non-Solicit Carve-Outs

Buyers generally seek to further limit the scope of the non-solicit by including some or all of the following exclusions:

“provided, however, that the foregoing will not prohibit Buyer from:

- (i) using solicitations not targeted at employees of the Seller, or employing any person who responds to such solicitations;
- (ii) using search firms, or hiring any persons solicited by such search firms, so long as such firms are not advised by Buyer [after the date hereof] to solicit employees of Seller;
- (iii) hiring, employing or discussing employment with any person who contacts Buyer independently without any solicitation by Buyer; or
- (iv) soliciting any person who has left the employment of the Seller prior to Buyer soliciting such person.”

Standstill

Sellers may propose a “standstill” to ensure an orderly auction and prevent “hostile” bids:

“For the period [ending the earlier of (i) two years from the date of this agreement and (ii) the date the Company enters into a definitive agreement with another party with respect to a Transaction] neither Buyer [nor its Representatives [acting on Buyer’s behalf] will without Seller’s prior consent: (i) acquire or offer to acquire any [voting] securities [5% or more of the outstanding voting securities of Seller] or assets of the Company [material assets, outside of the ordinary course of business, constituting 5% or more of the Company’s assets (measured by fair market value) or providing 5% or more of the Company’s revenue] ... (ii) propose any extraordinary transaction involving Seller ... (iii) solicit proxies or influence the management or policies of the Seller ... or (iv) participate in a “group” in connection with the foregoing. **Buyer agrees not to request or otherwise seek a waiver or amendment of any of the terms of this paragraph, including this sentence.**”

- ❑ Buyers often seek to limit the term of the standstill to 6 months to 18 months.
- ❑ Fallaway: Buyers may also seek to have the standstill “fall away” in certain circumstances, such as once the Seller signs up a deal with another party, or if the Seller becomes subject to a “hostile” bid, to preserve Buyer’s options.
- ❑ Buyers often seek to carve out from the standstill *de minimis*/minor acquisitions of securities and ordinary course and non-material asset acquisitions.
- ❑ Buyers typically seek to limit the reach of the standstill to actions by the Buyer and, if Seller insists, to Representatives acting on Buyer’s behalf.

Standstill (cont'd)

- ❑ Buyers may seek to preserve their ability to make confidential, non-public proposals to Seller, notwithstanding the standstill's other restrictions.
- ❑ Buyers often pay particular attention to the potential impact that the standstill could have on other M&A activity by Buyer (e.g., buying another company that happens to own securities of the Seller)
- ❑ Buyers may also seek to preserve the right to engage in ordinary course transactions with the Seller (such as buying Seller's products or services or engage in on-going business relationships).
 - As prohibitions may not even reach such activities, be wary of “negative implications” arising from well-intended clarifications

“provided, that **the foregoing shall not limit** Buyer in any way from:

- (a) making any confidential offers or proposals to the Company;
- (b) acquiring or offering to **acquire, directly or indirectly, any company or business unit thereof that beneficially owns Company securities** so long as (1) such prior acquisition of such securities was not made on Buyer's behalf and (2) such securities do not constitute all or substantially all of such company's or business unit's assets);
or
- (c) making any offer or entering into any transaction with respect to, or otherwise consummating, any transaction in the ordinary course of business or the parties' on-going business relationships.”

Most Favored Nations Clause (MFN)

- ❑ MFNs arise where Buyer seeks to ensure it receives the most preferential terms granted to any other Buyer – considered aggressive

“If the Company enters into any confidentiality agreement (or any amendment thereof or waiver thereof) [**relating to a transaction similar to the Transaction**] that contains **any provision that is [materially] more favorable to the other party to such agreement than the provisions of this Agreement (a “More Favorable Agreement”)**, including (without limitation) with respect to the nature and scope of the restrictions on such party, the duration of such restrictions and any exceptions to such nature, scope or duration, the Company shall promptly provide Buyer notice thereof and a copy of such provision (which need not identify such other party), and upon such notice [**unless Buyer elects otherwise within five days of such notice**] this agreement **shall be deemed to be amended** to conform the provisions of this agreement with such more favorable provision. [**The Company represents and warrants that it has not entered into any More Favorable Agreement as of the date hereof.**]”

- ❑ Still the exception rather than the rule; sellers seek to retain flexibility to respond to individual circumstances and avoid renegotiating closed points
- ❑ May apply broadly to all provisions in the confidentiality agreement (as in the above example) or only to selected provisions (e.g., the standstill or the non-solicit) or key points (e.g., scope or duration).

Return or Destruction of Materials

What happens to Confidential Information after negotiations have ended?

“At any time upon the request of the Seller for any reason, Buyer will promptly either **deliver and return** to Seller **or (at Buyer’s election) destroy** all Confidential Information ...”

- ❑ Buyers usually seek to preserve their option to **destroy** (rather than return) Confidential Information.
 - Returning all Confidential Information is a significant administrative burden (especially Confidential Information held by Representatives).
 - Confidential Information may also include analyses developed by Buyer or proprietary models that include Confidential Information.
 - Buyers typically prefer to avoid having to “certify” destruction and provide notification instead.
- ❑ Note that the definition of Confidential Information typically encompasses all information generated by Buyer or its Representatives that contains, reflects or was derived from Confidential Information but was not directly provided by Seller – (e.g., notes, summaries, analyses or models).
 - Sellers are generally amenable to destruction of Confidential Information within such “derivative” material, but sometimes are more insistent that other Confidential Information be returned.
 - Buyers often refuse to “return” derivative material to the extent that such material reflects the Buyer’s own notes and/or analyses.

Return or Destruction of Materials (cont'd)

Buyers may also propose additional carve-outs for electronically stored data, document retention policies, for compliance purposes and even to defend or maintain litigation relating to the confidentiality agreement or confidential information:

“... provided, that Buyer shall only be required to use **commercially reasonable efforts** to return or destroy any Confidential Information **stored electronically**, and neither Buyer nor its Representatives shall be required to return or destroy any electronic copy of Confidential Information created pursuant to its or its Representatives’ **standard electronic backup and archival procedures**, [provided that (i) personnel whose functions are not primarily information technology in nature do not access such retained copies and (ii) **personnel whose functions are primarily information technology** in nature access such copies only as reasonably necessary for the performance of their information technology duties (*e.g.*, for purposes of system recovery)].

“Notwithstanding the foregoing, Buyer and each of its Representatives may each retain one copy of any Confidential Information[, **in the offices of its [outside] counsel**], to the extent required to [**defend or maintain any litigation relating to this Agreement or the Confidential Information**] comply with **legal or regulatory requirements, established document retention policies or demonstrate compliance with this Agreement ...**”

“No Deal Until There’s a Deal”

Both Buyers and Sellers usually clarify that neither party is under any obligation to consummate a transaction until a definitive, written agreement has been executed:

“Each party agrees that unless and until a final, binding, written definitive agreement regarding a Possible Transaction between the Seller and Buyer (a “Definitive Agreement”) has been mutually executed and delivered, neither the Seller nor Buyer will be **under any legal obligation** of any kind whatsoever by virtue of this **letter agreement or any other written or oral expression** with respect to such a transaction by a party or any of its Representatives (except for the matters specifically agreed to herein).”

Both parties usually clarify that either of them may reject proposals, discontinue negotiations and terminate discussions at any time and for any (or no) reason to avoid the imputation of any obligation to negotiate in good faith:

“Each party reserves the right, in its sole discretion, to reject any and all proposals made by the other party or any of its Representatives with regard to a Possible Transaction, and to terminate discussions and negotiations with the other party or its Representatives at any time and for any reason or no reason.”

Disclaimer of Accuracy of Confidential Information

- ❑ Sellers will typically disclaim any representations/warranties that the Confidential Information is “accurate” or “complete.”
- ❑ Buyers generally seek to qualify any such disclaimers/limits on liability with reference to the potential “Definitive Agreements” to preserve their leverage and rights with respect to errors in Confidential Information and content of reps/warranties:

“Subject to the terms of any Definitive Agreement,

- (i) Buyer understands and acknowledges that neither the Company nor any of its Representatives makes any representation or warranty, express or implied, as to the accuracy or completeness of the Confidential Information; and
- (ii) Buyer agrees that neither the Company nor any of its Representatives shall have any liability to Buyer or to any of Buyer’s Representatives relating to or resulting from the use of the Confidential Information or any errors therein or omissions therefrom.”

Enforcement and Remedies

“It is further understood and agreed that money damages would not be a sufficient remedy for any breach of this letter agreement and that [the Company] [**both parties**] shall be entitled **to seek** equitable relief, including, without limitation, injunction and specific performance, as a remedy for any such breach.

Such remedies shall not be deemed to be the exclusive remedies for a breach of this letter agreement but shall be in addition to all other remedies available at law or equity to the non-breaching party.”

- ❑ Importance of Equitable Relief
- ❑ Mutuality/Two-Way (“both parties shall be entitled”)
- ❑ “To seek” equitable relief
 - Buyers often agree only to authorize the “seeking” of equitable relief to avoid relinquishing other arguments that may be available to defeat specific performance and the granting of an injunction.

Indemnification and Legal Costs

Seller may request an indemnification from Buyer or that Buyer reimburse Seller for legal costs if Seller is successful in litigation:

“Buyer agrees to **indemnify and hold harmless** Seller and Seller’s Representatives for any loss arising out of a breach of this agreement.”

“If a court of competent jurisdiction determines **in a final, nonappealable order** that this letter agreement has been breached by a party or by its Representatives, then such party will **reimburse the other party for its reasonable, documented costs and expenses, including attorneys’ fees.**”

□ Indemnification

- Practices varies with respect to indemnification obligations in confidentiality agreements
- Buyers often resist

□ Attorneys’ Fees/Costs:

- Buyers often do not agree to pay Seller’s attorneys’ fees but may accept a “Loser Pays” formula whereby the “winner” in a lawsuit has its costs and fees (including attorneys’ fees) reimbursed by the non-prevailing party (this may deter frivolous lawsuits).
- Mutuality

Term

Buyers prefer that confidentiality agreements contain a provision limiting their term:

“This confidentiality agreement, and all obligations hereunder, shall terminate upon the earlier of (i) **[two years]** from the date hereof [and (ii) the entering into of a Definitive Agreement [between the parties hereto] [the consummation of a Possible Transaction] with respect to a Possible Transaction].”

- ❑ Sellers usually prefer no term for various reasons, including special sensitivities with regard to certain information (e.g., trade secrets) and may seek longer or indefinite terms.
- ❑ Buyers often prefer that their obligations last one year or less and resist obligations extend beyond two years.
 - Special consideration should be given to the term if the agreement contains a standstill or non-solicit.
 - The standstill and non-solicit provisions may have their own term.
- ❑ Early Termination - Sellers are likely to resist early termination of the CA upon the Seller signing up a deal with another party or upon consummation of a deal.
 - Such “fallaways” are more likely to be accepted by Seller in the context of specific restrictions, such as the standstill or non-solicit.

Applicable Law: What Law Governs the CA?

“This letter agreement shall be governed by and construed in accordance with the laws of the State of [Delaware] [New York] applicable to agreements made and to be performed entirely within the State of [Delaware] [New York] without regard to any conflicts of law principles.”

- ❑ Practice varies as to which state’s law is chosen to govern the confidentiality agreement.
- ❑ Parties often seek to rely upon the law of their state of incorporation or principal place of business.
- ❑ English law is often used in cross-border deals.
- ❑ Important to clarify that “conflicts of law” principles will not apply to override the choice of law agreed upon in the confidentiality agreement.

Forum Selection: Where Can Lawsuits Be Brought?

Parties often seek to require that lawsuits – whether brought by Buyer or the Seller– be brought **only** in the courts of a specific state (e.g. New York or Delaware).

“Each party hereby irrevocably and unconditionally

- (i) consents to **submit to the [exclusive] jurisdiction** of the courts of the State of **[Delaware located within New Castle County] [New York located within the County of New York]** and of the United States of America located in the [District of Delaware] [Southern District of New York] for any actions, suits or proceedings arising out of or relating to this agreement and the transactions contemplated hereby (“Actions”) **(and agrees not to commence any Action except in such courts),**
- (ii) waives any objection to the laying of venue of any Action in the courts of the State of [Delaware] [New York] or the United States of America located in [State of Delaware] [Southern District of New York], and
- (iii) waives and agrees not to plead or claim that any such Action brought in such court has been brought in an inconvenient forum, or that venue is improper in such court, or that such court does not have jurisdiction over its person or the subject matter.”

- ❑ Mutuality/Two-Way (“each party agrees” not just “Buyer agrees”)
- ❑ Exclusive vs Non-Exclusive
- ❑ Cross-Border Deals: The courts of England are often used for cross-border deals.

Signatories – Who is Signing the CA?

- ❑ Buyers generally seek to have the Seller itself sign the CA to avoid difficulties in enforcing provisions that benefit the Buyer (e.g., limiting where Buyer may be sued; “stalking horse” provisions; restrictions on Seller disclosing Buyer’s confidential information)
- ❑ In rare cases, Seller may request that its banker or other financial advisor sign on its behalf. In such cases, the following provision is often inserted:

“[Investment Bank] and the Company each represents and warrants that [Investment Bank] has all requisite power and authority to execute and deliver this letter agreement on behalf of the Company, and that this letter agreement has been duly and validly executed and delivered on behalf of the Company and, assuming due execution and delivery by you, constitutes a legal, valid and binding obligation of the Company, enforceable against the Company in accordance with its terms.”