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KIRKLAND **M&A UPDATE**

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NDA Use Restrictions — Use With Caution

Recent decisions in Delaware and New York emphasize the potential unforeseen consequences to buyers of broad "use restrictions" in NDAs.

Much attention deservedly has been focused on the recent Delaware Chancery and Supreme Court decisions in the high-profile Vulcan/Martin Marietta case where the courts found that a "use restriction" in a confidentiality agreement (*i.e.*, a provision that limits the recipient's "use" of the disclosing party's confidential information to a specified purpose) could in certain circumstances preclude the recipient from later commencing a hostile offer for a target company even absent an explicit standstill. A recent decision by Judge Rakoff in the Southern District of New York refusing the defendant's motion to dismiss shows that "use restrictions" may also limit the ability of a recipient party to pursue an alternative opportunity after receiving confidential information under a non-disclosure agreement (NDA).

In the New York case (which at these preliminary stages accepts as true the factual allegations of the plaintiffs), a private equity investor signed an NDA with a broker/advisory firm that was seeking financing for a corporate client to implement a business idea in the cash management industry. The NDA stated that the PE firm would only use the confidential information shared by the broker to explore a potential business transaction involving the broker and the broker's client. After actively considering a number of transaction opportunities with the broker and its client, the broker asserted that the investor later pursued and completed an acquisition of one of the potential targets allegedly identified by the broker without including the broker and its client.

The broker alleged that the PE firm had breached the NDA by wrongfully using the confidential market insights about the cash management industry shared by the broker with the investor in order to pursue its own acquisition and thereby avoid a fee obligation to the broker. The PE firm argued that the NDA only covered a transaction that actually in fact involved the broker, and that the broker's proposed broad reading of the use restriction represented an "unreasonably indefinite obligation" on it not to enter the cash management industry.

The court rejected the PE firm's position and found that the NDA in fact imposed a very clear "definite obligation" — not to use the broker's confidential information other than for the specific purpose stated in the NDA (*i.e.*, pursuing a transaction involving the broker and client).

The court's reasoning was notably similar to the Delaware decisions in *Vulcan*. Just as the Delaware courts accepted that the NDA covering information shared in the consideration of a friendly deal did not by itself preclude a later hostile offer, the New York court did not find that the PE firm was necessarily prohibited from pursuing an alternative transaction in the cash management industry. However, in both cases, the courts found that in pursuing these permitted opportunities the recipient of confidential information under the NDA is not allowed to violate its explicit agreement with the disclosing party not to use confidential information shared by the other party for purposes other than those specified in the NDA.

While Judge Rakoff's decision was at a preliminary stage of litigation, was fact-specific and involved a damages claim for a fee (rather than injunctive relief), it still offers some cautionary lessons to parties entering into NDAs with use restrictions. In the M&A context, acquirers are usually asked to agree that they will only use the potential target's confidential information to explore a negotiated acquisition of the target. If the deal fails after the due diligence stage, the putative acquirer is exposed to the risk of claims that it "stole" and misused the target's confidential materials if it later pursues a similar opportunity through internal resources or via another acquisition.

This recent court decision in New York, coming on the heels of the *Vulcan* decisions in Delaware, emphasizes the potential unforeseen consequences to buyers of broad "use restrictions" in NDAs. Parties asked to agree to use restrictions should consider drafting changes to mitigate some of these unanticipated outcomes (*e.g.*, seeking express acknowledgment that the buyer may pursue similar deals or opportunities) while also taking steps (*e.g.*, internal firewalls) to buttress an argument that confidential information was not later misused in violation of the NDA.

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