MAKING THE DEAL
NEGOTIATING MERGERS & ACQUISITIONS
CHRISTOPHER S. HARRISON
MAKE THE DEAL
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Christopher S. Harrison currently serves as Chief Investment Officer of The Falconwood Corporation, a financial management firm and research laboratory that has incubated and operated numerous highly successful financial and technological ventures.

Having managed billions of dollars in successful investment transactions, including debt, equity, and real asset ventures, Mr. Harrison earned a reputation as a superb negotiator and business strategist. During his eight years at Cravath Swaine & Moore, one of the world’s most prestigious law firms, he handled numerous high-profile debt, equity, and M&A deals. As co-head of the market-leading asset management M&A practice at Schulte Roth & Zabel, the premier investment management law firm, he ran some of the most sophisticated public and private deals and facilitated the strategic growth of several prominent financial services and asset management businesses.

Mr. Harrison teaches popular courses at NYU School of Law on the financial and legal aspects of negotiating and investing in business transactions. He is a regular speaker at industry conferences and webinars.

He holds a JD degree, cum laude, from NYU School of Law, where he focused on law and economics.
Looking back, I have come to realize that careful attention to transaction details played a critical role in the businesses I founded over the course of my career. Thinking strategically about potential outcomes—and setting the stage in the contract to navigate them in the future—was critical to my success.

—Dr. Henry G. Jarecki

My proposal turned the tables. I had conveyed it cautiously. Sound legal advice had been hard to come by. None of the lawyers I had hired could do more than follow technical instructions. As the clock was working against us, I followed my intuition on what our legal rights were. As desperate as things stood for our company, I figured that I could not possibly make things worse.

The effect was stunning. Triumphantly smug a moment before, the guys on the other side backed down. Perhaps they had known the weakness of their position all along and played hardball to get the better of us. After all, they were a large national player with a reputation for running over minor league players like us. Perchance I surprised them. Or had they not thought seriously about our side of the issue, let alone the business implications of their own legalese? At that moment, I realized how crucial legal knowledge was to running a business.
From that conference room, I took the shortest way to law school—only to find in my subsequent career that corporate practice is effective only if business judgment and legal expertise coincide.

That is the impetus of this book. It brings business, finance, and law together, showing how legal form configures the economic outlook, and how to support a business strategy with a legal framework. More specifically, it is designed as a tool for individuals in both business and law—in-house, in practice, or in training—to understand how merger and acquisition (M&A) deals are negotiated and how acquisition contract terms impact economic outcomes. It analyzes current techniques and mechanics used in acquisition agreements and shows how to design deal terms to meet the needs of your particular transaction.

In the larger scheme of things, this book may be a small step further down the road of commoditizing and quantifying legal advice. But I hope this book will also caution against overdoing it. As the review of actual deals will show, each is different. There is no “one size fits all” solution. Effectively combining different elements, applying the law to a specific situation, and calculating the economic effect of contract terms requires skill, intellect, and often a good dose of ingenuity that is not inherent in any commoditized form of legal advice.

Creativity (among other human faculties) does not come in a box. If, in that conference room, I had not been able to find a new perspective, to think outside and beyond the paradigm that the legal experts—including my own counsel—had presented me, the company I managed would have ended up like the other small fry. It is innovation that, more often than not, will give you an edge.

What makes M&A practice such a rich experience is that almost every deal is distinct in its facts, the business issues at stake, the economic trends in play, and the personalities and negotiating tactics involved. Given the number of variables, a deal can take on many different forms. It is crucial to understand that these different forms will invariably produce different legal and economic results. Structuring to solve business issues—and sorting out business issues resulting from the structure—is what M&A is all about.

The art of negotiating has been much dwelled on, but it is absolutely useless when the reasons for having a provision are not understood, when the follow-on implications of winning or not winning a point escape the players, or when they come to the negotiating table without any idea regarding their company’s or client’s backup positions. How will you know when a point is worth the fight, when to give in, and when to walk away? How will you know what to ask for in the first place? Before getting cute at the negotiating table,
you have to understand your business goals and your options—including the legal terms with which to achieve them. Otherwise, your art will backfire: “In my many business negotiations, I have always been amazed that the other side will ask for something that is less advantageous to them than the deal they already have,” notes one of my clients.

This book starts by examining the various agreements that practitioners have to negotiate before actually sitting down to talk about the acquisition agreement. These include confidentiality agreements, standstill agreements, exclusivity agreements, and letters of intent or memoranda of understanding. These agreements protect the parties from economic disadvantage due to the deal process, set rules for the negotiations, and define preliminary objectives.

Separate chapters of this book show how the core elements of an acquisition agreement—that is, purchase price mechanics and adjustments, representations, covenants, conditions, material adverse effect clauses, financing contingencies and reverse breakup fees, fiduciary outs to top a public deal and indemnities—function within the context of a deal. Each chapter explains how a component is negotiated in real life with the purpose of creating value for and balancing risks between the parties. Comparing various strategies for solving business problems, some methods to provide for “rough justice” while other approaches are more refined. Transaction techniques often make a difference—and sometimes all the difference. The chapters include war stories to demonstrate potential pitfalls and bring out the relevance of certain techniques. In addition, statistics on how deal terms are negotiated in practice give an overview with regard to the prevalence of certain provisions and thus a sense for the market. Finally, sample provisions from actual contracts model the language that make a particular deal work.

This book next analyzes the overall framework of an acquisition agreement. It examines the different deal structures—that is, stock sales, mergers, asset sales, and complex structures—and lays out the criteria according to which practitioners choose (or should choose) between them.

**War Stories**

War stories from practice bring home the flavor of what is at stake in actual deals. Highlighting why drafting matters, the crux of each story elucidates the problems the parties grappled with, sidelined, or simply overlooked. Their successes and failures show the lessons learned. After all, to understand—and laugh at—the mistakes of others is the best way to appreciate why a point is important.
War Story

Thirty war stories reveal the workings of deal terms by way of example. The core issues at stake are conceptually “based on a true story,” but they are all works of fiction. Each mistake and problem described in those sections has happened in practice. The stories that go with them, however, bear no relationship to actual transactions. Any correlation to any real parties or lawyers—especially those who made mistakes or ended up on the wrong side of unexpected events—is purely coincidental.

The Market

Lawyers have been slow to quantify their expertise. But with the passage of time, and the continuously improving ease with which lawyers can gather and crunch the numbers on other deals, a more quantitative mind-set is filtering into practice.

This book uses quantitative analyses to see how deals fit into observable patterns of the marketplace, while, at the same time, cautioning against a simplifying, precedent-oriented approach to deal-making. After all, a weighted-average set of terms would, in fact, suit no one. And the examination of any one deal point in a vacuum can lead the parties to overlook the interactions among deal points or the specific needs of the parties at hand.

Nevertheless, as quantitative studies of transaction terms begin to proliferate, deal-makers will more frequently be pushed by the force of precedent into standardized provisions, paving the way for majority terms to become more and more dominant. As time goes by, the average may become the norm, whether or not the average fits the facts of a particular deal. Knowledge of what constitutes “market terms” (i.e., terms that have become commonplace in transactions) has become critical to arguing a position and can be a helpful tool for convincing the other side that a position is fair.

THE MARKET

Nearly 100 “The Market” sections are culled from studies of deals in which the author participated, as well as from a variety of other publicly available studies. As such, the data represent a generalized meta-analysis derived from numerous independent sources.

Quantitative analyses vary meaningfully from study to study. Different results are generated by:
• Sample size. The smaller the sample, the more they can be influenced by outlier deals.
• Sample selection. Rarely do studies consider all available data. How they pick and choose affects the results.
• Period reviewed. Trends change, by definition. The period studied matters.
• Mix of deal types. Different deal types constitute their own market. More or less of one type skews the results.

To help avoid the illusion that quantitative analysis of deal terms is a precise science, all results in this book have been rounded to the nearest 5 percent, or to thirds or halves, depending on the context.

Sample Provisions

Sample provisions illustrate model wording and key drafting choices. Frequently, these examples represent “form” language, or wording a practitioner would use as a starting point before changing it to fit a particular deal.

Sample Provision

Over 140 “Sample Provisions” are based on formulations used by the author as well as actual public deal precedents.

[Bracketed text] usually indicates a drafting choice. It shows an issue buyers and sellers may negotiate, or a provision that is more or less aggressive. Brackets are also used to summarize missing text, in order to focus an example on the primary topic.

Underlining is used to emphasize key words or phrases.
Litigation Endnotes

Good contracts are negotiated in the shadow of litigation. Rules of contract construction tell us that the court’s primary job is to interpret the intent of the parties, who are relatively free to draft any provision they wish.

Courts do this by first giving a plain-English interpretation to the words on the page. In doing so, courts often assume the lawyers understand the underlying case law. Practitioners, in contrast, often draft as if the dictionary rather than case law provides the primary resource for giving meaning to the words they draft—and the topics they decide to avoid and be silent on. Case law provides the backdrop for lawyers to determine when silence works for them or against them, and when they should try to clarify ambiguity.

Some of the cases that elucidate these issues are interspersed throughout this book in approximately 100 litigation endnotes. They are not intended to provide a definitive statement of case law in any particular jurisdiction. Instead, they highlight the kinds of issues that must be dealt with in drafting, to avoid your client’s falling into similar litigation.
Overview of the Predeal Process

Deals start in many different ways but progress along a relatively standard track. After one party introduces the concept of a deal to the other side, the predeal process kicks in.

If there is sufficient interest in a serious discussion, the first step is to negotiate a confidentiality agreement. This agreement protects the target’s sensitive business information, and requires the deal talks to be kept secret. A confidentiality agreement can also include other key transaction process terms. Those can include:

- A “no-poach” provision (also called “no-hire” and nonsolicitation provisions) that restricts the bidder from trying to hire away the target’s best employees, and
- A “standstill” that prevents the bidder from taking potentially hostile moves against a public company if a friendly deal cannot be negotiated.

If a deal is potentially worth the diligence effort, the bidder may ask for exclusivity. An exclusivity agreement prevents the target or sellers from working with competing bidders during a limited period of time. This gives the
bidder breathing room and comfort that the sellers are not negotiating with another bidder in the room next door.

In many cases the parties next go into full contract negotiations. If the deal is complex, they may first lay out the key terms in a term sheet, or in the more narrative form of a letter of intent. Such documents provide a deal summary and make sure the parties are generally on the same page before going into detailed, full transaction documentation. Term sheets and letters of intent are almost always nonbinding summaries of where negotiations stand; they do not represent a binding contract, but are merely a road map for the more formal contract to be drafted.

Each of these agreements is discussed separately in the next chapters.

**Confidentiality Agreements**

In almost any deal, a potential buyer will require access to nonpublic information regarding the target. This so-called “due diligence” review attempts to ferret out unexpected information regarding the target, its structure, liabilities and its prospects, and to refine the buyer’s financial analysis.

Although a buyer may often propose an indicative price or price range before completing its due diligence review, the buyer normally needs extensive private information before finalizing the binding deal price.

Depending on the target, some public information may be available. Very little public information will be available to the buyer if the target business is privately owned, which makes the buyer heavily reliant on the diligence process.

If the target is a public company, basic information will be available under the Securities and Exchange Commission’s (SEC’s) disclosure requirements, including historical financial statements. If the target business is a division or part of a public company, its SEC filings would not be specific enough for a buyer, especially if there are no separately reported “segment” financials for the target business. Whatever the situation, more information is always necessary.

To accommodate both the buyer and the seller, the target normally provides diligence information, but on the condition that the buyer agrees not to disclose it to third parties or use it for any purpose other than to evaluate the deal at hand.

Targets have good reason to avoid sharing information unnecessarily. Competitors may exploit the information for competitive advantage, or potential start-ups may strategically use the data in determining whether to
enter the market. A target may also suffer in its commercial dealings with customers if they learn the target's internal profit margins.

The core restrictions in a confidentiality agreement and how they operate are summarized below. This chapter also discusses the scope of what has to be kept confidential and several exceptions, the obligation to “return or destroy” information and the end of the process, and when and how confidentiality agreements terminate.

This chapter focuses on confidential information. However, the parties frequently enter into two-way agreements. For example, the target may conduct some diligence on the buyer, if any of the consideration will be in the form of buyer stock, and the buyer will want the target to keep the deal talks quiet.

**Due diligence**

There are several reasons for due diligence. One derives from the fiduciary duty of care that a corporate board has under corporate law. In addition, under securities laws that govern the offer and sale of stock, the issuing company and its board of directors (and others) can be held liable for material misstatements or misleading omissions made in connection with that sale. Under these same securities laws, the board can invoke a defense that relieves it of liability: it needs to show that it exercised due diligence in carrying out its responsibilities.¹ Conducting a thorough business and legal diligence review has become a central part of creating that due diligence defense.

Due diligence, however, is about more than avoiding securities law liability. It goes back to the Roman law doctrine of caveat emptor, or “let the buyer beware.” Under that doctrine, the buyer could not recover from the seller for defects that rendered an asset unfit for ordinary purposes unless the seller actively concealed latent defects. As discussed in the indemnity chapter,² the buyer's ability to recover for losses is limited in several ways. Because of these limitations, the rule of caveat emptor still applies. Sales are relatively final exchanges, and it is the responsibility of the buyer to ensure that it is satisfied with the bargain before entering into the contract.

**War Story**

A strategic investor was looking to buy a stake in a particular Asian venture that had been brought to its attention. The deal was small for the buyer, but the prospects looked great. Given the transaction size, the buyer thought that the diligence budget had to be kept small.
The sellers presented due diligence documents claiming that the target held a long-term, exclusive license to intellectual property rights to music in important markets outside of its home country. The diligence documents were all in English. They had been officially translated, all the way down to the stamped and sealed certificate from the state-owned music company.

It all looked good to the U.S. lawyers and diligence team. The buyer and target signed an exclusivity agreement and started negotiating a deal. As the transaction progressed, the buyer also engaged local counsel in the target’s home jurisdiction.

When local counsel reviewed the underlying (local language) diligence documents that had been “translated” into English, they were shocked. The target did not have an exclusive license to intellectual property at all—the target merely acted as an “agent” in marketing the intellectual property rights of others. There was no license, and their agency relationship could even be terminated at will at any time.

With a little more digging, it turned out that the local official who provided the official English translation was related to a board member of the target.

The buyer simply walked away, without pursuing fraud charges that could be embarrassing. The buyer lost its investment in time and legal fees, but close due diligence protected it from a much larger loss. The buyer never investigated whether the target gave up after that, or simply went shopping for a less careful buyer.

Restrictions on disclosure

Confidentiality agreements restrict the buyer from disclosing confidential information to third parties. This is the core element of the contract.

While this restriction may seem simple enough, it begs the question of who exactly counts as a third party and who does not. Normally, an exception allows confidential information to be disclosed to “representatives” of the buyer. Representatives include the bidder’s internal personnel, and external agents such as the financial advisors, accountants, and lawyers. That leaves everyone else as a third party.

Sample Provision

Recipient shall keep all Confidential Information received by it confidential and shall not disclose such Confidential Information, in whole or in part, to any person, except that Recipient may disclose Confidential Information to those of its Representatives who need to know the Confidential Information for the purposes of evaluating the Potential Transaction, provided that such Representatives are informed by Recipient of the confidential nature of such information and are bound by contractual or professional confidentiality terms substantially similar to those set forth herein.
The exception for representatives permits disclosure only to those who “need to know” the details in order to play their role in the transaction. The result is a kind of working group disclosure concept. The deal team gets the information it needs, but outside of the deal team, the data flow is cut off.

**Restrictions on use**

The use of confidential information by the buyer is also restricted by confidentiality agreements. While the restriction on disclosure defines the working group allowed to receive confidential information, the restriction on use determines what they can do with it.

Consider what a potential buyer could do with the target’s information if there were no restriction on its use. For instance, the potential buyer could use it to compete against the target in the future. Targets often express concern that strategic bidders may start negotiations merely to gain access to such data. Some targets view providing data to potential competitors as a necessary evil to get a deal done. Restrictions on use are one of the ways to help limit the potential damage from confiding in a competitor. Actually enforcing a restriction on use, however, is challenging.

**War Story**

There was great interest in the auction, since the target had made quite a name for itself as an innovator in a stodgy industry. It was almost viewed as “one of a kind.”

A large potential strategic buyer sent an entire deal team of 25 people from various departments for a week of in-person diligence sessions with the target. They sat through meetings with key management of each division, talked through the target’s projections, and chatted about the prospects for the target’s latest and greatest ideas. They were serious. They negotiated hard, as would be expected, and they stuck out the process until quite late in the game.

Eventually, the target selected a private equity buyer and finalized a deal. The private equity buyer wanted to consolidate the target into one of its existing portfolio companies in the industry and was willing to pay a hefty price.

For four months, the target and the new private equity buyer worked through the process of obtaining antitrust approval, securing the buyer’s financing, and obtaining target shareholder support. After that, they had an integration job ahead of them, which would distract their best management talent for yet another few months.

Once the target was ready to get back to business and continue their push to change the marketplace, they discovered a new competitor—the same strategic buyer that had lost out in the auction!
As far as the target could tell, none of the actual confidential information had been misused. They had no evidence of a breach. But they could not shake the feeling that they had just trained the competition and then given them over half a year to catch up while the target was distracted by the minutiae of closing and integration.

The customary restriction on use is a simple statement confirming that the target’s confidential information will not be used for any purpose other than evaluating the deal at hand. As a practical matter, it is difficult for a target to know how information is used by a bidder. And it may be impossible for a buyer to avoid indirectly or implicitly using what it has learned.

**Sample Provision**

Recipient shall not use any Confidential Information for any purpose other than to evaluate the Potential Transaction.

So much rides on the meaning of the three-letter word “use.” Relying on the word “use” in this context is an example of the drafting style that puts enormous weight on interpreting inherently vague terms in a variety of unpredictable contexts. Other examples include the concepts of “reasonableness” and “reasonable best efforts,” and notions of “materiality” and the term “material adverse effect.” At the same time, acquisition agreements also include inflexible and potentially arbitrary rules in other contexts, such as a defined expiration date or “drop-dead date.”

**War Story**

A start-up mining company struck a good deal and acquired rights to a rich set of mineral deposits. It promptly went looking for capital to develop a large mine. Obviously, it required all its potential investors to sign a standard confidentiality agreement.

One potential strategic investor decided the price was too high. After spending a lot of time focused on the region, that investor thought the small mining company had overlooked untapped surrounding areas. Rather than do a deal with the start-up company, that investor started buying up mining rights nearby, on the cheap.

It turned out that the investor was right: those nearby rights were in fact more valuable than the target’s location. The investor started putting money into the development of substantial mining operations, and the start-up company soon found its fledgling operations dwarfed by larger operations all around it.
The start-up company sued. It claimed that the big mines were developed only because the investor used the start-up company’s confidential information to discover how rich the region could be.

The investor countered that the start-up company had provided no data whatsoever on the surrounding land. The start-up company was actually trying to lay claim to the spark that shined light on the prospects of the region. That kind of claim, the buyer argued, went beyond the realm of protective intellectual property rights.

Eventually, a state court judge with little experience in commercial matters had to decide. It found for the underdog, and awarded the investor’s entire mining operation to the small company as compensation for the breach.

Confidential information exists not only on paper but also in the minds of the bidder’s management team. Assume the bidder knows how high the target’s projections are, and assume the bidder has spent a lot of time talking to the target about the catalysts that will determine its success. How could the bidder ignore those facts when making strategic decisions? How would the target or even the bidder know which catalysts the bidder would have focused on if they had not been pointed down the path blazed by the target?

Agreements rarely, if ever, attempt to distinguish what types of implicit uses of memory are permitted and which are not. At least the restriction on use does clearly prohibit uses of physical representations of the information, such as the bidder’s handing over the target’s product design plans to the bidder’s research and development team.

Definition of “confidential information”

Use and disclosure restrictions broadly apply to all “confidential information” (or “evaluation material”). These terms typically start with a broad definition, covering all information related to the target business provided by the seller (or its representatives) to the buyer (or its representatives), whether or not it is actually confidential. The definition generally covers oral as well as written disclosures.

Sample Provision

The term [“Confidential Information”] [“Evaluation Material”] means all information relating to the Target that is furnished to the Buyer by or on behalf of the Target, together with any summaries, analyses, extracts, compilations, studies, or other documents (whatever the form or data storage medium) that contain, reference, are based upon, or otherwise reflect such information relating to the Target.
In addition to covering raw data provided by the seller, the buyer’s internal analysis of that data is also covered. In other words, if the buyer evaluates and summarizes the seller’s business prospects using confidential information, the buyer’s own work product is restricted the same way as direct confidential information.

In some cases, a narrower concept of confidential information is used. Under that approach, confidential information is defined as all information that is, well, confidential. Since that begs the question of what is confidential, the definition is sometimes further limited to information that is actually stamped or marked as “Confidential.” This puts a burden on the target to mark every relevant piece of paper and every e-mail, so is often avoided by targets in the context of deal diligence.

Carve-outs from the scope of confidential information

As previously noted, confidentiality agreements usually start by covering, in overbroad strokes, all information provided by the target. Then, the contract cuts back the coverage through specific exceptions to the definition of the term “confidential information.” Information excluded from that definition is, for the most part, generally excluded from all the restrictions under the confidentiality agreement.

“Generally known by the public”

Information that becomes generally known by the public is normally excluded from the definition of confidential information. If the financial press or trade journals report facts about the target’s business, there is no longer the same justification for the seller to restrict the buyer from using that nonpublic information in the same way any other competitor or third party could use it.

Of course, other competitors may not have any certainty as to the accuracy of the information and, unlike the potential buyer, may not understand all the related “mosaic” of facts that provide context.

**Sample Provision**

The term “Confidential Information” does not include any information which:
(i) is or becomes generally [available to] [known by] the public other than as a result of disclosure, directly or indirectly, by Recipient or its Representatives [in violation of their obligations under this Agreement], […].
In some cases the potential buyer may use and disclose information that is “generally available” to the public, even if it is not actually “generally known” to the public. Neither standard is well defined. It may not be clear in any particular instance whether information is sufficiently public to meet these exceptions.

On its face, “generally available” means that public accessibility is all that counts, rather than actual public dissemination. The phrase “generally known” does not present the same issue, but does beg the question as to how broadly understood any particular piece of information needs to be before the exception applies.

If the potential buyer leaks confidential information and causes it to become publicly available, the potential buyer cannot profit from its own breach. The exception would not apply in that case. Theoretically, if the potential buyer’s representatives inadvertently disclose confidential information, all of its competitors could freely use the data, but not the buyer.

**Already in the buyer’s possession or received from an appropriate third-party source**

Information already in the buyer’s possession, or which it later receives from a third party, is often excluded from the definition of confidential information. If the buyer already has details about the target before it enters into deal talks, the buyer can continue to use that preexisting information. If the bidder learns information about the target through legitimate means outside of the diligence process, then that information stays outside of the reach of the confidentiality agreement. The bidder will not lose the ability to use data merely because the target reproduces a copy of what the bidder already has free use of.

**Sample Provision**

The term “Confidential Information” does not include any information which: […] (ii) was within or comes into Recipient’s possession on a nonconfidential basis from a source (other than the Target or any of its Representatives), [provided that Recipient is under the reasonable belief [after reasonable inquiry] that such source is not bound by a confidentiality agreement with or other contractual, legal or fiduciary obligation of confidentiality or secrecy to the Target [or any other party] with respect to such information].

In other cases, the seller wants to lock up the buyer from using and disclosing any confidential information—even if the buyer already had that
information before signing the confidentiality agreement or separately obtains it afterwards. In that case, the seller would delete this exception.

Usually, this type of exception does not apply if the buyer receives the information by inappropriate means—for example, if the buyer received it from a source, such as a former consultant to the target company, that passed on the information in violation of the source’s own obligations to the target.

What constitutes an “inappropriate” source varies from agreement to agreement. Sometimes, the buyer cannot use this type of exception if the source violates a duty of confidentiality to the target. Sometimes, the exception does not apply if the source breaches any duty to any party, even if not owed to the target. Sometimes, even if there is such a breach of duty by the source of the information, the buyer loses the benefit of this exception only if it actually knew (or, sometimes, if it should have known) that it was provided in breach.

**Independently developed by the buyer**

Information that the buyer separately develops without using the target’s confidential information may also be excluded from the definition of confidential information. For instance, if the buyer’s M&A team learns about a business technique from the seller, while the buyer’s internal research and development team is busy independently developing the same or a similar technique, the fact that the buyer’s M&A team also learned it from the seller will not stop the buyer from using its own, internally developed, version of that technique. The buyer would argue that it should not lose the benefit of its own product development as a cost of evaluating a deal with the seller.

**Sample Provision**

The term “Confidential Information” does not include any information that: [...] (iii) is developed by Recipient or its Representatives independently of and without reference to any Confidential Information, [provided such independent development can be reasonably proven [by Recipient] [by Recipient’s written records]].

Enforcement of this exception is challenging. Targets often fear that it would be impossible to prove that the buyer’s internal development teams used the target’s ideas. Sometimes this leads the target to avoid the independent development exception altogether, particularly when as a practical matter the information in question is unlikely to be independently developed.
Sometimes the target adds language that shifts the burden to the buyer to prove it did not misuse confidential information in its development process. Proving a negative is difficult for a buyer, however.

The best way for the target to protect its innovative ideas is to simply withhold the most sensitive information until a later stage of negotiation, if it discloses the ideas at all before closing.

**War Story**

The target’s law firm developed a transaction technique that, in its view, would allow a new class of deals to be done on a tax-free basis. Others had struggled with, and generally avoided, that type of transaction because of all the thorny tax issues.

The investment bank that was hired to provide a fairness opinion on the deal wanted its counsel to confirm that the transaction would be tax free. Otherwise, the after-tax proceeds would be relatively small and the price would not be as fair as it seemed.

The target’s law firm refused to disclose their tax theory. After some push-back, they agreed to explain the tax structure, but only if the investment bank’s counsel signed a confidentiality agreement without an “independently develops” exception. The target’s law firm was afraid that the investment bank’s lawyers would use the exception by seeking out an opportunity to independently develop and recreate the technique.

The investment bank’s lawyers were dumbfounded. Their tax experts were convinced that they, too, could easily come up with the newfangled tax structure on their own if needed for a particular deal. They did not want to be locked out of working on a whole class of transactions for fear of being sued over misappropriating the tax technique.

The target’s lawyers insisted on protecting their big idea. The investment bank’s counsel refused to yield. Since neither side would budge, the investment bank ended up giving the fairness opinion without diligencing the tax-free nature of the deal.

**Disclosures required by law**

Confidentiality agreements permit the buyer to make legally required disclosures. For instance, the buyer may need to disclose information regarding the seller’s business in a court proceeding relating to the deal, or could be compelled by securities laws and stock exchange regulations to disclose that it is engaged in talks for a potential transaction.
The parties may expand this exception to also include information requested by a governmental authority, even if not required to be disclosed. Regulated entities, in particular, will frequently keep their regulators apprised of confidential deals as they are proceeding. And they may want to provide information requested by the regulator, whether or not legally required to do so, in order to maintain good relations with that governmental authority.

Of course, if disclosure is required by law, the buyer will have to make the disclosure, whether or not doing so violates a contractual obligation to the seller. Since this exception applies, the buyer will not put itself in breach by making legally required disclosures. In other words, this exception shifts the risk of such disclosures to the seller, in the sense that the seller bears the loss of control over the information without recourse.

Procedural rights protect the target from inappropriate decisions by the buyer about what is required to be disclosed. The first line of protection is to require the buyer to give the seller notice of required disclosures. This provides an opportunity for the seller to pursue formal protections from a court, such as a protective order or limits on the scope of information disclosed. In order to make protective filings or challenge the buyer’s conclusions, the buyer would need prior notice.

Prior notice of required disclosures is not practicable or permitted by law. For instance, particular European anti-bribery laws require a bidder
to inform the authorities if it discovers bribery on the part of the target, but make it illegal to inform the target that the bidder has made such a report.

On occasion, actions of the bidder itself give rise to the legal requirement to disclose—which in turn triggers the exception under the confidentiality agreement that permits such disclosure. In some cases, the target has argued that the buyer should not be allowed to cause the disclosure requirement and then take advantage of the exception.  

**Return or destroy**

After a deal has died, the potential buyer no longer needs confidential information about the target. The target can require the potential buyer at any time to return to the target or destroy all physical and electronic forms of confidential information held by the potential buyer.

The potential buyer may prefer to destroy—rather than deliver to the target company—the buyer’s own internal reports that evaluate and comment on the target’s confidential information. Those evaluations (including, for instance, the embedded market and synergy assumptions) are proprietary information of the buyer.

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**Sample Provision**

Upon the Target’s request, Recipient and its Representatives will promptly return to the Company or destroy any and all Confidential Information (whether in written or tangible form, or in electronic or any other form), all summaries, analyses, extracts, compilations, studies, or other documents that contain, reference, are based upon, or otherwise reflect the Confidential Information.

Many targets require an officer of the potential buyer to sign a certificate confirming the destruction or return of the target’s confidential information. Although the officer may have no personal liability, as a practical matter, the officer is unlikely to put his or her own signature on the certificate if it were not true. Requiring a certificate is often a helpful technique; otherwise, it may be easy for the potential buyer to let things slip and not bother to destroy all the data, especially since the destruction cannot be practically monitored by the target company.
The obligation to return or destroy is triggered by the target sending a request. This usually occurs when the target decides that it is no longer going to work on a deal with the potential buyer. This requirement leads to the potential for a foot fault: once the deal is dead, it is easy for the target (and its lawyers) to forget to send out the return or destroy request.

**War Story**

The target ran a tight ship and led a successful auction. It included both strategic and private equity bidders in the process, casting a wide net.

Through successive stages of the process, the target had narrowed down the list of potential bidders. Eventually, it settled on a buyer and signed the deal at a nice premium. Exhausted from seemingly endless nights without adequate sleep, the lawyers on both sides collapsed. They were proud of the success of their clients, which, in some small way, they attributed to their own abilities.

When a competitor launched what appeared to be a copycat product a year later, the winning private equity buyer set out to investigate. It could not prove whether the competitor used any confidential information in the process but stumbled over a set of mishaps on its own end.

The target’s business and legal teams had not thought to send out instructions to the broad array of bidders in the auction process to require them to return or destroy their confidential information. All the bidders had retained the full sets of information—even after the term of the confidentiality agreement (and its restriction on use) had ended.

Such archived data can be hard to delete. For instance, it may be difficult as a practical matter for the recipient to destroy disaster recovery archives. Since virtually all critical information is exchanged by e-mail, there is very little destruction that actually occurs under the “return or destroy” provision. No longer do boxes of documents need to be taken to the shredder.

To deal with this, the potential buyer may carve out those archived files from the return or destroy obligation. Such electronic archive exceptions have become commonplace. When these “archive” exceptions were first crafted,

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**Sample Provision**

Recipient will provide the Target with the certification of an officer of Recipient’s organization [and that of each of its Representatives] certifying that such destruction has occurred.