



INSIGHTS

The NDA Use Clause: Avoiding An Unintentional Standstill

February 22, 2021

Parties to a confidentiality agreement (also known as a non-disclosure agreement or NDA) will often spend hours negotiating a standstill provision or non-circumvention clause, with the information recipient taking great care to avoid excessive restrictions on its ability to participate in transactions related to the target company.

What is often overlooked, however, is that the use clause – a standard feature of almost every transaction-related NDA – can have the same effect as a standstill or non-circumvent clause if it is not carefully drafted.

If an NDA permits you to use the confidential information only for a specific purpose, that means you cannot use it for other purposes. For example, a provision allowing you to use the confidential information “only for the purpose of considering a negotiated equity financing transaction with Company X” effectively prohibits you from using the information in connection with any other transaction involving Company X.

So, if a month after signing the NDA, a third party offers you an opportunity to buy debt of Company X, you may not be able to do so. You could argue that the only information you used in connection with the decision to buy debt was information received from the third-party seller, but if Company X wants to block the transaction, they can claim you inevitably also used the confidential information they disclosed to you in making your decision to buy debt – and you are therefore in breach of the use clause in the NDA that you signed with them earlier. Proving that a particular fact played no role in your decision-making process may be difficult.

But what if the use clause in your NDA with Company X permitted you to

RELATED PEOPLE



Cary M. Reiss

Partner
New York

P 646-746-2013
F 646-746-2001
CReiss@btlaw.com

RELATED PRACTICE AREAS

Corporate
Mergers and Acquisitions and Private Equity

use the confidential information for “any transaction related to Company X?” In that case (subject to any other restrictions in the NDA, such as a non-circumvent provision prohibiting other transactions involving Company X), you should be able to use Company X's confidential information in connection with your decision to buy their debt from the third party, as that would be a transaction “related” to Company X, even if it is not the specific transaction Company X was showing you when you signed the NDA.

Word Choice is Important

As you can see, small changes to the wording of the use clause can either open up – or lock you out of – opportunities in connection with a target company. If an NDA allows you to use confidential information only to consider a transaction “with” Company X, you will likely have to reach a negotiated agreement “with” Company X. In the leading case of *Martin Marietta Materials, Inc. v. Vulcan Materials Co.*, the Delaware Court of Chancery found that a provision in the NDA under consideration – permitting use of the confidential information only for the purpose of evaluating a possible business transaction “between” the parties – meant that the information could only be used in connection with a transaction that was “contractually agreed upon, or consented to, by the sitting boards of both companies.”

What about a use clause that contemplates a transaction “involving” Company X? Does that just mean Company X must be the subject of the transaction or does Company X have to be involved in the negotiations?

The article that precedes the word “transaction” can also be very important. If a broker brings you a confidential opportunity regarding Company X and your NDA permits you to use the confidential information to evaluate “the” transaction, that probably means the specific transaction the broker is showing you. If, however, the NDA allows you to use the information in connection with “a” transaction related to Company X, you have more flexibility.

Even something as simple as capitalization can make a big difference. Are you allowed to use the confidential information in connection with a “transaction” related to Company X or in connection with a “Transaction” related to Company X? If the word is capitalized, it will likely be specifically defined elsewhere in the agreement – as an example, your agreement may include language such as “for the purposes of this Agreement, ‘Transaction’ means a negotiated sale of certain assets of the Company.” Conversely, “transaction” with a lowercase “t” could mean any sort of business arrangement related to Company X.

Interaction With Other Provisions

The definition of the “Transaction” is one of a number of typical confidentiality agreement provisions that must be read carefully in conjunction with the use clause and other terms of the agreement. While an expansive definition of “Transaction” may allow you to use the confidential information in a wide variety of circumstances, before you look to expand the definition of “Transaction,” you must consider how that term is used elsewhere in the agreement. If there is a non-circumvention provision prohibiting your involvement in an opportunity that is competitive

with, or in substitution for, the “Transaction,” an overly broad definition could wind up foreclosing your participation in opportunities that otherwise would have been available.

From the perspective of the entity that receives the confidential information, the ideal confidentiality agreement may be one with a very specific definition of “Transaction” and a very broad use provision that either does not reference the “Transaction” or allows for use of the confidential information “in connection with the Transaction or any other transaction related to Company X.”

Assuming you are able to negotiate a broad use provision, watch out for language that effectively claws back many of the benefits. Some NDAs include a prohibition (either as part of the use clause or elsewhere in the agreement) on using the confidential information in a manner that is “detrimental” to the disclosing party. Any number of uses of the confidential information could be considered detrimental to the disclosing party in one way or another, and a disclosing party that does not want you to participate in a particular transaction may argue that your participation would be to its detriment and therefore in violation of the NDA.

If the disclosing party insists on a restrictive use provision, there may still be ways to mitigate its effects. If there is a specific transaction or category of transaction that you want to ensure is not off-limits to you as a consequence of the use provision, you may want to consider inserting language confirming that the agreement is not intended to prohibit that transaction or field.

For example, if your NDA counterparty is looking for financing for its widget manufacturing business, you could insert an acknowledgement by the discloser that you are actively involved in the widget loan market and the NDA will not prevent you from lending to competitors. The discloser will likely want to qualify that by confirming that you will not disclose any of its confidential information in connection with such loans, which is reasonable.

“Greater Overall Knowledge” and “Residual Knowledge” Provisions

Another way to limit the effects of a restrictive use clause is to insert a “greater overall knowledge” provision that distinguishes between a) specific facts about the target company or transaction and b) the expansion of your general understanding of the industry in which the target operates, which will be the inevitable consequence of your review of the confidential information. The discloser will expect that the former will be subject to the use clause, but may be willing to acknowledge that the latter is not.

In practice, it may be difficult to determine whether a particular item of information is target-specific or if it merely serves to enhance your overall knowledge of the industry, but in the event of a dispute, the presence of this sort of clause in an NDA should at least help demonstrate that the use clause was not intended to be interpreted as being completely restrictive.

A related concept is a “residual knowledge” clause, which will typically be phrased to allow you to use the “residuals” of the confidential information

retained in your unaided memory for your own purposes. Depending on the exact language of the clause, you may have a great deal of latitude to use confidential information for purposes unrelated to the transaction you are being shown.

Non-Disclosure vs. Use Restrictions

As a technical point, it is important to be mindful of the distinction between the non-disclosure provisions of an NDA and the use clause. The standard list of exceptions to the definition of “Confidential Information” will sometimes be written as an exception to the confidentiality provisions of the agreement; for example, “your confidentiality obligations hereunder shall not apply to information that is or becomes publicly available, information you receive from a third party, etc.” It may be that the parties intended “confidentiality obligations” to cover both the non-disclosure and non-use provisions but, strictly speaking, confidentiality and use are two separate concepts. In the above example, you may not be contractually permitted to use information that subsequently becomes available to the public for anything other than the purpose permitted by your NDA. The easiest way to address this is to ensure that the standard exceptions are built into the definition of “Confidential Information,” rather than having a separate paragraph dealing only with exceptions to the confidentiality obligations.

The non-disclosure/non-use distinction should also be kept in mind when considering the term provision. Occasionally, a disclosing party may insist on an extra-long NDA term to protect its business secrets from becoming publicly available. The discloser may not be as concerned about your using its confidential information for your own purposes once the contemplated transaction has been completed or abandoned and may therefore be willing to accept a shorter duration for your use obligations than your non-disclosure obligations.

We have seen that the use clause and its interaction with other provisions of a confidentiality agreement must be considered carefully. Small tweaks to the wording can open up new business opportunities or effectively subject you to a standstill. If you're not careful about the use clause, too much knowledge may indeed be a dangerous thing.

To obtain more information, please contact the Barnes & Thornburg attorney with whom you work, or Cary Reiss at 646-746-2013 or cary.reiss@btlaw.com.

©2021 Barnes & Thornburg LLP. All Rights Reserved. This page, and all information on it, is proprietary and the property of Barnes & Thornburg LLP. It may not be reproduced, in any form, without the express written consent of Barnes & Thornburg LLP.

This Barnes & Thornburg LLP publication should not be construed as legal advice or legal opinion on any specific facts or circumstances. The contents are intended for general informational purposes only, and you are urged to consult your own lawyer on any specific legal questions you may have concerning your situation.