MORE UNINTENDED CONSEQUENCES OF USE RESTRICTIONS IN CONFIDENTIALITY AGREEMENTS

A recent decision in the Southern District of New York again highlights the importance of careful review and negotiation of confidentiality agreements. In Goodrich Capital, LLC and Windsor Sheffield & Co. Inc. v. Vector Capital Corporation (S.D.N.Y. June 26, 2012), Judge Rakoff denied a motion to dismiss a complaint (the “Complaint”) filed by a financial advisor to a failed acquiror against a private equity firm. The Complaint alleged, among other things, breach by the private equity firm of a non-disclosure agreement entered into in connection with the potential financing by the private equity firm of an acquisition by the potential acquiror of a target company, where the private equity firm subsequently purchased another company in the same industry as the original target company. The financial advisor who filed the Complaint did not have any written contractual relationship with the private equity firm other than a non-disclosure agreement entered into in connection with the potential financing of the failed acquisition. The financial advisor had no written agreement explicitly providing for compensation to be paid to the financial advisor in any transaction. Nevertheless, the Court allowed breach of contract and other claims by the financial advisor to proceed against the private equity firm, including for payment of an advisory fee, based on the non-disclosure agreement entered into in connection with the potential financing of the failed acquisition.

This decision was highly fact-specific and the Court was required to accept as true all well pled factual allegations for purposes of deciding this motion to dismiss. However, this decision and the recent decision of the Delaware Chancery Court in Martin Marietta Materials, Inc. v. Vulcan Materials Company1 again highlight the importance of careful attention to the language in confidentiality agreements.

Background

Set forth below are the allegations in the Complaint:

Goodrich Capital, LLC (“Goodrich”) is a financial advisor that helps companies identify, develop and implement strategic business transactions. In 2009, The Treasurer (“Treasurer”), a cash management business, retained Goodrich to assist Treasurer in implementing a business strategy involving retail businesses that use safes to hold daily cash receipts. In 2010, Goodrich identified Corporate Safe Specialists as a smart safe developer that Treasurer might buy in order to implement Treasurer’s business model. An affiliate of Goodrich contacted Vector Capital Corporation (“Vector”), a private equity firm, to assist in financing the transaction. Vector allegedly had no previous knowledge of the retail cash management business.

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1 In Martin Marietta Materials, Inc. v. Vulcan Materials Company (Del. Ch. 2012), Chancellor Strine read the “use” provision in a confidentiality agreement as limiting the use of confidential information to a friendly deal, thus effectively adding a standstill provision to an agreement that did not otherwise contain one. As a result, the potential acquiror was enjoined from proceeding with its hostile acquisition for four months. On May 31, 2012, the Delaware Supreme Court affirmed the decision.
Vector, Goodrich and Treasurer entered into a non-disclosure agreement (the “Vector NDA”), which provided that Vector could not use any portion of the confidential information of “discloser” except to the extent reasonably necessary to explore a business arrangement or relationship with regard to a new business opportunity related to cash handling services. The Vector NDA also contained a non-circumvention provision providing that no party shall seek, in violation of any agreement between the parties entered into after the date of the Vector NDA, to directly or indirectly avoid or bypass the other party in order to avoid payment of fees or other compensation.

Goodrich then distributed to Vector presentation materials Goodrich had prepared analyzing the possible acquisition of Corporate Safe Specialists, which materials provided for a $3.5 million fee for Goodrich. However, Corporate Safe Specialists accepted a competing takeover bid in February 2011.

These presentation materials distributed to Vector also identified Tidel Engineering, L.P. (“Tidel”) as another potential acquisition target for Treasurer. Tidel had two main product lines, a line of smart safes and another line of safes for larger retailers. In March 2011, Goodrich, Tidel and Treasurer entered into a non-disclosure agreement (the “Tidel NDA”), which contained a non-circumvention provision similar to that contained in the Vector NDA, and the parties commenced negotiations. While the parties were negotiating, Vector, without notifying Goodrich or Treasurer, allegedly began preparing an offer to acquire Tidel. In July 2011, Goodrich contacted Vector about financing the possible acquisition by Treasurer of Tidel’s line of smart safes. In early August 2011, Vector prepared presentation materials based on Goodrich’s proposal for Treasurer to acquire Tidel, which materials indicated Goodrich would receive a $3.5 million fee, and Goodrich and Treasurer also advised Vector on drafts of a letter of intent outlining the proposed acquisition by Treasurer of Tidel.

Later in August, however, Vector allegedly indicated to Goodrich for the first time that Vector was instead going to acquire Tidel in a deal that did not involve Treasurer, and Vector and Tidel executed a letter of intent with terms allegedly conforming to the terms designed by Goodrich. Even though Treasurer was not part of this transaction, Tidel allegedly represented to Goodrich that Goodrich would still receive its fee in connection with the transaction. In November 2011, Vector completed the acquisition of all of Tidel but did not pay any fee to Goodrich.

The Opinion

The Court found that the Complaint stated viable claims for breach of contract, unfair competition, unjust enrichment and tortious interference with contract.

As to the breach of contract claim, Goodrich alleged that under the Vector NDA, Vector was restricted to using the confidential information for purposes of exploring a business arrangement among Treasurer, Goodrich and Vector related to cash handling services. Goodrich alleged that Goodrich distributed to Vector confidential presentation materials containing proprietary strategies and analysis and disclosed identified to Vector opportunities in the cash management industry of which Vector was previously unaware. In response, Vector argued that the Vector
NDA does not cover its transaction with Tidel as it applies only to transactions between Vector, Goodrich and Treasurer, and that the reading proposed by Goodrich would impose an indefinite obligation on Vector not to enter the cash management business. The Court disagreed with Vector, noting that the broad language of the Vector NDA prohibits Vector from using confidential information for any purpose other than the contemplated business arrangement with Goodrich and Treasurer, and that this restriction was a definite, rather than indefinite, obligation only to use Goodrich’s information for specific purposes.  

In addition, Vector argued that even if it used confidential information, such information belonged to Treasurer rather than Goodrich, and Treasurer is not a party to the lawsuit. The Court found, however, that this argument contradicts Goodrich’s factual allegations, the truth of which must be assumed for purposes of deciding a motion to dismiss at this stage of the litigation.

Goodrich also argued that Vector breached the non-circumvention provision of the Vector NDA, arguing that Vector structured its transactions with Tidel to avoid payment of fees to Goodrich. In response Vector argued that no agreement exists between the parties that would require payment to Goodrich of any fees. However, the covenant of good faith and fair dealing, which is implicit in all contracts, required Vector to deal with Goodrich in good faith, and the Court determined that Vector allegedly breached this duty when it represented to Goodrich that it would pay a fee, benefited from Goodrich’s continued advice and then subsequently refused to pay. Vector also argued that it did not implement the strategy devised by Goodrich as it acquired all of Tidel, rather than one product line as contemplated by the proposed Treasurer transaction, but the Court concluded that the Complaint plausibly suggests that Vector relied on Goodrich’s insights in the Tidel transaction.

The Court also allowed Goodrich’s claim for unfair competition to proceed, finding that Goodrich had plausibly alleged that Vector abused the confidential relationship between the parties under the Vector NDA by misappropriating the fruit of Goodrich’s labor, including its proprietary business strategies. As to Goodrich’s claim for tortious interference with contract, the Court held that the factual allegations of Goodrich supported the inference that Tidel avoided paying Goodrich’s fee only because Vector persuaded Tidel to breach its obligations to Goodrich under the Tidel NDA.

**Conclusion**

This decision again highlights the need for careful negotiation and consideration of the terms of confidentiality agreements, especially use restrictions and exceptions thereto.

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2 The Court also permitted the claim for unjust enrichment to proceed alongside the breach of contract claim, given Vector’s position as to the limited applicability of the Vector NDA.
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