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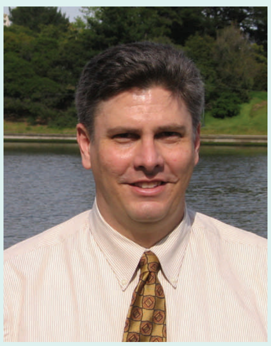
SILICON HANDSHAKE OR HANGMAN'S NOOSE: THE NDA'S OPPORTUNITIES AND RISKS



By Andrew K. Jacobson

Nondisclosure Agreements ("NDA") are everywhere. A recent *Wall Street Journal* article described a Silicon Valley Don Juan who had an NDA ready for every date. Coffee and NDAs are the normal start to many meetings. However, NDAs are not created equal -- what is good for the discloser is not good for the recipient. The "Silicon Handshake" can become a hangman's noose for the unwary.

Questions to Ask.
Any potential signer to an NDA needs to answer several questions before signing. Those questions include:

1. **Whose Secrets are Being Protected?**

Is the NDA mutual—does it cover the secrets of both parties? If you are presenting an NDA to protect your trade secrets, you may not want to bind yourself to protecting the other side's secrets. Alternatively, if someone presents you with an NDA, you may want to make sure your own secrets are protected.

2. **What Secrets are Being Protected?**

Is everything discussed to be considered confidential? This can be a trap for the unwary. If someone mentions something in passing, you could be foreclosing future opportunities for your company.
Do documents have to be marked as confidential to receive protection under the NDA, or does it cover everything that the recipient reads? How will the recipient know what is protected and what is not? Obviously, no NDA can specifically spell out in advance all the details of what is being disclosed. Still, an NDA that is too broad could restrict the recipient's future operations. What is good for the discloser is not always good for the recipient.

3. **Who is Covered by the NDA?**

Does the NDA allow for independent derivation? If your R&D office is working on a similar project, has your signature cut off future development of that project? Is there an option for independent development? Have you bound one of your independent partners? Is the protection limited only to those actually signing the NDA?

4. **How Long Does the NDA Last?**

Is the NDA to last into perpetuity? Does it carry over into new companies or ventures that a party may enter into? Is there any way of removing oneself from its provisions, such as returning all documents?

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LETTERS OF INTENT - HOW TO USE THEM WISELY

By Kalina V. Laleva

A letter of intent (LOI) could be a great tool that has to be used with caution.

What is an LOI?
An LOI is also known as a Memorandum of Understanding or Memorandum of Agreement.
It is used to indicate the parties' agreement to the basic structure of more serious negotiations. It sets forth some of the key terms of the proposed deal. The signed LOI forms a preliminary agreement.

Business Functions of an LOI.
An LOI serves several business functions:

- *Commitment to Each Other and to the Deal:* Signing an LOI, from a business perspective, indicates that each party has obtained senior management's approval to work toward closing the proposed business transaction and that the parties have moved into a stage of serious negotiations.

- *Commitment to the Deal for Others to See:* After signing an LOI, the parties often issue a joint press release announcing the event. This is used to provoke a positive reaction in the market place to the news and some times to send a message to competitors in the marketplace.

- *Commitment to a Timeline:* An LOI will set forth a timeline for negotiations, including a deadline for closing the deal and what will occur if the parties fail to meet the deadline.

- *Partial Performance and Authorization of Expenditures:* After signing an LOI, parties will often begin due diligence for the transaction and/or preparation of a formal estimate regarding the transaction.

Using an LOI.
The main uses of an LOI are:

- Contracts, corporate buyouts, mergers and other business matters can become very complicated and time-consuming for both sides.

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LOI *Cont. from pg. 1*

An LOI acknowledges that a merger between companies or an acquisition is being considered seriously.

- An LOI could provide investors with tangible proof of the deal or potential takeover. It is not unusual in the business world to make or receive numerous offers for lucrative deals or contracts. Most of these informal maneuvers never materialize into real agreements. An LOI allows a company to arrange for additional financing or report the new development to employees and stockholders.

- Indication by a mutual fund shareholder that he or she would like to invest certain amounts of money at certain specified times, develop or purchase companies or goods. In exchange for signing an LOI, the shareholder would often qualify for reduced sales charges.

- A seller might be unwilling to let the buyer go through the due diligence process without first obtaining an LOI.

- An LOI could indicate the general plans of an individual or company, involved in a business deal. If a large company plans to buy out a small manufacturing plant, for example, an LOI might contain a specific date for the proposed sale to take place. An LOI might also include plans for expansion or downsizing staff levels or rehiring employees.

Benefits.

The LOI can serve as evidence to third parties that there is an "agreement in principle." Despite the fact that the LOI may have some non-binding elements to it, once signed by the parties, it often creates a sense of moral obligation that the contemplated transaction should be consummated.

Drawbacks.

There can be a number of potential problems. Once signed, an LOI, even if it is non-binding, may place the seller at a negotiation disadvantage by creating an expectation of the consummation of the transaction for third parties. There is a potential for breaches of confidentiality. The buyer and its representatives may make improper disclosures of the information, or even use this data to compete with the seller. The seller can be greatly hurt by a "no shop" clause which would prevent the seller from conducting discussions with other buyers. If the deal does not take place, valuable time to get a deal done can be lost.

Binding Provisions.

While LOIs are thought to be non-binding, certain provisions within the document may indeed have legal effect. The seller may grant the potential buyer access to information to allow the buyer to conduct its due diligence. The seller may not want the buyer to make use of any information obtained in the course of the due diligence and negotiations process for any reason other than for the negotiation or consummation of the transaction.

BEWARE:
While LOIs are thought to be non-binding, certain provisions within the document may indeed have legal effect.

A "no shop" clause is a very common provision in LOIs. It puts the potential buyer in a stronger position. For example, a "no shop" clause might prohibit the seller from soliciting or even entertaining any competing offers from prospective third party buyers. The seller may not want to be restricted. The buyer may need to pay an amount of money for this privilege. It is also a good idea for the seller to put a time limit to this clause.

A "break-up fee" is sometimes used in lieu of a "no shop" clause. The buyer may have to pay a "break-up fee" to the seller if it does not proceed in good faith toward consummating the transaction.

Terminating an LOI needs to be addressed.
It could end on a certain date unless extended in writing by both parties. In other circumstances, it ends as of the occurrence or nonoccurrence of certain events. At other times, there is no end date to it in the document, but either party may end it on a certain number of days' notice to the other in writing.

Many LOIs state that the parties agree to engage in good faith negotiations of the terms of the definitive agreements. This might be very risky. The allocation of expenses relative to the transaction should be included in an LOI. It might state that each party will bear its own expenses relative to the transaction. Whatever the understanding is, it should be set forth.

Non-Binding Provisions.

These often focus on the "deal points." For example, there might be a general description of the structure of the transaction, the price or a method for determining the price. There are ancillary agreements which will also need to be finalized before the transaction may actually take place. For example, in a sale of a practice these agreements might include employment agreements, leases, non-competition agreements, etc. At times, conditions to closing are also listed. This might include financing contingencies, getting the necessary third party consents, getting the governmental approvals, getting on the hospital staff, etc.

Representations, Warranties, and Indemnification.

Every LOI should mention that representations and warranties are being made by the seller in favor of the buyer. This section can consume a lot of legal time during the negotiation of the definitive agreement.

The first thing is to specify who is making the representations. Given that many shareholders are unwilling to represent and warrant to the seller's situation, the LOI should point out that the company is making the representations.

All LOIs should also have a clause regarding indemnification in the event that one of the representations or warranties is breached. Considering how important this provision is to a merger, the standard text: "The Company shall make standards representations and warranties and provide standard indemnification to Acquirer," is usually not sufficient. It is advisable that the seller includes in the LOI an explanation of the indemnification.

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NDAs *Cont. from pg. 1*

5. **What are the exceptions?**
Are documents otherwise publicly available covered? Is the recipient released from the duty to protect the documents if they later become publicly available? If the recipient receives the information independently, does the duty to protect end?

6. **Whose law governs?**
Jurisdiction and choice of law questions are not excess verbiage designed to keep lawyers employed. They have important consequences, particularly because states often have very different protections. California tends to protect employees' rights to pursue a livelihood more than other states. If a choice is available, an attorney should review the NDA to see what is best for you.

Advantages v. Disadvantages.
Never is the old saw "where you stand depends on where you sit" more true than when considering an NDA. The discloser's motives are radically different from the recipient's: thus, the discloser's NDA should be different than the one you would be willing to sign as a recipient. An NDA covering mutual disclosures should not resemble that of a one-way disclosure. Good preparation should include having three different NDAs -- one for when you disclose documents, one for when you receive documents, and one for mutual disclosure. The mantra to remember is: how does this NDA help me maximize my gains, and minimize my risks?

Strategic Considerations.
NDAs are more than just the latest fashion in attorney make-work, but an integral part of business operations. If someone could use your information to triumph over you, you need an NDA. Alternatively, if you, as the discloser, would not sue someone for using the information being disclosed, an NDA is not necessary. Indeed, by revealing distrust of the other party, it could inhibit the relationship.

A Shield Can Be a Sword.
Commonly a shield, NDAs can also be a weapon. An unwary recipient can prevent itself from developing a new line of business that the discloser reveals -- and it can even handcuff those in alliances with the recipient. Sometimes two-layered NDAs are appropriate. The first layer is to someone who acts as a gatekeeper, to decide if the information threatens the recipient or its alliances; the second is for a broader, operational distribution.

Keeping Track of NDAs.
Who keeps track of the NDAs your business signs? Does anyone? If your VP of marketing left tomorrow, who at your company would know what NDAs exist that she may have signed, binding the company?

Is there anyone at your company who knows enough to gauge whether the NDA your R&D guy is about to sign conflicts with any other project you have? "Gee, I didn't know . . . " is usually the prelude to a disaster. With the prevalence of NDAs today, your company needs a firm-wide policy. One person or group should be the gatekeeper of every NDA your company signs. Do not let your partner -- or potential adversary -- dictate the progress of the relationship. Impatience in allowing your general counsel to review the NDA before signing can be a warning signal that you may have more to lose than to gain.

No one wants to repeat the well-known mistake one operating system company made when it refused to sign an NDA with IBM, which instead did business with a young company called Microsoft. However, the more common problem is finding the "silicon handshake" transformed into a noose around your neck.

LOI *Cont. from pg. 2*

Legal Functions of an LOI.

Courts have found that LOIs create binding obligations, even if the letter itself does not state that it is binding. This is part the potential risk of using an LOI.

Too often, parties will sign such a document, feeling that they have nothing to lose by doing so. While LOIs are not formal agreements, they often proceed to set forth agreed terms of the proposed transaction. If the deal does not go through, one of the parties could argue that those agreed-upon points were indeed agreed upon and in some cases, that the party relied on the LOI and has monetary damages based on this reliance.

If the LOI is held to be binding, you have a contract with general essential terms but without the many terms you would normally want in final agreements. If upheld in court, you have a contract in which either the court or the parties will have to work out all the details when the parties are at odds with each other.

In determining whether the parties intended for the document to be binding, the court will evaluate all of the words of the document and review the context of the negotiations. The court will also determine whether either or both parties have fully or partially performed their obligations; if there were any issues left to negotiate; and whether the subject matter was complex enough to require a definitive written agreement.

If the LOI's author tries to remedy this ahead of time by putting in as much detail as possible so if upheld by a court the important clauses will be there, then that author risks greater odds of a court upholding the document as a binding contract because so many of the essential terms were included.

If the parties do not want this LOI to be legally binding, it is important for the document to clearly state that. For example, it might state that this LOI is not a legally-binding document and that neither party will be bound by its terms unless and until the parties execute a definitive agreement

Contact your counsel so that no future problems arise from what you consider a "non-binding" letter.

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The FTC now has an ID Theft website which provides guidelines for victims of identity theft:

http://www.consumer.gov/idtheft/index.html

Eve Abbott is the author of "How to Do Space Age Work with a Stone Age Brain," and runs www.aBrainNewWaytoWork.com

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