

Confidentiality Agreements in the Current Marketplace: A Carve-Out to Permit Debt Investments as an Alternative to Equity Investments

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Confidentiality agreements are generally entered into to set forth the parties' rights and obligations regarding the use of confidential and proprietary information that one party discloses to another. Our clients are often asked to sign confidentiality agreements in the context of potential acquisitions of real property. Some confidentiality agreements pertaining to real property also cover other interests such as an underlying mortgage loan. When the recipient of confidential information shifts its focus from a property acquisition to a debt acquisition, the restrictions in the confidentiality agreement may preclude the recipient from doing so.

BE AWARE OF RESTRICTIONS IN CONFIDENTIALITY AGREEMENTS

Most confidentiality agreements obligate the recipient to use confidential information only in connection with the recipient's evaluation of a specific transaction expressly contemplated by the confidentiality agreement. The use of such confidential information in any other potential transaction is generally prohibited. The restriction may extend to the debt instruments relating to the subject property, as the definition of "potential transaction" is often purposely limited to an equity investment with respect to the subject property. While this limitation may be acceptable in a "one-off" transaction, it may create an unanticipated hurdle to future debt investment opportunities. Therefore, in instances in which the recipient may be interested in a debt investment as an alternative to an equity investment (or is not certain of its future plans), it may be important for the recipient to negotiate an appropriate carve-out to the potential transaction restriction.

WHEN TO INSERT THE DEBT CARVE-OUT

It may not be necessary to insert a specific carve-out to permit the recipient to pursue a debt investment as an alternative to an equity investment absent an express restriction in the confidentiality agreement against such action. In cases where the recipient knows it may want to consider a debt investment in lieu of an equity investment, however, an affirmative statement reflecting the recipient's right to do so may be advisable. With this in mind, we have set forth below two possible approaches providing for suggested terminology. The first example may be objectionable to the disclosing party because of its detail and breadth; in such case, a narrower, less comprehensive version of the language, as provided in the latter example, may be preferable. In all events, careful consideration should be given to the relative negotiating positions of the parties and the objective of the recipient with respect to each particular investment opportunity. For purposes of these examples, it is assumed that the terms "Recipient," "Disclosing Party," "Representatives," and "Property" have the meanings for such terms customarily utilized in confidentiality agreements.

THE DEBT CARVE-OUT: TWO APPROACHES

Comprehensive Debt Carve-Out. "Provided that the following shall not be deemed to modify any of the terms or requirements set forth in this Agreement, the terms of this Agreement shall not limit or restrict Recipient's ability or the ability of Recipient's Representatives to, directly or indirectly, (i) engage in transactions with respect to the Property or the debt of the Property and/or the Disclosing Party (whether such transaction(s) is/are in the primary or secondary market or otherwise), (ii) propose, commit to, participate in and/or make a loan or other debt financing on the Property and/or to the Disclosing Party, (iii) propose, commit to, participate in and/or provide debt financing to a prospective buyer regarding a transaction involving the Property and/or the Disclosing Party, (iv) finance a third-party's effort to make a loan or other debt financing on the Property and/or to the Disclosing Party, (v) take a security interest in any

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and all assets of the Disclosing Party (including the Property) as collateral security for any loan or other debt, or (vi) consider, negotiate or consummate any purchase of the Disclosing Party's assets or businesses (including the Property) that are the subject of a proposed sale or marketed for sale by the Disclosing Party. In the event that Recipient or any of Recipient's Representatives acquire any debt of Property and/or the Disclosing Party, this Agreement shall not limit or restrict Recipient's ability to take any actions provided for under the terms of such debt with respect to the debt of the Disclosing Party in connection with any restructuring, liquidation, recapitalization, dissolution or similar transaction involving the Property and/or the Disclosing Party. The term "debt" as used in this paragraph shall include, without limitation, institutional debt (bank or otherwise), commercial paper, notes, debentures, bonds, or other evidences of indebtedness."

Less Comprehensive Debt Carve-Out. "The terms of this Agreement shall not limit or restrict the Recipient's ability to, directly or indirectly, engage in transactions with respect to the debt of the Disclosing Party, provided that the Confidential Information shall be used only for the purpose of the Potential Transaction, or the evaluation thereof."

CONCLUSION

In the current marketplace, it is important to preserve the flexibility to pursue debt investment opportunities as an alternative to an equity investment. While confidentiality agreements may be presented as standard documentation at the outset of a deal, it is important to ensure that the recipient of confidential information retains the right to pursue all investment opportunities.

If you have any questions concerning this Legal Update, please feel free to contact any member of the Real Estate Group in Chicago at:

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