Confidentiality Orders in a Books-and-Records Inspection, Part II

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Editor's note: This article is part two of a series.

In part I of this article, we discussed how in *Quantum Technology Partners IV L.P. v. Ploom*, C.A. No. 9054-ML (Del. Ch. May 14, 2014) (Master's Final Report), Master in Chancery Abigail M. LeGrow faced the "unwelcome task" of finding an appropriate middle ground between the extreme positions taken by the parties in a Section 220 action concerning what terms should be included in a confidentiality order in connection with the inspection of corporate books and records where inspection was sought in part to assist the stockholder in marketing its shares. Specifically, we discussed how LeGrow dealt with the issues of defining competitor, confidential information and highly confidential information for purposes of the confidentiality order and the restrictions LeGrow recommended on the use of such information. LeGrow then turned to other matters that needed to be addressed in the order, including restrictions on which financial advisers could receive confidential information, who had the burden to justify confidentiality designations, the timeframe for production of information, liability for unauthorized disclosures, and whether the use of the information or the designations themselves were subject to any sunset provision.

• **Restrictions on financial advisers.** Ploom Inc. proposed that financial advisers who could receive Ploom's information be located in the United States and be a U.S. Securities and Exchange Commission-registered broker-dealer or investment adviser. According to Ploom, this would provide assurance that the financial adviser is reputable and will respect the terms of the third-party confidentiality agreement. LeGrow rejected these restrictions for three reasons: First, many of the potential purchasers were located outside the United States and might want to use financial advisers who are not located in the United States or registered with the SEC. Second, Ploom's interests were protected by the third-party confidentiality agreement, which required any signatory to submit to the jurisdiction of the Court of Chancery. Finally, the advance-notice requirement gave Ploom the opportunity to seek relief from the court barring any disclosure to that adviser.

• **Burden to justify confidentiality designations.** Quantum Technology Partners placed the burden of justifying the designations of potential purchasers as competitors or information as confidential or highly confidential on Ploom, but Ploom sought to strike that provision. LeGrow recommended that the party seeking confidential treatment bear the burden of demonstrating the need for such treatment consistent with the general rule in Delaware.

• Timeframe for production. Quantum proposed that production be made in five business days; Ploom proposed 10 business days. LeGrow recommended that production be made within eight days after entry of the order; that the information be current as of the date of the court's order; and that Quantum have the right to make two requests for updated information within a year of the entry of the order. The latter provision took into account the difficulties in selling stock in an early stage, close corporation.

• Liability for unauthorized use or disclosure. The parties disputed the degree to which liability could be imposed on Quantum for violations of the confidentiality order or third-party confidentiality agreements by persons receiving Ploom's information. Ploom proposed that Quantum ensure that each recipient of confidential information protect the information so it is not disclosed and made Quantum liable for any breach of the confidentiality order by any person to whom Quantum provided information. Rejecting Ploom's proposal as impractical and an impediment to Quantum's marketing of its shares, LeGrow recommended that recipients of information be required to protect the information "with at least the same degree of care and confidentiality that they use for their own information," but in no event less than a reasonable standard of care. LeGrow also noted that Ploom was further protected because the third-party agreements named Ploom as a third-party beneficiary and specified that specific performance and injunctive relief were available to remedy any violations of the agreement.

• Termination of rights and destruction of books and records. Ploom proposed a time limit on Quantum's ability to use the books and records to sell its shares and on a potential purchaser's time to hold information before destroying it. LeGrow found the restrictions to be unreasonable given the limited market for the shares and the fact that private sales of stock often take considerable time to negotiate and complete. LeGrow recommended that the confidentiality order contain no such time restrictions.

• **Expiration of confidentiality designations.** Quantum proposed that all of Ploom's confidentiality designations expire five years after the information is disclosed. LeGrow found the proposed sunset provision consistent with similar orders entered by the Court of Chancery; however, LeGrow recommended that the order provide that Ploom could seek continued confidential treatment of specified highly confidential information by filing a motion with the court no less than six months before such treatment would otherwise expire.

• **Information generally available or independently acquired.** The parties agreed that information that became generally available to the public or which was independently acquired may be used without restriction. They differed on who had the burden to establish those conditions. LeGrow recommended that Quantum bear the burden of proving that information falls within this category, but Ploom bear the burden of proving that any information was obtained in violation of the order.

• **Fee-shifting.** The parties agreed that the prevailing party should be entitled to have its fees and costs paid by the nonprevailing party, but disagreed about what types of action would qualify for fee-shifting. Ploom said fee-shifting was appropriate only in the event of a lawsuit to enforce the order, while Quantum said fee-shifting should occur in any action or lawsuit to enforce or interpret any provision of the order. LeGrow recommended that the court adopt Quantum's proposal, which LeGrow believed put the parties on more equal footing since actions to enforce the order were more likely to be initiated by Ploom rather than Quantum.

The issues discussed in the master's report were obviously framed by the parties' proposals and the facts they presented at trial. Nevertheless, LeGrow's recommendations regarding what items were appropriate and reasonable to include in the confidentiality order to accompany the inspection of books and records are both instructive and informative. Although both parties filed exceptions to the master's report, the parties subsequently reached an agreement to resolve their differences and the exceptions were never ruled upon by the court. Still, LeGrow's approach to these issues and her proposed recommendations should be considered in similar situations.

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