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

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

A minority stockholder in a privately held corporation makes a demand to inspect the books and records of the corporation under Section 220 of the Delaware General Corporation Law. The stockholder states that the purpose of the inspection is to value his shares and to explore a possible sale of the stock. The corporation offers to provide some, but not all, of the requested documents.

The corporation also insists that the stockholder agree to a broad, restrictive confidentiality agreement before it will produce any documents. It is an oft-repeated fact pattern. 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 both parties concerning what terms should be included in a confidentiality order in connection with the inspection of corporate books and records.

Quantum Technology Partners was a limited partnership that invests in early-stage information technology and life sciences companies and the holder of more than a million shares of Ploom Inc. Ploom was a privately held Delaware corporation that has as its primary line of business the development, design, manufacture, sale and distribution of "alternative" tobacco products,

including smokeless tobacco delivery systems. Ploom was part of an emerging market for such products, which included many of the world's largest tobacco-product producing companies.

For some time, Quantum had actively sought potential buyers of its interest in Ploom and had made at least one express offer to sell the shares. Quantum also identified several potentially interested buyers, but all of them required additional information regarding Ploom's financials before proceeding to negotiate terms. Quantum made a demand on Ploom pursuant to Section 220 to inspect the corporation's books and records, and attached to the demand a proposed confidentiality agreement. Ploom challenged Quantum's purpose, the scope of documents it demanded to inspect, and the proposed confidentiality agreement. With respect to the confidentiality agreement, Ploom said it would not permit the disclosure of its confidential information to third parties because "shar[ing such] information with third parties and even 'highly confidential information' with Ploom competitors ... is absurd for a technology company." Quantum then filed suit against Ploom to enforce its inspection rights.

At the conclusion of the trial, LeGrow instructed the parties to discuss the terms of a confidentiality order in an attempt to narrow their disputes. According to LeGrow's report, the parties failed to engage in the type of good faith meet-and-confer discussions expected by LeGrow, and as a result LeGrow devoted much of her report to crafting a confidentiality agreement on the parties' behalf. What LeGrow recommended is instructive for parties facing the same issues in the future.

Before addressing the scope of Quantum's Section 220 demand or the terms of an appropriate confidentiality order, LeGrow considered and rejected Ploom's contention that it should not be compelled to disclose sensitive and proprietary information because Ploom did not trust that Quantum would protect Ploom's confidentiality and Ploom did not want to weaken its hand in potential repurchase negotiations with Quantum. However, Ploom was unable to show that Quantum had failed to abide by confidentiality agreements in the past and, without more, "whether Ploom intrinsically trusts Quantum is irrelevant." Moreover, Ploom could not cite any authority for the proposition that the court should curtail a stockholder's statutory right to inspect books and records because it would disadvantage the company's negotiating position with respect to the repurchase of the company's shares from the petitioning stockholder.

LeGrow considered the confidentiality agreements proposed by each party. LeGrow concluded that Ploom's proposed agreement would unduly restrict Quantum's ability to sell its shares. Quantum's proposal, on the other hand, failed to balance appropriately Quantum's interests with Ploom's needs to safeguard its confidential and proprietary information. Accordingly, LeGrow sought to craft the contents of a confidentiality order that would protect both parties' interests.

• **Definition of competitor**. The first issue concerned the definition of "competitor." Quantum proposed that "competitor" mean a "direct competitor" of Ploom who develops, produces or manufactures electronic cigarettes or handheld tobacco vaporizers, has demonstrated an intent to do so, or publicly has disclosed that it holds 25 percent or more of the stock of such a company. Ploom proposed that "competitor" mean someone who is engaging or may engage in the same or similar line of business, provides the same or similar services, sells the same or similar

competitive products, or operates in the same market or markets as Ploom, or any person who owns or is affiliated with a person who owns 5 percent or more of the stock of such a company.

LeGrow recommended that "competitor" mean "any person whom Ploom identifies in good faith as a competitor" and who engages or is endeavoring to engage in the same or similar lines of business, provides the same or similar services, or sells the same, similar or competitive products, or who has disclosed publicly that it owns 5 percent or more of the stock of any such person. This definition, LeGrow explained, takes into account that Ploom's business was still developing and may include products or services other than those it then manufactured or sold. LeGrow rejected Quantum's proposed 25 percent ownership limitation as too high, and set the limit at the percentage of ownership recognized by the U.S. Securities and Exchange Commission as the appropriate point where ownership in a public company must be disclosed.

• **Definition of confidential information and highly confidential information.** LeGrow directed the parties to provide greater specificity regarding the type of information that would qualify as confidential or highly confidential. Quantum identified nearly all the books and records it sought as confidential. Ploom proposed definitions that gave it the authority to designate information as confidential or highly confidential unconstrained by any precise guidelines. LeGrow prefaced her definitions with the requirement that the information be "sensitive or proprietary to Ploom and not generally available to the public," and then classified each of the specific categories of documents to be produced as either confidential or highly confidential information.

• **Restrictions on use.** Ploom proposed that confidential information could be disclosed only to a competitor's third-party financial adviser and that highly confidential information could not be disclosed to anyone. Quantum proposed that it could provide confidential information to anyone, without advance notice to Ploom, and highly confidential information to a potential purchaser not identified as a competitor or to a competitor's financial adviser. Both parties agreed that no information could be provided to a potential purchaser before the potential purchaser agreed to a third-party confidentiality agreement. LeGrow recommended that in addition to this requirement, Quantum must provide advance notice to Ploom before it provides any confidential or highly confidential information to a potential purchaser.

If Ploom identifies the potential purchaser as a competitor, Ploom may provide confidential information to the competitor provided the competitor agrees that the confidential information will not be reviewed by any officer, manager, member, employee or director of the competitor who is directly engaged in a business that competes with Ploom. Quantum may not provide highly confidential information to any potential purchaser whom Ploom identifies as a competitor, but it may provide forecasts to a competitor's third-party financial adviser provided Ploom is given advance notice.

Having decided the definitions of competitor, confidential information and highly confidential information and the restrictions on use of each, LeGrow still had to deal with issues such as 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. We will describe how LeGrow dealt with those subjects in part two of this article in an upcoming issue of Delaware Business Court Insider.

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