

## New Jersey Court Protects Private Equity Funds' Confidential Agreements With State From Disclosure

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The investment of public pension monies and public university endowments in private equity funds has led to efforts by certain news organizations and others to require public disclosure of the private equity funds' confidential commercial and proprietary information through state Freedom of Information Act ("FOIA") requests to public investors. Although most states' FOIA laws protect confidential commercial information, many statutes lack explicit protections for the information private equity funds share on a confidential basis with their state investors. As a result, a number of lawsuits have been brought against public pension funds across the country demanding, among other things, private equity partnership agreements and financial information about portfolio companies in which private equity funds invest.

On March 5, 2008, in *Communications Workers of America v. John McCormac, Treasurer, State of New Jersey*, a New Jersey Superior Court issued an important decision rejecting one such attempt, reaffirming that private equity funds' investment agreements constitute trade secrets and confidential commercial information. Significantly, the *McCormac* Court made plain that the investment of public pension monies into private equity does not compromise protections against disclosure otherwise afforded under state law to the private equity funds' proprietary information.

### BACKGROUND

The facts of *McCormac* are straightforward. As part of an alternative investment program designed to maximize returns on state investment funds, New Jersey entered into investment agreements with several private equity funds that included: 1) partnership agreements creating the funds in question, and 2) letter agreements by which the state subscribed to limited partnerships in the funds (collectively, the "Investment Agreements"). The Investment Agreements were not boilerplate contracts, but rather set forth confidential management issues such as the amount of debt the fund can take on, the kinds of companies in which they can invest and the acquisition strategy for each fund.

In New Jersey, as in other jurisdictions, partnership and related agreements between private equity firms and the state constitute government records, rendering the state's FOIA law, the Open Public Records Act ("OPRA"), potentially applicable. However, trade secrets and "proprietary commercial or financial information" are expressly exempted from disclosure under OPRA.

In June 2005, two unions submitted requests under OPRA and the state's common law right of access for all contracts the state had with the Funds, characterizing their interest as a desire to better understand how the state is investing employees' pensions under the alternative investment

program. The request was an adjunct to litigation brought by the unions challenging the state's alternative investment fund strategy. When the state and five intervenor private equity firms refused to produce the Investment Agreements on the grounds that they contained trade secrets and proprietary confidential information, the union plaintiffs filed suit in New Jersey Superior Court to compel disclosure.

### **SUMMARY OF THE DECISION**

In a thoroughly reasoned 63-page opinion, the *McCormac* Court held that the records were exempted under OPRA because the Investment Agreements constituted proprietary information and trade secrets reflecting years of private equity firm experience which, if disclosed, would provide an unfair advantage to competitors, "who could simply piggyback on the experience of the private equity firms." Several considerations animated the *McCormac* Court's decision. The alternative investments were managed on a confidential basis and all investors, including New Jersey, agreed to maintain the confidential obligations set forth in the partnership agreements. The partnership agreements of each firm were unique, containing a fund-specific blend of investment strategies, investment parameters for fee structures and partners' rights and obligations.

Additionally, the *McCormac* Court recognized the pragmatic implications of failing to safeguard the funds' confidential commercial information. Citing the experiences of California, Texas and Michigan, the Court noted that court decisions in those jurisdictions requiring disclosure of confidential fund information were soon followed by corrective legislative action. In each of those states, after the funds rebuffed future investments from the states, the legislatures amended their respective state FOIA provisions to ensure prospective protection for the funds' confidential information.

The *McCormac* Court explained that "New Jersey need not repeat these mistakes through court ordered disclosure of the requested records." An overly broad reading of OPRA could impair the ability of the state to enter into investment agreements with private equity by compromising the state's bargaining power to negotiate future alternative investment agreements with prospective partners and by diminishing the number that will accept the state's business. Accordingly, the Court found that, "[p]ast experience in other states demonstrates that judicial interference with this balance can seriously compromise an alternative investment program."

### **IMPLICATIONS**

*McCormac* provides clear authority for trial courts to protect private equity funds' proprietary commercial information as trade secrets that are exempt from disclosure under state variants of FOIA. It also signals a potential shift in courts' understanding of the practical effect of broad and less protective FOIA regimes: if a state's FOIA subjects to public disclosure information that private equity funds regard as confidential, private equity funds may reconsider accepting future investments from public investors. As in *McCormac*, a court may pause before "impair[ing] the ability of the state to enter investment agreements with private equity funds. . . ." As states

continue to invest in private equity to maximize the return on public monies, *McCormac* will regularly be cited by private funds and state actors seeking to maintain their mutually beneficial financial partnership.

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