Understanding, drafting and using non-disclosure agreements

By **Kristin Hiibner** of Sheldon Mak Rose & Anderson.

If your company is thinking about entering into a joint venture or any other business relationship that will require you to disclose proprietary information to your potential partner, there is one document you should obtain before any substantive discussions begin: a non-disclosure agreement (NDA).

An NDA, also called a confidentiality or secrecy agreement, is a basic but vitally important contract between two parties investigating a future business relationship that specifies what confidential information will be shared and restricts its use.

At the outset of negotiations, if the party you are meeting with refuses to sign an NDA or asks for time to think about it, end your meeting and do not resume the conversation until an adequate agreement is reached. Disclosing your most valuable secrets without an NDA is tantamount to giving a free gift to another party that you cannot afford to give. With a carefully drafted NDA in place, on the other hand, you can proceed with confidence that your valuable intellectual property will be protected and that you will have recourse if your would-be partner reneges on the promise.

Uses and limits of an NDA

You may be inclined to assume that copyright and patent laws will protect your company's proprietary information from unauthorised use. In fact, those laws leave a great deal of intellectual property unprotected. Copyright laws, for example, protect only an expression of an idea, not the idea itself, and patent laws offer protection only for valid, issued claims. A confidentiality agreement can provide broader protection extending to ideas and to proprietary information about products that are in development and have not yet been put on the market or disclosed to the general public.

In fact, if you disclose information to someone outside your company without first obtaining an NDA, you could unintentionally lose your right to later obtain a patent. That is because the prior sale or public use of an invention for commercial gain rather than for experimentation can invalidate a patent claim. And public use:

> *'includes any use of the claimed invention by a person other than the inventor who is under no limitation, restriction or obligation of secrecy to the inventor.'*

An NDA can serve other purposes, such as putting limits on the use of the proprietary information, for example by specifying that it may be used only for testing purposes. In that way, an NDA can protect against reverse engineering that might otherwise be perfectly legal. A clause expressly prohibiting reverse engineering should be a part of any NDA if product samples will be exchanged by the business partners.

On the other hand, court rulings have made it clear that an NDA cannot be so broad as to cover information that is already available to the public. Nor will an NDA that is carelessly drafted do much good. Indeed, a confidentially agreement that has not been carefully constructed can backfire. If, for example, there are loopholes that leave some information that is disclosed to a partner outside the scope of the agreement, or if the NDA expires too soon, the party that has divulged secrets to a partner may be precluded from pursuing a claim for misappropriation of trade secrets, which otherwise might have been available against the partner who later appropriates the information.

Drafting an NDA

You may be tempted to draft an all-purpose NDA that can be used over and over in a variety of situations. If the other party presents you with an NDA, you may likewise be inclined to give it a cursory examination and get on with the negotiations, particularly if time is short or legal counsel to examine the document is not readily available. Given what is at stake – your hard-earning intellectual property – that would be unwise. Each NDA should be meticulously drafted and reviewed to meet the needs of the particular situation. When it comes to non-disclosure agreements, one size does not fit all.

To begin with, there are generally two types of non-disclosure agreements, the *'one-way'* or *'unilateral'* agreement, and the *'two-way'* or *'bilateral'* agreement. Unilateral agreements are generally used where one party is disclosing information to the other party. A typical unilateral disclosure situation would arise in a relationship in which one party is handing

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over a product to another party for testing. Where there will be a two-way flow of information, such as a collaboration between a pharmaceutical company and a university, a bilateral agreement would be needed. It is important to use the appropriate type of agreement for the particular relationship because some of the provisions typical of a unilateral agreement might be inappropriate for a bilateral agreement, and vice versa.

It is also important to check that the scope of the agreement is appropriate for the particular business relationship. A broad agreement, for example, asserting that *'Company A and Company B will exchange confidential information for the evaluation of a business relationship'*, may be appealing because it could be recycled for use in any number of situations. However, such a statement may be so broad that it inappropriately authorises use of information that is beyond the scope of the intended agreement. Alternatively, a statement that is too narrow, for example one that encompasses *'testing product X for application on Y'*, may not cover all of the information that needs to be disclosed during the term of the agreement.

Components of an NDA

An NDA should include a number of components, starting with provisions that identify the party or parties that will be covered by the agreement, specify what technology or trade secrets will be disclosed, and state the intended use of the information. For example, the agreement could state:

> *'Company A will disclose certain confidential, proprietary information relating to Polymer Z containing bleaching technology for evaluation by Company B for use in tooth whitening formulations.'*

This statement specifically identifies the disclosing and receiving parties, the confidential information, and its intended use. It is broad enough to encompass the scope of the information that will be disclosed but narrow enough to minimise the risk of unauthorised disclosure. The specific identification of the proprietary information that will be divulged will also simplify enforcement of the NDA, should that become necessary.

A thoughtfully drafted NDA should also identify the significance of the confidential information, for example by stating whether it is a valuable trade secret or confidential patent information. This makes it clear to all parties exactly why the information is proprietary, and it also sets the stage for other provisions in the agreement, such as the term and expiration date and the non-reverse engineering clause, if any. Furthermore, explaining at the outset why the information is so valuable to the disclosing party may motivate the receiving party to be especially vigilant about protecting it.

An NDA generally will contain a paragraph that identifies and defines the confidential information. A good agreement will not only include wording that specifies how the information is designated as confidential, but will also specifically list the physical forms in which it is likely to be disclosed during the term of the agreement. The agreement should specify that *'confidential information'* is all information and materials that the disclosing party designates as being confidential, either directly or indirectly in writing, orally or by inspection of tangible objects, and it includes information which, under the circumstances surrounding disclosure, ought to be treated as confidential.

The definition of *'confidential information'* should also encompass any information that is generated as a result of or in connection with the stated purpose of the agreement. Such a provision would provide confidentiality for information developed under the agreement that is not necessarily disclosed by one party or another, but is nonetheless confidential and should be protected as such under the agreement.

A provision stating that all *'confidential information'* shall be marked *'confidential'* can be added, but only if there is a limited amount of information that will be disclosed and the disclosers are diligent in marking it. Requiring that all confidential information be labelled as such can be problematic and is not advisable if all confidential information is not marked because that would create the presumption that inadvertently unmarked information is not confidential. In situations where marking cannot be assured, it is preferable to omit the marking provision from the agreement, though that could still be required internally as a good business practice.

To assure that the agreement cannot later be challenged for overreaching, the definition of *'confidential information'* should also define that which is specifically not regarded as confidential. For example, the agreement should specify that information is not confidential if it is already in the possession of the receiving party, is obtained from third parties, is publicly known prior to the disclosure, or becomes publicly known through no actions by the parties.

The *'no disclosure'* and *'no use'* provisions are at the heart of the agreements. Those provisions should specify that the receivers of confidential information must agree not to disclose the information to third parties and must also agree that the information or materials should not be used for any purposes other than those specified in the agreement. Exceptions can be made for necessary disclosures to third parties, for example for testing or business evaluation. These crucial provisions should be tailored to suit the particular relationship contemplated by the parties. They could limit disclosure to a specific list of employees within the organisation or to those who *'need to know'*. They could include a *'best efforts'* clause to protect inadvertent disclosure. The *'no disclosure'* and *'no use'* provisions also could include a clause requiring notification in the event of inadvertent disclosure or disclosure that is required by law, such as in response to a subpoena.

Another important provision in the agreement should specify that the receiver should take reasonable measures to secure the confidential information, for example by keeping samples locked up, limiting access to it by unauthorised parties or by ensuring that the receiver has an up-to-date computer security system in place.

As noted, a non-reverse engineering provision should be part of the agreement,

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particularly if one party will be providing the other with a product sample. That will help prevent unscrupulous would-be competitors from attempting to appropriate valuable trade secrets for their own gain while evaluating technology under the ruse of considering a potential business relationship.

A provision specifying how the confidential information will be controlled after it is disclosed to the receiving party should also be part of a well-worded NDA. A receiving party may propose an agreement that leaves them with discretion regarding how much time will be spent reviewing the information and under what circumstances they will be required to report on results of the review. The danger for the disclosing party is that the longer confidential information is left in the hands of the receiving party, the greater the risk of inadvertent disclosures. Accordingly, an NDA should provide for termination of the agreement at a specified date and provide for the return or destruction of the confidential information once the agreement expires.

Many standard NDAs include a choice of law provision, for example stating that *'any dispute arising under this agreement shall be governed by the laws of state X'*. Not surprisingly, *'state X'* will usually be the home state of the party drafting the agreement. A provision such as this is generally not problematic unless it is drafted in such a way that all parties are deemed to have consented to jurisdiction in the specified state. A reasonable middle ground in such a provision would provide that jurisdiction will be in the state of the party that has not initiated the legal action. Such an *'if you file, you travel'* provision would give the party bringing the action an extra incentive to attempt to amicably resolve any dispute before filing a costly lawsuit.

Depending on the particular situation, other provisions may be useful. For example, in some cases, an NDA should specify that the agreement is binding on heirs and successors in interest. It may be helpful to include an arbitration clause and/or a liquidated damages provision, or a clause providing for injunctive relief in the event of a breach. In some cases, disclosure of the mere fact that the parties have entered into a non-disclosure agreement may tip off other competitors about a product in development, in which case the NDA should include a clause keeping the existence of the NDA itself a secret.

Finally, an NDA should, in most circumstances, provide that the confidentiality obligations between the parties will survive termination of the agreement. In other words, the general termination of the NDA should not free the parties to publicly disclose each other's secrets. However, a well-written NDA should also specify that the confidentiality obligations will terminate at the time of public disclosure of the information, such as when a new product is launched or a patent application is published.

The importance of a provision stating that confidentiality obligations continue until the information is publicly disclosed was highlighted by the federal ruling in *Marketel International, Inc v Priceline.com, Inc*. In that case, five years after the expiration of an NDA, a former employee disclosed information that was covered by the agreement. The Court ruled that the written non-disclosure agreement supplanted any implied duty of confidentiality that may have existed between the parties, and that the party's legal obligation to keep the information under wraps ended when the agreement expired. The injured party in *Marketel* would likely have benefited from a provision in its NDA specifying a continued duty of confidentiality so long as the confidential information remained confidential.

Enforcing the NDA

Once a non-disclosure agreement is entered into, you have a legally binding contract. However, no matter how carefully worded an NDA is at the time of drafting, it may later be found not to suit the needs of the parties. If that is the case, you can and should negotiate for changes in the agreement. Or you can add a supplemental agreement to the NDA. In that way, you can resolve many disputes with the other party before they fester and turn into a lawsuit.

To help monitor compliance with the terms of an NDA, it may be helpful to maintain a centralised database keeping track of the names of all who have received the confidential information. That would be especially useful if you find that your confidential information has entered the marketplace from an unknown source.

Once the agreement expires, be sure to retrieve the confidential information and any samples, or receive assurances that it has been destroyed. Otherwise, someone working for your former partner could line his pockets with proceeds from your intellectual property.

Hopefully that will never happen. Having a meticulously drafted NDA in place is the best way to assure that it will not. ■

Kristin C Hiibner PhD is a partner with the intellectual property firm Sheldon Mak Rose & Anderson PC and a registered patent attorney. Kristin has a PhD in Organic Chemistry and extensive legal experience in handling both prosecution and litigation matters for her clients. Kristin's broad technical background, including work experience in organic and inorganic chemistry, plant pathology and molecular biology, give her a technological advantage in dealing with her clients' multidisciplinary intellectual property matters.