NDAs

How to Avoid the Perils of Overnegotiating

A technology startup company in New York called Little Tech and a giant international telecommunications company based in France called Huge Telecom have recently been engaged in discussions regarding a business deal that is extremely important to both companies. The deal could validate Little Tech's technology and could help to set the stage for Little Tech's planned initial public offering. For Huge Telecom, the deal could provide a unique technological advantage that would give Huge Telecom at least a 12- month lead on its competition. Integrating Little Tech's technology into Huge Telecom's products would almost immediately boost Huge Telecom's revenues following a two- year slump. Moreover, the team leader at Huge Telecom sees this deal as a way to seal his upcoming promotion to vice president.

Following a successful preliminary meeting between the business people from both companies, in-house counsel are now attempting to negotiate the nondisclosure agreement ("NDA") that will cover the discussions leading up to the deal. After some progress, the NDA negotiations grind to a halt. In-house counsel at Little Tech has objected to provisions regarding the following parts of the proposed NDA: the time period that oral disclosures of confidential information must be memorialized by the disclosing party in order to be protected by the NDA; employee nonsolicitation; warranties for confidential information; exclusion of "residuals"; and French choice of law and forum provisions. In reply, in-house counsel at Huge Telecom, who wants to use Huge Telecom's standard NDA, has insisted that the Huge Telecom NDA cannot be changed except, maybe, for a word here and there.

Meanwhile, the business people at Little Tech and Huge Telecom, who are eager to resume their discussions, are becoming increasingly nervous about the delay. What's so hard about negotiating an NDA, the business people keep asking one another. Why is an NDA so important? And most important, why are the negotiations getting in the way of the productive business talks?

BY MITCHELL C. SHELOWITZ

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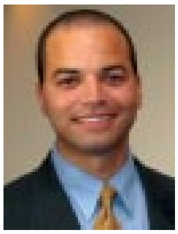

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The views set forth in this paper are those of the author alone and do not necessarily represent the views of Ceragon Networks Ltd. or its subsidiaries.

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As it happens, the NDA is crucial to the welfare of both companies. Little Tech has invested a substantial part of its limited cash reserves to develop the technology. An unauthorized disclosure of Little Tech's confidential and proprietary information describing the technology could be ruinous. A disclosure to a competitor, who could quickly use the unauthorized information to develop competing technology, would jeopardize Little Tech's planned initial public offering.

An unauthorized disclosure of Huge Telecom's information, including product development plans, interim sales results, marketing strategy, distribution, and resale pricing information, would be no less disastrous. This information in the hands of competing telecommunications companies could sink Huge Telecom's hopes of returning to profitability.

Despite their desire to move forward with this important business relationship, Little Tech's business people have heeded their counsel's advice to suspend further discussions until after the NDA has been signed. Huge Telecom's business people, on the other hand, have lost patience with the NDA process. They have decided to circumvent Huge Telecom's in-house counsel and to keep Huge Telecom's in-house counsel out of the loop at this stage. In their view, this business relationship is too important to be held hostage by the lawyers. Huge Telecom's business people are also trying to convince Little Tech's business people to ignore Little Tech's in-house counsel's advice and to move forward with the discussions.

Unfortunately for many of us, the scenario just described—lawyers who remember the professional norms of "zealous advocacy" a bit too well while forgetting the virtues of flexibility and compromise—is all too familiar. By losing their focus, these in-house lawyers on both sides are jeopardizing a potentially vital business opportunity for their companies—for no good reason. Moreover, they are risking their professional credibility with fellow employees and managers.

Most in-house counsel understand well the importance of protecting confidential and proprietary information with an NDA. These same in-house counsel, however, often overlook the perils of overnegotiating NDAs. This article will help you to avoid making the same mistakes that in-house counsel on both sides in the above scenario have made. This article will identify and explain the core goals of NDAs and will provide practical tips in drafting and negotiating NDAs for both U.S. and international transactions. If you follow the guidelines below, you will significantly shorten the time that you spend on NDA negotiations, thus freeing you for other substantive projects. You will also build the support of your business team by providing added value– all while conscientiously protecting your company's confidential and proprietary information.

This article addresses NDAs in the business-to-business context in the course of commercial negotiations. NDAs between employers and employees in the employment context and NDAs between adverse parties in pending or concluded litigation are beyond the scope of this article.

BACKGROUND

Terms in This Article

In the interests of clarity, the following terms are used in this article:

- Confidential information refers to all of the confidential and/or proprietary information that companies seek to protect with NDAs.
- Disclosing party refers to the party disclosing confidential information.
- Receiving party refers to the party receiving confidential information from the disclosing party.

What's the Purpose of an NDA?

There are three main reasons for using NDAs in business negotiations.

To Protect Intellectual Property

Companies make significant investments in personnel and technology. In the fast-moving world of business, each day may bring your company a new invention, a new product or process, new know-how, a new trade secret, and other new proprietary developments from such investments. For convenience, I'll refer to such assets as "intellectual property."

IN THE FAST-MOVING WORLD OF BUSINESS, EACH DAY MAY BRING YOUR COMPANY A NEW INVENTION, A NEW PRODUCT OR PROCESS, NEW KNOW-HOW, A NEW TRADE SECRET, AND OTHER NEW PROPRIETARY DEVELOPMENTS FROM SUCH INVESTMENTS.

Your company, like most companies, cannot and does not register all developed intellectual property with the applicable government authorities, in part because many kinds of intellectual property cannot be registered and in part because registering all the intellectual property that could be registered would be prohibitively expensive. For this reason, you may want to protect your company's intellectual property with NDAs instead of registration. If so, however, keep in mind the following factors:

In the United States and Germany,[1] public use or knowledge of an invention before patent registration could bar such patent registration.

Further, in the United States and various international jurisdictions, a party claiming misappropriation of a trade secret must typically demonstrate a good faith effort to maintain the secrecy of such information as the first step to support a finding that certain information is a trade secret.

The Uniform Trade Secrets Act ("UTSA") has been adopted by 42 U.S. states and the District of Columbia. It allows the owner of a trade secret to recover damages and in some instances obtain injunctive relief for the misappropriation of trade secrets. Under the UTSA, a trade secret is defined as

> information, including a formula, pattern, compilation, program device, method, technique, or process, that: (i) derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use, and (ii) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.[2]

States that have not adopted the UTSA, including New York and New Jersey, rely instead on the RESTATEMENT (FIRST) OF TORTS § 757. According to the RESTATEMENT, a trade secret "may consist of any formula, pattern, device or compilation of information which is used in one's business, and which gives him an opportunity to obtain an advantage over competitors who do not know or use it."[3]

In determining whether information is considered to be a trade secret, the RESTATEMENT enumerates six factors:

> (1) the extent to which the information is known outside of his business; (2) the extent to which it is known by employees and others involved in his business; (3) the extent of measures taken by him to guard the secrecy of the information; (4) the value of the information to him and to his competitors; (5) the amount of effort or money expended by him in developing the information; (6) the ease or difficulty with which the information could be properly acquired or duplicated by others.

U.S. courts applying both the UTSA and the RESTATEMENT have based a finding that information constitutes a trade secret upon the existence of NDAs.[4]

In Mexico, information is protected as a trade secret under the Industrial Property Law if, among other elements that are similar to the RESTATEMENT and the UTSA, a "person or entity has adopted sufficient means or systems of preserving confidentiality and restricting access."[5] Although it appears that an NDA would satisfy this element, the Mexican courts have not specifically addressed this issue.

Other than complete nondisclosure to outside parties, which is often not feasible, an NDA may be the best way to protect such intellectual property assets.

To Demonstrate Commitment to Protect Company Assets

In merger and acquisition discussions and financing transactions, a company's efforts to protect its intellectual property by use of NDAs could be the factor that persuades an investment bank, a venture capital fund, or an acquiring company to enter into a transaction. A policy and practice of regularly executing nondisclosure agreements at the outset of every potential business relationship is an important way to demonstrate a serious commitment to protecting and increasing the value of core assets.

A POLICY AND PRACTICE OF REGULARLY EXECUTING NONDISCLOSURE AGREEMENTS AT THE OUTSET OF EVERY POTENTIAL BUSINESS RELATIONSHIP IS AN IMPORTANT WAY TO DEMONSTRATE A SERIOUS COMMITMENT TO PROTECTING AND INCREASING THE VALUE OF CORE ASSETS.

To Protect Strategic Nonpublic Business Information

Disclosure of strategic nonpublic business information, such as business plans, marketing strategies, customer information, and pricing discounts, is often necessary in the course of discussions leading to the sale of products or a business. Such information may also need to be disclosed as part of negotiations leading up to technical cooperation between rival businesses, joint ventures, mergers, acquisitions, or financing transactions. Yet this information is often a company's most closely guarded secret. NDAs are the most typical, most accepted, and most practical way to protect a company from unauthorized disclosure and exploitation of its top-secret data.

Core Goals of NDAs

You should bear in mind that there are two core goals of every NDA:

- To restrict unauthorized disclosure of confidential information.
- To prohibit unauthorized use of confidential information.

With these two core goals in mind, negotiating a meaningful NDA that adequately protects your company's confidential information should be fairly straightforward. Remember that NDAs are usually intended as an interim measure to facilitate preliminary business discussions. If the desired business relationship develops, the parties may sign a definitive purchase, distribution, acquisition, or other agreement. Such definitive agreements should contain confidentiality and nondisclosure provisions that supersede the NDA. Sometimes, the definitive agreement will incorporate by reference the confidentiality provisions of the NDA. If the relationship does not expand beyond the NDA stage, all the confidential information disclosed will stay protected for the period agreed to by the parties in the NDA.

ANALYSIS: THE "STANDARD" NDA, SECTION BY SECTION

I am familiar with NDAs through my experiences as general counsel for Ceragon Networks Ltd., a manufacturer of high-capacity wireless telecommunications equipment that is involved in business activities in more than 45 countries. I have negotiated hundreds of NDAs with counterparts around the world from states (including New York, California, Massachusetts, Florida, and Alabama) and countries (including France, Sweden, Russia, Germany, India, China, Hong Kong, Korea, Nigeria, South Africa, Cameroon, and Israel). These NDAs were negotiated with large and small, private and public, mature and start-up companies, including semiconductor designers and manufacturers, telecommunications equipment manufacturers, software developers, telecommunications operators, distributors, marketing consultants, and project managers. Despite the huge geographic distances, different languages, and different sizes and types of companies, the final signed NDAs with these parties contain virtually the same basic provisions.

Understanding the reasons and meanings of customarily accepted NDA provisions will help you eliminate the unnecessary clauses that are, unfortunately, a staple in many companies' "standard" NDAs. Understanding what provisions need to stay and what provisions need to go not only saves drafting time but also helps you close a deal more quickly and avoid the nightmares that the in-house counsel on both sides of the negotiating table encountered in the opening scenario in this article.

Keep These Provisions

Although you will need to read all provisions closely to make sure that they don't harm your client in some way, usually both sides of the negotiation typically accept the following types of provisions in most NDAs.

1. Names of Parties

The opening paragraph identifies the parties to the NDA. Although naming the parties to the agreement seems obvious, you should carefully analyze the description the parties. Including parties that are controlled by, controlling of, or under common control with the signing party, often called affiliates, is not per se a bad idea, and objecting to this idea, when offered by the person across the negotiating table from you, may turn out to be counterproductive. As long as there are no competitive or specific business concerns, inclusion of affiliates could be very helpful.

For example, if your company has an opportunity to enter into business discussions with one of the listed affiliates, you can skip the entire NDA negotiation process by simply including this affiliate in the original NDA. Additionally, if the contemplated business transaction requires cooperation between divisions or subsidiaries of either party, these entities are protected by their inclusion in the original NDA.

2. Mutuality

Are both parties equally protected and obligated? In virtually all situations, I recommend mutual protection. Confidential disclosures by one party often give rise to confidential disclosures by the other party. By resorting to mutual NDAs, all disclosures are protected, all breaches of the disclosure agreement are actionable, and both parties have the same obligation to behave professionally.

Despite these compelling reasons, many companies still maintain a unilateral NDA in their standard agreement file. To efficiently convert a unilateral NDA to a mutual NDA, consider inserting the following paragraph at the end of the document:

> In connection with the purpose of this agreement, receiving party may make available to disclosing party information that would fall within the definition of confidential Information if it had been provided to receiving party by disclosing party. Accordingly, disclosing party hereby undertakes to receiving party the same obligations of confidentiality with regard to receiving party confidential information as receiving party has undertaken toward disclosing party. All provisions regarding the treatment of disclosing party confidential information and the rights, duties, and obligations of disclosing party shall apply mutually to receiving party and to receiving party confidential information.

3. Subject Matter

Identify the general subject matter of confidential information that each party possesses at the outset of the relationship. This description may help to avoid those situations in which a disclosing party thinks that a misappropriation has occurred when in fact a receiving party possessed, before the talks began, confidential information similar to but not identical to that of the disclosing party.

4. Purpose of Exchange

Identify the limited purpose underlying the exchange of confidential information and stipulate that the confidential information may not be used for any other purpose. For example, if information is being exchanged as part of the exploration of a potential business relationship, include a short description of such potential business relationship.[6] Keep in mind, however, that this part of the agreement is precisely the sort of place where balanced and careful drafting is required: many business discussions are free-ranging, and the statement of purpose may need to be broadly phrased so that a new NDA is not needed for each phase of the discussion but not so broadly phrased as to be useless.

5. Form of Confidential Information

Define the form and embodiments of confidential information. This section usually contains a comprehensive list of relevant items and is intended to ensure that all tangible and intangible embodiments of confidential information fall within the protections of the NDA. You may want to include the following language in your list:

> Information in oral, written, graphic, electromagnetic, or other form, including but not limited to past, present, and future business, financial, and commercial information, business concepts, prices and pricing methods, marketing

and customer information, financial forecasts and projections, technical data and information, formulae, analyses, trade secrets, ideas, methods, processes, know-how, computer programs, products, equipment, product road maps, prototypes, samples, designs, data sheets, schematics, configurations, specifications, techniques, drawings, and any other data or information delivered by either of the parties to the other or to which the other party has acquired by way of inspection or observation.

IN ORDER TO PREVENT INFORMATION IN THE PUBLIC DOMAIN AND INFORMATION ALREADY LAWFULLY HELD BY THE RECEIVING PARTY FROM BEING SUBJECT TO THE RESTRICTIONS OF THE NDA, THE AGREEMENT SHOULD CLEARLY DEFINE WHICH INFORMATION IS NOT SUBJECT TO RESTRICTIONS AND LIMITATIONS.

6. What Information Is Considered Confidential

After having described the subject matter, purpose, and format of confidential information, the NDA should provide rules for identifying the information that is considered confidential and covered by the NDA, both written and oral.

- **Written information.** Some NDAs provide that all written information disclosed by one party to the other should be confidential, whether or not specifically marked or identified as confidential. This practice treats harmless as well as highly confidential information in the same way and should be avoided because of its indiscriminate approach. Instead, careful methods for identifying and marking information as confidential should be used, and you should make sure to advise your business clients to mark all confidential information in some way that will provide NDA protection. With the prolific use of email and sharing of electronic versions of documents, such a confidentiality legend can be easily included in an email footer or in document headers or footers.[7]
- **Oral information.** Two methods may be used to protect confidential information that has been disclosed orally. The first is to require that, within a specified period of time, such as within 30 days of disclosure, the disclosing party must describe in writing the oral disclosure of confidential information or the disclosure will not be protected by the NDA. The time frame within which such a written statement must be made is often the subject of time-consuming negotiations between lawyers. The better approach is to stipulate that the NDA provisions will protect confidential information disclosed orally if, before oral disclosure, the disclosing party tells the receiving party that the information about to be disclosed is confidential. Although this approach could create evidentiary problems, such oral identification is more reflective of commercial realities and can be proven by deposition or courtroom testimony. Interestingly, in certain countries, such as Israel, Belgium, and France, oral identification of confidential information, even without an NDA, can give rise to contractual protection of such information.[8] Nevertheless, don't waste valuable time negotiating this provision. Your time would be better spent advising your clients of their responsibilities with regard to oral disclosures under the NDA.

7. Exclusions

In order to prevent information in the public domain and information already lawfully held by the receiving party from being subject to the restrictions of the NDA, the agreement should clearly define which information is not subject to restrictions and limitations. These provisions could be very helpful in the event of a claim of misappropriation or breach of contract.[9] For example, the parties might agree that the following information could fall outside the provisions of the NDA:

- Information already known to the receiving party before disclosure by the disclosing party.
- Information independently developed by the receiving party without use of or reference to confidential information as demonstrated by tangible evidence.
- Information that has appeared in any printed publication or patent or is in the public domain, except as a result of breach of the NDA by the receiving party.

- Information received by the receiving party from another person or entity having no obligation to the disclosing party.
- Information approved in writing by the disclosing party for release by the receiving party.

AN NDA CLAUSE WILL OFTEN RECITE THAT INCOMING CONFIDENTIAL INFORMATION SHOULD BE TREATED BY THE RECEIVING PARTY WITH THE SAME LEVEL OF CARE AND PROTECTION AS THE RECEIVING PARTY TREATS ITS OWN CONFIDENTIAL INFORMATION.

8. Authorized Personnel Only

In order to minimize the risk of unauthorized disclosure and use, the NDA should limit the personnel in the receiving party's business who are authorized to receive confidential information. For example, the agreement could specify individuals by name, title, or job description or limit access to those persons with a need to know, including employees, consultants, and representatives of a person or entity controlled by, controlling of, or under common control with the receiving party.

All such individuals on the receiving party side should be parties to a nondisclosure undertaking at least as restrictive as the NDA. I have seen NDAs that contain a demand for all receiving party personnel that would receive confidential information to sign another NDA specifically referring to the particular new NDA. This approach is not practical and is almost impossible to enforce. Counsel representing disclosing parties would serve their company better by accepting the removal of such an unreasonable demand. Another approach is simply to require that all such receiving party personnel be subject to a confidentiality obligation or undertaking that is at least as restrictive as the provisions of the NDA. Such a requirement should be easy to meet because such confidentiality obligations should already be an essential part of all company employment, consulting, and independent contractor agreements signed by receiving party personnel. If such provisions are not included as a matter of course in your company's employment, consulting, and independent contractor agreements, you should immediately update these standard agreements.

9. Treatment of Confidential Information

NDAs should specify how confidential information can be used and treated. This element is the essential part of every NDA. The two most important provisions are as follows:

- Confidential information can be used solely for the purpose stipulated in the NDA.
- Confidential information cannot be disclosed except as specified in the NDA.

An NDA clause will often recite that incoming confidential information should be treated by the receiving party with the same level of care and protection as the receiving party treats its own confidential information. Provided that the receiving party takes acceptable and reasonable measures to protect its confidential information, such a standard is usually acceptable. This provision can also support a claim of unauthorized use or disclosure of confidential information.

Other standards may impose a greater burden on the receiving party, including the following:

- Confidential information must be kept in a secure location.
- Confidential information may not be photocopied (sometimes only limited photocopying is permitted).
- Receiving party must attach a confidentiality notice on all files, binders, or envelopes containing the confidential information.

The second restriction above can interfere with the ordinary and legitimate use of confidential information. Moreover, confidential information is often sent via email, so even without photocopying, multiple "originals" can be sent by the receiving party to other authorized (or even unauthorized) recipients. Any restrictions on photocopying should be flexible enough to allow authorized recipients to make and distribute copies of the confidential information without the need to seek permission from the disclosing party for each copy. Any such provision, while protecting against the risk of unauthorized use and disclosure, should also allow the receiving party to evaluate the confidential information without creating additional administrative burdens.

10. No Grant of Licenses

The NDA should expressly provide that no license to use any intellectual property is granted except as may be specifically required for the purpose of the NDA and then only for such purpose. This provision prevents the receiving party from later claiming that, by virtue of the exchange of confidential information, the disclosing party granted the receiving party a license to use the confidential information for purposes outside of the scope of the NDA.

11. No Limits on Independent Development

NDAs should not restrict either party from independently developing any kinds of products, services, and technology so long as such development is not based on confidential information disclosed under the NDA. Courts addressing this issue have so far refused to infer an unauthorized use of confidential information—and thus an NDA breach—where the same people who have received confidential information from a disclosing party and who also undertake independent development for their company have breached an NDA.[10]

12. No Promises or Commitments

Signature of the NDA and/or exchange of confidential information should not give rise to any intention, commitment, or obligation to buy or sell or to enter into any kind of business relationship by the parties. Any commitments, obligations, or intentions beyond the protection of confidential information should be addressed in the definitive agreement.

13. Confidential Information Is Provided "As Is"

No warranties or representations are given for the confidential information. A receiving party relies on confidential information at its own risk. Until a definitive agreement is signed following a more developed relationship, confidential information is provided only for discussion purposes and only for the agreed purpose of the NDA.

14. Treatment of Disclosed Information after Termination of the Agreement

After an NDA has expired, all confidential information that had been disclosed can be either returned or destroyed. Maintaining an archival copy of the confidential information disclosed under the agreement can be useful in case of litigation, and some NDAs make this archival copy a standard provision.

15. Compelled Disclosure

The NDA should describe the appropriate response to an order by a court, an administrative agency, or other government body requiring the disclosure of confidential information. Such a provision often requires the receiving party to notify the disclosing party so that the disclosing party can seek a protective order or waive compliance with the NDA.

16. Remedies for Breach

Frequently, NDAs provide for injunctive relief for threatened or actual breach of the NDA in addition to all other remedies available at law. Because injunctive relief may be truly appropriate only for actual or threatened unauthorized disclosures or unauthorized uses of confidential information, rather than any and all breaches of the NDA, this provision should be narrowly drafted.[11] You may want to include in your NDAs the following suggested provision:

> The parties acknowledge and agree that the unauthorized use and/or disclosure of confidential information may cause irreparable damage to the disclosing party for which monetary damages would not provide adequate relief. Therefore, in addition to all other available remedies, the disclosing party shall be entitled to seek injunctive relief to remedy a threatened or actual unauthorized disclosure of confidential information.

17. Governing Law and Forum

These provisions are often the subject of extensive discussions. Because of an absence of case law in most jurisdictions, however, litigating NDAs is probably equally risky in all courts.

In a survey conducted with local counsel in 16 jurisdictions,[12] I have identified judicial decisions on NDAs in the business-to-business (nonemployment) context in only four countries: the United States, the UK, Hong Kong, and Israel.[13] The jurisdictions surveyed were Belgium, Brazil, Denmark, Finland, France, Germany, Hong Kong, India, Israel, Mexico, Russia, Singapore, Sweden,[14] Switzerland, United Kingdom, and the United States. The survey asked lawyers admitted to practice in these jurisdictions to find cases using the terms "confidentiality agree-

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- Application Programming Interface, nondisclosure agreement, available on ACCA Online℠ in ACC's Virtual Library at www.acca.com/protected/forms/agree/acmenondisc.html.

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ment," "secrecy agreement," and "nondisclosure agreement."

This survey highlights an intriguing aspect of the NDA practice: despite the enormous amount of time spent by in-house counsel and outside counsel and the costs incurred by companies in negotiating these agreements, judicial decisions based on NDA breaches in the business-to-business context are few and far between. Lawyers usually prefer their home jurisdictions as a place to litigate; however, to avoid overnegotiating the NDA, you should be flexible and agree, if possible, on a compromise jurisdiction as a place to litigate, recognizing that the risks in litigating NDAs are equally uncertain, as are the costs.

With regard to the choice of forum, there is often a willingness in international transactions to include an arbitration clause selecting the International Chamber of Commerce Court of Arbitration (the "ICC") as a neutral forum. Two decisions highlight the ICC's willingness to hear cases involving an alleged breach of an NDA and to award significant damages and unusual relief to the injured party. In one case, *Presstek Inc.v. Agfa-Gevaert N.V.*,[15] the arbitration court found that Agfa had breached its confidentiality agreement by improperly using Presstek's trade secrets in connection with the filing of patent applications. The arbitration court took the extraordinary step of ordering Agfa to transfer to Presstek one of Agfa's U.S. patents and to pay Presstek's legal expenses in the arbitration in the amount of $ 769,139.68.

In another ICC arbitration,[16] the panel awarded a U.S. company $854,425.12 in damages, concluding that a Thai company's repeated disclosures of confidential technical information to third parties had violated a contract between the companies. The provisions in question required the Thai company to inform and obtain written permission from the U.S. company before disclosing any confidential information to any third parties.

18. Term of NDA and Nondisclosure Obligations

There are two important temporal elements in NDAs:

- Period during which the continued exchange of confidential information by the parties will be covered by the terms of the NDA.
- Period during which the receiving party's nondisclosure obligations are valid and enforceable.

The term of the NDA is the period beginning on the effective date and ending at some specified time thereafter. During this time, the parties' exchange of confidential information will be protected by the NDA. Strictly speaking, an exchange of confidential information by either party after the NDA has expired is not subject to the NDA's obligations, but the receiving party may still wish to observe the restrictions for the sake of good will.

The time period during which the receiving party is held to the provisions of the NDA can extend beyond the life of the NDA. Even after the NDA has expired, the nondisclosure and nonexploitation obligations may continue in force for a specified time as agreed by the parties and set forth in the NDA. Depending on the kind of confidential information being disclosed, I have seen provisions that go on indefinitely, as well as provisions that extend anywhere from three to 10 years after the termination of the NDA.[17]

When discussing a proposed NDA with your business client, you may learn that confidential information has already been disclosed. In such situations, your NDA should include a statement that the agreement covers confidential information disclosed before the effective date of the NDA. You would also be well served to be as specific as possible and identify the dates of any disclosures made before the commencement of the NDA.

Watch Out: These Provisions Could Hurt You

Standard company NDAs often contain terms and conditions that are irrelevant or inappropriate to the situation at hand. Such provisions can increase the time required to negotiate and sign NDAs, but in-house counsel, fearful of unforeseen consequences, are often reluctant to remove these provisions.

Set forth below are provisions that should raise red flags. You should give these provisions your utmost attention.

1. Employee Nonsolicitation Provisions

Employee nonsolicitation provisions would prohibit either party from soliciting or hiring employees from the other party for a certain period of time or could include time limits and procedures for situations in which one party might hire the other's employees. In an early stage of a business relationship and particularly in a context that does not include merger and acquisition, these restrictions are usually inappropriate and unnecessary.

A case in New York highlights the risks implicit in such provisions. In *Global Telesystems, Inc. v. KPNQwest, N.V.,*[18] the district court upheld a nonsolicitation provision in an NDA between two potential merger partners based upon the risk of disclosure of confidential information. A former senior financial officer of plaintiff sought to join defendant company following the breakdown of discussions between plaintiff and defendant. The NDA contained the following provision:

> You undertake that for a period of eighteen months from the date of this Agreement, neither you nor any of your subsidiaries nor your or their Representatives shall, actively solicit, interfere with, or endeavor to entice away, any person who is at the date of this Agreement, or who is during discussions between [plaintiff] and you, a director, employee, consultant or individual employed by or seconded to work for [plaintiff] or its affiliates, or offer to employ, or assist in, or procure the employment for, any such person, provided that this restriction shall not prevent you from employing such person who responds to a general advertisement for recruitment without any other direct or indirect solicitation or encouragement by you.[19]

The court strictly interpreted the above provisions and granted the injunction against the defendant, leaving the senior officer jobless. There, the solicitation and hiring had been done on behalf of the hiring company's CEO with the assistance of a headhunter. The court concluded that such method did not fall within the strict requirements of the NDA. The court included the following footnote:

> I do not ignore the impact here of this decision on [the employee] as an individual. Assuming the facts set forth in his affidavit are true, he was unaware of the no-solicit and no-hire provisions of his former employers [NDA]. Nevertheless, sometimes in life, a person unfortunately walks through the wrong door. Such is the case here . . . .[20]

2. Noncompete Provisions

Such provisions prohibit one or both parties from developing and/or selling products or services that compete with those of the other party. As with the nonsolicitation provisions, such noncompete provisions are unnecessary in an NDA that covers disclosure of information at an early stage of a business relationship.

In a decision by the High Court of the Supreme Court of Hong Kong in 1992,[21] the court granted a preliminary injunction against a receiving party that had breached a noncompete provision of an NDA. The receiving party had purchased 50 percent of the disclosing party's business and then, armed with confidential information in disclosing party's books and records, had set up a competing business, directly breaching the noncompete provision.

3. Nondisclosure of NDA and Existence of Relationship

Some NDAs include provisions that seek to restrict disclosure of the NDA itself or disclosure of the existence and content of the discussions between the parties. In typical commercial circumstances, such as discussing a potential purchase, distribution, or research and development partnership, restricting disclosure of the NDA and the existence of discussions is not necessary. When a potential merger, acquisition, or joint venture is being discussed, however, compelling business justifications may warrant such provisions.

4. Exclusion of Residuals

This provision usually states that an intangible thing, often referred to as "residuals," resulting from a person's access to confidential information is not subject to the NDA obligations and that such residuals can be freely used by receiving party personnel without restriction. The term *residuals* is often defined as information in nontangible form that may be retained in the memory of people who have had access to confidential information and that includes ideas, concepts, know-how, or techniques.

This kind of provision completely undermines the protection of the NDA because it gives a receiving party license to use confidential information fortuitously committed to memory or fortuitously recalled. This provision is unreasonable and inappropriate and should be avoided.

5. Consent of Judgment/Liquidated Damages

Such provisions often impose substantial monetary penalties or liquidated damages for any breach of the NDA. In some countries, such as Denmark, this practice is routine although it should be avoided wherever possible because the provision drags parties into time-consuming negotiations about a figure that is impossible to determine in advance.

6. Receiving Party Notes Are Confidential Information

NDAs may provide that notes, letters, memos, documentation, and other receiving party work product that references or includes the disclosing party's confidential information is confidential information subject to the NDA and shall be "returned" upon the termination of the NDA.

This requirement is problematic and should be avoided. A receiving party's work product will inevitably contain the receiving party's notes, evaluations, ideas, and so on, and none of this information is appropriate for the disclosing party's review. If your adversary insists on retaining such a provision, you can propose that the disclosing party's confidential information that finds its way into the receiving party's work product continues to be covered by the nondisclosure provisions and nonuse provisions but is excluded from any "return" requirements.

7. Export Control Language

Companies are increasingly including provisions that require compliance with U.S. export control laws or similar laws of other countries. One common form of export control language is the following:

> The receiving party shall not export, directly or indirectly, any technical data acquired pursuant to this Agreement or any product using any such data to any country for which the U.S. government or any agency thereof at the time of export requires an export license or other governmental approval without first obtaining such license or approval.

Few commercial and corporate lawyers understand the obligations imposed by such a provision. Even more important, the party whose NDA includes such a provision often does not understand it, yet will refuse to remove or modify it. To help you understand the import of such a provision, you need to know about two U.S. export regulations.

The main regulations that govern U.S. exports are the Export Administration Regulations ("EAR")[22] and the International Traffic in Arms Regulations ("ITAR").[23] These regulations contain the export regulations for the U.S. Department of Commerce and the U.S. Department of State, respectively, and set forth the various licensing controls for information, technology, and end-items. The EAR generally applies to civil end-use and dual-use items, and the ITAR applies to items with a purely military application. The U.S. government refers to information, technology, and end-items that are subject to the EAR and the ITAR as "controlled."

YOU SHOULD REQUIRE THE DISCLOSING PARTY TO DETERMINE WHETHER ANY INFORMATION, TECHNOLOGY, OR END-ITEM ANTICIPATED FOR DISCLOSURE PURSUANT TO THE NDA IS CONTROLLED AND WHETHER THE DISCLOSING PARTY HAS OBTAINED APPROPRIATE EXPORT LICENSES.

In general, such a provision would preclude the receiving party from disclosing to unauthorized persons controlled information or technology or end-items that the disclosing party may have provided to the receiving party. For example, if the information or technology or end-item is controlled (referred to as "controlled information") and the disclosing party wishes to export such controlled information or materials, even to a foreign national in the United States (not including a U.S. Green Card holder), the information or technology or end-item must be properly licensed by the applicable U.S. government entity. A receiving party who receives controlled information under the export license, such as a foreign national, from the disclosing party would be expected not to reexport such controlled information.

You should require the disclosing party to determine whether any information, technology, or end-item anticipated for disclosure pursuant to the NDA is controlled and whether the disclosing party has obtained appropriate export licenses. You should then ask the disclosing party to identify specifically which export restrictions apply, if any—all in advance of the expected disclosure.

You could use the following add-on provision in your NDAs to shift the burden accordingly:

> Any such technical data must be identified as such in advance of disclosure by the disclosing party and in the event of disclosure to receiving party must bear a prominent legend stating: "This Confidential Information Contains Technical Data subject to the ITAR and EAR."

By using this provision, the receiving party will be able to identify with specificity the controlled information for which special care is necessary.

DON'T BE A BOTTLENECK: ADVICE FOR IN-HOUSE COUNSEL IN NDA NEGOTIATIONS

As we saw with Little Tech in-house counsel and Huge Telecom in-house counsel in the opening scenario of this article, in-house lawyers regularly face a dilemma: confidential information should not be disclosed to a third party without a signed NDA, yet NDA negotiations may get bogged down over one or more provisions that are unacceptable to one or both sets of lawyers.

You can take the following steps to strike a balance between protecting your company's confidential information and supporting your company's business objectives while taking a focused and practical approach to NDA negotiations:

- Stick to the basic objectives of the NDA: nonuse and nondisclosure.
- Stick to the "standard" terms addressed above.
- Don't waste time trying to force agreement on nonstandard terms.
- Be prepared to change your standard NDA during negotiations.
- Always keep the business objectives in mind—that is, concluding the NDA so that the business discussions can proceed. I am not suggesting that you give up on the two key elements of the NDA: nonuse and nondisclosure. You should, however, keep your company's main objectives in mind and avoid overnegotiating aspects of the NDA that are of marginal importance.
- Send a copy of this article to your counterpart.

CONCLUSION

NDAs are an extremely important means of protecting your company's intellectual property. Although these agreements have often required extensive negotiations, you can better serve your clients by blending flexibility with a commitment to the main principles: no unauthorized use or disclosure of confidential information. A

NOTES

1. In the United States, *see* 35 U.S.C. § 102(a), (b); in Germany, see § 3 I PatG (*Patentgesetz: The German Patent Law*).
2. Uniform Trade Secrets Act § 1(4).
3. RESTATEMENT (FIRST) OF TORTS § 757, cmt. B (1939).
4. *See* U.S. Reinsurance Corp. v. Humphreys, 205 A.D.2d 187, 618 N.Y.S.2d 270 (1st Dept. 1994) (granting preliminary injunction to prevent defendant from misappropriating plaintiff's reinsurance product because "the record [was] replete with evidence of plaintiff's efforts to maintain confidentiality of the product," including the fact that all employees and customers were required to sign confidentiality agreements concerning "the details and mechanics of the product"); Rapco Foam, Inc. v. Scientific Applications, Inc., 479 F. Supp. 1027, 1029–30 (S.D.N.Y 1979) (holding that plaintiff's manufacturing process was a trade secret because plaintiff had taken a number of steps to preserve the secrecy of the process, including requiring all employees of defendant, which had distributed plaintiff's product, to sign secrecy agreements); Integrated Cash Management Services, Inc. v. Digital Transactions, Inc., 920 F.2d 171, 173–74 (2d Cir. 1990) (court held that plaintiff's software product was a trade secret based upon fact that plaintiff's "[e]mployees, including [the individual defendants], were required to sign nondisclosure agreements"); Mai Systems Corp. v. Peak Computer, Inc., 991 F.2d 511, 521 (9th Cir. 1993) (customer database qualified as a trade secret based on fact that plaintiff's employees were required to sign NDAs).
5. Article 82 of Mexican Industrial Property Law.
6. *See* X-It Products, L.L.C. v. Walter Kidde Portable Equipment, Inc., 227 F. Supp. 2d 494 (E.D. Va. 2002) (receiving party had breached NDA by using disclosing party's nonpublic patent application provided under the NDA for evaluation purposes under the pretext of a potential business transaction in order to develop a competing product); Foster-Miller, Inc. v. Babcock & Wilcox Canada, 210 F.3d 1 (1st Cir. 2000) (receiving party had breached NDA by using proprietary information disclosed by disclosing party in order to develop competing product, and jury awarded $5,084,587).
7. In Krone EG v. Inbar Armoured Plastic, RCA 2015, 3608/95, PD 51 (3) 548, the Israel Supreme Court recognized that, even in the absence of a formal NDA between the parties, if the confidential information disclosed by

one party to another bears a marking that the information is confidential and that unauthorized disclosure is prohibited, a breach of such unilateral statement would give rise to a breach of a confidentiality understanding.

8. Lower courts in Israel have recognized an implicit obligation of confidentiality even in cases in which no NDA has been signed if the parties reveal trade secrets in the course of business negotiations. Courts have also implied that such obligation of confidence may arise from a duty to negotiate in good faith as set forth in the Israeli Contracts Law 5733-1973. *See* AMT Computing Ltd. v. Bank Hapoalim Investment Company cc (Tel Aviv) 2/64/90, Motion 13094/90 (unpublished).

   In Belgium, a party may be protected before any agreement has been concluded, that is to say during the period of negotiations. Belgian case law uses the notion of "*culpa in contrahendo*" to sanction faults committed by a party during negotiations, whether these negotiations resulted in an agreement or not. The disclosure or use of confidential information may be sanctioned as an abuse (whether voluntary or by negligence) of the legitimate confidence of the future cocontractor. The prejudiced party could sue on the grounds of civil liability established by article 1382 of the Belgian Civil Code, but must establish the fault of the other party, the prejudice caused, and the causal link between the two. It could also be that case law considers, in view of the nature or the object of the negotiations, that a precontract of confidentiality has been tacitly formed between the parties. The prejudiced party would then sue on the grounds of contractual liability. The evidence of the prejudice and the calculation of the damages in the precontractual period are, however, often problematic.

9. Penalty Kick Management Ltd. v. Coca Cola Co., 318 F.3d 1284 (11th Cir. 2003) (no breach of NDA in case in which information used was not protected by NDA relying on the exception that the NDA did not cover information that "at the time of disclosure is available to the public" or "is rightfully received from a third party").

10. *Id*. The court refused to infer the existence of misappropriation of a trade secret based on a claim that the same employees who had received disclosing party's confidential information had also approached a developer to develop a product similar to that of disclosing party's. In Sip-Top, Inc. v. Ekco Group, Inc., 86 F.3d 827 (8th Cir. 1996), in which the court found no proof of unauthorized use of confidential information disclosed under an NDA, the court refused to draw inference of NDA breach in a case in which receiving party had purchased products from competitor of receiving party, explaining that the "fact that the information provided by [disclosing party] might have made [receiving party] more informed in evaluating whether to acquire [disclosing party] or purchase [disclosing party's competitor's] product does not support" such an inference.

11. In Elite Israeli Chocolate and Sweets Industries Ltd. v. Serange, PD 49 (5) 796 C.A. 2600/90, the Israel Supreme Court upheld an NDA in a case in which a third-party service provider had exploited a disclosing party's proprietary Turkish coffee manufacturing process to set up a competing business. The court awarded financial compensation to plaintiff, yet refused to issue an injunction, reasoning that, because the term of the NDA (after having been truncated by the court) had expired and because the manufacturing process for Turkish coffee could be readily learned, an injunction was inappropriate.

12. The author is grateful to the following lawyers and their firms for conducting the research for this survey: Belgium: Hubert Andre-Dumont, McGuire Woods LLP; Brazil: Syllas Tozzini, Tozzini, Freire, Teixeira E Sila; Denmark: Morten Winsloev, C.C. Joergensen & M. Winsloev; Finland: Rainer Hilli, Roschier Holmberg, Attorneys Ltd.; France: Geoffroy Lyonnet, Curtis, Mallet-Prevost, Colt & Mosle LLP; Germany: Dr. Christian Cascante, Gleiss Lutz; Hong Kong: Stephen Wozencroft, Denton Wilde Sapte; India: Lira Goswami, Associated Law Advisers; Israel: Ashok Chandrasekhar, Goldfarb Levy, Eran & Co; Mexico: Luis Rubio, Rubio Villegas Y Asociados, S.C.; Russia: Michael J. Malloy, Gowlings International Inc.; Singapore: Gerald Singham, Rodyk & Davidson; Sweden: Johan Winnerblad, Mannheimer Swartling Advokatbyra; Switzerland: Steven J. Stein, Budin & Partners; United Kingdom: Jonathan Morris, Berwin Leighton Paisner; United States: Joshua Kiernan, White & Case LLP; Steven Becker, Coudert Brothers LLP; Gary Litke, Torys LLP.

13. *See* Bowyer v. Times Newspapers, [2000] QBD TLQ/00/ 1281, the court found that a defendant newspaper, the Sunday *Times*, had breached an NDA in the context of a book publishing relationship by advance publication of confidential information subject to the NDA although the information published was independently obtained and was not taken from the confidential information disclosed under the NDA. The court reasoned that it was "clear that the obligation on the Sunday *Times* was inter alia not to publish information contained in the book that was confidential." Moreover, the court explained that such an interpretation would defeat the commercial purpose of the NDA.

   In NDA matters before the English courts, as a complement to applicable contract law that governs nondisclosure obligations, the courts also look to the European Convention of Human Rights for guidance. Article 10 provides:

   > *Freedom of Expression*
   >
   > 1. Everyone has the right to freedom of expression. This right shall include the freedom to hold opinions and to receive and impart information and ideas without interference by public authority and regardless of frontiers. This article shall not prevent States from requiring the licensing of broadcasting, television or cinema enterprises.
   >
   > 2. The exercise of these freedoms, since it carries with it duties and responsibilities, may be subject

to such formalities, conditions, restrictions or penalties as are prescribed by law and are necessary in a democratic society, in the interests of national security, territorial integrity or public safety, for the prevention of disorder or crime, for the protection of health or morals, for the protection of the reputation of rights of others, *for preventing the disclosure of information received in confidence*, or for maintaining the authority and impartiality of the judiciary. (Emphasis added.)

14. A case has recently been filed in the Stockholm District Court, although no decision has yet been rendered by the court. *See* Fermigel AB v. Arla Forskning & Utveckling AB i likvidation and Arla Foods AB (publ), No T1894-03, Stockholm District Court (2003). In this case, an assignee of an inventor of a method of allowing low calorie thickened cream to be boiled is claiming a breach of NDA with a large Swedish producer of dairy products on the basis that the Swedish dairy producer implemented this boiling method in contravention of an NDA.
15. *Presstek Finding Costs Agfa $ 770K and a U.S. Patent for Plate Imaging*, Printing News East (ISSN: 1046-8595), Nov. 4, 1996, at 9.
16. *See* UCo v. TCo Case No. 7559/CK, ICC International Court of Arbitration, Mealey's International Arbitration Report, Nov. 1995, 10–11, MEALEY'S. INTL. ARB. REP. 6 (1995), *Disclosure of Confidential Information Results in ICC Award to U.S. Company*.
17. *See* Linda K. Stevens, *When Should a Confidentiality Agreement Contain a Time Limit?* FRANCHISE L.J., Summer 1999, at 3.
18. 151 F. Supp. 2d 478 (S.D.N.Y. 2001).
19. *Id.* at 480.
20. *Id.*
21. Buckley v. Weihs, unreported, HCA No. A635 (4 November 1992 (High Court of Hong Kong Supreme Court).
22. 15 C.F.R. Part 730 *et seq.*
23. 22 C.F.R. Part 120 *et seq.*