



CONTRACTPROBE



# Avoiding the Traps in Non-Disclosure Agreements





***Non-disclosure agreements (NDAs) are common where sensitive information is disclosed by one party to the other. They might be used when only one party divulges information to the other, such as in the case of a client and a professional. Or, there may be a mutual exchange of information, such as in the case of a business partnership. In either case, the discloser of information will need to be certain that their information is properly protected. Similarly, the recipient should insist on appropriate carveouts to ensure that their activities are not unfairly constrained. This whitepaper flags considerations which are important for the discloser, the recipient, or both.***

## **1. Definition of confidential information**

Developing an even-handed and clear definition of which information is confidential is critical for both parties to understand their rights and obligations under the agreement. This definition will depend to some extent on the nature of the agreement. Commonly, confidential information is defined as information which is disclosed in connection with the agreement and is either confidential in nature, designated as confidential by the discloser, or known to be confidential by the recipient.

**Tip for both parties:** be as specific as you can when describing the confidential information.

## **2. Express obligations of the recipient**

The obligations of the recipient set out the fundamental constraints on using the disclosed information. The discloser will typically seek to limit the use of the information in the following three ways:

- First, by including an express obligation of confidence. Breach of an obligation of confidence entitles the discloser to a broader array of remedies beyond the damages owed for breach of contract, including injunctions to prevent the recipient from acting.
- Secondly, by limiting the identity of the persons or entities to whom the information may be disclosed. Often this will have the effect of limiting the recipients to the officers or employees of a company who (a) need to know the information, (b) are subject to the provisions of the agreement, (c) have been notified that the information is confidential.
- Thirdly, by limiting the purpose for which the information may be used. This may mean limiting use of the information to the commercial purposes contemplated by the agreement or for the purposes of giving effect to a particular transaction.

**Tip for the discloser:** define the permitted purpose of disclosure as tightly as possible.

## **3. Audit and enforcement**

While establishing the recipient's obligations is critical, the discloser should also have powers of audit and enforcement for cases when breaches are suspected to have occurred or when permitted disclosures are made. These include obligations on the recipient to notify the discloser of a breach and to assist with the enforcement of the agreement by providing information about the nature of the wrongful disclosure. Further, the discloser may also wish to have a power to verify the recipient's compliance with the agreement on its own accord. This will require a right to inspect the recipient's premises and consult its records.

**Tip for the discloser:** include an obligation to notify of disclosures made in breach of the agreement or which were made as being required by law.

## **4. Termination**

It is also critical for the discloser to consider the implications of terminating the agreement on the security of the disclosed information. If all of the recipient's obligations end when the agreement terminates then the recipient might lawfully divulge the confidential information while it remains sensitive. There are two methods to avoid losing the protections of an NDA upon termination.

- First, stipulate that the confidentiality obligations of the recipient survive termination of the agreement for a certain period or perpetually. The recipient will then remain bound to confidence even if the relationship breaks down and the agreement is terminated.
- Secondly, include an obligation to return or destroy confidential information in the possession of the recipient before termination. This takes the information out of the recipient's hands before they are released from their obligations of confidence.

**Tip for the discloser:** require the recipient to give formal notice that it has destroyed all copies of the information, including in any backup memory storage media.



## 5. Liability for employees and agents

While disclosers often limit the transfer of confidential information on a need-to-know basis, that information may nonetheless pass in front of many pairs of eyes during its use by the recipient. The discloser should be alive to the possibility that the employees and agents of the recipient could commit a breach of confidence. Therefore, the discloser should include a clause which expressly states that the recipient bears liability for the acts of its employees and agents. This will avoid a future dispute about whether the recipient is liable where its employees have committed a breach of confidence and it is unclear whether they are acting within the scope of their employment.

**Tip for discloser:** where the information is extremely sensitive, consider requiring the recipient to have its employees sign individual confidentiality undertakings directly in favour of the discloser.

## 6. Data protection and security

The discloser should not only consider intentional wrongful disclosures. As recent events have shown, it is increasingly likely that information might be leaked or disclosed as the result of a cyber-attack. The discloser can protect against this possibility by imposing an obligation on the recipient to keep the confidential information secure. This will force the recipient to take steps to prevent unauthorised access to the confidential information. It may wish, either alternatively or additionally, to include a warranty stating that the recipient has appropriate security controls to safeguard the confidential information.

**Tip for the discloser:** specify the security controls that the recipient must have in place to protect the information.

## 7. Exclusions from the definition of confidential information

The recipient should ensure that the scope of information which is classified as confidential under the agreement is appropriate. This may require certain classes of information to be excluded from the application of the confidentiality obligations. Typical exclusions include:

- Information which the discloser consents to being used at the time of disclosure. This may seem obvious, however, the recipient should ensure that a specific carveout exists.
- Information which was already in the possession of the recipient, was disclosed by a third party, or was already in the public domain. The recipient should not be liable under the agreement for information which is not conveyed as part of the agreement but rather was already known to the recipient or acquired by other means.
- Works which are the same as the confidential information but are developed by the recipient independently. Again, so long as the recipient can establish that it developed the works independently and not on account of information conveyed under the agreement then those works should not be subject to the recipient's confidentiality obligations.

**Tip for discloser:** in order to take advantage of the exception for information which was already in its possession, require the recipient having documentary proof that the relevant information was already in possession.

## 8. Right to act if legally required

Another important carveout from the recipient's confidentiality obligations is the right to retain information and perform acts when legally required to do so. This will avoid a situation where the recipient is forced to choose between complying with the agreement or complying other laws and regulations to which it is subject.

**Tip for the discloser:** require the recipient to give advance notice (where possible) before making a disclosure that is required by law; that could give the discloser time to take action that protects the information even after the disclosure is made.

## 9. Obligation to ensure compliance

The recipient should also ensure that its obligation to ensure compliance with the terms of the agreement is not absolute. An absolute obligation may have the effect of making the recipient strictly liable for any breaches of confidence. However, in some cases, such as where the confidential information is stolen notwithstanding that the recipient's control protocols were adequate, the recipient should not be liable for a disclosure.

**Tip for recipient:** qualify the obligation to ensure compliance with the language of "reasonable endeavours".

## 10. Compliance with law

The recipient may wish to establish that the confidential information has been divulged lawfully. A warranty stating that the discloser has the right to disclose the confidential information and authorise the recipient to use that information should be used for this purpose. This will protect the discloser in the event that it is subsequently discovered that the information was wrongfully obtained and can no longer be used by the recipient.

**Tip for the recipient:** refer expressly to the recipient's proposed use of the information and link the warranty to that use.