

Nondisclosure Agreements

A nondisclosure agreement (NDA) helps a business protect its trade secrets.

Nondisclosure agreements are one of the best ways to protect trade secrets -- valuable confidential information that businesses want to keep under wraps. That information could be a sales plan, a list of customers, a manufacturing process or a formula for a soft drink. By using a nondisclosure agreement, you can ensure that your secrets stay secret -- or have legal recourse if they are misused or disclosed to the wrong parties.

A nondisclosure agreement -- also called an NDA or a confidentiality agreement -- is a contract in which the parties promise to protect the confidentiality of secret information that is disclosed during employment or another type of business transaction.

The use of nondisclosure agreements is widespread in the high-tech field, particularly for Internet and computer companies.

Example: Sabeer Bhatia, founder of Hotmail, collected over 400 NDAs from employees, friends and roommates. He believes that his secrecy efforts gave him a crucial six-month lead on the competition. He eventually sold Hotmail to Microsoft for a reported \$400 million in stock.

If you have a nondisclosure agreement with someone who uses your secret without authorization, you can ask that a court order the violator from making any further disclosures. You can also sue for damages.

Create a Confidential Relationship

The purpose of an NDA is to create a confidential relationship between the person who has a trade secret and the person to whom the secret is disclosed. People who have such a confidential relationship are legally bound to keep the information a secret.

An NDA is not the only way to create a confidential relationship. You can create a confidential relationship with an oral agreement or it can be implied from the conduct of the parties. However, these relationships are much more difficult to prove than a relationship based on a written agreement.

NDAs are often categorized as either "mutual" or "one-way." A mutual NDA is one in which both parties are exchanging confidential information -- for example, you provide secret information for a company to evaluate and they provide you with secret information about their marketing strategy. A one-way agreement is used when only one party is making a disclosure -- for example, when you explain your secret to a contractor or investor.

Protect Trade Secrets

Use of a nondisclosure agreement is one of the best ways to protect trade secrets -- that is, any information that is not generally known and gives your business a competitive advantage in the marketplace. For example, through a nondisclosure agreement, you can prohibit someone from disclosing a secret invention design, an idea for a new website, or confidential material contained in a copyrighted software program.

Elements of a Nondisclosure Agreement

There are five important elements in a nondisclosure agreement:

- definition of confidential information
- exclusions from confidential information
- obligations of receiving party
- time periods, and
- miscellaneous provisions.

Definition of Confidential Information

Every nondisclosure agreement provides a list of the types or categories of confidential information to be protected in the agreement. The purpose is to establish the boundaries, or subject matter, of the disclosure, without actually disclosing the secrets. For example, an NDA may state: *Confidential information includes programming code, financial information, related software materials and innovative processes.*

Exclusions From Confidential Information

Every nondisclosure agreement excludes some information from protection, meaning that the party that receives the excluded information has no obligation to protect it. These exceptions are based on established principles of law -- the most important one being that information is not protected if it was created or discovered by the receiving party prior to (or independent of) any involvement with the disclosing party. For example, if another company develops an invention with similar trade secret information before being exposed to the disclosing party's secrets, then that company is still free to use its independently created invention.

Obligations of the Receiving Party

The nondisclosure agreement will generally state that the receiving party must hold and maintain the information in confidence and limit its use. Under most state laws, the receiving party cannot breach the confidential relationship, induce others to breach it, or induce others to acquire the secret by improper means. Most businesses will accept these contract obligations without discussion.

Time Periods

Some agreements require that the receiving party maintain the secret information for a limited period of years. This is often done with language such as: *The receiving party shall not use or disclose the secret for a period of five years from the date of execution of the agreement.*

Parties often negotiate over the time period. Five years is common in American nondisclosure agreements, although many companies insist on only two or three years. In European nondisclosure agreements, it is not unusual for the period to be as long as ten years. Ultimately, the length used will depend on the relative bargaining power of the parties.

Miscellaneous Provisions

Miscellaneous terms (sometimes known as "boilerplate") are included at the end of every agreement. They include such matters as:

- which state's law will apply in the event the agreement is breached
- whether arbitration will be used in the event of a dispute, or
- whether attorneys' fees will be awarded to the prevailing party in a dispute.

Always Read an NDA Before Signing

Some agreements are titled Nondisclosure or Confidentiality Agreements, yet their terms have the opposite effect. Instead of agreeing to secrecy, the party with the secret effectively waives any claim of trade secret confidentiality.

If you sign one of these waiver agreements, you could lose the confidentiality of your trade secret and have no legal recourse. A waiver agreement usually contains language like the following (alternate terms appear in parentheses):

- This agreement does not create a confidential relationship.
- No confidential relationship is established or implied by the exchange (disclosure) of information (submission).
- The exchange (disclosure) of information (submission) is not made in confidence.
- No obligation of any kind is created (assumed, implied, imputed) by the receipt (exchange, disclosure) of information (submission).

To protect the valuable trade secrets of your business, get Nolo's downloadable eForm, *Confidentiality (Nondisclosure) Agreement*. You can customize this agreement according to the detailed instructions that are included.