Rules of Disclosure: The ABCs of NDAs

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In order to expand and thrive, entrepreneurs often need to disclose and receive confidential information from other businesses. When used properly, a non-disclosure agreement can be an important tool for protecting high-tech companies.

An NDA is a contractual relationship between parties that limits the disclosure and use of confidential information. NDAs are also referred to as "confidential disclosure agreements" or "CDAs." There are two main types of NDAs: one-way and mutual. A one-way NDA is used when confidential information flows in one direction—such as when a contractee discloses its confidential lens design to a contractor hired to build the lens. A mutual NDA applies when two companies must exchange confidential information—in a joint venture, for example.

Because mutual NDA terms apply equally to two companies, they tend to be balanced from the start. However, the terms can be tweaked to favor one side, so the involved parties must carefully review the document for potential asymmetries. With a one-way NDA, on the other hand, the receiving party bears virtually the entire burden of the agreement, and there is precious little balancing force to ensure fair terms. The wise receiving party will scrutinize a one-way NDA to make sure the terms are not too onerous.

Companies and organizations sometimes use mutual NDAs for one-way disclosure situations. Although this approach makes for easier document management (some companies have hundreds of signed NDAs on file), it is generally inadvisable because it creates unnecessary legal obligations.

NDAs serve a number of key business purposes. First, they put the parties on notice that confidential information has special status and that there are consequences for disrespecting this status. Second, they prevent the disclosure of confidential information from being considered “public.” This ensures that the companies’ trade secret and patent rights are not impacted. Third, they provide explicit directions for handling the confidential information.

What constitutes confidential information?

The definition of “confidential information” should be clearly set forth in the NDA. Confidential information can be any information that is unknown to the other party, and may include customer lists, business process information, inventions, trade secrets, know-how, etc.

A good definition is one that is tightly linked to the business reasons behind the NDA. If the NDA is for evaluating a new lens-polishing method, for example, “confidential information” should not be defined as a catchall that extends to business practices and unrelated inventions. A tight definition puts both sides on notice that important but superfluous information will be treated as non-confidential. This has the added benefit of keeping business discussions focused.

NDAs typically include a number of exclusions to what constitutes confidential information. Four standard exclusions are: (a) publicly available information; (b) already known information; (c) information disclosed by a third party not covered by the NDA; and (d) independently developed information.

Keeping secrets secret

As Benjamin Franklin once said, “Three may keep a secret if two of them are
dead.” Secrets are notoriously hard to keep, and one should not be too eager to obtain or disclose confidential information, even under an NDA. The receipt of confidential information is accompanied by limitations on its use and dissemination, along with an obligation to keep it secret, while the disclosure of such information comes with the risk of unauthorized disclosure and the consequent need to seek legal redress.

Obtaining damages due to a breach of an NDA can take years to hash out in court, and the compensation often does not fully cover the harm caused by the breach. Moreover, whether one can easily obtain an injunction (court order) to stop the use and/or disclosure of the confidential information depends on the degree of harm done, the adequacy of monetary damages, and a balancing of the hardships between the parties if the injunction is granted. A much easier way to obtain an injunction is contractually—that is, via an NDA clause in which the parties agree to injunctive relief as a legal remedy in the event of a breach.

Communicating the NDA terms

One person or group often negotiates and signs NDAs, while another is responsible for receiving, disclosing and maintaining the confidential information. When those who create the NDA terms do not communicate them to the people who actually exchange the information, the result could be disaster. For instance, if the NDA specifies that orally disclosed confidential information must ultimately be documented in writing, then failure to do so renders the information non-confidential.

Another common mistake is to share important information that is not covered by the NDAs definition of confidential. Like the “Cone of Silence,” as comically misused by the Chief and Maxwell Smart in the TV series Get Smart, the tightest NDA in the world cannot serve its intended purpose when the stated terms are not followed.

NDA mistakes are often noticed years later by chance when a patent on an invention issues or a product comes to market that looks suspiciously like the one disclosed confidentially to the patentee or product manufacturer years ago.

Handling and managing NDAs

Ideally, a single person should manage NDAs and keep all original, signed agreements in one location. In the absence of a managed process, NDAs will diffuse throughout an office and hide in cryptically labeled file drawers. While NDAs should be required reading for designated disclosers and receivers, these individuals should receive a copy of the agreement. The original should reside in a central file, along with all correspondence relating to disclosure, receipt and maintenance of the confidential NDA.

Another “best practice” is to keep an NDA log (e.g., a spreadsheet) that includes such items as: (a) the name of the other party; (b) the type of NDA; (c) the date signed and the signatory; (d) the business purpose/project name; (e) the scope of confidential information; (f) what confidential information was exchanged with whom and when; (g) the termination date of the agreement; and (h) the end of the confidentiality period (i.e., the date when the information need not be kept confidential). The log makes it easy to know the details and status for any NDA at a moment’s notice.

Summing up

An NDA is a crucial tool for handling confidential information. However, improper use of such agreements can undermine the effort that goes into preparing and signing them, and can provide a false sense of information security. By following some simple rules, such as having NDA management procedures, using the proper type of NDA, and tying the NDA terms to the underlying business purpose, NDAs can be used effectively by small and large optical entrepreneurs alike.

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