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Business Law

May 2015

Do You Want to Know a Secret? Do You Promise Not to Tell?

What to watch out for when dealing with Non-Disclosure Agreements

Often, the disclosure of confidential information or trade secrets is required to perform or achieve an overall business goal or purpose. For example, a business person seeking to sell their business might disclose financial information and customer lists to prospective purchasers. A business may also need to divulge proprietary specifications or technological know-how in situations where parties are discussing a custom manufacturing opportunity or licensing transaction. Employees are often required to sign confidentiality agreements with respect to confidential information of their employer they might learn as a consequence of their employment.

At common law, there are certain professions which carry a duty of confidentiality, like solicitor-client privilege and physician-patient privilege. However, commercial enterprises must resort to contractual rights when dealing with others in situations where they are required to disclose and wish to seek to protect non-public business information (or trade secrets) from being divulged. The contracts entered into in these circumstances may be known as Confidentiality Agreements or Non-Disclosure Agreements. For the balance of this article, the term Non-Disclosure Agreement will be used.

Many times, a business will be presented with another entity's standard form Non-Disclosure Agreement and asked to sign. Care should be taken in these circumstances to ensure your own business objectives are being met before committing to the terms of a contract undoubtedly drafted in favour of the other party. When possible, take advantage of any relative bargaining power you may have with the other business entity to present them with your own standard form or negotiate better terms.

At its core, a Non-Disclosure Agreement is a contract where one or more parties agree to hold information disclosed by one or more other parties in confidence; that is, they agree not to disclose the information to others except as permitted under the agreement. Typically, the recipient of the information is also prohibited from using the confidential information for any purpose except as permitted under the agreement.

When drafting or reviewing a Non-Disclosure Agreement, you'll want to take into account the following:

Why is Information being Disclosed?

To properly assess or draft a Non-Disclosure Agreement, the purpose for disclosure must be fully understood and described. Depending on whether you act for the discloser or the recipient, an understanding of the purpose for disclosure will help to inform you on matters such as whether the definitions should be broad or narrow, how long the contractual terms should bind the parties and how stringent the provisions should be. A discloser will try to have the broadest possible interpretations as to what constitutes disclosure and the most stringent of obligations and restrictions. A recipient will try to achieve the inverse. In any event, when acting for a discloser, the agreement should always restrict use or disclosure of the information to the purpose for which it is disclosed. A recipient should ensure the purpose is adequately stated so as to achieve the intended goals for the use of the information to be disclosed. Also consider whether disclosures to employees, advisors or agents is allowed and, if so, on what terms; e.g., should additional confidentiality obligations be established with these third parties and, if so, to whom should the obligations be owed?

Who are the Parties?

Besides making sure that the parties are accurately named, you'll want to determine whether disclosure of valuable information will be unilateral (i.e., only one party discloses) or multi-lateral (i.e., each party will receive disclosures from the others). This determination is often overlooked and many so-called standard forms assume mutual disclosure even though only one party is disclosing. The danger of accepting mutual disclosure in all circumstances is that the agreement may not adequately protect the interests or goals of the discloser, who will often choose to accept looser restrictions lest the more stringent ones be used against it. If acting for a recipient, you may prefer mutual disclosure provisions in order to take advantage of these looser restrictions.

You might also consider whether the circumstances require that affiliates of the recipient should be bound by the agreement provisions and, if so, should these affiliates be named as parties or is it feasible in the circumstances to hold the recipient liable for breaches of the agreement made by its affiliates despite them not being parties to the agreement. Should principals of a closely-held recipient be named parties? In most circumstances when acting for a discloser of information, both of these inclusions should probably be preferred. A recipient will usually try to resist agreeing to these provisions.

What Information will be Disclosed?

Determine what information is to be disclosed and protected and how the recipient of that information will come into possession of it. Will the information be delivered orally, in written form or by some other means? This can become important, not only for identifying the information and establishing that it was in fact provided, but also in establishing what happens to the information after the purpose for which it was to be used ends or the contract terminates. In any event, you'll also want to identify what (if anything) is to be excluded from confidential information. All of these determinations should be reflected in the definitions.

It is typical to include exceptions to what constitutes "confidential information" and the following are common exceptions: (1) information that is or becomes public knowledge other than as result of a breach by the recipient under the agreement, (2) information that becomes available to the recipient on a non-confidential basis from a third party that is not bound by obligations of confidentiality, (3) information that the recipient can show it knew prior to entering into the agreement, (4) information that is independently developed by the recipient without the use of the discloser's information, and (5) information required to be disclosed by law or judicial process, including legal proceedings between the parties.

Especially in the context of disclosures made in the process of negotiation of a larger business transaction, it is usual for a discloser to include a provision stating it bears no liability for the completeness or accuracy of the information provided and it is equally common for a recipient to limit this exclusion of liability by adding a proviso that any definitive agreement subsequently entered into between the parties will govern. In addition, a discloser will want to ensure that its ownership of disclosed information is clearly set out and that the agreement states the recipient receives no right or license to the information disclosed.

If you represent a recipient, watch out for a definition of information which would include disclosures made prior to the date of the agreement. These provisions should be carefully scrutinized and should be accepted only in the most unusual of circumstances.

What Obligations and Restrictions Should be Imposed on the Recipient?

In addition to restricting use to the purpose for disclosure, the discloser will seek to restrict the recipient from further disclosing the information to third parties. In addition to ensuring necessary disclosures are permitted to its employees, agents or advisors, a recipient will also want to ensure it is able to comply with disclosures required of it by law or legal process. A discloser will often want to have advance or contemporaneous notice of permitted disclosures so it can seek protective or restrictive orders. As

a recipient, you will want to ensure that any legal obligation to provide such notice is permissible and reasonably practicable in the circumstances.

A discloser will seek to require that a recipient protect and preserve the confidential nature of information disclosed. Consideration should be given to what standard of care should be taken to ensure this protection and preservation requirement. Consider whether a recipient should be required to use best efforts, reasonable efforts, commercially reasonable efforts or the same standard of care it uses in protecting its own confidential information. Will physical or virtual security measures be required and if so should specific standards be set out?

How Long should Contract Provisions Last?

You'll want to consider the period of time during which the contract is to remain in force. In most contexts, the term should last at least as long as the purpose for which disclosure is made. A discloser will want to ensure that at the end of the contract term the recipient returns or destroys tangible information provided and may also require the recipient certify its compliance in writing. A recipient may want to consider whether it should be entitled to retain one or more archival copies of information disclosed to it for legal or retention policy purposes.

You will also want to determine when and whether the confidentiality (or other provisions) will survive the term or termination of the agreement and, if so, for how long. In most circumstances when acting for a discloser of information, you'll want to have confidentiality and some other protective provisions survive indefinitely (e.g., the disclaimer of license rights, non-use and indemnity clauses). But there are sometimes arguments to be made by a discloser that, at some point, the information will be old and will cease to have value to the discloser, in which case, the discloser may argue, it should be entitled to stop expending resources required to comply with its obligations under the agreement.

What Happens if a Recipient Breaches the Agreement?

Consideration should be given to what happens if the recipient breaches the agreement. Should fixed damages be set out? Fixed damages will often favour the recipient who can limit its exposure or obtain protective insurance coverages for this risk. Will the discloser have the right to injunctive relief? A discloser will often seek automatic availability of injunctive relief (which is really not automatically available as injunctive relief is only granted at the discretion of the courts) while a recipient may insist on agreeing only to permit the discloser to seek such relief. Should an indemnity be provided? This can often come in handy when third parties can or will be affected by a breach of the recipient's obligations.

What Other Provisions Might You be Concerned With?

If prior agreements existed between the parties which governed the use and disclosure of confidential information, the agreement should clearly state that such prior agreements have been superseded by the current agreement. Also consider having the current agreement take precedence over any future "click-through" or other agreements purportedly entered into at the time of access to or disclosure of information.

A first draft of a Non-Disclosure Agreement will most likely be governed by the laws of the drafter's jurisdiction and the forum for disputes will be set to take place in that same jurisdiction. Typically, the party with the most bargaining power will determine both the governing law and the forum for disputes under the agreement. Consider whether neutral ground would be a more suitable governing law or venue. Also, consider whether arbitration (international or domestic) would be a preferred solution in the circumstances. If the information disclosed consists at least in part of intellectual property of the discloser, and especially if the parties are in different countries, you may want to consider arbitration under WIPO rules or jurisdiction. If you are the discloser, it may make sense to have the laws and courts of the recipient's jurisdiction

prevail so that you do away with any question as to whether the order is exportable in the first place and, if it is, avoid the need to do so.

Disclosers, especially, will try and insert non-competition or non-solicitation provisions into the agreement. In most circumstances, recipients should resist this and, even if agreeable to such restrictive covenants in the circumstances, should insist that they form part of a separate agreement. One good reason for this is that the disclosure or use of information obtained under a properly drafted Non-Disclosure Agreement is already restricted to a stated purpose. Furthermore, a Non-Disclosure Agreement is typically entered into at the inception of a business relationship while these additional restrictive covenants are more suited to ongoing dealings between the parties.

Finally, if information disclosed includes personal information of individuals, consider the addition of covenants confirming that the recipient will comply with all applicable privacy legislation, including the provisions of the *Personal Information Protection and Electronic Documents Act* (Canada), in its use, permitted disclosure, storage and handling of such information.

The above is meant as general guidance only and is not meant to be exhaustive. Each circumstance will be unique. Seek competent legal advice when drafting or reviewing the provisions of any Non-Disclosure Agreement. A member of our Business Law Group would be pleased to assist you.

Joe Conte is a member of the Business Law Practice.

Pallett Valo LLP Business Law Practice

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