Confidentiality

Protecting your confidential information and NDAs
Confidentiality

Introduction

More now than ever before, knowledge is king. Accordingly, how you use that knowledge or, more correctly, confidential information, is an important decision that all businesses have to take when interacting with others. This article looks at the legal and practical aspects of disclosing confidential information to others and the use of non-disclosure agreements (NDAs).

NDAs: What are they?

An NDA, a non-disclosure agreement, a confidentiality undertaking, a confidentiality letter or a confidentiality agreement are all names for essentially the same document. There are few formal requirements as to what can constitute an NDA and it is perfectly feasible for an NDA to be wrapped up in some other type of document or agreement, for example, some Heads of Terms or an Exclusivity Agreement, both being documents commonly used to begin formalising a transaction between two or more parties.

NDAs therefore come in all shapes and sizes, but have at their core one clear purpose: to identify certain information to be provided to another and to establish how that information can and cannot be used.

NDAs regulate and record the flow of information. This flow can be one way. For example, where a software designer is going to produce some software for your business based on certain confidential information you will provide. Or they can be mutual, i.e. the party receiving the information (the Information Recipient) is also providing their information to you. Both one-way and mutual arrangements are common, but it is important to identify from the outset which of the two arrangements is to be used.

Where would you expect to come across an NDA?

The short answer is that you’d expect to encounter an NDA in any situation where confidential information is being provided and the party providing the information (the Information Provider) wishes to record and regulate the treatment of that information. Typical examples therefore include:

- On an investment; the company seeking the investment would ask the investor to sign an NDA relating to the confidential due diligence information about the company the investor will receive.
- On the outsourcing of a service; the outsourcer would expect the service provider to sign an NDA relating to both the confidential information he will receive to allow him to commence providing the service, but it would also cover the information received in the course of such service provision.
- On taking a lease; the tenant would expect the landlord to sign an NDA if the tenant needs to pass on confidential information about his business to the landlord relating to the anticipated use of the property.

NDAs are also commonplace in normal trading arrangements where customers and/or suppliers are providing or receiving confidential information.
Should you expend time, cost and effort in putting one in place?

There is no definitive answer to this tricky and well-rehearsed question. However, this article will look at the question on a legal and then commercial level.

Legally, subject to certain formal considerations that apply to any contract, NDAs do work. They create a contractual right for the Information Provider to seek a judicial remedy from the Information Recipient should he breach the terms of the agreement. The remedies available should, assuming the NDA is drafted properly, allow the Information Provider to choose between financial compensation and a court order preventing disclosure of the confidential information concerned. Legally, to enforce an NDA, the Information Provider will need to go to court and to show that there was a contract, to establish its terms, to establish that on the face of the facts there was a breach by the Information Recipient and then to establish the financial damage the breach has caused the Information Provider.

A well-drafted NDA and a properly managed and controlled information disclosure process can make it relatively simple to provide strong evidence under most of these heads. Proving damage could be harder, but the facts normally speak for themselves. If, for example, you have provided your secret recipe to a manufacturer and the manufacturer in turn provides it to a competitor who then uses it to produce a competing but cheaper product, it is a good bet that your sales will fall, while your overheads will remain the same, or, put more simply, that you have suffered provable loss.

However, here the legal points necessarily give way to the commercial reality. It is often said that you would never wish to, or can afford to, sue a more established business or wealthy individual to whom information has been provided. It is true that the evidential and costs burden will be on you and it may also be true that your financial loss might be deemed small in the court’s view. Furthermore, it is true that you are not likely to have advance notice of any breach, so obtaining a court order to prevent unauthorised disclosure is not likely to be relevant. It has also been well noted that neither remedy might be what you are looking for; what you would have preferred is for there to have been no breach of confidence in the first place. In addition, suing the Information Recipient won’t make the information confidential again.

Having an NDA can’t be regarded as a panacea. That said though, I still believe they have their place as part of your wider approach to dealing with confidential information.

Having an NDA does have a number of irrefutable commercial advantages. The mere act of putting one together focuses the minds of the parties on what information is confidential and how it can be treated. This is beneficial and this process typically only takes place in the context of agreeing an NDA.

Having an NDA has a deterrent effect. Much like the role of criminal law, it establishes in the recipient’s mind that unauthorised disclosure might land him in court and could cost him financially.

Finally, you should not forget that having an NDA, or choosing not to, is not just a decision for your business in the here and now. For example, if you are considering looking for investment in due course, you will find that your IP and confidential information is seen as a key asset and you will also find that you have to disclose it to a number of potential investors before you find the investor or investors who actually inject cash into your business. Your successful investors will want to see that it is protected and, of course, what starts off as your information will become their information too on
investment. Just because you might not want to sue on an NDA, your investor may well want to in
order to protect his investment. Having an NDA will be especially useful in preventing disclosure by
the unsuccessful investors who performed due diligence.

How to draft or review an NDA

Before you get too bogged down with reading or amending the NDA itself, you should take the time to
work out what information you are going to be disclosing, how confidential it is (certain aspects may
be more confidential than others) and why you are disclosing it. You need to know this before you
can draft or analyse an NDA. This will also help you understand what it will cost you if your
confidential information is not kept confidential. If the cost is minimal, you might not require an NDA.
If the cost is moderate, you might well choose to draft your own NDA. If the cost is high, it might be
better to have a lawyer draft the NDA for you to make sure it really does protect you. Lawyers also
carry insurance, so if they make an error and you suffer loss, the insurer will pay.

The first point to note about how to draft an NDA is that you should never start with a blank piece of
paper. You need to start with a sensible template. To allow you to do this, we have made our own
template freely available through this link: http://bit.ly/Freenda (and a copy is set out at the end of this
article). As mentioned above, there are many sorts of NDA. The template we have made available is
only suitable for the one-way disclosure of information as part of a corporate transaction. This is the
type of NDA we are most commonly asked to provide.

You may find the other party to the deal gives you their standard document to sign. It is best to be
sure you are fully comfortable with the NDA you have been given and all of its terms before you sign
it. You should be aware that NDAs are normally biased in favour of the drafting party. So don’t be
afraid to ask why a clause is included, what it means and, if you are not satisfied, to ask to have it
removed or amended. An NDA is a commercial agreement much like any other and bargaining power
counts.

So, what does the document itself look like?

The NDA is likely to include the following clauses:

The parties

These are the parties to the agreement. In most cases there will be two parties: the Information
Provider and the Information Recipient. Insert their full names and, if relevant, company numbers.

The definition of “Confidential Information”

The NDA will define what is meant by “Confidential Information”. This is probably the most important
clause in the agreement. You need to spell out what you mean by Confidential Information. A
description or a list is a good way of doing this. The definition must not be too wide in scope; be
aware that mixing patently non-confidential information with confidential information will cause all
information to be treated as non-confidential and render the agreement useless. Similarly, it must not
be too narrowly defined as this might mean key information is not caught by the obligations in the
NDA. Linked to this, you need to consider whether copies, notes and secondary information created
by the Information Recipient having seen the confidential information should also be included.
The definition of “Permitted Purpose”

The NDA will also use this key defined term. As the words would suggest, this sets out exactly what the Information Recipient is permitted to do with the information. For example, supposing you ran a drinks manufacturing company and you were in talks with an investor to buy half of your shares, the investor would rightly want to carry out his due diligence and this will involve you sending him a great deal of confidential information about your company. This might for example include the recipe for one of your best-selling drinks. The Permitted Purpose of the information you supply is to allow the investor to decide whether he wants to invest. An investor would therefore not only be obliged to keep the information confidential, but also would only be allowed to use the confidential information for the Permitted Purpose. The Permitted Purpose of course does not extend to the potential investor keeping the information confidential but then using it to manufacture the drink himself.

The confidentiality obligation

This is the main clause. It sets out what the Information Recipient must do and must refrain from doing. Keeping information confidential is a given. However, you should consider stating exactly how it should be kept confidential and who may access it, and add in an obligation to return or destroy it and all copies of it on request. The more specific you are, the easier it is for you to inspect for compliance and to prove a breach. For example, where the Information Recipient is a company, consider limiting access to certain named directors and requiring it to be password protected. Consider whether it can be shared with their lawyers or accountants and, if so, consider limiting this to a need-to-know basis.

Duration of the obligation

It is customary to limit the duration of the obligations to a period that reasonably reflects the shelf life of the information being provided. Anything from one year to five years would be normal, but there is no reason why it could not be longer. As a sanity check though, you should ask yourself how long it would take until you would no longer be concerned by a breach of the (now) “old” information. There would seem to be little point in asking for a longer period of protection than you need.

Other clauses

While we have not included many supplementary clauses in our template NDA, other firms may and you should know what to expect.

Briefly, you may find the following clauses also included:

Non-compete/non-solicit

This is a clause that will prevent the Information Recipient from competing with your business, and from poaching your staff or clients. It is easy to see why this might be something you ask for, but be aware that it may well not be acceptable to the Information Recipient. Investors might decline to accept such terms as they are not really relevant to their interest in your business and competitors would not wish to accept terms that restrict their existing (and proposed) business. However, they might accept an obligation not to poach your staff or clients, though they would probably seek customary limitations which, for example, allow them to hire respondents to job adverts and to deal with unsolicited customers who approach them. You should be aware that you can only lawfully protect your legitimate business interests and, therefore, any such provision will need to be limited with respect to duration and applicable geographic area.
Break clause/lock in/exclusivity

This is a clause found only in corporate deals where one party is locked in to the negotiations for a period of time during which due diligence takes place. If, at the end of the period, a deal is not then completed, one party may be required to pay the other a break fee. Such provisions are unusual, but are relevant where one party requires the other to prove he is serious about the deal at hand.

Announcements

This clause sets out who can announce what. Normally, you would expect announcements only to be permitted with the consent of both parties.

Costs

This clause would set out who will bear the costs of preparing the NDA. Remember that NDAs are contracts and it is common for both parties’ lawyers to amend the NDA before the parties sign it. This of course incurs costs. Normally, each party would bear its own costs, but sometimes a party can have sufficient bargaining power to compel the other side to pay its legal costs.

Practical Points

When to sign?

There is no question that it is preferable to have the NDA in place before you disclose confidential information. However, this actually conceals another important point. What do we mean by confidential information and, so, when do you get to the stage that you should refuse to hand over any more information without an NDA? The decision will of course be yours, but be aware that an Information Recipient would expect to know why he was being asked to sign an NDA and the nature of the information he will be provided with, should he sign. To understand the reasoning behind this, ask yourself: how happy would you be if you signed an NDA and the confidential information disclosed under it turned out to be similar to something you were working on? Far from being a windfall benefit, this might actually interfere with a course of action on which you had already embarked. Accordingly, you should accept that there will have to be information you disclose before you sign an NDA, and this information should be less sensitive.

Where you might not have any choice

There will be times when you have no choice. For example, you may find that VCs won’t sign an NDA and that if you are the Information Recipient and you are working with a big Information Provider, then you will be required to sign their standard NDA. You will often be confronted with decisions like this and you need to take a risk-based commercial decision as to whether to sign/whether to accept that you won’t be offered an NDA.

What if you don’t have an NDA?

The equitable law of confidence will apply in all cases and will offer the Information Provider some limited legal protection in so far as the Information Recipient may not take unfair advantage based on information received in confidence. Where you have a choice, it is best not to rely on this general rule of law, not least because it is hard to enforce and you will need to show that there was both a relationship of confidence in place and that the Information Recipient knew he was required to treat
the information in confidence. However, you might not have a choice, in which case the equitable law of confidence will be of assistance.

There are two other factors that might assist you where you have no NDA. The first is the reputation of the Information Recipient. While VCs typically won’t sign an NDA, they are not in the business of leaking your confidential information, as to do so would ruin their reputation and would undermine their ability to attract future investment opportunities. The second relates to advisors such as lawyers and accountants. Regulated advisors have a code of conduct to uphold which includes strict requirements for them to safeguard confidential information. They risk losing their ability to practise, and thus their career, should they breach this duty. Needless to say, this is strong comfort for Information Providers and explains why regulated advisors also typically will not sign NDAs.

Conclusion

The best protection is not to disclose confidential information at all. In circumstances where it is required, it is a good idea to take practical measures to ensure the information’s confidentiality. By disclosing the information through only allowing inspection of hard copies at your offices or through a controlled online data room, and by keeping a log of who has seen what, you will have maximised the chance of your information staying confidential. You should also not be afraid to perform your own due diligence on the Information Recipient. Ask yourself: Do I trust them? Having an NDA is a highly advisable second stage. It is enforceable and, by not having one, you take a permanent decision not to require a contractual commitment to confidentiality, risk sending a signal that confidentiality is not important to you and you take a decision that may later be questioned by investors.

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Disclaimer

We have written these materials to help you, but no article can address all the issues. The benefit of using an experienced lawyer is that they ask the right questions and build the solution around you. Please therefore note that these materials only provide you with general information and should not be regarded as a substitute for taking legal advice.

Would you like to know more?

Keystone is a corporate law firm that has grown rapidly since 2002 when it was set-up to service the SME community. It is a full-service law firm with over 100 partner level solicitors and turnover in excess of £10 million. The firm has a unique structure whereby a central London office supports its
solicitors who in turn work from their own satellite offices. Overhead savings are passed onto the firm’s clients who benefit from a very personalised service.

If you would like to know more, or for a competitive quote please call 020 7152 6550 or email enquiries@keystonelaw.co.uk.
Dear [Name]

Disclosure to you of confidential information

[NAME OF DISCLOSING PARTY] [Limited/PLC], acting in its own capacity, through its agents, directors, employees, representatives or advisers (together referred to in this agreement as “we” or “us”, as appropriate) has agreed to disclose certain information to [NAME OF RECEIVING PARTY][Limited/PLC] (referred to in this agreement as “you”).

The confidential information (“Confidential Information”) we are disclosing to you is all the information we send or make available to you [and have already made available to you] in whatever form. However, the Confidential Information does not include:

a) any information that is or becomes generally available to the public (other than as a result of its disclosure by you in breach of this agreement), except that any compilation of otherwise public information in a form not publicly known shall nevertheless be treated as Confidential Information;

b) any information independently made available to you by a third party on a non-confidential basis;

c) any information you can prove with your written records that you already lawfully held before we sent such information to you;

d) any information you can prove with your written records that you have developed independently of the Confidential Information; and

e) any information that cannot reasonably be considered to be of a confidential nature.

We have given you the Confidential Information for the purpose (“Purpose”) of [your due diligence investigations into our business in relation to [your proposed investment in us] [the proposed joint venture between you and us] [your proposed acquisition of the entire issued share capital of COMPANY NAME OF DISCLOSING PARTY] [your proposed acquisition of our business]] [your agreement to provide [describe services or products] to us] in whatever form. However, the Confidential Information does not include:

a) any information that is or becomes generally available to the public (other than as as a result of its disclosure by you in breach of this agreement), except that any compilation of otherwise public information in a form not publicly known shall nevertheless be treated as Confidential Information;

b) any information independently made available to you by a third party on a non-confidential basis;

c) any information you can prove with your written records that you already lawfully held before we sent such information to you;

d) any information you can prove with your written records that you have developed independently of the Confidential Information; and

e) any information that cannot reasonably be considered to be of a confidential nature.

We agree to provide the Confidential Information to you and in return you agree to use it only for the Purpose and to keep it confidential.

In particular, unless we agree otherwise in writing, you will ensure that:

a) the Confidential Information is only used for the Purpose;
b) the Confidential Information (or any part of it) will only be made available to those of your agents, directors, employees, representatives or advisers if, to achieve or work towards the Purpose, they each have a genuine need to know;

c) the Confidential Information must be kept in a reasonably secure manner and, if you keep your own information with a higher degree of security, then you must store the Confidential Information with the same degree of security;  

iv  and

d) the Confidential Information must not be reduced to writing or otherwise copied or recorded, unless to do so is strictly necessary for the Purpose.

You agree to ensure that your agents, directors, employees, representatives and advisors will keep the Confidential Information confidential and you will ensure their compliance with the obligations set out in this agreement. You agree to accept liability for any breach of this agreement by your agents, directors, employees, representatives and advisors, as if they were your actions or omissions.

You may disclose Confidential Information only to the extent required by law or regulation. Where lawful, you agree to inform us in writing immediately following a request to you to make any such disclosure.

At our written request you shall promptly:

a) return to us by courier the Confidential Information and all documents, materials and copies which contain any Confidential Information (except as required by law or regulation);

b) where practicable, erase all electronic documents, materials and copies of the Confidential Information from any IT systems you use and to which you have access (except as required by law or regulation); and

c) notify us in writing that you have complied with these requirements.

Save as required by law or regulation, you and we agree to keep the terms of this agreement confidential and to refrain from making any public announcement concerning it.

Please note that we reserve all our rights in relation to the Confidential Information. We accept no obligation and grant no rights other than those set out in the agreement. We offer you no express or implied warranty or representation as to the validity, source, accuracy, appropriateness or completeness of the Confidential Information. You acknowledge that, in entering into this agreement, you have not relied on, and shall have no right or remedy in respect of, any statement, representation, assurance or warranty (whether made negligently or innocently) other than as expressly set out in this agreement. Nothing in this agreement shall limit or exclude any liability for fraud or for fraudulent misrepresentation.

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At present we only wish to provide you with the Confidential Information for the Purpose. If we would like to progress matters in any other way we will do so in a separate agreement.
You acknowledge that damages alone would not be an adequate remedy for the breach of any of the provisions of this agreement. Accordingly, without prejudice to any other rights and remedies we may have, we shall be entitled to the granting of equitable relief (including without limitation injunctive relief) concerning any threatened or actual breach of any of the provisions of this agreement.\textsuperscript{vii}

You shall indemnify us and keep us fully indemnified at all times against all liabilities, costs (including legal costs on an indemnity basis), expenses, damages and losses including any direct, indirect or consequential losses, loss of profit, loss of reputation and all interest, penalties and other reasonable costs and expenses suffered or incurred by us arising from any breach of this agreement by you.\textsuperscript{viii}

If you decide not to become involved in the Purpose, you shall notify us in writing immediately. Your obligations under this agreement shall last indefinitely but such notification shall not affect any accrued rights or remedies.

This agreement constitutes the whole agreement and supersedes all previous agreements relating to the Confidential Information.\textsuperscript{ix}

This agreement shall terminate \textsuperscript{NUMBER} years after the date of its signature.\textsuperscript{x}

No variation of this agreement shall be effective unless it is in writing and signed by you and us.

Failure to exercise, or any delay in exercising, any right or remedy provided under this agreement or by law shall not constitute a waiver of that or any other right or remedy, nor shall it preclude or restrict any further exercise of that or any other right or remedy.

No single or partial exercise of any right or remedy provided under this agreement or by law shall preclude or restrict the further exercise of that or any other right or remedy.

You may not assign, sub-contract or deal in any way with any of your rights or obligations under this agreement.

Nothing in this agreement is intended to, or shall be deemed to, establish any partnership, joint venture or any other commitment between you and us.

This agreement is made for the benefit of you and us, and is not intended to benefit, or be enforceable by, anyone else.

This agreement and any dispute or claim arising out of or in connection with it or its subject matter or formation (including non-contractual disputes or claims) shall be governed by and construed in accordance with the law of England and Wales.

You and we irrevocably agree that the courts of England and Wales shall have non-exclusive jurisdiction to settle any dispute or claim that arises out of or in connection with this agreement or its subject matter or formation (including non-contractual disputes or claims).
Yours [sincerely][faithfully]

........................................

[name]

We acknowledge, and agree to be bound by, the terms of this agreement.

........................................          ........................................

[name]                                      Date

\[i\] You need to ensure that you only send Confidential Information to one designated person within the receiving party. This helps with tracking what has been sent and gets round the issue of information not being ‘Confidential Information’ (and so covered by the NDA) if sent to the receiving party's advisors, accountants, lawyers etc.

\[ii\] As a rule you should sign the NDA before sending any confidential information over; but if you have already made some disclosures then you need to ensure that those past disclosures are also included in the definition of “Confidential Information”.

\[iii\] The Purpose for which the information is to be used is vital. The final NDA will need to explain why the Confidential Information is being provided. This draft has suggested a joint venture, an investment, a sale of your business or having a third party provide development/manufacturing assistance. This is not an exhaustive list and an appropriate purpose should be set. The reason for setting a purpose is to prevent it from being used for any other purpose, e.g. to launch a competing product or service.

\[iv\] If the Confidential Information includes something unique, e.g. a prototype that cannot be easily replaced, then you need to add a further obligation in the NDA requiring them to preserve the Confidential Information.

\[v\] Having an NDA is important, but it is better to ensure compliance than end up in court seeking compensation. As such, if there is any particular action you want the receiving party to take, you should add this obligation in the NDA. You should also discuss with the receiving party and agree how you can both check the agreed rules are being followed. You should consider using practical methods such as locked private web sites or hard copy files available for inspection in your offices; control of the confidential information is the best protection you can have.

\[vi\] This is extremely important; otherwise you may end up being sued if there is any inaccuracy or insufficiency with the Confidential Information. There are of course times when the receiving party will be able to rely on the information you provide, but it is essential that these rights are given to them at the right time and in the right manner. That time and manner is when you sign the
ultimate deal to sell, invest, manufacture, develop etc and at this point you will need further special legal protection, for example, limiting the maximum financial exposure you will accept etc.

vii This too is important, this means that if you hear of an impending breach of confidentiality you can go to court urgently and ask the court to prevent it.

viii You never want to be relying on damages to compensate you for breach; you can have no guarantee that damages may be enough. However, this paragraph gives you the largest amount of damages permitted by law. The legal issue is best explained by considering confidential information consisting of the designs for a new product. Such designs have little or no current value, i.e. you would suffer little or no loss if they are made public. The courts do not look at what value they might have had if you later went on to make that product and it was profitable.

ix This is known as an ‘entire agreement provision’ and is intended to stop the receiving party from arguing that something you mentioned in a later email changed the agreement. These are legally effective, but it is still important that you have a process for how you send the Confidential Information over to the receiving party. Any letter or email should make it clear that this is being sent subject to the NDA and then cite its date. You should not go on to say anything else, it is better to let them draw their own conclusions.

x You need to agree how long the receiving party will be bound. This will depend on the nature of the information. If it goes out of date quickly (e.g. financial information that will need to be filed at Companies House in due course anyway) a period of six to twelve months might be appropriate. If it will remain sensitive for a longer time you should choose a longer term. For very sensitive technical information a period of five years or more might be appropriate.