Confidentiality Agreements 101 for Entrepreneurs

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As an entrepreneur, you have spent countless hours developing the concept for a new product or service, building your product prototype or proof of concept for your service, preparing a business strategy for your new company, and progressing your client and supplier database. The details regarding your product or service, along with your proposed business strategy and prospective client and supplier database, are your confidential information, representing valuable assets of your emerging company. As such, your confidential information needs to be properly protected. A key step to protecting confidential information is to avoid sharing it with any third party prior to entering into an appropriate Confidentiality Agreement (sometimes referred to as a Non-Disclosure Agreement) with that third party. Third parties could include potential employees or consultants, financing sources, suppliers or vendors, or other collaboration partners.

Here are some key issues to consider when negotiating a Confidentiality Agreement with the intended recipient(s) of your confidential information.

1. Purpose of the Confidentiality Agreement

A Confidentiality Agreement should specify the specific purpose for which the recipient may use your confidential information. A commonly used purpose is to evaluate a potential business relationship between the parties. However, you may want to include a narrower scope for the purpose. For example, you may want to specify the type of business relationship being considered, or tie the purpose to the specific asset, product, or activity to which the Confidentiality Agreement relates. If you do choose to narrow the scope, you need to make sure to amend the Confidentiality Agreement in the future (or enter into a new Confidentiality Agreement) if the scope discussed broadens.

2. Definition of Confidential Information

The scope of confidential information should be clearly defined in a Confidentiality Agreement. In general, you will want to utilize a definition of confidential information that provides the broadest coverage possible, as this will provide maximum protection for your assets. The following is an example of a broad definition of confidential information: “Any information or material which is disclosed by or on behalf of the disclosing party to the recipient in connection with the Purpose, including, without limitation, corporate information, marketing information, financial information, operational and technical information, and personal information, which may be provided or observed in any tangible form.” This definition could be expanded to include specific examples of each category of information.

Many recipients, however, request a tighter definition of confidential information. You should carefully consider if a tighter definition is acceptable. For example, recipients may seek to

tighten the scope of confidential information by (i) requesting that confidential information provided in written form be marked with a conspicuous legend identifying it as "confidential" or "proprietary," or (ii) requiring that confidential information disclosed in other forms, such as orally, be reduced to writing within a set period following the disclosure. If you agree to these requests, you need to confirm that you have proper processes in place to comply with these procedural requirements, otherwise the confidential information you disclose to the recipient will not be properly protected.

3. Information that is not Deemed Confidential Information

Confidentiality Agreements typically include exceptions to the definition of confidential information. These exceptions specify when certain information of a disclosing party will no longer be considered confidential information for purposes of the agreement. The following are common exceptions regarding when disclosed information will no longer be deemed confidential information: (i) such information becomes generally available to the public through no wrongful act on the part of the recipient; (ii) such information was independently developed by the recipient without use or access, directly or indirectly, of the disclosing party's confidential information; or (iii) the recipient received the information from a third party who had the right to transfer or disclose it. The burden should be on the recipient to demonstrate that the disclosed information falls within one of these exceptions through competent, contemporaneous evidence, such as written records.

4. Who has the Right to Use the Confidential Information

Confidentiality Agreements should also specify if the recipient has the right to share the disclosing party's confidential information with any other people. This right to share should be limited to certain groups of people, referred to as representatives of the recipient. Typical representatives include employees, consultants, financial advisors, lawyers, investors, and prospective investors of the recipient, who have a need to know the disclosing party's confidential information for the specific purpose of the Confidentiality Agreement. You may also want to further limit disclosure of certain types of confidential information to an even smaller subset of the recipient's representatives. For example, pharmaceutical and biotechnology companies often restrict disclosure of their compound structures to specific, named employees and consultants of the recipient who are not conducting research and development that is competitive with the compound that is being disclosed. The recipient should remain liable for its representatives' breaches of the Confidentiality Agreement.

5. Certain Rights to Disclose Confidential Information

Although Confidentiality Agreements should protect confidential information to the greatest extent possible, there are some situations where a recipient needs the right to disclose the confidential information. The most common reason is the recipient's need to disclose a disclosing party's confidential information for legal or regulatory purposes, including in response to a subpoena, judicial, or administrative order. Even though these are legitimate reasons for disclosure, you should still seek to limit these disclosure rights as much as possible. For example, the recipient should give you prior written notice of the need to disclose, allow you to review the proposed disclosure, and, if necessary, seek a protective order for your confidential information. Furthermore, the recipient should only disclose the portion of your confidential information that is specifically required for the purpose of the request, and any disclosure in response to such request will not void the information's status as confidential information under the Confidentiality Agreement.

6. Length of Confidentiality Period

A Confidentiality Agreement should specify a specific time period during which the recipient agrees to keep confidential information protected from disclosure. The length of the confidentiality period generally varies based on the purpose of the Confidentiality Agreement,

the nature of the recipient, and the type of confidential information disclosed. For example, financial investors generally require shorter confidentiality periods than potential collaboration partners. In general, the confidentiality period should last during the term of the Confidentiality Agreement and for a period of time (such as five years) following the termination or expiration of the agreement. If the Confidentiality Agreement does not specifically state that the confidentiality period extends beyond the termination of expiration of such agreement, the confidentiality period will terminate upon the termination of expiration of the agreement. Similarly, if the Confidentiality Agreement does not include a specific term or expiration date, the confidentiality period will last until the information disclosed no longer falls within the definition of confidential information.

7. Remedies for Breach

Given the importance and value of confidential information, monetary damages are typically insufficient to compensate a disclosing party for a recipient's breach of a Confidentiality Agreement. Therefore, Confidentiality Agreements should include a specific right to seek injunctive relief in a court of competent jurisdiction in the event of any breach of such agreements. If injunctive relief is awarded, the recipient will immediately need to cease the breaching activity, which should help limit the damage caused by such breach.

Given the critical importance of confidential information to your company, it's strongly advisable that you consult with an attorney to structure your Confidentiality Agreement and to develop an appropriate disclosure strategy for your confidential information. Your disclosure strategy will likely contain various levels based on (a) the importance of the information that you expect to disclose and (b) the degree of risk associated with applicable disclosure.

If you have any further questions about this, please contact Laurie Burlingame.