

Issues Enforcing Nondisclosure Agreements

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Overview

Confidential information is a basic business requirement. Such information is essential to protect business vitality, competitive advantage, industry leadership, and ultimately the market share. Sometimes a business may have to disclose confidential information to others to advance its business interests. Nondisclosure agreements can allow businesses to disclose confidential information without the risk of losing ownership of that information. However, nondisclosure agreements are only as effective as they are enforceable. A valid nondisclosure agreement can result in monetary damages or an injunction against the breaching party. An invalid agreement may result in the information losing its confidential status. Although businesses recognize the need for nondisclosure agreements, they may not consider the validity of terms or additional steps needed for an agreement to be enforceable. The validity of the agreement depends on the language of its specific terms, so it is important to be aware of potential issues that can arise during enforcement. This article examines common issues that can arise when enforcing a nondisclosure agreement.

Basics of Nondisclosure Agreements

A nondisclosure agreement ("NDA"), also known as a confidentiality agreement, is a contract that requires at least one party to protect confidential information and prohibits that party from disclosing it to third parties. The party disclosing confidential information is called the disclosing party, while the party receiving the information is called the receiving party. NDAs can either be unilateral if only one party discloses confidential information or mutual if both parties disclose confidential information. **An NDA will at least include the definition of “confidential information,” obligations of the receiving party, the time period for which the NDA will be valid, and any exclusions.** In general, the disclosing party usually wants the confidentiality obligation to last at least as long as the information remains confidential, and the receiving party will want the obligation to be short term.

Challenges Enforcing Nondisclosure Agreements

Violating an NDA creates a breach of contract claim, but could create other claims including trade secret misappropriation, copyright infringement, or unfair competition depending on what the confidential information was. However, an NDA is limited and does not give the disclosing party complete protection. The party seeking to enforce an NDA has the burden of proving the other party breached and the resulting injury. If an NDA is challenged in court and determined to be unenforceable, it may affect the party's other NDAs and may lead to those agreements being challenged. While the challenges of enforcing a particular NDA depend on its specific terms, some of the most common issues that arise when enforcing an NDA are:

A. The terms of the NDA are overly broad.

An NDA must be reasonable to be enforceable. Although the test for reasonableness varies between jurisdictions, courts typically will consider the interest of the disclosing party in keeping the information secret, the period of time the information must be kept secret, the burden on the receiving party, and the interest of the public. Courts may invalidate or limit the scope of an NDA that is unreasonable or overly burdensome. **Additionally, an NDA that is ambiguous may be void for vagueness if the terms are too ambiguous to enforce.** For an NDA between employers and employees, the terms of the NDA must be reasonably limited to serve the employer's legitimate business interest and cannot include things that

are obviously not confidential information. Typically, a former employee's skills or industry knowledge is not confidential information, even if it was obtained at his or her former position.

B. Lack of consideration.

Like other contracts, an NDA is valid only if there is consideration. This means both parties must be induced to enter the agreement. In the case of NDAs between employers and their employees, the consideration requirement is met if the NDA was executed when the employee was hired. However, issues may arise if the NDA was executed during employment.

C. The information is not confidential or valuable.

Courts will not enforce an NDA if the information sought to be protected is not confidential or valuable. Information that is in the public domain or already known by the receiving party is not confidential, and an NDA protecting such information will not be enforced. Additionally, confidential information protected by a NDA does not include any information that was available prior to entering into the NDA, received from an unbound third party, or independently developed without the use of confidential information. Examples of confidential information include trade secrets and client lists.

D. Failure by the disclosing party to take reasonable efforts to maintain its secrecy.

The disclosing party must also take reasonable efforts to maintain secrecy for an NDA to be enforceable. What constitutes reasonable efforts varies based on the circumstances, but can include using and enforcing NDAs, limiting and tracking disclosures, and keeping the information in a secure location. The disclosing party bears the burden of proving reasonable efforts were taken. Failure to meet that burden may result in the disclosing party paying damages and the other party's attorney's fees in addition to potentially losing the confidential information.

E. Disclosures to third parties.

An NDA can only be enforced against the contracting parties, not third parties. This can become an issue when the receiving party discloses the disclosing party's confidential information to a third party. Even if it is necessary to perform the receiving party's business obligations to the disclosing party, the disclosure between the receiving party and the third party is not protected because the third party is not a contracting party. Thus, the third party can disclose the confidential information. To prevent this issue from arising, it is important to understand how the third party will perform its business obligations and include a provision in the NDA between the receiving and disclosing parties that requires the receiving party to enter into an NDA with the third party before disclosing.

F. Perception of unequal bargaining power or inequitable conduct by either party.

Like with other contracts, the court will consider inequitable conduct, unequal bargaining power during negotiations, and overreaching by either party when considering the extent of the NDA.

G. Obtaining an injunction when a former employee breaches an NDA in states that recognize the inevitable disclosure doctrine. When determining whether to grant an injunction for breach of an NDA, the court balances the policy considerations in favor of the injured party with the ones in favor of the breaching party. When there is an NDA between an employer and its former employee, the inevitable disclosure doctrine can be used to obtain a preliminary injunction preventing the former employee from working for the employer's competitor. Under the doctrine, the former employee may be enjoined from working for the competitor if the employer can demonstrate that the former employee's new employment will inevitably lead them to rely on or disclose the employer's trade secrets or confidential information. However, the doctrine is not accepted in every state. In general, states that recognize the doctrine will only grant a temporary injunction. Only a few states will grant permanent injunctions.

H. Difficulty quantifying damages.

Damages for breach of an NDA may be difficult to quantify. While this is not determinative, the parties may want to include a provision stating the receiving party acknowledges that a breach of the NDA would result in irreparable harm. When an NDA has a liquidated damages clause that sets the total damages or a formula for calculating damages, the clause will be enforced if the court determines the NDA was breached and the liquidated damages are comparable to the

actual or anticipated damages . However, if the amount is disproportionate, the clause may be void, and the injured party would only be limited to actual damages from the breach. Courts most likely will not grant an injunction if there is a liquidated damages clause.

Conclusion

Nondisclosure agreements are a double-edged sword. On one hand, if valid, they protect the disclosing party from losing ownership of confidential information. On the other, if unenforceable, they may result in the disclosing party losing ownership of that information, leading to severe business consequences. Taking care when drafting a nondisclosure agreement and not disclosing confidential information before entering a nondisclosure agreement are good preliminary steps to protecting that information. However, businesses must take additional steps to maintain the secrecy of that information for the agreement to be enforceable in case a receiving party breaches. Although awareness of common issues that can arise during enforcement is useful, businesses should review the enforceability of the specific terms of a nondisclosure agreement during drafting and the enforceability of previous nondisclosure agreements to ensure their confidential information is protected.

Additional Resources

- <https://everynda.com/blog/11-ways-invalidate-nda/>
- <https://everynda.com/blog/enforce-non-disclosure/>
- <https://everynda.com/blog/non-disclosure-valid-legal/>
- <http://onlinelibrary.wiley.com/doi/10.1002/ert.21538/full>
- <http://read.nxtbook.com/ncma/contractmanagement/january2014/difficultiesinenforcing.html>
- <http://smallbusiness.findlaw.com/intellectual-property/a-nondisclosure-agreement.html>
- <https://www.cov.com/-/media/files/corporate/publications/2000/02/oid6364.pdf>

<http://www.acc.com/legalresources/quickcounsel/issues-enforcing-nondisclosure-agreements.cfm>