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Non-Disclosure Agreements: A Litigator's Perspective on Best Practices

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NDA's Are Often Drafted More Casually Than Other Transactional Documents

- NDA's are often adopted from a pre-existing form agreement.
- A template is revised by merely changing the parties, without forethought as to the specific objectives or needs of the situation.

What is an NDA?

Non-disclosure and **use restriction agreement**

- Use restrictions are often vague or imprecise
- Disputes usually arise from breach of use restrictions

Some Start-Ups Skip Using NDAs

Recent news articles highlight how start-ups often resist NDAs entirely because they slow things down, and financing opportunities may be lost during the delay.

The New York Times

<https://www.nytimes.com/2014/07/03/business/smallbusiness/why-more-start-ups-are-sharing-ideas-without-getting-legal-protection.html>

SMALL-BUSINESS GUIDE

Why More Start-Ups Are Sharing Ideas Without Legal Protection

By Eilene Zimmerman



Forbes

<https://www.forbes.com> > Entrepreneurs

Death By NDA? How An Innocent Contract Can Stifle Entrepreneurship

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Consequences of Skipping NDAs

- Unprotected trade secrets lose trade secret status!
- A bad NDA is better than no NDA.

Roadmap – A Litigator’s Perspective

- Most NDA disputes are not about disclosure — they are about *use*.
- The failure mode is often process, not contract language.
- The evidence record (marking, tracking, follow-up emails) often determines outcome more than the text of the NDA.

Use Restrictions Are Important!

- If sharing information with a potential competitor, breach of the *use* restriction becomes much more consequential.
- The receiving party who obtains trade secrets under an NDA becomes an “arm’s length insider” who may be capable of using the information in competition with the disclosing party.
- Parties in competitive relationships more typically comply with the non-disclosure restrictions, but often not the use restrictions – and especially if the use restrictions are vague and imprecise.

Use Restrictions and “Purpose”

- Use restrictions are often tied to a (vague) “purpose.”
- Example: “The Purpose of this NDA is for the parties to assess market opportunities and to explore a possible business relationship.”
- The Receiving Party will only use the confidential information of the Disclosing Party in connection with the Purpose.
- Is the use restriction clear and unambiguous?

Establish the Purpose(s) for Disclosure

Olaplex, Inc. v. L'Oreal USA, Inc., 2021 WL 1811722 (Fed. Cir. May 6, 2021).

- NDA restricted use of confidential information “for any purposes other than to evaluate, negotiate and, if applicable, consummate a possible Transaction”
- Olaplex claimed L'Oreal misappropriated trade secrets that constituted “business information” and “financials” in L'Oreal’s “build vs. buy” analysis -- whether L'Oreal should acquire Olaplex or launch its own products.

Establish the Purpose(s) for Disclosure

Olaplex, Inc. v. L'Oreal USA, Inc., 2021 WL 1811722 (Fed. Cir. May 6, 2021).

- Lower court awarded damages of \$22 million for mis-use of confidential information.
- The Federal Circuit reversed, concluding that Olaplex had consented – through the “evaluate” purpose in the NDA – to L'Oreal's use of the trade secrets to assess whether to “build or buy.”

Examples

- **Weak Purpose**
- “...to explore a possible business relationship.”
- **Stronger Purpose**
- “...solely to evaluate a potential [license/acquisition/joint development] and not for internal product development, competitive analysis, or independent commercialization.”

Practice Tip!

- Add language that restricts the Receiving Party from using confidential information for its own benefit (or for the benefit of another) and that it will not manufacture products (or components thereof) utilizing or incorporating any part of the confidential information.
- *Such language will further define and limit the permitted uses of the confidential information.*

Sample Language

“The Receiving Party may only use the Disclosing Party’s Confidential Information in connection with considering, advising, evaluating, implementing, or acting upon the Purpose. The Receiving Party agrees not to use the Disclosing Party’s Confidential Information for its own benefit or the benefit of another, and not to manufacture products or components thereof utilizing or incorporating any part or all of the Confidential Information.”



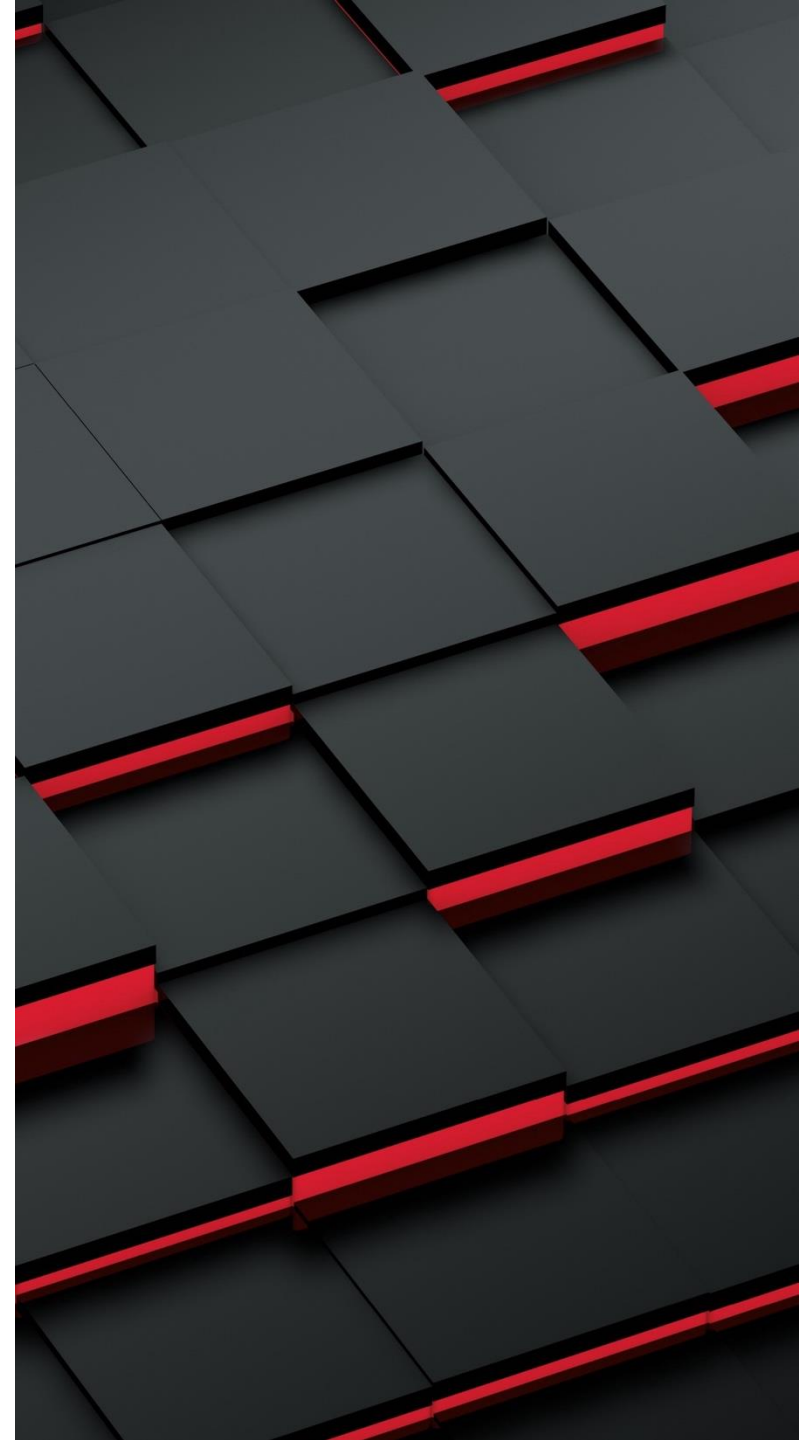
Handling Confidential Information During the Relationship

Tip: Be Deliberate About What Information to Disclose

- Does the receiving party need to know the “secret formula?” Or does it simply need to understand what results the secret formula has achieved?
- The disclosing party should assess the reason for every disclosure.
- As for the receiving party, the more information it receives, the more for which it must protect and account.

Contemporaneous Designation When Confidential Information Is Disclosed

- The receiving party must be put on notice about what information to protect.
- If small universe of documents is shared, identification is easy.
- If more voluminous, or shared over many months and through interactive meetings, identification is harder.



Big Vision Private Ltd v. E.I. DuPont de Nemours & Co.,
1 F. Supp.3d 224 (S.D.N.Y. 2014), aff'd 610 Fed. Appx.
69 (2nd Cir. 2015).

- Trade secret owner was unable to enforce their trade secrets because they had failed to give clear notice to DuPont, who also had been developing technology in the same area, about what specific trade secret information was being shared.
- Trade secret owner has a duty to provide *notice* to its counter-party about its claimed trade secrets, or else lose the right to enforce trade secrets later.

Big Vision Private Ltd v. E.I. DuPont de Nemours & Co.,
1 F. Supp.3d 224 (S.D.N.Y. 2014), aff'd 610 Fed. Appx.
69 (2nd Cir. 2015).

- “In order to avail itself of trade secret protection, [the disclosing party] must have, at a minimum, notified [the receiving party] of its trade secret. It need not have said the words “trade secret” or put forth the same degree of detail that would be required in litigation, but it must have done *something*.”
- Thus, an overbroad NDA might be saved by effective “process management,” making sure that key material is marked, and recognizing (and documenting) that not every email or conversation is subject to the agreement’s terms.

Sample Language To Avoid!

The term “**Confidential Information**” refers to all information about the Disclosing Party or its affiliates that is made available to the Receiving Party or its Representatives and that is considered confidential or proprietary by the Disclosing Party. This includes all business, financial, technical, commercial, operational, staff, and management information, as well as any information about the Disclosing Party’s or its affiliates’ products, services, prices, costs, and clients. Confidential Information may be marked as “confidential” or “proprietary,” either at the time it is disclosed or later. **Even if information is not marked as “confidential” or “proprietary,” it will still be considered Confidential Information if a reasonable person would understand it to be confidential based on the nature of the information or the circumstances of its disclosure.**



Recommended Clause

“Confidential Information” includes information disclosed in writing, electronically, visually, or orally that is:

- (a) marked or identified as confidential at the time of disclosure;
- or (b) confirmed in writing as confidential within [15–30] days after disclosure.

The Disclosing Party may periodically provide written summaries or indices identifying categories of Confidential Information disclosed under this Agreement.

The Receiving Party acknowledges that such notices are intended to clarify — not limit — the scope of protection for properly designated Confidential Information.



Follow Notice Procedures

- If NDA includes requirements as to how confidential information is to be identified, but disclosing party does not follow them, the disclosing party may lose its rights.
- *Convolve, Inc. v. Compaq Computer Corp.*, 527 F. App'x 910, 925 (Fed Cir. 2013) (affirming summary judgment dismissing breach of contract and trade secret claims because plaintiff did not follow procedures for identifying information as confidential).

How Much Detail in Notice?

- If receiving party is already steeped in the field at issue, a fairly granular description of what information is to be protected is likely necessary to distinguish what the disclosing party claims to be protectable from what the receiving party already knows.
- *Big Vision Private Ltd.* (much greater specificity is required when the receiving party already holds a patent in the field, lest otherwise the scope of the patent be unfairly diminished).

How Much Detail in Notice?

- If the receiving party was previously entirely unfamiliar with the field at issue, a fairly broad description of information to be protected might be appropriate.
- Example: “all information disclosed by Company A relating to digital lenses”
- *Altavion, Inc. v. Konica Minolta Systems Lab. Inc.*, 226 Cal. App. 4th 26 (2014) (receiving party had no prior familiarity with bar code document authentication technology so virtually everything plaintiff presented on the subject was new)

Receiving Party May Have “Developments Already in Process”

- Receiving party may benefit from provision about “developments in process” that are similar to disclosing party’s confidential information.
- This language can protect receiving party from post-execution claims arising out of receiving party’s development work that in fact pre-dated the NDA.

Sample Language About “Development Efforts Already In Process”

“The Disclosing Party acknowledges that the Receiving Party may currently be developing information, or may in the future develop information, or may be exploring or may in the future explore other opportunities, any of which may be similar or related to the Disclosing Party's Confidential Information. Accordingly, nothing in this NDA will be construed as a representation or agreement that the Receiving Party will not develop or have developed for its products, concepts, systems or techniques that are similar to or compete with the products, concepts, systems or techniques contemplated by or embodied in the Disclosing Party's Confidential Information”

AI Tools Create a New Category of Irreversible Disclosure

Key Risks

- Entering confidential information into public AI platforms may permanently destroy confidentiality
- Confidential information may be ingested into gen AI platforms, LLM tools, or training pipelines
- Prompts, outputs, and embeddings may persist beyond the engagement

Gen AI Restriction Language:

“The Receiving Party shall not disclose or submit Confidential Information to any public or shared generative artificial intelligence platform or similar tool that may retain, learn from, or otherwise use submitted information, without the Disclosing Party’s prior written consent.”



NDA's and “Feedback”

“Feedback” related to confidential disclosures can lead to improvement and new inventions.

Who owns any “feedback” provided in connection with confidential disclosures?

Ownership and assignment language should be explicit.



Sample “Feedback” Language

Feedback. All Customer feedback pertaining to the Licensed Products and the Services, including suggestions for customizations, corrections, changes, additions, or Extensions, are the exclusive property of [Company], and Customer assigns all rights in and to any feedback to [Company] and will take those actions and will execute those documents as reasonably requested by [Company] to effectuate [Company’s] sole ownership of that feedback.



Remedies for Breach of Non-Disclosure Obligations

What are remedies for breach of non-disclosure obligations?

- If confidential information becomes public, courts cannot restore confidential status.
- Remedy for breach – and public disclosure – is money damages (and often hard to quantify).
- Liquidated damages?

Courts Cannot Restore Confidential Status After Information Becomes Public

- *Arconic Corporation v. Novelis Inc.*, 2022 WL 17082378, *5 (W.D. Pa. Nov. 18, 2022).
 - Court addressed claims for alleged disclosures of confidential information contrary to an NDA.
 - Court noted equitable remedy of restitution “is not an appropriate remedy for disclosure of confidential information” after being “publicly disclosed in a patent application,” because “that information cannot be returned to the exclusive use” of the disclosing party.
 - “[T]he court cannot unring the bell,” and any order to the contrary would not be “feasible or appropriate.” The plaintiff, however, could allege money damages.

Courts Cannot “Unring the Bell” After Confidential Information Becomes Public

- *Evans Consoles Inc. v. Hoffman Video Sys., Inc.*, 2001 WL 36238982 at *9 (N.D. Tex Dec. 6, 2001).
 - While courts are ill-equipped to “unring the bell” and restore confidential status for information that has been disclosed to the public domain, injunctive relief – and especially preliminary injunctive relief – is available with respect to information that has not been disclosed (i.e., non-public patent *applications*) and to prevent further improper disclosures.

Patents Based on Information Shared Under NDA

What if the receiving party takes confidential information and includes it in patent filings, thereby obtaining patent rights based on confidential information shared under terms of the NDA?

SiOnyx LLC v. Hamamatsu Photonics K.K., 981 F.3d 1339 (Fed. Cir. 2020)

- SiOnyx, a startup, and Hamamatsu, an established manufacturer interested in the SiOnyx technology, entered into an NDA to allow them to share confidential information relating to SiOnyx's technology and joint development opportunities.
- SiOnyx shared proposed architecture and manufacturing process for a photodetector device, all marked as confidential.

SiOnyx LLC v. Hamamatsu Photonics

- After Hamamatsu severed the relationship with SiOnyx, Hamamatsu filed for, and was awarded, several patents – first in Japan – based on the confidential information shared under the NDA.
- Hamamatsu subsequently obtained US patents with the same information.
- The Hamamatsu patents all related to photodetector devices.

SiOnyx LLC v. Hamamatsu Photonics

- Hamamatsu also went on to develop and bring to market products based on this technology and the awarded patents.
- SiOnyx sued Hamamatsu for unjust enrichment, breach of contract, ownership of the patents that Hamamatsu was awarded, and injunctive relief to prohibit Hamamatsu from practicing the patents in question.

SiOnyx LLC v. Hamamatsu Photonics

- After trial in district court, the jury made SiOnyx a co-inventor on the US patents but took no action on Japanese patents.
- In post-trial motions, SiOnyx argued for transfer of US patent and Japanese patent families based on language in the NDA:

“The Receiving Party acknowledges that the Disclosing Party . . . **claims ownership** of the Confidential Information disclosed by the Disclosing Party and **all patent, copyright, trademark, trade secret, and other intellectual property rights in, or arising from, such Confidential Information.**”

SiOnyx LLC v. Hamamatsu Photonics

- The trial court granted SiOnyx's motion for transfer of patent ownership with respect to **US patents**.
- The court held that, in its discretion, it could transfer patent ownership as an equitable remedy based on the language in the NDA confirming Disclosing Party's ownership in all "*patent ... and other intellectual property rights in, or arising from, such Confidential Information.*"
- As for Japanese patents, the trial court held that it had no jurisdiction with respect to the Japanese patent family.

SiOnyx LLC v. Hamamatsu Photonics

- On appeal, the Federal Circuit affirmed transfer of ownership of US patents.
- The Federal Circuit also held it was abuse of discretion not to transfer the Japanese patents because – under the language in the NDA – *the court could exercise jurisdiction over the contracting party*, Hamamatsu, and there was no need to exercise jurisdiction over the patent office in Japan.
- The Federal Circuit rejected Hamamatsu's appeal for co-inventorship of all patents because Hamamatsu did not establish that the patents contained *Hamamatsu's* confidential information as contemplated by the NDA.

SiOnyx LLC v. Hamamatsu Photonics

Absent language about Disclosing Party's "ownership" in any patents, the litigation result would have been, at best, co-inventorship on the US patents and no remedy whatsoever (at least in US courts) with respect to the Japanese patents.

Recommended Language

“The Receiving Party acknowledges that the Disclosing Party . . . claims **sole and exclusive** ownership of the Confidential Information disclosed by the Disclosing Party and all patent, copyright, trademark, trade secret, and other intellectual property rights in, or arising from, such Confidential Information.”

Injunctive Relief Provisions – Example

“The Parties agree that money damages may not be a sufficient remedy for breach of this Agreement and that *the Disclosing Party may be entitled to seek equitable relief* including, without limitation, restraining orders, injunctions, and specific performance in the event of any such breach in addition to all other remedies available to Disclosing Party at law or in equity.”

Injunctive Relief Provisions

- Courts have discretion about whether to enter injunctive relief. Courts view these provisions as a “private agreement” that does not compel the court to do anything, because injunctive relief still requires satisfying irreparable harm and other requirements.
- But not wrong to include them, and they may be helpful to show an employee or counter-party about the gravity of the obligations.



NDA's and Trade Secrets

NDA's Are Required to Protect Trade Secrets

- *Abrasic 90 Inc. v. Weldcote Metals, Inc.*, 364 F.Supp.3d 888 (N.D.Ill. 2019) (summary judgment for defendant on trade secret claims because no NDAs governing the alleged trade secrets).
- *Niemi v. Am. Axle Mfg. & Holding, Inc.*, 2007 WL 29383, at *2 (Mich. Ct. App. Jan 4, 2007) (affirming summary judgment where trade secret plaintiff “did not enter into written confidentiality agreements [] or label the documents confidential”).
- *R.C. Olmstead, Inc., v. CU Interface, LLC*, 606 F.3d 262, 276 (6th Cir. 2010) (affirming summary judgment under Ohio UTSA based on absence of confidentiality agreements).

Confidential Information or Trade Secret?

Durational Limits Matter

- Some states have durational limits for confidential information.
 1. In GA and NC, confidentiality obligations can extend indefinitely if the information remains confidential.
 2. In other states (Florida, Illinois, Indiana, and Wisconsin), confidentiality agreements must have limited time duration.
- Trade secrets, in contrast, can be protected indefinitely as long as the underlying information remains a trade secret.

NDA and Trade Secrets: *Durational Limits Matter*

- Fixed time limitations expire, which will terminate the receiving party's use restrictions or non-disclosure obligations.
- Temporal limits have consequences for trade secret protection beyond the outcome for the receiving party in a single expired NDA.

NDA With Temporal Limits and Trade Secrets

When a trade secret is disclosed under a time-limited obligation, rather than a perpetual obligation to keep it confidential, courts have found that trade secret protection cannot apply.

- *DB Riley, Inc. v. AB Engineering Corp.*, 977 F. Supp. 84 (D. Mass. 1997) (no trade secret protection when disclosure was made under a time-limited confidentiality agreement).
- “[A] temporary pledge to secrecy is exactly that: temporary. Once a ... confidentiality obligation ... expires, so does the trade secret protection.”
Structured Capital Solutions, LLC v. Commerzbank AG, 177 F.Supp.3d 816, 836 (S.D.N.Y. 2016).

Trade Secrets Solely In a Person's Unaided Memory?

- Conceptually, trade secret protection can extend to information in an individual's unaided memory.
- BUT the law distinguishes between trade secrets and general skills, knowledge, and experience.
- And case law for the proposition that courts cannot compel a “lobotomy” when individuals change employers.
- The inevitable disclosure doctrine can extend to circumstances involving trade secrets in a person's memory, but this doctrine is discredited. Most states have rejected this doctrine, finding that it is a *de facto* non-compete or injunction restricting employment.

Distinctions Between Confidential Information and Trade Secrets in NDAs

- If trade secrets do not usually include information solely in a person's unaided memory, the confidential information vs. trade secret distinction is consequential.
- Confidential information can always include information in a person's unaided memory.

Residual Clauses—What Are They?

A residual clause allows the Receiving Party to use information retained in the **unaided memory** of its personnel after exposure to Confidential Information. The concept is that information remembered without reference to tangible materials may be used for any purpose.

Why Receiving Parties Request Them

- Employees cannot “unlearn” knowledge
- Protects innovation and employee mobility
- Limits accidental liability

Why Disclosing Parties Should Care

- May permit competitive use of know-how in person’s memory
- Hard to prove misuse in litigation
- Can materially narrow NDA protection



Residual Clause Drafting: Competing Approaches

Receiving-Party Favorable

- “Receiving Party may use Residuals retained in unaided memory for any purpose.”

Disclosing-Party Protective

- “No use of Confidential Information is permitted except for the Purpose, whether retained in memory or otherwise.”

Market Compromise (Common Outcome): Residual use allowed only for:

- general skills and experience
- non-competitive purposes only
- no intentional memorization

Common Pre-Litigation Dispute Scenario

Receiving party wants to develop “bespoke” technology that may match or mirror information and technology from the disclosing party.

How to guard against liability?

- Implement “screening” protocols for independent development.
- If no “screening,” do not rely on tangible materials.
- Distinction between what is in unaided memory (confidential information) and tangible material (trade secret).

Summary of NDA Best Practices:

- Specify the specific *purpose(s)* for which the information may be used.
- Set forth the *duration* of the restrictions on use and disclosure.
- Describe *how the information is to be managed* over the course of the relationship and *what happens with the information when the agreement comes to an end*.
- Put the receiving party on *notice* about the specific information to be treated as confidential and protected from both improper *use* and improper *disclosure*.

A Litigator's Bottom Line on NDAs

1. Purpose Controls the Case

Vague purpose can lead to permitted competitive use

2. Process Beats Paper

Marking, notice, and tracking determine outcomes

3. Ownership Language Determines Remedies

Especially for patents and derivative IP

4. Courts Cannot “Unring the Bell”

Prevention matters more than remedies

5. Residual Clauses Change Risk Allocation

Memory-based use is effectively permitted

Questions?



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