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Confidence in confidentiality agreements

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In recent years, confidentiality agreements seem to have pervaded the IT and technology industries. People involved in IT contracting and technology development are constantly either being asked to, or asking others to, enter into confidentiality agreements.

Just what are you signing up for? What is your position if you do not enter into a confidentiality agreement and someone makes unauthorised use of your information? What should you look for in terms of the content of confidentiality agreements? And what are the limitations of these agreements?

Essentially, confidentiality agreements (also known as non-disclosure agreements) seek to ensure that confidential information disclosed during negotiations between two or more parties remains confidential and is not used other than for the purpose disclosed.

Confidentiality agreements can be used in almost any commercial context. They are commonly used where an entity is looking to enter into a research and development collaboration or joint venture with another entity, and commercially or technically sensitive information might pass between them before they have reached a formal agreement. Another common situation where a confidentiality agreement may be called for is where an entity has invented a new process or product and wishes to prevent potential manufacturers or end licensees from disclosing details of its invention.

Confidentiality agreements can also be used in relation to more general transactions including arrangements for sale and purchase. In some instances, confidentiality provisions will appear within the body of wider agreements such as licences or sale and purchase agreements.

What if I don't have a confidentiality agreement?

If an entity to whom you have disclosed confidential information (without entering into a confidentiality agreement) then uses or discloses that information without your permission, you may still be able to take action through the courts.

The position at common law is that any person who receives confidential information has an

equitable duty not to disclose or use it without permission. Unauthorised disclosure or use of confidential information can be prevented through a common law action for breach of confidence.

To establish breach of confidence (absent an enforceable confidentiality agreement), you must show that:

- ▣ the information in question was of a confidential nature (ie not public property or knowledge);
- ▣ the information was communicated in circumstances importing an obligation of confidence; and
- ▣ there was an actual or anticipated unauthorised use or disclosure of the information to the detriment of the disclosing party.

Without supporting evidence, it can be difficult to establish that the information was imparted in circumstances where it ought to have been apparent that the information was given confidentially. This requires that the party to whom you disclose the information must have been asked to treat the information as confidential or it must have been obvious to him or her that the information was given in confidence. Establishing that the unauthorised use or disclosure was to your detriment can also be problematic.

Benefits of confidentiality agreements

A formal written confidentiality agreement can provide a disclosing party with a greater level of protection of its sensitive technical or commercial information than that offered at common law. It also provides certainty around the extent of protection by setting out in detail the conduct which the disclosing party expects from the recipient.

A confidentiality agreement does not need to be limited to trade secrets (secrets which give the disclosing party a commercial advantage). It only matters that the information is not in the public domain, and is important to the disclosing party's interest.

A confidentiality agreement establishes a simple contractual obligation which, as well as being easier to enforce, will assist a claim for breach of confidence because it confirms that the relationship is one of confidence (which can otherwise be difficult to establish). As such, in the event of unauthorised disclosure of confidential information, an action may be brought for breach of confidence at common law and for breach of contract.

A further benefit of a confidentiality agreement is that it enables the parties to tailor the rights and responsibilities of both parties to the particular circumstances, and to include other contractual provisions such as mechanisms for dispute resolution. If a collaboration or joint venture is involved, the confidentiality agreement can also lay ground rules regarding intellectual property ownership and licensing.

Also, much of the information that companies will look to protect is in the form of ideas or concepts, eg a new business idea or a way of obtaining a competitive advantage. Unless these ideas or concepts are patentable, the only way they can be safeguarded is to keep them secret. Confidentiality agreements are often the best form of protecting these ideas and concepts from unauthorised exploitation when you need to share with them with others.

What provisions should I look for?

A confidentiality agreement will typically contain the following key provisions:

1. A definition of the confidential information to be protected.

2. The basic obligation to keep the information confidential and to use it only for the permitted purpose.
3. The circumstances in which, and persons to whom, the recipient is entitled to disclose the information.
4. Detail of what is to happen to the information and records if the transaction does not proceed.
5. The duration/term of the obligation of confidentiality.

As a general comment, the way in which the agreement is drafted will vary depending on whether you are disclosing or receiving confidential information under it.

Definition. The definition of confidential information should generally be limited to information that is genuinely confidential, though it is not uncommon for disclosing parties to define confidential information as broadly as possible. Information which is in the public domain, already known to the recipient or which comes into its possession through no fault of the recipient should be specifically excluded. If you are intending to adopt a broad definition of confidential information without including these standard exclusions, you should be aware of the risk that the agreement will be considered an unenforceable restraint of trade.

Permitted purpose. The recipient's use of the confidential information should be restricted to a specific permitted purpose, for example "to perform its obligations under this agreement" or "to consider whether to enter into a commercial arrangement with the disclosing party". If the recipient's use is not restricted, this potentially leaves the recipient free to use the information for a much wider purpose than the disclosing party intended. This is particularly important where you are selling your business and prospective buyers conduct due diligence. These buyers may take note of information gained through due diligence and seek to take unfair advantage of that information without actually disclosing that information to a third party.

Employees and advisers. In practice, if the recipient is considering entering into a commercial arrangement with the disclosing party, it is likely that it will need to disclose the information to individual employees, and possibly to external advisers. The agreement should therefore specify exactly whom the recipient may disclose the confidential information to, and on what basis.

The disclosing party may wish to specifically approve the employees and external advisers to whom information can be disclosed in advance. Alternatively, the disclosing party can agree to authorise disclosure to employees and advisers on a "need to know" basis. The agreement should always restrict the employees' and external advisers' use of the confidential information to a particular purpose (or tie it to the permitted purpose).

The recipient should be required to ensure that its employees and external advisers keep the information confidential. In some cases, the disclosing party may wish to require the recipient to obtain separate confidentiality agreements from each individual.

It is also usual to allow confidential information to be disclosed to third parties if required by law (but only to the extent necessary).

Treatment of records. It is likely that in providing the confidential information, the disclosing party will supply the recipient with electronic or hard copies of documents. The confidentiality agreement should set out whether the disclosing party wishes all such records to be returned or destroyed if the contemplated transaction does not proceed.

Duration. The obligations of confidentiality set out in the agreement should not

terminate when the relationship between the parties ends. In fact, the agreement should usually specify that the confidentiality obligations continue for as long as the information remains confidential. There are exceptions to this position where you are the recipient of confidential information and want some certainty as an organisation around when you can use and disclose that information freely. This is particularly the case for large organisations that receive considerable amounts of unsolicited information, often in different countries. These organisations may resist signing confidentiality agreements at all, but at the very least they tend to seek to limit how long they apply for.

Limitations of confidentiality agreements

A confidentiality agreement does not provide the disclosing party with an absolute guarantee that the relevant information will be protected. An agreement will have its limitations, especially if the potential purchaser has little intention of complying with it. This is because:

- ❑ the main remedy for breach of the agreement is an injunction to prevent any unauthorised disclosure or use of the information, but you may not know that a breach is about to take place;
- ❑ once information has been disclosed, an injunction may be of little use;
- ❑ once information has entered the public arena, no legal remedy under the confidentiality agreement will make it secret again; and
- ❑ even if the recipient intends to adhere to the terms of the agreement, it will inevitably take the disclosed confidential information into account in its own commercial plans, whatever the terms of the agreement provide.

Notwithstanding the limitations, the commercial benefits of disclosing

information under the confidentiality agreement (ie the possibility that the recipient will be encouraged to enter into a commercial arrangement) will normally outweigh the risks of disclosing the information.

Disclosers of information often seek to improve their position regarding potential relief for breach by including a broad indemnity in the agreement. This can provide wider relief, including recovering legal costs, if the recipient breaches its obligations under the agreement. However, indemnities are usually resisted by recipients on the grounds that their legal exposure can be too great, particularly where information is disclosed accidentally.

By entering into a carefully drafted confidentiality agreement, a disclosing party can obtain a level of certainty regarding the extent to which their sensitive information is protected. Other benefits include comfort around the recipient's conduct in relation to the disclosing party confidential information, whom the recipient can share the information with (and on what basis), and the recipient's treatment of the disclosing party's records.

Potentially, and perhaps most significantly, disclosing parties will also gain a greater level of protection of their confidential information than that offered at common law. Even if you find negotiating confidentiality agreements difficult or frustrating, this process does have the distinct advantage of focusing each party's mind on the issue. Where you are disclosing your own information, it also impresses on the other party that you are serious about protecting it.

The bottom line

- ❑ **Make sure you have a suitable confidentiality agreement in place when disclosing sensitive commercial information to third parties. This can provide for a greater level of protection than remedies available at common law.**
- ❑ **Consider carefully what information you are protecting (or being prevented from disclosing, if you are the recipient), and also the exceptions that may apply to the relevant non-disclosure obligations.**
- ❑ **When disclosing confidential information for use by others, it is critical that your agreement records that the information may be used by the other party only for the stated specific purposes for which it is disclosed.**
- ❑ **A confidentiality agreement will also impress on the recipient of your confidential information that you are serious about protecting it. This should help to develop the right behaviours when they are dealing it.**
- ❑ **If you receive a confidentiality agreement, read it carefully to ensure it only contains provisions you would expect.**

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