

The Importance of Non-Disclosure Agreements in Real Estate Transactions

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This article illustrates the importance of entering into a non-disclosure agreement, sets forth the basic elements thereof, describes best practices in drafting a non-disclosure agreement, and provides some sample provisions for use in non-disclosure agreements governed by New York law.

Developer is driving home from work. Rather than sit in traffic, he decides to take a different route home. While driving, he sees a large, undeveloped, 50+ acre, waterfront, close-to-great-schools, gorgeous tract of land. He pulls over immediately and thinks to himself, “if only this were for sale.” To his great surprise, he spots a “For Sale” sign. Developer calls Investor and describes the land and the endless development possibilities. Investor agrees to partner with Developer and to fund the acquisition and development of the land. Fast-forward three years. Developer, once again, is driving home from work. He passes by that gorgeous, once-in-a-lifetime-opportunity-giving land. The land is now a fully developed, bustling, profitable, luxury shopping and residential condominium complex. Developer sees the sign: “Owned and operated by Investor.” Developer cries in his hands and thinks to himself, “if only I had

Investor sign that non-disclosure agreement my lawyer told me about!”

In our fictional story, Investor used Developer’s information to Investor’s benefit and cut Developer out of the deal. What should Developer have done differently to protect himself? He should have had Investor sign a non-disclosure Agreement. This article will illustrate the importance of entering into a non-disclosure agreement, set forth the basic elements thereof, describe best practices in drafting a non-disclosure agreement, and provide some sample provisions for use in non-disclosure agreements governed by New York law.

What is a Non-Disclosure Agreement?

A non-disclosure agreement or “NDA” is an agreement between two or more parties whereby one party agrees not to disclose or use information it receives from the other party,

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except in connection with a certain limited purpose and certain limited exceptions. The NDA may also be mutual such that each party agrees not to disclose or use information it receives from the other. Anyone in possession of information he or she believes gives him or her a competitive advantage or which is considered to be a secret (referred to herein as “Confidential Information”) and is about to disclose such Confidential Information to another party, should enter into an NDA with such other party.

The Importance of an NDA

If the Developer’s plight isn’t enough to convince you of the importance of NDAs, consider what is necessary to pursue a legal remedy without one. With no NDA in place, for example, a disclosing party that wants to prevent a receiving party from using Confidential Information will likely need to prove to a court that the Confidential Information constitutes the type of information that is protected under common law, such as, for example, a trade secret. This approach can be risky, costly and, most likely, will come into play after a disclosing party is already harmed by an inappropriate disclosure. With an NDA, parties can agree to protect more information than the law would otherwise protect. Additionally, signing an NDA encourages free and open negotiations between the parties because the disclosing party has the comfort it needs that the disclosed information is protected.

Who Should Sign an NDA? When?

NDAs can and should be used in any business transaction where Confidential Information is being disclosed (e.g., joint ventures, development agreements, negotiations of all types, etc.).

An NDA should be executed as early as possible in the (potential) transaction (i.e., at the onset of business discussions/negotiations) and, as illustrated by the Developer/Investor example, before any Confidential Information is disclosed.

Basic Elements of an NDA

Identify the Parties

As discussed above, an NDA can restrict the use of Confidential Information disclosed by one party to the other party or the NDA can be mutual, thereby obligating both parties to protect the Confidential Information shared between them. Using our Developer/Investor example, the Developer could have structured an NDA such that any Confidential Information disclosed by Developer to Investor would be protected. Similarly, Investor could have also negotiated for the protection of any Confidential Information that Investor disclosed to Developer (e.g., pro formas, financial projections, business models, etc.). In the latter example, where both parties are granted specific protections, the NDA is considered a “mutual” NDA. No matter the form, an NDA should clearly identify the party disclosing the Confidential Information and the party receiving the Confidential Information.

Best Practices Tip

You may wish to consider defining the “receiving party” (i.e., the party obligated to protect the Confidential Information) and the “disclosing party” (i.e., the party disclosing the Confidential Information) as including the affiliates, officers, members, shareholders, etc. of each of the receiving party and the disclosing party.

Define the Confidential Information

The Confidential Information should be clearly

defined to avoid any ambiguity and confusion as to what information is protected by the NDA. Since the receiving party and the disclosing party have competing interests in this respect, defining the Confidential Information will likely involve a balancing act. The disclosing party wants to define the Confidential Information as broadly as possible to include everything the disclosing party discloses to the receiving party, whether written or oral. The receiving party wants to define the Confidential Information as narrowly as possible to minimize the receiving party's liability for misuse, disclosure, etc. The receiving party may ask that all Confidential Information must be "marked" as confidential, otherwise, the information will not be protected under the NDA. There are typical carve-outs to what information will be deemed "Confidential Information." One example of such a carve-out is information that receiving party can demonstrate is public knowledge or it already has in its possession.

Best Practices Tip

Try to avoid "marking" (which is the practice of labeling something "confidential") because it is expensive, risky and time consuming (i.e., the disclosing party will need to appoint someone to spend the time to mark all written information confidential and some information may get missed). If the disclosing party has agreed to "mark" confidential all Confidential Information, the NDA should include a grace period post-delivery (or disclosure for oral information) in case something is missed.

Best Practices Tip

Don't define the Confidential Information by using the receiving party's standards (i.e., the receiving party will treat the Confidential Information the same way it treats its own Confidential Information) because the receiving party may not take any care to protect its own Confidential Information.

Sample Language re: Common Carve-outs:

Confidential Information does not include information which receiving party demonstrates is already known to receiving party or is currently publicly available or has become publicly available, provided that such knowledge to receiving party and/or public availability did not result from the misappropriation or improper disclosure of the Confidential Information by receiving party or anyone else or the Confidential Information was not obtained by improper means by receiving party or anyone else. If the Confidential Information is already known to receiving party, receiving party shall provide Company with written notice no later than three (3) business days after the Confidential Information is disclosed by the disclosing party to receiving party stating the specific Confidential Information which is known to receiving party and the means by which receiving party came to know such Confidential Information (including the name of the person or other entity which provided receiving party with such Confidential Information).

Restrict Disclosure and Use of the Confidential Information

In order to protect the Confidential Information, the NDA should restrict both the disclosure of the Confidential Information by the receiving

party to a third party and limit the actual use of the Confidential Information by the receiving party to a specific purpose. The receiving party should be restricted from using the Confidential Information for any purpose other than the development, discussion and/or negotiation of

the business transaction with the disclosing party, and the NDA should therefore carefully define the business transaction. For example, Developer was not necessarily harmed because Investor disclosed the Confidential Information to a third party but because Investor used the Confidential Information to the detriment of Developer, and contrary to the purpose for which Developer disclosed the Confidential Information (i.e., discussion regarding development of the property). If Investor had signed an NDA, the NDA would have limited Investor's use of the Confidential Information for the narrow purpose of discussing the development of the property with Developer.

Note that there are certain typical carve-outs

to the restriction on disclosing Confidential Information. For example, a receiving party may need to discuss the Confidential Information with a team of professional advisors (i.e., lawyers, accountants, engineers, etc.) to properly evaluate the business opportunity. Therefore, an NDA will typically allow a receiving party to disclose the Confidential Information to such third parties, provided that the receiving party promises to cause such third parties to protect the Confidential Information as required by the NDA. Another common carve-out to the restriction on disclosing Confidential Information is the receiving party's right to disclose the Confidential Information when legally compelled to do so.

Sample Language re: Common Carve-out:

In the event that receiving party becomes legally compelled (by deposition, interrogatory, request of documents, subpoena, civil investigative demand or similar process) to disclose any of the Confidential Information of disclosing party, receiving party shall provide disclosing party with prompt prior written notice of such requirement so that it may seek a protective order or other appropriate remedy and/or waive compliance with the terms of this NDA. In the event that such protective order or other remedy is not obtained, or the disclosing party waives compliance with the provisions hereof, receiving party agrees to furnish only such portion of the Confidential Information which is legally required to be furnished.

Sample Language re: Common Carve-out:

Receiving Party will not use any Confidential Information for any purpose other than in furtherance of the Business Purpose [should be a defined term] or as expressly authorized in writing by the disclosing party. Receiving Party shall not disclose the Confidential Information to any person or entity other than receiving party's officers, employees, consultants and legal advisors who need access to such Confidential Information to affect the intent of the Business Purpose.

Remedies – Injunctive Relief and Indemnification

If the receiving party breaches the NDA, the disclosing party will, among other things, seek an injunction to prevent the further unauthorized use and/or disclosure of the Confidential

Information. Additionally, the disclosing party will want to be indemnified for any losses/damages sustained by the disclosing party by virtue of the unauthorized use and/or disclosure of the Confidential Information. To make it easier to obtain injunctive relief, the receiving party should specifically acknowledge in the NDA that

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the unauthorized use and/or disclosure of the Confidential Information will result in irreparable harm to the disclosing party for which there is no adequate remedy at law. The disclosing

party may also try to include a provision in the NDA for liquidated damages because disclosing party's damages in the event of a breach by receiving party would be difficult to ascertain.

Sample Language:

Receiving party shall indemnify, defend (with counsel acceptable to disclosing party) and hold harmless disclosing party and its members, managers, officers, employees and agents from and against any and all losses, damages, costs, expenses and liabilities of whatever nature (including, without limitation, reasonable attorney's fees), directly or indirectly resulting from or arising out of receiving party's breach of any of the terms of this NDA. Receiving party acknowledges and agrees that disclosing party will suffer irreparable harm in the event that receiving party breaches any of the obligations under this NDA and that remedies at law, including, without limitation, monetary damages may be inadequate to compensate disclosing party for any such breach. In the event of any such breach or threatened breach by receiving party of the terms and conditions of this NDA, disclosing party shall be entitled to seek and obtain a temporary restraining order, preliminary injunction and/or permanent injunction, without a requirement for posting a bond, in order to prevent or restrain any such breach or threatened breach in addition to all other rights and remedies available at law or equity, including, without limitation, recovery of attorney's fees and all costs incurred in enforcing the terms and conditions of this NDA and receiving party hereby agrees in advance to the granting of injunctive relief in favor of disclosing party without proof of actual damages. Receiving Party waives all counterclaims, defenses, and rights of deduction, reduction or set-off to the fullest extent permitted by applicable law.

Miscellaneous

An NDA, in addition to protecting against the unauthorized use and disclosure of Confidential Information, can also protect the proprietary nature of the Confidential Information, protect the disclosing party from liability arising from

any inaccuracy in the Confidential Information and prevent the receiving party from using the Confidential Information to circumvent the disclosing party. Below are a few sample provisions.

Sample Provisions:

All Confidential Information shall remain the sole and exclusive property of disclosing party. Upon disclosing party's request, the receiving party shall promptly return to disclosing party all copies of the Confidential Information, shall destroy all notes, e-mails, abstracts and other documents that contain Confidential Information, and shall provide disclosing party a written certification of an officer of the receiving party that receiving party has complied with its obligations under this paragraph.

In providing the Confidential Information under this NDA, the disclosing party makes no representation, either express or implied, as to its adequacy, sufficiency, completeness, performance or freedom from defect of any kind, and disclosing party shall not incur any liability or obligation whatsoever by reason of such Confidential Information.

Sample Provisions:

Nothing in this NDA, nor any action taken by the receiving party, either during any discussions related to the Business Purpose or in providing services related to the Business Purpose, shall be construed to convey to the receiving party any right, title or interest in the Confidential Information, or any license to use, sell, exploit, copy or further develop in any way any Confidential Information. No license is hereby granted or implied under any patent, copyright or trademark, any application for any of the foregoing, or any trade name, trade secret or other proprietary information, in which disclosing party has any right, title or interest.

The receiving party agrees that it will not contact or otherwise deal with any person or entity employed by, associated with, represented by, or introduced to the receiving party by, the disclosing party without the written consent and participation of the disclosing party. Notwithstanding anything to the contrary in this NDA, the receiving party agrees it will not engage in any transaction that will interfere with, or deprive the disclosing party of the business opportunities disclosed by the Confidential Information.