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Will that NDA Cost You Your Trade Secret?

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Anyone who has worked in technology is familiar with nondisclosure agreements (NDAs). Differences among NDAs usually are small; they tend to cover the same territory in similar ways.

NDAs provided by large technology companies, however, sometimes contain a most pernicious provision: The “residuals” clause.

Purpose of Residuals

A residuals clause excludes from confidentiality obligations information that the recipient’s personnel retain in their memories. Here is a typical provision from an IBM Confidential Disclosure Agreement that I found online when this article was written but which appears to be no longer available:

The term "residuals" shall mean Information in intangible form, such as ideas, concepts, techniques and knowhow, which may be retained in the mind of those employees who have had rightful access to the Information. Each party shall be free to use the residuals of the Information for any purpose, subject to the patent, copyright and trademark rights of the Discloser.

IBM is not the only large company that commonly uses a residuals provision. See, for example, Intel’s Source Code License Agreement at <http://www.secinfo.com/drjtj.6mn.a.htm>.

At first glance, a residuals clause appears merely to acknowledge that people remember things that they see. The problem is that the clause gives any recipient with a good memory the right to use your information and reveal it to third parties, even if the information constitutes your trade secret!

Importance of Trade Secrets

Trade secret protection is inexpensive and easy to obtain. As a result, businesses rely on it routinely to protect information assets.

California Civil Code Section 3426.1(d) says that a trade secret is “information...that [d]erives independent economic value...from not being generally known to the public...and...*is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.*” (Emphasis added.)

NDAs exist to maintain the secrecy of information. Consequently, NDAs are the tools that we commonly use to protect trade secrets.

Imagine that you disclose information under an NDA, knowing that you are protecting your trade secret. Now imagine that the NDA has a residuals provision. If that provision is broad enough, not only will recipients be able to use whatever they remember about your trade secret – they also will be able to disclose that information to third parties without obligation of confidentiality, potentially destroying the trade secret status that you are relying on!

DANA H. SHULTZ Attorney at Law

+1 510 547-0545 • dana@danashultz.com • danashultz.com/blog

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Protection of Information

So here is what I recommend if you will be disclosing information under an NDA but do not have the negotiating leverage to remove the recipient's standard-form residuals clause:

First, if at all possible, negotiate an amendment that excludes trade secrets from the definition of residuals. This change will protect you from the greatest harm.

Second, look at how long the NDA restricts the recipient from disclosing your confidential information to third parties. If the restriction is not perpetual, make sure the period is long enough to provide the protection that you need.

Third, disclose as little as you can while still accomplishing your business objectives.

In summary, so long as you are vigilant and revise or work around the most dangerous provisions, there is no need to be afraid of NDAs.

The information in this article is not intended as legal advice. If you need legal advice on a matter, please contact an attorney directly.

DANA H. SHULTZ Attorney at Law

+1 510 547-0545 • dana@danashultz.com • danashultz.com/blog