

TOP STORY

Confusion Over NDA Leads to Dismissal of Trade Secret Action

By Anna E. Mallen – September 9, 2022

Prior to disclosing trade secret information, attorneys should ensure their client's nondisclosure agreement is enforceable. That is the hard lesson from a federal court's affirmed dismissal of a trade secret lawsuit where the plaintiff disclosed confidential information on a call with an interested buyer who, instead of purchasing the company, used the information to create its own competing product. [ABA Litigation Section](#) leaders warn this opinion is a "cautionary tale" for corporate clients and attorneys participating in the drafting and execution of not only nondisclosure agreements, but also professional service agreements.

The "Unexpected Happens"

In [Protégé Biomedical, LLC v. Duff & Phelps Securities, LLC, et al.](#), the plaintiff entered into a professional services contract (services agreement) with the defendant, an investment management company, to assist with securing a buyer for the plaintiff. The defendant's obligations under the services agreement included protecting the plaintiff's trade secrets by obtaining a nondisclosure agreement from any potential buyer. In exchange for these services, the plaintiff agreed to pay a nonrefundable transaction fee to the defendant if the company sold. The services agreement provided the defendant with immunity from various claims and shielded its employees from individual liability.

After execution of the services agreement, the defendant found a potential buyer. The defendant, with the assistance of the plaintiff's attorney, drafted a nondisclosure agreement (NDA) for the buyer's signature prior to any formal discussions regarding the potential sale. Rather than signing as the buyer's representative, however, a member of the buyer's board of directors signed the NDA in his individual capacity. The plaintiff, believing both parties were bound by the NDA, participated in a conference call with the buyer and disclosed its confidential and proprietary information. Shortly thereafter, the buyer terminated discussions with the plaintiff, used the confidential information disclosed, and created its own competing product.

Services Agreement Immunizes Defendant from Claims

The plaintiff first sued the buyer in the [U.S. District Court for the District of Minnesota](#). After settling that suit, the plaintiff sued the defendant and its board member, individually, in

Minnesota state court, asserting claims for breach of fiduciary duties, breach of contract, and negligence. The defendant removed the case to federal court, claiming the board member had been fraudulently joined to defeat federal jurisdiction. The defendant then moved to dismiss the action for failure to state a claim based on the language of the services agreement, which the district court granted. The plaintiff appealed.

In a split opinion, the [Court of Appeals for the Eighth Circuit](#) first affirmed that the board member had been fraudulently joined, primarily because he was not a party to the services agreement. Therefore, jurisdiction properly rested in federal court.

Second, the appellate court affirmed the dismissal of the plaintiff's claims. Relying on the language of the services agreement, the appellate court held that the defendant was responsible only for its *own* conduct, not the conduct of the plaintiff, who ultimately was the discloser of its own confidential information. In addition, while the services agreement excepted gross negligence claims from its broad indemnification language, the appellate court found that negligent performance of a contract is not a cognizable claim under New York law; and, even if it were, the defendant's failure to execute a binding NDA was a "reasonable mistake of fact," not an "outrageous act of folly."

Conversely, the dissent found that the services agreement obligated the defendant to do more than "personally keep confidential all nonpublic information and not disclose anything to third parties." Specifically, the dissent noted the gross negligence exception in the services agreement. In its view, the plaintiff had made sufficient allegations to call into question whether the defendant had exercised reasonable and professional care in executing the NDA for the plaintiff. The dissent doubted that the defendant, who held itself out as an expert financial advisor in multimillion dollar transactions "could have reasonably believed" that the buyer was bound by the NDA. Accordingly, the dissent believed sufficient causes of action had been plead.

Protection of Trade Secrets Is Key

"This is the worst thing that can happen to a client," warns [Sara A. Brown](#), Dallas, TX, vice-chair of the Litigation Section's [Business Torts & Unfair Competition Committee](#). "Sellers need to understand the roles of the various parties to a transaction and, if trade secrets are a key part of their business, sellers must stay vigilant about protecting them," Brown comments.

"The majority seems to get it right here" opines [George F. Ritchie](#), Baltimore, MD, vice-chair of the Section's Business Torts & Unfair Competition Committee. Attorneys representing sellers in these transactions "must be directly involved in the negotiation, drafting, and execution of

nondisclosure agreements,” states Ritchie, who believes that this opinion “could put a damper on sellers’ willingness to share confidential information with a competitor” during the negotiation process. “This is a harsh result, but a warning signal to all companies that they cannot rely on third-party nonlawyers to draft and execute nondisclosure agreements on their behalf,” he concludes.

[Anna E. Mallen](#) is a contributing editor for Litigation News.

Hashtags: #tradesecrets #NDA #nondisclosure

Related Resources

- Rebecca Edelson and Patrick McGill, “[Best Practices for Negotiating and Entering into Nondisclosure Agreements](#),” *Bus. Torts & Unfair Competition* (Apr. 12, 2022).
- Nicole D. Galli, “[Why Litigators Should Care about Trade Secret Management](#),” *Bus. Torts & Unfair Competition* (Dec. 11, 2019).
- Steven D. Ginsburg, “[Tips for Protecting Trade Secrets and Proprietary Information](#),” *Bus. Torts & Unfair Competition* (Nov. 6, 2017).