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# Pandora's Box Got Opened – "Catch & Kill" Agreements Gone Awry

## I. Nondisclosure Agreements Have Different Forms

### A. Types of Nondisclosure Agreements and Purposes

Nondisclosure agreements (NDA) come in a variety of forms and serve different purposes. For example, a simple nondisclosure agreement can be used as a mechanism to facilitate open communication between parties seeking for form a more formal business relationship. The agreement allows the parties to investigate facts related to a potential business arrangement without fear of having the information used inappropriately during the investigation and negotiation process, as each party agrees to treat information revealed by the parties as confidential.

Other traditional NDAs that appear in a business context include agreements signed by officers, directors, employees, and/or vendors for the purpose of protecting a business's proprietary information and trade secrets.[1] [2] In the legal context, parties to litigation can agree

[1]Generally, California courts will enforce a nondisclosure agreement that protects trade secrets. California's Uniform Trade Secrets Act defines a trade secret as "any confidential information that gives a business a competitive advantage and that the business takes reasonable precautions to keep other from learning about." In California, a trade secret includes "a formula, pattern, compilation, program, device, method, technique, or process." *See* Cal. Civ. Code, § 3426.1. California courts have recognized that nondisclosure agreements are evidence of a reasonable effort to maintain secrecy. Information no longer qualifies as a trade secret if it was disclosed to a third party under a NDA that expired by reason that the plaintiff failed to take reasonable efforts to maintain the secrecy of the information because a third party is now free to use the information. *See Silicon Image, Inc. v. Analogix Semiconductor, Inc.*, 2008 WL 166950, **16-17 (N.D. Cal. Jan. 17, 2008); *see also* G*ordon v. Schwartz*, 147 Cal. App. 2d 213, 217 (1956) (discussing client lists); *Sketchley v. Lipkin,* 99 Cal. App. 2d 849, 854)(1950) (discussing protection of marketing plans, pricing and discount structures and unpatented inventions); *Vacco Indus., Inc. v. Van Den Berg*, 5 Cal. App. 4th 34, 50 (1992) (discussing business methods; production

to keep certain information exchanged during the litigation confidential, and can either stipulate to, or seek a court's assistance in obtaining, a confidentiality agreement and protective order.

Another type of NDA can arise in settlement negotiations, whereby the parties agree to keep the terms of the settlement confidential. This type of agreement typically also contains provisions for disclosure of the settlement to certain third parties, such as accountants, and can allow for other disclosure as may be required by law with notice to the other party.

Yet another type of NDA exists in the form of what has come to be known as a "catch and kill" agreement. This type of agreement typically involves payment of money for a media story with the intent of the buyer having the exclusive right to the story, only to have the story "killed." This type of agreement gained widespread media attention following the 2016 presidential election, when Karen McDougal filed a complaint for declaratory relief against American Media, Inc. [3] and when Stormy Daniels sued Donald Trump to have a nondisclosure agreement invalidated.[4] Both lawsuits raise numerous issues related to not only the agreements themselves, but also the underlying ethical implications related to confidentiality agreements in general, liability imposed on attorneys involved in negotiating and drafting such agreements, and the legal ramifications of such agreements and enforcing them.

Finally, another area where NDAs arise is in the realm of settling sexual abuse and workplace harassment claims. These types of claims are commonly subject to settlement on the terms that not only the settlement remain confidential, but also that the entire underlying

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processes; product plans and designs); *Brescia v. Angelin*, 172 Cal. App. 4th 133, 151 (2009) (discussing recipes and chemical formulas).

[2] Texas law also provides that nondisclosure agreements are enforceable. In Texas, such agreements are common in business, and they are often enforceable even when a non-compete agreement is not. *See, e.g., Tom James of Dallas, Inc. v. Cobb*, 109 S.W.3d 877, 888 (Tex. Ct. App. 2003) ("A non-disclosure agreement may be enforceable even if a covenant not to compete is not."). The vast majority of case law in Texas about the enforceability of NDAs is limited to the specific issue of trade secrets. Conversely, non-compete agreements, to be enforceable, must meet the strict requirements of Tex. Bus. & Comm. Code § 15.50. For example, a non-compete agreement must be reasonable in scope. If an employee convinces a court that a nondisclosure agreement prohibits him from using his "general knowledge and skills," the court may treat the nondisclosure as a non-compete agreement. Under the statute, an overly broad non-compete agreement must be reformed to make it reasonable.

[3] *See McDougal v. American Media, Inc.,* Los Angeles County, California Superior Court, No. BC698956 (filed March 20, 2018).

[4] *See Stephanie Clifford a.k.a. Stormy Daniels a.k.a. Peggy Peterson v. Donald J. Trump a.k.a. David Dennison and Essential Consultants, LLC*, U.S. District Court for the Central District of California, No... 18-cv-02217,

claim remain confidential. These types of agreements also raise legal and ethical issues, not only for the attorneys involved, but also for the claims professionals who handle the claims. Since 2017, according to the National Conference of State Legislatures, at least ten states have introduced, or enacted legislation related to sexual harassment in the workplace. California, Arizona, New York, and Pennsylvania statutes are discussed herein.

B. Practical Considerations Arise in Negotiating Certain Agreement Language

1. Scope of agreement must be included as to time, parties, what is included
2. Exceptions to confidentiality agreement should be included
2. Consideration needs to be given for confidentiality
3. Liquidated Damages Provisions can be problematic and raise tax consequences

Parties negotiating nondisclosure agreements need to keep in mind that confidentiality must be requested as part of the settlement negotiation itself, and that some consideration must be given for confidentiality. However, the parties also need to be careful in including large liquidated damages provisions related to consequences of breach, as such provisions can be interpreted as relating to the consideration value and result in unforeseen and unfavorable tax consequences for the settling party.

C. Enforcement Mechanisms
1. Investigation
2. Cease and desist letters
3. Lawsuit

As with any contract-based cause of action/claim, in the case of breach of a nondisclosure agreement, thorough investigation into the facts, people, and effect of a breach is necessary. Typically, as soon as the initial investigation as to the facts is completed, a "cease and desist" letter is written to the breaching party that demands that any activities related to the breach stop immediately. The letter should also set forth the consequences that would follow in the event the conduct is not stopped and/or if the property subject to the agreement is not returned. Finally, a nonbreaching party may have to institute litigation to enforce the agreement and to seek damages arising out of the breach. Notably, as to certain nondisclosure agreements, damages can be difficult to prove.

II. Ethical Issues Abound in Negotiating and Drafting Confidentiality Agreements

### A. Attorneys need to keep in mind rules of professional responsibility

Any agreement that restricts an attorney's right to practice is prohibited under ABA Model Rule of Professional Conduct 5.6(b). This rule prohibits an attorney from making "an agreement in which a restriction on the lawyer's right to practice is part of the settlement of a controversy between private parties." An example of a prohibited provision is one where the plaintiff's attorney agrees not to represent others in future litigation against the same defendant. Another example of a provision that would violate ethical rules is where the agreement forbids an attorney from disclosing public information regarding an attorney's handling of a particular type of case. See Opinion 2012-1, Ethics Committee of the Bar Association of San Francisco; Opinion 730 of the New York Bar Association; *Hu-Friedy Mfg. Co., Inc. v. General Electric Co.,* 1999 U.S. Dist. LEXIS 11213 (N.D. Ill. 1999) (holding that plaintiff's attorney was not precluded from seeking documents in future discovery that were deemed confidential in prior litigation).

### B. Insurance professionals need to keep in mind ethical rules and claims settlement statutes

Every state has a code of ethics applicable to claims adjusters, and many are based on Florida's model, which is contained in Florida Administrative Code Section 69B-220.201, Ethical Requirements for All Adjusters and Public Adjuster Apprentices. ("Requirements"). The Requirements consist of standards of conduct that define ethical behavior and are binding on all adjusters. The Requirements list twelve (12) standards applicable to claims handling and investigation and settlement. Fla. Admin. Code R. 69B-220.201(3)(a)-(l). Subsections (e) and (i) specifically relate to settlements, stating:

> (e) An adjuster shall handle every adjustment and settlement with honesty and integrity and allow a fair adjustment or settlement to all parties without any compensation or remuneration to himself or herself except that to which he or she is legally entitled.
>
> (f) An adjuster shall not attempt to negotiate with or obtain any statement from a claimant or witness at a time that the claimant or witness is, or would reasonably be expected to be, in shock or serious mental or emotional distress as a result of physical, mental, or emotional trauma associated with a loss. The adjuster shall not conclude a settlement when the settlement would be disadvantageous to, or to the detriment of, a claimant who is in the traumatic or distressed state described above.

The Requirements provide that a violation of the standards constitutes grounds for administrative action against a licensee, and that a violation constitutes an unfair claims settlement practice. Fla. Admin. Code. R. 69B-220.201(2)(a)-(b).

The Model Unfair Claims Settlement Practices Act ("UCSPA") was drafted by the National Association of Insurance Commissioners to establish standards for investigation and disposition of claims under policies or certificates of insurance issued to residents of states that adopt the model act. Model Unfair Claim Settlement Practices Act, Section 1 (1997). Most states have adopted a version of the model act.[5] A violation of the UCSPA can provide the basis for a bad faith claim against an insurer.

Examples of good and bad adjuster conduct

1. A claims professional who finds the acts of an insured distasteful should never let his/her personal views affect his/her attempt to negotiate a settlement that is in the best interest of the insured. For example, a claims professional was assigned a case whereby the insured was the CEO of the company where her sister worked. The insured was sued by various women in the company for allegations of widespread sexual harassment. However, despite her disdain for the insured and his actions towards women, the claims professional put her personal views aside and strongly negotiated a settlement in the best interest of insured and assisted with negotiating the terms of the nondisclosure agreement as part of the settlement.
2. A claims professional should never attempt to contact a claimant/plaintiff to negotiate a settlement when he/she knows the claimant/plaintiff is represented by counsel without counsel's permission. For example, a claims professional was attempting to negotiate a physical abuse claim on behalf of company that cared for elderly patients. However, he became increasingly frustrated with claimant's attorney as he felt that claimant wanted to settle the case, but her attorney was holding out for more money and failing to communicate his offers of settlement to her. As such, he contacted claimant directly (without permission from her attorney) and made a $5,000 settlement offer. He told claimant that she could use the money to go Christmas shopping for her grandchildren. The elderly claimant told her attorney about the call and settlement offer and counsel immediately reported the actions of the claim's professional to the state's Department of Insurance, and he filed a bad faith suit against the carrier based on the claims professional's egregious behavior.

[5] Florida's UCSPA is codified at Fla. Stat. Section 626.9541. California's UCSPA is codified in the California Insurance Code, Section 790.03. Texas's UCSPA is codified at Tex. Ins. Code Section 541.060.

C. What is legal is not always ethical, and what is ethical is not always legal

There are multiple arguments against nondisclosure agreements, including, but not limited to, the position that the agreements are against public policy, and that confidentiality prevents public access to information and the judicial system. Courts and legislatures across the country have addressed these arguments, and nondisclosure is prohibited or may be circumvented in certain situations. Key cases and statutes are discussed below.

1. Confidentiality agreements are against public policy

Some courts have held that confidentiality agreements are unenforceable on the grounds that the agreement prevents public knowledge of wrongful conduct, and any agreement that subverts public policy is unenforceable. *Brockport v. Calandra,* 745 N.Y.S.2d 662 (2002).

2. Certain confidentiality agreements are barred

a. Fair Labor Standards Act Settlements

Settlements of FLSA suits must be approved by the court, and confidentiality terms are prohibited on public policy grounds. *See Lynn's Food Stores, Inc. v. United States,* 679 F.2d 1359 (11th Cir. 1982); *Hansen v. Wells Fargo Bank,* 2009 WL1490582 (S.D. Fla. 1982).

b. California Lemon Law Settlements – Cal. Civ. Code 1793.26

Nondisclosure agreements related to problems with motor vehicles are prohibited in cases involving claims under California's Lemon Law. Cal. Civ. Code 1793.26(a)(1)-(2). However, it is permissible to include a nondisclosure clause related to financial terms associated with the reacquisition of a vehicle pursuant to the statute. Cal. Civ. Code 1793.26(c).

c. Public hazards – Fla. Stat. 69.081

Florida's Sunshine in Litigation Act prohibits nondisclosure agreements concerning "public hazards," which are defined as an "instrumentality, including but not limited to any device, instrument, person, procedure, product, or a condition of a device, instrument, person, procedure or product, that has caused and is likely to cause injury." Fla. Stat. Section 69.081(2).

d. Sexual assault/Sexual harassment - Arizona – Ariz. Rev. Stat. 12-720

Arizona recently enacted a statute to allow for the disclosure of factual information related to sexual assault, sexual harassment, or allegations of sexual assault or sexual harassment. Effective January 1, 2019, Arizona Revised Statute 12-270 allows victims of sexual misconduct who have signed nondisclosure agreements as part of a civil settlement to talk to police or testify in a criminal case. Specifically, it provides that the terms of a NDA cannot be used to prohibit a party from responding to an inquiry from a peace officer or prosecutor regarding an alleged offense or from making a statement not initiated by that party in a criminal proceeding. A victim's actions of speaking with police or testifying cannot "be used to avoid or invalidate a party's right to consideration under the contract or to require the return of consideration that has already been provided to the party."

e. Sexual assault/Sexual harassment – California

Under California law, NDAs and confidentiality agreements are also not enforceable if they are attached to civil settlements involving crimes such as felony sexual assault and child sex abuse. In such a case, if a victim breaks the confidentiality agreement, a court may reject a breach of contract lawsuit.

With regard to limiting NDAs in the employment context and in light of the #MeToo movement, in September 30, 2018, Governor Jerry Brown approved SB 280, which prohibits and makes void any provision of an NDA that prevents the disclosure of information related to civil or administrative complaints of sexual assault, sexual harassment, and workplace harassment or discrimination based on sex for settlement agreements entered into on or after January 1, 2019. SB 820 expressly authorizes provisions that (1) preclude the disclosure of the amount paid in settlement and (2) protect the claimant's identity and any fact that could reveal the identity, so long as the claimant has requested anonymity and the opposing party is not a government agency or public official. SB 820 suggests that a violation of its provisions would give rise to a cause of action for civil damages. Section 1001 of the California Code of Civil Procedure, which codifies SB820, goes into effect on January 1, 2019.

f. Sexual assault/Sexual harassment – New York

Effective July 11, 2018, New York employers are prohibited from including an NDA in any settlement of a claim involving sexual harassment that would prevent the person who complained from disclosing the underlying facts and circumstances of the harassment, unless the complainant requests confidentiality. Section 5-336 was added to the General Obligations Law ("GOL") of New York and Section 5003-b was also added to the Civil Practice Law and Rules ("CPLR"). Under GOL Section 5-336, employers are prohibited from including an NDA in any settlement of a sexual harassment claim unless the complainant requests confidentiality. If the complainant requests confidentiality, the terms must first be provided to all parties. The complainant then has 21 days to consider the terms, and, after 21 days, if the term is still the complainant's preference, the condition must be memorialized in an agreement signed by all

parties. The complainant then has 7 days to revoke the agreement, which shall not be effective or enforceable until the revocation period expires. GOL Section 5-336 appears to apply to settlements of *all* claims of sexual harassment, not just those filed in court. CPLR Section 5003-b includes the same provisions as GOL Section 5-336 but applies to settlements of sexual harassment *lawsuits*.

g. Sexual assault/Sexual harassment – Pennsylvania

With regard to the #MeToo movement, a bill is pending before the Pennsylvania Senate, SB 999, that voids contracts executed after the effective date that: (1) prohibit disclosure of the name of anyone accused of sexual misconduct (including stalking); (2) suppress or attempt to suppress information relevant to a sexual harassment investigation; (3) impair or attempt to impair the ability of individuals to report claims; (4) attempt to waive a substantive or procedural right relating to a claim of sexual misconduct; or (5) require someone to expunge relevant information from documents. For contracts executed prior to the effective date of the legislation, should it take effect, the bill would authorize employees to void agreements if entered into while under duress, incompetent or impaired, or before the age of majority.

h. Notable Federal Statutes and Introduced Legislation re NDA

**ME TOO Congress Act (HR 4396).** In 2017, Congress has introduced a bipartisan bill named the ME TOO Congress Act that proposes to limit NDAs in harassment settlements.[6] The bill would seek to prevent and respond to sexual harassment in Congress by overhauling the complaint system, improving training, and making the process more transparent. It would end required mediation and mandatory nondisclosure agreements, require annual sexual harassment training by members and employees, and require members to settle harassment claims against them with their own money. Counseling and mediation would no longer be required to file a complaint, and instead would be optional. If counseling and mediation is waived, the deadline for filing a complaint would be 180 days after the alleged violation, and the complaint could be made anonymously. Nondisclosure agreements would no longer be imposed as a condition of initiating a complaint but would still be allowed for the contents of mediation or as part of a negotiated settlement. Complainants could also waive confidentiality in counseling.

**Tax Cuts and Job Act of 2017.** The recently-enacted Tax Cuts and Jobs Act amends Section 162 of the Federal Tax Code, which generally allows businesses to deduct certain ordinary and necessary expenses paid or incurred during the year as part of running the business. The amended tax law erases that deduction for a settlement or payment related to a sexual harassment or abuse claim, if the settlement is subject to an NDA. Additionally, no attorneys' fees associated with such a settlement can be deducted.

[6] The bill's full title is the Member and Employee Training and Oversight on Congress Act.

Another tax-related proposal in the U.S. House would further reduce employer deduction opportunities under section 162. The STOP Act (HR 4495) would deny deductions for "any amount paid or incurred on account of a judgment or settlement (whether by suit or agreement and whether as lump sum or periodic payments) . . . originating from . . . a claim or accusation" of criminal sexual abuse or sexual harassment. The bill defines "sexual harassment" to include "unwelcome sexual advances, requests for sexual favors, or other verbal or physical harassment of a sexual nature." It also explicitly covers payments made "to require the non-disclosure of or otherwise prevent" claims of sexual misconduct.

On the whole, the measure appears to curb deductions for "any amount paid or incurred in connection with negotiating or settling" a harassment claim—whether or not an NDA is involved. Given the enactment of the Tax Cuts and Jobs Act, however, this stand-alone measure is not likely to advance.

**Defense Trade Secrets Act of 2016.** On May 11, 2016, President Obama signed the Defend Trade Secrets Act of 2016 ("DTSA") into law, which provides federal statutory framework that governs confidentiality agreements pertaining to trade secrets. *See* Defend Trade Secrets Act of 2016, 130 Stat. 376 (codified at 18 U.S.C. §§ 1831-1836). The DTSA creates a federal cause of action for trade secret misappropriation that allows private parties to bring civil trade secret claims in federal court. Prior to the DTSA, confidentiality agreements were traditionally governed under state law.

The DTSA provides a federal cause of action for an owner of a trade secret that is misappropriated if the trade secret is related to a product of service used in, or intended for use in, interstate of foreign commerce (18 U.S.C. §1836 (b)(1)). Under the DTSA, trade secret is defined as all forms and types of financial, business, scientific, technical, economic, or engineering information, including patterns, plans, compilations, program devices, formulas, designs, prototypes, methods, techniques, processes, procedures, programs, or codes, whether tangible or intangible, and whether or how stored, compiled, or memorialized physically, electronically, graphically, photographically, or in writing if both: (1) the owner has taken reasonable measures to keep such information secret, and (2) the information derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable through proper means by, another person who can obtain economic value from the disclosure or use of the information. (18 U.S.C.A. § 1839(3).)

The DTSA does not preempt state trade secret laws, and injunctions under the DTSA may not conflict with state law prohibiting restraints on the practice of a lawful profession, trade or business.

## II. Problems Abound When Agreements are Breached

### A. Claims Issues

#### 1. Breach of Fiduciary Duty

Breach of fiduciary duty claims arise against employees, officers and directors who violate a nondisclosure agreement, particularly related to disclosure of trade secrets and proprietary business information.

2. Conversion

A conversion claim can arise against an employee, or former employee, officer or director of a business who uses information gained through their position for financial gain. An example of conduct giving rise to a conversion claim involves the use of client lists of the former employee's business in connection with starting a competing venture.

3. Breach of Contract

A claim for breach of contract arises against a party that violates a nondisclosure agreement. Defenses to such a claim include, but are not limited to, unenforceability or unconscionability of the contract, as well as statutory exceptions listed above for certain claims.

B. Coverage Issues

1. Directors and officers – contract exclusion and "wrongful acts" coverage

Directors and officer's insurance provide indemnification for the "wrongful acts" of a company's directors and officers, which typically includes claims for breach of fiduciary duty and negligent or reckless conduct. However, sexual misconduct claims involving bodily injury, mental anguish, emotional distress, humiliation, libel, slander and defamation and willful and intentional misconduct are not covered under directors' and officers' policies. Additionally, the policies contain an exclusion for breach of contract claims. The contract exclusion has been narrowly construed in Texas. *See, e.g., Spec's Family Partners, Ltd. v. Hanover Ins. Co.,* 739 Fed. App'x 233 (5th Cir. 2018) (finding, *inter alia,* that contract exclusion did not bar coverage for liability for alleged noncompliance under contract); *Admiral Ins. Co., Inc. v. Briggs,* 264 F. Supp. 2d 470 (N.D. Tex. 2003) (holding that contract exclusion did not preclude coverage for claims involving misstatements and misrepresentation). On the other hand, the contract exclusion, as well as a professional services exclusion has been upheld in Florida. *See, e.g., Bond Safeguard Ins. Co. v. National Union Fire Ins. Co.,* 628 Fed. App'x 648 (11th Cir. 2015) (affirming summary judgment holding that insurer was not liable for payment of stipulated judgment based on contract exclusion); *see also, Stettin v. National Union Fire Ins. Co.,* 861 F.3d 1335 (11th Cir. 2017) (applying Florida law, holding that bank's directors and officers professional service exclusion precluded coverage). California has declined to find coverage for a policyholder's contractual obligations, even in the absence of a specific exclusion. *See August Entertainment, Inc. v. Phladelphia Indemnity Ins. Co.,* 146 Cal. App. 4th 565 (2007).

2. Errors and omissions coverage for attorneys

Attorneys involved in drafting and negotiating confidentiality agreements may also be subject to errors and omissions claims when the agreements are breached or subject to a claim of invalidity. Care should be taken to narrowly tailor the agreement, provide for adequate consideration, and avoid areas, or provide exceptions within the agreements, where confidentiality agreements are barred by statute or where there is a statutory exception for disclosure of otherwise confidential information.

3. Ramifications of sexual and physical abuse, sexual harassment and molestation coverage, exclusions and sublimit

General Liability insurance policies provide coverage for claims arising from "personal injury" which is typically defined to include defamation. As such, a defamation suit by an accused harasser could be covered under a CGL policy. However, General Liability policy precludes coverage for direct claims of physical assault pursuant to the "expected and intended" exclusionary language in the policy; however, some courts have ruled that the exclusion does not apply to claims against a company for negligent hiring an individual who commits a sexual assault. Other courts have also ruled that claims made by employees where the alleged misconduct occurred outside the workplace and otherwise unrelated to employment, is covered under the General Liability policy. Breach of contract claims are not typically covered under General Liability policies.

4. Claims made, and claims made and reported policy issues

Errors and omissions and directors' and officers' policies are claims-made policies (not all Employer Professional Liability Insurance are claims-made policies) that require that claims/suits be made/filed during the policy period, while others require that claims be made **and** reported during the policy period. Consequently, if claims are not made during the policy period or made and reported during the policy period, coverage will be denied.

5. Professional services, wrongful acts, and wrongful employment practices issues

It is important to consider whether a claim arises out of professional services, wrongful acts or wrongful employment practices. In order to trigger coverage under a Professional Liability policy, the claim/suit must arise out of the failure to provide professional services as defined in the policy. To trigger coverage under a directors' and officers' policy, the claim/suit

must arise out of the "wrongful acts" of directors and officers as defined in the policy. In order to trigger coverage under an Employer Professional Liability Insurance policy, the claim/suit must arise out of "wrongful employment practice" as defined in the policy. If the claim or suit fails to arise out services acts or practices as defined in the policy, coverage will be precluded for the claim/suit.

6. Eroding limits may affect indemnity payments

Professional Liability, Errors and Omissions, and Directors' and Officers' policies are eroding limits policies, meaning that the Limits of Liability are diminished by the payment of defense costs. As such, depending on the nature of the case, the policy limits may be eroded to such a degree that there may not be enough of the limit left to cover a claim, settlement or judgment, which could expose the insured to personal liability.

IV. Conclusion and Take Away/Questions