

CONTRACTS OF CONFIDENTIALITY

In recent years, the subsistence of companies has depended largely upon the influx of ‘innovative ideas and suggestions’ and hence their protection has acquired paramount importance which sometimes entails placing specific restrictions on when, where, how and with whom the employees work. This has, in turn, resulted in a boost in the concept of making employees enter into agreements consisting of non-competition and non-disclosure clauses, as a precondition to employment. Today a company's most valuable assets are its trade secrets and employees. But how does one retain them? Agreements consisting of non-competition and non-disclosure clauses can help prevent employees from:

- (i) starting a competing business,
- (ii) working for a competitor,
- (iii) soliciting ones customers,
- (iv) recruiting ones current employees, and
- (v) disclosing trade secrets or confidential information.

Non-competition clauses originated in the 1950s, when owners made attempts to protect themselves from unfair competition. In the 1980s and 1990s, non-competition clauses became more prominent as a means for protection of clientele from ‘solicitation’ by former employees. Most recently, the technical workforce shortage, especially in dot.coms and other high-tech endeavors, has led to an increase in the usage of non-competition and non-disclosure agreements and in their enforcement and legal action. Non-disclosure clauses are essentially used to maintain confidentiality of private information, which range from trade secrets to personal details of customers. Sometimes, information that is not a trade secret can be even more valuable or potentially damaging. Companies also look for ways to protect information about their inner working that could be leaked by former employees.

Non-competition clauses and non-disclosure clauses are not a means to dissuade competition thereby restraining a person from refraining from practicing a lawful trade or profession. No person has an abstract right to be protected against competition per se in his trade or business. Section 27 of the Indian Contract Act,

1872 states that agreements in restraint of trade are void. The only exception being in the case of sale of goodwill of a business whereby the buyer may be refrained from carrying on a similar business, within specified local limits, so long as the buyer, or any person deriving title to the goodwill from him, carries on a like business therein, provided such local limits are reasonable.

Validity of confidentiality agreements

Any agreement in restraint of trade is considered void. However, certain restraints are permitted such as agreements consisting of non-disclosure and non-competition clauses. An employee owes certain duties to the employer one among them being the duty of fidelity. It is the duty of the employee not disclose to others or use to his own profits, trade secrets or confidential information that he learns during the course of employment. Equity awards injunction against such erring servants and common law awards damages. The most common explanation of this duty has been that of an implied term in the contract of employment. But this has ceased to be the view and now it is based merely on confidence. The principle of ‘breach of confidence’ was used in *Saltman Engineering Co. v. Campbell Engineering Co.* (1963) 3 All. E. R. 413. This was not a case of contract, but a duty not to use information of a process was extended to a person receiving information in circumstances showing confidence, e.g. by one trader to another and the latter making use of it by way of competition with the former (*Peter Pan Corpn. V. Corsets* (1963) 3 All. E.R. 402, 406). An employer is thus entitled to protect confidential information which amounts to a “trade secret” or which prevents “some personal influence over customers being abused in order to entice them away” (*Faccenda Chicken Ltd. v. Fowler* (1987) Ch. 117, 137).

A covenant that is reasonably necessary to protect an employer against the betrayal of trade secrets or confidential information is not void merely because it unavoidably protects the employer against competition (*Schroeder (A) Music Publishing Co. Ltd. v. Macaulay* (1974) 3 All. E.R.616). A restraint against competition is justifiable if its object is to prevent the exploitation of trade secrets that learned by the servant, in the course of his employment. An instance of this occurred in *Forster & Sons Ltd. v. Suggett* ((1918) 35 T. L. R. 87), where a works manager had knowledge of certain confidential methods concerning the correct mixture of gas and air in furnaces for making glass and glass bottles. It was held in the above case that a restraint is justifiable if its purpose is to prevent the exploitation of trade secrets and/or confidential information. Apart from the protection of trade secrets or confidential information an employer is not entitled

to restrain an employee from making use after the employment has ceased of any knowledge or skill gained during the period of employment (Herbert Morris v. Saxelby (1916) 1 A. C. 688).

What information is considered confidential?

This brings us to the important question i.e. the kind of information that may be protected vide confidentiality agreements. For deciding as to whether a particular information is capable of protection, the Court will take into consideration two factors viz. firstly, the nature of information sought to be protected and secondly, whether the employer impressed on the employee the confidential nature of the information. Thus, if the so-called secret is nothing more than a special method of organization adopted in the business or if only the servant knows a part of the secret whereby its successful exploitation of that information by him is impossible, there can be no valid restraint (Herbert Morris v. Saxelby (1916) 1 A. C. 688). Thus for an information to be confidential it must have the necessary quality of confidence about it and should also have been given under circumstances which imply a degree of confidentiality about it.

The terms “trade secret” and “confidential information” are often interchanged. A “trade secret” is any information that derives independent economic value from not being generally known or readily ascertainable. The Quebec courts have defined the term “trade secret” as being manufacturing processes and recipes. The term “confidential information” is generally used to describe information conveniently compiled throughout the years by an individual or a company, such as a clients list, a marketing strategy based on client’s preferences, a supplier’s list, pricing information or the financial position of a company which may partially become known on the market place by the mere fact of being in business. Not all information that is available to an employee in the course of his work is confidential in nature. Only those information which are in essence so confidential that they are assimilated to trade secrets and become part of the third category described in the Faccenda case, will enjoy a legal protection.

There are three categories of information that are accessible to the employee as laid down in Faccenda Chicken Ltd. v. Fowler ((1985) 1 All. E.R. 724). The first category includes things that are within the reach of any interested individual. Such information does not require any kind of protection. The next category consists of information must remain confidential during the entire time during which employment exists because there is an implicit loyalty clause in any lease

and hire of work. This prohibits an employee from giving away privileged information to a competitor. However, once the employment is over, the use of skill and knowledge acquired while working with the former employer is allowed even when in direct competition. Finally, the only kind of information protected even after the termination of work with an enterprise is information that is likened to trade secrets, which are the property of the employer.

The springboard theory

In the field of protection of confidential information and trade secrets, it is very pertinent to mention the doctrine of the Springboard theory. This theory has been expressed as follows in *Terrapin Ltd. v. Builders Supply Co. (Hayes) Ltd. and Others* (R.P.C. (1967) p.375).

"... a person who has obtained information in confidence is not allowed to use it as a springboard for activities detrimental to the person who made the confidential communication, and springboard it remains even when all the features have been published as can be ascertained by actual inspection by any member of the public... The possessor of the confidential information still has a long start over any member of the public... It is, in my view, inherent in the principle upon which the *Saltman* case rests that the possessor of such information must be placed under a special disability in the field of competition to ensure that he does not get an unfair start."

When confidential information or trade secrets are leaked to a competitor, the application of the Springboard theory will protect the "head start" of the owner of this information and trade secrets and will "set back" those who illegally obtained access to the information.

Factors on which reasonableness of restraint depends

The restraint in order to prevent misuse of confidential information has to be reasonable so that the interest of the parties afford adequate protection to the covenantee, which depends upon two factors of time and space. As the time of restriction lengthens or the space of its operation grows, the weight of the onus on the covenantee to justify it grows too. But a restraint for life was held valid in *Fitch v. Dewes* ((1921) 2 A. C. 158). An ex-servant confidentially employed in the manufacture of an article under a secret process is under an implied obligation to his late master not to disclose any knowledge or information as to that secret process acquired during his employment. This applies to information retained in

the servant's memory as well as to information committed to writing and existing in a tangible form (*Amber Size & Chemical Co. v. Menzel* (1913) 2 Ch. 239). A contract not to divulge a trade secret may be reasonable though unlimited as to space or time and a restraint imposed in order to give effect to such a contract would apparently be treated in the same way as stated in the Halsbury's Laws of England, Vol. 38, p.33 (3rd Edition).

Remedies

Although an injunction is the most common remedy in cases of breach of confidential information the confidence can be enforced by damages also (*National Broach & Machine Co. v. Churchill Gear Machines Ltd.* (1965) 2 All. E.R.961). In *Cranleigh Precision Engineering Ltd. v. Bryant* ((1965) 1 W. L. R. 1293, 1311), an injunction was given against a servant who as a servant acquired confidential information and sought to take advantage of it after leaving the service of the master. The Courts have awarded damages as compensation even though the breach committed was innocent (*Seager v. Copydex* (1967) 2 All. E.R. 415).

The Indian perspective

The Indian perspective in this aspect is based more on common law than on contractual law. The reason being that Indian law, which is essentially derived from English law, believes that the concept of confidentiality is more a concept of equity than of contract. Hence, there is a very strong reliance on English Common law and English case laws. Another factor that points out the inadequacies of Indian law in matters relating to 'confidentiality' is that unlike the United States or the United Kingdom there is no well defined law to that effect. The United States has a Uniform Trade Secrets Act (UTSA) to that effect. The theft of trade secrets is now a federal criminal offense in the United States. This is a major development in the law of trade secrets both in the United States as well as internationally. The Department of Justice in the United States now has sweeping authority to prosecute trade secret theft whether it is in the United States, via the Internet, or outside the United States.

However, the concept of 'confidentiality' is well accepted in India and subsequent agreements for protection of confidential information are considered valid. In a Gujarat case, *Sunil Mazumdar v. Aryodaya Spinning & Weaving Mills Co. Ltd.* ((1964) A. Guj. 115), the Defendant, a qualified technician and diploma-holder, in

textile technology agreed to serve the plaintiff's spinning mills for 5 years. After serving for about a year as a Senior Assistant he resigned and accepted an employment in another spinning company on a salary higher than he was getting. The Plaintiff employed him because of his specialized training and there was considerable dearth of such trained technicians. The agreement was held valid and an injunction to prevent breach of negative covenant was granted. But in another similar case, *Magan Lal v. Ambica Mills* ((1964) A. Guj. 215), the same court did not grant an injunction. The reason for upholding restraint against an employee is to protect the proprietary rights of the employer if it is reasonably necessary in the case of trade connections or trade secrets but it is not available if directed to prevent competition or against the use of personal skill and knowledge acquired by the employee in his employers business (*Herbert Morris Ltd. v. Saxelby* (1916) 1 A. C. 688; (1916-17) All. E.R. 305).

Thus, if the restraint is reasonable then the agreement to that effect is held to be valid. When drafting and applying the clauses pertaining to confidentiality it is essential to consider the factual circumstances relevant to the operation of the clause. If the Courts are of the opinion that the purpose of the restraint is to inhibit the employee from leaving his employment or to prevent legitimate competition, then the clause in question will not be upheld. There is always an implied duty of fidelity to the employer that would prevent an employee from using his skill for the benefit of a rival company in cases relating to confidential information. Even in the absence of an agreement or even a clause in an agreement, which restrains a person from breach of confidential information, there is an implied duty of fidelity towards the employer, which prevents breach of confidential information.

The jurisprudence of confidentiality is still in its infancy in India and therefore a resort to the English law and decisions of various courts on this point will be useful in understanding the concept of confidentiality contracts.