



CONFIDENTIALITY AND RESTRAINT OF TRADE: PRACTICAL ISSUES

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Confidentiality and restraint of trade are two related and important issues that come up time and again in the technology sector. Wigley & Company address some of the problems and some of the ways in which those problems can be solved.

INDEX

1	Protecting Confidential Information	2
1.1	It's best to contract.....	2
1.3	What's protected?	2
1.7	What type of information?	3
1.10	Who should sign?	3
1.12	What if information is already disclosed publicly?	3
1.17	How to do an NDA	4
1.28	Walk the Talk	5
1.32	Public Sector Disclosure	5
2	Restraint of Trade	6

1 Protecting Confidential Information

1.1 It's best to contract

1.2 There are duties to keep certain information confidential (especially trade secrets and the like)¹. This can be so even if there is no contract to that effect. But it's much safer to sign an agreement. Doing this makes it clear that confidentiality is intended. The agreement should clarify what the information is that's to be confidential.

1.3 What's protected?

1.4 Even then, the recipient of A's information (B) won't always be able to protect the information. Employees are a special example. Employees can often be restrained from using "trade secrets" and other particularly confidential information. But they usually won't be restrained, post-employment, from using information they would normally pick up when working for similar employers (that information is often called "know-how").

1.5 Where the line is drawn is often unclear and can depend on a number of factors. Like much IP risk, nothing is certain. A well-drawn agreement increases the chances of preserving confidentiality.

¹ See, eg: *AB Consolidated* [1978] 2 NZLR 515.

- 1.6 Confidential information is not limited to what's written down. It includes confidential information in someone's head. For employees however, much information in his or her memory can be used after employment finishes. Broadly speaking, information that hasn't been deliberately memorised or written down, and information that isn't especially confidential (eg: something that's not a trade secret) can be used. This description oversimplifies what is a complex and risky area for former employer, new employer, and the employee alike.²
- 1.7 **What type of information?**
- 1.8 Agreements could be signed to protect many types of information including, for example:
- 1.8.1 Software being developed, source code, etc.
 - 1.8.2 Business systems and concepts.
 - 1.8.3 Customer lists, customer details and the like. (Information like this might be protected for a limited period of time, even though it could be obtained from third party sources such as the Yellow Pages. The Courts can injunct a party to stop it getting a "headstart" or "springboard"³).
 - 1.8.4 New ideas created by and discussed with employees and others.
 - 1.8.5 Business plans.
 - 1.8.6 Marketing strategies.
- 1.9 While the trivial won't be protected, there is a relatively low threshold as to what will be treated as confidential⁴ especially where specified by contract.
- 1.10 **Who should sign?**
- 1.11 A (the supplier of information) could sign a confidentiality agreement (often call a non-disclosure agreement or NDA) with parties such as:
- 1.11.1 Employees.
 - 1.11.2 Contractors.
 - 1.11.3 Potential investors.
 - 1.11.4 Potential JV partners (this may require a 2-way agreement for exchange of information).
 - 1.11.5 Potential customers.
- 1.12 **What if information is already disclosed publicly?**
- 1.13 There is an additional reason to protect confidential information by contract. It is more likely that the information may be protected even though it's published elsewhere. For example, applying for a software

² *Peninsular Real Estate v. Harris* [1992] 2 NZLS 216.

³ *Peninsular Real Estate v. Harris* [1992] 2 NZLS 216.

⁴ See, eg: *Cadbury Schweppes v. FBI Foods* (1999) 167 DLR (4th) 577.

or other patent requires publication of what is otherwise a commercial secret (details of the invention have to be publicly registered). But if A has separately disclosed details to B, and B has signed an NDA, B can be restrained from using the information, even though it's been published for patent purposes.

- 1.14 That's the type of situation in the *Maggbury* case.⁵ The confidentiality commitment is unlikely to work if A and B don't sign an agreement (and that agreement should expressly state it covers published material). A will often be keen, in situations like this, to stop B from getting a headstart with information that it received (eg: because it helped develop the IP) ahead of others. There is a risk – however – that such an approach will not be enforced by the Court. In some circumstances, it could constitute an unenforceable restraint of trade. If this is a risk, one way to improve A's position is to limit the time period (and maybe extent) of the confidentiality commitment, for the reasons noted below in relation to restraint of trade.
- 1.15 Our draft NDA doesn't provide for confidentiality persisting after public disclosure. Words would have to be added to cover that specific issue.
- 1.16 Confidentiality applies even where the information includes components which are publicly available.⁶ For example, a software programme being developed which incorporates Microsoft, Open Source and the developer's library code can be protected. Note also that there might be copyright protection too. The advantage of a confidentiality agreement is that it can strengthen the developer's position. Other IP rights, such as copyright, won't always be enough.
- 1.17 **How to do an NDA**
- 1.18 The NDA should at least be an agreement. The agreement could be in the form of, for example, a "lawyers" agreement or a letter from A countersigned by B or a deed. An employee confidentiality agreement should, if possible, be included in the employment agreement. It's far better to sign it in advance.
- 1.19 If signed later, and/or especially if risk is high, consider:
- 1.20 Signing a deed.
- 1.21 A paying B as consideration for entering the agreement (this increases the chance there would be an enforceable contract).
- 1.22 Getting legal advice.
- 1.23 Getting not only B to sign the NDA, but also B's relevant employees and contractors as well. Don't just leave that to B to do. A should see the signed NDA's. Additionally, consider getting B's relevant people to

⁵ (2001) 185 ALR 152.

⁶ *Saltman v. Campbell* [1963] 3 All ER 413.

- give a confidentiality undertaking direct to A (rather than just requiring B to set up the obligation). If you do this, ideally ensure that B remains liable for all breaches by its people anyway. How far you go in practice depends on how important it is to keep the information secret.
- 1.24 Instead of limiting access by B's employees on a "need to know" basis, name exactly who (of B's staff) can access the information.
- 1.25 In the NDA, identify clearly the confidential information but not in a way which limits it too narrowly. See the example in the enclosed NDA. It may also be useful to refer to (a) the particular transaction and what's happening (eg: negotiations) and (b) use of the information in modified form.
- 1.26 This highlights a key point: like restraints of trade (dealt with below), generic NDAs often are inadequate. Ideally, they should be tailored to the circumstances. However, A can have standard forms applicable to most of its business dealings (which A can amend each time to suit the circumstances).
- 1.27 Our example of an NDA is in letter form. Make sure the right person signs an NDA on behalf of B. He or she must be sufficiently senior to bind B where it's a company, government department, etc.
- 1.28 **Walk the Talk**
- 1.29 "Walk the Talk", such as by:
- 1.29.1 giving frequent reminders about confidentiality;
 - 1.29.2 limiting access on a "need-to-know" basis;
 - 1.29.3 maintain good security;
 - 1.29.4 marking relevant material as confidential;
 - 1.29.5 make clear to your people what can and can't be disclosed to others;
 - 1.29.6 keep paper trails, and appoint one person to control confidential information.
- 1.30 This obviously helps keep the information confidential in practice. And "walking-the-talk" would also help A uphold its NDA in court.
- 1.31 In practice, B, signing an NDA, can be lax in fulfilling its requirements. That's potentially dangerous. B should take care and have/use good systems.
- 1.32 **Public Sector Disclosure**
- 1.33 Note that disclosure of confidential information to a local or central government agency runs the risk that the agency will disclose it to third parties even if it's signed an NDA. The agency may be required to disclose under the Official Information Act or the LGOIM Act,

balancing confidentiality as against public interest. A could insert a clause in the NDA requiring the agency (B) to notify A before disclosing. This clause would be enforceable (and must be honoured by the agency) despite the agency's statutory protection from liability.⁷

- 1.34 For more detailed information on confidential information, see the New Zealand Law Society's October 2002 seminar paper, *Confidential Information* by S. Fitzgerald and V. Heine.

2 Restraint of Trade

- 2.1 Like our confidential information summary, (a) this is a "heads-up" overview of a complex area, which is full of pitfalls and (b) it's important to get good specialist legal advice.
- 2.2 NDAs and other protection may not be enough. It can often be difficult to enforce an NDA because, for example, A can't prove misuse of information. Additional/alternative protection may be available via a restraint of trade clause. This ideally should be signed up in advance (eg: as part of an employment contract). Suitable candidates include employees, contractors and a company (and/or people) that sells a business to A.
- 2.3 Particularly with employees, the starting point is that restraint of trade clauses are unenforceable unless A can show they are reasonable, in all the circumstances, to protect A.⁸ The idea is that employees should not be unreasonably restricted in getting other employment. The Courts won't protect against competition as such (there must be underlying interests such as confidential information to protect). However, the courts are much more likely to enforce a restraint of trade clause against a vendor, contractor, or someone with a business relationship, rather than an employee relationship.⁹ Where the employment flows from a business deal (eg: the new employee has sold substantial IP to her new employer) the Courts are more likely to enforce the restraint.
- 2.4 Under our Illegal Contracts Act, the court can alter the wording of the clause to make it more acceptable (eg: to reduce the period of restraint from 1 year to 6 months, and to reduce its scope from, say New Zealand to Wellington City). But A should not rely on this and should draft restraints narrowly. For example, the high end for employee restraints is around 1 year with the acceptable period closer to 3-6 months, depending on the issues involved.¹⁰

⁷ *Astra v. Pharmac* [2001] 1 NZLR 415; *Wyatt Co v. Queenstown Lakes District Council* [1991] 2 NZLR 180.

⁸ *Fletcher Aluminium* [2001] 2 NZLR 731.

⁹ *Fletcher Aluminium* [2001] 2 NZLR 731.

¹⁰ *Gallagher v. Whalley* [1999] 1 ERNZ 490.

- 2.5 The restraint could cover, for example:
- 2.5.1 period;
 - 2.5.2 the area (eg: Wellington City) in which B can operate; and/or
 - 2.5.3 type of business in which B can operate; and/or
 - 2.5.4 particular companies (eg: competitors) for which B can or can't do work; and/or
 - 2.5.5 a restriction on poaching employees, dealing with suppliers, etc.
- 2.6 Each restraint of trade clause should be tailored to the circumstances. There are even cases which say that identical restraints across the board point away from A being able to enforce the restraint.
- 2.7 These are difficult clauses to get right. Start with clauses drafted for A's various circumstances by specialist lawyers. They can be varied on a case by case basis.
- 2.8 We've included an example of a restraint of trade clause. We emphasise again that these clauses must be tailored to the circumstances and so it's important to get advice (the same applies to NDAs as well).
- 2.9 Consider "garden leave" by which B can't work for the competitor for say, 3 months, and is paid by A during that period.
- 2.10 Given IT is often developed, bought and sold outside B's home town, IT players are generally more likely to be able to enforce a wider restraint against B (eg: nationally or even internationally).
- 2.11 The classic lawyer's answer applies: with restraint of trade and confidential information, it all depends on the circumstances.

Wigley & Company is a specialist technology (including IT and telecommunications), procurement and marketing law firm founded 11 years ago. With broad experience in acting for both vendors and purchasers, Wigley & Company understands the issues on “both sides of the fence”, and so assists its clients in achieving win-win outcomes.

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