

The Dangers of Confidentiality Pacts

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In today's technology and information sensitive economy, most executives are asked, and readily agree, to sign "Confidential and Proprietary Information" agreements that protect their employer. Until recently, few executives gave them much thought. How, after all, does one object to agreeing not to "use" or "disclose" the "confidential or proprietary information" of his or her employer for the benefit of a competitor? As with most things, however, the devil is in the detail, or in this case, the definition.

Typical employment agreements drafted by employers create broad restrictions on use of information which would not qualify as "trade secrets" or "confidential information" under the common law definitions developed by New York courts. Because of the expansive contractual definition of "confidential information" in these agreements, agreeing to a confidentiality provision as part of an employment contract can severely constrain an executive's ability to carry out his or her duties upon obtaining new employment and may even limit his or her ability to be re-employed in a business where such "confidential information" would inevitably be used.

"Confidential information" is often defined in employment agreements as anything the employee has seen, heard, learned or came across in the course of his or her employment, unless "available to the public." This somewhat vague definition may seem intuitively fair, but in practice it can create real challenges to de-posted executives. Typical examples of "confidential information" in the non-exclusive litany contained in many such agreements include: "promotion and pricing techniques" or "information concerning products and services and their development". These are all things that become part of the executive's general knowledge and experience in an industry — and are routinely "used" if not explicitly disclosed — for the benefit of new employers. While such information is not a trade secret, it is included under the definition of "confidential information" in many employment agreements and probably does not fall within the "available to the public" exception.

Common Law Trade Secret Protection

New York recognizes a common law duty prohibiting an employee from disclosing an employer's confidential information. This duty continues after his or her employment ends, regardless of whether a written confidentiality agreement exists. *ABKO Music, Inc. v. Harrisongs, Ltd.*, 722 F.2d 988, 994 (2d Cir. 1983); *Royal Carbo Corp. v. Flameguard, Inc.*, 229 A.D.2d 430, 431, 645 N.Y.S.2d 18 (2d Dept. 1996). To prevail on a common law misappropriation of trade secrets claim, a former employer must show: (1) that it possessed a trade secret and (2) that the defendant used that trade secret in breach of an agreement, a confidential relationship or duty, or as a result of discovery by improper means. *Hudson Hotels Corp. v. Choice Hotels Int'l*, 995 F.2d 1173, 1176 (2d Cir. 1993).

The following factors are used in determining whether information is a protectable trade secret: (1) whether the information is not known outside the plaintiff's business; (2) the extent to which it is known by employees and others involved in the business; (3) the measures taken to guard the secrecy of the information; (4) the value of the information to plaintiff and its competitors; (5) the amount of effort or money plaintiff expended in developing the information; and (6) the ease or difficulty with which the information could be properly acquired or duplicated by others. *Hudson Hotels*, 995 F.2d at 1176 (quoting *Restatement of Torts* § 757 cmt. b (1939)); *Ashland Management Inc. v. Janien*, 82 N.Y.2d 395, 604 N.Y.S.2d 912 (1993).

Common law trade secret protection is not available for information that constitutes general business knowledge or experience. *Fairchild Engine v. Airplane Corp*, 50 N.Y.S.2d 643, 650-51 (N.Y. Sup. 944); *ABKO*, 722 F.2d at 994. See *Investors Guaranty Fund Ltd. v. Morgan Stanley & Co.*, 1998 U.S. Dist. LEXIS 20225 (S.D.N.Y. 1998), at * 12 (use of underwriting risk program was not unfair competition since system was widely known in market), *aff'd*, 1999 U.S. App. LEXIS 28902 (2d Cir. 1999); *Anchor Alloys, Inc. v. Non-Ferrous Processing Corp.*, 39 A.D.2d 504, 507, 336 N.Y.S.2d 944 (2d Dept. 1972) (knowledge of melting and smelting of metals, costs thereof, prices and specifications not a trade secret). Further, the "mere knowledge of the intricacies of a [former employer's] business operation does not constitute a protectable secret that would justify prohibiting the employee from utilizing his knowledge and talents in this area." *International Paper Co. v. Suwyn*, 966 F. Supp. 246, 256 (S.D.N.Y. 1997) (quoting *Reed, Roberts Assoc., Inc. v. Strauman*, 40 N.Y.2d 303, 386 N.Y.S.2d 677 (1976); internal quotations omitted);

It is also well-established law that an employee's "remembered information as to specific needs and business habits of particular customers is not confidential." *Anchor Alloys*, 39 A.D.2d at 507. This is particularly so where the information can be readily obtained from the customers themselves. See *Ivy Mar Co., Inc. v. C.R. Seasons, Ltd.*, 907 F. Supp. 547, 557-58 (E.D.N.Y. 1995) (list of large retailers and information about customer preferences that can easily be recalled by former employee, or obtained from customers directly, not protectable as trade secret); *Bijan Designer for Men, Inc. v. Katzman*, 1997 U.S. Dist. LEXIS 1426 (S.D.N.Y. 1997), at * 24 (customer clothing size is confidential information,

but court declines to enjoin use of information by competitor because information would be disclosed by customers eventually); *In re Golden Distrib. Ltd.*, 134 B.R. 750, 757 (Bankr. S.D.N.Y. 1991) (credit terms and price schedules not confidential because readily offered by customers). Indeed, trade secret protection generally is improper where information can be readily obtained from other sources. *See Ashland*, 82 N.Y.2d at 406-08 (a financial program which could be reproduced from public disclosures was not a trade secret so much as a promotional device).

Thus, common law cases protecting trade secrets and confidential information offer considerable protection to former employees against unreasonable limitations on their future employment. However, the broad definition of confidential information contained in many employment agreements erases these reasonable limits, potentially making it very difficult for a de-posted executive to work for a competitor. These agreements do not distinguish between real secrets (*i.e.*, the scope and targeting of a new ad campaign) and useful information the executive has learned (*i.e.*, the preferences of consumers developed by an outside consultant). While the latter type of information may not be “publicly” available, and therefore subject to an exception in the definition of “confidential information,” it is likely to be known by or available to (through consultants or internal means) senior executives in the industry. Restricting an executive’s ability to use such general business or industry information would make it extremely difficult to function at a senior level.

DoubleClick and the “Inevitable Disclosure Doctrine”

While restrictions on employment caused by overreaching confidentiality agreements can seriously impinge on an executive’s ability to successfully work for a competitor, application of the “inevitable disclosure” doctrine may threaten to take away his or her opportunity to try. Fortunately for executives, New York courts for the moment appear reluctant to expand this doctrine into new territory.

In the 1997 case, *DoubleClick, Inc. v. Henderson*, 1997 N.Y. Misc. LEXIS 577 (N.Y. Sup. Ct. 1997), the New York Supreme Court applied the “inevitable disclosure” doctrine to enjoin two senior Doubleclick executives from launching a competing company or working for a competitor. The court based its ruling on the “high probability of ‘inevitable disclosure’ of trade secrets” because the employees’ centrality made it unlikely that they could eradicate Doubleclick’s secrets from their mind while working for a competitor. *Id.* at *5-6. Although one employee had a non-compete agreement and both employees had signed a confidentiality agreement, the court based its holding on the common law duty of employees to protect employers’ confidential information. *Id.* at *4. The practical effect of the court’s application of the inevitable disclosure doctrine was to bind the employees to a de facto restrictive covenant and by-pass New York’s strict scrutiny of non-compete agreements.

Because the definition of confidential information contained in many employment agreements is considerably broader than the common law trade secret definition, an employer could use the “inevitable disclosure” doctrine to argue that an executive should be

enjoined from working for a competitor based upon no more than the executive's extensive knowledge of business or industry information.

Although *DoubleClick* appears to have opened the door for employers who seek to convert confidentiality agreements into restrictive covenants, expansion of the "inevitable disclosure" doctrine has been questioned. Indeed, even absent the broad expansion of the definition of confidential information imposed by contractual confidentiality agreements, the "inevitable disclosure" doctrine has been criticized for its effects on employee mobility. In the recent case *Earthweb, Inc. v. Schlack*, 71 F. Supp.2d 299, 310 (S.D.N.Y. 1999), Judge Pauley wrote:

the court is essentially asked to bind the employee to an implied-in-fact restrictive covenant based upon a finding of inevitable disclosure. This runs counter to New York's strong public policy against such agreements and circumvents the strict judicial scrutiny they have traditionally required.

In addition to effectively allowing an employer to side-step the regular inquiry imposed upon non-compete agreements, application of the inevitable disclosure doctrine overturns the expectations of employers and employees and shifts the bargaining power between them. The "parties' confidentiality agreement may be wielded as a restrictive covenant [placing] a powerful weapon in the hands of an employer." *Id.* The expansion of the "inevitable disclosure" doctrine also poses practical problems for courts seeking to apply it because

there is no express non-compete agreement to test for reasonableness. Instead, courts must grapple with a decidedly more nebulous standard of "inevitability." The absence of specific guideposts staked-out in a writing will only spawn such litigation

Id. at 311. These policy concerns may cause future courts to pause when considering whether to expand the "inevitable disclosure" doctrine, especially to protect "trade secrets" in name only. But the risk to executives, and their new employers, is that courts could enforce the literal terms of confidentiality agreements, leaving executives unable to work in new jobs that require "use" of "confidential information," as broadly defined by the agreements.

The Standards for Injunctive Relief

Even if New York courts continue to cite *DoubleClick* with approval, there is some doubt that a court would grant an injunction to enforce broad confidentiality agreements. In New York, a party seeking a preliminary injunction must prove (1) a likelihood of success on the merits; (2) danger of irreparable harm and (3) a balance of equities in its favor. *Aetna Ins. Co. v. Capasso*, 75 N.Y.2d 860 (1990). Of course, employees might still be exposed to claims for damages.

Generally, irreparable harm is presumed if a trade secret has been misappropriated. *North Atlantic Instruments, Inc. v. Haber*, 188 F.3d 38, 49 (2d Cir. 1999) (quoting *FMC Corp. v. Taiwan Tainan Giant Indus. Co.*, 730 F.2d 61, 63 (2d Cir. 1984)). Although the “inevitable disclosure” doctrine implies that “confidential information” necessarily will be disclosed if an employee works for a competitor, theoretically disposing of the need to show that the employee has committed any wrongdoing prior to obtaining injunctive relief, the *DoubleClick* court did not rely solely on “inevitable disclosures” in granting injunctive relief because the employees had already stolen trade secrets and committed breaches of fiduciary duty. *DoubleClick*, 1991 N.Y. Misc. LEXIS 577 at *6, *7. See *Earthweb*, 71 F. Supp.2d at 310 (“While Doubleclick appears to represent a high water mark for the inevitable disclosure doctrine in New York its holding rests heavily on evidence of the defendants’ overt theft of trade secrets and breaches of fiduciary duty. . . . Such misconduct has long been recognized as appropriate ground for enjoining the disclosure of trade secrets, irrespective of any contract between the parties.”)

Further, trying to establish irreparable harm may be difficult for an employer who seeks to enjoin an employee from working for a competitor based upon an overly broad confidentiality agreement. The court need not assume that information is a trade secret simply because it falls under the contractual definition of “confidential information.” *Cf. Arias v. Solis*, 754 F. Supp. 290, 294 (E.D.N.Y. 1991) (Court was not bound by express statement that an employee’s services were unique and extraordinary when determining whether injunctive relief was available); *Iroquois Indus. Corp. v. Popik*, 91 Ill.App.3d 505, 508, 415 N.E.2d 4, 6 (1980) (Contractual recital that customer lists were confidential was insufficient to establish a protectable business interest justifying enforcement of a restrictive covenant). Thus, a court might refuse to grant injunctive relief to the extent that the definition of confidential information exceeds the common law trade secret definition. Indeed, contractual recitations aside, it may be difficult for an employer to prove that it will be irreparably harmed by the disclosure of information that is generally known within the industry or is easily generated or duplicated.

The balance of the equities analysis also poses a potential problem to an employer seeking injunctive relief based upon a broad confidentiality agreement. A request for an injunction prohibiting a former employee from working for a competitor in order to protect “confidential information” raises the same policy concerns as a request for specific enforcement of a restrictive covenant. In such cases, the Court of Appeals has noted “the general public policy favoring robust and uninhibited competition,” *American Broadcasting Cos. v. Wolf*, 52 N.Y.2d 394, 403, 438 N.Y.S.2d 482 (1982) and the “powerful considerations of public policy which militate against sanctioning the loss of a man’s livelihood,” *Reed Roberts*, 40 N.Y.2d at 307; *Purchasing Assocs. v. Weitz*, 13 N.Y.2d 267, 272, 246 N.Y.S.2d 600 (1963). The Court of Appeals stated in *Reed, Roberts*:

our economy is premised on the competition engendered by the uninhibited flow of services, talent and ideas. Therefore no restrictions should fetter an employee's right to apply his own best advantage the skills and knowledge acquired by the overall experience of his previous employment. This includes those techniques which are but skillful variations of general processes known to the particular trade.

Reed, Roberts, 40 N.Y. at 307 (internal quotations and citation omitted).

Because of New York's strong public policy against depriving an employee of his or her livelihood and right to use the skills and general knowledge acquired on the job, restrictive covenants are only enforced "to the extent necessary to prevent the disclosure or use of trade secrets or confidential customer information." *Id.* at 308. Courts closely scrutinize the employer's claims concerning trade secrets and confidential information and will not enforce restrictive covenants if "the knowledge at issue does not qualify for protection as a trade secret and there has been no conspiracy or breach of trust resulting in commercial piracy." *Id.* at 309. "A contrary holding would make those in charge of operations or specialists in certain aspects of an enterprise virtual hostages of their employers." *Id.*

Given the well-developed case law and strong policy concerns regarding the limited enforcement of restrictive covenants in New York, it is unlikely that a court would allow an employer to indirectly achieve what it has been prohibited from doing directly and enjoin an employee from competing with a former employer to enforce a confidentiality agreement unless the employer can establish that the injunction is necessary to protect true trade secrets. Even in such situations, the court might impose the same restrictions on enforcement of restrictive covenants and require that any injunction be "reasonable in time and area, necessary to protect the employer's legitimate interests, not harmful to the general public and not unreasonably burdensome to the employee." *Id.* at 307.

All of these are matters for future judicial interpretation. In the meantime, employees with broad "confidentiality agreements," especially in information-intensive businesses, are at risk when they take new jobs. The likelihood is that former employers will only grow more aggressive in using "confidentiality agreements" to restrict the activities of former executives. Rather than expending significant time and money litigating the enforceability of such agreements and risking an unfavorable decision, the lesson for executives is to object to overreaching definitions of confidential information in employment agreements. New employers need to be aware of the restrictions encumbering new executive employees, ensure that no documents or electronic information from a former employer get used, and make common sense judgements about the executive's immediate post-arrival activities. These steps will reduce the probability of a successful claim against both the executive and his or her new employer.