PROTECTING TRADE SECRETS USING NON-DISCLOSURE AGREEMENTS

24 February 2017

This article was written by Alex Ross and Jenifer Elmy (an articling student at Gowling WLG). It was originally published in the Hamilton Law Association Journal and is reprinted with permission.

Recent US case law has raised the possibility that the common practice of including an expiry date in a non-disclosure agreement or "NDA" (also known as a confidentiality agreement) may lead to an inadvertent loss of trade secret protection.

Typically, parties to a contract will enter into an NDA to protect valuable information that is to be disclosed by one party to the other. An NDA restricts the covenantor's ability to disclose or use information that has been defined as confidential by the covenantee. The confidential information protected by the NDA can include trade secret information. A "trade secret" is a type of confidential information that has exceptional value to a business and is subject to special efforts to maintain its secrecy.

NDAs, however, may be deemed void if they are seen to be a restraint of trade. A restraint of trade occurs if the covenantor's future liberty to carry on trade with other individuals or businesses that are not part of the contract is restricted. Being contrary to public policy, a restraint of trade is considered prima facie void and can only be rebutted by proof that the restraint is reasonable. The onus of proving reasonableness lies on the covenantee, who must demonstrate that the restraint is in the interest of the public and the contracting parties. The covenantee must also demonstrate that the restraint is not excessive or wider than necessary to protect their interest. The common use of expiry dates in NDAs limits the scope of the restraint and thus provides some protection against a finding that an NDA is void because it constitutes a restraint of trade.

In Canada, the issue of whether an NDA may be an unenforceable restraint of trade has been explored in the employment law context, however, there has been very little
discussion as to whether an NDA could be considered a restraint of trade in transactions between two or more businesses. There has also been little discussion in Canada as to the distinction between trade secrets and ordinary confidential information. As such, US case law may provide some guidance.

**US Case Law**

The Uniform Law Commission of the USA defines trade secrets, under the Uniform Trade Secrets Act, as:

- information, including a formula, pattern, compilation, program, device, method, technique, or process, that:
  
  (i) derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use, and

  (ii) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.

Recent US case law has held that where a trade secret is disclosed under an NDA that expires after a specific time period, the obligation to protect the trade secret also expires after that time period, thereby vitiating trade secret protection. More particularly, at least two US courts have essentially held that because the trade secret was disclosed under a time-limited (as opposed to perpetual) obligation to keep it confidential, it was not the subject of reasonable efforts to maintain its secrecy and therefore ceased to be a trade secret entitled to protection.

In DB Riley Inc v AB Engineering Corp, the plaintiff claimed that the defendant had acquired the plaintiff’s trade secret information and used that information to provide itself with a competitive advantage, despite an existing contractual agreement with the plaintiff that restricted disclosure. The United States District Court in Massachusetts held that the information acquired by the defendant was trade secret information. Despite that finding, the court held that the trade secrets were not adequately protected by the plaintiff because the plaintiff was unable to demonstrate that reasonable steps were taken to preserve secrecy. In support of this ruling, the court noted that the plaintiff obtained a time-limited confidentiality agreement to maintain its trade secrets. As a result, the plaintiff could not prove "eternal vigilance" over its trade secrets.

Thus, since the plaintiff was unable to demonstrate a likelihood of success on the merits of
its claim for trade secret misappropriation, the court could not award the preliminary injunction the plaintiff sought.[x]

A year later, the United States District Court in California explored a similar question in Silicon Image Inc v Analogk Semiconductor Inc. [x] The plaintiff claimed that the defendant wrongfully misappropriated the plaintiff’s trade secrets and sought to prevent the defendant from producing or selling copies of its work.[xi]

According to the court, in California, information will qualify as a trade secret only if reasonable efforts have been made to protect its secrecy. "Reasonable efforts to maintain secrecy have been held to include advising employees of the existence of a trade secret, limiting access to a trade secret on 'need to know basis,' and controlling plant access."[xii] Extreme and unduly expensive measures do not need to be taken to protect trade secrets. However, disclosure of trade secret information under an NDA with a limited duration has resulted in previous denials of trade secret protection.[xiii]

In light of the evidence provided, the court held that it could not conclude that the plaintiff had a high probability of success on its claim for trade secret misappropriation.[xiv]

Thus, a time-limited term of confidentiality resulted in a loss of trade secret protection in at least two U.S. cases. While imposing a perpetual or indefinite term of confidentiality would seem to be the obvious solution, in some US states such indefinite durations are viewed as unreasonable restraints of trade. If an indefinite/perpetual term NDA is in (or governed by the law of) one of these states, then the NDA will be deemed unenforceable because of a perceived unreasonable restraint of trade, which results in no protection to any form of confidential information.[xv] Presently, there is a risk that there will be a similar finding in Canada.

The Canadian Context

In the US, 45 states and the District of Columbia have adopted the Uniform Trade Secrets Act. In Canada, however, legislators have not enacted a similar statute.[xvi]

While the Canadian courts have not adopted a singular definition, they have identified several characteristics of a "trade secret". A trade secret includes a technique or process, a tool, mechanism or compound, a formula, pattern, device or a compilation of information that is used in one's business, only known to its owner and the employees that assisted in making it, which gives the business a competitive advantage. Most importantly, the trade secret must be secret.[xvii] The constituent elements of a process may be known, but where the combination is unique and arrived at by using great time, effort and money, it
should be legally protected as a trade secret.\textsuperscript{xviii}

Furthermore, the Supreme Court of Canada in Merck Frosst CanadaLtée c Canada (Ministre de la Santé) recognized that the common law has tended not to make a clear distinction between a trade secret and the broader category of confidential information.\textsuperscript{xix} While trade secret is a "technical legal term, it does not have a comprehensive definition."\textsuperscript{xx}
When analyzing section 20(1) of the Access to Information Act, the court defined a trade secret as requiring that:

(1) the information must be secret in an absolute or relative sense (is known only by one or a relatively small number of persons);

(2) the possessor of the information must demonstrate that he has acted with the intention to treat the information as secret;

(3) the information must be capable of industrial or commercial application;

(4) the possessor must have an interest (e.g. an economic interest) worthy of legal protection.\textsuperscript{xxi}

Thus, a trade secret is distinct from a broader category of confidential commercial information.\textsuperscript{xxii}

While this case only defines trade secrets in the context of the Access to Information Act, it does demonstrate that the Canadian common law has recognized trade secrets as a special category of confidential information.

\textbf{Managing The Risks}

How can a Canadian lawyer balance the risk that an NDA may be found to be an unenforceable restraint of trade against the risk of losing trade secret protection by providing for a definite expiry of the confidentiality obligations? The key is to distinguish between trade secrets and "ordinary" confidential information, both definitionally and in terms of the duration of the protection obligation.

The first step is to make it clear that the parties consider trade secrets to be a special category of confidential information. The current practice of defining "confidential information" broadly (to encompass as much information as possible) can continue, but "trade secrets" should be carved out. If your client is planning to disclose specific information, you should expressly define the information that it considers to be a trade secret. If, for example, your client has a secret formula that they want protected in the
NDA, then the drafter of the NDA should use clear and concise language to define that formula as a trade secret. Language like "whether or not a trade secret" may be used in, or in association with, the definition of "confidential information" (this latter approach can be helpful when it is not known in advance which trade secrets, if any, are to be disclosed).

The second step is to specify separate protection durations for confidential information and trade secrets. The use of a distinct, different term of protection for trade secrets (as opposed to ordinary confidential information) provides for indefinite protection of trade secret information while reducing the risk that the NDA could be found to be an unreasonable restraint of trade. The following is an example of language that could be included in an NDA:

**Duration of Obligations**

a. For Confidential Information that is not a trade secret, Recipient's obligations hereunder shall continue for the shorter of:

   i) perpetually; and

   ii) such maximum duration as permitted by applicable statute and/or common law; and

b. For Confidential Information that is a trade secret, Recipient's obligations hereunder shall be perpetual.\[\text{[iv]}\]

Finally, although it should go without saying, you should use an appropriate governing law clause to ensure that Ontario law governs the NDA (or, if the other party insists on another jurisdiction, seek advice from a lawyer qualified in that jurisdiction to confirm that the above approach would be effective under that jurisdiction's law).

[i] Stephens v Gulf Oil Canada Ltd, 11 OR (2d) 129, 25 CPR (2d) 64, 65 DLR (3d) 193 at 24.
[ii] Canadian Vapotred Ltd v Leonard, 1972 CarswellOnt 1041, 6 CPR (2d) 45 at 43.
[iii] Uniform Trade Secrets Act, §1 "Definitions".
[v] Ibid at 86-89.
[vi] Ibid at 89-90.
[vii] Ibid at 90-91.
[viii] Ibid at 91.
[ix] Ibid at 92-93.
[xi] Ibid at 1-2.
[xiii] Ibid at 17.
[xiv] Ibid.
[xvi] Christopher Heer, Employees and Trade Secrets: How the Concept of Inevitable Disclosure May Fit into Canadian Common Law, Article, 19 IPJ 323.
[xvii] Ontario Realty Corp, Re, [2007] OIPC No 171 at 18-19;
[xx] Ibid at 104.
[xxi] Ibid at 109.
[xxii] Ibid at 110-111.

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Author

Alex S. Ross
Counsel - Hamilton

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<table>
<thead>
<tr>
<th><a href="mailto:alex.ross@gowlingwlg.com">alex.ross@gowlingwlg.com</a></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Phone</strong></td>
</tr>
<tr>
<td>+1 905-540-3243</td>
</tr>
<tr>
<td><strong>vCard</strong></td>
</tr>
<tr>
<td>Alex S. Ross</td>
</tr>
</tbody>
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