Time Limits in Confidentiality Agreements

By Julianne M. Hartzell

Trade secret owners must be careful when including time limits in confidentiality agreements. Business needs often require the owner of a trade secret to disclose protected information to customers or joint venture partners. In those circumstances, it is customary to enter into confidentiality or nondisclosure agreements (NDAs). The agreements impose burdens that require policing and impose costs on the party receiving confidential information. The receiving party may seek to limit this burden by negotiating for an explicit expiration of the party's obligations to maintain confidentiality, often a five- to ten-year term. While this kind of time limit is intended to balance the disclosing party's need for secrecy and the receiving party's interest in minimizing its responsibility under the agreement, such expiration dates in NDAs can unintentionally undermine efforts to maintain trade secret protection.

Trade secret owners also must regulate their present and former employees' use and disclosure of trade secrets. It is customary for a new employee to sign an agreement that includes obligations to protect the confidentiality of the company's information. Although restrictions on employees' mobility and right to use their skill and general knowledge in future employment are frequently disfavored by the courts, placing an expiration date on the employee's obligation to protect confidentiality of the company's trade secrets can inadvertently undermine trade secret protection.

Time limits in confidentiality agreements may have unintended consequences as several courts have relied upon time limits in NDAs to find that the trade secret owner failed to take reasonable precautions to restrict access to trade secrets upon the expiration of the confidentiality term. The effect of such a decision is that trade secrets disclosed under the NDA expire when the confidentiality term expires. This unintentional effect can erase the primary advantage of trade secret protection as compared with patent protection—trade secrets do not expire so long as the protected information remains secret and continues to be valuable to the trade secret owner.

Trade secret owners, while admonished by the courts to maintain eternal vigilance to protect their trade secrets, often face immediate business concerns and market demands that make agreeing to a proposed time limit on confidential information look like an attractive alternative. By agreeing to a time limit, the owner risks destroying the long-term value of trade secrets. Two situations in which time limits on confidentiality agreements may be tempting are discussed: when demanded by customers or joint venture partners, and when drafting restrictive covenants directed to departing employees.

Customer or Joint Venture Access

While maintaining trade secret protection may be very important, a company's primary, day-to-day focus is generally on developing products and selling them to customers. Achieving these goals may require sharing trade secret information with a joint venture partner or a customer. The recipients of trade secret information in this scenario have bargaining power; therefore, it is in the trade secret owner's best interest to share the protected information. When the recipients demand time limits in a confidentiality agreement, the trade secret owner faces a difficult decision between achieving an immediate business goal in the short term and risking the loss of a trade secret that may or may not continue to have value in the long term.

In an attempt to address this problem, one company, Silicon Image, Inc., agreed to what it perceived to be an industry standard by including time limits in the NDAs it provided to its customers.[1] Silicon Image sells semiconductor chips used in consumer electronic products (such as video cameras, cell phones, and video game systems) to transfer digital high-definition video and audio. Silicon Image's customers purchase the chips and use them to manufacture consumer electronics. The design of the semiconductor chips, including register maps that identify locations within the chip where particular information or functionality is stored, were considered by Silicon Image to be trade secrets.

Silicon Image took multiple steps to protect its trade secret information, including at least the following:

- Requiring its own employees to sign NDAs restricting disclosure of Silicon Image information
- Requiring customers and business partners to execute NDAs before confidential information was provided to them
- Restricting unauthorized access to its facilities by maintaining a key card access system and by requiring visitors to sign in
- Protecting computer systems through network security and access control
- Labeling confidential proprietary information and watermarking all information disclosed outside the company with the name of the individual receiving the information
- Providing training sessions each fiscal quarter to its employees on the company's trade secret protection program

To use the semiconductor chips in their consumer electronic products, Silicon Image's customers required access to Silicon Image's design information. Prior to disclosure, Silicon Image conducted due diligence to confirm that its customers were not also competitors. The customer then signed an NDA that included standard language:

> Recipient shall not disclose Confidential Information received from the Discloser under this NDA [nondisclosure agreement] to any third party. The Recipient shall use the same degree of care in maintaining the confidentiality of the Confidential Information as it uses with respect to its own information that is regarded confidential and/or proprietary by such party, but in any case shall at least use

reasonable care. Recipient agrees that it will restrict access to all Confidential Information to carry out the Business Purpose for which the Confidential information is provided, which persons will be bound to the Recipient by a written confidentiality agreement that contains substantially the same obligations as contained in this NDA.

However, Silicon Image found that the standard in the industry in Silicon Valley was to limit the term of confidentiality obligations. One in-house attorney for Silicon Image noted that "high-tech companies in Silicon Valley generally will not sign a non-disclosure agreement that imposes perpetual confidentiality obligations."[2] The typical term of confidentiality provisions used by those in the industry was three to four years. Faced with this industry standard, Silicon Image entered into NDAs with its customers having a duration of two to four years.

Silicon Image's decision was put to the test when it sought a preliminary injunction against a competitor, Analogk Semiconductor, Inc., which was marketing a product whose design Silicon Image believed incorporated Silicon Image's register maps. Silicon Image alleged that Analogk misappropriated its trade secrets and sought an order from the court preventing Analogk from continuing to sell certain of its semiconductor chips.

To prevail on its trade secret misappropriation claims under the California Uniform Trade Secrets Act, Silicon Image needed to demonstrate both that the information at issue was misappropriated and that the information was entitled to protection as a trade secret. The court found that Silicon Image had provided both direct and circumstantial evidence of copying and concluded that Silicon Image demonstrated a "strong probability of success" on the question of misappropriation.

The court then considered whether Silicon Image's information was subject to trade secret protection. The crux of this analysis turned on whether Silicon Image made reasonable efforts to protect the secrecy of its register maps. Despite the many steps taken by Silicon Image to restrict access to its information, the court focused on whether or not the NDAs between Silicon Image and its customers and distributors provided adequate protection. To address this issue, the court focused on two main points:[3] whether the time limits were adequate and whether Silicon Image and its customers disregarded the NDA-imposed obligations.

The court relied on previous decisions in reaching its holding that reasonable steps to protect trade secrets were not shown where obligations to maintain information as confidential had expired. In *D.B. Riley, Inc. v. AB Engineering Corp.*, the United States District Court for the District of Massachusetts relied upon the Massachusetts Supreme Court's reasoning that "one who claims that he has a trade secret must exercise eternal vigilance," requiring all persons to whom a trade secret becomes known to acknowledge and promise to respect the secrecy in a written agreement.[4] The *Riley* court found that a 10-year time limit contained in the single NDA submitted as evidence to the court demonstrated Riley's own expectations that obligations to maintain its trade secrets were time limited and, thus, Riley failed to demonstrate "eternal vigilance" over its trade secrets.

After consideration of the prior case law and other evidence regarding adequacy of Silicon Image's the NDAs with its customers, the court ultimately denied the motion for preliminary injunction, finding that Silicon Image could not demonstrate a high probability of success on its trade secret claim despite "strong evidence" of misappropriation. The evidence presented raised "serious questions" about Silicon Image's ability to show that it had taken reasonable measures to protect its alleged trade secrets.[5]

Trade secret owners entering into NDAs with customers or joint venture partners may be faced with pressure to include time limits in the agreement to minimize the burden imposed on the receiving party. In the rare event when a trade secret owner can be entirely sure that the trade secrets will no longer have value at the expiration of the NDA, this agreement may not be harmful to the trade secret owner. In the vast majority of cases, though, trade secret owners should stand firm and refuse to include a set term for the receiving party's obligations to maintain the information in confidence.[6] To protect itself adequately, the trade secret owner should insist that the obligation to maintain confidentiality survive as long as the information disclosed qualifies as a trade secret under the requirements of the applicable law.

Departing Employees

The issue of time limits also arises in the context of protecting trade secret information known to employees who are leaving a company. Because of the general policy disfavoring restrictive covenants on departing employees to promote competition, the mobility of workers, and an employee's right to use skill and general knowledge in future employment, the treatment of time limits in NDAs with departing employees is particularly complex. Although the NDA may need to include time limits of some type, time limits should not be placed on restrictions prohibiting the misappropriation of trade secrets.

The second case cited by the court in *Silicon Image* demonstrated how a former employee subject to a confidentiality agreement can use a time limit to his or her advantage.[7] John Zwerlein was employed as an application specialist and product manager at ECT International, Inc., a distributor of software used in the design and documentation of electrical control systems. During his employment, he trained customers to use the software and answered their technical questions. Upon leaving ECT, Zwerlein went to work for one of ECT's customers. Thirteen months later (approximately one month after the expiration of his Confidential Information Agreement with ECT), he founded a consulting firm called Synergy Solutions. As a consultant, he recommended software solutions to his customers, including both ECT's software and products available from ECT's rival. ECT believed that Zwerlein's customers included some identified in an internal ECT prospective customers list. ECT filed a complaint alleging that Zwerlein misappropriated trade secrets, including knowledge of the workings of the software, as well as ECT's customer and prospects lists.

To protect its confidential and trade secret information, ECT required its employees (including Zwerlein) to sign a Patent and Confidential Information Agreement, in which the employee acknowledged that certain company information, including customer lists, were considered confidential or trade secrets and agreed not to make use of the

confidential information "either during or for a period of one year after the termination of employment . . ."

The Wisconsin Court of Appeals affirmed the trial court's grant of Zwerlein's motion for summary judgment. The *ECT* court acknowledged the difficult balance between preventing former employees from revealing trade secrets and the right of the employee to use skills, experience, and general knowledge in future employment. The court noted that confidentiality agreements have been found to be sufficient evidence of reasonable efforts to maintain secrecy if the agreements plainly informed the employees that the employer's information is confidential.[8] However, the court was not convinced that ECT's agreement sufficiently accomplished the task of keeping information secret. Rather, "in imposing a one-year period, after termination of employment, during which an employee could not divulge trade secrets," ECT manifested an intent that, after the expiration of that period, a former employee is under no restrictions and does not need to maintain the secrecy of any sensitive or confidential information learned while employed. Ultimately, the court held that ECT did not have a protectable trade secret in its software, its customer list, or its list of prospects.

As noted previously, however, several states make a clean distinction between NDAs that protect confidential information that does not rise to the level of a trade secret and those that protect trade secrets. Those states, including Georgia and Wisconsin, do allow NDAs of unlimited duration for departing employees that protect trade secrets but require reasonable restrictions, which may include time limits on NDAs covering other confidential information.[9]

To address these dueling concerns, NDAs for employees should include a bifurcated confidentiality provision that provides a time limit on the employee's responsibility to maintain information in confidence only for information that does not rise to the level of a trade secret. In such a bifurcated provision, the employee would have a continuing obligation to respect the company's trade secrets.[10] This is not an ideal solution—it may be difficult or impossible to know, prior to litigation, which category information falls into. If the information is deemed to be a trade secret, however, the bifurcated agreement will minimize the possibility of unintentional trade secret expiration.

Conclusion

To take advantage of the potentially unlimited duration of trade secret protection, a trade secret owner must be vigilant in maintaining confidentiality. Although agreeing to limit obligations to maintain secrecy to a set period of time may be tempting in the face of market pressure and convenience, such an agreement places the trade secret itself in jeopardy.

Julianne M. Hartzell is a partner at Marshall, Gerstein & Borun, LLP, in Chicago, Illinois. She may be reached at jhartzell@marshallip.com.

Endnotes

1. Silicon Image, Inc. v. Analogk Semiconductor, Inc., No. 07-cv-00635 JCS, 2008 WL 166950 (N.D. Cal. Jan. 17, 2008).

2. Declaration of Doris Suh, Associate General Counsel for Silicon Image, Inc., in Support of Plaintiff Silicon Image, Inc.'s Motion for Preliminary Injunction at ¶ 8. *Silicon Image*, No. 07-cv-00635 JCS (N.D. Cal. Jan. 17, 2008).

3. Portions of the court's analysis of the reasonableness of plaintiff's efforts to protect its trade secrets have been redacted. This discussion mentions only those issues discussed in the publicly available opinion obtained via PACER.

4. D.B. Riley, Inc. v. AB Engineering Corp., 977 F. Supp. 84, 91 (D. Mass. 1997) citing J.T. Healy & Son, Inc. v. James A. Murphy & Son, Inc., 260 N.E.2d 723, 730–31 (Mass. 1970).

5. *Silicon Image*, 2008 WL 166950 at *16–17. The parties ultimately settled the litigation prior to judgment on the trade secret cause of action. *See* Press Release, Silicon Image, Silicon Image and Analogk Announce Settlement of Outstanding Litigations (Dec. 4, 2008), *available at* http://ir.siliconimage.com/ReleaseDetail.cfm?ReleaseID=352512 (last visited Dec. 10, 2008).

6. Upon expiration of a joint venture or a customer relationship, the trade secret owner should still require the return or destruction of all trade secret information disclosed. Such agreement may allow counsel for the receiving party to maintain a single copy of the information returned or destroyed. This obligation should, however, be separate from the continuing obligation to maintain in confidence the information known to the receiving party.

7. ECT Intern., Inc. v. Zwerlein, 597 N.W.2d 479 (Wis. Ct. App. 1999).

8. *Id.* at 484–85 (citing Aries Info. Sys., Inc. v. Pacific Mgmt. Sys. Corp., 366 N.W.2d 366, 368–69 (Minn. Ct. App. 1985)); Integrated Cash Mgmt. Servs., Inc. v. Digital Transactions, Inc., 732 F. Supp. 370, 375–76 (S.D.N.Y. 1989), *aff'd*, 920 F.2d 171 (2d Cir. 1990) (holding that if plaintiff possessed a trade secret, the nondisclosure agreements signed by its employees would prevent the secret's disclosure); Stargate Software Int'l, Inc. v. Rumph, 482 S.E.2d 498, 502 (Ga. Ct. App. 1997) ("Requiring employees to sign confidentiality agreements may, in some circumstances, be 'sufficient to constitute a reasonable step to maintain the secrecy of information alleged to have been misappropriated.'").

9. *See* Atlanta Bread Co., Int'l v. Lupton-Smith, 663 S.E.2d 743, 748–49 (Ga. Ct. App. 2008); IDX Systems Corp. v. Epic Systems Corp., 285 F.3d 581, 585–86 (7th Cir. 2002). Several states include an explicit provision in the enacted UTSA that acknowledges the enforceability of nondisclosure agreements of unlimited duration protecting trade secrets. *See, e.g.*, Ga. Code Ann. § 10-1-767; Illinois Trade Secrets Act, 765 ILCS 1065/8(b)(1).

10. For an example of such a bifurcated provision, *see* Linda Stevens, *Special Litigation Issues Pertaining to Trade Secrets*, Trade Secrets 2002: How to Protect Confidential Business & Technical Information, 719 PLI/Pat 197, App. A (Sept. 2002).