When is a Confidentiality Agreement Not Enough to Keep Information Confidential?

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Daniel Avery

When is a signed confidentiality agreement insufficient to protect, as confidential, information provided by the disclosing party? According to the Seventh Circuit Federal Court of Appeals, if the disclosing party itself hasn't taken reasonable steps to protect the information, it cannot be confidential.

In *nClosures Inc. v. Block and Company, Inc*. (7th Circuit Court of Appeals, No. 1303906 and 14-1097, October 22, 2014), nClosures sought to enforce a confidentiality agreement.

nClosures was in the business of developing metal cases for electronic tablets. One of the company's metal cases - - called the Rhino Elite - -was designed in 2011 by an independent contractor retained by the company.

After the Rhino Elite was developed, nClosures displayed prototypes of the case at a trade show in Chicago. At the trade show, discussions occurred between nClosures and Block - -a manufacturer of metal devices - - with respect to a possible business arrangement. In connection with these discussions, nClosures and Block entered into a mutual confidentiality agreement, in which the parties agreed:

"that the Confidential Information received from the other Party shall be used solely for the purposes of engaging in the Discussions and evaluating the Objective (the "Permitted Purpose"). Except for such Permitted Purposes, such information shall not be used, either directly or indirectly, by the Receiving Party for any purpose."

The term "Objective," used in the provision above, was defined in the confidentiality agreement to mean "a potential business relationship with respect to iPad Enclosures."

After execution of the confidentiality agreement, nClosures provided Block with the design files for the Rhino Elite product. Notwithstanding negotiations and exchanges of draft agreements, the parties never finalized a formal agreement, but instead agreed orally that Block would manufacture and sell the Rhino Elite product to nClosures. The Rhino Elite was introduced to the market in 2011, but not without design problems,which Block helped to address.

In 2012, Block designed its own tablet case which it called the Atrio, and terminated its relationship with nClosures. In turn, nClosures filed suit, invoking, among other things, the terms of the confidentiality agreement and claiming a breach of the agreement by Block.

The Court stated at the outset that under Illinois law, which governed the dispute, "in order to enforce the confidentiality agreement between nClosures and Block, we must find that nClosures took reasonable steps to keep its proprietary information confidential."

Looking at the various facts at hand, the Court ruled that "[t]hese facts show that nClosures did not engage in reasonable steps to protect the confidentiality of its proprietary information, and therefore that the confidentiality agreement with Block is unenforceable."

Specifically, in reaching this determination the Court observed that:

- the design drawings were not kept secure in a vault or otherwise under "lock and key;"

- the computer files on which the design drawings were stored were not "limited access" files (presumably meaning the files were not password-protected);

- apart from the confidentiality agreement between nClosures and Block, no individuals accessing the design files signed confidentiality agreements;

- the product drawings were not marked with protective words or phrasing such as "confidential" or the like;

- the independent contractor who designed the Rhino Elite, referenced above, did not sign a confidentiality agreement; and

- nClosure's manufacturers that produced versions of the product previous to the one manufactured by Block also did not sign confidentiality agreements.

In its decision, the Court of Appeals analogized the nClosure situation to an earlier Seventh Circuit decision holding a confidentiality agreement unenforceable because the information was not marked "confidential" and only some recipients signed confidentiality agreements, and distinguished it from another Seventh Circuit decision where the information was kept in a vault and marked proprietary, and where the engineers and vendors who dealt with the information signed non-disclosure or confidentiality agreements.

While the *nClosure* decision specifically applied Illinois law, it reflects a judicial willingness to look outside the four corners of a confidentiality agreement and consider whether the party seeking to enforce a confidentiality agreement is itself treating the information as confidential and proprietary in its day-to-day business operations.

For questions about the information contained in this advisory, please contact your usual Goulston & Storrs attorney or one of the attorneys listed below.

Daniel Avery
Director
(617) 574-4131
davery@goulstonstorrs.com

goulston&storrs

Gregory Getschman
Director
(617) 574-6479
ggetschman@goulstonstorrs.com

Michael Hickey
Director
(617) 574-4157
mhickey@goulstonstorrs.com

Gregory Kaden
Counsel
(617) 574-3818
gkaden@goulstonstorrs.com

Kitt Sawitsky
Director
(617) 574-4036
ksawitsky@goulstonstorrs.com

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