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Confidentiality Agreement Not Enough to Protect Confidential Information

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Confidentiality agreements have become routine as a part of conducting business. Parties frequently exchange confidentiality agreements, or sign a mutual confidentiality agreement, as a preliminary step to starting business with each other. But, as a recent 7th Circuit Court of Appeals decision makes clear, having a signed confidentiality agreement is not just a first or the only step required to protect a company's confidential information. Rather, owners of confidential information must take additional steps to protect it in court. The decision also gives practical legal guidance on what owners must do to protect their information, and some cautions about how they can lose protection of their information. (*nClosures Inc. v. Block and Company, Inc.*, 7th Circuit Court of Appeals, No. 1303906 and 14-1097, October 22, 2014)

nClosures was founded by three individuals. nClosures designed metal enclosures for tablet computers, such as iPad. One of nClosures's devices was Rhino Elite, designed by an independent contractor in early 2011. Block and Company ("Block") manufactured the metal enclosures. In May, 2011, two nClosures founders attended a trade show in Chicago and displayed prototypes of Rhino, an early version of Rhino Elite. Block's CEO also attended the trade show and approached nClosures about a possible business relationship.

In May, 2011, the parties began to work together and, at the outset of their relationship, they signed a mutual confidentiality agreement on May 24, protecting the confidential information of both parties.

The confidentiality agreement included the following:

> "The Parties . . . agree 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."

nClosures then disclosed to Block the enclosure device known as Rhino Elite and the design files to enable Block to manufacture it.

As it turned out, nClosures and Block were not successful in negotiating a written agreement for the manufacture and sale of Rhino Elite. Nevertheless, Block manufactured and sold the Rhino Elite to nClosures. Rhino Elite entered the market in October, 2011. But design problems soon appeared. Block's engineers helped re-design Rhino Elite to improve the ability of the enclosure to hold the tablet in place. In March 2012, Block designed its own tablet enclosure, which it called the Atrio. In August, 2012, Block terminated its relationship with nClosures. nClosures then filed suit against Block in November 2012. In connection with the

litigation, one of nClosures' founders signed a declaration stating, "It is nClosures's policy to not share its designs, know-how, or market knowledge with other parties unless pursuant to a non-disclosure agreement. nClosures has a policy of granting employees access to this information only on a need-to-know basis."

nClosures claimed, among other things, breach of the mutual confidentiality agreement. In December, 2012, nClosures was even successful in obtaining a preliminary injunction against Block. But that's as far as it got. In September 2013, the district granted summary judgment to Block, thwarting nClosures's efforts to enforce the mutual confidentiality agreement and to protect its confidential information. nClosures appealed and the 7th Circuit, in an opinion written by Judge Flaum, affirmed the district court. But nClosures had a confidentiality agreement with Block. Why wasn't that enough? Did the court ignore the agreement?

The court did not ignore the agreement. But clearly the court thought the agreement was not enough.

Judge Flaum cited Illinois law that confidentiality agreements will be enforced "only when the information sought to be protected is actually confidential and reasonable efforts were made to keep it confidential." (emphasis added) Judge Flaum cited one Illinois case in which the court declined to protect alleged confidential information that had been distributed to 600-700 people (only some of whom signed confidentiality agreements) and that was not stamped or designated as confidential.

Judge Flaum contrasted this with another case in which the court looked more favorably on the steps taken to protect confidential information. In that case, the owner of the confidential information kept the confidential information in a vault with limited access. The engineers using the information were required to sign confidentiality agreements. Vendors to which the information was disclosed also signed confidentiality agreements. In addition, the confidential information was marked as confidential.

Judge Flaum cited some facts that were critical to nClosures's enforcement (or non-enforcement) of the mutual confidentiality agreement.

- Remember the independent contractor who designed Rhino Elite? He did not sign a confidentiality agreement.
- How about other employees and engineers of Block who improved the design – did they sign confidentiality agreements? No, they did not.
- If nClosures confidential information was so important, wasn't it marked or designated somehow as confidential? It was not.
- Wasn't nClosures confidential information put under lock and key and access restricted to those with a need to know and who had signed confidentiality agreements with nClosures? No it was not.
- To the extent the confidential information was electronic, wasn't it password protected to prevent unauthorized parties from accessing it? No, it was not.

The court concluded that "nClosures did not engage in reasonable steps to protect the confidentiality of its proprietary information, and therefore . . . the confidentiality agreement with Block is unenforceable. . . . [N]o reasonable jury could find otherwise."

This decision is certainly a critical blow to nClosures, but one which it brought on itself. By not taking even the minimal steps described in the opinion, nClosures can only watch helplessly while Block uses what nClosures

believes is valuable proprietary information. But it's even worse. Since the information is not protected, and nClosures did not treat it as such, it is most likely available to any party which can obtain access to it. As a result, nClosures has found that, through neglect and failure to take basic steps, it has lost a valuable asset. The court's decision makes clear that the owner of valuable confidential information cannot just rely on a confidentiality agreement. It must do more to demonstrate that it values and protects the confidential information that it is disclosing.