

Validity of Non-Disclosure Agreement (NDA) Concluded with a Former Employee*

— Countermeasures against Leakage of Technical Information from a Former Employee —

by Yosuke SOGO**

1. Introduction

There is increasing social attention on the leakage of technical information kept confidential in Japanese companies, such as the leakage of technology about magnetic steel plates from NIPPON STEEL CORPORATION to South Korea's POSCO, the leakage of the technology about NAND flash memories from TOSHIBA CORPORATION to South Korea's SK Hynix.

When a company develops new technology, it is a common practice to file a patent application for protecting it. However, filing a patent application also causes a disadvantage in that the technical information related to the application must be disclosed. Thus, this disadvantage needs to be taken into consideration when determining whether to file a patent application or not. When it is determined that no patent application will be filed, this technology is appropriately kept confidential within the company so as to be protected under the Unfair Competition Prevention Act.

In recent years, employment mobility of engineers has increased. For example, the number of people who changed their jobs in 2017 increased twofold or more as compared with 2009. Thus, in this situation where job mobility has been increasing, it is difficult to prevent job changes of engineers. Thus, it is an important management task to prevent the leakage of technical information to other companies resulting from the job changes of engineers.

It is conceivable to conclude a confidentiality agreement with a person who is leaving a company, as a means for preventing such leakage of technical information to other companies due to the job changes of engineers. When concluding such a confidentiality agreement, employers tend to extensively and comprehensively stipulate the definition of confidential information in the agreement, in order to expand the scope of the information to be kept confidential. This article provides a review about problems and countermeasures in the case where confidential information is extensively and comprehensively defined in a non-disclosure agreement (NDA) concluded between an employer and an employee who leaves a company. For the purpose of this review, we will refer to the following two cases: Heisei 28 (wa) No. 7143 (Tokyo District Court; October 25, 2017) (hereinafter referred to as the "First Case"); and Heisei 24 (wa) No. 7562 (Osaka District Court; September 27, 2013) (hereinafter referred to as the "Second Case").

* This article was originally carried in *Fukami Patent Office, p.c. News Letter vol. 17, January 2020*; and is reprinted with permission.

** Attorney at Law,
Legal adviser of *Fukami Patent Office, p.c.*

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2. The First Case (Heisei 28 (wa) No. 7143; Tokyo District Court, October 25, 2017)

(1) Overview of the First Case

Defendant Y1 who was formerly employed by plaintiff X1 left plaintiff X1 for a new job at defendant Y2. When defendant Y1 left plaintiff X1, defendant Y1 signed and sealed a written oath about confidentiality and submitted it to plaintiff X1. On the ground that, in violation of the confidentiality obligation defined in the oath, defendant Y1 leaked, to defendant Y2, the confidential information that defendant Y1 acquired at plaintiff X1, plaintiff X1 exercised the right to seek compensation for damage based on breach of contract and the like.

(2) Point at Issue in the First Case

The point at issue in the First Case was the validity of the non-disclosure clause in the above-mentioned written oath.

(3) Assertion from Parties Concerned and Court Decision about Point at Issue

Defendants asserted that the non-disclosure clause in the written oath imposed restrictions exceeding a necessary and reasonable scope on defendant Y1 and also excessively infringed on the freedom of job change and the freedom of career choice for defendant Y1, so that the non-disclosure clause was invalid as a violation of public policy (Article 90 of the Civil Code). As grounds for claiming the excessiveness of the restrictions, defendant Y1's assertions included, among others, that the non-disclosure clause included no limitation on specific areas and specific time periods, and that the information prohibited from being used was comprehensive.

In response to the above assertions, the court issued the following decision (underline added).

[Court's Decision about Point at Issue]

An employer can take necessary protection measures in order to prevent leakage or disclosure to outsiders of information such as trade secrets important for the employer to execute the business.

However, when the employer concludes an agreement with an employee to prohibit leakage or disclosure to outsiders of information such as trade secrets and the like that the employee acquires at the company, after the employee leaves the company, such an agreement imposes a certain restriction on the employee's actions after leaving the company. Thus, such an agreement should be construed as valid as long as the contents of the agreement are reasonable and do not excessively restrict the employee's actions after leaving the company.

In the non-disclosure clause in this instance, the information defined as prohibited from being disclosed or leaked is "confidential matters that can be acquired in the course of business", which includes: (1) all information about management, sales and marketing and technology; (2) all information about clients; (3) all information about trading, such as trading conditions; and (4) all information designated as confidential matters. Firstly, the information targeted in the non-disclosure clause in this instance is "confidential matters." Secondly, the comprehensive provision (4) is based on the premise that an employer "designates" information as a confidential matter. In consideration of these two features, it should be interpreted that the confidential matter needs: to be publicly unknown; to have certain usefulness for a plaintiff to execute business; and to be managed by a plaintiff such that employees can clearly recognize the information as confidential. Only on the precondition of the above-mentioned interpretation, the non-disclosure clause in this instance should be recognized as valid.

3. The Second Case (Heisei 24 (wa) No. 7562; Osaka District Court, September 27, 2013)

(1) Overview of the Second Case

Defendant Y3 who was formerly employed by plaintiff X2 left plaintiff X2 for a new job at another company in the same industry. When defendant Y3 left plaintiff X2, defendant Y3 signed and sealed a written oath about confidentiality and submitted it to plaintiff X2. On the ground that, in violation of the confidentiality obligation defined in the oath,

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defendant Y3 leaked, to the above-mentioned other company in the same industry, the confidential information that defendant Y3 acquired at plaintiff X1, plaintiff X2 exercised the right to seek compensation for damage based on breach of contract and the like. Thus, the second case is extremely similar to the first case.

(2) The Point at Issue in the Second Case

The point at issue in the second case was also the validity of the non-disclosure clause in the written oath, as in the first instance.

(3) Assertion from Parties Concerned and Court Decision about Point at Issue

Defendant Y3 asserted that the non-disclosure clause in the written oath excessively infringed on the freedom of career choice, and therefore, was invalid due to violation of public policy (Article 90 of the Civil Code).

In response to the above assertion, the court issued the following decision (underline added).

[Court's Decision about Point at Issue]

The agreement that defines the confidentiality obligation after an employee leaves a company merely restricts leakage and the like of information such as trade secrets. Accordingly, it can be recognized that this agreement does not so strictly restrict the freedom of career choice and the freedom of business for employees as compared with an agreement that defines a duty to refrain from competition. However, in the case where the scope of trade secrets and the like defined in the NDA as described above is unclear and excessively wide, or does not essentially need to be protected as trade secrets, this agreement may unfairly infringe on the freedom of career choice and the freedom of business for employees. Thus, in the case where the restriction by the above-described NDA exceeds a necessary and reasonable scope in comprehensive consideration of: the specificity and the scope of targeted trade secrets and the like; the existence or non-existence and the degree of the value to be protected as confidential; and the circumstances such as the employee's previous status, the NDA should be construed as invalid due to violation of public policy.

(Omission)

First, in consideration of the specificity and the scope of the NDA in this instance, the trade secrets and the like targeted in the NDA in this instance are defined as "overall information about the other party, customers and business contents that can be acquired in the course of business", "information about the company and the client that can be acquired in the course of business", and "the existence and the details about trading with customers". Thus, the NDA neither sufficiently specifies targeted trade secrets and the like, nor limits specific scopes. Therefore, it has to be said that the NDA excessively restricts the freedom of career choice and the freedom of business for a person who has left the company.

Then, as to the existence or non-existence and the degree of the value to be protected as confidential, as described in the above (1), the information about the plaintiff's clients and trading prices are available also to other companies doing the same business, so that protection of this information as confidential cannot be regarded as highly necessary.

(Omission)

In comprehensive consideration of the above-described circumstances, it should be recognized that the NDA in this instance imposes restrictions exceeding a necessary and reasonable scope, and therefore, construed as invalid due to violation of public policy.

4. Analyses of the First Case and the Second Case

(1) Difference between Protection by Unfair Competition Prevention Act and Protection by Agreement

Examples of protection of the technical information kept confidential in companies include: protection by the Unfair Competition Prevention Act; and protection by an agreement (protection by an NDA).

In order to protect the technical information

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kept confidential in companies by the Unfair Competition Prevention Act (Article 2(vi)), the following conditions are required.

- The information should be “useful” information (usefulness: should be useful for business activities, for example, should be helpful for production, marketing, and research and development of items and service)
- The technical information is “publicly unknown” (non-publicity): commonly unavailable unless permitted by an information possessor);
- The technical information is “managed as confidential” (confidentiality management; not only the information possessor has an intention to keep the information confidential, but also the information is objectively recognized as being managed to be kept confidential from employees and outsiders).

In the case where the technical information kept confidential in one company corresponds to a trade secret defined by the Unfair Competition Prevention Act, leakage of the technical information can be put under sufficient protection by: exercising the right to seek an injunction (Article 3 of the Unfair Competition Prevention Act); exercising the right to seek compensation for damage (Article 4 of the Unfair Competition Prevention Act); applying presumption of amount of compensation for damages (Article 5 of the Unfair Competition Prevention Act); applying penal provisions (Article 21 of the Unfair Competition Prevention Act); and the like.

However, based on an analysis of past cases, there are many cases for which protection cannot be allowed, on the ground that the information kept confidential in each company is not recognized as a trade secret defined by the Unfair Competition Prevention Act (particularly on the ground that confidentiality management is not satisfied).

In other words, protection of the technical information kept confidential in a company under the Unfair Competition Prevention Act provides an advantage that sufficient protection is allowed, but also provides a disadvantage of fulfilling severe requirements for allowing protection (particularly, confidentiality management).

The technical information kept confidential in a company only by an NDA is not sufficiently protected to the extent defined by the Unfair Competition Prevention Act. However, protection by an NDA is construed as effective for other information not corresponding to a trade secret as defined by the Unfair Competition Prevention Act. Accordingly, irrespective of the Unfair Competition Prevention Act, an NDA is widely used for protection of the technical information kept confidential in companies.

(2) Features of an NDA Associated with Employee's Leaving Company

There is a difference between an NDA concluded when an employee leaves a company and a commonly applied NDA, as follows. Specifically, the NDA associated with an employee's leaving a company has an aspect of restricting the freedom of career choice (Article 22 of the Constitution) for the person who leaves a company. Thus, depending on the type of obligation, this NDA is more likely to be construed as invalid due to violation of public policy (Article 90 of the Civil Code). This is a concept that has been established based on a leading case (Nara District Court, October 23, 1970; Hanreijihō No. 624, p. 78).

(3) Practical Guidelines based on the First Case and the Second Case

In order to reduce the risk that a person who has left a company leaks the information kept confidential in the company, it seems appropriate for the company to attempt to comprehensively and widely define the scope of the target confidentiality information in an NDA concluded with the person leaving the company.

However, as described above, the NDA concluded when a person leaves a company has an aspect of restricting the freedom of career choice for that person, thereby characterizing this NDA as requiring special consideration for its relation with public policy. This characteristic influences the interpretation of the NDA concluded with an employee who leaves a company.

In the first case, the target information to be kept confidential by the person leaving the company was comprehensively and widely defined. This information was interpreted as being narrowly

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restricted, substantially in the same meaning as the trade secret defined by the Unfair Competition Prevention Act. Based on past trial cases, the requirements for confidentiality management are not necessarily lenient. Thus, according to the above-described interpretation, leakage of technical information by a person who has left a company may be unable to be appropriately addressed if the information management system in the company is insufficient (in fact, in the first case, the requirements for confidentiality management were not satisfied, with the result that the claim of plaintiff X1 was dismissed).

Also, in the second case, on the ground that the confidentiality target was comprehensively and widely defined so as to include also information with low protection necessity, the non-disclosure clause was decided as invalid due to violation of public policy.

Thus, in each of the instant cases, the target information to be kept confidential when the person left the company was comprehensively and widely defined, so that its desired purpose could not be achieved. This, however, does not necessarily lead to a complete loss of the usefulness of the attempt to protect the information kept confidential in companies by concluding an NDA with a person who is leaving a company.

The problem for the district courts in each of the first and second cases was that the scope of the information targeted for the confidentiality obligation was wide and comprehensive. Thus, it is considered that creation of an NDA so as to solve the above-described problem allows the NDA concluded with a person who has left a company to exercise its function of protecting the technical information.

For example, a company that attempts to protect the technical information kept confidential therein by concluding an NDA with a person who leaves the company should prepare an NDA so as to specify a product, a technology, a project and the like that the person leaving the company has been involved with. In the course of preparation, the company should clarify the in-house technical information that has been accessed by the person who is leaving the company, and reflect the clarified information in

the NDA specifically as much as possible, thereby allowing reduction of the risk that the NDA will be regarded as invalid or that the scope of the confidentiality obligation will be construed as narrow. Thus, it is considered that the desired protection for the technical information kept confidential in the company will be more likely to be implemented.