Enforcement of Non-Disclosure Agreements

Does MCLA 445.1901 and Related Case Law Apply in Other States?

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General Michigan Practice

There are few types of transactions that are as ubiquitous in commerce today as the non-disclosure agreement (NDA). NDAs usually arise in one of two contexts, either businesses request or respond to NDAs with potential suppliers and customers, or employers demand NDAs from employees when offering employment.

In either case, companies often fail to understand the significance of NDAs and sign them as a matter of course. More sophisticated businesses establish a tight procedure for handling the negotiation and execution of NDAs, including maintaining a standard, pre-approved NDA; routing all NDAs to assigned persons for review; maintaining copies in a separate NDA file; and allowing final review of certain sensitive terms by outside or in-house counsel.

Regardless of how NDAs are handled, one of the major issues that is not adequately addressed in NDA review by Michigan entities and Michigan lawyers is the enforceability of NDAs with employees and with customers or suppliers in other states.

The Michigan Legal Landscape

Michigan companies often propose NDAs that have no time, geographic, or scope limitations because Michigan law generally permits the complete prohibition on the disclosure of a party's trade secrets by a third party. MCLA 445.1901 (also referred to as the Michigan Uniform Trade Secrets Act or MUTSA); *Hayes-Albion Corporation v Kuberski*, 421 Mich 170 (1984). NDAs generally will only be enforced if the enforcing party can show: (1) the existence of a trade secret or other confidential information; (2) that the trade secret or confidential information was acquired improperly or as a result of a confidential relationship; and (3) that there was actual or threatened unauthorized use of the trade secret or confidential information.

The MUTSA defines a trade secret as information that both derives independent economic value from not being known to others and is the subject of efforts that are reasonable under the circumstances to maintain its secrecy. MCLA 445.1902(d). Under Michigan common law, "confidential information" that does not qualify as a trade secret may still be protected under a confidentiality agreement or fiduciary relationship. *Follmer, Rudzewicz & Co v Kosco*, 420 Mich 394, 402 (1984); *Chem-Trend, Inc v McCarthy*, 780 F Supp 458, 463 (ED Mich 1991).

Neither Michigan common law nor the MUTSA requires any specific geographic, temporal, or other limitations on the restrictive use of trade secrets. Although the MUTSA does not specifically provide for court modifications to cure overreaching provisions, such "blue-penciling" is a traditional power of equity. See *Follmer*, supra, at 409. This power is not directly affected by the MUTSA. This laissez-faire approach lulls Michigan companies and counsel into believing that other states follow Michigan's view on the protection of confidential information. Unfortunately, for parochial Michigan businesses and attorneys, the Michigan view is not universally accepted in other states. A few examples illustrate the contrary positions.

The Legal Landscape in Some Other States

Approximately 44 states have adopted some form of the MUTSA. Most of the state trade secret acts are similar; however, some states have adopted additional provisions that are substantively different. Only South Carolina and Nevada have criminalized the theft of trade secrets. See also, Federal Economic Espionage Act. 18 UCSA 1831. In addition, judicial interpretation of the trade secret acts varies significantly from state to state.

California

California has a strong public policy against covenants not to compete. See Cal Bus & Prof Code Sec 16600. Though similar, California's uniform trade secrets act differs from MUTSA. A California court can award exemplary damages if the misappropriation is willful or malicious. Cal Civ Code Sec 3426.3(c). To be protected as a trade secret under California law, "confidential material" must convey an actual or potential commercial advantage, presumably measurable in dollar terms. *Religious Technology Center v Wollersheim*, 796 F2d 1076 (CA 9, 1986).

Florida

Florida also adopted a version of the uniform trade secrets act that is similar to the MUTSA, see Fla Stat Sec 688.001. However, in 1996, the Florida legislature replaced its statute regulating covenants not to compete with a statute that regulates covenants not

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to compete as well as covenants of non-disclosure. Fla Stat Sec 542.335. Under the new statute, if a post-term restrictive covenant predicated on the protection of trade secrets or other statutory "legitimate business interests" is scrutinized, a court shall presume the covenant to be reasonable in time if it is for five years or less and to be unreasonable if greater than 10 years. All presumptions are rebuttable. Fla Stat Sec 542.335(1)(e). The court is directed to modify an offending term to make it enforceable.

Georgia

Georgia permits indefinite restrictions on disclosures of trade secrets, but not on other confidential information. In addition, a court will not modify or blue-pencil an offending clause unless it is part of a sale of a business. *Allen v Hub Cap Heaven, Inc*, 225 Ga App 533, 484 SE2d 259 (1997).

Nevada

Nevada enforces NDAs against former employees only if the agreement is supported by valuable consideration and is otherwise reasonable as to scope and duration. Nev Rev Stat Ann 613.200. In determining "reasonableness," Nevada courts will look to the amount of time a covenant lasts, the territory it covers, and the hardship imposed on the restricted person. *James v Deeter*, 112 Nev 291, 913 P2d 1272 (1996). Nevada also criminalizes the theft of trade secrets. Nev Rev Stat Ann 600A.035.

Pennsylvania

Pennsylvania law provides an employer the right to the protection of its confidential information under certain defined circumstances. *MacBeth-Evans Glass Co v Schnelbach*, 239 Pa 76, 86 A. 688 (1913). Generally, the information must be a particular secret of the employer, not a general secret of the trade, and must be of peculiar importance to the conduct of the employer's business. Pennsylvania may enforce NDAs without a temporal limitation if the restriction expires when the information no longer is confidential. Henry *Hope X-Ray Products, Inc v Marron Carrel, Inc*, 674 F2d 1336 (CA 9, 1982) (applying Pennsylvania law).

Wisconsin

In Wisconsin, covenants not to compete in employment contracts are enforceable if the restrictions are reasonable. Any covenant imposing an "unreasonable restraint is illegal, void, and unenforceable *even as to any part of the covenant that would be a reasonable restraint.*" Wis Stat Sec 103.465. Thus, unlike in Michigan, if any part of the restrictive covenant violates the statute, the entire provision is stricken and not merely modified by the court to make it reasonable or otherwise in compliance with the law. An NDA in an employment agreement or agency agreement is judged the same as a non-competition agreement under the Wisconsin statute. *Tatge v Chambers & Owen, Inc*, 219 Wis 2d 99, 579 NW2d 217 (1998).

Thus, it is not certain what reception will be given by courts in other states that are called upon to enforce provisions drafted in Michigan that contain unlimited restrictions on the use and disclosure of trade secrets or contractually defined confidential information. Michigan counsel may be gambling when drafting broad Michigan-style NDAs, because the court of another state may enforce the NDA differently, or not at all. Michigan counsel and businesses must understand that they cannot assume that the strong protection of trade secrets that exists in Michigan also exists in other states.

Conclusion

Michigan counsel should advise their clients that the laws of some other states are more restrictive than those in Michigan, and NDAs with employees, customers, and suppliers should be drafted with a sense of "reasonableness" much like non-competition agreements. NDAs should definitely include the adoption of Michigan law (other than its conflicts of law principles) and jurisdiction. Jurisdiction provisions should be included in the NDA, and the forum selection should be done with enforcement concerns in mind. In a recent unpublished opinion by the Michigan Court of Appeals, the court upheld a jurisdiction provision selecting Oakland County as the proper venue in an employment agreement prohibiting an employee from providing services or information to the employer's clients even though the employee accepted another employment position in California. *VED Software Services, Inc v Fernando*, No. 224393 (Oakland County Circuit Court filed November 27, 2001).

Michigan companies should not agree to another state's law without knowing the law of that state. It may also be helpful to include specific language providing for a directive for blue-penciling ("the court shall modify the otherwise invalid provision to make it valid") and indirect blue-penciling ("an indefinite period not to exceed that permitted by law"), though some states may expressly prohibit court modification. ✦

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