
Protection of Confidential Information in the Engineering Industry

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Abstract

This article explains how confidential information in the engineering industry can be protected by the common law action of breach of confidence and by confidentiality (secrecy) clauses in contract law. First the article discusses breach of confidence, examining cases such as *Saltman Engineering Co Ltd v Campbell Engineering Co Ltd* (1948) 65 RPC 203 and *Surveys & Mining Ltd v Morrison* [1967] VR 37. Then it discusses confidentiality clauses in contracts, and considers the nullifying effect of the doctrine of restraint of trade, looking at recent decisions such as *Maggbury v Hafele* (2001) 210 CLR 181 and *AIM Maintenance v Brunt* [2004] WASC 49.

Introduction

To say that trade secrets have enormous economic value is trite, but many companies find to their cost that either they have not taken sufficient steps to protect their secrets, or the steps they have taken are unenforceable in a court of law. Breach of confidence is a legal action that recognises the economic value of information, and is relevant to the engineering industry because it protects all manner of trade secrets. As the name would indicate, it provides some protection to the holder of valuable information, the value of which will be lost if the information becomes public. The modern law of breach of confidence can be said to have started in 1948 with the decision of the English Court of Appeal in *Saltman Engineering Co Ltd v Campbell Engineering Co Ltd*.¹ The *Saltman Engineering* case is important because, prior to this, there was some argument that there must be a contract between the parties before liability for breach of confidence would exist. *Saltman Engineering* made it clear that breach of confidence is a distinct cause of action and liability exists quite separately from any other legal action.

Confidentiality or secrecy clauses are those which an engineering company should consider inserting into any contract between the company and its employees, or its suppliers, joint venture partners, sub-contractors and so on. These clauses stipulate that the contracting party must not divulge certain information to third parties. These clauses must, however, be carefully worded in order to be valid because if they are expressed too widely the courts will strike them down (make them ineffective) if they are held to be a 'restraint of trade'.²

This article first discusses breach of confidence, then it discusses confidentiality clauses in contracts, and considers the nullifying effect of the doctrine of restraint of trade.

Breach of confidence

² The standard form contract used most often in engineering construction is AS (Australian Standards) 2124-1992. Clause 13 of this contract, headed 'Patents, copyright and other intellectual property rights', requires the parties not to do anything which may infringe these rights. 'Confidentiality' will be implied under this clause.

¹ (1948) 65 RPC 203. The facts of the case will be discussed in more detail later.

There are four main classes of information covered by breach of confidence, although these may overlap to some extent.³ The categories are personal information, such as marital secrets,⁴ government information, such as tax office information or Cabinet discussions, artistic and literary secrets, such as the idea for a series of television programs,⁵ and trade secrets. The type of information that is of most relevance to the engineering industry is 'trade secrets'. Trade secrets '... consist of items or collections of information which, because of their inaccessibility to the rest of industry, confer a competitive advantage on the firm which possesses or uses them'.⁶ Sometimes the confidential information may be the main asset of a business.

The confidential information may be conveyed orally or in writing. It may take many different forms. In the engineering industry this would include, for example, technical and conceptual drawings, photographs of plant and equipment, designs of plant and equipment and scientific data relating to the work done by the company. Other relevant information for the engineering industry which may be subject to protection includes sources of supply, expansion plans, sales statistics and details contained in engineering company contracts, for example on prices and costs. It would also include information that is not in material form, such as plans and ideas discussed in informal meetings between engineering company employees, or between engineering company employees and other parties. Of course the statutory regimes relating to copyright, trademarks, designs and patents also offer protection, sometimes for technical reasons they are not available, and in any event none of them cover ideas.⁷ Here

³ The categories follow those set out by F. Gurry in his book *Breach of Confidence* (1998 reprint) 7-21 and Ch. V.

⁴ Such as *Argyll v Argyll* [1967] 1 Ch. 302 which concerned the disclosure of marital secrets, i.e. the plaintiff's intimate affairs, following an acrimonious separation.

⁵ This was the information at the centre of the dispute in *Talbot v General Television Corp Pty Ltd* [1980] VR 224.

⁶ Gurry, above n 3, 7.

⁷ The legislation relating to copyright, designs, patents and trade marks is the *Copyright Act 1968* (Cth), *Designs Act 2003* (Cth), *Patents Act 1990* (Cth) and the *Trade Marks Act 1995*

breach of confidence may be the only legal action available to protect the information.

A wide range of information is covered. Technical secrets were the issue in the *Saltman Engineering Case*. Saltman Co, the plaintiff, had conceived the idea for some leather punches, and it asked another company to draw up plans for the punches. The second company instructed a third company, the defendant, to manufacture the dies in accordance with the plans provided by the second company. The defendant company then used the information to make leather punches for sale by themselves. The plaintiff was successful in a breach of confidence action. In *Ansell Rubber Co Ltd v Allied Rubber Industries Pty Ltd*⁸ the court protected information relating to the design, construction and operation of a machine for manufacturing rubber gloves. These two cases clearly indicate that protection will be given to information about new kinds of plant or equipment that are being used by an engineering company, and even to information about new ways of using plant and equipment already in existence.

Business secrets were the issue in *Rob v Green*.⁹ The information concerned the customer list of the plaintiff's business. Although the information was available in public directories, the defendant was not allowed to take advantage of the labour undertaken by the plaintiff in compiling the lists. *Surveys & Mining Ltd v Morrison*¹⁰ was a case involving a geologist and a mining company. Confidential geological data had been made known to the geologist while he was employed as a consultant to the mining company. The geologist then rather hastily applied for certain mineral leases. In finding him liable for breach of confidence, the court

(Cth). The case of *Donoghue v Allied Newspapers* [1938] Ch 106, relating to an alleged breach of copyright, illustrates that there is no copyright protection in the idea alone.

⁸ [1967] VR 37.

⁹ [1895] 2 QB 315. *Robb v Green* is an English case. An example of a more contemporary Australian case is *NP Generations Pty Ltd v Feneley* (2001) 80 SASR 151.

¹⁰ [1967] Qd R 470.

inferred that it was the unauthorised use of the confidential information which led to those particular mining lease applications.

The legal requirements in a breach of confidence action

The plaintiff, the engineering company, in a breach of confidence action must prove three things:¹¹

1. The information is confidential

There are varying degrees of secrecy and the requirement for confidentiality is not limited to information that is known only to the two parties involved. Material that is in the public domain, or common knowledge, cannot be protected, but in some circumstances information can remain confidential even if a number of people know about it. Thus if a large group of employees of an engineering company are privy to the employer's trade secrets for the purpose of their employment, the confidentiality of the information is not necessarily lost. Once a product is in the marketplace, however, breach of confidence can do nothing to prevent what is known as 'reverse engineering' - the process of taking the product apart to determine its constituent parts.

2. The information is communicated in confidence

The person to whom the information is imparted must be aware that they are receiving it for 'a limited purpose'.¹² This may arise from a pre-existing relationship between the parties, for example from a contract. The contract may be a commercial agreement, such as a joint venture, or it may be a contract of employment. In *Surveys & Mining Ltd v Morrison*, discussed above, Campbell J said that the relationship '... between a consulting geologist and the mining company which employs him must necessarily be one of complete confidence'.¹³

Where there is no pre-existing legal relationship the test is whether the confidant was aware that the information was disclosed for 'a limited purpose'. These situations will include the case where one of the parties negotiating a contract, which does not eventuate, discloses confidential information. In *Coco v A N Clark (Engineers) Ltd*¹⁴ the plaintiff had designed a moped engine and entered into negotiations with the defendant to manufacture the engine. The negotiations fell through, but the plaintiff claimed that the defendant used his design later on without his agreement. The court agreed that the circumstances were 'redolent of trust and confidence',¹⁵ but the plaintiff lost the case because the design was not different enough from information already in the public domain to be categorised as confidential.

Certain difficulties arise where the confidential information comes into the hands of third parties. Where the third parties know that the information is confidential, they will be liable. In addition the third parties may be liable if they do not actually know the material is confidential, but they ought to know. In *Surveys & Mining Ltd v Morrison* the associates of the defendant geologist, who were parties in the mineral lease applications, were also liable. The court fixed liability on the geologist's associates because it was found that they knew that the defendant geologist was a consultant to the plaintiff company. Even if they did not actually know the information was confidential, they should have had some suspicion of its origins.

The problem area is where a third party receives information, innocent of the fact that it is confidential, particularly when the information is paid for. Here the innocent third parties will be liable from the time they become aware that the information is confidential,

¹¹ The three requirements were established by Megarry J in *Coco v A N Clark (Engineers) Ltd* [1969] RPC 41 at 47.

¹² See Gurry, above n 3, 113-114.

¹³ [1967] Qd R 470, 473.

¹⁴ [1969] RPC 41.

¹⁵ *ibid*, 51, per Megarry J.

whether or not the information was paid for.¹⁶ The innocent third parties may be given actual notice that the information is confidential, for example in the form of a writ for breach of confidence, or notice might be imputed to them from circumstances subsequent to acquisition.

3. There must be an unauthorised use of the information to the detriment of the plaintiff

There are some theoretical arguments that it is necessary for the plaintiff to show detriment.¹⁷ In practice detriment may be shown by something as simple as hurt or embarrassment to the plaintiff. Detriment must, however, be shown in those cases where the government is the plaintiff,¹⁸ and when any plaintiff can raise evidence of material detriment, such as loss of profits, it will have an effect on the remedy granted.

Defences

One defence is 'just cause or excuse' where the disclosure may be justified because the defendant can show that the breach of confidence reveals an 'iniquity', such as fraudulent or criminal behaviour on the part of the plaintiff. Another defence is 'legal compulsion' where the confidant is obliged by law to divulge information, for example where a bank may be compelled by law to disclose information about a client's earnings to the Commissioner of Taxation, or a doctor must notify relevant authorities of any patient with HIV/AIDS.

Remedies

The different remedies available to the successful plaintiff in a breach of confidence action allow for a range of alternative outcomes.

¹⁶ *Fraser v Evans* [1969] 1 QB 349, per Lord Denning, 361. Note that this is in contrast to the situation where the third parties knew or ought to have known from the outset that the information was confidential; here liability arises from the time of acquisition.

¹⁷ For discussion see Gurry, above n 3, 407-408, and J. McKeough & A. Stewart, *Intellectual Property in Australia* (1997) 4.13.

¹⁸ *Commonwealth v John Fairfax & Sons Ltd* (1980) 147 CLR 39, 40.

1. Injunctions

In many breach of confidence cases the plaintiff engineering company may not be seeking monetary compensation, but would rather keep the information out of the public domain altogether. This may be achieved by an injunction which is a court order either restraining the defendant from doing something or compelling the defendant to do something.

2. Account of profits

An account of profits is a remedy that strips the defendant of the profits made as a result of the infringement. Because of the difficulties associated with the remedy, not least of which is determining exactly how much profit, if any, the defendant made at the expense of the plaintiff, it is in fact little used.

3. Damages

Where there is a contract between the confider and confidant, damages are awarded for the breach of contract. Where there is no contract, the court seeks to return the plaintiff to the pre breach of confidence position. Damages may include past losses, future losses, loss of profits, or loss of royalty payments. Damages may also be awarded in addition to an injunction.

4. Order to deliver up for destruction

This is an unusual remedy where the court orders the defendant to hand over for destruction any goods resulting from the unauthorised use of the information. An example would be where a defendant makes tools or equipment following a confidential disclosure about a particular design or pattern and for some reason there is no copyright, design or patent coverage available.

Contractual confidentiality (secrecy) clauses

When dealing with another party, whether it is an employee, supplier, subcontractor or client, a good way for an engineering company to protect its confidential

information is by means of a confidentiality or secrecy clause in a contract. Such a clause can be part of a larger contract, for example a contract of employment or supply, or it can be the basis of the entire contract. Breach of the clause may enable the party wishing to enforce the covenant to sue in order to obtain an injunction, as discussed above, or damages. Great care must be taken when drawing up confidentiality clauses, however, because potentially a court may find them invalid as being a 'restraint of trade'.

Contracts or covenants in restraint of trade

Historically contracts or covenants in restraint of trade were void (unenforceable). The common law regarded them as being contrary to public policy because they were anti-competitive and encouraged the existence of monopolies, but over time this position has been relaxed to some extent.¹⁹ Nowadays when a confidentiality contract, or confidentiality clause in a contract, comes before the court the starting point is that it will be treated as unenforceable unless it can be shown to be 'reasonable'.

Where the confidentiality covenant restricts an individual's ability to earn a living, for example, a clause in an employment contract restraining the employee after s/he leaves that particular employment, it is more difficult to show that the restraint is 'reasonable'. This is exemplified by *Buckley v Tutty*,²⁰ a case that does not relate to confidentiality clauses but to employment contracts generally. Here the High Court found that the Rugby Football League rules which restricted a professional rugby league player from moving freely between clubs were in restraint of trade and invalid. Where the confidentiality covenant restricts the employee's ability to divulge secrets during the course of that particular employment it is more likely to be enforceable. Even where there is no express confidentiality covenant in the contract the court may

imply one. This proposition was suggested in the case of *Faccenda Chicken Ltd v Fowler*²¹ where the English Court of Appeal said, 'While the employee remains in the employment of the employer the obligations are included in the implied term which imposes a duty of good faith or fidelity on the employee'.

One of the important factors to be taken into account by a court when determining the validity of a confidentiality covenant is the 'protection of those whose bargaining power is weak against being forced by those whose bargaining power is stronger to enter into bargains that are unconscionable'.²² The potential for a bargain to be unconscionable is obvious in the employer/employee relationship, but not so obvious in a business relationship. The leading case in this area, and one which discusses issues relating to the determination of what is 'reasonable', is the case of *Nordenfelt v Maxim Nordenfelt Guns and Ammunition Co Ltd*.²³ The defendant Nordenfelt was a well known manufacturer of guns with worldwide sales. He sold his business to the plaintiff company, covenanting in the sale contract that he would 'not for 25 years, if the company so long continued to carry on business, engage, except on behalf of the company, either directly or indirectly, in the trade or business of a manufacturer of guns, gun mountings or carriages, gunpowder explosives or ammunition, or in any business competing or liable to compete in any way with that for the time being carried on by the company.' The English House of Lords found all but the last part to be valid, applying the following reasoning:

Restraints of trade and interferences with individual liberty of action may be justified by the special circumstances of a particular case. It is a sufficient justification, and indeed it is the only justification, if the restriction is reasonable – reasonable in reference to the interests of the parties concerned and reasonable in reference to the interests of the public, so framed and guarded as to afford

¹⁹ *Australian Contract Law Reporter* (1991-2004) 62, 903.

²⁰ (1971) 125 CLR 353.

²¹ [1986] 1 All ER 617, 625.

²² *Schroeder Music Publishing Co Ltd v Macauley* [1974] 1 WLR 1308, 1315, per Lord Diplock.

²³ [1894] AC 535.

adequate protection to the party in whose favour it is imposed, while at the same time it is in no way injurious to the public.²⁴

Two recent cases have provided interesting examples of how the law operates. In *Maggbury Pty Ltd v Hafele Australia Pty Ltd*²⁵ the plaintiff Maggbury filed applications under the *Patents Act 1990* (Cth) for patents of inventions relating to foldaway ironing boards. Thereafter Maggbury sought commercial partners for development of the inventions, and started discussions with the defendant Hafele whose parent company was located in Germany. Before allowing the defendants to inspect the prototypes, Maggbury insisted on the execution between the parties of a 'Deed of Confidentiality' which included the following clauses:

5.6 Hafele [Australia] shall not at any time hereafter use the Information for any purpose whatsoever except with the Inventor's informed prior written consent.

11 'Duration'

It is a condition of this agreement that Hafele [Australia] will forever observe the obligations of confidence set out in this Agreement, unless released from such obligations in writing by the Inventor.

Shortly afterwards Maggbury exhibited the foldaway ironing boards at trade fairs in Sydney and Melbourne. The negotiations between Maggbury and Hafele eventually failed and no commercialisation agreement resulted. Maggbury later became aware that Hafele had begun distributing in Australia wall-mounted foldaway ironing boards, and manufacturing in Germany wall-mounted and drawer-mounted ironing boards.

Maggbury sued Hafele in the Supreme Court of Queensland and the trial judge, Byrne J, found for the plaintiff, awarding \$25,000 in damages and granting an injunction restraining the defendant from manufacturing and distributing the wall mounted ironing board. Hafele's appeal to the Queensland Court of Appeal was

successful, the court reducing damages to \$5,000 and setting aside the injunction. This was done on the basis that 'the agreement not to use information is unenforceable, because it has no time limit and it covers all information whether or not publicly disclosed ... No injunction should be granted under the general law, because the information has been made public, so far as it is of significant value'.²⁶ The appeal by Maggbury to the High Court was dismissed by a three to two majority. In a joint judgment Gleeson CJ, Gummow and Hayne JJ found the provisions to be a restraint of trade because '[t]hey restrict the liberty of the Hafele companies in the future to conduct their operations and dealings with third parties in such manner as they think fit.'²⁷ The majority went on to say:

The fact that the restraint can be said to have freely bargained for by the parties to the contract provides no sufficient reason for concluding that the doctrine should not apply. All contractual restraints can be said to be of that character.

The result is that the doctrine applied to the restraints as we have identified and rendered them invalid, subject to their justification as reasonable in the interests of the public and parties. The respondents correctly emphasise that such an enterprise was not undertaken at trial. Further, it may be added that there would be substantial difficulty in doing so.²⁸

Kirby J, in a powerful dissenting judgment made the following points:

Hafele freely negotiated the agreements with Maggbury. The contracting parties were at arm's length. This is not a case where advantage was taken of Hafele as a party in a vulnerable economic position. Indeed, Hafele was in a much stronger economic situation than Maggbury. Both parties to the confidentiality agreements were advised by lawyers and other experts. Hafele executed the agreements with its eyes wide open.

On the face of things, this was therefore a case where Hafele, having agreed to explicit,

²⁴ *ibid*, 565, per Lord Macnaghten.

²⁵ (2001) 210 CLR 181.

²⁶ *ibid*, 195.

²⁷ *ibid*, 202.

²⁸ *ibid*, 203.

limited and particular restrictions on the use it could make of 'the Information', proceeded, in clear breach of its covenants, to do exactly what it had promised not to do.²⁹

In an equally powerful dissenting judgment, Callinan J, like Kirby J, would have allowed the appeal and restored the judgment and order of the trial judge. It is difficult not to agree with the sentiments expressed above in the judgment of Kirby J, and to have some sympathy for the plaintiff, Maggbury, caught between two stools as it were. Because the information Maggbury had been trying to keep secret had been revealed in the patent application and at the trade fairs, the first requirement in a breach of confidence action (that the information is confidential) could not be proved. In the majority judgment because the confidentiality covenant was a restraint of trade, and Maggbury had not introduced evidence to show it to be 'reasonable', it was unenforceable. Even if Maggbury had produced such evidence, the majority judgment had intimated that it had been too widely drawn (by using words such as 'forever') and they would have still found the contract to be void as a restraint of trade.

*AIM Maintenance Ltd v Brunt*³⁰ concerned an employment contract between the plaintiff, AIM Maintenance, and the defendants Brunt and Jenkins. The case was an application in the Supreme Court of Western Australia before Roberts-Smith J for an interlocutory injunction to restrain, *inter alia*, the defendants from using the plaintiff's trade secrets or confidential information. The plaintiff designed and manufactured gearboxes and pumps for mining machinery, and the business involved a number of trade secrets. Brunt was initially employed as a fitter, then later as an engineering supervisor. Jenkins was employed as foreman and supervisor of the plaintiff's workshop personnel. There were areas of significant factual dispute, including whether the defendants had in fact signed the plaintiff's 'Intellectual Property

Assignment Agreement' and 'Confidentiality Agreement', but for the purposes of granting an injunction Roberts-Smith J felt only that he needed 'to assess whether or not there is a serious issue to be tried on the basis of the issues pleaded and as to which there is evidence from the plaintiff.'³¹

The plaintiff considered the sort of confidential information to which the defendants were exposed included pricing structures and pricing arrangements with customers, technical knowledge, details of AIM's customers including their needs, work projects and existing contracts. The two main clients of the plaintiff were Lightning Mixers Pty Ltd and National-Oilwell Pty Ltd. In January 2004 the defendants resigned at short notice and almost immediately solicited business from Lightning and National, business which at the time was conducted with the plaintiff and the conduct of which involved the plaintiff's trade secrets. The loss of these clients would eventually cause the failure of the plaintiff company, whereas the new business of the defendants was not dependent on these customers, nor would the injunction that had been applied for stop them from carrying on their business with other customers. Finding that it was sufficiently arguable that there was a serious question to be tried, and that the balance of convenience fell in favour of the plaintiff, Roberts-Smith J granted the injunction.

Recommendations

The *AIM* case demonstrates that a well drawn confidentiality clause in an employment contract will provide an employer with some protection notwithstanding some factual disputes, at least until the trial proper can take place. When drafting a confidentiality covenant, be it a clause in a larger contract or the substance of an entire contract, care must be taken to ensure it is 'reasonable'. Any time frame must be one that is tailored to the needs of each covenant, bearing in mind that such a covenant in an

²⁹ *ibid*, 205 and 206 respectively.

³⁰ [2004] WASC 49 (26 March 2004).

³¹ *ibid*, 21.

employment contract is likely be construed more strictly by the courts than one in a commercial contract between parties of equal bargaining power. The *Maggbury* case shows that even the latter must be drawn up with caution. Framing a time limit that roughly coincides with the period it would take to reverse engineer the product (or the information) would assist in a finding that the covenant is reasonable in that respect.

Covenants as to geographical exclusions, for example, one that the employee must not work within 20 (or 50 or 100) kilometres of the present employer's place of business, must also be carefully structured to the needs of each individual covenant. The temptation to include broad brush statements ('world wide', 'forever') to ensure all contingencies are covered must be resisted if the covenant is to have any chance of being enforceable.

Conclusion

Breach of confidence applies to the engineering industry in many ways, and where the information is an idea rather than something in material form, breach of confidence may provide the only avenue of legal protection. The usefulness to the engineering industry of this relatively unknown legal action should not be underestimated. As well as breach of confidence, a well drafted confidentiality covenant will assist in preventing the disclosure of trade secrets by employees, contractors and the like, providing of course that the 'restraint' will only be enforceable if it is reasonable 'by the special circumstances of a particular case'.³² *Maggbury v Hafele* has demonstrated that even in the twenty first century, and between two parties on an equal footing, a restraint clause containing words like 'forever' will not be reasonable.

Breach of confidence and confidentiality covenants both have great potential to protect the economic worth of valuable information relating to the business of an

engineering company. While information is secondary to the main focus of an engineering company's operations, the seepage of confidential information with an intrinsic value will ultimately have an effect on competitiveness and viability.

³² *Nordenfelt v Maxim Nordenfelt Guns and Ammunition Co Ltd*. [1894] AC 535, 565, per Lord Macnaghten.

