

Establishing

a Security

Against a

Confidentiality Obligation

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Security usually is not provided in a normal Confidentiality Agreement because determining a monetary value for the confidential information is more difficult for the parties since confidential information is an intangible asset. Consequently, the actual damage, which is the matter sought to be secured under the agreement, will be difficult to determine by the court in the event of violation of the confidentiality obligation.

In Taiwan, enforcement of a confidentiality obligation principally relies upon criminal law deterrence. Specifically, the Criminal Code imposes criminal punishments on a person who discloses a commercial or industrial secret which he/she is required by a contract to preserve. (§ 317 Criminal Code). In addition, Fair Trade Law punishes the act of acquiring the manufacturing, selling, or technical secret of another business by use of improper method. (§ 19, Fair Trade Law) Civil remedies in forms of injunctions and damages are also available under the Trade Secret Act.

Security Interest Against a Confidential Obligation Is Enforceable And Having a Liquidated Damages Provision Is Advisable

Notwithstanding the fact that criminal punishments constitute the principal measure in the enforcement of a confidentiality obligation, a proprietor is indeed entitled to compensation for damages in case of breach, and a security against such a claim is enforced by the courts. As a rule, the proprietor carries the burden of proving its actual damage when exercising its right of claim.

As was mentioned earlier in this letter, proving the actual damage caused by the violation of the confidentiality obligation is typically difficult. To obviate the burden of proof, a preferable method is to add a provision to the agreement whereby a fixed amount of liquidated damages (or punitive damages) can be claimed by the suffering proprietor in case of breach by the other party. A security interest may be further created against the complete or partial payment of the liquidated damages. We must emphasize that the courts are not strictly bound by such a liquidated damage provision, and may adjust the amount of the liquidated damages at their discretion by balancing the equity of the parties in any specific case. (§252, Civil Code)

Alternative Forms of Security Interest That May Be Available

If the parties have agreed to create a security interest against the confidentiality obligation under the agreement, the best way is to establish a mortgage in the tangible assets (real property or personal property) of the obligor or a third party. That method is relatively burdensome in formality in that a mortgage right must be recorded with the administration authorities to be effective.

Similarly effective, yet less powerful, is to create a pledge in the intangible assets such as stocks or intellectual property (IP) rights. However, the stock market in Taiwan is highly speculative, and the price of stocks can fluctuate significantly in a short period of time. The value of an IP right is not always appreciated by the public and may not be easily capitalized when the security interest is sought to be enforced.

A security by a check or a promissory note issued by the obligor can also be considered. Most medium or small size companies in Taiwan are family-owned with their essential assets retained in the hands of the controlling shareholders. If the obligor is a company, the check or promissory note must be endorsed by the controlling individual, which can be the chairman or the president of the company. In fact, whether a company will be held as a principal obligor or a guarantor under the confidentiality agreement, holding it's the company's controlling shareholder jointly and severally liable for the identical obligation is always desirable.

No matter which form of security interest is preferred by the proprietor, a precise, objective criteria in the agreement to determine when a breach of the confidentiality obligation has taken place is important so that the security can be enforced without much dispute. Since getting a court judgment can be time-consuming, an award of arbitration may be a better choice.

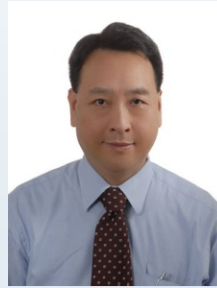
Do Not Place False Reliance On a Secured Confidentiality Agreement

In Our Opinion, One Characteristic of a confidentiality agreement is that it is difficult to monitor and to determine when one party has violated the confidentiality agreement. Further, the damage caused by a breach of the obligation is often irrecoverable simply by a compensation of damages. Therefore, even though a Confidentiality Agreement consisting of a security has been established and executed between the

parties, a prudent proprietor will not put false confidence in the protection of the agreement. Precautions including the following may minimize the harm that may result from possible breach by the obligor:

1. to withhold core technology of a key trade secret in the process of negotiation with the obligor;
2. to obtain IP protection before disclosure or delivery of the confidential information; and
3. to conduct diligent inspection and monitoring activities to assure compliance by the obligor with its confidentiality duty.

 **AUTHOR**



Perkin LIAW has an LL.B. degree and an LL.M. degree in IP Law. He acted as the Chief of Trademark Group at this firm for a number of years before he took the current position of the Manager of the International Services. His specialty is in the fields of trademark law, international IP litigation, technology licensing, corporate/commercial law and other international agreements.

