PROTECTING TRADE SECRETS IN KNOWLEDGE-BASED INDUSTRIES

by Douglas E. Dexter and Valerie R. Park

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I. IMPORTANCE OF TRADE SECRETS

A. Trade secrets can be critical to a company's operations and competitive position.

1. A company's trade secrets can be among its most important assets, the key intellectual property that allows it to keep its market position for its products or services.

   a) A company need not be a huge corporation with a highly technical product to need trade secret protection. A bakery in Ellsworth, Iowa was known for "fresh, never-frozen" bagels. Central to its secret was a proprietary method of bagging bagels in air-tight containers. A court held this method protectible because it was "not readily ascertainable what equipment or process is involved in so bagging the bagels, nor is it readily ascertainable what part the formulation and preparation of the bagels themselves may have in their freshness without freezing and long shelf-life."[3]

   b) In the bagel case the court decided that "Uncle B's Bakery has derived economic value from its secret processes, because, as it asserts, it is the only bagel maker to produce 'fresh, never-frozen' bagels for supermarket distribution, giving it a unique share of the grocery store bagel market. This value of the information would accrue to either the owner or a competitor and is information which protects the owner's competitive edge or advantage."[4]

2. As will be seen more fully in part II below, trade secrets can relate to a product or service itself, or to the company's efforts to sell the product or service.

   a) Examples of the first kind include the recipe for the secret sauce, the plans for the new process or invention, and the source code on which product-related software is built.

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3 *Uncle B's Bakery, Inc. v. O'Rourke*, 920 F.Supp. 1405, 1428 (N.D. Iowa 1996) (applying Iowa law).

4 *Ibid.* (internal quotation marks omitted).

b) Examples of the second kind include confidential customer lists, marketing plans, and pricing information.

c) Secrets of either kind provide the company with a competitive advantage which would be lost if the information were available to its rivals, or to the public.

d) This is especially true in the technology industry, where complicated and constantly changing knowledge is the basis of the product.

3. The company cannot hold its secrets apart from its employees.

a) The company can only operate through its people. While it can restrict information according to a need to know, as to just about every company secret *some* employees (or contractors) *will* need to know. Someone has to make the secret sauce.[5] And someone must seek customers for it.

b) In order to keep its secrets while still allowing them to be used, the company must devise and implement ways to make its employees respect and preserve its secrets, and keep them aware of the consequences of not doing so. Although Human Resources will administer these policies, counsel (whether inside or outside) will ordinarily be expected to design them to be effective under applicable law. Counsel as well as HR will be held accountable if the policies fail.

4. The policies counsel design for HR managers will be basic instruments for protecting the company's secrets.

a) As noted, they must protect the company's secrets and ensure that employees and contractors understand the policies and are motivated to obey them.

b) Moreover, they will govern the portal through which intellectual property enters and leaves the company, carried in the minds and perhaps the briefcases and laptops of arriving and departing employees and contractors.

(1) As will be seen in section V below, both arrival and departure present sensitive issues of trade secret protection.

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5 See, e.g., *205 Corp. v. Brandow*, 517 N.W.2d 548, 551 (Iowa 1994): "In order to maintain freshness the [pizza] crust had to be prepared daily. The kitchen employees who prepared the dough were thus necessarily made aware of the recipe. Accordingly, in contrast to other recipes, the crust recipe became known to all employees * * * Given the evidence of the special needs inherent in crust preparation, … substantial evidence supported the conclusion that plaintiff's secrecy procedures were reasonable under the circumstances."

(2) Important nodes in the trade secret protection process include (among others) pre-hiring interviews, orientation, periodic reviews, in-service education and exit interviews.

(3) Counsel must also design related policies for protecting the company from inadvertent improper acquisition of trade secrets.

c) The whole complex apparatus of non-disclosure, non-compete, non-solicitation, and invention agreements, discussed in section V below, although *administered* by HR, are *devised* by counsel. For example, counsel will draft the form non-disclosure agreements presented and signed at the post-hiring orientation, and will review and approve (or reject) any variances. The company therefore relies on counsel to ensure that a protective system is in place and will be available if needed to control behavior or vindicate its rights.

d) Counsel will also have the responsibility of designing whatever other policies (such as taking steps to maintain internal secrecy) are needed to protect the company's legal position with respect to its secrets.

5. Trade secrets are a prolific source of litigation.

a) Examples include actions by the company against others for misappropriating the company's secrets, actions *against* it for misappropriating the secrets of *other* companies, and attempts to enforce (or resist enforcement of) restrictive agreements regarding disclosure or use of proprietary intellectual property.

b) In the present uncertain economic climate, and especially in highly fluid and competitive knowledge-based industries, there is more employment-based trade secret litigation than ever before.

(1) For example, when a company's survival is threatened, or is thought to be so, its people can be motivated to defect. For the threatened company this additional threat, which might in other times have been thought marginal, may be seen as critical. Fearing a "last straw" effect, the company may be more likely to devote resources to protecting its rights than it might have before the current crisis.

c) Counsel will likely be held accountable here too if litigation follows, or is even credibly threatened, because policies adequate to avoid trouble were not in place.

B. The materials which follow are designed to help counsel perform their task of helping HR managers preserve a company's secrets and avoid litigation, and therefore avoid failures which could have unpleasant consequences for the company, the CEO, and ultimately perhaps for themselves as well. They are not of course a substitute for legal advice, which must be tailored precisely to specific circumstances and to the law of the jurisdiction.

II. WHAT IS A TRADE SECRET?

A. Statutory definition of trade secret

1. The Uniform Trade Secrets Act ("UTSA") is the main civil vehicle for protecting rights to trade secrets in the United States. It has been adopted in varying forms by 44 states, including California where the high technology industry is centered.[6] Its development and significant local variations will be discussed further in Part IV below.
2. The UTSA defines a trade secret as follows: "'Trade secret' means information, including a formula, pattern, compilation, program, device, method, technique, or process, that: (i) derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use; and (ii) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy."[7]
3. A California court has stated this definition more economically, saying "the definition consists of three elements: (a) information (b) which is valuable because unknown to others and (c) which the owner has attempted to keep secret."[8]
   a) A confidentiality agreement is not a prerequisite to recovery under UTSA.[9]
4. The UTSA provides both legal remedies such as damages for actual loss[10], and equitable remedies such as injunction[11] and disgorgement of unjust

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6 See California Civil Code §§ 3426 *et seq.*

7 UTSA § 1(4); and see California Civil Code § 3426.1(d). The full text of the UTSA, with commentary, the variations adopted in each of the states, annotations to state case law, and other useful material, can be found at 14 UNIFORM LAWS ANNOTATED 433 (West 1990 and supplement) (hereafter U.L.A.).

8 *ABBA Rubber Co. v. Seaquist*, 235 Cal.App.3d 1, 18 (1991).

9 See, e.g., *Strata Marketing, Inc. v. Murphy*, 317 Ill.App.3d 1054,1066 (2000).

10 UTSA § 3(a); California Civil Code § 3426.3(a).

11 UTSA §§ 2(a), 2(c); California Civil Code § 3426.2.

enrichment.[12] It also provides for an involuntary royalty, which might be difficult to obtain without statutory authorization.[13]

a) The UTSA also allows for exemplary damages of up to twice the basic award for "wilful and malicious misappropriation."[14]

B. <u>"Information, including …"</u>

1. The list in the statute is meant to be illustrative but not exhaustive. Technical information about a manufacturing process is the paradigmatic kind of trade secret, but not the only one. For example, as noted, pricing and marketing information can be a trade secret if they meet the statutory criteria.

2. "The words 'method, technique' are intended to include the concept of know-how."[15]

a) What "know-how" knows how to do has an infinite range – all are protectible if they meet the statutory requirements. Typical examples include a method of coating pipes which avoids blemishes which make the pipes weaker at the blemish point[16], a paintless dent-removal process[17], and a proprietary system for growing, harvesting and curing tobacco.[18] The possibilities are limited only by human ingenuity.

3. "The fact that some or all of the components of the trade secret are well-known does not preclude protection for a secret combination, compilation, or integration of the individual elements. * * * In other words, a trade secret process may be established even if known components are assembled and

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12 UTSA § 3(a); California Civil Code § 3426.3(a). For an example of disgorgement for unjust enrichment, see *Morlife, Inc. v. Perry*, 56 Cal.App.4th 1514, 1518 (1997).

13 UTSA §§ 2(b), 3(a); California Civil Code §§ 3426.2(b), 3426.3(b). The § 3(a) royalty is a "general option" to compensate for past misconduct, as distinguished from the § 2(b) royalty accompanying an injunction "in exceptional circumstances" to regulate future conduct. Comment (1985) to UTSA § 3. For an example of an imposed royalty see *Robert L. Cloud & Associates, Inc. v. Mikesell*, 69 Cal.App.4th 1141, 1149-1151 (1999).

14 UTSA § 3(b); California Civil Code § 3425.3(c). Arkansas, Michigan and Nebraska do not include this provision in their versions of the UTSA. In Ohio the multiplier is three rather than two, see Ohio Revised Code § 1333.63(B); in Colorado it is one, see Colorado Revised Statutes § 7-74-104(2) Vermont allows for exemplary damages but does not specify a multiplier, see Vermont Statutes Annotated title 9, § 4603(b).

15 Comment to UTSA § 1; Senate Comment (1984) to California Civil Code § 3426.1.

16 See *Saunders v. Florence Enameling Co., Inc.*, 540 So.2d 651 (Ala. 1989).

17 See *Weston v. Buckley*, 677 N.E.2d 1089 (Ind. App. 1997).

18 See *Star Scientific, Inc. v. Carter*, 204 F.R.D. 410 (S.D.Ind. 2001)

known techniques are combined to produce a useful process which is not known in the industry."[19]

4. "[T]he commonly accepted definition of a trade secret does not include a marketing concept or new product idea submitted by one party to another. Therefore, simply possessing a non-novel idea or concept without more is generally, as a matter of law, insufficient to establish a trade secret."[20] This is true in Restatement jurisdictions also, on the additional ground that the idea has not been used continuously and secretly in commerce.[21]

5. Computer software, diagnostic and otherwise, can qualify for trade secret protection under the UTSA.[22]

   a) A program can be a secret when the source code is secret, even if the object code is not.[23]

   b) Field information bulletins containing technical information used by a company in repairing and servicing its products can be a trade secret.[24]

6. The examples mentioned by no means exhaust the field – anything which meets the statutory definition can be a trade secret. Some states add additional examples.[25]

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19 *Penalty Kick Management Ltd. v. Coca-Cola Co.*, 164 F.Supp.2d 1376, 1379 (N.D.Ga. 2001) (citations and quotation apparatus omitted) (applying Georgia version of UTSA). South Carolina provides for this by statute – see South Carolina Code 1976 § 39-8-20(5)(b).

20 See, e.g., *Daktronics, Inc. v. McAfee*, 599 N.W.2d 358, 361, 1999 SD 113 (1999) (citations omitted).

21 See, e.g., *Hudson Hotels Corp. v. Choice Hotels International*, 995 F.2d 1173, 1176 (2nd Cir.1993) (applying New York law).

22 See, e.g., *MAI Systems Corp. v. Peak Computer, Inc.*, 991 F.2d 511, 522 (9th Cir. 1993) (applying California version of UTSA); *Aries Information Systems, Inc. v. Pacific Management Systems Corp.*, 366 N.W.2d 366, 368 (Minn.App.1985); see also *TDS Healthcare Systems Corp. v. Humana Hospital Illinois, Inc.*, 880 F.Supp. 1572, 1582 (N.D.Ga. 1995) (applying Georgia version of UTSA) (computer software programs are trade secrets if statutory test is met). Idaho's version of the UTSA provides for this by statute, see Idaho Code § 48-801(5), and see § 48-801(4) (definition).

23 See *Q-Co Industries, Inc. v. Hoffman*, 625 F.Supp. 608, 617 (S.D.N.Y.1985) (applying New York law).

24 See *MAI Systems Corp. v. Peak Computer, Inc.*, 991 F.2d 511, 522 (9th Cir. 1993) (applying California version of UTSA).

25 See, e.g., Georgia Code Annotated § 10-1-761(4), adding drawings, "technical or non-technical data," financial data, financial plans, and lists of customers or suppliers. Idaho adds computer programs, see Idaho Code § 48-801(5). Colorado, Connecticut, Ohio, Oregon and South Carolina also add other examples. This listing is not exhaustive.

7. The fact that an employee participates in the development of a process, "rather than learning an already-developed process" when entering employment, does not give the employee intellectual property rights in the resulting trade secret.[26]

8. Governmental entities can have trade secrets under UTSA. For example, an Ohio state hospital succeeded in protecting economic data prepared in connection with a contemplated purchase of a private hospital.[27]

C. Secrecy

1. If the information is not secret, it cannot be not a trade secret. "Public disclosure, that is the absence of secrecy, is fatal to the existence of a trade secret."[28] "The crucial characteristic of a trade secret is secrecy rather than novelty."[29] When the secret is publicly disclosed "it loses any status it ever had as a trade secret."[30]

2. "If an individual discloses his trade secret to others who are under no obligation to protect the confidentiality of the information, or otherwise publicly discloses the secret, his property right is extinguished."[31]

3. "Once trade secrets have been exposed to the public, they cannot later be recalled."[32] This is so even if the use of the product itself causes the disclosure.[33]

   a) For example, in a recent California case, a court held telemarketing scripts could not be trade secrets because they had been disclosed in the course of use.[34]

   b) The same was true in a Maryland case concerning a method of teaching swimming to children. It had been disclosed by use without confidentiality requirements, and therefore could not be protected.[35]

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26 See *Components for Research, Inc. v. Isolation Products, Inc.*, 241 Cal.App.2d 726, 729 (1966).

27 See *State ex rel. Besser v. Ohio State University*, 87 Ohio St.3d 535, 541 (2000).

28 *In re Providian Credit Card Cases*, 96 Cal.App.4th 292, 304 (2002).

29 *Dionne v. Southeast Foam Converting & Packaging, Inc.*, 240 Va. 297, 302 (1990).

30 *State ex rel. Lucas County Board of Commissioners v. Ohio Environmental Protection Agency*, 88 Ohio St.3d 166, 174 (2000).

31 *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1002 (1984) (applying Missouri law, at that time based on the first Restatement of Torts). See note 146 below.

32 *Religious Technology Center v. Netcom On-Line Communication Services*, Inc., 923 F.Supp. 1231, 1254 (N.D.Cal. 1995) (applying California version of UTSA).

33 See *Vacco Industries, Inc. v. Van Den Berg*, 5 Cal.App.4th 34, 49-50 (1992).

34 See *In re Providian Credit Card Cases*, 96 Cal.App.4th 292, 304 (2002).

c) But this is not always true everywhere. For example, as noted, Nevada law provides that under certain circumstances involuntary exposure on the internet need not be fatal.[36] Without such a statutory provision it would be fatal.[37]

4. Information known within an industry cannot be a trade secret even if it is unknown to the general public.[38]

a) For example, in a Maryland case a court denied trade secret protection to a substitution of ingredients where this practice "was an obvious cost-saving measure generally known in the industry."[39]

b) "The [statutory] language 'not being generally known to the public or to other persons' does not require that information be generally known to the public for trade secret rights to be lost. If the principal person who can obtain economic benefit from information is aware of it, there is no trade secret. A method of casting metal, for example, may be unknown to the general public but readily known within the foundry industry."[40]

5. There is no trade secret protection in a patented invention.

a) A company can have trade secrecy protection or patent protection, but not both. The holder of the secret which is the basis of the patent exchanges its trade secret interest in the technology for the patent's limited monopoly. The information then becomes public (although still proprietary) as part of the process, and moves into the public domain when the patent expires.[41]

(*footnote continues…*)

35 See *Harvey Barnett, Inc. v. Shidler*, 143 F.Supp.2d 1247, 1252-1253 (D.Colo. 2001) (applying Colorado version of UTSA).

36 See Nevada Revised Statutes Annotated § 600A.055. Nevada also provides specifically that a court may order misappropriated information removed from the internet. See Nevada Revised Statutes Annotated § 600A.040(3).

37 See *Religious Technology Center v. Netcom On-Line Communication Services, Inc.*, 923 F.Supp. 1231, 1256 (N.D.Cal. 1995) (applying California version of UTSA).

38 See, e.g., *Mangren Research and Development Corp. v. National Chemical Co., Inc.*, 87 F.3d 937, 942 (7th Cir. 1996) (applying Illinois version of UTSA).

39 *Microbix Biosystems, Inc. v. Biowhittaker, Inc.*, 172 F.Supp.2d 665, 676 (D.Md. 2000) (applying Maryland version of UTSA).

40 Senate Comment (1984) to California Civil Code § 3426.1.

41 See, e.g., *Stutz Motor Car of America, Inc. v. Reebok Int'l, Ltd.*, 909 F.Supp. 1353, 1359 (C.D.Cal. 1995) (applying California version of UTSA); accord *Forcier v. Microsoft Corp.*, 123 F.Supp.2d 520, 528 (N.D.Cal. 2000) (same).

b) "Trade secret law and patent law – both aspects of the elusive concept of intellectual property – serve quite different functions. Patent protection, which is often difficult and costly to obtain, gives the patent holder the right to exclude others from using the patented device, process, etc., for a limited time period. Trade secret law, on the other hand, protects a person's right to keep certain information 'secret,' by providing a cause of action against anyone who misappropriates a reasonably-protected secret."[42]

c) The fact that a device was denied a patent because it was "obvious based on prior art" does not mean it is "readily ascertainable" under UTSA § 1(4)(i), because "information may be found a trade secret even if not sufficiently novel to merit patent protection."[43]

6. Trade secret protection also differs from copyright. Among other differences, copyright protects only expression but not the underlying idea, while trade secrecy protects the idea itself, if novel and undisclosed (or disclosed only on a confidential basis).[44]

7. Things which are obvious or public are not secrets no matter how closely they are held within the company.

   a) "[I]nformation which is readily obtainable through public sources such as directories do not derive the independent economic value necessary to the existence of a trade secret. In addition, information which is not exclusive or is generally in use by good faith competitors also cannot be classified as a trade secret."[45]

      (1) For example, a federal court in Kansas rejected an argument for trade secret status for the crystalline structure of its products, saying that

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42 *Pioneer Hi-Bred International v. Holden Foundation Seeds, Inc*., 35 F.3d 1226, 1239 n.42 (8th Cir. 1994).

43 *Basic American, Inc. v. Shatila*, 133 Idaho 726, 736 (1999).

44 See *Boeing Co. v. Sierracin Corp*., 108 Wash.2d 38, 49 (1987). For this reason the federal Copyright Act does not preempt state trade secret law. For another rationale for the same result see *Avtec Systems, Inc. v. Peiffer*, 21 F.3d 568, 574 (4th Cir. 1994) (rejecting preemption defense because "recovery for trade secret misappropriation [under Virginia version of UTSA] requires proof of breach of confidence – an element of proof additional" to that required for copyright recovery. However, preemption is not impossible. In *Foresight Resources Corp. v. Pfortmiller*, 719 F.Supp. 1006, 1011 (D.Kan. 1989) the court held that a copyright statute on adapting computer programs preempted the Kansas version of the UTSA, because granting an injunction on that basis would deny the defendant the benefit of the federal statute.

45 *Scott v. Snelling and Snelling, Inc*., 732 F.Supp. 1034, 1044 (N.D.Cal. 1990) (applying California version of UTSA).

"[a]ny competitor with a microscope can readily ascertain plaintiffs' crystalline structure."[46]

(2) A case involving a supposedly proprietary employment counseling program gives some good examples. "The alleged trade secrets include such instruction techniques as: the program being conducted on consecutive days, beginning with Wednesday; instructor review and critique of thank you notes; holding a surprise cocktail party prior to the normal ending time on the last day of class; and conducting dress rehearsals for job interviews on the last day of class. * * * Each of these items is either already a matter of common public knowledge or completely disclosed to students taking the … course. It would be absurd to permit Hoffman to appropriate as his own 'secrets' common pedagogical and job search techniques which would be used in any job placement course."[47]

D. <u>Independent economic value</u>

1. The critical factor here is that the confidentiality of the information *add value* to the information itself. That added value (actual or potential) is the property of the owner of the secret.

   a) Thus the secrecy of a restaurant's recipes did not add value when the dishes were "were little more than typical American fare" and "so obvious that very little effort would be required to 'discover' them."[48]

      (1) The same was true of their staff manuals, which "contain[ed] little more than such food service truisms as 'when tasting foods, never use cooking utensils' and 'follow each recipe exactly.' Thus, while it may have been reasonable to conclude that [plaintiff] obtained value from the manuals, there is little to suggest that any value was obtained from the manuals being kept secret."[49]

   b) When a faithless corporate officer used a confidential list of employee salaries to help him recruit his co-workers to defect to the competition, the court held he had violated his fiduciary duty to the corporation by using its secrets against it. But the court also held the list was a not a trade secret

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46 See *BioCore, Inc. v. Khosrowshahi*, 96 F.Supp.2d 1221, 1227 (D.Kan. 2001) (applying Kansas version of UTSA).

47 *Self Directed Placement Corp. v. Control Data Corp.*, 908 F.2d 462, 465 (9th Cir. 1990) (applying California version of UTSA).

48 *Buffets, Inc. v. Klinke*, 73 F.3d 965, 968 (9th Cir. 1996) (applying Washington version of UTSA).

49 *Ibid.* (quotation apparatus omitted).

because its confidential nature did not add value. The company "mistakenly assumed that secrecy equals economic value. It does not."[50]

c) "[A] trade secret may be embodied in documents, or other personal property, but has an intrinsic value which is based upon, or at least preserved by, being safeguarded from disclosure. The documents [here], on the other hand, are not shown to have any intrinsic value to anyone other than their owner…"[51]

d) This test, like most of the others under the UTSA, is fact-specific, an different circumstances often produce different results. So for example in a Wisconsin case engineering drawings of past installations were held protected trade secrets, while in a California case old technical drawings for an item already in production were held not to be trade secrets because they had long since lost any economic value to the manufacturer.[52]

2. This need for added economic value is shown with particular clarity in the case of customer lists.

a) "With respect to the general availability of customer information, courts are reluctant to protect customer lists to the extent they embody information which is 'readily ascertainable' through public sources, such as business directories. On the other hand, where the employer has expended time and effort *identifying customers with particular needs or characteristics*, courts will prohibit former employees from using this information to capture a share of the market. Such lists are to be distinguished from mere identities and locations of customers where anyone could easily identify the entities as potential customers."[53]

(1) Examples of such "added value" from the case law include lists of ophthalmologists who did a high volume of lens implants using the company's products[54], lists of clients of a temporary employee agency

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50 *GAB Business Services, Inc. v. Lindsey & Newsom Claim Services, Inc*., 83 Cal.App.4th 409, 428 (2000).

51 *Pillsbury, Madison & Sutro v. Schectman*, 55 Cal.App.4th 1279, 1287 (1997) (finding no protection).

52 Compare *La Calhene, Inc. v. Spolyar*, 938 F.Supp. 523, 529 (W.D.Wis. 1996) (applying Wisconsin version of UTSA to protect drawings) with *Gemini Aluminum Corp. v. California Custom Shapes, Inc*., 95 Cal.App.4th 1249, 1263 (2002) (holding drawings unprotected).

53 *Morlife, Inc. v. Perry*, 56 Cal.App.4th 1514, 1521-1522 (1997) (citations omitted; emphasis added).

54 See *Surgidev Corp. v. Eye Technology, Inc*., 648 F.Supp. 661 (D.Minn. 1986) (applying California version of UTSA) *affd* 828 F.2d 452 (8th Cir. 1987).

recording how satisfied the customers were with specific employees[55], a list of pharmacy customers including the numbers and dollar values of prescriptions filled for each per year[56], a list of customers who had bought products from a home-service food company[57], and a list of customers with the dates their contracts were due for renewal.[58] Examples could be multiplied.

(2) But "[w]hether customer information constitutes a trade secret or confidential information depends upon the facts of each individual case."[59] For example, protection was denied where, for example, "only a few dozen names are at issue, and a competitor could obtain those names simply by calling the company and inquiring, 'Who buys your copier equipment?'"[60]

(3) In a Florida case involving customer lists owned by a company which customized clothing with fraternity emblems, the court distinguished between a *prospective* customer list of 9,600 fraternities and sororities (not protectible because compiled from public information and not the "product of any great expense or effort," and an *active* list of 6800 who had actually ordered from the company and which contained a detailed purchasing history for each sorority and fraternity on the list. This list was "confidential and not readily ascertainable to the public," and so the court granted injunctive relief to prevent its unauthorized use.[61]

b) "[A] showing of value, by itself, is not sufficient to satisfy the statutory definition. A list of those persons who have demonstrated a willingness to order and pay for the goods or services of a particular business will always have value to that business. However, the statute also requires that the information have value to other businesses which are unaware of the

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55 See *Dial Temporary Help Service, Inc. v. Shrock*, 946 F.Supp. 847, 854 (D.Ore. 1996) (applying Oregon version of UTSA).

56 See *Fred's Stores of Mississippi, Inc. v. M & H Drugs, Inc.*, 725 So.2d 902, 909 (Miss. 1998).

57 See *Home Pride Foods, Inc. v. Johnson*, 262 Neb. 701, 709-710 (2001).

58 See *TIE Systems, Inc., Illinois v. Telcom Midwest, Inc.*, 203 Ill.App.3d 142,148 (1990).

59 *McGlothen v. Heritage Environmental Services, L.L.C.*, 705 N.E.2d 1069, 1072 (Ind.App. 1999).

60 *IKON Office Solutions, Inc. v. American Office Products, Inc.*, 178 F.Supp.2d 1154, 1168 (D.Ore. 2001) (applying Oregon version of UTSA).

61 *Sethscot Collection, Inc. v. Drbul*, 669 So.2d 1076, 1078 (Fla.App. 1996).

information and which could put that information, if known, to beneficial use."[62]

(1) One way to demonstrate that a list has value is to show that marketing companies or others are willing to pay money to obtain it.[63]

c) Even value-added lists must be subject to reasonable efforts to maintain secrecy.

(1) For example, in an Illinois case the court held that the list itself, which contained thousands of customers nationwide "who have either purchased from plaintiff the wire shelving products manufactured by defendant or purchased other goods sold by plaintiff," was "the type of information the [UTSA] intended to protect,"[64] it would not be protected because sufficient steps were not taken to keep it secret.

(2) Similarly, a Georgia federal court denied trade secret protection where "copies of the customer lists freely floated around the office without any system in place to track or monitor the whereabouts of the lists[,…] throw[ing] into question the legitimacy of Plaintiff's efforts to maintain the secrecy of its lists."[65] Examples could be multiplied.

3. That the information on a customer list may be *ultimately* obtainable from public sources is not dispositive. For example, in a Kansas case the plaintiffs "invested a great amount of time, effort, and expense in developing their customer information – including hundreds of hours of 'cold-calling.' While the information contained on the lists and the notes is *ultimately* ascertainable from public sources, it is not readily *ascertainable* from public sources: [a] third party wishing to duplicate the information could not do so without investing a significant amount of time, effort, and expense – similar to that which Plaintiffs invested."[66]

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62 *ABBA Rubber Co. v. Seaquist*, 235 Cal.App.3d 1, 19 (1991).

63 See *Fred's Stores of Mississippi, Inc. v. M & H Drugs, Inc.*, 725 So.2d 902, 910 (Miss. 1998); see also *Religious Technology Center v. Netcom On-Line Communication Services, Inc.*, 923 F.Supp. 1231, 1253 (N.D.Cal. 1995) (applying California version of UTSA) (willingness of church members to pay for secret teachings showed that they had economic value).

64 *Gillis Associated Industries, Inc. v. Cari-All, Inc.*, 206 Ill.App.3d 184,190 (1990).

65 *AmeriGas Propane, L.P. v. T-Bo Propane, Inc.*, 972 F.Supp. 685, 701 (S.D.Ga. 1997) (applying Georgia version of UTSA).

66 *Fireworks Spectacular, Inc. v. Premier Pyrotechnics, Inc.*, 147 F.Supp.2d 1057, 1066 (D.Kan. 2001) (emphasis added) (applying Kansas version of UTSA).

4. "If an outsider would obtain a valuable share of the market by gaining certain information, then that information may be a trade secret *if it is not known or readily ascertainable*."[67]

5. A company's secret information about its "pricing, profit margins, costs of production, pricing concessions, promotional discounts, advertising allowances, volume rebates, marketing concessions, payment terms and rebate incentives … has independent economic value because [it] would be valuable to a competitor to set prices which meet or undercut" their own.[68]

   a) But it is important to distinguish between cost and pricing data unique to a company (which may qualify as trade secrets) and commonly used industry formulas for setting prices (which cannot). Thus only "cost and pricing information *not readily known in the industry*" can be a trade secret.[69]

   b) Similarly, an actual bid on a contract may be a trade secret subject to misappropriation, while "the methods of calculating the bid or the constituent elements of the bid" might not be.[70]

   c) "[T]he results of confidential marketing research; advertising and marketing strategy, plans, and techniques; and [a company's] five-year strategic plan … would be valuable if known by a competitor because it would allow the competitor to predict and counter [its] advertising and marketing."[71] So they can be trade secrets.

      (1) For example, "Iowa's broad definition of trade secrets, together with its liberal construction by Iowa courts, rebut [defendant's] contention that any of [plaintiff's] research, development, pricing, cost or marketing data fell outside the definition of a trade secret. So long as [plaintiff] received value from keeping the information secret and made attempts to keep it secret, the information is considered a trade secret under Iowa law."[72]

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67 *Electro-Craft Corp. v. Controlled Motion, Inc.*, 332 N.W.2d 890, 900 (Minn. 1983) (emphasis added).

68 *Whyte v. Schlage Lock Co.*, 101 Cal.App.4th 1443, 1455 (2002).

69 *Id.* at 1456 (emphasis added).

70 See *Ovation Plumbing, Inc. v. Furton*, 33 P.3d 1221, 1224 (Colo. App. 2001).

71 *Whyte v. Schlage Lock Co.*, 101 Cal.App.4th 1443, 1456 (2002).

72 *EFCO Corp. v. Symons Corp.*, 219 F.3d 734, 741 (8th Cir. 2000) (citation omitted).

(2) And a franchisee's business plan can be a protected trade secret in appropriate circumstances.[73]

(3) But "market research does not enjoy … blanket trade secret protection. Marketing research can be trade secret if it explores the needs of numerous, diverse buyers, but is not protectible if it relates to a single prominent buyer that is presumably aware of its own needs."[74]

6. "[T]he fact that several competitors each independently use a process that each has independently discovered would not necessarily mean this undisclosed information is no longer a trade secret. The undisclosed information could still have actual or potential value, for example, in the sale of the business. On the other hand, the fact that every competitor had discovered the same process might be relevant to establish that the information was 'generally known' and 'readily ascertainable' to competitors."[75]

7. "Value will be inferred if the owner can show that the information confers upon it an economic advantage over others in the industry."[76]

8. "[T]here is no requirement that a trade secret have any value to the defendant; the value can be to others who do not possess it. * * * [T]he definition of trade secret does not require that there currently be competitors, only that there be actual or potential value from the information being secret. Thus, potential competition is sufficient."[77]

E. Reasonable efforts to maintain secrecy

1. As has been seen, if information is not secret it cannot be a trade secret. The statute goes further and says unless the owner of the secret takes *reasonable efforts to maintain* its secrecy the information is not protected *even if* it has not yet become known outside the company.[78]

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73 See *Motor City Bagels, L.L.C. v. American Bagel Co*., 50 F.Supp.2d 460, 479 (D.Md. 1999) (applying Maryland version of UTSA). The plan was not protected because secrecy had not been maintained.

74 *Whyte v. Schlage Lock Co*., 101 Cal.App.4th 1443, 1456 (2002) (citation and quotation apparatus omitted).

75 *Bestechnologies, Inc. v. Trident Environmental System, Inc*., 681 So.2d 1175, 1176 (Fla.App. 1996) (citation omitted) (applying Florida version of UTSA; quoting Restatement of Torts § 757).

76 *Enterprise Leasing Co. of Phoenix v. Ehmke*, 197 Ariz. 144, 150 (Ariz.App. 1999).

77 *Religious Technology Center v. Netcom On-Line Communication Services, Inc*., 923 F.Supp. 1231, 1253 (N.D.Cal. 1995) (applying California version of UTSA).

78 See UTSA § 1(4)(ii), defining reasonable efforts to maintain secrecy as an independent statutory element of a trade secret.

2. Failure to do this can be fatal, and later attempts to impose secrecy will be too late.

   a) For example, in a case noted earlier, a special method of teaching children to swim was denied trade secret status because it had been taught openly for some time. "[S]ome variation of the swim, float, swim method is known both inside and outside the children's aquatic business. Although ISR took precautions to guard the secrecy of the information, it did not do so until at least 1996, after hundreds of instructors had been trained and thousands of students taught. ISR did, eventually, advise its independent contractors and employees of the existence of a trade secret. However, ISR did not limit access to a need-to-know basis, and did not control access to locations where the information may be learned. For example, parents and bystanders were allowed to watch and videotape lessons."[79]

3. Therefore a program designed to maintain secrecy is not only good policy, it is essential to qualify for statutory coverage. If these efforts are not made, a company's trade secret protection can evaporate.

   a) Elaborate security procedures almost always meet the statutory requirement because they show an intention to maintain secrecy and serious efforts to accomplish it, even if they may ultimately be unsuccessful.

      (1) One secrecy program a court found sufficient "included (1) extensive internal controls (e.g., visitor logs, sign-out sheets for proprietary documents and a document destruction policy), (2) availability and required use of locked storage cabinets in the engineering department and (3) strict security control measures with respect to documents which necessarily had to be made available to third party vendors or subcontractors," and a policy that engineering notes and detailed plans and drawings used in the manufacturing process never be made available to third parties.[80]

      (2) In another approved program, a company implemented a policy to "divulge … confidential and proprietary information to its … employees only as is necessary for them to effectively carry out their specific duties. The sales, customer and employee information for one branch office is not generally revealed to any other branch employees. As to any information revealed to such employees, the employees are told of the confidential and proprietary nature of such information. Access to

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79 *Harvey Barnett, Inc. v. Shidler*, 143 F.Supp.2d 1247, 1252 (D.Colo. 2001) (applying Colorado version of UTSA).

80 *Vacco Industries, Inc. v. Van Den Berg*, 5 Cal.App.4th 34, 42 and n.3 (1992).

such customer information was divulged to employees only on an 'as needed basis' to perform their duties and was limited to the branch office [where they] worked. Furthermore, employees were advised of its confidentiality."[81]

(3) In the Church of Scientology case, "RTC's president describes elaborate means taken to ensure the confidentiality of the Advanced Technology works, including use of locked cabinets, safes, logging and identification of the materials, availability of the materials at only a handful of sites worldwide, electronic sensors attached to documents, locked briefcases for transporting works, alarms, photo identifications, security personnel, and confidentiality agreements for all of those given access to the materials."[82]

(a) Where the Church of Scientology distributed its trade secret material to thousands of members as part of its ministry, but required an undertaking of confidentiality from all of them, the wide dissemination of the information did not vitiate its trade secret protection.[83]

b) Programs need not be as extensive as this to qualify under the statute. But some affirmative measures have to be taken.[84]

(1) In one case three factors were listed as a reasonable program in the aggregate: the information was stored on computer with restricted access; it was specifically referred to in the confidentiality clause of its employment contract; the employee handbook contained an express statement forbidding post-employment disclosure.[85]

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81 *Courtesy Temporary Service, Inc. v. Camacho*, 222 Cal.App.3d 1278, 1288 (1990).

82 *Religious Technology Center v. Netcom On-Line Communication Services*, Inc., 923 F.Supp. 1231, 1254 (N.D.Cal. 1995) (applying California version of UTSA).

83 *Ibid.* The court noted that that fact "makes this a rather unusual trade secrets case. However, because parishioners are required to maintain the secrecy of the materials, the court sees no reason why the mere fact that many people have seen the information should negate the information's trade secret status. * * * While it is logically more likely that a secret will leak out when more people are entrusted with it, absent evidence of leakage the court finds that giving out the secrets to a large number of people, though no more than necessary, is not itself an unreasonable security step." *Ibid.*

84 See *Jackson v. Hammer*, 274 Ill.App.3d 59, 67-68 (1995).

85 See *Morlife, Inc. v. Perry*, 56 Cal.App.4th 1514, 1523 (1997).

(2) Courts have held that "[r]equiring employees to sign confidentiality agreements is a reasonable step to insure secrecy."[86] But a company would be unwise to rely on confidentiality agreements alone as a sufficient secrecy program. More suggestions follow in section V below ("Best Practices").

c) Nevada provides by statute that "[t]he owner of a trade secret is presumed to make a reasonable effort to maintain its secrecy if the word 'Confidential' or 'Private' or another indication of secrecy is placed in a reasonably noticeable manner on any medium or container that describes or includes any portion of the trade secret. This presumption may be rebutted only by clear and convincing evidence that the owner did not take reasonable efforts to maintain the secrecy of the trade secret."[87]

4. Even if a trade secret is not sufficiently protected to qualify for statutory coverage, revealing it after a contractual promise not to do so is still actionable. But because of the remedies available under the statute, its protection should be retained if possible.

F. <u>Other points</u>

1. The more secretly the information is held within the company, the more security precautions have been taken to protect it, the more it cost the company to acquire and develop the information, and the more value it has to a competitor, the more likely the information is to be a trade secret. The more people within the company who know the information, the more access the public and competing companies have to it, and the easier it is to duplicate and transport, the less likely it is to be a trade secret.[88]

2. "The efforts required to maintain secrecy are those 'reasonable under the circumstances.' The courts do not require that extreme and unduly expensive procedures be taken to protect trade secrets against flagrant industrial espionage. It follows that reasonable use of a trade secret including controlled

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86 *Whyte v. Schlage Lock Co*. 101 Cal.App.4th 1443, 1454 (2002); *MAI Systems Corp. v. Peak Computer, Inc*., 991 F.2d 511, 521 (9th Cir. 1993) (applying California version of UTSA).

87 Nevada Revised Statutes Annotated § 600A.032.

88 See William G. Porter II and Michael C. Griffaton, "Identifying and Protecting Employers' Interests in Trade Secrets and Proprietary Information," 68 Defense Counsel Journal 439, 440-441 (2001).

disclosure to employees and licensees is consistent with the requirement of relative secrecy."[89]

3. Trade secrets and other confidential information can be protected even if they are not in writing but reside in the employee's memory.[90]
4. "[B]eing the first person to develop and introduce a product into the market does not guarantee possession of a trade secret."[91]
5. Although "a former employee may use general knowledge, skill, and experience acquired in his or her former employment in competition with a former employer, the former employee may not use confidential information or trade secrets in doing so."[92]
6. It used to be thought that only information positively and continuously used in a company's business could qualify as a trade secret. But it is now accepted in UTSA jurisdictions that "negative" information or research – knowledge of what does not work – can also be covered.[93]

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89 UTSA, Comment to § 1 (citation omitted); Senate Comment (1984) to California Civil Code § 3426.1; and see, e.g., *Network Communications, Inc. v. Boor-Crepeau*, 790 P.2d 901, 902 (Colo.App. 1990) (echoing Comment).

90 See *Morlife, Inc. v. Perry*, 56 Cal.App.4th 1514, 1522 (1997); see also, e.g., *Stampede Tool Warehouse, Inc. v. May*, 272 Ill.App.3d 580, 590 (1995): "A trade secret can be misappropriated by physical copying or by memorization. There was substantial evidence that defendants misappropriated the customer list either through copying down names or through memorization. In fact, defendants admitted that they redeveloped their customer lists by remembering the names and locations of at least some of their … customers. Using memorization to rebuild a trade secret does not transform that trade secret from confidential information into non-confidential information. The memorization is one method of misappropriation."

91 *Hutchison v. KFC Corp.*, 883 F.Supp. 517, 521 (D.Nev. 1993) (applying Nevada version of UTSA); see also *Southwest Whey, Inc. v. Nutrition 101, Inc.*, 117 F.Supp.2d 770, 777 (CD.Ill. 2000) (applying Illinois version of UTSA): "[M]erely being the first or only one to use certain information does not alone turn what is otherwise general knowledge into a trade secret. Otherwise, no matter how ordinary or well known the information, the first person to use it would be able to obtain the protection of the statute."

92 *Morlife, Inc. v.* Perry, 56 Cal.App.4th 1514, 1519 (1997). See also, e.g., *American Red Cross v. Palm Beach Blood Bank, Inc.*, 143 F.3d 1407, 1410 (11th Cir. 1998) ("employer may not preclude its former employee from utilizing contacts and expertise gained during his former employment") (applying Florida version of UTSA).

93 See, e.g., *Courtesy Temporary Service, Inc. v. Camacho*, 222 Cal.App.3d 1278, 1287 (1990); *Morton v. Rank America, Inc.*, 812 F.Supp. 1062, 1073 (C.D.Cal. 1993) (applying California version of UTSA). This is one of the areas where the UTSA superseded the rule of the first Restatement of Torts. See text at note 149 below.

7. What a company or even a contract calls this information is not necessarily dispositive. The tests in the statute and the case law, and the actual conduct of the company where relevant, govern whether information is or is not a trade secret.[94]

8. Where special procedures are used, they must be used consistently. In at least one case where "confidential – do not distribute" stamps were used for some material but not for others, this was taken as evidence that the others were not treated as trade secrets.[95]

9. "The maintenance of standards of commercial ethics and the encouragement of invention are the broadly stated policies behind trade secret law."[96]

III. WHAT IS MISAPPROPRIATION OF A TRADE SECRET?

A. Definition

1. As epitomized in a recent case, misappropriation is "improper acquisition of a trade secret or its nonconsensual use or disclosure."[97]

2. The UTSA approach focuses at the threshold on whether the information at issue meets the statutory definition of a trade secret, and only then turns to the question of misappropriation.

   a) "In defining the existence of a trade secret as the threshold issue, we first focus upon the 'property rights' in the trade secret rather than on the existence of a confidential relationship. We recognize that the confidential relationship is also a prerequisite to an action for misappropriation, and that the elements of trade secret status and the confidentiality of the relationship should not be artificially separated for purposes of analysis since, in a significant sense, they are interdependent. However, without the finding of a trade secret, we cannot grant relief …. Otherwise this court would come dangerously close to expanding the trade secrets act into a catchall for industrial torts."[98]

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94 See *State Farm Mutual Automobile Ins. Co. v. Dempster*, 174 Cal.App.2d 418, 426 (1959).

95 See *In re Providian Credit Card Cases*, 96 Cal.App.4th 292, 308 (2002).

96 *Kewanee Oil Co. v. Bicron Corp*., 416 U.S. 470, 481 (1974); accord, e.g., *Amoco Production Co. v. Laird*, 622 N.E.2d 912, 921 (Ind. 1993) (quoting case); *Religious Technology Center v. Wollersheim*, 796 F.2d 1076, 1089 (9th Cir. 1986) (same).

97 *Whyte v. Schlage Lock Co*., 101 Cal.App.4th 1443, 1457 (2002).

98 *Electro-Craft Corp. v. Controlled Motion, Inc*., 332 N.W.2d 890, 897 (Minn. 1983) (citations and quotation apparatus omitted).

3. The statutory definition on which this epitome rests seems at first forbiddingly complex.

   a) UTSA defines *misappropriation* as meaning: "(i) acquisition of a trade secret of another by a person who knows or has reason to know that the trade secret was acquired by improper means; or (ii) disclosure or use of a trade secret of another without express or implied consent by a person who (A) used improper means to acquire knowledge of the trade secret; or (B) at the time of disclosure or use, knew or had reason to know that his or her knowledge of the trade secret was (I) derived from or through a person who had utilized improper means to acquire it; (II) acquired under circumstances giving rise to a duty to maintain its secrecy or limit its use; or (III) derived from or through a person who owed a duty to the person seeking relief to maintain its secrecy or limit its use; or (C) before a material change of his [or her] position, knew or had reason to know that it was a trade secret and that knowledge of it had been acquired by accident or mistake."[99]

   b) The law defines *person* as meaning not only a natural person but also a "corporation, business trust, estate, trust, partnership, association, joint venture, government, governmental subdivision or agency, or *any other legal or commercial entity*."[100]

   c) The law defines *improper means* as including "theft, bribery, misrepresentation, breach or inducement of a breach of a duty to maintain secrecy, or espionage through electronic or other means."[101]

      (1) Reverse engineering and independent invention are not improper means of acquiring the information.[102]

         (a) Reverse engineering means "starting with the known product and working backward to divine the process which aided in its development or manufacture."[103]

      (2) Discovery under a license, by observation of the item in public use or on public display, and by a survey of the published literature are also proper means of acquiring the information.[104]

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99 UTSA § 1(2) (brackets in original); see also identical language in California Civil Code §3426.1(b).

100 UTSA § 1(3) (emphasis added); Civil Code § 3426.1(c).

101 UTSA § 1(1); California Civil Code § 3426.1(a) adds "limited liability company."

102 UTSA, Comment to § 1; California Civil Code § 3426.1(a).

103 *Kewanee Oil Co. v. Bicron Corp.*, 416 U.S. 470, 476 (1974).

(3) "Because a trade secret need not be exclusive to confer a competitive advantage, different independent developers can acquire rights in the same trade secret."[105]

(4) "The law of trade secrets will not protect talent or expertise, only secret information."[106] Thus the personalities of individual reporters were not subject to trade secret protection

4. If we mix and match phrases from these definitions to suit specific circumstances, the definitions become clearer.

a) Thus the paradigmatic case of an employee who is trusted with secrets in the course of her employment and later takes them to a new employer is covered by the language of the statute forbidding "disclosure … of a trade secret of another without … consent by a person who … at the time of disclosure … knew or had reason to know that his or her knowledge of the trade secret was … acquired under circumstances giving rise to a duty to maintain its secrecy or limit its use."

(1) It is also covered by the definition of "improper means" as including "breach of a duty to maintain secrecy."

b) Similarly, a new employer's use of a misappropriated secret is also misappropriation, *if* s/he knows *or has reason to know* of the circumstances of its acquisition. This is covered by the phrase "disclosure *or use*," and by the ban on acquisition of information acquired by improper means.[107]

(1) "Employing the confidential information in manufacturing, production, research or development, marketing goods that embody the trade secret, or soliciting customers through the use of trade secret information, all constitute use."[108]

(*footnote continues…*)

104 UTSA, Comment to § 1; Senate Comment (1984) to California Civil Code § 3426.1.

105 UTSA, Comment to § 1.

106 *Electro-Craft Corp. v. Controlled Motion, Inc.*, 332 N.W.2d 890, 900 (Minn. 1983). See also, e.g., *Dynamics Research Corp. v. Analytic Sciences Corp.*, 9 Mass.App.Ct. 254, 274-75 (1980) (engineering management system really involved talent of consultants, not information, so not a trade secret); *Metro Traffic Control, Inc. v. Shadow Traffic Network*, 22 Cal.App.4th 853, 862 (1994) ("stable of trained and talented at-will employees does not constitute an employer's trade secret").

107 See, e.g., *PMC, Inc. v. Kadisha*, 78 Cal.App.4th 1368, 1383 (2000).

108 *Ibid.*

c) Likewise the statute explicitly covers "acquisition of a trade secret … by a person who … has reason to know that the trade secret was acquired by … espionage."

d) The UTSA statutory language is capable of many other permutations. Close study of the statutory definitions will show that they contain combinations of phrases to cover almost every circumstance.

e) Carelessness has led some courts to treat business use by the misappropriator (or even use *to the plaintiff's injury*) as an element of the tort.[109]

(1) Actually the language of UTSA § 1(2) is considerably broader than that.

(2) The correct view is that "in making a claim for misappropriation of a trade secret, [a] plaintiff need not show that the defendant actually used the secret. The extent to which [the defendant] actually employed the trade secrets becomes appropriate when determining damages."[110]

(3) The misappropriator need not even gain any advantage from disclosure of trade secret. It is enough to show disclosure by one who knew or should have known of a duty no to do so.[111]

f) The UTSA "prohibits the improper acquisition of a trade secret, whether or not the secret is used in direct competition with the rightful owner. This is so because the value of the trade secret as an asset of the company is diminished by its disclosure, whether or not the person acquiring it uses it competitively."[112]

B. <u>Other points</u>

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109 See, e.g., *Leggett & Platt, Inc. v. Hickory Springs Mfg. Co*., 285 F.3d 1353, 1360 (Fed. Cir. 2002) (footnote omitted) (holding that Illinois version of UTSA requires that information be secret, misappropriated, and "used in the defendants' business"); *Microbix Biosystems, Inc. v. Biowhittaker, Inc*., 172 F.Supp.2d 665, 672 (D.Md. 2000) (same for Illinois version); *Utah Medical Products, Inc. v. Clinical Innovations Associates, Inc*., 79 F.Supp.2d 1290, 1311 (D.Utah 1999) (holding on basis of earlier Utah authority that use to plaintiff's injury is element of tort). Examples could be multiplied.

110 *EFCO Corp. v. Symons Corp*., 219 F.3d 734, 741 (8th Cir. 2000) (citations to Iowa version of UTSA omitted).

111 See *Religious Technology Center v. Netcom On-Line Communication Services, Inc*., 923 F.Supp. 1231, 1257 n.31 (N.D.Cal. 1995) (applying California version of UTSA).

112 *Smithfield Ham and Products Co., Inc. v. Portion Pac, Inc*., 905 F.Supp. 346, 350 (E.D.Va. 1995) (citations omitted) (applying Virginia version of UTSA).

1. To constitute misappropriation under the UTSA, under most circumstances the information has to have been acquired improperly.
   a) "A trade secret is simply a piece of information the value of which to the creator of the information depends on its not being generally known. It is not a property right in the sense that a patent is, for it is perfectly lawful for a competitor to buy a product embodying a trade secret and unmask the secret by reverse engineering. Only if the competitor (or anyone else for that matter) discovers the secret by breaking a contract or engaging in other unlawful or improper conduct can the individual or firm whose secret it was obtain a remedy."[113]
   b) "[A] contractual or confidential relationship is not required to maintain a trade secret action[;] … a plaintiff may prevail in the absence of such a relationship by showing that the secret was obtained by improper means."[114] In particular, no explicit confidentiality agreement is necessary to make an appropriation improper or unlawful under the UTSA.[115]
2. "Because the trade secret can be destroyed through public knowledge, the unauthorized disclosure of a trade secret is also a misappropriation."[116] Under the UTSA, disclosure of a trade secret is actionable even without use.[117]
3. Even though the statute protects the secrets "of another," a joint owner of a trade secret can nevertheless misappropriate it.[118]
4. In UTSA jurisdictions, the fact that "information is 'readily ascertainable' is not part of the definition of a trade secret [… but] is available as a defense … based upon an absence of misappropriation, rather than the absence of a trade secret."[119]

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113 *Micro Data Base Systems, Inc. v. Dharma Systems, Inc.*, 148 F.3d 649, 657 (7th Cir. 1998) (citations omitted) (applying Indiana version of UTSA).

114 *Pioneer Hi-Bred International v. Holden Foundation Seeds, Inc.*, 35 F.3d 1226, 1238 (8th Cir. 1994) (applying Iowa version of UTSA).

115 See *Perdue Farms Inc. v. National Union Fire Ins. Co. of Pittsburgh*, 197 F.Supp.2d 370, 382 n.20 (D.Md. 2002) (applying Florida version of UTSA).

116 Senate Comment (1984) to California Civil Code § 3246(1).

117 See *Intermedics, Inc. v. Ventritex, Inc.*, 822 F.Supp. 634, 654 (N.D.Cal. 1993) (applying California version of UTSA). As noted, some states nevertheless require use. See discussion at section II.A.4.e above.

118 See *Morton v. Rank America, Inc.*, 812 F.Supp. 1062, 1074-1075 (C.D.Cal. 1993) (applying California version of UTSA).

119 *Imax Corp. v. Cinema Technologies, Inc.*, 152 F.3d 1161, 1168 n.10 (9th Cir. 1998) (citation and quotation apparatus omitted) (applying California version of UTSA).

IV. SOURCES OF THE LAW OF TRADE SECRETS

A. Unlike some civil rights protections, which were created by statute, protection for trade secrets has existed for generations under the common law. The National Conference of Commissioners on Uniform State Laws began working on a uniform trade secrets law in 1968; for reasons now of only historical importance it did not finish until 1979.[120] The actual authors were a committee of lawyers, judges and law professors; the final adoption was done by the Commissioners, who are appointed by the states.[121]

1. The UTSA "does not … represent a major deviation from the … common law of unfair trade practices. [It] mostly codifies rather than modifies the common law doctrine that preceded it."[122] "The Uniform Act codifies the basic principles of common law trade secret protection, preserving its essential distinctions from patent law."[123]

2. The purpose of the UTSA, as with the uniform laws on many other subjects, is "to make uniform the law with respect to [trade secrets] among states enacting it."[124]

   a) As of this writing 44 states have adopted the UTSA in more or less the same form.[125]

   b) This means that court decisions over most of the country are interpreting more or less the same provisions, and so can be persuasive authority across state lines.[126] California adopted the UTSA in 1984, effective in 1985.

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120 See UTSA, Prefatory Note, 14 U.L.A. 435-436. The UTSA was amended in 1985.

121 For more on the Commission and how it works, see Walter P. Armstrong, Jr., A CENTURY OF SERVICE: A CENTENNIAL HISTORY OF THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS (West 1991).

122 *PepsiCo, Inc. v. Redmond*, 54 F.3d 1262, 1269 (7th Cir. 1995) (citations omitted) (holding earlier case survived Illinois adoption of UTSA).

123 UTSA, Prefatory Note, 14 U.L.A. 434.

124 UTSA § 8; and see, e.g., California Civil Code § 3426.8 (same); Indiana Code § 24-2-3-1(b) (same); see also *Flavorchem Corp. v. Mission Flavors and Fragrances, Inc*., 939 F.Supp. 593, 595 (N.D.Ill. 1996): "Both the Illinois Act and the California Act are intended to safeguard intellectual property and business information by codifying, and eliminating inherent inconsistencies in, the existing common law relating to trade secrets."

125 See 14 U.L.A. 433 (1990) and Supp. (2002) at 182-183. The District of Columbia counts as a state for this purpose.

126 See, e.g., *Auto Channel, Inc. v. Speedvision Network, LLC*, 144 F.Supp.2d 784, 788 (W.D.Ky. 2001) (because Kentucky Uniform Trade Secrets Act is based on uniform law, "decisions in other

(*footnote continues* →)

(1) When a case presents a choice of law question, the similarity of the laws in UTSA jurisdictions can make a decision on the point unnecessary.[127]

c) Federal courts generally apply state law in civil cases about trade secrets, which makes their decisions also persuasive in interpreting the Uniform Law, and heightens its unifying effect. As a result there is close to a national consensus on the protection of trade secrets.

d) Of course there are local differences. Every state adopting the UTSA does so as a sovereign act of its own legislature, and usually there are some changes.[128]

(1) These can be as small as changing the numeration of subparagraphs[129] or substituting "must be" for "shall be."[130] Sometimes material from the UTSA's official comments is put into the body of the statute.[131]

(2) Or they can be major substantive additions[132], or omissions[133], or state law may provide for significant variations in policy from that endorsed by the Commissioners or found at common law.[134] In some instances

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(*footnote continues…*)

jurisdictions provide guidance for its application and construction"). Accord, e.g., *World Wide Prosthetic Supply, Inc. v. Mikulsky*, 640 N.W.2d 764, 767, 251Wis.2d 45 (2002).

127 See, e.g., *Motor City Bagels, L.L.C. v. American Bagel Co*., 50 F.Supp.2d 460, 478 (D.Md. 1999) (applying Maryland version of UTSA where Virginia version might have been chosen).

128 The examples which follow are only illustrative and not exhaustive.

129 Compare, e.g., UTSA § 1(1) with Nevada Revised Statutes § 600A.030.

130 Compare UTSA § 2(a) with Montana Code Annotated 30-14-403(1) ("injunction must be terminated").

131 See, e.g., Georgia Code Annotated § 10-1-761(1), adding the language that reverse engineering or independent development is not an improper means for acquiring secret information. Other states make the same addition.

132 For example, Nevada's provision that prominent placement of the words "confidential" or "private" raises a rebuttable presumption of reasonable efforts to maintain secrecy, see Nevada Revised Statutes Annotated § 600A.032, or South Carolina's statutory incorporation of trade secret protection for secret combinations of known elements, see South Carolina Code (1976) § 39-8-20(5)(b).

133 For example, Alaska, Idaho, Missouri, Nebraska and Vermont omit attorney fees for a bad faith claim of "willful and malicious misappropriation," and Connecticut omits the last-stated ground.

134 For example, Nevada provides that under some circumstances a misappropriated trade secret posted on the Internet does not lose its status as a secret. See Nevada Revised Statutes § 600A.055. California provides that a royalty may be substituted for damages only if no actual loss or unjust enrichment are "provable," see California Civil Code § 3426.3(b), while § 3(a) of

(*footnote continues* →)

states adopting the original UTSA text did not adopt the 1985 amendment.[135]

(3) Or procedural points may differ.[136]

(4) Two states adopting the UTSA depart from the official text "in such manner that the various instances of substitution, omission, and additional matter cannot be clearly indicated by statutory notes."[137]

(5) Seven states – Massachusetts[138], New Jersey[139], New York[140], North Carolina[141], Pennsylvania[142], Texas[143] and Wyoming[144] – have not

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(*footnote continues…*)

the UTSA provides only that a royalty may be imposed "in lieu of damages measured by any other methods," without requiring a failure of other methods of proof.

135 For example, UTSA § 3(a) now says that "damages can include" both actual loss and unjust enrichment not taken into account in computing loss. The purpose of identifying them separately, with the qualifier on the unjust enrichment, is to prevent double counting. UTSA, Comment to § 3. But damages are a legal remedy and unjust enrichment is an equitable one. The California version of the statute, based on the original version of the UTSA superseded in 1985 but not replaced in state law, puts this better, stating that a complainant "may recover damages for actual loss caused by misappropriation. A complainant may also recover for the unjust enrichment caused by misappropriation that is not taken into account in computing damages for actual loss." California Civil Code § 3426.3(a).

136 For example, the three-year limitations period established by UTSA § 6 is changed to four years in Maine (see Maine Revised Statutes title 10 § 1547) and Ohio (see Ohio Revised Code § 1333.66) and five years in Illinois (see 765 Illinois Compiled Statutes 1065/7) and Georgia (see Georgia Code Annotated § 10-1-766).

137 UTSA, General Statutory Notes, 14 U.L.A. at 436 (Alabama and Wisconsin). See also note 141 below.

138 Massachusetts has its own trade secrets statute – see Massachusetts General Laws, ch. 93, §§ 42-42A. The first American trade secrets case was from Massachusetts, and concerned a secret recipe. The court upheld the claim against a defense of restraint of trade because "it is of no consequence to the public whether the secret art be used by the plaintiff or by the defendant." See *Vickery v. Welch*, 36 Mass. 523, 527 (1837).

139 New Jersey follows the first Restatement of Torts (1939). See *Sun Dial Corp. v. Rideout*, 16 N.J. 252, 257 (1954); accord, *Rohm and Haas Co. v. Adco Chemical Co.*, 689 F.2d 424, 431 (3d Cir. 1982).

140 New York follows the first Restatement of Torts § 757. See note 146 below. "In determining whether a trade secret exists, the New York courts have considered the following factors to be relevant: (1) the extent to which the information is known outside of his business; (2) the extent to which it is known by employees and others involved in his business; (3) the extent of measures taken by him to guard the secrecy of the information; (4) the value of the information to him and to his competitors; (5) the amount of effort or money expended by him in developing the information; (6) the ease or difficulty with which the information could be properly acquired or

(*footnote continues* →)

adopted the UTSA in any form, but use their own statutes or the common law.[145]

(a) In many of these states the Restatement of Torts (1939) is the basis for state trade secrets law.[146] "Courts for the most part have adopted one of two views as to what constitutes a trade secret. One view is

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(*footnote continues…*)

duplicated by others." *Integrated Cash Management Services, Inc. v. Digital Transactions, Inc.*, 920 F.2d 171, 173 (2d Cir. 1990). This epitome of the Restatement definition is echoed in other states. See, e.g., *Space Aero Products Co., Inc. v. R.E. Darling Co., Inc.*, 238 Md. 93, 110 (1965).

141 In his treatise, Melvin Jager lists North Carolina as having adopted the UTSA, see Jager, TRADE SECRET LAW § 51:1. But actually the North Carolina Trade Secrets Protection Act, N.C. General Statutes §§ 66-152 through -157, was a kind of hybrid, based on the UTSA but much simplified. It has not been often construed, but is exhaustively analyzed in David P. Hathaway, *Is The North Carolina Trade Secrets Protection Act Itself a Secret, and Is the Act Worth Protecting*?, 77 North Carolina Law Review 2149 (1999).

142 "Pennsylvania has no version of the Uniform Trade Secrets Act or other civil statute dealing with the protection of trade secrets. The Uniform Trade Secrets Act was introduced in the 1999 legislature as House Bill 897. The bill died in Committee. Instead, the state has one of the most well-developed and strongest body of common law covering trade secret protection. Pennsylvania adheres to the view that a trade secret is a legally protectible 'property' interest." Jager, TRADE SECRET LAW § 56:1.

143 "Texas is one of the large industrial states that has not enacted a version of the Uniform Trade Secrets Act. Instead, the courts have established a trade secret common law that is one of the strongest and well developed in the nation. Texas trade secret law has adopted Section 757 of the Restatement and its definition of trade secrets." Jager, TRADE SECRET LAW § 61:1.

144 "Wyoming does not have a version of the Uniform Trade Secrets Act. The definition of a trade secret developed in the Wyoming common law is the same as followed in the common law of other states." Jager, TRADE SECRET LAW § 68:1. "There is a paucity of Wyoming state cases defining the remedies available in a trade secret case." *Id.* at 68:2.

145 See Table of Jurisdictions in 14 U.L.A., Supp. at 182 (2002). Melvin Jager's treatise TRADE SECRET LAW, available on Westlaw, contains a very detailed state-by-state analysis of the trade secrets law of every state.

146 "To date, the courts in New York uniformly follow the concepts and definitions of trade secret protection set forth in Section 757 of the First Restatement of Torts. Trade secrets are not addressed in the Second Restatement of Torts. The Commissioners believed that the subject no longer belonged in the Restatement of Torts but was more appropriately included in a restatement of unfair competition and trade regulation. The modern rules for the trade secrets common law were presented in the 1995 Restatement, (3d) of Unfair Competition (see §§ 3:5 to 3:26)." Jager, TRADE SECRET LAW, § 50:1 (Footnotes omitted).

found in the Restatement of Torts; the other is found in the Uniform Trade Secrets Act."[147]

(b) Although the Restatement, like the UTSA, built upon the common law and purported to synthesize it, it differed from the UTSA in a number of ways. For example, it required that a trade secret be "continuously used" in the owner's business to qualify for protection,[148] and provide an advantage to the possessor. The UTSA abandoned these rules because they do not protect secrets not yet used, or negative research about what does not work.[149]

(c) Where the Restatement presents a narrower rule than UTSA courts applying UTSA consider it superseded.[150] But even where the rules no longer coincide, Restatement principles "still provide helpful guidance."[151]

(6) State laws unrelated to the UTSA can also have an important effect in this area. An important example is California's policy against enforcement of non-compete agreements. See section V.D.6 below.

e) In case of conflict usually a state version of the UTSA prevails over earlier state law.[152] But if the state uniform law has no provision on a given point

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147 *Optic Graphics, Inc. v. Agee*, 87 Md.App. 770, 782 (1991) (citations omitted).

148 See UTSA, Comment to § 1.

149 See UTSA, Comment to § 1: "The definition of 'trade secret' contains a reasonable departure from the Restatement of Torts (First) definition which required that a trade secret the "continuously used in one's business." The broader definition in the [UTSA] extends protection to a plaintiff who has not yet had an opportunity or acquired the means to put a trade secret to use. The definition includes information that has commercial value from a negative viewpoint, for example the results of lengthy and expensive research which proves that a certain process will *not* work could be of great value to a competitor." (Emphasis in original.) For practical examples see, e.g., *Courtesy Temporary Service, Inc. v. Camacho*, 222 Cal.App.3d 1278, 1287 (1990); *Morton v. Rank America, Inc.*, 812 F.Supp. 1062, 1073 (C.D.Cal. 1993) (applying California version of UTSA).

150 See *Optic Graphics, Inc. v. Agee*, 87 Md.App. 770, 783 (1991).

151 *Id.* at 784. See, e.g., *Basic American, Inc. v. Shatila*, 133 Idaho 726, 735, 992 P.2d 175, 184 (1999) (citing *Optic Graphics* and applying Restatement factors).

152 See, e.g., *American Credit Indemnity Co. v. Sacks*, 213 Cal.App.3d 622, 630 (1989): "In the event of a conflict between prior case law and the statute, the UTSA controls." For this principle in action see, e.g., *Cacique, Inc. v. Robert Reiser & Co., Inc.*, 169 F.3d 619 (9th Cir. 1999) (permitting recovery of a royalty not allowed under prior law); *Morlife, Inc. v. Perry*, 56 Cal.App.4th 1514, 1527 (1997) (holding case decided before adoption of UTSA inapposite because superseded by statute). In *State ex rel. Besser v. Ohio State University*, 87 Ohio St.3d 535, 541 (2000), the Ohio Supreme Court abrogated its decision of only a few years earlier (in

(*footnote continues* →)

the earlier law still applies. As the UTSA restates many common law principles, pre-adoption precedents are still often used in cases decided under state uniform laws.[153]

3. In addition to the UTSA, a party whose trade secrets have been misappropriated can sometimes recover under other state laws. Of special importance in Silicon Valley is the California Unfair Business Practices Act ("CUBPA")[154] This law extends to "any unlawful, unfair or fraudulent business act."[155] "The California Legislature intended this sweeping language to include anything that can properly be called a business practice and that at the same time is forbidden by law,"[156] including activity forbidden by the UTSA. Aggrieved parties routinely sue under this law as well the UTSA. Although private damages are not recoverable under CUBPA, disgorgement is, and suing under CUBPA has technical advantages which are beyond the scope of these materials.

   a) "Thus, even if Courtesy's customer list would not qualify as a trade secret under [the California Trade Secrets Act], the unfair and deceptive practices of employees in stealing Courtesy's customers should have been enjoined" under CUBPA.[157]

4. Although misappropriation of trade secrets is itself an intentional tort,[158] the same conduct is often tortious for other reasons as well. Thus, absent a limiting provision in the UTSA, aggrieved parties could sue on additional tort theories. However, the UTSA provides that it "displaces conflicting tort, restitutionary, and other law of this State providing civil remedies for misappropriation of a trade secret."[159] Contractual remedies, other civil

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(*footnote continues…*)

State ex rel. Toledo Blade Co. v. University of Toledo Foundation, 65 Ohio St.3d 258, 264 (1992)) because the intervening adoption of the UTSA had changed the governing law.

153 See, e.g., *Dicks v. Jensen*, 172 Vt. 43, 46-47 (2001): "[B]ecause the Uniform Act codifies the basic principles of common law trade secret protection, cases decided in the absence of a statute are also relevant." (Citation omitted).

154 California Business & Professions Code §§ 17200 *et seq*.

155 California Business & Professions Code § 17200.

156 *Ballard v. Equifax Check Services, Inc*., 158 F.Supp.2d 1163, 1176 (E.D.Cal. 2001).

157 *Courtesy Temporary Service, Inc. v. Camacho*, 222 Cal.App.3d 1278, 1291 (1990).

158 See *PMC, Inc. v. Kadisha*, 78 Cal.App.4th 1368, 1382 (2000); see also, e.g., *Cockerham v. Kerr-McGee Chemical Corp*., 23 F.3d 101, 105 (5th Cir. 1994) ("actionable wrong") (stating Mississippi law).

159 UTSA § 7(a)

remedies not based on misappropriation, and criminal remedies are excluded from this displacement.[160]

a) This makes the civil remedies for misappropriation of trade secrets exclusive remedies.[161]

b) This is not true in every jurisdiction. Some states omit this provision altogether.[162] In Connecticut the displacement can be overriden by agreement of the parties.[163] And California provides instead that the UTSA "does not supersede any statute relating to misappropriation of a trade secret, or any statute otherwise regulating trade secrets."[164]

   (1) As a result the UTSA remedies are cumulative in California, and plaintiffs have sued on additional grounds, for example interference with prospective economic advantage and breach of a confidential or fiduciary relationship.[165]

c) The law is unsettled as to whether an action for breach of fiduciary relationship is permitted under UTSA § 7.[166]

5. Companies typically require some form of non-disclosure agreement when exposing their trade secrets to employees or others. See discussion at section V.D.5 below. These agreements can form the basis for a contract action even where the elements of a state trade secrets act violation or other tort cannot be proved.

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160 UTSA § 7(b).

161 See, e.g., *Leggett & Platt, Inc. v. Hickory Springs Mfg. Co.*, 132 F.Supp.2d 643, 649 (N.D.Ill. 2001) (Illinois version of UTSA preempted tort claim), *affd*, *rev'd in part on other grounds* 285 F.3d 1353 (Fed.Cir. 2002); *Del Monte Fresh Produce Co. v. Dole Food Co., Inc.*, 136 F.Supp.2d 1271, 1291 (S.D.Fla. 2001) ("Florida's Uniform Trade Secret Act displaces tort law regarding trade secret misappropriation")..

162 Iowa, Nebraska and New Mexico do not have this provision.

163 See Connecticut General Statutes Annotated § 35-57(a).

164 California Civil Code § 3426.7(a). A saving clause reads "except as otherwise provided " *Ibid*.

165 For a case alleging these torts as well as a CTSA violation, unfair competition, and breach of the implied covenant of good faith and fair dealing, see *Courtesy Temporary Service, Inc. v. Camacho*, 222 Cal.App.3d 1278 (1990).

166 Compare *Boeing v. Sierracin Corp.*, 108 Wash.2d 38, 48 (1987) (yes: proof of trade secrets is not required for breach of confidentiality claims, so they may be brought independently of trade secrets claims) with *Thomas & Betts Co. v. Panduit Corp.*, 108 F.Supp.2d 968, 972 (N.D.Ill. 2000) (no: breach of fiduciary duty claim pre-empted by Illinois Trade Secrets Act).

a) A contract may cover confidential material which does not technically qualify as a trade secret, such as confidential lists which do not derive independent economic value from secrecy.

b) A contract can also specify remedies not available under the statute or tort law, but enforceable by agreement. It can also provide for liquidated damages, choice of law, and settlement of disputes by arbitration.

6. Finally, there are criminal penalties for misappropriation of trade secrets. These include the state criminal laws against theft of trade secrets,[167] and the federal Economic Espionage Act of 1996.[168]

a) The existence of criminal penalties is a powerful deterrent to misconduct, effective sometimes where the threat of a civil action might not be. It is legitimate to take advantage of this deterrent, which exists to protect the rights of ownership, and employers and other proprietors of trade secrets should mention them when warning of the consequences of misappropriation. However, it is dangerous for anyone, and unethical for an attorney, to threaten to instigate a criminal prosecution to gain advantage in a civil dispute.[169] The criminal statutes should therefore be mentioned only in a cautious and deliberate fashion.

V. BEST PRACTICES FOR EMPLOYERS

A. <u>Put all policies into writing</u>

1. To be effective a trade secrets policy should be in writing. Counsel should assume primary responsibility for writing the policy, with input from Human Resources and the line managers who control the storage and use of the company's secrets.

2. The policy should cover not only technical secrets but commercial secrets (such as customer lists and marketing plans) as well.

3. Someone in the company should be specifically designated to be responsible for implementing and enforcing the policy, and making sure it doesn't become lax.

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[167] For example the California Theft of Trade Secrets Act, California Penal Code § 499c, augmented in felony thefts above $50,000 in value by the California Economic Crime Act of 1992, California Penal Code § 1203.044.

[168] 18 U.S.C. §§ 1831-1839.

[169] See, e.g., California Rules of Professional Conduct 5-100(A).

a) Just assuming that Human Resources, or the line department working with the secrets, is “responsible for” protecting the company’s secrets will not work.

b) Likewise assuming that the mere existence of a written policy, or of signed confidentiality agreements, or even of a corporate culture of loyalty, will protect these secrets probably will not work either.

c) Whoever is selected for this function should work closely with counsel.

4. The diligence with which the policy is implemented and followed up can determine the outcome in later legal actions, where the company’s efforts to protect its secrets may become a key issue.

a) A trade secrets policy is like a sexual harassment policy in this way: adopting the policy is essential, but unless once adopted it is taken seriously by management in concrete and provable ways, and is seen to be so by the employees, it may be insufficient either to prevent abuses or protect the company’s position in later litigation.

B. <u>Role of counsel in establishing best practices</u>

1. Counsel should provide Human Resources and department managers with a detailed list of best practices, to govern their handling of procedures which could affect the company’s secrets. For Human Resources these concentrate on critical stages in an employee’s career with the company, from initial interview through periodic reviews until departure. For other managers they concentrate on procedures for protecting the company’s secrets and learning when secrecy has been compromised.

2. Although the front-line responsibility for *implementing* these policies usually lies with others, counsel is responsible:

a) for *devising* them (ideally in cooperation with the managers who will apply them),

b) for *drafting* the many forms and acknowledgements they use,

c) for *codifying* them into checklists that lay managers can use effectively,

d) for *impressing* on Human Resources and the department managers the importance to the company of following these procedures with scrupulous care, and

e) if necessary, *obtaining the backing of executive management* for a system including these practices.

f) These responsibilities are similar to counsel’s duties in many compliance areas, again like sexual harassment policies, where counsel understands the need for the policies and the steps needed to implement them and must ensure that the policies are put in place and followed. While counsel is unlikely to encounter institutional opposition, as s/he might in areas like sexual harassment, there will be inertia and counsel must overcome it in service to her client.

3. The following four sections will provide a framework for the checklists to be provided as appropriate to Human Resources and department managers.

C. Steps to take before an employee is hired

1. Pay attention to trade secrets issues at the interview, before a hiring decision is made.

a) The interviewer should *first* explain the policy of the company (and of the law) that it may not improperly acquire another company's trade secrets. *Then* the interviewer should inquire what secrets the candidate knows and how s/he obtained them.

(1) The explanation must come first, or else it may appear as if the candidate is being considered *because* of her knowledge of trade secrets rather than *despite* that knowledge.

(2) Obviously any inquiry about the candidate's knowledge of trade secrets must be done in general terms only – the secrets should be *identified*, but not *explained*. Thus a candidate may say s/he knows the recipe for the secret sauce, but not what the ingredients are.

b) One reason for needing to know what a candidate knows is to decide: Can s/he do the job we want her for, without using forbidden knowledge?

(1) No one can deliberately forget what s/he knows. If it would be difficult for the candidate to do the job the new company wants her for without using the old company's secrets, then perhaps s/he is not a suitable candidate.

(a) This may be easier with commercial secrets than with technical ones – a person can make a product using the new company's existing technology without revealing the old company's techniques, but it may be harder to fill a sales position without using contact information developed for the old employer.

(b) But possessing an old employer's technical secrets can also put an employee in a difficult position. A person can make a product with existing technology, but if the job is not to make the product but improve its design it may become hard to do this when the employee knows a way to improve it which s/he cannot reveal.

(c) One way out would be to place the new employee in a department or with a product line which does not involve these specific secrets.

(d) If the candidate is part of a "pack," all of whom are being recruited from the same company to work in the same general area, that should signal danger.

(i) Can the members of the pack be spread out among differing departments and projects?

(ii) Can the suspicion of improper corporate raiding be refuted? See subsection 3 below.

(e) It is important to distinguish between an employee's professional skills and trade secrets.

c) If a decision is made to offer the candidate a position, try to schedule her departure *before* a key meeting in which s/he will learn more secrets. Knowingly waiting until afterward can raise concerns which may be hard to answer later.

2. With some adaptations, similar steps should be considered for contractors, consultants, and others who may have confidential information which must not be improperly acquired.

3. Another consideration in hiring, although not directly related to protecting trade secrets, is "corporate raiding."

a) No law or policy specifically prohibits raiding the competition's workforce, provided no contractual obligations are interfered with. "A competitor is privileged to hire away an employee whose employment is terminable at will." [170] Indeed the California Supreme Court held long ago that "it is not

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[170] *Motorola, Inc. v. Fairchild Camera & Instrument Corp.*, 366 F.Supp. 1173, 1180-1181 (D.Ariz 1973) (22 citations omitted). "As Judge Learned Hand emphatically pronounced the rule: 'That nobody in his own business may offer better terms to an employee, himself free to leave, is so extraordinary a doctrine, that we do not feel called upon to consider it at large.' *Triangle Film Corp. v. Artcraft Pictures Corp.*, 250 F. 981, 983 (2d Cir. 1918)." *Id.* at 1181. See also Restatement (Second) of Torts § 768 comment I (1979): if an employee at will "is free to terminate his contractual relation with the plaintiff when he chooses, there is still a subsisting contract relation; but any interference with it that induces its termination is primarily an interference with the future relation between the parties, and the plaintiff has no legal assurance of them. As for the future hopes he has no legal right but only an expectancy; and when the contract is terminated by the choice of the third person there is no breach of it. The competitor is therefore free, for his own competitive advantage, to obtain the future benefits for himself by causing the termination. Thus he may offer better contract terms, as by offering an employee of the plaintiff more money to work for him or by offering a seller higher prices for goods, and he may make use of persuasion or other suitable means, all without liability."

ordinarily a tort to hire the employees of another for use in the hirer's business."[171]

b) But, the court continued, "[t]his immunity against liability is not retained … if unfair methods are used."[172] In such circumstances there may be exposure for interference or other torts.

   (1) Also, inducing workers under a contract to break their contracts can lead to civil exposure for interference, unfair business practices, and other torts.

c) Raiding the competition's workforce can also be an antitrust violation.

   (1) "Unlawful predatory hiring occurs when talent is acquired not for purposes of using that talent but for purposes of denying it to a competitor. Such cases can be proved by showing the hiring was made with such predatory intent, i.e. to harm the competition without helping the monopolist, or by showing a clear nonuse in fact."[173] If other necessary elements are present this can be the basis of an antitrust violation.

   (2) "Acquiring talent not to use it but to deny it to possible rivals is exclusionary. Such an arrangement has the same harmful tendency and the same lack of redeeming virtue as the promise by a non-employee that he will not compete with the monopolist."[174]

   (3) Intent is the critical element in an antitrust case based on raiding, and it can be proved circumstantially. For example, in one case predatory intent was shown by a memo describing the proposed hiring as a "wound" to the competitor.[175]

D. <u>Steps to take when an employee is hired</u>

1. Inventory what secrets the new employee has.

   a) As to information held in memory, this should have been covered at the interview, as discussed above. Still, discuss it again.

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171 *Buxbom v. Smith*, 23 Cal.2d 535, 547 (1944).

172 *Ibid.*

173 *Universal Analytics, Inc. v. MacNeal-Schwendler Corp.*, 914 F.2d 1256, 1258 (9th Cir. 1990) (citing 3 P. Areeda & D. Turner, ANTITRUST LAW ¶¶ 702(a)-702(c) at 108-110 (1978)).

174 *Universal Analytics*, 914 F.2d at 1258.

175 *Id*. at 1259.

b) People tend to take things with them when they leave a job, even if they don't necessarily bring them with them to the new job. Inquire what the new hire possesses *anywhere*, including documents, manuals, disks &c

c) Explain that company rules forbid bringing anything of this sort onto company premises (including cyberpremises such the new company's computer memory, e-mail archives, etc.).

d) Confirm that all confidential material has been returned to the former employer, *and require the new hire to certify this in writing* on a form counsel will provide.

2. Review what was done with the former employer.

   a) What was discussed at the exit interview?

   b) What agreements were signed? Ask to see any such agreements, including but not limited to confidentiality, non-compete, non-solicitation, and invention agreements. Make copies for the company's personnel files and for counsel.

      (1) Remember that these agreements don't necessarily govern: *for example*, a non-compete agreement may not be enforceable in California, and where adopted the UTSA governs even if there is no agreement.

3. Explain and emphasize company's trade secrets policy.

   a) Explain again that it applies to the secrets of the old company as well as the new one.

   b) State the reasons for the policy. It is advisable to have these reasons listed in a brief handout, which counsel should prepare.

   c) Emphasize that the company is committed to the policy, and to the rules set out in the non-disclosure agreement the new hire is required to sign, and will enforce them both – the policy by discipline including dismissal, and the agreement by legal means if required.

      (1) Additional points to mention could include personal liability for violations, the possible absence of company support in later litigation, and possible criminal penalties.

4. Be sure the new hire understands all this!

   a) All the points made should be repeated in writing – counsel should prepare a form for this purpose to be given to the new hire.

   b) The new hire should be required to acknowledge in writing that s/he has received the written policy, that it has been explained to her, and that s/he understands all the notices and warnings and agrees to comply with them all *as a condition of employment*.

(1) This should include an acknowledgement of the policy concerning secrets learned during prior employment.

c) The specificity and possible redundancy of all these statements and acknowledgements emphasizes the seriousness of the policies, discourages abuse, and constitutes a record of admissions for use if required in later legal action.

d) Although it is not a secrecy issue, this might also be a good time to explain the rules against insider trading.

5. The new hire must execute a non-disclosure agreement governing present employment.

a) This must of course be written by counsel.

b) It should specify in detail what the employee's obligations are. Clear, simple English is better than legalese.

c) It should specify coverage of as many items and areas of confidential information as possible, *plus* a broad residual clause covering items not mentioned.

(1) While a residual clause covering *all* an employer's trade secrets could in theory cover the situation, listing specifics helps the employee understand her obligations, and can help in later disputes over what was covered and was understood to be covered.

(2) A non-disclosure agreement may cover information which is not covered by the CTSA, for example because its secrecy has no independent economic value, or because it has been disclosed elsewhere.

d) It should contain other acknowledgements, including but not limited to the following:

(1) consideration (that is, that the non-disclosure undertaking is a condition of employment);

(2) the undertakings run beyond the current employment;

(3) the secrecy <u>and value</u> and company ownership of the specified technical and commercial information;

(4) this information belongs exclusively to the company despite whatever equity share the new hire may in time achieve within the company;

(5) dismissal for violation of the agreement is dismissal for good cause;

(6) unauthorized disclosure is forbidden not only to competitors but to anyone, whether for personal or business purposes, and whether for gain or not.

e) The detailed nature of these acknowledgements reinforces the seriousness of the undertakings, discourages abuse, and constitutes a record of admissions if needed in later legal action

f) The agreement may also contain provisions for arbitration or liquidated damages, or other features, depending on company policy.

g) The new hire should also execute other agreements (covering non-competition, non-solicitation, inventions, etc.) as appropriate.

6. If valid in the state where it would be executed, the new hire should be required to sign a non-compete agreement. Where permitted these agreements go beyond protecting trade secrets and limit the employee's ability to work for (or become) a competitor after leaving the company.

a) Nineteen states regulate non-compete agreements by statute.[176] The others rely on common law tests.

(1) "The modern, prevailing common-law standard of reasonableness for employee agreements not to compete applies a three-pronged test. A restraint is reasonable only if it: (1) is *no greater* than is required for the protection of the *legitimate interest* of the employer, (2) does not impose undue hardship on the employee, and (3) is not injurious to the public. A violation of any prong renders the covenant invalid."[177]

(a) As to the first prong, "[a] covenant not to compete will be held unenforceable if the covenant is unreasonable in duration, geographical area, or scope of activity."[178]

(b) To be valid most states also require that the agreement be ancillary to a valid contract and supported by valuable consideration. Employment is usually a valid consideration, but where the person is already employed opinions vary on whether *continued* employment is a sufficient consideration., but where a person is already employed

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176 The states are Alabama, California, Colorado, Florida, Georgia, Hawaii, Louisiana, Michigan, Montana, Nevada, North Carolina, North Dakota, Oklahoma, Oregon, South Dakota, Tennessee, Texas, West Virginia and Wisconsin. This list is taken from Kenneth J. Vanko, "You're Fired! And Don't Forget Your Non-Compete: The Enforceability of Restrictive Covenants in Involuntary Discharge Cases," 1 DePaul Business & Commercial Law Journal 1, 2 n.5 (2002), where statutory references may also be found.

177 *BDO Seidman v. Hirshberg*, 93 N.Y.2d 382, 389 (1999) (citations omitted; emphasis in original).

178 *Pinnacle Performance, Inc. v. Hessing*, 135 Idaho 364, 367 (Idaho App. 2001).

a non-compete can be void if additional benefits are not offered in exchange.[179]

(c) Some states impose further requirements – for example in Oregon the non-compete is void unless ancillary to the *first* employment contract between the employer and employee.[180]

(d) Because they can impede mobility in employment, non-compete agreements are disfavored and even where enforced will be strictly construed.[181]

(e) "Cases involving noncompete agreements are extremely fact-specific, involving an analysis of the agreement's terms and a weighing of the company's interests, the employee's interest, and the public's interest. Often, authority can be found within a jurisdiction for enforcing or rejecting the same noncompete agreement."[182]

(2) Non-compete agreements are generally unenforceable in California, which has a strong public policy favoring mobility in employment. This policy is of great economic importance, especially in the Silicon Valley technology industry. Some observers have even suggested that the free mobility of employment was instrumental in the rise of Silicon Valley to its present importance as the center of the knowledge-based technology industry.[183]

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179 Compare, e.g., *Computer Sales International, Inc. v. Collins*, 723 S.W.2d 450, 452 (Mo.App. 1986) (continued employment a valid consideration) with, e.g., *Jostens, Inc. v. National Computer Systems, Inc*., 318 N.W.2d 691, 703 (Minn. 1982) (non-compete failed of consideration because it did not offer additional benefits).

180 See, e.g., *IKON Office Solutions, Inc. v. American Office Products, Inc*., 178 F.Supp.2d 1154, 1160 (D.Ore. 2001) (applying Oregon law).

181 See *ibid.* (stating Oregon law); see also, e.g., *Burk v. Heritage Food Service Equipment*, 737 N.E.2d 803, 811 (Ind.App.2000) (noncompetition agreements strictly construed against the employer and enforced only if reasonable); *Turner Professional Services, Ltd. v. Broussard*, 762 So.2d 184 (La.App.2000) (noting strong public policy against noncompetition contracts); *Kallok v. Medtronic, Inc*., 573 N.W.2d 356, 361 (Minn. 1998) (non-competition agreements looked upon with disfavor, cautiously considered, and carefully scrutinized).

182 William G. Porter II and Michael C. Griffaton, "Using Noncompete Agreements to Protect Legitimate Business Interests," 69 Defense Counsel Journal 194 (2002).

183 See, e.g., Donna Pasqualone, "*Globespan, Inc. v. O'Neill,*" 17 Berkeley Technology Law Journal 251, 258 (2002): "[S]everal commentators have attributed the success of Silicon Valley, California's technology center, to the mobility of its employees and particularly to [California Business & Professions Code §] 16600. Lacking the restraints of noncompetition agreements, the job-hopping culture of Silicon Valley has encouraged the 'spill-over' of knowledge among established technology firms and start-ups. Although such spill-overs may put trade secrets at

(*footnote continues* →)

(a) A California statute implementing this policy provides that "every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void."[184] This statute "protects a person's right to follow any of the common occupations of life and to pursue the business or profession he may choose,"[185] and so defeats non-compete agreements in California employment contracts.

(b) Even non-compete agreements signed in another state and valid there may be unenforceable in California because of its strong interest in the mobility policy.[186]

(i) Although California courts are reluctant to enforce out-of-state non-compete agreements which violate California's policy favoring mobility in employment, they are also reluctant to interfere with enforcement in the state where the contract was formed. Last year the California Supreme Court ruled that even where the out-of-state provision may be void under § 16600, "this policy interest does not, under these facts, justify issuance" of a restraining order preventing a former employer from suing on the contract in its home state.[187]

(ii) The court continued: "A parallel action in a different state presents sovereignty concerns that compel California courts to use judicial restraint when determining whether they may properly issue a TRO against parties pursuing an action in a foreign jurisdiction."[188]

(*footnote continues…*)

risk, their overall effect is to promote innovation and invention. These benefits appear to have exceeded the potential costs of trade secret disclosure, as demonstrated by the rapid expansion and sustained growth of Silicon Valley compared to other technology centers in the United States." (Footnotes omitted).

184 California Business & Professions Code § 16600; see also, e.g., *Whyte v. Schlage Lock Co.*, 101 Cal.App.4th 1443, 1462 (2002).

185 *Whyte*, 101 Cal.App.4th at 1462 (citations and quotation apparatus omitted).

186 See *Hollingsworth Solderless Terminal Co. v. Turley*, 622 F.2d 1324, 1338 (9th Cir. 1980) (stating California law); and cf. *Globespan, Inc. v. O'Neill*, 151 F.Supp.2d 1229 (C.D.Cal. 2001) (same).

187 *Advanced Bionics Corp. v. Medtronic, Inc.*, 29 Cal.4th 697, 706-707 (2002).

188 *Id.* at 707. The contract in *Advanced Bionics* also contained a clause choosing Minnesota law as the law of the contract. Because the court decided the procedural question on the basis of

(*footnote continues →*)

(iii) In federal court the Anti-Injunction Act[189] would also prevent an employee from interfering with an action on a non-compete agreement valid in the state where created. The Ninth Circuit has recently held that that the Anti-Injunction Act bars federal district court injunctions that would prohibit parties from participating in parallel state court lawsuits to enforce non-compete clauses.[190]

(c) Although non-compete agreements are generally void in California, there are exceptions.

(i) The policy does not apply to equity stakeholders selling all their stock, or in other specified circumstances mostly relating to the sale of a business and/or its goodwill.[191] The shareholder provision has been applied to a holding of only 3% of the company's stock.[192]

(ii) But stock sold back to the company by a departing employee-stockholder under a repurchase agreement may be insufficient to invoke the statutory exception.[193]

(iii) The exception for equity stakeholders may have unexpected applications where (as the California high-tech industry) stock ownership is a significant means of employee compensation and businesses change corporate forms with some fluidity. The rules are complex.

(d) "[I]f a former employee *uses* a former employer's trade secrets or otherwise commits unfair competition, California courts recognize a judicially created exception to section 16600 and will enforce a

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(*footnote continues…*)

"principles of judicial restraint and comity," *id.* at 700, it did not reach the choice-of-law question which might also have supported the decision not to halt the parallel proceeding. *Id.* at 708 n.6.

189 28 U.S.C. § 2283.

190 *Bennett v. Medtronic, Inc*., 285 F.3d 301 (9th Cir. 2002). See also *Atlantic Coast Railroad Co. v. Brotherhood. of Locomotive Engineers*, 398 U.S. 281, 297 (1970) ("[a]ny doubts as to the propriety of a federal injunction against state court proceedings should be resolved in favor of permitting the state courts to proceed in an orderly fashion to finally determine the controversy").

191 See California Business & Professions Code § 16601.

192 See *Vacco Industries, Inc. v. Van Den Berg*, 5 Cal.App.4th 34, 48-49 (1992).

193 See *Hill Medical Corp. v. Wycoff*, 86 Cal.App.4th 895 (2001).

restrictive covenant in such a case."[194] But a general *situational likelihood* of use is insufficient.

(e) It can be actionable as a wrongful discharge to fire an employee for refusing to sign an unenforceable non-compete agreement.[195] It might also be actionable to refuse to hire a candidate for this reason also.[196] While the moral effect of having signed the agreement may influence employees even though it has no legal force, there is little to be gained by insisting on one over objection.

(f) Although it is of doubtful utility, a company may require an agreement limited to "unfair" competition.

(i) It may also require an agreement limited to circumstances allowed for in the statutory exceptions, even if those circumstances (such as equity ownership) have not yet occurred. Counsel can prepare a special *contingent* non-compete agreement which applies only where permitted by law.

(ii) A "regular" blanket non-compete agreement with a severance clause for parts held unenforceable will not work in California.[197]

(iii) Even in a contingent agreement the terms should be carefully drawn, restricting employment as little as possible, for a specified term and within geographical or other limits as narrow as will meet the company's legitimate needs.

b) Under the so-called "inevitable disclosure" doctrine, "a plaintiff may prove a claim of trade secret misappropriation by demonstrating that defendant's new employment will inevitably lead him to rely on the plaintiff's trade secrets."[198]

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194 *Scott v. Snelling and Snelling, Inc.*, 732 F.Supp. 1034, 1043 (N.D.Cal. 1990) (applying California law) (emphasis added).

195 See *D'Sa v. Playhut, Inc.*, 85 Cal.App.4th 927, 933-934 (2000); *Latona v. Aetna U.S. Healthcare Inc.*, 82 F.Supp.2d 1089, 1092-1093 (C.D.Cal. 1999) (applying California law).

196 Cf. *Baker Pacific Corp. v. Suttles*, 220 Cal.App.3d 1148, 1154 (1990) (holding unlawful conditioning employment on signing waiver of asbestos risk which was contrary to public policy).

197 See *D'Sa v. Playhut, Inc.*, 85 Cal.App.4th at 934-935.

198 *Whyte v. Schlage Lock Co.*, 101 Cal.App.4th 1443, 1458 (2002) (quoting the leading case, *PepsiCo, Inc. v. Redmond*, 54 F.3d 1262, 1269 (7th Cir. 1995); quotation apparatus omitted) (applying Illinois version of UTSA).

(a) This doctrine has been held compatible with the UTSA.[199]

(b) But it is nevertheless not accepted in California.[200] "[T]he doctrine of inevitable disclosure creates a *de facto* covenant not to compete and runs counter to the strong public policy in California favoring employee mobility."[201] It does not apply under CUBPA either.[202]

(c) The status of the inevitable disclosure doctrine varies markedly from state to state, and it is impractical to track it here.[203]

7. The new hire should also execute a non-solicitation agreement.

a) "An agreement not to engage in competition with the employer is vastly different from an agreement not to solicit the employer's customers or employees or to engage in a business relationship with the employees or contractors."[204]

(1) Non-solicitation agreements are subject to many of the same restrictions that apply to non-compete agreements. For example, a Georgia court recently held that "[n]oncompetition and nonsolicitation covenants against competition contained in employment agreements are in partial restraint of trade. As such, they may be upheld only when they are strictly limited in both time and geographical effect. Additionally, these restrictions must be otherwise reasonable, considering the business interests of the employer needing protection and the effect of the restrictions on the employee."[205]

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199 See *Strata Marketing, Inc. v. Murphy*, 317 Ill.App.3d 1054,1070 (2000) ("inevitable disclosure is a theory upon which a plaintiff in Illinois can proceed" under the Illinois version of UTSA).

200 *Whyte v. Schlage Lock Co.*, 101 Cal.App.4th 1443, 1462 (2002); *Bayer Corp. v. Roche Molecular Systems, Inc.*, 72 F.Supp.2d 1111, 1112 (N.D.Cal. 1999) (applying California law).

201 *Whyte*, 101 Cal.App.4th at 1462 (citations and quotation apparatus omitted).

202 See *Globespan, Inc. v. O'Neill*, 151 F.Supp.2d 1229, 1235 (C.D.Cal. 2001) (applying California law).

203 For a thorough and current exploration of the status of the inevitable disclosure rule, by jurisdiction, see Brandy L. Treadway, "An Overview of Individual States' Application of Inevitable Disclosure: Concrete Doctrine or Equitable Tool?", 55 Southern Methodist University Law Review 621 (2002).

204 *John Jay Esthetic Salon, Inc. v. Woods*, 377 So.2d 1363, 1366 (La.App. 1979).

205 *Pregler v. C&Z, Inc.*, 575 So.2d 915, 916 (Ga.App. 2003).

(2) But they do not restrict the employee's ability to work and so do not violate state policies favoring employee mobility. For this reason non-solicitation agreements are enforceable in California.[206]

b) A departing salesperson bound by a non-solicitation agreement may accept business from a former customer if the customer calls her first.[207]

(1) In the Georgia case just mentioned, the nonsolicitation clause was held unenforceable because it prevented the former employee from accepting business from *unsolicited* former clients. "The restraint is overbroad. It prohibits not only solicitation of former clients but also acceptance of any work from such clients regardless of who initiated the contact. This is an unreasonable restraint, because in addition to overprotecting [the company's] interest, it unreasonably impacts on [the former employee] and on the public's ability to choose the professional services it prefers."[208]

(2) "[U]nless the nonsolicit covenant pertains only to those clients with whom the employee had a business relationship during the term of the agreement, the nonsolicit covenant must contain a territorial restriction."[209]

(3) "Merely informing customers of one's former employer of a change of employment, without more, is not solicitation. Neither does the willingness to discuss business upon invitation of another party constitute solicitation on the part of the invitee. Equity will not enjoin a former employee from receiving business from the customers of his former employer, even though the circumstances be such that he should be prohibited from soliciting such business."[210]

c) A letter from a departing salesman to the customers on his old list, simply announcing his new address and affiliation does not violate a non-solicitation agreement.

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206 *John F. Matull & Associates, Inc. v. Cloutier*, 194 Cal.App.3d 1049, 1054 (1987); accord *Whyte v. Schlage Lock Co.*, 101 Cal.App.4th 1443, 1462 (2002).

207 See *American Credit Indemnity Co. v. Sacks*, 213 Cal.App.3d 622, 634-638 (1989); accord, *Hilb, Rogal & Hamilton Ins. Services v. Robb*, 33 Cal.App.4th 1812, 1821 (1995).

208 *Pregler v. C&Z, Inc.*, 575 So.2d 915, 916 (Ga.App. 2003).

209 *Advance Technology Consultants, Inc. v. Roadtrac, LLC*, 250 Ga.App. 317, 321 (2001).

210 *Aetna Building. Maintenance Co. v. West*, 39 Cal.2d 198, 204 (1952); accord e.g. *Hilb, Rogal & Hamilton Ins. Services v. Robb*, 33 Cal.App.4th 1812, 1821 (1995).

(1) But including a pitch for business crosses the line.[211]

(2) So does a notice stating the salesman's new address, but not his new affiliation, so that customers call him thinking he is still with his old firm.[212]

d) As with non-competition agreements, overbreadth can make them void. In another Georgia case such an agreement was held overbroad because it did not limit the type of business that the former employee was prohibited from doing with his former company's client.

(1) "The terms 'employment' and 'contractual agreement' are not limited in the agreement and could encompass work that has nothing to do with the type of work that [the defendant] did while he was employed with [the plaintiff]. Based on the contract as written, any employment or contractual agreement, even though completely unrelated to [the company's] business, would be in violation of the nonsolicit agreement. Such a provision is not reasonably necessary to protect the interests of [the company] and is therefore overbroad and unenforceable."[213]

e) Sometimes these distinctions can be quite fine. Counsel must decide on a case-to-case basis what actions may constitute violations calling at least for a cease-and-desist letter.

8. Another form of non-solicitation agreement is an agreement that if the employee leaves the company s/he will not solicit other company people to work for her new employer, at least not for a specified time. This is sometimes called a "no poach" or "no switching" agreement.

a) This kind of agreement does not conflict with state policies favoring mobility, as it does not restrict anyone's ability to work.[214]

b) Even without an agreement, soliciting employees to break employment contracts is an interference tort. The contract only extends the no-poach zone to at-will employees.

c) But an agreement *with another company* not to hire each other's employees is not enforceable (at least in California), as it hampers mobility in much

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211 See, e.g., *Morlife, Inc. v. Perry*, 56 Cal.App.4th 1514, 1525-1526 (1997) and cases cited therein.

212 For an example see *Courtesy Temporary Service, Inc. v. Camacho*, 222 Cal.App.3d 1278 (1990).

213 *Allied Informatics, Inc. v. Yeruva*, 251 Ga.App. 404, 406-407 (2001).

214 See *Loral Corp. v. Moyes*, 174 Cal.App.3d 268, 279-280 (1985).

the same way as an agreement with the employee herself restricting where she can work.[215]

(1) It may also be an antitrust violation.[216]

d) As a result a former employee can be bound not to recruit someone from his old company, but if that person *sends him* an unsolicited résumé he can accept it and follow up. The difference is that although he is *hiring* the person, he has not *solicited* her to join the new company.[217]

(1) "The [employees of the old company] are not hampered from seeking employment with [the new company] nor from contacting [the employee who crossed over]. All they lose is the option of being contacted by him first. It does not restrain them from being employed by [the new company]…"[218]

9. Yet another agreement useful in preserving the company's intellectual property is an "invention and disclosure" agreement.

a) "The employer/employee relationship does not necessarily entitle the employer to ownership of inventions made by the employee even if the inventions are related to the employment or business. The [common] law does not recognize the routine contract of employment as including the products of the inventive genius of the employee.[219]

b) There is a complex taxonomy of inventions.

(1) Employer-specified invention are made at the employer's request and expense; general inventions are made partly or wholly at the employer's expense, but are not specified by the employer; and private inventions are made without the employer's expense of time or assistance.[220]

(2) Not accounting for local variations, employer-specified inventions belong to the employer, private inventions belong to the inventor; and

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215 See *The Ingle Co., Inc. v. Video Tours, Inc.*, 116 F.3d 1485 (9th Cir. 1997). This case is unpublished and therefore not binding precedent. But in the absence of any reported case on this issue, it provides a good indication how a California federal or state court would decide the point.

216 See *Roman v. Cessna Aircraft Co*., 55 F.3d 542, 544-545 (10th Cir. 1995).

217 See *Loral Corp. v. Moyes*, 174 Cal.App.3d 268, 279-280 (1985).

218 *Id.*, 174 Cal.App.3d at 279.

219 Evelyn D. Pisegna-Cook, "Ownership Rights of Employee Inventions: The Role of Preinvention Assignment Agreements and State Statutes, " 2 University of Baltimore Intellectual Property Law Journal 163, 165 (1994).

220 *Ibid.*

general inventions belong to the employee subject to the employer's "shop right," a compulsory but non-exclusive license.

c) To gain larger and surer rights than those available under the common law, an employer therefore must generally secure its right to employee inventions through agreement, often by a provision in the employment contract.

(1) In an "invention and disclosure agreement" the employee typically promises as a condition of employment to disclose in confidence to her employer any invention or scheme for one, acknowledges that inventions or other creative work done by the employee for the company belong to the company, and acknowledges that she does not retain any intellectual property rights in the work other than those provided for in the agreement.

(a) The employee need not surrender all her rights. For example, in their contracts university researchers typically retain the right to a portion of the royalties for their general inventions.

(2) For existing employees there must be some other consideration besides employment. Other circumstances can affect the validity of this agreement, and it must be carefully drafted with reference to local statutory and case law.

(3) State laws can restrict the scope of assignment agreements.

(a) For example, a California statute provides that an employer may not require assignment of rights to "an invention that the employee developed entirely on his or her own time without using the employer's equipment, supplies, facilities, or trade secret information *except* for those inventions that either: (1) Relate at the time of conception or reduction to practice of the invention to the employer's business, or actual or demonstrably anticipated research or development of the employer; or (2) Result from any work performed by the employee for the employer."[221] No such agreement is enforceable in California.[222]

(b) Another California statute upholds "the right of an employer to provide in contracts of employment for disclosure, provided that any such disclosures be received in confidence, of all of the employee's

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221 California Labor Code § 2870(a).

222 See California Labor Code § 2870(b).

inventions made solely or jointly with others during the term of his or her employment."[223]

(c) Seven other states have passed mostly similar statutes regulating pre-invention assignment agreements.[224]

d) An invention (or even part of one) covered by a disclosure and inventions agreement can be a trade secret. To the extent the rights to the invention belong to the company, so do the rights to its secrecy.

e) Where the employee's expected product is literary or artistic rather than inventive, even though technical, a "work for hire" agreement may be substituted.

10. As a final precaution, Human Resources should send a letter (written by counsel) to the new hire's former employer, stating that the person has been hired, setting forth the company's strict policy against acquisition or use of technical or commercial trade secrets acquired during prior employment, and inviting a response if the former employer has concerns to raise.

E. <u>Steps to take while the employee is on the job</u>

1. Secrecy precautions

a) As noted in section II.E above, "reasonable" efforts to maintain secrecy are essential to preserving trade secret protection. The following elements can contribute to a program which not only preserves legal protection but helps prevent dissemination of confidential information. *They need not all be used*, but the more that are used, the better from a trade secrets perspective.

b) Non-disclosure agreements. As noted in section V.D.5 above, every employee should execute a non-disclosure agreement.

(1) The list of items specifically mentioned in the in confidentiality agreement should be updated when new secret information becomes available to the employee.

(2) Even though the residual clause will cover new items, a new listing reinforces the employee's awareness of her obligations and can defeat later claims that an item was not (or was not understood to be) covered.

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223 California Labor Code § 2871.

224 The states are Delaware, Illinois, Kansas, Minnesota, North Carolina, Utah, and Washington. For statutory references see Pisegna-Cook, note 219 above, at 178 n.122. All the statutes (except Utah's) have roughly the same form and purpose as California's statute. See *id.* at 179. Pisegna-Cook misstates the statutory reference for Utah – it is Utah Code 1953 § 34-39-1 through –3.

(3) Every contractor, consultant, vendor, and other non-employee with access to secret information should also be required to sign a non-disclosure agreement.

c) Restricted access.

(1) To the extent possible, secret information should be physically segregated and kept in closed files and areas.

(a) A single depository, with a guard and logbook recording who accesses what information, is the classic model, but there are others.

(b) Where necessary, employees may be subjected to search when they leave the restricted area, or when they leave the plant.

(2) Access to confidential information should be strictly limited on a need-to-know basis.

(a) In many cases an employee who needs to know part of a secret process, for example, does not need to know all of it.

(b) However efficient it may be in other respects, including all the secret information relating to a given project into a large manual available to everyone who works on the project is not a good way to preserve secrecy.

(c) There is a tradeoff between compartmentalization of information and efficiency of operation. The right mix is a policy decision to be taken by executive management, in consultation with counsel and with the line managers who run the operation whose efficiency may be impaired.

(3) Nowadays information is usually kept in electronic form, making physical barriers to access obsolete.

(a) Among the steps which can be taken to meet this situation are encryption, segregation of confidential material by requiring special passwords, automatic tracking of access, automatic restrictions on sending of given files by e-mail or otherwise, monitoring of e-mail by selected keywords, frequent changing of passwords, and similar technical devices.

(b) Counsel should meet with the Information Systems Department to explore available techniques.

(4) For hard copies, copying is a vulnerable point in a secrecy program. There are ways to limit copying exposure.

(a) Some are physical – as for example having only one designated copier in a restricted area, which records a user's password, or having all copying done by a dedicated employee, who logs what is copied and by whom.

(b) Others are technical – for example having secret documents printed in blue ink or on special blue paper which resists copying.

(5) A company's employees are not the only ones who may seek to acquire company secrets. Anti-espionage techniques should be studied and applied – there are consultants with the expertise to do this. Anti-hacking protection is also part of a counter-espionage program.

d) Secret stamps

(1) It is good practice to stamp all secret documents with a secrecy stamp.

(2) Such a stamp might read: "WARNING: TRADE SECRET!! This document contains trade secret material which is the proprietary information of Prudentcorp Inc. It is confidential and subject to the protections the [State] Trade Secrets Act and applicable criminal laws. Disclosure without permission is strictly forbidden. Do not circulate or copy except in accordance with company policy. If in doubt consult your supervisor or the Director of Technology [or Sales]."

(3) But make sure these stamps are used only on actual secret material, and be sure that if used they are used on *all* such material. As noted, using secret stamps on some material but not on others can be taken as an admission that the unstamped material is not secret.

e) Other techniques

(1) Periodic checks of offices, computers, PDAs and e-mails to see if secrets are there which shouldn't be there.

(2) Sensitivity to suggestions from any source that misappropriation may be threatened or information security compromised.

(3) Shredding secret material no longer needed, including drafts and interim material, and material copied for a completed purpose. A written document retention policy is useful in this regard.

(4) Avoiding faxes for transmitting secrets. The boilerplate confidentiality notice on faxes are helpful but only in a limited way.

2. Frequent reiteration of policy and elements

a) There is no substitute for frequent reiteration. Suitable occasions for restatement of the policies include:

(1) at the pre-hiring interview;

(2) at new hire orientation;

(3) in the employee manual;

(4) in periodic memos and internal newsletters;

(5) by updates as new secret information is added or existing information augmented or refreshed;

(6) at the annual performance review;

(7) in boilerplate at top of documents (boilerplate can be in large type);

(8) by periodic compulsory in-house education programs; and

(9) by periodic refresher of non-disclosure agreements.

3. Deliberate misappropriation is not the only way secrecy can be breached. Even inadvertent disclosure terminates trade secret protection. Careful precautions, including warnings to *all* employees,

   a) giving people such as customers, consultants or even co-workers more detail than they need without checking to see whether a non-disclosure agreement is necessary;

   b) disclosing secret elements of process or device at trade shows, in sales materials or sales talk, or in technical articles;

   c) carelessness in contacts with former employer or former co-workers, here in terms of getting secret information as well as giving it out; and

   d) inadvertent disclosure through casual talk. Loose Lips Sink Chips!

4. Be careful with non-employees such as consultants, contractors, vendors and visitors.

   a) Where feasible they should sign non-disclosure agreements.

   b) Where possible their access should be compartmentalized.

   c) Public tours of plants and facilities can compromise security.

5. Insist on pre-screening of speeches, trade show material, marketing information, website postings, etc.

   a) Be especially careful to keep secrets out of public databases or publications

   b) Employees should be strictly forbidden to speak to the press, and instructed to refer all inquiries to the company press office.

6. Of course all of this can't defeat a determined thief. But it can:

   a) avoid careless or thoughtless disclosure;

   b) make sure *only* a determined thief can breach secrecy and misappropriate trade secrets;

   c) create a trail so a thief can be identified, and inadvertence disproved; and

d) ensure that secrets qualify for protection under local trade secrets law, and that other contentions (such as tort claims) are provable.

7. The company should designate safe company contacts in case questions arise under the policy concerning information learned during prior employment.

   a) Such question may arise, for example, if:

      (1) there is doubt whether particular information is a protected trade secret;

      (2) an employee is asked for information by an outsider, or even within the company in ways which seem irregular;

      (3) an employee is assigned to work where it would be hard to avoid using prohibited information, or if such an assignment is being considered;

      (4) an employee is contacted by a former employer in ways which arouse suspicion;

      (5) or otherwise.

   b) There should be more than one designated contact, so that every employee has someone s/he feels comfortable raising the issue with – for example the manager of a division which would benefit from use of forbidden information may not be the best choice to rule on whether a given piece of information is forbidden.

      (1) Employer-designated contacts should be at least of supervisorial grade, and should be specially trained in how to respond to such inquiries.

   c) Employees should also be encouraged to discuss with one of these contacts any suspicious activity suggestive of possible misappropriation of company secrets.

   d) Employees should be reliably assured that there will be *no retaliation* for invoking the process, whatever the result.

   e) The same mechanism can be used for answering questions about the current employer's secrets, for example: Is a given datum a secret or not? Will the Vendorcorp rep need to sign a non-disclosure agreement? Can I tell a potential customer how the new process works?

F. <u>Steps to take when an employee leaves</u>

1. Exit interview

   a) Reiterate:

      (1) the employer's confidentiality policy, reminding the departing employee that s/he bound herself to continue to comply with it even after leaving employment;

(2) the extent of provisions of the other agreements s/he signed (for example non-compete, non-solicitation and invention agreements);

(3) the legal provisions (civil and criminal) which bind her; and

(4) the company's determination to enforce all its rights under all these provisions.

(5) Give the departing employee a letter stating all this in writing, with a copy of all agreements attached.

b) Obtain written acknowledgment of receipt of all these warnings, written and oral, and a written promise to comply, a written promise to consult the company if questions arise, and a new written reaffirmation of all undertakings, extending to all secrets without limitation.

c) Have the departing employee certify, in writing, that s/he has returned all copies of secret material, written or electronic, including work in progress, and including those at home, in the car, in a PDA, on a home computer, or anywhere else.

(1) This includes order guides, customer and contact lists, rolodex, presentation and sales material, etc.

d) Agree on statement the departing employee will make to customers and others about her departure, whether or not there is a non-solicitation agreement in place. This applies more to sales than to technical personnel.

2. Other precautions

a) Surrender of badges, switch-off of passwords, voicemail and e-mail access, check of computer and e-mail files, etc.

b) Once it is decided that an employee is to leave, schedule the actual departure before key meetings where more secrets will be disclosed.

c) If the departure is voluntary and amicable, these matters can be addressed as seems most convenient. But if the employee is terminated, or if relations are not amicable, or if there is reason to suspect misappropriation or defection to a competitor, they may sometimes be best implemented at once, without warning.

(1) If an employee leaving employment under these conditions has time remaining before actual departure, the company may choose to place the employee on terminal leave, continuing salary and benefits for the remaining time but not allowing the employee to return to the premises.

3. Counsel should send a letter to the new employer, with a copy to the departing employee, outlining its rights under the statutes and applicable agreements, perhaps including a copy of these agreements, and drawing the new employer's

attention to the provisions of law forbidding acquisition from a new hire of trade secrets belonging to a former employer.

VI. LITIGATING THE TRADE SECRETS CASE

A. Preventing a departing employee from misappropriating the company's trade secrets

1. There are many steps (as outlined above) for the employer to take when an employee departs; however, it is not always practicable or possible to follow them. The employee that the company typically needs to be concerned about is the one who leaves suddenly to join another company, or whose employment is terminated by the company. In such cases, exit interviews and orderly return of company property may not be possible. Regardless of whether the company suspects that the departing employee intends purposely to misappropriate the company's information, or whether s/he may simply fail to return things, the company must take steps to recover any property the employee possesses so that the company's information will not be used to its detriment.
   a) Failure to take steps to recover confidential information could jeopardize its status as a trade secret (see section II.A above).
2. The employer first must determine exactly what information the employee may have. A common problem arises when employees have been given a laptop or other computer for company work. Departing employees may be reluctant to return a computer, or may just fail to do so, particularly if they feel that they have no incentive to return it.
3. There are steps an employer can take to create incentives for the employee to return tangible property.
   a) For example, the employer may be able to withhold payment of the employee's wages if that condition was clearly stated to the employee in writing when the equipment was given out.[225]
   b) The company may be required by agreement or company policy, or may otherwise wish, to offer the departing employee a severance payment as an additional incentive to return company property. The company can require the employee to reaffirm non-disclosure agreements and other promises regarding confidentiality and confirm that company property has been returned.

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[225] Employers should be advised to have employees sign agreements at the time they receive the property, stating the property's value and giving the employer permission to withhold wage payments until the property is returned. This helps the company avoid running afoul of labor laws.

(1) However, companies should be careful not to overreach. Adding unenforceable provisions (such as non-competition provisions in California) can nullify otherwise valid agreements.[226]

(2) Employees also should be extremely careful when drafting the release language. Often employees, on advice of counsel, request a mutual release of all claims. Employers are often willing to provide such a release. This could be very dangerous, however, if the employee has already misappropriated the company's information. In *Cadence v. Avant!* the Ninth Circuit recently decided that a claim for misappropriation of trade secrets arises when the information is misappropriated, not when it is used to the rightful owner's detriment.[227] Thus the release agreement entered into by the parties after the misappropriation occurred barred Cadence's action for damages resulting from the misappropriation.

(a) Counsel for the employer, therefore, must ensure that a mutual release is conditioned upon a certification that all information has been returned to the company and that the release does not cover claims concerning material not returned.

c) The employer may allow the employee to keep a computer, laptop, or other equipment. The employer should, however, ensure that the equipment is brought to the company to be stripped of all confidential information.

d) Finally, the employer may initiate a civil action for return of the company's property or may contact the local law enforcement officials to seek help in securing its return. For example, in *Cadence* the key evidence surfaced when the district attorney searched Avant!'s headquarters and seized a log that showed line-by-line copying of computer code.[228]

4. Preventing disclosure to subsequent employers

a) The employer's greatest concerns arise when it learns that the departing employee is planning to or has begun working for a competitor. A common practice is to put the employee and the third party employer on notice by sending a letter explaining the Company's concern and reminding the employee of his or her obligation not to disclose the Company's confidential information. When drafting the letter, counsel should be careful not to make any defamatory comments about the employee. If the

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226 *See* note 196 above.

227 See *Cadence Design Systems, Inc. v. Avant! Corp.*, 253 F. 3d 1147 (9th Cir. 2001).

228 *Ibid* .at 1149.

Company has reason to believe that specific information is wrongfully in the employee's control, the Company may make such claims to the employee directly, without publication to others.

B. Civil or criminal litigation

1. More often than not, after the employer has made efforts to have the property returned, and the former and new employer have exchanged letters affirming obligations not to disclose and/or use the others' trade secrets, the potential for conflict subsides.

    a) The prior employer may decide it is not worth the time and effort to continue pursuing the matter – the "confidential" information in question may not be particularly critical, or the employee's role at the new company may be sufficiently different to minimize the danger of misuse, or there may be other reasons for deciding not to fight.

    b) But if the company is not satisfied, it must decide whether to pursue civil or criminal proceedings (or both).

2. There are advantages to initiating a criminal action.

    a) Generally the criminal case will proceed more quickly than civil litigation. This is important where technology changes quickly and misuse of the old company's trade secrets can give the competitor a devastatingly unfair advantage.

    b) Also a criminal proceeding is less expensive, because the state provides the investigation and the prosecution.

    c) A criminal proceeding may be more successful in actually returning the trade secrets, because the law enforcement authorities can use methods such as wire taps and searches which are unavailable to a private company.

    d) The fear of criminal penalties may induce cooperation and lead to an early resolution.

3. On the other hand, by initiating a criminal proceeding the company relinquishes significant control over how the trade secrets are handled.

    a) Protective orders, common in civil litigation, may not be as easily enforced.

b) Also the authorities have discretion not to prosecute – before deciding which way to go counsel will need to determine the level of interest federal or state prosecutors have in the case.[229]

C. Proving the trade secret case in the civil action

1. The trade secret plaintiff first must decide whom to litigate against, as individuals as well as business entities may be proper defendants.[230] Counsel should consider a broad range of possible defendants including officers, directors, employees, former employees, vendors, etc.

   a) In one case, a court even found that individuals who joined the defendant's company after the alleged misappropriation were proper defendants, on the theory that they might have invested in the company at a bargain price with knowledge that the company had stolen information.[231]

   b) Counsel must consider how adding an individual defendant may affect jurisdiction for the case as well as access to discovery. In general, it will be easier to obtain discovery against a defendant than against a third party witness.

   c) Damages arising from a defendant's willful acts may not be dischargeable in bankruptcy proceedings.

2. The plaintiff in a trade secret case must establish:

   a) a trade secret;

   b) a misappropriation; and

   c) damages.

3. Whether information qualifies as a trade secret is a mixed question of law and fact.

   a) The court decides as a matter of law whether the information is of a type that may be protected as a trade secret.[232]

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229 See Peter J. Viscounty, "Criminal Liability for Trade Secret Misappropriation", in TRADE SECRETS PRACTICE IN CALIFORNIA (California Continuing Education of the Bar, 2d ed. 2002), at § 13.11.

230 See section III(A)3(b) above.

231 See *PMC, Inc. v. Kadisha*, 78 Cal. App. 4th 1368 (2000).

232 See Lowell Anderson, "Litigation Issues," *in* TRADE SECRETS PRACTICE IN CALIFORNIA, note 229 above, at § 11.18.

4. The trier of fact, on the other hand, decides whether the information has independent economic value and whether the employer has reasonably maintained the secrecy of the information.[233]

   a) A difficult initial problem for counsel, therefore, is how much information to release about the trade secret. In general, counsel will want to disclose enough information to establish that a trade secret exists while keeping secret as much information as possible.

   b) The particular jurisdiction will determine the level of specificity required by the pleadings.

      (1) For example, in California, the plaintiff must identify the "trade secret" sufficiently enough to distinguish it from general knowledge.[234]

      (2) If the plaintiff fails to identify the secret sufficiently, the case may end on a motion to dismiss.

      (3) The framing of the "trade secret" will define the scope of discovery and trial issues.

   c) Because the plaintiff will likely have to reveal secret information to prove that it qualifies for protection, the plaintiff should submit the information to the court under a protective order.

5. Expert witnesses are generally needed to prove the economic value of the information and of its secrecy.

D. <u>Discovery in the trade secrets case</u>

1. Discovery in a trade secrets case is particularly difficult and fraught with issues because the litigants are seeking a public determination about a matter that by its very definition is secret. Because of that, the UTSA specifically requires the Court to take precautions in protecting the trade secrets at issue.[235]

   a) A protective order is the main vehicle for protecting trade secrets in discovery. The parties to the litigation normally craft a stipulated protective order. Some jurisdictions even have adopted standard protective

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[233] *Id.* at §11.18 (citing *Uncle B's Bakery, Inc. v. O'Rourke*, 920 F. Supp. 1405 (N.D. Iowa 1996)).

[234] See California Code of Civil Procedure § 2019(d).

[235] See UTSA § 5: "In an action under this [Act], a court shall preserve the secrecy of an alleged trade secret by reasonable means, which may include granting protective orders in connection with discovery proceedings, holding in-camera hearings, sealing the records of the action, and ordering any person involved in the litigation not to disclose an alleged trade secret without prior court approval." California Civil Code § 3426.5 contains the same language.

orders. Even so, counsel may be required to prove the need for protection against public disclosure.[236]

b) A protective order also may have levels of protection that allow the attorneys, but not in-house employees or counsel, to see the competitor's confidential information.[237]

c) Counsel must be careful when selecting experts.

(1) Because the expert will likely be given access to a competitor's trade secret information, to review subject to a protective order, the expert must be independent and not someone the company plans to use in the future for consulting purposes. It may be difficult to use the same expert later as a consultant without gaining (or being suspected of gaining) prohibited access to those secrets.

(2) It may be wise to secure an undertaking from the expert not to disclose the information afterward, or otherwise except as required and permitted for the purposes of the instant case.

2. Personal liability of officers and directors

a) The trade secret plaintiff first must decide who to litigate against, as individuals as well as business entities may be proper defendants.[238] Counsel should consider a broad range of possible defendants including officers, directors, employees, former employees, vendors, etc.

(1) In one case, a court even found that individuals who joined the defendant's company after the alleged misappropriation were proper defendants on the theory that they might have invested in the company at a bargain price with knowledge that the company had stolen information.[239]

b) Counsel must consider how adding an individual defendant may affect jurisdiction for the case as well as access to discovery. In general, it will be easier to obtain discovery against a defendant than against a third party witness.

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236 See, e.g., *Star Scientific, Inc. v. Carter*, 204 F.R.D. 410, 417 (S.D.Ind. 2001) (requiring "showing of good cause by the party seeking protection").

237 Cf., e.g., *Intel Corp. v. VIA Technologies, Inc.,* 198 F.R.D. 525 (N.D.Cal. 2000) (in-house counsel denied access to confidential information under protective order).

238 See section III(A)3(b) above.

239 *PMC, Inc. v. Kadisha*, 78 Cal.App.4th 1368 (2000).

c) Damages arising from a defendant's willful acts may not be dischargeable in bankruptcy proceedings.

E. Remedies

1. There are a wide variety of remedies available to the plaintiff in a trade secrets case. The plaintiff may seek injunctive relief as well as damages based on actual loss and unjust enrichment.[240]

2. The UTSA also provides that in lieu of actual damages, the plaintiff may seek the imposition of a reasonable royalty.[241]

a) Jurisdictions differ on when royalties may be imposed. For example, under California's enactment of the UTSA, plaintiffs are entitled to a reasonable royalty only if neither actual damages nor unjust enrichment are provable.[242] In *Cacique*, the plaintiff, a cheese producer, alleged that the defendant, an equipment manufacturer, had disclosed the plaintiff's trade secrets to a third party competitor. The plaintiff sought discovery of the third party competitor's profits, arguing that the information was relevant to its claim for a reasonable royalty. The Ninth Circuit denied the discovery request as irrelevant – Cacique would be entitled to a royalty only if actual damages or unjust enrichment could not be proved, and there was "no reason to believe that unjust enrichment could not be proved."[243]

(1) Cacique was permitted discovery of the defendant's to quantify unjust enrichment. profits the amount of profit it made from misappropriating any trade secret. But the Court declined to impose a "throughput" or "running" royalty, even though "[u]nder such circumstances, unjust enrichment may not be as complete a remedy as a plaintiff might desire."[244]

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240 See, UTSA § 2 (injunctions); California Civil Code § 3426.2 (same); UTSA § 3 (damages); California Civil Code § 3426.3 (same).

241 UTSA § 3(a); California Civil Code § 3426.3(b).

242 *Cacique, Inc. v. Robert Reiser & Co., Inc*, 169 F.3d 619, 623 (9th Cir. 1999).

243 *Ibid.*

244 *Id.*, 169 F.3d at 623-624 and n.6.

FORM 1:

ACKNOWLEDGEMENT REGARDING FORMER EMPLOYMENT

As a condition to my interviewing for employment with PRUDENT CORPORATION (the "Company") and as a condition of that employment, if it is offered by the Company and accepted by me, I, ERNEST WORKER, represent and agree as follows:

1. I have disclosed to the Company the identity of every person, corporation, limited liability company, limited partnership, general partnership, sole proprietorship or any other business entity currently retaining my services as an employee, independent contractor or consultant ("Current Employer") or which has retained my services either as an employee, independent contractor or consultant ("Former Employer") during the past ten years. I have disclosed to the Company the title and general responsibilities for every position that I now hold with my Current Employer or have held with my Current Employer or any Former Employer during the past ten years.

2. Except where prohibited by a confidentiality obligation owed by me to my Current Employer or a Former Employer, I have provided to the Company a copy of any confidentiality, non-disclosure, non-solicitation or non-competition agreements that I have entered into with my Current Employer or any Former Employer retaining my services during the past ten years (which may be contained in employee handbooks, employment agreements, confidentiality agreements, proprietary information and inventions agreements, stock option agreements, or stock purchase agreements).

3. I have complied with and, during my contacts and employment with the Company, if any, I will comply with any confidentiality, fiduciary or loyalty obligation owed by me to my Current Employer or Former Employer(s).

4. I have not disclosed, and will not disclose, to the Company any trade secret of my Current Employer or any Former Employer, and I will not during the course of my employment with the Company, if any, use any trade secret of my Current Employer or any Former Employer. I am advised that California law defines "trade secret" to mean "information, including a formula, pattern, compilation, program, device, method, technique, or process that: (1) derives independent economic value, actual or potential, from not being generally known to the public or other persons who can obtain economic value from its disclosure or use; and (2) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy." **[in other states substitute local statutory language]**

5. If, in the course of any interview or discussion with any representative of the Company, I am asked a question the answer to which may lead me to divulging a trade secret, I will decline to answer the question and express that concern. I am advised that compliance with this directive shall not adversely affect my candidacy for employment with the Company.

6. I have not engaged, during my employment with my Current Employer or any Former Employer, in the active solicitation or recruitment of any employees or customers of that employer to become employees of the Company in violation of any contractual agreement, fiduciary or loyalty duty or other law. No representative of the Company has encouraged me to do otherwise.

7. On my acceptance of the Company's offer of employment, if any, I will notify my Current Employer on the same business day (or, if the offer was not accepted during a business day, on the next business day) of my acceptance of that offer.

8. If I am offered and accept employment with the Company, following the end of my employment with my Current Employer and continuing during my employment with the Company, I will not have in my possession any keys or security passes of my Current Employer or any Former Employer or any document, computer disks, other media or any other thing that includes or is a trade secret of my Current Employer or any Former Employer or is subject to any confidentiality obligation owed by me to my Current Employer or any Former Employer.

9. If I have any questions about whether or not any information or thing is a trade secret of my Current Employer or a Former Employer or is subject to a confidentiality obligation owed by me to my Current Employer or any Former Employer, I will consult my own private attorney.

10. The Company and I agree that this Acknowledgement is not intended to create contractual rights for any third party.

Dated: __________________________

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Signature

____
Print Name

FORM 2:

PROPRIETARY INFORMATION OBLIGATIONS CHECKLIST

Prudent Corporation respects the right of every company to protect its confidential and proprietary information. We do not want you or any individual interested in employment with Prudent Corporation to use or disclose to anyone at Prudent Corporation any confidential or proprietary information belonging to any other company at any time before, during or after your employment with Prudent Corporation. Therefore, it is critical that you understand and comply with your continuing obligations to protect your current and former employer's confidential and proprietary information. In addition, you must ensure that your employment with Prudent Corporation does not violate any existing and/or continuing contractual obligations. Your failure to observe those continuing obligations could result in Prudent Corporation's refusal to hire or to continue employing you.

In order to ensure your compliance with those obligations, please fill out, sign, and bring this checklist on your first day of employment:

1.	Have you brought any property belonging to your current or former employer to Prudent Corporation's offices or to your home, or have you given any of your current employer's property to any of Prudent Corporation's employees?	Yes ❒	No ❒
2.	Have you forwarded any of your voicemails or emails concerning your current or former employer's business without their permission to Prudent Corporation or to anyone at Prudent Corporation?	Yes ❒	No ❒
3.	Have you made any copies of your current or former employer's software, source code, or any other document without their permission for the purpose of using that information at Prudent Corporation, or bringing it to Prudent Corporation or to your home?	Yes ❒	No ❒
4.	Have you brought any of your current or former employer's keys, badges, equipment – for example a laptop, computer disks, hardware, modem, cell phone or pager – to Prudent Corporation or to your home, or have you given them to any Prudent Corporation employee?	Yes ❒	No ❒
5.	Have you brought, in paper or electronic form, your rolodex, daytimer, calendar, notebooks, books, charts, business papers or other printed material to Prudent Corporation or to your home, or have you given them to any Prudent Corporation employee?	Yes ❒	No ❒

6.	Have you brought any financial documents or credit cards or your current or former employer to Prudent Corporation or to your home, or have to given them to any Prudent Corporation employee?	Yes ❒ No ❒

If you answered “Yes” to any of the above questions, please explain:

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I understand that I have continuing obligations to protect my current and all past employers' proprietary and confidential information before, during and after my employment with Prudent Corporation. I certify that the information provided in this Proprietary Information Obligations Checklist is accurate, and that I have taken no steps to use or disclose any confidential or proprietary information improperly between the date of my offer letter and the date I begin employment with Prudent Corporation, nor will I use or disclose any confidential or proprietary information improperly to Prudent Corporation after I become an employee of Prudent Corporation. In addition, I certify that I do not anticipate that my employment at Prudent Corporation will violate any existing or continuing contractual agreements with my current and former employers.

_____________________ _______________________________

Date Signature of Applicant

FORM 3:

LETTER TO DEPARTING EMPLOYEE RE PROPRIETARY INFORMATION OBLIGATIONS

November 26, 200*x*

Ernest Worker
1234 Home Street
San Generic, California

RE: Proprietary Information Obligations

Dear Ernest,

We wish you the best in your future work with Reckless, Inc. and look forward to your continued relationship with Prudent Corporation through your consulting work. At this time, I am obliged to remind you of your continuing obligations to Prudent Corporation with respect to proprietary information.

In your position with Prudent Corporation, you have had access to, and were entrusted with, intimate knowledge of Prudent Corporation's confidential and proprietary information, including information concerning Prudent Corporation's technology, strategic plans, and personnel. Prudent Corporation considers such information to be highly confidential and proprietary, and takes steps to safeguard such information. To this end, on October 30, 199*x*, you signed a Prudent Corporation, Inc. “Proprietary Information and Assignment of Inventions Agreement” (the “Agreement”), defining "Confidential Information" and setting forth your obligations with respect to such information. A copy of the Agreement is enclosed for your reference and convenience.

In Paragraph __ of the Agreement, you promised not to copy or to disclose any Confidential Information without Prudent Corporation’s authorization. In the same paragraph you also promised to return all Confidential Information in any tangible form to Prudent Corporation upon its request or on termination of your employment, which includes your recent resignation. In addition to the Agreement, under California's Uniform Trade Secret Act, you must not use or disclose for the benefit of others any commercially valuable information which Prudent Corporation maintained as confidential. Finally, in Paragraph 4 of the Agreement, you agreed to assign to Prudent Corporation your rights and interest in any inventions that you develop or reduce to practice during your employment with Prudent Corporation.

Prudent Corporation hereby confirms that it has not authorized you to disclose Confidential Information to Reckless, Inc., or any other third party going forward. For instance, you must not discuss Prudent Corporation’s technology, strategic plans, or personnel information with <u>any</u> third party, including Reckless, Inc.. Prudent Corporation requests that you ensure that you have returned any Confidential Information, in whatever form, in your possession or control.

We apologize for the formality of this letter, but experience has shown that it is best to be clear about these matters. Prudent Corporation appreciates your contributions to date and anticipates a successful consulting relationship going forward.

Sincerely yours,

Herman Hardnose
General Counsel
Prudent Corporation