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601:Trade Secrets & Restrictive Covenants- Competing Considerations in a Mobile Marketplace

Bob Bailey
Vice President, Assistant General Counsel and Assistant Secretary
Bausch & Lomb Incorporated

Deborah L. Thaxter
Partner
Nixon Peabody LLP

Glenn E. Westreich
Partner
Nixon Peabody LLP

Faculty Biographies

Bob Bailey

Bob Bailey is vice president, assistant general counsel, and assistant secretary for Bausch & Lomb Incorporated, an eye health company, in Rochester, New York. His responsibilities include managing legal affairs for the company's contact lens, lens care, and pharmaceuticals businesses, as well as its European commercial region.

Mr. Bailey began his career as an associate at the Nixon, Hargrave, Devans & Doyle law firm. He also spent two years as assistant general counsel at Goulds Pump Inc., an industrial and residential pump manufacturer.

Mr. Bailey received his BA from St. Olaf College and is a graduate of the University of Minnesota Law School.

Deborah L. Thaxter

Deborah L. Thaxter is the cochair of the national securities group at the Boston office of Nixon Peabody LLP. Her responsibilities include complex business litigation in both federal and state jurisdictions, with special emphasis on securities and corporate disputes representing corporations and their officers and directors, as well as general partnerships and public and private limited partnerships. She also specializes in litigation involving trade secrets and the enforcement of restrictive covenants.

Ms. Thaxter has prosecuted and defended numerous class actions and derivative suits involving, among other things, securities fraud, vanishing premiums, and the fiduciary duties of directors and officers. Ms. Thaxter has also litigated a variety of control contests, including proxy solicitations and tender offers, and she has broad experience in lender liability and bankruptcy litigation.

Ms. Thaxter has extensive trial experience in both state and federal courts, including bankruptcy courts, throughout the country. She has also taught and lectured extensively on state and federal trial tactics topics involving securities class action litigation, lender liability, and the use and enforcement of restrictive covenants.

Ms. Thaxter received a BA from Smith College and is a graduate of the Northeastern University School of Law.

Glenn E. Westreich

Glenn E. Westreich is a partner at Nixon Peabody LLP, and focuses his practice in the areas of business litigation, technology and intellectual property, and brand management. His responsibilities include representing technology companies, officers, and directors in all aspects of civil litigation, including numerous trials in state and federal courts.

Mr. Westreich has successfully handled cases involving a broad range of issues including patent infringement, trade secret litigation, bankruptcy, real estate, securities, fraud and breach of contract, class action litigation, eminent domain, and a variety of corporate law and commercial disputes. He has also recently successfully resolved a number of complex cases involving technology, securities, and bankruptcy issues.

Mr. Westreich is a member of both the ABA and the Bar Association of San Francisco.

Mr. Westreich received a BA from the University of California at Berkeley and is a graduate of its School of Law (Boalt Hall).

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Theft of Trade Secrets: Stakes are High

- Theft of trade secrets and critical technologies costs the U.S. economy upwards of **$240 billion** per year.

  Source: "Stealing Secrets Solved - Economic Espionage Investigations by the FBI," Thomas R. Stutler. *The FBI Law Enforcement Bulletin*, November 2000.

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What Qualifies as "Trade Secret"

- Uniform Trade Secrets Act defines a "trade secret" as 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 to 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.

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Trade Secrets Are Not the Exclusive Domain of High-Tech Industries

- Common Types of "Trade Secrets"
  - Secret formulas
  - Software
  - Customer lists and information
  - Operating procedures and manuals

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What Qualifies as "Trade Secret"

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Protecting Trade Secrets

- Restrictive covenants in employment contracts
  - Non-disclosure vs non-compete agreements

What Constitutes Misappropriation?

- Uniform Trade Secrets Act defines "misappropriation" as:
  1. 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

What Constitutes Misappropriation?

2. Disclosure or use of a trade secret of another without express or implied consent by a person who:
   - Used improper means to acquire knowledge of the trade secret; or
   - At the time of the disclosure or use, knew or had reason to know that his or her knowledge of the trade secret was:

What Constitutes Misappropriation?

- Derived from or through a person who had utilized improper means to acquire it;
- Acquired under circumstances giving rise to a duty to maintain its secrecy or limit its use; or
- Derived from or through a person who owed a duty to the person seeking relief to maintain its secrecy or limit its use; or

- 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.

Damages for Misappropriation

- Under the Uniform Trade Secrets Act, an injured party may seek recovery of damages for the actual loss caused by the misappropriation and may also recover for any unjust enrichment caused by the misappropriation (to the extent not taken into account in computing actual loss).

Equitable Relief for Misappropriation

- Interim Equitable Relief: TROs and Preliminary Injunctions
- Standard for Obtaining:
  - Likelihood of success on the merits
  - Irreparable harm
  - Balance of hardships
  - Public Interest
- Bond Requirements

The Inevitable Disclosure Doctrine

- *Pepsico Inc., v. Redmond et al.*, 54 F.3d 1262 (7th Cir. 1995).
- Rejected in some jurisdictions, including California and New York.

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Trade Secret Litigation

- Strategies for Prosecuting and Defending:
  - Whether to seek a Temporary Restraining Order
  - Expedited discovery
  - Identification and disclosure of trade secrets

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Other Means of Protecting the Company's Intellectual Property

- Federal Criminal Liability: 18 U.S.C. Section 1831
- Mail and wire fraud statutes
- Computer Fraud and Abuse Act
- Copyright protection
- Patent protection

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Restrictive Covenant Cases are Generally Won or Lost at Injunction Stage

- Employers' burden to prove:
  1. The contract restrictions are necessary to protect a legitimate business interest such as trade secrets, confidential information or good will
  2. The contract is supported by consideration
  3. The contract is reasonable in scope and duration
  4. The employee defendant has likely breached the restriction
  5. The breach has or will result in irreparable harm to old employer and balance of harm favors employer

STEP ONE: REVIEW THE CONTRACT

- Do:
  - Look for the original signed contract
    - Which parties, which version and who signed?
    - Signor still employed by company?
  - Determine what employee received as consideration
    - Real or illusion?
    - Sale of business?
  - Determine the scope and duration of the restrictions
    - Non-compete preventing employment with a competitor
    - Non-solicitation preventing solicitation of customers
    - Non-recruitment preventing solicitation of employees

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STEP ONE: REVIEW THE CONTRACT

- Do:
  - Consider other relevant provisions
    - Assignability of contract
    - Legal fee shifting
    - Is duration of restriction extended if injunction entered?
    - Forum selection and choice of law
- Don't:
  - Assume contract will be enforced as written
  - Assume contract is with right company or has been properly assigned
  - Ignore follow-up memos and communications

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STEP TWO: INVESTIGATE THE FACTS

- Do:
  - Review employee personnel file
    - Employee complaints?
    - Employee about to be terminated?
  - Secure and review employee computer files
    - Transfer of confidential or proprietary information?
    - Contact with customers to divert sales?
    - Recruitment of other employees?
  - Interview co-workers
    - Recruited by old employee or new employer?
    - Pre-departure activity?

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STEP TWO: INVESTIGATE THE FACTS

- Do:
  - Review company's procedures about protecting confidential information
    - All employees sign non-disclosure or non-compete agreements?
    - Company consistently enforce agreements?
    - Company hire new employees with existing restrictive covenant agreements?
    - Company limit access to confidential information?
  - Learn what employee is doing at new job
    - Send letter informing new employer of contract
    - Ask customers, vendors or manufacturers if contacted by employee

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STEP TWO: INVESTIGATE THE FACTS

- Don't:
  - Wait
  - Assume you are hearing the whole story from your employees or customers

STEP THREE: DECIDE WHERE TO BRING SUIT

- Do:
  - Look to contract jurisdiction and choice of forum clause
    - Permissive or mandatory?
    - Is it enforceable?
  - Compare the law in the available forums
    - Is continued employment sufficient consideration?
    - Will a change in job responsibilities void the contract?
    - Do the courts recognize the inevitable disclosure doctrine?
    - Do the courts enforce non-compete provisions as opposed to non-solicitation of customers provisions?
    - Are restrictive covenants assignable?
    - Will courts blueline the contract?
    - Is irreparable damage presumed?

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STEP THREE: DECIDE WHERE TO BRING SUIT

- Do:
  - Analyze state or federal court option
    - Standard of proof for irreparable harm
    - TRO option
    - Review local state court decisions
    - Affidavits versus evidentiary hearing
    - Availability of state business court
- Don't:
  - Let employee beat you to court with a declaratory judgment action
  - Accept employee choice of venue
  - Proceed without knowledgeable local counsel

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STEP FOUR: WHO TO SUE FOR WHAT

- Do:
  - Consider suing just the employee
    - Breach of contract
    - Breach of duty of loyalty
    - Misappropriation of trade secrets or IP claims
  - Consider the benefit of naming new employer
    - Include new employer in injunction request
    - Raiding/interference with contract
    - Statutory claims – multiple damages and attorney's fees
  - Determine if any other ex-employees with restrictive covenants involved in recruiting for new employer

STEP FOUR: WHO TO SUE FOR WHAT

- Don't:
  - Ignore contract jurisdiction limitation
  - Lose sight of objectives
    - Injunction versus damages?
    - How broad the injunction?

STEP FIVE: EVALUATE THE RISKS OF SUIT

- Do:
  - Anticipate potential counterclaims
    - Wage claims
    - Fraud in the inducement
    - Abuse of process / unfair competition
    - Employment discrimination claim
    - Defamation
    - Jury
  - Your own pleadings are used against you
  - Expect extensive discovery
    - Disclosure of trade secrets
    - Disclosure of information relating to sales

STEP FIVE: EVALUATE THE RISKS OF SUIT

- Do:
  - Recognize difficulty in proving damage claim
  - Consider precedential impact of court rulings
- Don't:
  - Be a wimp!

In-house Counsel Considerations

- Relationship with competitors
- Potential disclosure of trade secrets to competition in discovery
- Risk of having trade secret found by court to be public
- Risk that specific contract provision is found to be unenforceable

In-house Counsel Considerations

- Risk that failure to enforce is deemed to be failure to protect confidential / trade secret information
- Message to current employees
- Unpredictability of results
- Costs of litigation

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Sheraton Chicago
Tuesday, October 26, 2004
2:30 – 4:00 p.m.

I. INTRODUCTION

As the American workforce continues to become more mobile and the notion of lifetime employment becomes an ever more distant memory, businesses have come to rely on non-competition agreements and other restrictive covenants to safeguard their trade secrets, confidential information, and customer goodwill. Theft of trade secrets alone is estimated to cost the United States economy upwards of $240 billion per year (Thomas R. Stutler, *Stealing Secrets Solved –Economic Espionage Investigations by the FBI*, The FBI Law Enforcement Bulletin, Nov. 2000). Not surprisingly, there has been a resulting increase in the amount of litigation concerning enforcement of various forms of restrictive covenants and non-competition agreements.

Unfortunately, the resulting litigation has done anything but create stability or predictability in the marketplace. Rather, it has created a patchwork of different standards and statutes governing enforceability of restrictive covenants throughout the United States. Despite this, certain patterns have emerged. Today, depending on the location of the business, the location of the employee, and the nature of the interests a former employer seeks to protect, a majority of states will enforce limited restrictive covenants. Elsewhere, however, such covenants are routinely rejected on statutory and constitutional grounds. These materials address the basic concepts concerning restrictive covenants and the issues employers must consider in using and enforcing them.

II. WHAT "PROTECTABLE INTERESTS" CAN A COMPANY PROTECT BY MEANS OF A RESTRICTIVE COVENANT?

Although most jurisdictions today will enforce "reasonable" restrictive covenants, a would-be litigant must demonstrate that enforcement of an otherwise reasonable covenant is necessary to safeguard a legitimate "protectable interest." Generally, protectable interests fall into three categories: (i) trade secrets; (ii) confidential information; and (iii) goodwill. If an employee did not have access to any of these three types of interests during his or her tenure, enforcement of a restrictive covenant is almost impossible, no matter how "reasonable" it may otherwise be. If an employee had substantial access to a company's trade secrets or confidential information or played a significant role in building a business's goodwill, enforcement is much more likely. To better understand the likelihood of enforcement, each of these protectable interests is discussed below.

A. Trade Secrets

The Uniform Trade Secret Act ("UTSA") defines a "trade secret" as 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 to 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.

Generally, in the context of restrictive covenants, “trade secrets” are viewed as information or devices of a more technical nature. Examples include software code, products under development, and proprietary recipes and formulas. [*See e.g.*, *LeJeune v. Coin Acceptors, Inc.*, 381 Md. 288, 849 A.2d 451 (2004) (holding computer software budgeting program constituted a trade secret under UTSA); *Diversified Fastening Sys., Inc. v. Rogge*, 786 F. Supp. 1486 (N.D. Iowa 1991) (holding products under development to be a trade secret under UTSA and enjoining former employer from working for competitor); *see also Sofitel, Inc. v. Dragon Med.*, 118 F.3d 955 (2d Cir. 1997), *cert. denied*, 523 U.S. 1020 (1998) (recognizing trade secret status of computer software code)]. Where an employee has absconded with a bona fide trade secret of his or her former employer and goes to work for a competitor, the former employer has a substantial likelihood of enjoining that employment and recovering any damages it may have suffered.

In addition to technical data, other types of information have been recognized as trade secrets under the UTSA. One example is customer lists, which many courts have recognized as trade secrets under the UTSA. [*See e.g., North Atl. Instruments, Inc. v. Haber*, 188 F.3d 38, 44 (2d Cir. 1999) (“A customer list developed by a business through substantial effort and kept in confidence may be treated as a trade secret and protected at the owner's instance against disclosure to a competitor, provided the information it contains is not otherwise readily ascertainable.”) (internal quotation marks and citation omitted)]. Other courts have recognized customer lists as “confidential information” an employer is entitled to protect by means of a restrictive covenant. [*See Nationwide Mut. Ins. Co. v. Cornutt*, 907 F.2d 1085 (11th Cir. 1990) (recognizing customer lists as a “protectable interest” employer can protect with a restrictive covenant)].

Another example of information widely recognized as either a trade secret or confidential information is operating procedures and/or manuals. [*See e.g., Minnesota Mining & Mfg. Co. v. Pribyl*, 259 F.3d 587 (7th Cir. 2001) (affording trade secret status to operating manuals)]. Such documents can take a variety of forms, including franchise operating manuals, computer manuals, and policies. [*See e.g., Hamilton v. State Farm Mut. Auto. Ins. Co.*, 204 F.R.D. 420 (S.D. Ind. 2001) (holding manuals, handbooks, and policies regarding claims handling constituted trade secrets)].

Although all these types of information and others *may* constitute trade secrets, oftentimes they are denied trade secret status because a company failed to meet the second prong of the trade secret test: taking appropriate steps to keep the information confidential. While it is clear that information need not reach the level of novelty and originality necessary for patent protection to be considered a trade secret, *see e.g., Rivendell Forest Prods., Ltd. v. Georgia Pac. Corp.,* 28 F.3d 1042 (10th Cir. 1994), employees have argued successfully that information is not a "protectable interest" because the company failed to take adequate steps to safeguard its secrecy. [*See e.g., Omega Optical v. Chroma Tech. Corp.*, 174 Vt. 10, 800 A.2d 1064 (2002) (company's failure to take steps to maintain confidentiality of process to produce thin film optical filters or designate documents as confidential prevented trade secret status); [*Briskin v. All Seasons Servs., Inc.*, 615 N.Y.S. IId 166 (App. Div. IV th Dep't 1994) (customer was not protected where names of customers could be obtained through yellow pages)].

While taking steps to maintain information's secrecy is essential in establishing its trade secret status, this does not mean that the information must be kept in a vault and never utilized. Rather, companies must take "reasonable" steps to maintain the information's confidentiality. What is reasonable depends on the size of the company, the resources it has available, and the nature of the information. Depending on the information, marking documents and manuals as "confidential," telling employees that the information therein must be kept confidential, and requiring all third parties given access to the information to execute non-disclosure agreements are oftentimes sufficient to maintain confidentiality. A lone provision in a restrictive covenant reciting that certain information is confidential will not, however, likely be sufficient to meet a company's burden. It is, therefore, important both to implement "reasonable" steps to safeguard information's confidentiality generally and to review whether those steps have been followed before initiating litigation.

B. Confidential Information

The second category of information courts have recognized as a "protectable interest" is "confidential information." Although closely related to trade secrets, confidential information generally includes information less technical in nature, such as customer lists, and policies. Confidential information also can include business plans, marketing data, and financial information. [*See e.g., Marcam Corp. v. Orchard,* 885 F. Supp. 294 (D. Mass. 1995) (recognizing strategies and plans for future development as confidential information)]; [*Platinum Mgmt., Inc. v. Dahms,* 666 A.2d 1028 (N.J. super Ct 1995) (recognizing customer buying habits, mark-up structure, merchandizing plans, sales projections, and product strategies as confidential information)]. Generally, like trade secrets, confidential information is information that is economically valuable and not known to the general public. A company must take reasonable steps to protect the confidentiality of its "confidential" information. Where information is either disclosed to the public or generally ascertainable through publicly available documents, courts are unlikely to enforce a restrictive covenant to protect such information. [*See e.g., Shapiro v. Regent Printing Co.,* 549 N.E. 2d 793 (Ill. App. Ct. 1989) (holding that former employer's pricing formula for printing work did not constitute protectable confidential information because former employer took no steps to segregate or restrict access to the printing methodology)].

Unlike "trade secrets," there is less protection available for "confidential information" absent a specific non-disclosure agreement. Although employees may have a common law duty of loyalty to protect confidential information, as discussed below, there is often no statutory claim analogous to the UTSA that an employer can bring to protect disclosure of its confidential information. A non-disclosure agreement may therefore be necessary to protect confidential information.

C. Goodwill

The final "protectable interest" that the majority of courts have recognized is goodwill. [*See Intellus Corp. v. Barton*, 7 F. Supp. 2nd 635 (D. Md. 1998) (recognizing employer goodwill as a protectable interest)]; [*Saliterman v. Finney*, 361 N.W. 2d 175 (Minn. Ct. App. 1985) (same)]. A business's goodwill has been variously defined as:

- A business's reputation, patronage, and other intangible assets that are considered when appraising the business, especially for purchase (Blacks Legal Dictionary 715 Edition 2004).
- "[A]nother name for reputation, credit, honesty, fair name, reliability." Harry D. Nims, *The Law of Unfair Competition and Trade Marks* 36 (1929) (Blacks Legal Dictionary 715 Edition 2004).

Goodwill is often an issue in the enforcement of restrictive covenants for salespeople and other employees who are the "face" of an organization. Where an employer can show that its goodwill will be negatively impacted by a former employee working for a competitor, there is a substantial likelihood that some form of restrictive covenant will be enforced.

III. WHAT TYPES OF RESTRICTIVE COVENANTS CAN A COMPANY USE TO SAFEGUARD ITS "PROTECTABLE INTERESTS?"

Having identified what interests and information an organization can protect, the next step is to determine what an organization must actually do to protect that information. The common means of protecting trade secrets, confidential information, and goodwill is through the use of restrictive covenants. These covenants take a variety of forms and have been greeted by the courts with varying degrees of skepticism. Despite the fact that almost all courts express a general hostility to restrictive covenants, the overwhelming majority of jurisdictions today will enforce restrictive covenants reasonably limited in scope and duration that will safeguard an organization's protectable interests.

The two primary types of restrictive covenants are non-disclosure agreements and non-competition agreements. These are generally stand-alone written agreements that employees sign at the beginning of their employment. A third type of agreement is a customer limitation that prevents former employees from contacting current or prospective customers. Some customer restrictions are limited to customers with whom the employee actually has contact and others include all customers of an organization.

Apart from non-competition and non-disclosure agreements, the UTSA provides an independent cause of action for both injunctive relief and monetary damages for misappropriation of trade secrets. Finally, employers may also have a common law cause of action for breach of the duty of loyalty.

As discussed below, each method of safeguarding protectable interests has certain benefits and risks. When, where, and what type of covenant, if any, an employer should use to protect its information must be carefully considered on a case-by-case basis and oftentimes varies in where the employee resides and works.

A. Non-competition Agreements

Non-competition agreements, when enforced, provide the highest degree of protection to employers and their protectable interests. The touchstone for enforcement of a non-competition agreement is a demonstrable need for enforcement to safeguard one of the three protectable interests. Absent substantial proof of the existence of a protectable interest and a likelihood of harm to that interest if an agreement is not enforced, courts are loath to prohibit a person from being able to earn a living in his or her chosen profession.

Most non-competition agreements restrict an employee from working for an organization's competitors during the term of the employee's employment and for a period of time thereafter. To meet the "reasonableness" test courts impose, most restrictive covenants are limited to two or three years following employment. In addition, such agreements are usually limited to competitors in a certain geographic area. In appropriate cases, such as truly global salespersons, non-competition agreements may have no geographic boundaries.

B. Non-disclosure Agreements

Non-disclosure agreements are specifically designed to protect employers' trade secrets and confidential information from disclosure. [*See e.g., Nelson v. Agro Globe Eng'g, Inc.,* 579 N.W.2d 659 (Iowa 1998) (distinguishing non-disclosure agreement from non-competition agreement)]. Because they are premised on the existence of trade secrets and confidential information, courts tend to be more accepting of non-disclosure agreements than non-competition agreements and they are more routinely enforced. Many employers require employees to sign agreements that have separate non-competition and non-disclosure covenants.

Unlike non-competition agreements, non-disclosure agreements are not generally subject to time limitations. An employee is obligated to maintain the secrecy of confidential information until such time as the owner of that information decides to make it generally available. The corollary is that for information to be protected, it must truly be confidential. An added advantage to requiring employees to execute non-disclosure agreements is that employers have the opportunity to define the scope of "confidential information" that is not subject to disclosure. This definition often goes beyond "trade secrets" to include business plans, financial data, and other proprietary information that may or may not qualify as "trade secrets." As explained in the discussion below concerning the inevitable disclosure doctrine, many employers have attempted to use the courts' more favorable response to non-disclosure agreements as a means to enforce otherwise unenforceable non-competition agreements.

C. Uniform Trade Secrets Act

The UTSA provides an independent cause of action to maintain the confidentiality of "trade secrets," even absent a specific non-competition or non-disclosure agreement. To recover damages, a trade secret owner must prove that the information qualifies as a "trade secret" and that it was "misappropriated." Once the owner establishes these two requirements, it can recover damages for the actual loss caused by the misappropriation and may also recover damages for any unjust enrichment by the misappropriator. The UTSA also specifically provides for interim injunctive relief, such as temporary restraining orders and preliminary injunctions, to safeguard trade secrets. Due to its statutory nature, courts have not expressed the same type of suspicion of UTSA actions that they have expressed toward non-competition agreements.

D. Common Law Claim for Breach of Duty of Loyalty

Employers in many states also have available a common law claim for breach of the duty of loyalty. The duty of loyalty exists regardless of whether an employee has signed a non-competition or non-disclosure agreement. The duty of loyalty has been defined as the duty to maintain the confidentiality of knowledge acquired by an employee during his or her hire and not to use such knowledge for his or her own advantage or to the injury of the employer. [*See e.g., Allen Mfg. Co. v. Loika*, 144 A2nd 306 (Conn. 1958)]; [*Newco Waste Sys., Inc. v. Swartzenberg*, 510 N.Y.S.2d 399 (4th Dept. 1986) (defining duty of loyalty as prohibiting employee from utilizing employer's confidential information in a manner that constitutes a breach of trust)]. Although claims for breach of the duty of loyalty are often brought in connection with claims for breach of non-disclosure and non-competition agreements, they usually take a back seat to such claims. This is because information that a court will protect under the duty of loyalty should also be protected under a non-disclosure or non-competition agreement. Where an employer has not secured such agreements, however, the duty of loyalty may be all that is available to an employer attempting to seek protection of its confidential information and goodwill.

IV. WHEN AND WHERE ARE RESTRICTIVE COVENANTS ENFORCED?

As discussed above, the enforcement of non-competition and non-disclosure agreements varies on a state-by-state basis. Some states, such as California and Texas, have enacted statutes specifically addressing the enforceability of such agreements, while other states such as Georgia have developed case law generally hostile to such agreements. Despite this, if prepared and executed correctly and reasonably limited in temporal and geographic scope, the overwhelming majority of jurisdictions will today enforce both non-competition and non-disclosure agreements.

A. The Majority of Jurisdictions Will Enforce Reasonable Restrictions Necessary to Safeguard Protectable Interests.

Today, the majority of jurisdictions have recognized the enforceability of limited restrictive covenants. [*See e.g., ChemiMetals Processing, Inc. v. McEneny*, 476 S.E.2nd 374 (N.C. App. Ct. 1996) (enforcing non-competition agreement based on need to protect confidential information and trade secrets)]; [*Shearson Lehman Bros., Inc. v. Schmetzler*, 1500 N.Y.S.2d 512 (N.Y. App. Ct. 1986) (enforcing non-competition agreement where former employee's services were unique or extraordinary and covenant was reasonable)]. As described above, to be enforceable most jurisdictions require that employers demonstrate that the former employee had either access to trade secrets or confidential information, and that his or her employment by a competitor will lead to a disclosure of the information, or that the employee will unfairly use the information to benefit his or her new employer. Alternatively, an employer can show that a former employee (usually a salesperson) has misappropriated its goodwill, that he or she is using that goodwill for the benefit of another (including him or herself) and therefore such new employment must be enjoined. In addition, assuming the employer can prove the misappropriation of a protectable interest, the restrictive covenant must be reasonably limited in temporal and geographic scope.

As more employees seek to avoid restrictive covenants and more employers seek to enforce them, new trends are beginning to emerge. One such trend is the need for additional compensation to support the restrictive covenant. In a recent Massachusetts case, the court refused to enforce a restrictive covenant signed by an employee at the beginning of his employment when it was not reaffirmed after a promotion. [*See e.g., R.E. Moulton, Inc. v. Lee*, C.A. No. 04-933, 2004 Mass. Super. LEXIS 268 (June 17, 2004 Mass. Super. Ct.)].

B. <u>Certain Jurisdictions Will Not Generally Enforce Restrictive Covenants.</u>

Certain jurisdictions, notably California and North Dakota, are extremely hostile to restrictive covenants. In California, Business and Professional Code §16600 prohibits enforcement of "every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind." This provision has been interpreted as representing a "strong public policy of [California]" and prohibiting enforcement of restrictive covenants. [*See e.g., Scott v. Snelling and Snelling, Inc.*, 732 F. Supp. 1034, 1042 (N.D. Cal. 1990)]. While it is true that §16600 will invalidate most restrictive covenants, California courts have recognized that this provision "did not make all restrictions unenforceable." [*See e.g., Campbell v. Board of Trustees*, 817 F.2d 499, 502 (9th Cir. 1987)]. Where the covenant is limited to prohibiting a person "from pursuing only a small or limited part of the business, trade, or profession, the contract has been upheld as valid." [*See e.g., Boughton v. Socony Mobil Oil Co.*, 41 Cal. Rptr. 714, 716 (Cal. Ct. App. 1964)]. In addition, California has recognized a "trade secret" exception to §16600 that allows employers to prohibit future employment that jeopardizes their trade secrets. [*See Muggill v. Reuben H. Donnelley Corp.*, 62 Cal. 2d 239 (1965)];

[*Gordon Termite Control v. Terrones*, 84 Cal. App. 3d 176, 178 (1978)]. Overall, however, California is appropriately characterized as one of the most hostile jurisdictions to restrictive covenants and enforcement there is unlikely at best.

Another state hostile to the enforcement of restrictive covenants is North Dakota. Under North Dakota Code §9-08-06, covenants not to compete are void except for those involving the sale of a business or made in anticipation of a partnership dissolution. Indeed, the North Dakota courts have gone so far as to hope that §9-08-06 prohibits enforcement of non-solicitation agreements in addition to non-competition agreements. [*See e.g., Warner and Co. v. Solberg*, 634 N.D.2d 65 (N.D. 2001)]. Absent extraordinary circumstances, employers in North Dakota or employers otherwise subject to North Dakota law cannot reasonably expect to enforce the terms of most restrictive covenants.

C. <u>Employers May Be Able to Rely On a Non-Disclosure Agreement and the Inevitable Disclosure Doctrine to Enjoin Subsequent Employment</u>

To state a claim based on the Inevitable Disclosure Doctrine an employer must show that a former employee (1) had access to confidential information; (2) is working for or is about to commence working for a competitor of the former employer; and (3) the employee's new duties and responsibilities will inevitably lead to the disclosure of confidential information. [*See e.g., PepsiCo, Inc. v. Redmond*, 54 F.3d 1262, 1269-70 (7th Cir. 1995)]. Stated simply, the inevitable disclosure doctrine has been adopted by certain courts to enjoin employment because the duties and responsibilities of an employee's new position makes it is "inevitable" that he or she will use a former employer's trade secrets or confidential information.

Most inevitable disclosure cases follow the same familiar path that non-competition actions follow. An employer brings suit to enjoin its former employee(s) from beginning or continuing to work for one of its competitors. In the usual case, the employee has signed some type of confidential information/non-disclosure agreement. Whether or not the former employee has actually misappropriated any trade secrets is usually a contested fact, but oftentimes the parties agree that no actual misappropriation has yet occurred. Despite this, the former employer argues that, because the former employee is working for a competitor in a position identical to or very similar to his or her previous position, it is simply impossible for the employee not to disclose or not to make use of the confidential information he or she learned at the original employer. Indeed, former employers often argue that, because the nature of the new position is so similar to that of the previous one, affirmative directives to the employee from the new employer not to use such confidential information cannot effectively safeguard the protected information.

Most inevitable disclosure cases are resolved at the preliminary injunction stage, so that there has been limited or no discovery by the plaintiff to support its allegations, and the factual records upon which judges can make determinations are less than fully developed. Not only does this affect the accuracy of a court's decision in these matters, but it also has the effect of limiting appellate review of many decisions. As a result, an employer's success in obtaining an injunction issued on the limited basis of inevitable disclosure is oftentimes as dependent on the judge one draws as the available facts.

The inevitable disclosure doctrine has been met with varying degrees of skepticism across the country. [*See PepsiCo, Inc. v. Redmond*, 54 F.3d 1262 (7th Cir. 1995) (adopting doctrine)]; [*Campbell Soup Co. v. Giles*, 47 F.3d 467 (1st Cir. 1995) (recognizing viability of doctrine under Massachusetts law but rejecting application under facts of case)]; [*Earthweb, Inc. v. Schlack*, 71 F. Supp. 2d 299 (S.D.N.Y. 1999), remanded, 205 F.3d 1322 (2d Cir. 2000), *aff'd*, 2000 WL 1093320 (2d Cir. Jun. 12, 2000) (refusing to apply the inevitable disclosure doctrine under New York law to justify imposing a broader post-employment restrictive covenant than the one to which the parties previously agreed)].

V. CONCLUSION

As these cases discussed above demonstrate, enforcement of restrictive covenants has become a heavily litigated issue. Despite a general acceptance of such agreements in most jurisdictions, employers must still affirmatively demonstrate that enforcement is necessary to safeguard a "protectable interest" and is reasonably limited in time and geography. Moreover, some jurisdictions will almost never enforce restrictive covenants. The result is that employers must carefully review what type of information they seek to safeguard through the use of a restrictive covenant, choose the right agreement to protect that interest, and recognize that, in certain jurisdictions, enforcement of any restrictive covenant may be an uphill battle.