601 Top 10 Reasons Employers Lose Trade Secret Cases (and How to Prevent Them)

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Prior to joining Gallup, Mr. Perkins practiced commercial litigation both as a partner and in his own firm. He has extensive experience in litigation and has represented clients in more than $1.5 billion in transactions and litigation.

Mr. Perkins has been a life-long community activist and advocate. For almost 20 years, he has been an education advocate, studying and writing about educational reform. His community activities include creation of a permanent multi-million dollar endowment for the Louisville, Kentucky Free Public Library; assisting in the drafting of a new system of government for the new Greater Louisville government; and promoting the enactment of legislation protecting the disabled and elderly. He has served as an adjunct professor at Jefferson Community College in Louisville where he was named outstanding instructor each semester.

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He is past chair of the Civil Litigation Section of the Pennsylvania Bar Association; past president of the American Inns of Court Pittsburgh Chapter; past member of the Board of Governors of the Academy of Trial Lawyers of Allegheny County; and past chair of the Council of the Civil Litigation Section of the Allegheny County Bar Association. He was a delegate to the 1987, 1988, 1989, 1993, 1995, 1997, 1999 and 2001 Judicial Conference of the Third Circuit.

Mr. Schwab has been quoted in numerous national and regional printed media and published several articles. He also serves on the faculty of the Trial Advocacy Institute of the University of Virginia School of Law.

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TOP 10 REASONS EMPLOYERS LOSE TRADE SECRET CASES (AND HOW TO PREVENT THEM)

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GUARDING THE CROWN JEWELS: A GUIDE TO PROTECTING YOUR TRADE SECRETS

Washington Legal Foundation
MONOGRAPH

EXECUTIVE SUMMARY

In our current economy, no issue is more vital to the success and survival of businesses today than protecting proprietary technology and information from competitors. The most common method of protecting a business= trade secrets and intellectual property is for the company to enter into various contractual agreements with its employees and managers. These contracts require legal counsel and mangers to balance the competing interest of information security, business efficiency, and workers' rights. It is essential that the right legal balance is established in developing and implementing a trade secret protection strategy.

In the latest edition of the Washington Legal Foundation=s (WLF) education Monograph series, **Arthur J. Schwab** and **David J. Porter** of the Pittsburgh law firm *Buchanan Ingersoll* provide a comprehensive overview of how to effectively guard a company=s trade secrets from competitors. The Monograph, ***Guarding the Crown Jewels: A Guide to Protecting Your Trade Secrets***, features a foreword by **Laura Stein**, Senior Vice President and General Counsel of H.J. Heinz Company, and an introduction by **John K. Williamson**, Assistant General Counsel Intellectual Property of PPG Industries.

The authors provide a wealth of information in the Monograph=s eight sections. The first section presents a brief introduction of the issues that will be discussed throughout the Monograph. Section two provides a historical overview of what is considered a trade secret. This section examines the Uniform Trade Secrets Act, Section 757 of the First Restatement of Torts, and the Economic Espionage Act. The authors also focus on the requirements of confidentiality and economic value with regard to the type of information considered protected. They explain that to meet these requirements the information must be kept sufficiently confidential and it must derive economic value. Section two concludes by highlighting the categories of information afforded trade secret protection.

The Monograph=s third section tackles the difficult issue of covenants not-to-compete in the employment context. The authors address the considerations courts apply to determine the validity of covenants not to compete. Throughout the discussion of these considerations, the authors furnish valuable insight regarding ways to draft a covenant not-to-compete which can prevail in court.

The next section offers advice on types of post-employment procedures that should be used in order to prevent the loss of trade secrets and customers. The authors review the effect of involuntary termination and present various helpful ideas on how to properly conduct an exit interview. The discussion also examines steps that should be taken to protect a company=s customer list, and the importance of communicating with customers during the transition phase when a vital employee leaves. The authors conclude this section by discussing the benefits and cautions of providing notice to a new employer of a former employee=s obligations.

Sections five and six discuss the enforcement of trade secret rights and the discovery process. The authors focus on the benefits and costs of suing or not suing, and the tactical questions that need to be asked when determining whether to sue. If the decision to sue is made, the authors outline helpful steps that can be utilized to protect a company=s trade secrets from being exposed unnecessarily. With regard to discovery, the Monograph examines the use of certain motions to preserve the integrity of a company=s trade secrets during the process. In addition, the authors list beneficial sources and types of information to pursue during discovery, and steps that should be used to access computer and electronic data.

Section seven presents an overview of the relief available in trade secret misappropriation cases. The authors discuss the various forms of relief a company might be permitted to pursue, including injunctions and tort recovery. The section also includes a discussion of monetary relief and the standard of proof required to show damages.

The final section is a discussion of the Economic Espionage Act of 1996 (EEA). The authors provide a detailed explanation of the EEA and its application to trade secret law. The discussion begins with the legislative background of the EEA and then proceeds to deliver a elaborate analysis of the Act. The authors conclude by sharing ideas on how to handle an EEA violation.

Washington Legal Foundation is a national, non-profit public interest law and policy center. By utilizing a unique approach to forwarding its mission C publishing timely legal studies, engaging in innovative litigation, and communicating directly to the public C WLF has become the nation=s most effective advocate of freedom and free enterprise. This Monograph is one of six free-standing formats in which WLF=s Legal Studies Division produces legal policy papers and promotes free enterprise legal thought.

Copies of *Guarding the Crown Jewels: A Guide to Protecting Your Trade Secrets* are available for $10 per copy. Please forward a request for copies and a check made out to AWashington Legal Foundation@ to: Publications Department, Washington Legal Foundation, 2009 Massachusetts Avenue, N.W., Washington, D.C. 20036.

PROTECTING VITAL COMPANY INFORMATION:
RESTRICTIVE COVENANTS AND TRADE SECRETS

CHAPTER 16 FROM THE 2002–2003

NATIONAL EMPLOYER®

MAY 2002 – APRIL 2003

PRESENTATION BY
MARGUERITE WALSH, ESQ.
2002 ACCA ANNUAL MEETING

LITTLER MENDELSON®
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IMPORTANT NOTICE

We hope you find this publication helpful in your effort to understand, and comply with, the complex and confusing web of employment laws confronting employers today. Please remember, however, that due to the complexity of employment law, and its rapidly changing natures, this publication is not, and cannot be, a substitute for legal counsel on any particular matter or case. By its very nature, employment law requires decisions to be made on a case-by-case basis. We therefore urge you to obtain legal advice from qualified legal counsel about any specific matters, circumstances or questions which may arise. Although we are confident that the matters discussed herein are up-to-date through January 2002, the very subject matter of this publication makes clear how very quickly the law can evolve and change in unexpected directions. Moreover, our commentary and policies are provided for discussion purposes only, as such material obviously cannot be made specifically applicable for each employer interested in this type of publication. Nevertheless, we hope the publication will prove helpful in developing your own specific forms and policies.

Sincerely,

The Attorneys of
Littler Mendelson

CHAPTER 16

PROTECTING VITAL COMPANY INFORMATION: RESTRICTIVE COVENANTS & TRADE SECRETS

I. RECENT TRENDS & DEVELOPMENTS

A. RENEWED INTEREST IN THE INEVITABLE DISCLOSURE DOCTRINE

§ 360

With the tightening job market, companies necessarily place a premium on hiring and retaining talented employees. While layoffs have become more commonplace, the contributions of those remaining employees have increased in importance. Thus, employee mobility in the current economic climate is becoming a serious concern for employers facing the challenges of a more competitive market.

In this context, an emerging trend in the law governing unfair competition is the increased focus on a familiar theory – the doctrine of inevitable disclosure. While discussed in more detail below in this chapter, inevitable disclosure generally applies when a former employee with prior access to trade secrets takes a job with a competitor to perform duties so similar that the new job cannot be done without using the prior employer's trade secrets. Courts that have adopted inevitable disclosure apply traditional trade secret misappropriation principles to circumstances where there has been no actual or threatened disclosure. *Del Monte Fresh Produce Co. v. Dole Food Co., Inc*., 148 F. Supp. 2d 1326 (S.D. Fla. 2001). Indeed, it is viewed as a shorthand method of proving threatened misappropriation of trade secrets.

The doctrine is not a new theory, having been asserted in employment cases since the 1960's. *See, e.g., Allis-Chalmers Mfg. Co. v. Continental Aviation & Eng'g Corp*., 255 F. Supp. 645, 654 (E.D. Mich. 1966) (former employee enjoined from working for competitor when there is an inference that the employee would inevitably disclose the former employer's trade secrets). The more recent and leading decision in *PepsiCo, Inc. v. Redmond*, 54 F.3d 1262 (7th Cir. 1995) has generated repeated efforts to rely on the doctrine to preclude former employees from working for competitors. Central to its value to a former employer, it can provide for an injunction without proof that actual or threatened disclosure of trade secret information has occurred, even in the absence of a non-compete agreement. In *PepsiCo*, the former employee had signed a confidentiality agreement with his former employer, but did not have a non-compete agreement. Nonetheless, the court issued an injunction to preclude the former employee from working for six months for the competitor.

Key to the court's decision in *PepsiCo* was the employee's lack of honesty about his intentions in leaving his former employer. The former employee's failure to be forthright and his lies about his intention to take a new job with a competitor led the court to conclude that he could not be trusted to act in good faith.

Thus, the *PepsiCo* decision provides a good example of how the tension between protecting a former employer's proprietary information is balanced with an employee's freedom to earn a living in their chosen field of work in circumstances involving a former employee's bad faith. Recent cases applying the inevitable disclosure doctrine demonstrate that bad faith – such as an employee's lack of candor – is an important element to determine whether an injunction will issue.

RKI, Inc. v. Grimes: Injunctive Relief Granted When Employee Acts in Bad Faith

In *RKI, Inc. v. Grimes*, 177 F. Supp. 859 (N.D. Ill. 2001), the court applied the inevitable disclosure doctrine as an alternative ground to preclude a former employee, Grimes, a sales representative, from working for a competitor. Citing *PepsiCo*, the court in *RKI* identified the factors to assess the inevitability of disclosure of trade secrets as: (1) the level of competition between the former employer and the new employer; (2) whether the employee's position with the new employer is comparable to the former position; and (3) preventative actions taken by the new employer to prevent the former employee from using or disclosing the former employer's trade secrets. *Id.* at 875. The *RKI* court found that these factors were well satisfied, and compared the facts in this case to those in *PepsiCo*, noting particularly that evidence existed to show that Grimes intended to use his former employer's trade secret information. Grimes, while still employed by his prior company but knowing that he was taking a job with a competitor, purposefully copied confidential data from his company's database including sensitive customer information. Days after he resigned and assumed his new position, he solicited business from customers he had called upon immediately prior to his resignation, using his former employer's confidential information in the process.

It is noteworthy that in *RKI*, Grimes had signed a non-compete agreement with his former employer, which presented substantial evidence of actual misappropriation of trade secret information. Nonetheless, the court still applied the inevitable disclosure doctrine, explaining that even in the absence of the direct evidence of misappropriation that was presented, the record justified injunctive relief to restrain Grimes from working for the competitor. As the *RKI* court observed, "this is a textbook case of how not to" sign a non-compete agreement and then chose to join a competitor. *Id*. at 859.

Central to the court's decision in *RKI* was Grimes' bad faith conduct in willfully plotting to join a competitor, lying about joining the competitor when directly asked, sneaking into his office late at night and copying his former employer's confidential customer information for the purpose of using it against the company, and ignoring a cease and desist letter after he joined the competitor. Under these circumstances, the court had little difficulty in finding actual misappropriation, but also found injunctive relief appropriate under the inevitable disclosure doctrine. *Id.* at 875-76.

Drayton Enterprises, LLC v. Dunker: Injunction Request Denied

In contrast, the court in *Drayton Enterprises, LLC v. Dunker*, No. A3-00-159, 2001 WL 629617 (D.N.D. Jan. 9, 2001) rejected a former employer's claim of inevitable disclosure of trade secrets, where no evidence existed to show any bad faith on the part of the former employee. In that case, Dunker, a former vice-president of operations who had signed a confidentiality agreement, went to work for a competitor two years after he left his former company. Because Dunker had knowledge of a formula and process for making specialized bread products, his former employer sought an injunction to prevent him from working for the competitor. The former employer presented evidence that the competitor had entered the same market with similar products, that it touted Dunker as important because he had "been there and done that" in the industry, and that the competitor was using equipment similar to that of the former employer. Id. at *2. Unlike the former employee in *RKI*, however, Dunker had not engaged in willful acts aimed at using his former employer's trade secrets or at deceiving his former employer. While acknowledging the force of the former employer's inevitable disclosure argument, the *Drayton Enterprises* court refused to issue an injunction.

In the broader view, *RKI* and *Drayton Enterprises* present the wide spectrum of facts that might justify a finding of inevitable disclosure sufficient to issue an injunction. On the one hand, the former employee in *RKI* engaged in a deliberate and concerted effort to steal his former employer's trade secret information and use it to its competitive disadvantage. *Drayton Enterprises*, on the other hand, involved no such bad faith, and even though the court was troubled by evidence showing the similarity in the positions held with the two companies, the circumstances did not merit an injunction. It is significant that while at least twenty states have adopted the inevitable disclosure doctrine, the majority of reported cases considering it have refused to enjoin former employees on that basis alone. *See EarthWeb, Inc. v. Schlack*, 71 F. Supp. 2d 299, 310 (S.D.N.Y.)("[I]n its purest form, the inevitable disclosure doctrine treads an exceedingly narrow path through judicially disfavored territory. Absent evidence of actual misappropriation by an employee, the doctrine should be applied in the rarest of cases.").

Accordingly, although employers appear to assert inevitable disclosure more frequently, the likelihood of succeeding under the theory, particularly absent a written non-compete agreement, is significantly enhanced by a showing of a former employee's bad faith. Thus, in any effort to enjoin a former employee from stealing trade secrets, an employer should pay careful attention to the employee's conduct prior to his or her departure, including whether they had copied information, contacted clients or deceived the employer about their intentions. In the current economic climate, this type of evidence will have even greater importance to an employer's interests in preserving proprietary information and, correspondingly, its competitive advantage.

In addition to discussing the inevitable disclosure doctrine, the following chapter sets forth the general law of noncompete covenants and trade secrets contained in the Uniform Trade Secrets Act (UTSA), which has been adopted in many states, as well as other generally applicable legal principles. The law of several states is also summarized regarding: (1) the enforceability of covenants not to compete and (2) the protection of confidential business information through the use of restrictive covenants and nondisclosure agreements. At the end of the chapter information on how to conduct a trade secret audit and steps for maintaining the secrecy of trade secret information is also provided.

II. OVERVIEW OF THE LAW OF RESTRICTIVE COVENANTS & TRADE SECRETS

A. THE LAW OF NONCOMPETE COVENANTS

§ 361

The unique aspect of noncompete covenants is that they restrict activities of an employee after the employee stops working for the employer. Because noncompete covenants are post-employment restrictions on an employee's ability to earn a living, they are viewed in most states with disfavor and are narrowly construed. Generally, courts view covenants not to compete as enforceable only to the extent they are necessary to protect the employer's interest in its goodwill, confidential information and customer relationships. Most courts attempt to strike a balance between the employer's interest in protecting confidential information and the employee's interest in earning a living.

To be enforceable, covenants not to compete must be narrowly tailored as to the time, geographic scope, and prohibited activity necessary to protect a legitimate employer interest. Drafting considerations for covenants can become increasingly complicated as a result of the new global economy. Before the Internet and the digital economy, a noncompete of a duration of one or even two years was generally considered conservative and reasonable. However, in the new economy, clauses which previously were viewed as valid may be unenforceable. As one court stated in invalidating a one-year noncompete provision, "when measured against the IT industry and the Internet environment, a one-year hiatus from the workforce is several generations, if not an eternity." *EarthWeb v. Schlack*, 71 F. Supp. 2d 299 (S.D.N.Y. 1999).

Likewise, geographical restrictions, measured in counties within a state or miles from the old workplace, may have little meaning in an economy that is increasingly global in reach. Restrictions may be defined in geographical terms as to where the company's products or services are sold.

Defining what activity is prohibited is also crucial in noncompete agreements. Typically, clauses may prevent persons from working for a competitor for a specific period of time in specific locations, and may even name the specific competitors for whom the employee is prohibited from working. The clause may prohibit a particular type of work or research from being performed. The clause may prohibit the former employee from soliciting or accepting business from customers of the employer, or more narrowly, specific customers of the employer for whom the former employee provided services. In each instance, the scope and the reach of the clause depends upon the underlying factual circumstances. In order to be enforceable, the clause must be tied to the employer's legitimate interest in protecting confidential information, customer goodwill, or other business trade secrets.

Some employees might be unwilling to sign such an agreement once they are already employed. This refusal places the employer with a choice of taking steps to ensure that they sign. In some instances, conditioning a bonus or other form of benefit on the employee is enough to induce compliance. Other times, terminating those employees who refuse to sign may be the only means to provide uniform compliance, although some states such as Oregon and California have endorsed wrongful termination claims under these circumstances. In *Dymock v. Norwest Safety Protective Equipment*, the Oregon Court of Appeals recognized such a claim where an employee was fired for refusing to sign a midstream nonsolicit agreement that prohibited solicitation of employees, customers and potential customers. In that case, the court observed that the agreement was void and should not be enforced if not entered into

(a) upon initial employment, or (b) subsequent to bona fide advancement of the employer (i.e., a promotion).

The various stages of the pre-employment process can provide opportunities to inform potential employees of responsibilities and expectations regarding protecting the company's valuable proprietary business information. For example, inasmuch as many employment applications contain the company's Equal Opportunity Statement, employers might also consider including language summarizing policies around disclosure of confidential and trade secret information. This puts potential employees on notice early in the process that the company's concerns about protected information are to be taken seriously and will require consent to contractual provisions to that effect.

The employment interview is another opportunity to find out if an applicant will be constrained by a prior non-disclosure or noncompete agreement, for this might in fact affect the decision whether to hire the individual. It is problematic for a new employee to be unable to do what it is he or she was hired to do because of restrictions in place from a prior employment situation. In addition, this process can place new employees on notice that they should not bring with them any confidential information from their prior employers that might pose the risk of a lawsuit

When new employees are hired and asked to sign an agreement not to divulge trade secrets or other confidential business information, they should be made aware of how they will be able to determine what information falls within the protected category. For example, employees may be told that any document stamped "Confidential" or for which a computer password is required for access is subject to the agreement. Employees might also be provided with specific examples of protected information to which they will be given access upon commencement of their employment. In one often-cited case in this area, *Motorola v. Fairchild*, 366 F. Supp. 173 (D. Ariz. 1973), the court dismissed Motorola's claim against a group of its former executives who defected to a competitor, in part because although the employees had signed non-disclosure agreements, the company did not make any effort to tell the employees exactly what information was confidential or secret and therefore subject to the agreements. Many times employers blindly require their employees to sign form non-disclosure agreements that may not apply to the job they are doing. An engineer's confidentiality obligation will likely differ from a salesperson's based on the information to which each will have access in their jobs.

B. THE LAW OF TRADE SECRETS

Definition of a Trade Secret

§ 362

The Uniform Trade Secrets Act (UTSA) defines a *trade secret* as:

> Information, including a formula, pattern, compilation, program, device, method, technique, or process that:
>
> Derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertained by proper means by other persons who can obtain economic value from its disclosure or use; and

Is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.

This definition covers economically valuable information that is not generally known to competitors. It can include the concept of know-how, and protects not only presently valuable information but also information that may be of potential useful value to the holder.

It is important to remember that, for those states that have adopted the UTSA, the statute specifically defines what constitutes a *trade secret*. This means that companies and individuals typically cannot vary the definition by contract or classify a particular thing as a trade secret if the law does not classify it as such. Moreover, information is not protected if it is generally well known in the industry, even if it is not known by the general public. For those states that have not adopted the UTSA, their case law generally contains similar restrictions.

Misappropriation of a Trade Secret

§ 363

Trade secret misappropriation occurs when there is disclosure or use of a trade secret without express or implied consent, by one who: (a) used improper means to acquire the knowledge of the trade secret; (b) knew or had reason to know that his or her knowledge of the secret was derived from a person who had utilized improper means to acquire it, acquired it under circumstances giving rise to a duty to maintain its secrecy or limit its use, or derived it from a person who owed a duty to the one seeking relief to maintain its secrecy or limit its use; or (c) knew or had reason to know that it was a trade secret and that knowledge of it had been acquired by accident or mistake. An employee is not liable for the mere possession of a trade secret; the trade secret must be used to establish liability.

A trade secret can be improperly acquired by theft, bribery, misrepresentation, breach or inducement of a breach of a duty to maintain secrecy, espionage, etc. Independent derivation or reverse engineering, that is, the dismantling and examination of a publicly available product in order to understand how it is put together and operates, is not considered improper. Similarly, there is no misappropriation if the claimed trade secret may be observed in public use or obtained from published literature.[1]

The Inevitable Disclosure Doctrine

§ 363.1

In trade secret law, some courts have been willing to imply a noncompete agreement based upon the "inevitable disclosure doctrine." The doctrine holds that a company can prevent a former employee from going to work for a competitor if it is shown that the employee would "inevitably disclose" the former employer's trade secrets during the scope and course of discharging his duties in the new job. The leading case on inevitable disclosure, *Pepsi Co., Inc. v. Redmond*, 54 F.3d 1262 (7th Cir. 1995), held that the inevitable disclosure doctrine was applicable because the former employer is left in "the position of a coach, one of whose players has left, playbook in hand, to join the opposing team before the big game."

[1]The UTSA contains complete definitions of improper means of acquisition and misappropriation.

The factors considered in determining whether the inevitable disclosure doctrine applies include whether the companies are direct competitors providing the same or similar goods or services, whether the new position is so nearly identical to the former position of the employee that he could not reasonably be expected to fulfill the duties of the new position without using the trade secrets of the former employer, and whether the trade secrets at issue are highly valuable to both employers.

The 1999 ABA Trade Secret Subcommittee Survey found that courts in 20 states had accepted and applied the inevitable disclosure doctrine, that no courts had come out against the doctrine, and that courts in five states were divided on the applicability of the doctrine. 162 Daily Lab. Rep. (BNA), Aug. 21, 2000, p. C3. One significant state that has not adopted the inevitable disclosure doctrine is California. In fact, the California Supreme Court depublished a decision of a lower court recognizing the doctrine. *Optical Industries, Inc. v. White*, 76 Cal. App. 4th 656 (1999). At this stage, no California court has adopted the inevitable disclosure doctrine.

Enjoining the Misappropriation of a Trade Secret

§ 363.2

A court may enjoin the actual or threatened misappropriation of a trade secret. This means that an employer may seek an injunction against an employee who walks off with a trade secret prior to its actual use. Depending on the circumstances, an issued injunction may terminate when the trade secret has ceased to exist or continue for an additional period to eliminate commercial advantage that otherwise would be derived from the misappropriation. In other words, if a showing is made that the early misappropriation of a trade secret would give a former employee or his or her new company an unfair advantage, the court may craft an injunction to eliminate the unfair commercial advantage that might otherwise occur.

Recovery of Damages for Misappropriation

§ 363.3

The UTSA and laws in most states provide for recovery of the actual loss caused by the misappropriation, as well as recovery for the unjust enrichment created by the misappropriation. Unjust enrichment would be the profits realized by the taker of the secret. If the court determines that neither damages nor unjust enrichment are provable, it may order payment of a reasonable royalty for the time during which the use could have been prohibited.

If willful and malicious misappropriation exists, the court may award punitive damages, usually in an amount equal to twice the damages awarded as actual loss. An award of attorney's fees also may be sought if the misappropriation is willful or malicious. Likewise, if a claim of misappropriation is brought in bad faith, the court may award attorney's fees to a prevailing defendant.

Misappropriation by Independent Contractors and Other Non-Employee Relationships

§ 363.4

Employees are not the only concern when it comes to protecting valuable business information. While employees might have the most regular access to trade secrets, there are others who might also come into contact with sensitive information. These include independent contractors, vendors, customers, joint venture partners, potential acquirers, licensees and even government agencies. Can a company protect its confidential information if it is disclosed to these outsiders? Will trade secret status be destroyed or compromised? The answer depends in large measure on the steps a company takes to ensure that its information is disclosed under an agreement of confidentiality.

While the Uniform Trade Secrets Act (UTSA) generally proscribes the misappropriation of trade secrets and is not restricted only to employees, it is nonetheless important to affirmatively implement reasonable measures to maintain the secrecy of trade secret information when information is disclosed to outsiders.

Nondisclosure Agreements

§ 363.5

In the case of independent contractors – who are not employees – a company cannot exercise the same level of control as with an employee, but the law nonetheless imposes a duty upon them as agents of their principals not to disclose trade secrets to third parties (Restatement of Agency 2d §396). Nonetheless, in any instance where a third party such as an independent contractor or consultant is provided access to confidential business information, the company should require that they enter into written non-disclosure agreements before allowing access. These agreements might include, at a minimum:

- **A general description of the information to which the third party will have access.** It is critical to identify the information sought to be protected so there is no later misunderstanding about whether something should be treated as secret

- **A clear identification of the parties to the agreement.** For example, if the third party to whom access is provided is another company, such as a consultant organization, the particular individuals to whom the information is shared should be specified. Only those third parties with a need to review and use the information should have access, since broad disclosure without regard to a clear business purpose may jeopardize the protected status of the information.

- **Specific measures to ensure secrecy after disclosure.** Although a company may exercise great care to protect trade secrets in its possession, once the information is disclosed to a third party under a non-disclosure agreement the same measure of control obviously does not exist. Thus, imposing specific requirements on the handling of the information will create a contractual obligation to ensure secrecy. For example, a company may wish to require that the disclosed information be maintained in a dedicated file cabinet that is to remain locked and opened only when access by particular designated individuals is needed. Also, the disclosing company may prohibit making copies of the information to further limit the risk of disclosure. Provision should also be made for the return of the trade secrets once the business purpose for disclosure expires.

- **A remedy for violation.** What happens if evidence arises that the third party has disclosed or is about to disclose the information? It is useful for all parties to agree up front what steps the disclosing company can take if the agreement is breached. Allowing for an injunction and making representation about the harm that will occur in the event of unauthorized disclosure will not only demonstrate the importance of the information but also may persuade a judge to grant relief if the company must go into court to protect its interests.

In addition to having these written agreements, it is also useful to document any discussions about the disclosed information. Thus, to the extent a non-employee to whom trade secret access is provided raises issues about the information or other circumstances arise, efforts should be made to document these communications. For example, while a non-disclosure agreement may identify specific individuals to whom access to the disclosing company's trade secrets may be provided, circumstances may dictate expanding the list subsequent to the parties' original signing of the agreement. Any additions, especially if agreed upon orally, should be properly documented to reflect all those properly authorized to obtain access.

Courts in several states have confronted issues involving the disclosure of trade secrets to third parties including independent contractors, and in certain instances have deprived companies of trade secret protection for their disclosed information. In *Wheelabrator Corporation v. Fogle*, 317 F. Supp. 633 (W.D. La. 1970), a federal court in Louisiana denied a company's request for an injunction against a former employee because of the "routineness that customers, potential customers, independent contractors, and repairmen were allowed admission to the plant. . . . Significantly, there was no evidence of contractual relationships between those touring the plant and Wheelabrator. Nor, was there evidence of admonitions or notice to the independent contractors and repairmen as to the allegedly confidential nature of the operations."

The court found that the processes that the company wanted to protect as trade secrets were not in fact secret at all, as the company had not made adequate attempts to conceal them from third parties or ensure that those third parties did not impermissibly disclose them.

In a Colorado case, *Colorado Supply Company v. Stewart*, 797 P.2d 1303 (Col. Ct. App. 1990), the court addressed the danger to an employer based on its failure to protect its trade secrets that were developed by an independent contractor it had hired. In that case, the company had attempted to protect its customer list as a trade secret and sought an injunction to prevent its use by an independent contractor. But, because the information was developed by the independent contractor in the absence of any efforts by the company to impose an obligation to maintain secrecy, the court, based on that fact and other considerations, found that the company's customer lists were not trade secrets.

Key points to help protect trade secrets when dealing with non-employees:

- Document what information you consider to be a trade secret.
- Document efforts you have taken to inform those with access to protected information what you expect from them with regard to maintaining confidentiality.
- Restrict access (including visual access to manufacturing facilities) to those with a business need.
- Execute non-disclosure/confidentiality agreements with non-employees.

- When entering into agreements with independent contractors, take appropriate steps to ensure that any inventions or similar protectable information remain the property of the employer.

Economic Espionage Act of 1996 (EEA)

§ 364

The Economic Espionage Act (EEA), 18 U.S.C. §§1831-1839 enacted in 1996, is the first federal law specifically addressing trade secret misappropriation. The EEA is a broad criminal statute covering a wide range of protectable trade secrets, with substantial penalties – $5 or $10 million in fines and 5 to 10 years in jail, as well as property forfeiture. As the Act is a criminal law, only the U.S. Department of Justice has jurisdiction over enforcement; there is no private right of action for misappropriation under the law. Private, civil actions for trade secret theft remain governed by state law.

The EEA prohibits intentional theft of trade secrets, and provides different penalties depending on whether the intended beneficiary of the theft is a foreign government or not. The penalties are more severe when a foreign government is to be the beneficiary.

The EEA defines a trade secret as:

> All forms and types of financial, business, scientific, technical, economic, or engineering information, including patterns, plans, compilations, program devices, formulas, designs, prototypes, methods, techniques, processes, procedures, programs or codes, whether tangible or intangible, and whether or how stored, compiled, or memorized physically, electronically, graphically, photographically, or in writing if:
>
> (A) the owner thereof has taken reasonable measures to keep such information secret; and
>
> (B) the information derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable through proper means by, the public.

The definition of trade secret contained in the EEA is somewhat different from the one found in the UTSA in several respects. The EEA's definition expressly covers intangible information, and specifies that the form and location of the information is irrelevant. The EEA specifically applies the requirement of reasonable efforts at protection to the *owner* of the information, and it requires that the information in question not be generally known to the "public," while the UTSA required that the information not be ascertainable by others who could benefit from it economically. Another significant difference from the UTSA is that under the Espionage Act, the fact that a stolen secret was not actually used is not available as a defense. Like the UTSA, parallel development and reverse engineering are not considered misappropriation under the EEA.

While the EEA gives companies seeking to protect their trade secrets a new means of doing so, the flip side is the potential liability that a new employee might bring with them in the form of *their* former employer's trade secrets. Companies are advised to develop a compliance plan to avoid such dangers.

§ 364.1

The UTSA and the EEA Compared

	Economic Espionage Act	**Uniform Trade Secrets Act**
Jurisdiction	Federal	State
Type of action	Criminal	Civil
Use required to find misappropriation	No	Yes
Intangible information expressly protected	Yes	No
Requirement of reasonable efforts to protect	Directed specifically at owner of information.	Information must be "subject to" efforts to protect.
Penalties	*Economic espionage (for foreign govt.):* Individual: up to $500,000 fine, up to 15 years in prison, or both. Organization: $10,000,000 fine. Trade secret theft: Individual: fine (no limit specified); up to 10 years in prison, or both. Organization: up to $5,000,000 fine. Either: Individual: property forfeiture	Injunction Payment of royalties Damages (actual and punitive) Attorney's fees

C. SUMMARY OF STATE LAWS: COVENANTS NOT TO COMPETE & PROTECTION OF CONFIDENTIAL BUSINESS INFORMATION

§ 365

The following summary highlights a sampling of state laws regarding covenants not to compete, trade secrets and the enforceability of nondisclosure agreements. The summary is intended to provide a general overview of this area of the law, rather than an exhaustive statement of the law in these jurisdictions.

Alabama

§ 365.1

Covenants Not to Compete

Alabama Code section 8-1-1 invalidates blanket prohibitions against competition but does permit agreements to prevent carrying on or engaging in a similar business within a specified geographical territory, which could include the entire state. Alabama courts will enforce a covenant not to compete complying with the above restriction if: (1) the employer has a protectable interest; (2) the restriction is reasonably related to that interest; (3) the restriction is reasonable in time and geographical limitation; and (4) the restriction imposes no undue hardship on the employee. *Ex parte Caribe, U.S.A., Inc.*, 702 So.2d 1234 (Ala. 1997) (enforcing noncompetition and nonsolicitation provisions in an employment agreement); *James S. Kemper & Co. Southeast, Inc. v. Cox & Assocs., Inc.*, 434 So. 2d 1380, 1384 (Ala. 1983).

Alabama allows both customer and geographical restrictions if the restriction does not impose an undue hardship on the employee. *Sheffield v. Stoudenmire*, 553 So.2d 125 (Ala. 1989). In assessing undue hardship, age, marital status, financial obligations, and lack of other training or expertise are considered. The employer may have a protectable interest "[i]f an employee is in a position to gain confidential information, access to secret lists, or to develop a close relationship with clients." *DeVoe v. Cheatham*, 413 So.2d 1141, 1143 (Ala. 1982).

Alabama courts have the power to revise overly broad restrictions by narrowing their scope, sometimes called the "blue-pencil" rule. *Dobbins v. Getz Exterminators of Alabama Inc.*, 382 So.2d 1135 (Ala. Civ. App. 1980). Thus, for example, in *Ex parte Caribe*, the Alabama Supreme Court enforced the trial court's order prohibiting direct competition for three years—reduced from the five-year period that had been contained in the employment agreement. *Ex parte Caribe*, 702 So.2d at 1237. Even when a covenant not to compete is declared void, the remaining provisions in the contract remain enforceable. *Ex parte Crisona*, 743 So.2d 452 (Ala. 1999).

Disclosure of Trade Secrets or Confidential Information

Alabama law provides separate statutory protection against the misappropriation of trade secrets. ALA. CODE § 8-27-1 *et seq.* Thus, the general prohibition against covenants not to compete does not bar enforcement of nondisclosure covenants or nonsolicitation covenants that are properly restricted as to territory, time, and persons, and supported by sufficient information. *Sevier Ins. Agency, Inc. v. Willis*

Corroon Corp. of Birmingham, 711 So.2d 995 (Ala. 1998). This means that an employer can make an employee sign a contract precluding the employee from disclosing or making use of confidential information. *Ex parte Caribe*, 702 So.2d at 1237-38; *Buckley v. Seymour*, 679 So.2d 220 (Ala. 1996).

Protectable interests include information in a sufficiently unique business, pricing lists, and customer contacts where they are central to the business. An employer cannot prevent an employee from using easily obtainable information *i.e.*, information: (1) which the employer has not undertaken to keep secret; (2) which is generally known throughout the industry; or (3) which is available through public or specialized trade directories.

Arizona

§ 365.2

Covenants Not to Compete

Arizona does not have a specific statute prohibiting the use of noncompetition covenants. A restrictive covenant in an employment agreement will be enforced if: (1) it is reasonably limited in time and place; (2) it is limited to what is reasonably necessary to protect the employer's business; (3) it does not unreasonably restrict the rights of the employee; and (4) it does not contravene public policy. *American Credit Bureau, Inc. v. Carter*, 462 P.2d 838, 840 (Ariz. Ct. App. 1969).

Time restraints for periods of several months are usually considered reasonable. However, if the selling or servicing relationship is relatively complex, a longer period may be acceptable. *Amex Distrib. Co. v. Mascari*, 724 P.2d 596, 604 (Ariz. Ct. App. 1986). However, Arizona courts have found two-year restrictive covenants to be unenforceable. *Hilb, Rogal & Hamilton Co. of Ariz. v. McKinney*, 946 P.2d 464 (Ariz. Ct. App. 1997). The geographical scope of a noncompetition clause must not exceed that which is reasonably necessary to protect the employer's business, or unreasonably restrict the employee's ability to work in a chosen occupation.

The following covenants not to compete have been found reasonable: (1) a three-year covenant restricting an orthopedic surgeon from practicing orthopedic medicine within a five-mile radius of the employer's three offices. *Phoenix Orthopaedic Surgeons, Ltd. v. Peairs*, 790 P.2d 752 (Ariz. Ct. App. 1989); *but see Valley Med. Specialists v. Farber*, 982 P.2d 1277 (Ariz. 1999) (three-year restriction against practicing any medicine within five miles of any of former employers offices held unenforceable); (2) a one-year covenant restricting a disc jockey from becoming employed by or associated with any radio station within fifty miles of the city limits. *Titus v. Superior Court, Maricopa County*, 368 P.2d 874 (Ariz. 1962); and (3) a five-year covenant prohibiting an employee from practicing veterinary medicine within twelve miles of the city limits, which included four other small cities, an air force base, and two-thirds of a larger city. *Lassen v. Benton*, 346 P.2d 137, *modified*, 347 P.2d 1012 (Ariz. 1959).

Disclosure of Trade Secrets or Confidential Information

An employer has a legitimate interest in guarding against the misappropriation of valuable confidential information and trade secrets. *Bryceland v. Northey*, 772 P.2d 36, 39 (Ariz. Ct. App. 1989). Arizona has adopted the position of the RESTATEMENT (SECOND) OF CONTRACTS, which states that an unreasonable restriction against competition may be modified or enforced to the extent that it is reasonable as long as the restriction is divisible and that divisibility is apparent from the terms of the agreement. The courts look to the intent of the parties in enforcing nondisclosure agreements and covenants not to compete.

Arkansas

§ 366

Covenants Not to Compete

Arkansas does not favor covenants not to compete because they are considered partial or total restraints on trade. *Federated Mut. Ins. Co. v. Bennett*, 818 S.W.2d 596, 597 (Ark. Ct. App. 1991). Courts generally enforce a covenant not to compete only when the employer has provided special training or made available to the employee trade secrets, confidential business information, or customer lists, and then only if it is found that the employee was able to use the information to gain an unfair competitive advantage. *Owens v. Penn Mut. Life Ins. Co.*, 851 F.2d 1053 (8th Cir. 1988).

The following three requirements must be met to enforce a covenant not to compete: (1) the employer must have a valid interest to protect; (2) the geographical restriction must not be overly broad; and (3) a reasonable time limit must be imposed. *Federated Mut. Ins. Co.*, 818 S.W.2d at 597.

For example, the following covenants have been held to be reasonable: (1) a two-hundred-mile, two-year restriction against an insurance agent where the agent was given special training and confidential business information including customer lists that he used to gain an unfair competitive advantage against his former employer. *Owens v. Penn Mut. Life Ins. Co.*, 851 F.2d 1053 (8th Cir. 1988); and (2) a one-year covenant restricting former salesmen from competing in the area over which they most recently had responsibility. The court enforced this covenant on the grounds that personal relationships are of paramount importance in the industry and that the former employees had the opportunity to develop solid relationships with customers in their assigned territories and to establish a good track record for service. *Olin Water Serv. v. Midland Research Lab., Inc.*, 596 F. Supp. 412 (E.D. Ark. 1984).

Disclosure of Trade Secrets or Confidential Information

Covenants not to compete are more likely to be upheld where trade secrets and confidential business information are involved. For example, a covenant was found enforceable that restricted the manager of a pest-control business from competing or soliciting former customers in the seventy-five-mile radius around eight cities for one year because the manager possessed confidential business information. *Orkin Exterminating Co. of Ark. v. Murrell*, 206 S.W.2d 185, 189 (Ark. 1947). However, an employer's manner of doing business is not considered a trade secret. *Borden, Inc. v. Smith*, 478 S.W.2d 744, 746 (Ark. 1972). In fact, in a recent case, the Arkansas Supreme Court ruled that the failure to protect potential trade secret information by using a valid noncompete and nondisclosure agreement was fatal to the company's claim for misappropriation of trade secrets. *ConAgra, Inc. v. Tyson Foods*, 30 S.W.3d 725 (Ark. 2000).

Arkansas courts will not rewrite or alter covenants not to compete, "either directly, by giving effect to the parties' intent, or indirectly, by approving a limited injunction that would in fact enforce a covenant not to compete that the parties might have made but did not make." *Rector-Phillips-Morse, Inc. v. Vroman*, 489 S.W.2d 1, 5 (Ark. 1973). The entire agreement will be invalidated if any portion is found objectionable. *Olin Water Serv.*, 596 F. Supp. at 414 (*citing Rector-Phillips-Morse, Inc. v. Vroman*).

California

§ 366.1

Covenants Not to Compete

California Business & Professions Code section 16600 *et seq.* prohibits an employer from restraining an employee who seeks to engage in a lawful profession, trade, or business of any kind. A clause that is void under section 16600 may also amount to a violation of California's Unfair Practices Act set forth in sections 17200 *et seq.* of the California Business & Professions Code. *See, e.g.*, *Application Group, Inc. v. Hunter Group, Inc.*, 61 Cal. App. 4th 881 (1998). Thus, an employer who uses noncompete clauses in California not only risks having the clause declared unenforceable but also risks being found to have committed an unlawful business practice by including the clause in its agreements.

In addition to prohibiting the enforcement of unlawful agreements not to compete, Business and Professions Code section 16600 may also permit employees to sue when terminated or denied employment for refusing to enter into an unlawful agreement. In *Latona v. Aetna U.S. Healthcare Inc.*, 82 F. Supp. 2d 1089 (C.D. Cal. 1999), a federal trial court found that an employee had been fired for refusing to sign a noncompete agreement containing language violating Business and Professions Code section 16600. Rejecting the employer's argument that section 16600 would not apply unless it attempted to *enforce* the agreement, the court found that the employee's termination violated the public policy contained in section 16600 and therefore supported an action under the Act. Likewise, a California appellate court recently held that "an employer cannot lawfully make the signing of an employment agreement which contains an unenforceable covenant not to compete, a condition of employment, even if such agreement contains choice of law or severability provisions which would enable the employer to enforce the other provisions of the employment agreement." The court further held that "an employer's termination of an employee who refuses to sign such an agreement constitutes a wrongful discharge in violation of public policy." *D'Sa v. Playhut, Inc.*, 85 Cal. App. 4th 927 (2000).

The risks posed to employers who adopt national agreements for use in California cannot be underestimated. Not only noncompete agreements, but broad nonsolicitation of customer clauses have been held void and unenforceable under Business and Professions Code section 16600. *Latona, supra; Kolani v. Gluska*, 64 Cal. App. 4th 402 (1998). Thus, many standard agreements used by many out-of-state employers may be void and against public policy in California, and may expose those employers to claims of unfair business practices and, if adverse employment actions are taken against employees who refuse to sign such agreements, violation of public policy claims.

Unlike other states, California does not follow the common law *rule of reason* analysis regarding covenants not to compete. Furthermore, in general, geographical and temporal restrictions are not recognized as limited (and thus potentially enforceable) restrictions. *KGB, Inc. v. Giannoulas*, 104 Cal. App. 3d 844 (1980); *Scott v. Snelling & Snelling, Inc.*, 732 F. Supp. 1034 (N.D. Cal. 1990), *but see General Commercial Packaging, Inc. v. TPS Package Engineering, Inc.*, 126 F.3d 1131, 1132-34 (9th Cir. 1997) (enforcing a one-year noncompetition agreement between a contractor and its subcontractor that proscribed the subcontractor from directly providing work for any of the contractor's clients because the agreement did not preclude the subcontractor from "engaging in its trade or business altogether").

However, federal courts interpreting the California prohibition have allowed enforcement of limited covenants not to compete when they do not amount to a complete restriction on a former employee's ability to engage in his profession. *International Business Machines Corp. v. Bajorek*, 191 F.3d 1033 (9th Cir. 1999). In *Bajorek*, the Ninth Circuit Court of Appeals allowed enforcement of a restrictive covenant that required an employee to return any profits from stock option awards if he began working for a competitor of IBM for six months after his employment with IBM. In that case, however, the court was applying New York law. A recent case in New York found a similar forfeiture provision for restricting stock and stock option awards to be unenforceable. *Lucente v. IBM*, 117 F. Supp. 2d 336 (S.D.N.Y. 2000).

There are several statutory exceptions to the general prohibition against covenants not to compete. The most important exceptions allow covenants not to compete in the context of a sale of corporate assets involving the goodwill of the business or the dissolution of a partnership. CAL. BUS. & PROF. CODE §§ 16601, 16602. The exception for the sale of goodwill is a narrow one. Persons selling the goodwill of a business may be restrained from competing to preserve the value of the assets purchased. *Hilb, Rogal & Hamilton, Inc. v. Robb*, 33 Cal. App. 4th 1812 (1995). In order to fall within the exception, the person restrained must sell or otherwise dispose of all of his shares or ownership interest in the company, the shares or interest must constitute a substantial interest, and there must be a clear indication that the sales transaction includes the value of goodwill in the price. *Hill Medical Corporation v. Wycoff*, 86 Cal.App. 4th 895 (2001).

The principal nonstatutory exception is where the covenant not to compete is necessary to prevent unfair competition. *Monogram Industries, Inc. v. Sar Indus.*, 64 Cal. App. 3d 692 (1976). An employer may restrain by contract the conduct of a former employee only to the extent that the conduct would be subject to judicial restraint under the law of unfair competition. *Metro Traffic Control, Inc. v. Shadow Traffic Network*, 22 Cal. App. 4th 853 (1994). For example, a former employee may not use the former employer's confidential information to compete or to solicit business from a former customer, since such action constitutes unfair competition. *John F. Matull & Assocs., Inc. v. Cloutier*, 194 Cal. App. 3d 1049 (1987). In addition, agreements that restrain former employees from raiding their former employer's employees have been upheld on the grounds that the employer has a valid interest in an undisrupted workplace. *Loral Corp. v. Moyes*, 174 Cal. App. 3d 268 (1985).

An employer may terminate an employee who transfers loyalty to a competitor. Employees may seek outside employment and make preparations to compete while employed without transferring loyalty. However, an employer deserves the individual loyalty of employees during employment and loyalty may be compromised by outside employment. The determination of transferred loyalty sufficient to justify termination will be made on a case-by-case basis. *Stokes v. Dole Nut Co.*, 41 Cal. App. 4th 285 (1995).

Disclosure of Trade Secrets or Confidential Information

Nondisclosure agreements will be enforced when the employer has a strong proprietary interest in protecting trade secrets. *Loral Corp. v. Moyes*, 174 Cal. App. 3d 268 (1985). Covenants not to solicit the employer's customers have been upheld where the employer has shown such a strong proprietary interest in confidential client information that it is essentially a trade secret. *American Credit Indemnity Co. v. Sacks*, 213 Cal. App. 3d 622 (1989). Thus, in *Morlife Inc. v. Perry*, 56 Cal. App. 4th 1514 (1997), the court upheld the trial court's issuance of injunctive relief, concluding that the plaintiff's customer lists satisfied the statutory definition of a trade secret. The court found significant the company's unusual roofing process and that the lists had been developed over a period of years through considerable cost and effort, and were maintained as secret by the company and not generally known in the industry. *Id*. at 1521-23.

California has adopted the Uniform Trade Secrets Act and uses the definition of trade secret set forth at the beginning of this chapter. CAL. CIV. CODE § 3426.1(d). The determination of whether information is confidential or a trade secret is a question of fact for a jury, with the former employer bearing the burden of proof. *Scott v. Snelling & Snelling, Inc.*, 732 F. Supp. 1034, 1043 (N.D. Cal. 1990). However, some information is not confidential or a trade secret as a matter of law. *Id.*; *Moss, Adams & Co. v. Shilling*, 179 Cal. App. 3d 124, 130 (1986).

Some courts have allowed employers to enjoin former employees from working for direct competitors where the new employment would inevitably lead an employee to rely on a former employer's trade secrets. Initially developed in the federal Court of Appeals for the Seventh Circuit, this position, known as the "inevitable disclosure" doctrine was briefly recognized by one California appellate court. *Electro Optical Industries, Inc. v. White*, 76 Cal. App.4th 653, 660 (1999) (*citing PepsiCo, Inc. v. Redmond*, 54 F.3d 1262 (7th Cir. 1995)). However, the California Supreme Court has apparently expressed its disapproval of the inevitable-disclosure decision by "depublishing" the appellate decision. *Electro Optical Indus., Inc. v. White* 2000 CDOS 2830 (2000).

The viability of the 2000 inevitable-disclosure doctrine in California is not recognized. A string of recent federal cases have held that the "inevitable disclosure" doctrine violates California public policy favoring employee mobility. *Bayer Corp. v. Roche Molecular Sys., Inc.*, 72 F. Supp. 2d 1111 (N.D. Cal. 1999); *Danjaq LLC v. Sony Corp.*, 50 U.S.P.Q. (BNA) 2d 1638 (C.D. Cal. 1999); *Computer Sciences Corp. v. Computer Associates Int'l., Inc.*, 1999 U.S. Dist. LEXIS 21803 (C.D. Cal. Aug. 12, 1999).

Colorado

§ 366.2

Covenants Not to Compete

Colorado law provides that covenants not to compete are generally not enforceable, except in narrowly defined circumstances. The exceptions to the unenforceability of covenants not to compete include: (1) any contract for the purchase and sale of a business or the assets of a business; (2) any contract for the protection of trade secrets; (3) any contract providing for the recovery of the expenses of educating and training an employee who had served an employer for a period of less than two years; and (4) any contract for executive or management personnel, officers, and employees who constitute professional staff to executive or management personnel. COLO. REV. STAT. § 8-2-113.

Colorado courts have consistently struck down noncompete agreements which do not comply with Colorado Revised Statutes section 8-2-113(2). For example, a noncompete agreement signed by a sales representative was found by the Colorado courts to be void because it did not fall within any exception to the statute. *Colorado Supply Co., Inc. v. Stewart*, 797 P.2d 1303 (Colo. Ct. App. 1990). Similarly, the Colorado Court of Appeals found that a general covenant not to compete, containing a blanket prohibition of an employee's right to compete, was void. *Management Recruiters of Boulder, Inc. v. Miller*, 762 P.2d 763 (Colo. Ct. App. 1988). A Colorado court also struck down a liquidated damages provision in a contract requiring an anesthesiologist to pay 50% of the fees generated from his practice in competition with his former employer for two years. *Wojtowicz v. Greeley Anesthesia Servs., P.C.*, 961 P.2d 520 (Colo. Ct. App. 1998).

However, the courts will enforce carefully crafted agreements that fall within the narrow exceptions to the statute. For example, in *Management Recruiters of Boulder, Inc.*, 762 P.2d 763, while the court of appeals struck down a general noncompete clause, it upheld a specific provision governing the employee's ability to contact customers. The court held that the clause prohibiting the former employee from contacting clients for a period of twelve months was valid because it was intended to protect trade secret information regarding the employer's clients. However, the court interpreted the clause narrowly as preventing contact only with those clients with whom the former employee had actual contact, as opposed to prohibiting contact with all of the employer's approximately ten thousand clients.

The courts also have upheld covenants not to compete executed by executive and management personnel. The determination of whether any particular employee falls within the executive and management personnel exception is a question of fact. *Occusafe, Inc. v. EG&G Rocky Flats, Inc.*, 54 F.3d 618, 621 (10th Cir. 1995).

In addition to falling within one of the specified statutory exemptions, the noncompetition agreements must also be "reasonable both in terms of duration and geographic scope." *National Graphics Corp. v. Dilley*, 681 P.2d 547 (Colo. Ct. App. 1984). The reasonableness of a noncompete agreement is determined on a case-by-case basis.

Disclosure of Trade Secrets or Confidential Information

Colorado has adopted, with some revisions, the Uniform Trade Secrets Act. COLO. REV. STAT., § 7-74-102 *et seq.* The determination of whether any particular information is a trade secret is extremely fact-specific and must be determined by the trier of fact. *Gold Messenger, Inc. v. McGuay*, 937 P.2d 907, 911 (Colo. App. 1997).

District of Columbia

§ 366.3

Covenants Not to Compete

The District of Columbia does not prohibit covenants not to compete. It prohibits unfair competition, including contracts that create unreasonable restraints upon trade. D.C. CODE ANN. § 28-4502 (1981).

Hence, a restriction against competition will be invalidated if unreasonable. *Gryce v. Lavine*, 675 A.2d 67, 70 (D.C. 1996); *Ellis v. James Hurson Assocs., Inc.*, 565 A.2d 615 (D.C. 1989). In order to enforce a covenant not to compete, an employer must show that the restriction is: (1) reasonable as to time and geography; (2) needed for the protection of the employer; and (3) intended and agreed upon by the parties. *National Chemsearch Corp. of New York v. Hanker*, 309 F. Supp. 1278, 1280 (D.D.C. 1970).

In determining whether time and geographical restrictions are reasonable, the courts consider: (1) the nature of the business; (2) the character of the service performed; (3) the station of the employee in relation to the area in which the former employee seeks to be protected; (4) the existence of bad faith; and (5) whether the employer has a legitimate interest in protecting its sales in a particular area. *Chemical Fireproofing Corp. v. Krouse*, 155 F.2d 422, 423 (D.C. Cir. 1946).

Reasonable restraints have included a three-year customer-nonsolicitation clause against a former employee of a lobbying firm. *Ellis v. James Hurson Assocs., Inc*., 565 A.2d 615 (D.C. 1989). Reasonable restraints have also included a one-year customer-nonsolicitation covenant against a former employee of a coin-operated-machine leasing company. *Byram v. Vaughn*, 68 F. Supp. 981 (D.D.C. 1946).

Unreasonable restraints include a three-year, six-state customer-nonsolicitation clause, where the job (fireproofing) was characterized as hard and not particularly skilled labor involving no trade secrets. *Chemical Fireproofing Corp. v. Krouse*, 155 F.2d 422 (D.C. Cir. 1946).

Courts in the District of Columbia distinguish between solicitation and competition. When the employer is merely prohibiting a former employee from soliciting customers as opposed to competing, there is generally no requirement that the employer impose a territorial limitation. *Ellis v. James Hurson Assocs., Inc.*, 565 A.2d at 620.

Although there is no express "blue-pencil" rule in the District of Columbia, courts have enforced decisions that gave effect only to portions of covenants not to compete. The District of Columbia Court of Appeals recently noted that partial enforcement of otherwise unenforceable covenants is only available where the employer obtained the covenant in good faith, in accordance with reasonable standards of fair dealing, and did not engage in serious misconduct. *Id.*

Disclosure of Trade Secrets or Confidential Information

The District of Columbia has adopted the UTSA. A contract preventing the disclosure of trade secrets is valid if the employer has a protectable interest in the claimed trade secret, confidential knowledge, expert training, or fruits of employment. *Saul v. Thalis*, 156 F. Supp. 408, 412 (D.D.C. 1957). As long as the nondisclosure covenant follows the rule of reason and meets the requirements generally applicable to covenants not to compete, an employer can legitimately forbid employees to disclose and use confidential business information and trade secrets.

Florida

§ 366.4

Covenants Not to Compete

On May 29, 1996, the state legislature repealed the prior covenant-not-to-compete statute, Florida Statute section 42.33 *et seq.*, except for covenants entered into before July 1, 1996, which remain governed by the prior statute. This successor statute is unusually comprehensive and covers all covenants entered into on or after July 1, 1996. FLA. STAT. ANN. § 542.335 *et seq.*

Among other things, the current statute:

- provides that a restrictive covenant falling within its coverage must be contained in a writing, signed by the person against whom enforcement is sought;
- sets forth specific time limitations for various types of covenants that are presumptively reasonable and enforceable;
- sets forth specific time limitations for various types of covenants that are presumptively unreasonable and unenforceable;
- authorizes judicial modification of unreasonable covenants;
- provides that the violation of an enforceable restrictive covenant creates a presumption of irreparable injury to the person seeking enforcement of the covenant;

- bars construing a restrictive covenant against the drafter, or from considering individualized economic or other hardship that might be caused to the person against whom enforcement is sought in assessing the enforceability of a restrictive covenant; and

- provides for the award of costs and attorney's fees. The court's power to issue such an award may not be avoided by a contrary agreement between the parties.

For claims involving restrictive agreements entered into before July 1, 1996, there may be no need to show a particular protectable interest to justify enforcement of a noncompetition covenant, at least where the agreement is neither harsh nor oppressive. *Foster & Co., Inc. v. Snodgrass*, 333 So.2d 521 (Fla. Dist. Ct. App. 1976). It must, however, be reasonable.

For covenants entered into on or after July 1, 1996, the implication of a protectable employer interest is necessary and is expressly defined to include, but is not limited to, the following:

- trade secrets, as defined in Florida Statutes Annotated section 688.002(4);

- valuable confidential business or professional information that otherwise does not qualify as trade secrets;

- substantial relationships with specific prospective or existing customers, patients, or clients;

- customer, patient, or client goodwill associated with

- an ongoing business or professional practice, by way of trade name, trademark, service mark, or "trade dress";

- a specific geographic location; or

- a specific marketing or trade area; and

- extraordinary or specialized training.

FLA. STAT. ANN. § 542.335(1)(b) 1-5.

The new statute imposes an initial burden on the party seeking enforcement to plead and prove that the contractually specified restraint is reasonably necessary to protect legitimate business interests or interests justifying the restriction. If such a *prima facie* showing is made, the burden shifts to the party opposing, who must demonstrate that the restraint is overbroad, overlong, or otherwise not reasonably necessary. The court shall modify any restraint that is overbroad, overlong, or otherwise not necessary to protect the established legitimate interest(s), and grant only the relief necessary to protect such interests.

In order to enforce a covenant not to compete, an employer must establish the existence of a protectable interest. One interest commonly justifying a covenant not to compete is "specialized training" provided by the employer. *Aero Kool Corp. v. Oosthuizen*, 736 So.2d 25 (Fla. Dist. Ct. App. 1995) (training in aircraft component repair an interest justifying enforcement of the covenant); *Balasco v. Gulf Auto Holding, Inc.*, 707 So.2d 858 (Fla. App. 1998). However, if an employee has not received specialized training, or has worked for a number of competitors prior to working for the employer seeking to enforce the covenant, the covenant may not be enforced. *Austin v. Mid State Fire Equipment of Cent. Florida, Inc.*, 727 So.2d 1097 (Fla. Dist. Ct. App. 1999).

Disclosure of Trade Secrets or Confidential Information

Both the prior and new statutes prohibit the unauthorized use or disclosure of trade secrets. Furthermore, under both statutes the scope of a noncompetition or nonsolicitation covenant may be modified by the court where the scope of the restriction exceeds the scope of the employer's protectable interest. FLA. STAT. ANN. § 542.355(1)(c); *Marshall v. Gore*, 506 So.2d 91 (Fla. Dist. Ct. App. 1987).

Georgia

§ 366.5

Covenants Not to Compete

Georgia has provided by statute that any contracts in general restraint of trade are unenforceable as contrary to public policy. GA. CODE. ANN. § 13-8-2. As a result, Georgia has historically viewed with disfavor covenants not to compete and in many instances has held them to be unenforceable. Such covenants are enforced in narrow circumstances where the business has a recognized interest in preserving the goodwill, specialized training, and confidential information invested in an employee. Such covenants will be upheld "if the restraint imposed is not unreasonable, is founded on a valuable consideration, and is reasonably necessary to protect the interest of the party in whose favor it is imposed and does not unduly prejudice the interests of the public." *Rakestraw v. Lanier*, 30 S.E. 735, 738 (Ga. App. 1898). For example, in *Wright v. Power Indus. Consultants, Inc.*, 508 S.E.2d 191 (Ga. Ct. App. 1998), the court upheld a covenant prohibiting former employees from contacting the company's customers, but struck down a clause in the contract that sought to prohibit them from working for a competitor.

The geographic area within which competition is restrained must be narrowly drawn so as not to exceed the area necessary to protect the employer's business interests. *Wiley v. Royal Cup, Inc.*, 370 S.E.2d 744 (Ga. 1988). Generally, a reasonable area is considered to be the territory in which the employee performs services for the employer. *Howard Schultz & Assocs. v. Broniec*, 236 S.E.2d 265, 268 (Ga. 1977); *superseded by statute as stated in Femero v. Associated Materials, Inc.*, 923 F.2d 1441 (11th Cir. 1991). The reasonableness of any time limitations depends on the factual circumstances of each case. Georgia courts have upheld restrictions ranging from one year to two years. *Edwards v. Howe Richardson Scale Co.*, 229 S.E.2d 651 (Ga. 1976); *Chaichimansour v. Pets Are People Too*, 485 S.E.2d 248 (Ga. Ct. App. 1997). Georgia Courts also look to the nature of the underlying business in determining whether the covenant reasonably restricts the disclosure or use of information. *Witty v. McNeal Agency, Inc.*, 521 S.E.2d 619 (Ga. Ct. App. 1999) (nature of commodities and stock market justify noncompete agreement).

Georgia courts will not "blue pencil" agreements that do not contain some form of temporal or geographic limitation. Instead, such agreements will be declared void. *Hogan Mgmt. Servs. v. Martino*, 530 S.E.2d 508 (Ga. Ct. App. 2000), *cert. denied*, 121 S. Ct. 770 (2001). In fact, an agreement containing a territorial limitation that cannot be determined until the time of the employee's termination is similarly void. *Ceramic & Metal Coatings Corp. v. Hizer*, 529 S.E.2d 160 (Ga. Ct. App. 2000).

A former employee cannot be restrained from soliciting customers of the former employer, notwithstanding a covenant to the contrary, if those customers had previously terminated their relationship with the employer. *Gill v. Poe & Brown of Georgia, Inc.*, 524 S.E. 2d 328 (Ga. Ct. App. 1999).

Disclosure of Trade Secrets or Confidential Information

Under the Georgia Trade Secrets Act of 1990, a trade secret is defined as any information which is not commonly known by or available to the public in which information derives economic value from not being generally known to or readily ascertainable by proper means by other persons and is the subject of efforts that are reasonable under the circumstances to maintain its secrecy. GA. CODE. ANN § 10-1-761(4). Like the UTSA, the definition covers economically valuable information that is generally not known to competitors.

Illinois

§ 366.6

Covenants Not to Compete

In *Callahan v. L.G. Balfour*, 534 N.E.2d 565, 569 (Ill. App. Ct. 1989), the court observed that "Illinois courts encourage fair competition in business and abhor restraints on trade, and covenants in employment contracts not to compete are carefully scrutinized." Nevertheless, covenants that are reasonable, properly tailored in geographic and temporal scope, and necessary to protect legitimate business interest will be enforced. *Applied Micro, Inc. v. SJI Fulfillment, Inc.*, 941 F. Supp. 750, 753 (N.D. Ill. 1996). A restrictive covenant must also be ancillary to a valid employment agreement. This means that an agreement whose sole purpose is to restrict competition is unenforceable. *Woodfield Group v. DeLisle*, 693 N.E.2d 464 (Ill. App. 1998).

A restrictive covenant's reasonableness is "measured by its hardship to the employee, its effect upon the general public, and the reasonableness of the time, territory, and activity restrictions." *Lawrence & Allen, Inc. v. Cambridge Human Resource Group, Inc.*, 685 N.E.2d 434, 441 (Ill. App. Ct. 1997). Legitimate business interests will be found: (1) where, by the nature of the business, the employer has a near-permanent relationship with its customers and, but for his or her employment, the employee would not have had contact with them; or (2) where the former employee learned trade secrets or acquired other confidential information during his or her employment and subsequently attempted to use it for his or her own benefit. *Rapp Ins. Agency, Inc. v. Baldree*, 597 N.E.2d 936, 939 (Ill. App. Ct. 1992); *see also Lawrence & Allen, Inc.*, 685 N.E.2d at 443-444.

Disclosure of Trade Secrets or Confidential Information

An employer may protect trade secrets or other confidential information a former employee acquired through his employment and may try to use for his own benefit. *Capsonic Group v. Swick*, 537 N.E.2d 1378, 1382 (Ill. App. Ct. 1989). Customer lists will be protected only if the names of the customers are not available to the public, *Iroquois Indus. Corp. v. Popik*, 415 N.E.2d 4 (Ill. App. Ct. 1980), and the employer takes reasonable steps to maintain the list's secrecy. *Jackson v. Hammer*, 653 N.E.2d 809, 815-17 (Ill. App. Ct. 1995). A covenant not to solicit is subject to a lower degree of scrutiny than a covenant not to compete. *Lawrence & Allen, Inc.*, 685 N.E.2d at 442. Similarly, a lower degree of scrutiny is applied to agreements incidental to the sale of a business than is applied to agreements in employment contracts. *Eichmann v. National Hosp. and Health Care Servs., Inc.*, 719 N.E.2d 1191 (Ill. App. Ct. 1999). Misappropriation of a trade secret occurs even when the trade secret is only partially used to develop a new product, if the trade secret was necessary to the development of the new product. *Mangren Research & Dev. Corp. v. National Chemical Co., Inc.*, 87 F.3d 937, 944-45 (7th Cir. 1996).

The inevitable-disclosure doctrine was advanced by the Seventh Circuit Court of Appeals while interpreting Illinois law. The court decided that injunctive relief is appropriate when: (1) a former employee's promise to refrain from divulging confidential information was untrustworthy; (2) the new position of the former employee was closely related to his position with the former employer; and (3) the former employee would inevitably be influenced in this new position to use the confidential information. *PepsiCo, Inc. v. Redmond*, 54 F.3d 1262, 1268-1269 (7th Cir. 1995). An Illinois state court expressly recognized the "inevitable disclosure doctrine" from *Redmond*, finding that the plaintiff could proceed on the theory of inevitable disclosure. *Strata Marketing v. Murphy*, 740 N.E. 2d 1166 (Ill. Ct. App. 2001). Contractual restrictions on the disclosure of confidential or trade secret information are not void for a lack of geographic or temporal scope. *Coady v. Harpo, Inc.*, 719 N.E.2d 244 (Ill. App. Ct. 1999).

Illinois courts may employ the "blue-pencil" rule to modify restrictive covenants to make them reasonable. However, courts have consistently refused to modify a covenant or limit a covenant unless the employer sought partial enforcement in its prayer for relief. *Prudential Ins. Co. of Am. v. Sempetrean*, 525 N.E.2d 1016, 1020 (Ill. App. Ct. 1988); *accord Cockerill v. Wilson*, 281 N.E.2d 648, 650 (Ill. 1972). Furthermore, modifications will not be made to save a restrictive covenant where its deficiencies are too significant. *See, e.g.*, *Lawrence & Allen, Inc.*, 685 N.E.2d at 443.

Indiana

§ 366.7

Covenants Not to Compete

Covenants not to compete will be enforced where a protectable interest is involved and the covenant is reasonable in light of the legitimate interest sought to be protected. *Licocci v. Cardinal Assocs., Inc.*, 445 N.E.2d 556, 561 (Ind. 1983). To determine whether a covenant is reasonable, three factors are considered: (1) whether the restraint is reasonably necessary to protect the employer's business; (2) the effect of the restraint on the employee; and (3) the effect of enforcement upon the public interest. *Waterfield Mortgage Co., Inc. v. O'Connor*, 361 N.E.2d 924, 926 (Ind. Ct. App. 1977).

Interests that can be protected include an employer's confidential information, customer lists, goodwill, investment in special training or techniques, and actual solicitation of customers and trade secrets. Third parties may be enjoined from aiding or assisting the employee in violating the covenant so long as there is evidence that the third party operated in concert with the employee to breach the covenant. *Norlund v. Faust*, 675 N.E.2d 1142 (Ind. Ct. App. 1997). Covenants that restrict the employee from using general skills and knowledge, but do not protect the employer's interest in confidential or proprietary information, are not enforceable. *Duneland Emergency Physician's Med. Group v. Brunk*, 723 N.E.2d 963 (Ind. Ct. App. 2000).

Generally, covenants for terms of one year to three years after the employment ends have been upheld. *Licocci*, 445 N.E.2d at 556; *Sleweon v. Burke, Murphy, Constanzo & Cuppy*, 712 N.E.2d 517 (Ind. Ct. App. 1999) (two-year covenant). Covenants must have either a durational or geographical limitation to avoid a violation of Indiana public policy. *College Life Ins. Co. of Am. v. Austin*, 466 N.E.2d 738 (Ind. Ct. App. 1984). For a postemployment covenant to be valid, it must be ancillary to the main purpose of an employment or compensation agreement and have a significant nexus to the employment situation. *Ohio Valley Communications, Inc. v. Greenwell*, 555 N.E.2d 525 (Ind. Ct. App. 1990).

The courts generally will not revise an unreasonable restriction into one that is reasonable since this would "subject the parties to an agreement they had not made." *Licocci*, 445 N.E.2d at 561. However, if the covenant is clearly separated into parts, the contract may be divisible. In such cases, the unreasonable aspects will be stricken and reasonable restrictions may then be enforced. *Id*. The court in *Smart Corp. v. Grider*, 650 N.E.2d 80 (Ind. Ct. App. 1995), struck from a covenant as unreasonable a geographical restriction covering the entire United States and enforced the covenant's language "to the extent permitted by applicable law" by limiting the geographical restriction to the State of Indiana. *Smart Corp.*, 650 N.E.2d at 84. The courts will not rewrite or add to the existing language, however. *See, e.g.*, *Seach v. Richards, Dieterle & Co.*, 439 N.E.2d 208, 214-215 (Ind. Ct. App. 1982), ("[c]ourt redaction of contracts cannot, of course, add any terms to the instruments and must restrict itself to the application of existing terms"). A covenant will not be enforced if the geographical limitation is too severe, even if the terms of the covenant are severable. *South Bend Consumers Club, Inc. v. United Consumers Club, Inc.*, 572 F. Supp. 209 (N.D. Ind. 1983), *appeal dismissed*.

Disclosure of Trade Secrets or Confidential Information

"In Indiana, an employee who is entrusted with or who obtains trade secrets may make a valid covenant that prohibits him from the competitive use or disclosure of those trade secrets." *Buckley v. Seymour*, 679 So.2d 220, 223 (Ala. 1996) (applying Indiana law). The agreement will be enforced so long as it is reasonable. Indiana has adopted the UTSA and follows the trade secret definition set forth at the beginning of this chapter. Thus, protectable interests in Indiana include trade secrets, which may be protected with and without a specific nondisclosure covenant. *Buckley*, 679 So.2d at 223-24 (*citing* to and applying Indiana precedent). Information that is readily or easily available to the public or the particular industry is not a trade secret. *College Life Ins. Co. of Am. v. Austin*, 466 N.E.2d 738 (Ind. Ct. App. 1984).

Iowa

§ 366.8

Covenants Not to Compete

In Iowa, covenants not to compete are considered restraints of trade. A covenant not to compete will be enforced only if: (1) it is no wider than reasonably necessary for the protection of the employer's business interest; (2) it does not impose an undue hardship on the employee; and (3) it is not prejudicial to the public interest. *Lamp v. American Prosthetics, Inc.*, 379 N.W.2d 909, 910 (Iowa 1986). In assessing the reasonableness of a covenant not to compete, Iowa courts look at temporal and geographical restrictions, the nature of the business itself, the access to information peculiar to the employer's business, the nature of the occupation being restrained, and basic fairness. *Baker v. Starkey*, 144 N.W.2d 889, 895 (Iowa 1966). Nondisclosure covenants will be enforced only where postemployment restraints are reasonably necessary to protect the employer from loss of business caused by an employee's use of confidential knowledge acquired by training and service in the employer's business. *Orkin Exterminating Co. (Arwell Division) v. Burnett*, 146 N.W.2d 320, 324 (Iowa 1966).

Unless the employer has acted in bad faith, the courts will enforce a covenant "if it is reasonably necessary for the protection of the employer's business and is not unreasonably restrictive of [the] employee's rights nor prejudicial to the public interest." *Tasco, Inc. v. Winkel*, 281 N.W.2d 280, 281 (Iowa 1979) (*citing Ehlers v. Iowa Warehouse Co.*, 188 N.W.2d 368, 370 (Iowa 1971)). It has been noted that a covenant with a "five-year time period is at the very limits of what the Iowa courts have found enforceable." *Uncle B's Bakery, Inc. v. O'Rourke*, 920 F. Supp. 1405, 1433. (N.D. Iowa 1996). However, a covenant precluding competition within a fifty-mile radius for a ten-year period has been upheld. *Van Oort Constr. Co., Inc. v. Nuckoll's Concrete Serv.*, 599 N.W.2d 684 (Iowa 1999). Covenants that are overly stringent may be partially enforced to protect the employer's legitimate interest. *Phone Connection, Inc. v. Harbst*, 494 N.W.2d 445 (Iowa Ct. App. 1992) (noting, "[w]here the court finds a covenant unduly restrictive, the court has the authority to modify that covenant").

Disclosure of Trade Secrets or Confidential Information

In Iowa, confidential information may be protected under the Iowa Uniform Trade Secrets Act (Iowa UTSA), by common law (the Iowa UTSA omitted the section of the Uniform Trade Secrets Act specifically displacing other methods of recovery), and/or by agreement (enforceable nondisclosure and confidentiality agreements). *See, e.g.*, *Uncle B's Bakery, Inc*, 920 F. Supp. at 1425. Information will be recognized as a trade secret if it derives independent economic value, actual or potential, from not being generally known or readily ascertainable by proper means, by a person able to obtain economic value from its disclosure or use, *and* is the subject of reasonable efforts to maintain its secrecy. *Id*.

Kansas

§ 366.9

Covenants Not to Compete

Only a legitimate business interest may be protected by a noncompetition covenant. *Weber v. Tillman*, 913 P.2d 84, 89 (Kan. 1996). "Seeing that contacts with clients continue," "loss of clients," "customer contacts," "good will," "referral sources," "reputation," and "trade secrets," are among the possible legitimate and protected interests. *Id*. at 91. The reasonableness of the time and territory restrictions imposed by a noncompetition agreement is "part of the factor evaluating the legitimate business interests of the employer. The restrictions must be no greater than necessary to protect the employer's interests." *Id.*

Covenants that protect legitimate business interests will be enforced if they are "reasonable under the circumstances and not adverse to the public welfare." *Id*. at 89; *see also Puritan-Bennett Corp. v. Richter*, 679 P.2d 206, 210 (Kan. 1984). Kansas courts consider four factors when determining whether a covenant not to compete is enforceable: "(1) Does the covenant protect a legitimate interest of the employer? (2) Does the covenant create an undue burden on the employee? (3) Is the covenant injurious to the public welfare? (4) Are the time and territorial limitations contained in the covenant reasonable?" *Weber v. Tillman*, 913 P.2d 84 (Kan. 1996). The mere desire to prevent ordinary competition does not qualify as a legitimate interest of an employer to be protected. *Eastern Distrib. Co. Inc. v. Flynn*, 567 P.2d 1371, 1376 (Kan. 1977). A federal district court found that a covenant not to compete with nationwide application and a one-year limitation had a substantial likelihood of being found reasonable under Kansas law. *Heatron, Inc. v. Shackelford*, 898 F. Supp. 1491 (D. Kan. 1995). A noncompetition covenant prohibiting a physician from practicing dermatology for two years within a thirty-mile radius of any office or place of business of the former dermatology clinic at the time the former employee physician's employment ended was also deemed reasonable. *Weber*, 913 P.2d at 92.

Disclosure of Trade Secrets or Confidential Information

An employer may protect confidential information and trade secrets from disclosure by its employees so long as the restrictions on disclosure and use are reasonable. Kansas has adopted the UTSA and employs the definition of a trade secret found at the beginning of this chapter. KAN. STAT. ANN. §§ 60-3320 to 60-3330 (1994). "Kansas employers may pursue trade secret misappropriation claims against former employees under the Kansas UTSA independently of actions seeking enforcement of a nondisclosure covenant." *See Curtis 1000, Inc. v. Pierce*, 905 F. Supp. 898, 901 (D. Kan. 1995); *All West Pet Supply Co. v. Hill's Pet Prods. Div., Colgate Palmolive Co.*, 847 F. Supp. 858, 861 n. 2 (D. Kan. 1993) (holding that contractually imposed duty to keep customer information confidential is independent of statutory duty imposed by UTSA).

The courts in Kansas have equitable power to modify a restrictive covenant. *Eastern Distrib. Co. v. Flynn*, 567 P.2d at 1378-79. Not only are they able to narrow unreasonable restrictions, but they may also *extend* restrictions when it is reasonable to do so. *Puritan-Bennett Corp.*, 679 P.2d 206, 210 (Kan. 1984).

Nevada

§ 366.10

Covenants Not to Compete

Nevada Revised Statute section 613.200 previously prohibited an employer from willfully preventing a discharged employee from obtaining new employment with another employer. Amendments now expressly exclude from coverage efforts to enforce a reasonable noncompetition and/or nondisclosure agreement. *Jones v. Deeter*, 913 P.2d 1272 (Nev. 1996). Nevada Revised Statute sections 598A.010-280 make up the Nevada Unfair Trade Practices Act (NUTPA). The NUTPA broadly proscribes restrictions on trade and would presumably apply to unreasonable employment agreement covenants. NEV. REV. STAT. § 598A.040 expressly excludes from its coverage restrictive covenants that are part of the sale of a business and restrict competition within a reasonable market area and for a reasonable period of time.

A noncompetition agreement will not be enforced unless it is "reasonable." *Comco, Inc. v. Baker*, 936 P.2d 829, 832 (Nev. 1997). A covenant cannot impose a greater restraint than is reasonably necessary to protect the employer's business and goodwill interests, unless public policy or statute otherwise dictates. *Id*. (*citing Hansen v. Edwards*, 426 P.2d 792, 793 (Nev. 1967)).

When determining reasonableness, postemployment restrictive covenants are scrutinized more closely than sale-of-business restrictive covenants. It has been noted that "because the loss of a person's livelihood is a very serious matter, postemployment anti-competitive covenants are scrutinized with greater care." Temporal and geographical limitations are also important factors in determining the reasonableness of restrictive covenants. *Hansen*, 426 P.2d at 793. An at-will employee's continued employment will constitute sufficient consideration to enforce an otherwise valid restrictive covenant entered after the employee's employment commenced. *Comco, Inc*., 936 P.2d at 832.

Nevada courts have upheld covenants restricting competition for two years, *Ellis v. McDaniel*, 596 P.2d at 222, while they have not upheld covenants of unlimited duration. *Hotel Riviera, Inc. v. Torres*, 632 P.2d 1155 (Nev. 1981). A geographical limitation to the area serviced by a medical clinic was found to be reasonable. *Ellis*, 596 P.2d at 224. However, a one-hundred-mile radius around the City of Reno was not reasonable. *Hansen*, 426 P.2d at 792. A restrictive covenant prohibiting an employee from competing with an employer within a one-hundred-mile radius for five years was *per se* unreasonable. *Jones v. Deeter*, 913 P.2d 1272 (Nev. 1996).

Disclosure of Trade Secrets or Confidential Information

Nevada has enacted the UTSA. NEV. REV. STAT. §§ 600A.010 to 600A.10. Nevada courts will exercise their equitable power to modify unreasonable restrictive covenants in order to make the covenants' limitations reasonable. *Ellis*, 596 P.2d at 224-25.

New York

§ 366.11

Covenants Not to Compete

Covenants not to compete are enforceable in New York where the employer can establish, among other things, that it has a protectable interest, that the covenant is necessary to protect that interest, and that the covenant is reasonably limited geographically and temporally to give no more protection than is necessary to safeguard the protectable interest. *Lumex, Inc. v. Highsmith*, 919 F. Supp. 624, 628-29 (E.D.N.Y. 1996). Such covenants are enforceable to the extent that they can afford an employer demonstrably necessary protection against unfair competition stemming from the use or disclosure of trade secrets. *American Broadcasting Co., Inc. v. Wolf*, 52 N.Y.2d 394, 403 (N.Y. 1981). Agreements restricting the competition of former "professional employees" are scrutinized to a lesser degree than agreements restricting other types of employees. *BDO Seidman v. Hirshberg*, 690 N.Y.S.2d 854 (N.Y. App. Div. 1999).

"It is well settled that restrictive covenants which tend to prevent a similar vocation after termination of employment are disfavored by the law." *H & R Recruiters, Inc. v. Kirkpatrick*, 663 N.Y.S.2d 865, 866 (1997). Noncompetition agreements will not be enforced "unless necessary to protect the trade secrets, customer lists or good will of the employer's business, or perhaps when the employer is exposed to special harm because of the unique nature of the employee's services." *Lumex, Inc.*, 919 F. Supp. at 628-29 (quoting *Skaggs-Walsh, Inc. v. Chmiel*, 638 N.Y.S.2d 698 (1996)). To be found reasonable, the covenant must: (1) provide a reasonable restriction as to time and geographical scope; (2) not place an undue hardship on the employee; (3) not harm general public policy; and (4) be necessary for the employer's protection. *Mallory Factor, Inc. v. Schwartz*, 536 N.Y.S.2d 752, 753 (N.Y. 1989). As with most states, however, "no hard-and-fast rules have yet been formulated and courts have been continuously engaged in the ongoing task of determining what restrictions are reasonable given the peculiar circumstances and context of each individual case." *Ivy Mar. Co., Inc. v. C.R. Seasons, Ltd.*, 907 F. Supp. 547, 555 (E.D.N.Y. 1995). However, a former employee's knowledge of the identity of "but one" of his former employer's customers may not constitute knowledge of a trade secret. *Chemfab Corp. v. Integrated Liner Tech., Inc.*, 693 N.Y.S. 2d 752 (N.Y. App. Div. 1999).

Disclosure of Trade Secrets or Confidential Information

New York courts are most willing to enforce restrictive covenants to protect confidential business information and/or trade secrets. *Primo Enter. v. Bachner*, 539 N.Y.S.2d 320, 321 (N.Y. App. Div. 1989). In determining whether information constitutes a trade secret, New York courts consider: "(1) the extent to which the information is known outside the business, (2) the extent to which the information is known to employees and others involved in the business, (3) the extent that measures are taken to guard the secrecy of the information, (4) the value of the information to the business and its competitors, (5) the amount of effort or money expended in developing the information, and (6) the ease or difficulty with which the information could properly be acquired or duplicated by others." *Ivy Mar. Co. Inc.*, 907 F. Supp. at 556. "Although New York courts have identified a number of factors that courts may look to in determining whether information constitutes a trade secret . . . the most important consideration is whether the information was kept secret." *Geritrex Corp. v. Dermarite Indus., LLC*, 910 F. Supp. 955, 961 (S.D.N.Y. 1996). Substantial efforts to protect the secret nature of the information must be made. *Id*. (*citing Ashland Mgmt., Inc. v. Janien*, 82 N.Y.2d 395 (1993)). The inquiry is highly fact-specific, and conclusory statements that information constitutes a trade secret will be rejected by a court. *Stipes v. Stanley Works*, 691 N.Y.S.2d 535 (N.Y. App. Div. 1999).

Overly broad covenants will be modified in such a way as to make the covenants reasonable and valid. For example, where an otherwise valid covenant contains no geographical limitation, the court will construe one, such as defining the limit to be the employer's business area. *Deborah Hope Doelker, Inc. v. Kestly*, 449 N.Y.S.2d 52, 53 (N.Y. App. Div. 1982). However, a court will not rewrite the covenant where infirmities in the provision are too patent and the court would essentially be required to rewrite the entire provision. *Leon M. Reimer & Co., P.C. v. Cipolla*, 929 F. Supp. 154, 160 (S.D.N.Y. 1996).

Ohio

§ 366.12

Covenants Not to Compete

Noncompetition covenants will be valid and enforceable so long as the restraint (1) is not beyond that reasonably necessary for the protection of the employer's business, (2) is not unreasonably restrictive upon the rights of the employee, and (3) does not contravene public policy. *Briggs v. Butler*, 45 N.E.2d 757, 762-763 (Ohio 1942).

In assessing a covenant's enforceability, courts consider:

> The absence or presence of limitations as to time and space; whether the employee represents the sole contact with the customer; whether the employee is possessed with *[sic]* confidential information or trade secrets; whether the covenant seeks to eliminate competition which would be unfair to the employer or merely seeks to eliminate ordinary competition; whether the covenant seeks to stifle the inherent skill and experience of the employee; whether the benefit to the employer is disproportional to the detriment to the employee; whether the covenant operates as a bar to the employee's sole means of support; whether the employee's talent which the employer seeks to suppress was actually developed during the period of employment; and whether the forbidden employment is merely incidental to the main employment.

HCCT, Inc. v. Walters, 651 N.E.2d 25, 27 (Ohio Ct. App. 1994) (quoting *Raimonde v. Van Vlerah*, 325 N.E.2d 544, 547 (Ohio 1975)). Delay in the enforcement of a covenant may increase the detrimental effect on the employee. *Wilson v. Kreusch*, 111 Ohio App. 3d 47 (Ohio Ct. App. 1996). Continued employment may constitute sufficient consideration to support a covenant not to compete, although Ohio courts are split on the issue. *Willis Refrigeration, Air Conditioning & Heating, Inc. v. Maynard*, 15 IER Cases 1795 (Ohio App. 2000); *Canter v. Tucker*, 674 N.E.2d 727 (Ohio Ct. App. 1996).

A covenant not to compete in the entire state of Ohio for two years was upheld where the employer showed that it provided medical equipment to entities throughout the state and a client source list was difficult to develop. *Columbus Med. Equip. Co. v. Watters*, 468 N.E.2d 343, 347 (Ohio Ct. App. 1983). A covenant not to compete within the states of Ohio or Michigan was upheld where the employer and employee were patent attorneys and those states comprised a large portion of the employer's business. *Toulmin v. Becker*, 124 N.E.2d 778 (Ohio Ct. App. 1954).

On the other hand, a covenant not to compete in the city of Columbus was found unenforceable where the employee was an osteopathic physician and the employee's services were held to be vital to the public. *Williams v. Hobbs*, 460 N.E.2d 287 (Ohio Ct. App. 1983). A covenant not to compete within two hundred miles of Cleveland was ruled unreasonable where the former employer's business was generally within a sixty-mile radius of Cleveland. *E.P.I. of Cleveland, Inc. v. Basler*, 230 N.E.2d 552 (Ohio Ct. App. 1967).

Disclosure of Trade Secrets or Confidential Information

An employer may use a nondisclosure agreement to protect trade secrets or other confidential information that the former employee acquired through his employment and which the employee may subsequently try to use for his own benefit. OHIO REV. CODE ANN. §§ 1333.61(A), (B), 1333.62 (Anderson 1993). For information to be confidential, it must be unavailable outside the business and the employer must take precautions to guard its secrecy. *Biomedical Innovations Inc. v. McLaughlin*, 658 N.E.2d 1084 (Ohio Ct. App. 1995).

Ohio courts are free to modify or amend unreasonable restrictive covenants in order to make them reasonable. "When a covenant imposes an unreasonable restriction, the court should modify the agreement to protect the employer's legitimate interest and then enforce the covenant as modified." *National Interstate Ins. Co. v. Perro*, 934 F. Supp. 883, 890 (N.D. Ohio 1996); *see also Raimonde v. Van Vlerah*, 325 N.E.2d 544, 547 (Ohio 1975).

Oklahoma

§ 366.13

Covenants Not to Compete

Oklahoma statute provides, "every contract by which anyone is restrained from exercising a lawful profession, trade or business [other than in connection with the sale of the goodwill of the business or upon dissolution of a partnership] … is to that extent void. Okla. STAT. tit. 15 § 217.

Before 1989, Oklahoma courts strictly interpreted this statute to prohibit noncompete agreements between employers and employees. Significantly, in contrast to this interpretation, the Oklahoma Supreme Court upheld as reasonable an agreement prohibiting an employee from soliciting clients of the employer in the capacity that the employee had worked for the employer, finding that it did not prohibit the exercise of a lawful profession. *Tatum v. Colonial Life and Accident Ins. Co.*, 465 P.2d 448, 451 (Okla. 1970).

However, in 1989, the Oklahoma Supreme Court held that the state statute only prohibits "unreasonable restrictions." *Bayly, Martin & Fay, Inc. v. Pickard*, 780 P.2d 1168, 1170 (Okla. 1989). The court in *Bayly* also ruled that if a contractual provision is unreasonable, judicial modification of a covenant not to compete "is justified if the contractual defect can be cured by imposition of reasonable limitations concerning the activities embraced, time, or geographical limitations." *Id.* at 1173. However, the court specified that a covenant not to compete cannot be judicially modified if essential elements of a contract must be supplied. *Id.* at 1169.

Despite its recognition that some restraints would be acceptable, the court in *Bayly* struck down as unreasonable an agreement that prohibited an employee from soliciting clients and potential clients of the employer for three years following employment. *Id.* at 1170-72. While recognizing that employees had a protectable interest in their customers and customer lists, the court focused on the fact that restraint was not limited to clients with whom the employee had contact during employment. *Id.* The court also found that the contract could not be saved by judicial modification. Further, under the framework established by the Oklahoma Supreme Court, the determination of whether a restraint is reasonable depends on all the facts and circumstances, but a restriction must: (1) be no greater than is required for the employer's protection from unfair competition; (2) not impose undue hardship on the employee; and (3) not be injurious to the public. *Loewen Group Acquisition Corp. v. Matthews*, 12 P.3d 977, 980-82 (Okla. Ct. App. 2000).

Oklahoma courts are very reluctant to find that a noncompete agreement is a reasonable restraint of trade. *See, e.g., Loewen Group Acquisition Corp. v. Matthews,* 12 P.3d at 980-82 (finding that a covenant not to compete was an unreasonable restraint on trade, where it was intended to prevent an employee from using the considerable experience, contacts, and recognition within the community that he already had gained before the agreement was executed, the geographic area covered in the covenant extended to a city in which manager had no contacts or "following" and the time period of the restriction was three years); *Cohen Realty, Inc. v. Marinick*, 817 P.2d 747 (Okla. Ct. App. 1991) (finding a restriction unreasonable because it prevented a broker in a real estate sales company from engaging in nursing home sales for ten years); *Herchman v. Sun Med., Inc.*, 715 F. Supp. 942 (N.D. Okla. 1990) (striking down a noncompetition covenant because it prohibited a salesman in a medical equipment company from working for a competitor in any capacity in four states for one year).

Disclosure of Trade Secrets or Confidential Information

Nondisclosure agreements will be enforced when the employer has a strong proprietary interest in protecting trade secrets. Oklahoma has adopted the UTSA.

If a covenant not to compete or solicit is found to be unreasonably broad, Oklahoma courts may "blue pencil" the covenant to make it reasonable and enforceable, *e.g.*, by limiting a geographical limitation to the employer's business area. *Threlkeld v. Steward*, 103 P. 630 (Okla. 1909). However, the contract will not be completely rewritten. The court will only alter terms if the changes necessary do not modify the essential terms of the contract.

Oregon

§ 366.14

Covenants Not to Compete

Oregon does not have a *per se* prohibition against covenants not to compete. To enforce a valid covenant, the employer must show that the covenant is (1) partial or restricted as to time and place, (2) based on good consideration, and (3) reasonable. *Farmers Ins. Exchange v. Fraley*, 720 P.2d 770, 771 (Or. Ct. App. 1986). Temporal and geographical limitations will be considered along with all other relevant factors, including the general nature of the business involved. *Eldridge v. Johnston*, 245 P.2d 239, 252 (Or. 1952). The absence of both geographical and time limitations is not necessarily fatal; reasonable limitations will be implied if possible. *Renzema v. Nichols*, 731 P.2d 1048, 1049 (Or. Ct. App. 1987).

A two-year covenant against competition was enforced against the ex-employees of a truck brokerage business. *Cascade Exchange, Inc. v. Reed*, 565 P.2d 1095 (Or. 1977). A two-year covenant with no geographical restriction has also been upheld for employees of a lumber company. *North Pac. Lumber Co. v. Moore*, 551 P.2d 431 (Or. 1976). On the other hand, a three-year covenant purporting to bar competition within three hundred miles of both the place of employment and the subsidiaries of the employer was held unreasonable and unenforceable because enforcement would have effectively barred the employee from working at his vocation in almost every major population center in the nation. *Kennedy v. Wackenhut Corp.*, 599 P.2d 1126 (Or. Ct. App. 1979), *modified, reh'g granted*, 601 P.2d 474 (Or. Ct. App. 1979).

Disclosure of Trade Secrets or Confidential Information

Trade secrets are a protected interest that an employer may safeguard by entering into a nondisclosure agreement. Employees may be also be prevented from disclosing or using confidential customer information that will give them an unfair advantage in competing with the employer.

Oregon courts may modify an overly broad covenant, and can provide a reasonable limit if no temporal or geographical limitation is provided in the covenant, based on all the facts and circumstances of the case. *Lavey v. Edwards*, 505 P.2d 342, 344 (Or. 1973).

Pennsylvania

§ 366.15

Covenants Not to Compete

Restrictive covenants are valid and enforceable under Pennsylvania law so long as: 1) the covenant relates either to a contract for the sale of goodwill or other subject property, or to a contract for employment; 2) the covenant is supported by adequate consideration; and 3) the application of the covenant must be reasonably limited in both time and territory. *Piercing Pagoda, Inc. v. Hoffner*, 351 A.2d 207, 210 (Pa. 1976). Additionally, the Pennsylvania Supreme Court sometimes adds a fourth requirement, that the restriction must be reasonably necessary to protect a legitimate need of the employer. *Sidco Paper Co. v. Aaron,* 351 A.2d 250 (Pa. 1976).

A company's employment of an individual constitutes sufficient consideration for accepting the terms of a restrictive covenant, but continued employment alone is not sufficient consideration. *Geisinger Clinic v. DiCuccio,* 606 A.2d 509, 513 (Pa. Super. Ct. 1992), appeal denied, 637 A.2d 285 (Pa. 1993), cert. denied, 512 U.S. 1112 (1995); *Ruffing v. 84 Lumber Co.,* 600 A.2d 545, 548 (Pa. Super. Ct. 1991), appeal denied, 610 A.2d 46 (Pa. 1992). Therefore, employers seeking to create binding covenants not to compete with current employees might consider entering into a regular, formal employment relationship, or offering "new" consideration, such as the acquisition of stock, special training, promotions, or pay raises. *Morgan's Home Equipment Corp.*, 136 A.2d 838 (Pa. 1957); *In re Verdi*, 244 B.R. 314, 323-324 (Bankr. E.D. Pa. 2000). In *Morgan's Home Equipment Corp*., employment with the successor company was deemed sufficient consideration for several "provisional" employees whose company had been taken over in a corporate merger. *Morgan's*, 136 A.2d at 841.

In measuring reasonableness, courts seek to avoid excessively open-ended restrictions; most of the covenants enforced by Pennsylvania courts range from one to three years in duration. *National Bus. Servs., Inc. v. Wright,* 2 F. Supp. 2d 701, 708 (E.D. Pa. 1998)(holding that Pennsylvania courts "routinely uphold one-year covenants not to compete"); *John G. Bryant Co. v. Sling Testing & Repair, Inc.*, 369 A.2d 1164 (Pa. 1977). However, courts have upheld non-compete agreements as long as five years where the covenant prohibits employees from soliciting customers, but does not bar them from working in a particular industry. *Vector Sec., Inc. v. Stewart*, 88 F. Supp. 2d 395 (E.D. Pa. 2000). In terms of geographic restrictions, while nationwide covenants are disfavored generally, they may be upheld where the employer's business is nationwide, or not limited by state boundaries. *National Bus. Servs., Inc.*, 2 F. Supp. 2d at 708. This is especially the case for businesses that rely upon Internet-based sales. Id.

The range of legitimate business interests that can be protected by a restrictive covenant include business information, specialized skills and training, customer information and goodwill, and trade secrets and other proprietary information. *Thermo-Guard, Inc. v. Cochran*, 408 Pa. Super. 54 (1991). If appropriate, courts may limit enforcement of a covenant to only those parts that are necessary to protect the employer's legitimate business interests. *Sidco Paper Co. v. Aaron*, 351 A.2d at 254.

Disclosure of Trade Secrets or Confidential Information

Lacking its own statute, Pennsylvania courts have adopted the following definition of a trade secret, taken from the Restatement of Torts, section 757, comment b:

> A trade secret may consist of any formula, pattern, device or compilation of information which is used in one's business, and which gives him an opportunity to obtain an advantage over competitors who do not know or use it. It may be a formula for a chemical compound, a process of manufacturing, treating or preserving materials, a pattern for a machine or other device, or a list of customers.

(adopted in *Van Products Co. v. General Welding and Fabricating Co.*, 213 A.2d 769, 775 (Pa. 1965); *Mettler-Toledo, Inc. v. Acker*, 908 F. Supp. 240, 246 (M.D. Pa. 1995).

However, competitors are free to compile the same information as that which constitutes the trade secret so long as they obtain their knowledge through their own independent efforts and not merely through "borrowing" the information from the owner. *Mettler-Toledo*, 908 F. Supp. at 246; *Greenberg v. Croydon Plastics*, 378 F. Supp. 806, 812 (E.D. Pa. 1974).

Any party seeking an injunction in a trade secret case, in either the federal or state court system in Pennsylvania, must demonstrate that: (1) there was a trade secret or secret manufacturing process; (2) it was valuable to the employer and important in the conduct of his business; (3) that by reason of discovery or ownership the employer has the right to the use and enjoyment of the secret; and (4) that secret was communicated to the employee while he or she was employed in a position of trust and confidence, under such circumstances as to make it inequitable and unjust for him to disclose it to others, or to make use of it himself, to the prejudice of his employer. *SI Handling Sys., Inc. v. Heisley*, 753 F.2d 1244, 1255 (3d Cir. 1985); *Mettler-Toledo*, 908 F. Supp. at 246.

Texas

§ 366.16

Covenants Not to Compete

Texas has supplanted its common law relating to covenants not to compete by enacting and amending the Covenants Not to Compete Act. TEX. BUS. & COM. CODE ANN. § 15.50 *et seq*. Under the Act, to be enforceable, a covenant not to compete must be: (1) ancillary to or part of an otherwise enforceable agreement at the time the agreement is made; and (2) limited as to time, geographical area, and scope of activity to be restrained, while not imposing a greater restraint than is necessary to protect the goodwill or other business interest of the employee. *See Light v. Centel Cellular of Tex.*, 883 S.W.2d 642 (Tex. 1994). Under this test, a covenant may be ancillary to promises made in at-will employment relationships as long as the promises are not dependent on continued employment, since such promises would be illusory in that the promisor retains the option of discontinuing employment in lieu of performance. *CRC-Evans Pipeline Int'l, Inc. v. Myers*, 927 S.W.2d 259 (Tex. Ct. App. 1996).

For example, in *Ireland v. Franklin*, 950 S.W.2d 155 (Tex. App. 1997), the court found that although an at-will employment relationship between the plaintiff and defendant had existed, a covenant not to compete contained in the defendant's employment agreement was ancillary to an otherwise enforceable agreement. Although the court confirmed that the "otherwise enforceable agreement cannot be an at-will employment contract, because at-will employment contracts are illusory," the court found that the noncompetition covenant's consideration was not tied to its illusory employment term. Instead, the employer had promised to share certain trade secrets with the employee in consideration for the employee's promise not to disclose or use the trade secrets during or after employment, and had not tied its promise to continued employment of the employee. *Id*. at 158; *see also Curtis v. ZIFF Energy Group, LTD*, 12 S.W.3d 114 (Tex. Ct. App. 1999).

Determinations under the Texas Covenants Not to Compete Act as to the reasonableness of time, geography and scope of activity limitations must be done on a case-by-case basis to determine if the limitations are no greater than necessary. Time restrictions of two to five years have been held valid and enforceable so long as the restrictions protect a legitimate interest. *See, e.g., Property Tax Assoc. v. Staffeldt*, 800 S.W.2d 349, 350 (Tex. Ct. App. 1990); *Investors Diversified Services, Inc. v. McElroy*, 645 S.W.2d 338, 339 (Tex. Ct. App. 1982). Generally, a reasonable geographic restriction is considered to be the territory in which the employee worked for the employer. *Evan's World Travel, Inc. v. Adams*, 978 S.W.2d 225, 252 (Tex. Ct. App. 1998); *Zep Mfg. Co. v. Harthcock*, 824 S.W.2d 654, 661 (Tex. Ct. App. 1992). Finally, as with time and geography requirements, the reasonable scope of activity requirement is satisfied if the court finds that the restraint is tailored to match the beneficiary's protectable interest. Most often this restriction should be related to the activities the former employee engaged in while with the employer. *Peat Marwick Main v. Haas*, 818 S.W.2d 381, 387 (Tex. 1991); *McNeilus Companies, Inc. v. Sams,* 971 S.W.2d 507, 509-510 (Tex. Ct. App. 1997).

Under Texas law, there may be a substantial difference between a contract limiting a former employee's competitive activity and an agreement to refrain from soliciting a former employer's employees. In *Totino v. Alexander & Associates, Inc.*, 198 Tex. App. LEXIS, 6504 (Tex. Ct. App. 1998), the court held for the first time under Texas law that a nonrecruitment covenant is not a contract in restraint of trade or commerce. Consequently, such an agreement is not subject to the strict requirements normally applied to a covenant not to compete. In *Totino*, the court reasoned that a nonrecruitment agreement does not prevent a former employee from exercising his trade or profession. Rather, such an agreement merely restricts which people a former employee may recruit.

Unreasonable contractual restrictions may be modified to make them enforceable if the covenant was entered into at the time of contracting or entered into later and supported by consideration. TEX. BUS. & COM. CODE ANN. § 15.51(c). Such covenants may be modified and enforced to the extent necessary to protect the promisee's legitimate interest. *McNeilus Companies, Inc. v. Sams*, 971 S.W.2d 507 (Tex. Ct. App. 1997).

Disclosure of Trade Secrets or Confidential Information

The misuse or misappropriation of trade secrets and other confidential or proprietary information is a legitimate employer interest that can be protected by a nondisclosure agreement. *Investors Diversified Servs*., 645 S.W.2d at 339; *Stocks v. Banner Am. Corp.*, 599 S.W.2d 665 (Tex. Ct. App. 1980). An individual is liable for disclosure of trade secrets when he discovers the secrets by an improper means, or the disclosure or use breaches a confidence. *American Derringer Corp. v. Bond*, 924 S.W.2d 773 (Tex. Ct. App. 1996). Further, notwithstanding the existence of a written agreement, an employee has a duty to refrain from using confidential or proprietary information acquired during the employment relationship to the detriment of the employer. This duty survives termination, but does not bar a former employee from using general knowledge, skill, and experience acquired while employed. *Miller Paper Co. v. Roberts Paper Co.*, 901 S.W.2d 593 (Tex. Ct. App. 1995).

Virginia

§ 366.17

Covenants Not to Compete

Covenants not to compete are enforceable in Virginia to the extent necessary to protect employer interests, including customer contacts and knowledge of methods of operation. The employer must show that the restraint is (1) no greater than necessary to protect a legitimate business interest, (2) not unduly harsh and oppressive in curtailing the employee's legitimate efforts to earn a livelihood, and (3) consistent with sound public policy. *Paramount Termite Control Co., Inc. v. Rector*, 380 S.E.2d 922, 925 (Va. 1989). However, covenants not to compete are not assignable unless both parties agree to the assignment. *Reynolds & Reynolds Co. v. Hardee*, 932 F. Supp. 149, 153-55 (E.D. Va. 1996). Thus, an employer who purchases the assets and goodwill of a company has no standing to sue on covenants made between the selling employer and current employees. *Id.*

Temporal and geographical restrictions must be no greater than are necessary to protect the employer in some legitimate business interest. For example, a five-year time limit was upheld on the ground that it was directly related to an important element of the insurance business in which the parties were engaged, since many policies came up for renewal in either three or five years. A fifty-mile territorial limit was also upheld on the basis that the area was practically coextensive with the business of the agency. *Meissel v. Finley*, 95 S.E.2d 186 (Va. 1956).

Geographical restrictions may be upheld even if they are not specific. In *Blue Ridge Anesthesia & Critical Care, Inc. v. Gidick*, 389 S.E.2d 467, 470 (Va. 1990), the territory serviced by the employees was upheld as a reasonable geographical restriction. The Virginia Supreme Court has upheld all covenants not to compete that it has ruled on since 1962.

Disclosure of Trade Secrets or Confidential Information

Trade secrets and other confidential information can be protected by nondisclosure agreements. Whether restrictive covenants will be enforced depends upon the facts of each case and the reasonableness of the restraint. *Richardson v. Paxton Co.*, 127 S.E.2d 113, 117 (Va. 1962).

The scope of permissible restraints between employer and employee is more limited than in other contexts and is construed in favor of the employee. *Id.* A federal district court held that Virginia law did not provide for "blue-pencil" power, but did permit the court to sever two unenforceable provisions concerning competition from two enforceable provisions pertaining to confidential information in the same clause. *Roto-Die Co., Inc. v. Lesser*, 899 F. Supp. 1515, 1523 (W.D. Va. 1995).

Washington

§ 366.18

Covenants Not to Compete

Under Washington law, employers have the right to protect information in which they have a particular interest. To enforce a covenant not to compete, an employer must show that the covenant is reasonable and that a protectable interest such as trade secret or confidential information is at stake. *Perry v. Moran*, 766 P.2d 1096 (Wash. 1989).

Washington courts consider three factors when determining reasonableness: (1) whether the covenant is necessary to protect the employer's business or goodwill; (2) whether the covenant restrains the employee more than is reasonably necessary to secure the employer's business or goodwill; and (3) whether the public's interest makes the covenant unenforceable. *Knight, Vale & Gregory v. McDaniel*, 680 P.2d 448, 451-52 (Wash. Ct. App. 1984). When determining whether temporal and geographical limitations in a covenant not to compete are reasonable, courts consider whether the covenants are necessary to protect the employer's legitimate interests without imposing an undue hardship on the employee; *e.g.*, *Perry v. Moran*, 748 P.2d 224, 229 (Wash. 1987), *judgment modified on reconsideration*, 766 P.2d 1096 (1989). Washington courts have also determined that continued employment with additional training and experience given to the employee is sufficient consideration to enforce a covenant not to compete. *Machen, Inc. v. Aircraft Design, Inc.*, 828 P.2d 73 (Wash. Ct. App. 1992). However, a covenant not to compete is not enforceable to protect only the employer's investment of training an employee. *Copier Specialist, Inc. v. Gillen*, 887 P.2d 919, 920 (Wash. Ct. App. 1995).

Washington courts have found three-year limitations on competition to be reasonable. *Knight, Vale & Gregory v. McDaniel*, 680 P.2d 448 (Wash. Ct. App. 1984). However, a five-year and one-hundred-mile-radius limitation was not reasonable. *Wood v. May*, 438 P.2d 587 (Wash. 1968). A covenant restricting employees from soliciting customers may be substituted for a geographical limitation. *Perry*, 748 P.2d at 230.

Disclosure of Trade Secrets or Confidential Information

The Washington legislature has enacted the UTSA. WA. REV. CODE ANN. § 19.108.010 *et seq.* (West 1996). The Washington State Supreme Court recently affirmed that the Washington UTSA focuses on the nature of the information and not its form. *Ed Nowogroski Ins., Inc. v. Rucker*, 971 P.2d 936 (Wash. 1999) (affirming the lower court holding that "the distinction between written and memorized information is without legal significance"). It also displaced tort claims based on trade secret misappropriation. *Id*.

In *Rucker*, the Washington Supreme Court also enunciated a three-prong inquiry to determine whether customer lists constitute trade secrets. The three prongs are: (1) whether the list is a compilation of information; (2) whether it is valuable because unknown to others; and (3) whether the owner has made reasonable attempts to keep the information secret. *Id.* at 945.

Washington will enforce covenants not to compete to the extent reasonable. The courts will partially enforce or modify a covenant not to compete if there is no injustice to the parties and no injury to the public. *Armstrong v. Taco Time Int'l, Inc.*, 635 P.2d 1114 (Wash. Ct. App. 1981).

West Virginia

§ 366.19

Covenants Not to Compete

There is no *per se* rule restricting the use of covenants not to compete in West Virginia. Covenants not to compete are valid to the extent that they are reasonable, and necessary to protect legitimate employer interests. A covenant not to compete will be enforced if the employer shows that the covenant is supported by consideration, ancillary to a lawful contract, reasonable, and consistent with the public interest. A reasonable restriction is one which (1) is not greater than required for the protection of the employer, (2) does not impose an undue hardship on the employee, and (3) is not injurious to the public. *Reddy v. Community Health Found. of Man*, 298 S.E.2d 906, 911 (W. Va. 1982).

Protectable employer interests include confidential information unique to an employer, customer lists generated by the employer, or trade secrets. Other commonly asserted valid employer interests are the skills the employee acquired in the course of employment and employer goodwill.

The time or distance of a restriction will vary with the type of business involved. Restrictions of up to five years have been validated. *Chicago Towel Co. v. Reynolds*, 152 S.E. 200 (W. Va. 1930). Likewise, a three-year restriction on two Canadian provinces and those states east of the Mississippi in which the employer actually engaged in business was upheld. *O. Hommel Co. v. Fink*, 177 S.E. 619 (W. Va. 1934). However, several lesser limitations have been struck down for lack of a legitimate employer interest; *e.g.*, *Moore Business Forms, Inc. v. Foppiano*, 382 S.E.2d 499, 501 (W. Va. 1989) (two-year covenant not to compete covering any area employee worked during the year preceding termination unenforceable for lack of legitimate employer interest). A less stringent test for reasonableness is applied to restrictive covenants ancillary to the sale of a business. In one such case, a restriction in a fifty-mile radius for fifteen years was upheld. *Weaver v. Ritchie*, 478 S.E.2d 363 (W Va. 1996).

Skills and information acquired by the employee that are of a general, managerial nature, such as supervisory, merchandising, purchasing, and advertising skills and information, cannot be restricted by covenants not to compete. In addition, where the evidence indicates that it was the former employee's efforts, rather than the employer's reputation, that induced the former employer's customers to do business with the former employee, there is no protectable interest.

Disclosure of Trade Secrets or Confidential Information

Nondisclosure agreements are enforceable to the extent necessary to protect the legitimate interests of the employer. There is no protectable interest in customer lists if the names and addresses are ascertainable by independent sources. In addition, courts have refused to enforce a covenant not to disclose information where it would have been impossible for an employee to memorize the vast amount of information the former employer characterized as confidential business information.

Although a covenant may be enforceable as written, West Virginia courts will typically find that an employer is entitled "to that limited measure of relief within the terms of the noncompetitive agreement which is reasonably necessary to protect [its] legitimate interests, will cause no undue hardship on the [employee] and will not impair the public interest." *Reddy v. Community Health Found. of Man*, 298 S.E.2d at 914 (brackets in original; citations omitted). The covenant will therefore be enforced, consistent with that principle.

Wisconsin

§ 366.20

Covenants Not to Compete

Contracts that operate to restrict trade or competition are *prima facie* suspect in this state, and will be liberally construed in favor of employees. *Wausau Med. Ctr., S.C. v. Asplund*, 514 N.W.2d 34 (Wis. App. 1994). Nonetheless, such contracts may be used to prevent dissemination of confidential business information or unfair competition. *Id*. at 283; *Pollack v. Calimag*, 458 N.W.2d 591, 598-599 (Wis. Ct. App. 1990). Wisconsin state law specifically addresses and approves of covenants not to compete as they pertain to current employees.

To be enforceable, a covenant not to compete must pass a five-part test: (1) it must be reasonably necessary for the protection of the employer; (2) it must provide a reasonable temporal restriction; (3) it must provide a reasonable territorial limit; (4) it must be reasonable as to the employee; and (5) it must be reasonable as to the general public. *Harris v. Ponick*, 608 N.W.2d 437 (Wis. Ct. App. 1999) (*citing Chuck Wagon Catering v. Raduege*, 277 N.W.2d 787, 792 (Wis. 1979)).

Whether particular restrictions as to time and area are reasonably necessary to protect the employer are determined by the court. Restrictions containing neither geographical nor temporal limitations are unenforceable. *Gary Van Zeeland Talent, Inc. v. Sandas*, 267 N.W.2d 242 (Wis. 1978). The reasonableness of a time limitation depends upon the period of time required for customers to cease to identify the employee with the employer. *Pollack v. Calimag*, 458 N.W.2d at 598. The courts have consistently affirmed covenants for terms of one year to two years after employment ends. *Id.*

Restrictive covenants must be limited geographically to the area where the employer does business. *Id*. The area where the employer does business is identified by considering the location of the employer's customers and the location where the employer performs its actual business transactions. *Id.*

Disclosure of Trade Secrets or Confidential Information

Nondisclosure agreements will be enforced to protect the employer's trade secret and confidential business information. Such covenants must meet general standards of reasonableness. Information that requires development to become productive is not protectable as confidential information or a trade secret. In *Leske v. Leske*, 539 N.W.2d 719 (Wis. App. 1995), the plaintiff gathered information to establish an ice-selling business. His parents stole the ideas and created the business. The court held that there was no protectable interest because the information was only a "feeble" step towards an end product. *Id*. at 723.

The Wisconsin courts will not "blue pencil" contracts to make them reasonable and enforceable. *Streiff v. American Family Mut. Ins. Co.*, 348 N.W.2d 505, 509 (Wis. 1984). If an indivisible contract imposes an unreasonable restraint, the covenant is illegal, void, and unenforceable even as to so much of the covenant as would be a reasonable restraint. *Id*. at 512.

III. PRACTICAL RECOMMENDATIONS FOR THE HR PROFESSIONAL

§ 367

A. CONDUCT A TRADE SECRET AUDIT

§ 368

It is important for employers to have in place a comprehensive program for the protection of trade secrets. Such a program includes informing employees and others of confidentiality requirements, entering into agreements with employees and others to ensure compliance with these requirements, and adopting company-wide policies for trade secret protection. Another integral part of any successful trade secret protection program is the trade secret audit.

A trade secret audit is a review, conducted on a regular basis, to identify company information that may be a protectable trade secret. The process is designed to clarify what information is currently subject to trade secret protection, as some previously protectable information may have become obsolete while other vital information has emerged. In litigation over trade secret misappropriation, it is critical that an employer be able to demonstrate what steps were taken to protect the information in question. Conducting a regular audit will help to ensure that vital information is designated as protected and can provide important evidence to that effect in litigation.

In general, a comprehensive trade secret audit includes the following steps:

- Determine what information constitutes the company's trade secrets
- Evaluate means to protect the information
- Identify potential problems in protection of the information
- Consult with professionals (legal, security, computer technician)
- Weigh the costs versus the benefits of various means of protection

- Designate personnel responsible for maintaining secrecy
- Review regularly

What Should Be Included in the Audit?

Obviously the type of information that will fall into the protectable category will vary significantly by company. Generally, the kinds of information that should be covered in a trade secret audit will be technical or research & development information (formulas compounds, prototypes, etc.), production/process information (cost/price data, process/ manufacturing technology, quality control information, etc.), and proprietary financial information (budgets, forecasts, product margins and costs, etc.). In general, the information must not be generally known or ascertainable and it must have economic value to the possessor.

If an audit has never been done before, a good starting point is to ask various employees within the company what kinds of information the company has that they believe gives it its competitive advantage and would like to maintain as secret. Trade secrets are not always complex, technical information. Simple knowledge of a slight change in a commonly known manufacturing process that saves the company substantial money can constitute a trade secret, as can business information such as customer lists and the negative (unsuccessful) results of research and development. The individuals throughout the company who are familiar with its processes and why they were adopted are a good source of possible trade secrets that should be included in an inventory. In many instances, a company possesses trade secret information without realizing it is entitled to such protection.

All proprietary information should be specifically identified. It is a good idea to prepare and maintain lists within different departments of protectable information, and also to compile these into a master list. (The process of compiling the list will often lead to the discovery of additional information that needs to be classified.) The lists should include names of individuals who have access to the information noted on the list. Again, by going through the exercise of noting who has access to confidential information, companies may discover that access is being granted too liberally and can take steps to impose greater limits. Ideally, only those with a “need to know” should have access to confidential information. Documenting individuals with access will also enable the identification of sources of leaks should a breach of confidentiality occurs.

Having this information documented regularly and with specificity will enable an employer to remind both current and departing employees of what they must keep as confidential, and provide critical evidence in the event of a conflict or litigation. There are many examples of plaintiff companies losing in court when they tried to claim trade secret protection because the court found that they had not specified in enough detail exactly what was a trade secret. *Canter v. West Publishing*, 31 F. Supp. 2d 1193 (N.D. Cal. 1999); *ECT Int’l v. Zwerlein*, 597 N.W.2d 479 (Wis. App. 1999). The court in *Computer Economics, Inc. v. Gartner Group, Inc.*, 50 F. Supp. 2d 980 (S.D. Cal. 1999) articulated several reasons for early identification of trade secrets: discouraging meritless claims, preventing abusive discovery of defendant’s secrets, helping to define the scope of discovery, and informing thoughtful defenses.

How Often?

It is important that companies conduct trade secret audits at least annually, to ensure that all employees and relevant parties are aware of what information is currently considered protectable. Once information is identified through the audit as meriting protection, appropriate policies and procedures can be implemented that are tailored to the information and those who have access to it.

Who Should be Involved?

Each department or unit within a company should have an individual designated to conduct periodic audits of their area to maintain a current log of protectable information. This person will be more familiar with the information and processes employed in that department and can better identify firsthand what information qualifies as a trade secret.

It is advisable to involve corporate counsel in the audit process to the extent possible. This will protect the audit results from discovery in the event of litigation, as it will come under the attorney-client privilege. The attorney (in-house counsel or outside counsel) could actually draft the written audit report, or the report could be crafted in the form of a memo to counsel, thus invoking the privilege.

Review Systems and Processes

In addition to identifying the information that should be protected in a company's trade secret program, it is also important to identify processes that might have the potential to compromise information security. For example, proprietary information might be included in submissions to government entities; certain procedures should be followed to protect such information from a Freedom of Information Act request. Contractual relationships with some outside parties (such as customers or vendors) often call for the return of proprietary information upon termination of the relationship, and it is important that steps are followed to ensure timely recovery of such information. Departing employees, even if they have signed nondisclosure agreements, should be reminded of their obligations. In general, any formation or dissolution of a relationship that involves individuals gaining access to proprietary information should be reviewed for its potential to compromise trade secret integrity.

A comprehensive trade secret audit, in addition to creating an inventory of confidential information and those who have access to it, should also review company security procedures to ensure that they are in fact effective in protecting trade secrets. Policies and procedures that should be considered for trade secret protection include noting confidential status on the documents themselves, protecting electronically stored information with restricted access and passwords, and controlling physical access to facilities in which information and/or processes are used and observable. The trade secret audit will be strengthened by denoting not just what information is subject to protection, but how it is protected.

A trade secret protection program will function better if there are also procedures in place to declassify information that no longer requires strict confidentiality, and to destroy information that is no longer being used but that might nonetheless be of value to a competitor. Use of such procedures can help to demonstrate that an employer's efforts to protect its trade secrets are both rigorous and reasonable. It will provide little guidance to employees or others if virtually *everything* is deemed confidential; over-classifying may also undermine the credibility of the company's trade secret protection efforts in litigation.

An effective audit system also includes mechanisms for detecting when trade secret theft has occurred. This goes beyond discovering that documents are missing. It includes monitoring the market and remaining aware of competitors' activities to discover unusual similarities in products or unusual rapidity in bringing new products to market, possible evidence of trade secret misappropriation.

B. HOW TO PROTECT COMPANY INFORMATION WHEN THE EMPLOYMENT RELATIONSHIP ENDS

§ 369

The end of an employment relationship presents critical challenges for an employer on many levels. In addition to losing valuable employees, an employer may also find itself facing the loss of its proprietary and confidential information, research and technology, key clients and hard-earned goodwill. Too often, when employees leave, a company neglects to consider the ramifications of the departures on anything other than a short-term basis. This is a mistake.

A company's ability to preserve its information, clients and goodwill when an employment relationship ends is only as strong as the steps it has taken to protect these assets in the first place. Thus, important considerations apply when an employment relationship ends, such as:

- Has the company properly identified its confidential information/trade secrets and taken reasonable steps to protect them?
- Has the company maintained proper security with regard to its computer and electronic data systems to minimize the likelihood of theft or misappropriation?
- Has the departing employee signed a non-disclosure, non-compete and/or non-solicitation agreement that is likely to be enforced if subject to court scrutiny?

The cessation of the employment relationship, however, brings with it special considerations which the savvy employer will anticipate and be prepared to address.

Termination vs. Resignation

One of the most important issues which must be analyzed when an employee leaves a company and the employer wants to enforce his or her non-compete obligations is the manner in which the employment relationship ended. It is easy to justify enforcing a non-compete following a middle-of-the-night departure of a group of key employees who have made off with secret company files and data. Similarly, the supposedly loyal executive who pledges his or her commitment to the company at a meeting where high-level strategy is discussed, only to resign and open a competing business a month later, is not particularly sympathetic from an equity standpoint. But what about the middle manager who is fired for poor performance and tries to find work elsewhere in the industry? Or the longtime sales employee who loses his or her job as part of a reduction in force? These latter two situations obviously present different considerations.

Not surprisingly, courts in many states have addressed the issue whether an employer can enforce a covenant not to compete where the cessation of the employment relationship comes at the hands of the employer, rather than the employee. The following table briefly summarizes the positions of various state courts which have considered the question:

§ 369.1

States	Position
Arkansas	Not where termination is without cause
District of Columbia	Not when employer voluntarily terminates the employment
Florida	Not where employer breaches the employment agreement
Georgia	Not where the termination is improper
Illinois	Not where the termination results from the employer's bad faith
Indiana	Not where there is bad faith or a material breach of the employment agreement by the employer.
Iowa	Employer's breach may be a defense to enforcing a non-disclosure agreement
Maryland	Cases suggest that not where the employer breaches the employment agreement.
Minnesota	Cases suggest that not where wrongful termination occurs
Mississippi	Not where termination is arbitrary, capricious, or in bad faith
Missouri	Not where the termination is a breach of the employment agreement
New Jersey	Not where there is a material breach
New Mexico	Not where there was no just cause (when "just cause" is a specific requirement in the employment agreement)
New York	Not where there was no just cause
North Carolina	Presumably not where there is a material breach
Pennsylvania	Not where the termination is wrongful
Texas	Not where the former employer breached the underlying contract
Wisconsin	Law indicates that not where there is a substantial breach
Wyoming	Not where the at-will employee is terminated in bad-faith

While these states may differ somewhat in their precise approaches and results, two underlying themes are apparent. The first is that an employer should not be able to benefit from its own wrongdoing to enforce a covenant not to compete. For example, in *Marcre Sales Corp. v. Jetter*, 476 S.E. 2d 840 (Ga. Ct. App. 1996), the termination provisions of the contract required the employer to give the employee salesman thirty days' notice of termination before expiration of the one-year term of the contract, which was to renew annually. However, the employer terminated the contract seven months before expiration, which the court found to be a breach that precluded the employer from enforcing the non-compete provisions contained in the agreement.

The second theme underlying these decisions is that an employer should not be able to claim that an employee was a poor performer sufficient to warrant his or her termination, yet at the same time contend that the employee now poses a competitive threat so as to justify enforcement of a covenant not to compete. This was the rationale adopted by the Pennsylvania Superior Court in *Insulation Corp. of America v. Brobston*, 667 A.2d 729 (Pa. Super. 1995), a case of first impression. In *Brobston*, the court determined that the employer's decision to terminate the employee for poor performance implicitly reflected the employer's conclusion that the employee was "worthless" and that, consequently, "it is unreasonable as a matter of law to permit the employer to retain unfettered control over that which it has effectively discarded as worthless to its legitimate business interests." *Id*. at 734-35 (footnotes omitted).

It is important to note that courts may perceive non-disclosure obligations differently from non-compete obligations. Logically, even though an employee may have been terminated for poor performance, while this may excuse him or her from complying with restrictions on competition, it can be argued that a termination should have no effect on the employee's obligation not to disclose confidential information. Thus, in cases where an employer may be precluded from enforcing a non-compete if an employee is terminated for poor performance, it does not automatically follow that the employer must give up its right to protect its confidential information from disclosure.

> **Tip**: When considering to terminate an employee for poor performance, do not automatically assume that you will be able to enforce that employee's covenant not to compete. The same is true when terminating an employee under an employment agreement which contains a non-compete, but also contains other provisions which may give the employee a basis to claim failure to comply with the agreement in other respects

The Exit Interview

The exit interview is often overlooked as a useful tool for employers in avoiding or at least minimizing the loss of confidential information and business when employees leave. While many companies utilize exit interviews on a regular basis, they are often not sufficiently focused on this aspect of the employment relationship and companies miss an important opportunity to safeguard their property and business relationships.

Many, if not most, trade secret/covenant cases arise from some combination of the following facts: an employee gives notice and announces that he or she is leaving the company to pursue unspecified "other opportunities." All seems well and the parting is, at least on the surface, amicable. Two weeks later, the employee is gone. A few more weeks go by, when the employer calls on a longtime customer previously serviced by the former employee. The customer mentions that the former employee has called to solicit business and has offered a significantly lower price for the product in question. At about the same time, another few employees announce that they too are leaving to pursue "other opportunities." Next thing the employer knows, they too have gone and joined the first employee in a directly competing business and begin calling on customers left and right. The employer panics and begins searching the company's files and electronic data to see whether the former employees made off with any confidential information. Unfortunately, their laptop computers have all been reissued to new employees and put back in circulation, so it is impossible to tell what they may have done before they left in terms of copying or downloading files. By now, the employer faces the real possibility of a significant business loss.

While exit interviews with the departing employees may not have completely prevented this scenario from unfolding, there is a good chance that, properly conducted and documented, they could have at least helped to minimize the damage or, at the very least, provided helpful evidence to the employer in any subsequent litigation.

Ten Tips in Conducting Effective (& Protective) Exit Interviews

1. Educate and train management and human resource personnel as to the importance of the exit interview as a mechanism to remind the departing employee of any continuing obligations regarding confidential information/non-competition; obtain the return of any confidential information or documents and other company property, such as computers and access cards; and obtain information as to the employee’s reasons for leaving and future plans.

2. Try to avoid allowing the exit interview to turn into a venting session, which can easily happen given the emotions which often accompany it. This is not productive and not only leads to a breakdown of whatever goodwill might remain between employee and employer, but also defeats the employer’s purpose of protecting its property and interests.

3. Before the interview, be familiar with and have at hand all documents which support the departing employee’s continuing obligations, whether they be non-compete agreements, confidentiality agreements, handbooks, job descriptions, corporate secrecy or trade secret policies or the like. If the employee has not signed or acknowledged any such documents, be familiar with any common law obligations not to disclose confidential information.

4. If you are unsure as to the nature or scope of the employee’s continuing obligations, consult with legal counsel beforehand so that you are well-prepared to articulate the company’s position at the interview itself. You may also wish to consider having legal counsel present at the exit interview depending on the circumstances.

5. Carefully and thoroughly review with the employee his or her continuing obligations, whether based on documents or common law. If based on documents, show them to the employee and remind him or her that they are binding and for what time period. Explain what it is you expect from the employee in this regard. If, for example, there are specific customers that the employee is prohibited from soliciting, or particular types of information that should not be disclosed, you may wish to describe these specifically. Do not, however, allow the employee to “rewrite” his or her obligations by agreeing to waive, modify or defer any applicable provisions, unless of course you are prepared and willing to do so.

6. Be prepared to discuss with the departing employee exactly what company property he or she has and arrange for its prompt return. This would include, for example, access cards; credit and phone cards; any company documents and materials received during the course of employment; computers, software and computer disks; cell phones, pagers and Palm Pilots. Be thorough and

specific and remember to include not only information and materials maintained in the workplace, but at home as well.

7. Pay particular attention to home computer equipment and laptops. If the employee has a company-owned laptop, be sure that it is returned and do not recirculate it to others in the workforce until you have had it examined to determine whether company files have been copied, deleted, or otherwise altered. You may wish to consider having a mirror image made of the computer's hard drive. Also be sure to maintain an adequate chain of custody over the computer in the event that litigation becomes necessary. Similarly, if the employee has a home computer with company information stored on it, make arrangements to have that information deleted from the home computer under company supervision.

8. Try to ascertain from the employee his or her future plans. While this is not always possible, if an employee denies going into a competitive business or says that he or she is uncertain about the future, and suddenly turns up at a competitor, this earlier denial/uncertainty may serve as evidence that the employee was intentionally trying to hide the truth.

9. Make sure that arrangements are made to return to the employee any personal property or other items which legitimately belong to him or her. Determine from the employee how he or she wants future personal mail and any outstanding paychecks handled, i.e. where they should be sent. This avoids later accusations that you are withholding personal items or salary.

10. Consider having the employee sign an acknowledgment of the matters discussed in the exit interview, which again reaffirms his or her continuing obligations; states that the employee has returned all confidential information and other company property; and that the employee has received all personal property to which he or she is entitled. Also, consider the use of an exit interview checklist to memorialize the matters discussed with the departing employee.

Communications with New Employer

One of the most difficult choices faced by the employer is whether to communicate with the new employer regarding the employee's continuing obligations and, if so, what to say. The reason for this difficulty is that, if the former employer says the wrong thing, it could face liability for such claims as intentional interference with contract and/or business relations (in the form of the new relationship between the former employee and his or her new employer) and/or defamation. Without embarking on an extensive discussion of either of these torts, a good rule of thumb is to draft any communication with the new employer extremely carefully. A "friendly reminder" letter is often an effective way of providing notice to the new employer of the former employee's duties and obligations. The letter should advise the new employer that the former employee had access to confidential information and trade secrets and/or is subject to non-compete obligations. If the former employee has signed a written agreement, you should reference the applicable sections in the letter. You may even attach a copy. This provides notice to the new employer of your rights so that it cannot later claim that it had no notice. In addition, you may wish to ask the new employer for written assurances that it will not allow the former employee to disclose or use any of your trade secrets/confidential information or to violate any non-compete obligations.

Communications with Customers

From a business standpoint, protecting the customer base when you lose one or more employees who had relationships with those customers is paramount. Consider sending a written communication to the customers advising them that the employee(s) with whom they formerly dealt are no longer with the company and advising them of their new contact. Be careful, though, not to cross the line into any potentially defamatory or other tortious conduct or words in communications with customers. This is true with regard to written communications, and just as true with regard to oral communications. Those who deal with the customers should be instructed not to make any accusations or derogatory comments about the former employee(s), no matter how tempting.

IV. ESSENTIAL TOOLS FOR PROTECTING COMPANY TRADE SECRETS

A. STEPS FOR MAINTAINING THE SECRECY OF TRADE SECRET INFORMATION

§ 370

One of the key issues that often arises in claims to protect trade secrets is whether the owner has taken reasonable steps to maintain the secrecy of the information for which protection is sought. It is difficult to preserve trade secret status when the information is not treated as secret, or efforts to maintain secrecy are half-hearted or not uniformly applied. What are reasonable efforts under the circumstances? In one case involving a manufacturing plant constructed by Dupont, the company considered the way in which the plant was designed and laid out as trade secret information. Accordingly, the company erected barriers around the plant to ensure that it was not readily visible to outsiders. However, a competitor went so far as to obtain aerial photographs of the facility. When the parties ended up in court, the competitor argued that Dupont had not undertaken reasonable efforts to maintain the secrecy of its plant configuration. The court rejected that argument, finding that what Dupont had done under the circumstances was reasonable and did not have to construct a covering over the plant to conceal from aerial view.

While what is reasonable will depend in large measure on the circumstances, the following are commonly used means to ensure security in dealing with trade secret information:

1. Stamp or label documents or other material as “confidential”

2. Limit access to files containing confidential information

3. Maintain confidential information under lock and key

4. Shred or otherwise destroy any drafts or discarded copies of confidential information (looking through trash is not unheard of and there is no expectation of privacy in discarded materials, making it fair game for a competitor)

5. Have sign-in logs at company facilities
6. Require visitors to wear name badges issued through a security checkpoint and never let them wander unescorted through the facility
7. Implement passwords for all databases containing confidential information
8. Have inventory check-outs and check-ins for employees using confidential information
9. Implement written non-disclosure or other employment agreements restricting employee use of confidential information
10. Install monitoring software to track access to databases containing confidential information
11. Conduct periodic inventories to assess the nature and quality of the company's confidential information
12. Implement written non-disclosure agreements for non-employees who are provided access to confidential information.
13. Centralize the means of access to confidential information through a limited number of employees (have one administrator who knows who has had access and make records accordingly)
14. Erect fences or other barriers to limit access
15. Number (and making a record using that number) of all copies of confidential information
16. Prepare job descriptions for employees having access to confidential information, spell out that the job requires use of such information, and that information should be kept secret
17. Include in the company's employee handbooks a policy concerning access to confidential information
18. Include in an employee's offer letter that they will gain access to confidential information

Note: This list is not exclusive and the applicability of any of them will depend on the nature of the information for which protection is sought and the company's practical needs.

B. HOW TO PROTECT ELECTRONIC DATA

§ 371

It is no surprise that the digital workplace is here to stay, and employers must develop policies and practices to address the many issues that arise as a result. Common and perhaps essential features of today's working environment include the Internet, company Intranets, e-mail, and voicemail. The effects of the digital workplace are becoming more evident in the laws that have developed to govern the handling of an employer's information. Because of the ease with which information can be transmitted – and thus improperly used or misappropriated – employers must implement safeguards to protect their assets.

Consider the following scenario:

> A company spends considerable resources, through a team of employees and substantial expense, developing a new formula for a key product. The effort to produce this formula involved employees from various company locations across the country. Owing to the importance of the formula to the company's business, painstaking efforts were undertaken to treat the formula as a trade secret and ensure its secrecy during the development process including non-disclosure agreements and limited access. As the final phase of the product's development becomes complete, the company prepares a final report at its headquarters and plans to distribute it to the team members for one last review before implementing the formula and beginning production on the product. Ambitious in its efforts and enthused about the potential revenues from this key product, the company issues a press release to tout its upcoming launch. Because of a shortage of support personnel at the company headquarters, a part-time secretary is working on the final report, making the last revisions and edits based on directions and input from the company's head of research and development. After the revisions are complete, the research and development head instructs the secretary to e-mail the report to the team members. Unfamiliar with the company's system, the secretary hits the wrong keys and mistakenly posts the final report onto a public Internet message board that is viewed by thousands of people. By the time the mistake is discovered, the final report has been copied and posted to several other message boards.
>
> Can the company still maintain its trade secret and prevent others from using it? What can be done to retrieve the information? What could the company have done to avoid this disaster?

Angry employees sometimes can do even more damage in the digital workplace than negligent ones. A large company brought suit against 21 employees for allegedly disclosing company secrets in Internet chat rooms. A company vice president with a grudge against the company was alleged to be responsible for the postings and resigned in the wake of the lawsuit.[2]

While trade secret status is generally lost if the information is publicly disseminated, steps are available to protect a company's interests. In the scenario described above, the company, at a minimum, could have prominently marked the final report "Confidential" and provided a distribution list of specific individuals so that the intent was clear to limit access. Likewise, the company also could have included an instruction that any inadvertent recipient of the information should return the message immediately. Perhaps the best measure under those circumstances to ensure against improper disclosure, however, is implementing appropriate workplace policies. For those employees who have access to trade secret information, employers should:

- Identify online information as secret and limit online access through passwords or other controls.

[2] William M. Bulkeley, *Two Raytheon Employees Resign in Wake of Internet Posting Suit,* Apr. 5.1999, *available at* http://www.msnbc.com/news/256092.asp.

- Instruct all employees having access to trade secret information to include prominent warnings at the top of every e-mail message containing such information.

- Train employees who deal with trade secrets to exercise care in transmitting the information, including what information is considered confidential, how access is limited and follow up to ensure that the proper recipient receives the information.

- Consider monitoring access to sensitive information by implementing software that tracks the identity of persons accessing the information.

- Prepare and implement written policies to address these issues.

C. SAMPLE INTERNET/E-MAIL POLICY

§ 372

Written policies should make clear that the employee should have no expectation of privacy in using the employer's e-mail systems. To that end, the employer should explain that an employee's e-mails, as well as Internet access will be monitored. The policy should also provide general restrictions on usage of e-mail and Internet for business purposes only. As a practical matter, personal use by employees of e-mail and the Internet in the workplace is commonplace, but the extent to which an employer may strictly prohibit or acknowledge and permit such use will depend on the company's culture. At a minimum, a company must take some step to place employees on notice of the trade secret status of the company's information and the limitations on access and disclosure.

The following is a sample policy and should be used only in consultation with legal counsel to ensure compliance with applicable federal, state or local law.

E-MAIL/INTERNET POLICY[3]

The Company's technical resources – including desktop and portable computer systems, fax machines, Internet and World Wide Web (Web) access, voice mail, electronic mail (e-mail), electronic bulletin boards, and its intranet – enable employees quickly and efficiently to access and exchange information throughout the Company and around the world. When used properly, we believe these resources greatly enhance employee productivity and knowledge.

This policy applies to all technical resources that are owned or leased by the Company, that are used on or accessed from Company premises, or that are used on Company business. This policy also applies to all activities using any Company-paid accounts, subscriptions, or other technical services, such as Internet and World Wide Web access, voice mail, and e-mail, whether or not the activities are conducted from Company premises.

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[3]This is a sample policy only and does not constitute and is not a substitution for consultation with legal counsel. The law in this area consistently changes and must be reviewed before implementing any policy in this regard. This sample policy should not be implemented or executed except on the advice of counsel.

1. Acceptable Uses

The Company's technical resources are provided for the benefit of the Company and its customers, vendors, and suppliers. These resources are to be used solely for the pursuit of Company business and are to be reviewed, monitored, and used only in that pursuit, except as otherwise provided in this policy.

Employees may post notices on the Company's Intranet and electronic bulletin board provided they obtain advance approval from their manager or the Human Resources department. Employees are otherwise permitted to use the Company's technical resources for occasional, non-work purposes as long as such use does not interfere with an employee's work. However, at no time do employees have a right of privacy as to any information or file maintained in or on the Company's property or transmitted or stored through the Company's computer, voice mail, e-mail, or telephone systems.

2. Unacceptable Uses

The Company's technical resources, especially use of the Internet, may not be used for personal gain or the advancement or expression of individual views. The Company's technical resources may also not be used to solicit for commercial ventures, religious or political causes, outside organizations, or other non-job related solicitations.

Employees may not send e-mail or other communications that mask their identity or indicate that they were sent by someone else. Employees are not allowed to access any technical resources using another employee's password. Similarly, employees should only access the libraries, files, data, programs, and directories that are related to their work duties. Unauthorized review, duplication, dissemination, removal, installation, damage, or alteration of files, passwords, computer systems or programs, or other property of the Company, or improper use of information obtained by unauthorized means, is strictly prohibited.

Sending, saving, or viewing offensive material is prohibited. Messages stored and/or transmitted by computer, voice mail, e-mail, or telephone systems must not contain content that is disruptive or that may reasonably be considered offensive to any employee. Offensive material includes, but is not limited to, sexual comments, jokes or images, racial slurs, gender-specific comments, or any comments, jokes or images that would offend someone on the basis of his or her race, color, religion, sex, age, national origin or ancestry, physical or mental disability, veteran status, marital status, sexual orientation, as well as any other category protected by federal, state, or local laws. Any use of the Internet/World Wide Web, the Company's intranet, or electronic bulletin board to harass or discriminate is unlawful and strictly prohibited.

3. Access to Information

The Company maintains the right and the ability to enter into any of its technical resource systems and to inspect and review any and all data recorded in those systems. Because the Company reserves the right to obtain access to all voice mail and electronic mail messages left on or transmitted over these systems, employees should not assume that such messages are private and confidential or that the Company or its designated representatives will not need to access and review this information. Individuals using the Company's business equipment should also have no expectation that any information stored on their computer – whether the information is contained on a computer hard drive, computer disks or in any other manner – will be private.

The Company has the right to, but does not regularly, monitor voice mail or electronic mail messages. The Company will, however, inspect the contents of computers, voice mail or electronic mail in the course of an investigation triggered by indications of unacceptable behavior or as necessary to locate needed information that is not more readily available by some other less intrusive means.

The contents of computers, voice mail, and electronic mail, properly obtained for some legitimate business purpose, may be disclosed by the Company if necessary. Nevertheless, such messages should be treated as confidential by other employees and accessed only by the intended recipient.

In order to facilitate the Company's access to information on its technical resources, you may not encrypt or encode any voice mail or e-mail communication or any other files or data stored or exchanged on the Company's systems without the express prior permission of the Director of Information Technology.

4. Copyrighted Materials

You should not copy and distribute copyrighted material (e.g., software, database files, documentation, articles, graphics files, and downloaded information) through the e-mail system or by any other means unless you have confirmed in advance from appropriate sources that the Company has the right to copy or distribute the material. Failure to observe a copyright may result in disciplinary action by the Company as well as legal action by the copyright owner. Any questions concerning these rights should be directed to your manager.

5. Confidential Information

E-mail and Internet/Web access are not entirely secure. Others outside the Company may also be able to monitor your e-mail and Internet/Web access. Conveying the Company's legally protected confidential information (e.g., trade secrets, employee or client information) and confidential communications (e.g., communications with the Company's legal counsel) by electronic mail could result in the information losing its legally protected confidential status. Talk to your manager prior to conveying such information.

6. Software Policy

If you want to install software on Company computers, you must contact the Director of Information Technology and request to have the software installed. Employees are prohibited from installing any software on any Company technical resource without the express prior permission of the Director of Information Technology.

7. Discipline

Violations of any policies listed above may result in disciplinary action up to and including termination. In addition, the company may advise appropriate legal officials of any illegal violations.

8. Acknowledgement and Release

I hereby acknowledge that I have reviewed and understand the Company's policy regarding e-mail and Internet use. I am aware that the computer files, e-mails and Internet use I am involved with may be accessed at any time without notice by the Company. I agree to fully release and hold harmless the Company, and its agent and employees, from any liability arising from the Company's request for access and any employment decisions made based on such access. I also acknowledge that the Company may, upon its discretion, notify law enforcement officials under certain circumstances.

____________________________ ____
Employee Signature Date

The Top 10 Reasons Employers Lose Trade Secret Cases

Presented by

Marguerite S. Walsh

Arthur J. Schwab

Evan G. Perkins

Craig T. Elson

...and how to prevent them

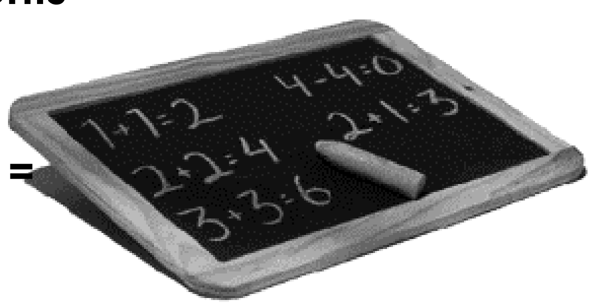
The Failure Formula

Bad agreements +

Bad habits +

Bad planning =

Bad results



Reason Number Ten: Deficient Agreements

The Agreements Are

- **Outdated**
- **Irrelevant to the employee's actual job duties**
- **Overbroad**
- **Unenforceable for technical reasons**

Common Provisions

- **Non-competition**
- **Non-solicitation of customers/prospects**
- **Non-solicitation of employees**

Non-Competition Agreements

- **Restrictions must be reasonable as to**
  - time
  - geography
  - legitimate interest sought to be protected
- **Consideration must be adequate**

Common Problems

- One size does NOT fit all
- Non-customer contact jobs with customer/prospect restrictions (e.g. research)
- "Accept" vs. "solicit" business
- Global economy/workforce can make time and geography meaningless

Common Problems (cont'd)

- Continued employment can be adequate consideration in most BUT NOT ALL states (e.g. not in Pennsylvania)
- Lack of assignability clause can render agreement unenforceable
- Termination for poor performance can render agreement unenforceable
- Not all states "blue-pencil" (e.g. not in Georgia)

Practical Steps

- **For existing employees, undertake periodic review to determine continuing viability of agreement in light of passage of time and new or different job duties/responsibilities**
- **Update if necessary**
- **For new employees, draft agreements with above considerations in mind**

Reason Number Nine:

Poorly Defined Trade Secrets

Defining the Trade Secrets

- **THE most common litigation problem**
- **Until they walk out the door, no one can define them**
- **But once they do, then "everything" qualifies**

Trade Secret Definition

Uniform Trade Secrets Act ("UTSA")

- Information
- Having independent economic value
- Not generally known or readily available to the public
- Subject to reasonable efforts to maintain its secrecy

Other Legal Sources

- State civil statute
- State criminal statute
- Common law

Information Generally Entitled to Protection

- **Technical formulas**
- **Unique processes**
- **Drawings & diagrams**
- **Experimental prototypes**
- **Current cost/pricing data**
- **Manufacturing methods**
- **Product specifications**

- **Sales/marketing information and forecasts**
- **Budgets & forecasts**
- **P & L statements**
- **Strategic business plans**
- **Proprietary software applications & programs**
- **Compilations**

Common Problems

Definition may be too vague

- "confidential business data"
- "proprietary information"
- "sensitive material"

Other potential problems

- already within the public domain
- readily ascertainable from other sources
- general industry knowledge
- stale information

Practical Steps

- **Business people must be the drivers in defining the company's trade secrets and must do so before any lawsuit**
- **They will be the witnesses at deposition and trial**
- **Their credibility will be on the line**
- **Their bottom line will be impacted**

Reason Number Eight:

Poorly Secured Trade Secrets

Reasonable Efforts to Maintain Secrecy

- **Easy to overlook but powerful evidence**
- **Simple but critical steps**
- **Building block approach**
  - small measures add up
- **Consistency is the key**

Common Problems

- **Lack of physical security measures**
- **Inconsistent application and enforcement**
- **Lax corporate mentality**

Practical Steps

Notice to employees, including

- confidentiality agreements
- corporate trade secret policy
- dissemination of policies and practices
- specific notice to trade secret recipients
- exit interviews
- acknowledgment of non-disclosure obligations

Practical Steps (cont'd)

Physical Security Measures, including

- locked files
- authorized passwords
- encryption of information
- documents stamped "confidential"
- restricted access and limited circulation
- posted "keep out" signs
- sign in/sign out procedures

Reason Number Seven: Inadequate Post-Hiring Mechanisms

Common Problems

- **No exit interview/inadequate exit interview**
- **Inadequate documentation**
- **No clear game plan as to return of company property, especially computers and electronic devices**
- **Lack of information about future plans**
- **Promises of "no enforcement"**
- **Misguided comments in the field**

Practical Steps

- Educate/train management and HR personnel as to importance of exit interview
- Avoid "venting" session
- Gather all relevant documents signed or acknowledged by employee
- Carefully review all obligations and expectations

Practical steps (cont'd)

- Thoroughly discuss and review plans for return of all company property, including that kept at employee's home
- Include laptops, PDAs, cell phones
- Consider mirror image
- Chain of custody is critical

Practical Steps (cont'd)

- ➢Arrange for return of all legitimate personal property, including future mail, paychecks
- ➢Try to ascertain future plans
- ➢Document any denials/uncertainty
- ➢Consider signed acknowledgment of matters discussed and of continuing obligations
- ➢DO NOT make any promises

Issue: Communications with New Employer

- ➢Possible issues: defamation and intentional interference
- ➢Consider "friendly reminder" letter
- ➢Draft carefully
- ➢Consider asking for written assurances from new employer

Reason Number Six: Inattention to Computer/ Electronic Security

Security of Computer and Electronic Data

- **After poorly-defined trade secrets, this is the second most common litigation problem**
- **Ineffective computer/electronic data control and recovery**
- **Recirculation of laptop before investigation**
- **Inexperienced/interested personnel are charged with computer data recovery**

Practical Steps

- **Periodic audit of computer security programs**
- **Consider prominent warnings in e-mails containing confidential information**
- **Have written policies in place, acknowledged by employees, regarding use and monitoring of company e-mail, computers and other electronic devices (e.g. PDAs, Blackberries, cell phones)**

Reason Number Five:

Inadequate Investigation of Potential Misappropriation

The Big Picture

- Seizing the moral high ground
- Finding the bad acts
- Explaining how you have been hurt
- Driving towards trial

Launching the Investigation from Within

- Define the investigative team
- Define the investigative tasks
- Investigate quickly but thoroughly
- Be prepared for leaks

Securing the Key Documents

- Agreements, handbooks, manuals, & memos reflecting confidentiality expectations
- Signed acknowledgment of receipt form
- Those identifying confidential info/trade secrets
- Those showing access to confidential information

Securing the Key Documents

- Those reflecting trust and confidence placed in ex-employee
- Building and security logs
- Copier access records
- Expense records

Investigating Computer and Electronic Data

- **Use expert familiar with <u>all</u> aspects of system**
- **Check for**
  - unusual access to files not normally used
  - unusual computer access
  - Internet gateway/modem transfers to employee's home
  - Unusual copying or deleting of files

Investigating Computer and Electronic Data

- **Examine e-mail communications**
- **Review phone records**
- **Examine server and backup tapes**
- **Retrieve home/laptop computer**
- **Chain of custody is critical**

Investigating Other Sources of Information

Other employees

- beware of the Mole

Customers

- business ramifications

Using an Outside Investigator

- **Records search**
- **Pretext calls**
  - new employer
  - customers/ prospects
  - recruiter
- **Surveillance**
- **"Dumpster dives"**
- **Security/ termination plan if offender still employed**

Keeping It All Together

- **Central reporting structure**
- **Careful documentation**
- **Chain-of-custody**
- **Key documents in topic order**

Reason Number Four: Inadequate Efforts Made to Retain the Business

Common Problems

- The departing employees have a head start
- Customers hate involvement in trade secret disputes
- Emotions and frustration levels are running high

Practical Steps

- Immediately assemble team to contact customers and assure them of continued service and quality
- Guard against derogatory comments in the field about former employees or new employer
  - possible defamation issues
  - diversion in the litigation
- Consider written communication to customers but draft carefully

Reason Number Three:

The Company Underestimates the Business Disruption Involved in a Lawsuit

Trade Secret Litigation

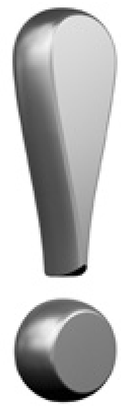
- **Is enormously time-consuming and draining**
- **Is fast-paced with little lead time**
- **Diverts attention from retaining and expanding the business**
- **Invites second-guessing if things go wrong**

Practical Steps

- **Business people most affected by the events MUST be involved from the outset**
- **Review of pleadings before filing**
- **Affidavit(s) of key personnel who will then serve as fact witnesses**
- **Ongoing updates and strategy input**
- **Periodic re-evaluation in light of business goals**

Reason Number Two: Too Little Attention is Paid to Relief Sought

- **The proposed Order is THE most important part of initial filing**
- **BUT it usually invites the least degree of attention**



Common Issues

TRO vs. preliminary injunction

– seek TRO only if you can win

Precise wording of injunctive relief

– Specific “hands-off” customers provision
– Specific “hands-off” employees provision
– Time limits
– Persons and entities covered
– Indirect activities, e.g. aiding and abetting

Common Issues (cont'd)

Damage models may include

- your lost profits
- the new employer's gain
- R & D costs
- lost training costs
- replacement costs
- attorneys' fees and costs under statute

Practical Steps

- **Have business people define a "win" at the outset**
  - best "win"
  - least "win"
- **Draft the proposed form of Order FIRST based on these parameters**
- **Consider sending opponent a proposed form of Order with lesser relief that still defines a "win"**

Reason Number One:

Failure to Realize that Trade Secret Litigation **IS** Different

Legal Issues

Examples

- inevitable disclosure
- state law differences, e.g. blue pencil, assignability, consideration
- interrelationship of different statutes/theories, e.g. raiding, UTSA, Copyright Act, Lanham Act, Electronic Espionage Act

Practical Issues

- **Prompt, efficient investigation using trained experts/personnel who don't learn on your nickel**
- **Choice of forum**
- **Choice of parties—new employer only? Former employee only? Both? Headhunter?**
- **Form of relief**

Discovery Issues

Examples

- preservation of evidence order
- confidentiality/ attorneys' eyes only issues
- computer recovery issues

Trial Issues

Examples

- Topical presentation of massive amounts of evidence/data
- Use of summary/demonstrative exhibits
- Computer programs/video clips

Settlement Issues

- **Consent Order vs. Settlement Agreement**
- **Mediation/Arbitration**
- **Relief consistent with business goals**
- **Use of experts to aid in process**
- **Recovery of attorneys' fees**

The Success Formula

Anticipation +

Preparation +

Investigation =

Successful Litigation

