NEGOTIATING EMPLOYMENT AGREEMENTS: COVENANTS NOT TO COMPETE, TRADE SECRETS AND CONFIDENTIALITY AGREEMENTS

by
Steven Hymowitz*
R. Bradley Mokros**

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* Steven Hymowitz is a member of the law firm of Kiesewetter Wise Kaplan Prather, PLC which has offices in Memphis, Tennessee and New Orleans, Louisiana. The firm limits its practice exclusively to the representation of management in the field of labor and employment law. Mr. Hymowitz received his B.S. degree from Fordham University and graduated from University of Memphis School of Law in 1974, where he was an Associate Editor of the Law Review. Mr. Hymowitz is a former Management Co-chair of the Committee on Employment Rights and Responsibilities of the American Bar Association Labor and Employment Law Section, listed in Best Lawyers in America (1989-2008), Mid-South Superlawyers, International Who’s Who of Labor and Employment Lawyers, Corporate Counsel Magazine’s Best Lawyers, and is a Fellow of the College of Labor and Employment Lawyers.

** R. Bradley Mokros is a Legal Research Specialist in the law firm of Kiesewetter Wise Kaplan Prather, PLC in Memphis, Tennessee. Mr. Mokros provides support for various types of labor and employment litigation in federal and state courts, as well as before the National Labor Relations Board and labor arbitrators. He received his B.A. degree from Washington University in St. Louis.
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INTRODUCTION

This speech addresses covenants not to compete and the protection of trade secrets. Two preliminary points are worth noting. First, both of these areas are governed by state law, which often varies substantially. Second, although there is some conceptual overlap between these two areas, the legal differences are more significant. For example, non-compete agreements can be used as a prophylactic means to protect trade secrets, while trade secrets constitute a valid “protectable interest” to support a non-compete agreement. Despite this overlap, these areas are treated substantially different under the law. Courts are generally hostile toward non-compete agreements – which are viewed as restraints on trade – whereas they are typically solicitous toward the protection of trade secrets, as courts reason that such protection encourages innovation and enhances economic efficiency while it discourages unethical commercial practices.¹

COVENANTS NOT TO COMPETE

I. INTRODUCTION

The success of many businesses depends upon trade secrets and other confidential or proprietary information developed by the employer. Other businesses may rely upon customer lists and professional contacts or relationships. To maintain their competitive advantage, employers need to protect these and other legitimate business interests. Because employees often have access to this information, employers may protect these interests by requiring employees to sign a post-employment covenant not to compete.

Through a covenant not to compete, an employer and employee contractually negotiate what terms and conditions apply to the employment relationship. Because these agreements restrict commerce and free competition, however, covenants not to compete are not viewed favorably by the law. Accordingly, courts strictly construe the agreement against the employer to prevent overbroad restrictions that do not actually protect legitimate business interests.

II. GENERAL REQUIREMENTS

No uniform standards govern covenants not to compete. Each state applies its own requirements for drafting a valid and enforceable agreement. While these requirements vary from state-to-state, covenants not to compete must satisfy certain minimum criteria. First, the agreement must contain valid consideration in exchange for the employee's agreement not to compete with the employer. Second, the agreement must be “reasonable.” Most states examine the reasonableness of the agreement based upon: (1) the geographic restrictions in the agreement, (2) the duration of the agreement, and (3) the interests of the employer, employee, and the public affected by the agreement.²

² See, e.g., Omniplex World Services Corp. v. U.S. Investigations Services, Inc., 618 S.E.2d 340 (Va. 2005) (non-competition agreement between employer and employee enforced if contract is narrowly drawn to protect employer's legitimate business interest, is not unduly burdensome on employee's
An employer that seeks to enforce a covenant not to compete has the burden of proving that the covenant is reasonable. Employees usually claim that the agreement does not satisfy the essential elements of consideration and reasonableness required in an enforceable agreement. In addition, employees claim traditional contractual defenses such as fraud, duress, or incapacity and the defense of “unclean hands” to defeat a restrictive covenant. Because each state provides different standards and the courts strictly construe covenants not to compete, the employer should carefully draft the covenant to ensure that the agreement satisfies all legal standards.

III. DRAFTING AN ENFORCEABLE COVENANT NOT TO COMPETE

To draft a valid, enforceable, and comprehensive covenant not to compete, the employer should consider including each of the following provisions in the agreement.

A. Choice of Law That Applies to Restrictive Covenant

Many agreements include a statement of which state’s law applies to the enforcement of covenant not to compete. Since the laws that apply to covenants not to compete vary widely from state-to-state, a choice of law provision that provides the parties with a level of predictability should be included in the overall agreement.

In some states, covenants not to compete are void and unenforceable unless the agreement adheres to the requirements set forth in the applicable statute. See, e.g., Cal. Bus. & Prof. Code § 16600, La. Rev. Stat. 23:921.A. In these states, courts recognize a strong public policy against agreements that do not meticulously conform to the statute. In other states, courts simply rely on common law to supply the rules for enforcing covenants not to compete. In these states, the employer may find more flexible standards that support enforcement of the agreement. By not including a choice of law statement in a covenant not to compete, the employer loses control over which jurisdiction regulates the agreement.

Typically, courts uphold the parties’ agreement that a particular state’s law applies to the agreement.

- Vantage Technology, LLC v. Cross, 17 S.W.3d 637, 644 (Tenn. Ct. App. 1999). The court held that where the parties to a non-compete agreement manifest an intent to apply the laws of a jurisdiction other than that in which the contract was executed, that intent will be honored, provided that certain requirements are met: the choice of law provision must be executed in good faith; the jurisdiction chosen must bear a material connection to the transaction, the basis for choosing another jurisdiction's law must be reasonable and not merely a sham or subterfuge, and the choice of another jurisdiction's law must

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not be contrary to a fundamental policy of a state having a materially greater interest in the matter and whose law would otherwise govern. See also Restatement (Second) of Conflict of Laws § 187(2).\(^3\)

- *Medtronic, Inc. v. Advanced Bionics Corp.*, 630 N.W.2d 438 (Minn. Ct. App. 2001). Consensual employment contract that included choice-of-law provision specifying the use of Minnesota law, created expectation by both parties that any dispute arising under the employment contract would be resolved by application of Minnesota law. The former employee's current employer, who, together with the employee, had challenged the non-compete agreement in a California court, had no justifiable expectation under the choice-of-law provision that California law would be applied. The court noted the importance of predictability inherent in a choice-of-law analysis. See also *St. Jude Medical S.C., Inc. v. Hasty*, 2007 WL 128856 (D. Minn. Jan. 12, 2007) (outlining factors used to determine which law should govern).

Employers should carefully select a forum that has a rational connection to the employment relationship with the employee. Some courts will void the choice of law in the contract if there is an insufficient connection to the selected state or the selected state's laws on covenants not to compete violate the public policy of the other state.

- *Manuel v. Convergys Corp.*, 430 F.3d 1132 (11th Cir. 2005). Employee filed declaratory judgment action challenging the validity of a non-competition agreement which contained a choice-of-law provision requiring the application of Ohio law. The Georgia district court refused to enforce the provision despite the fact that the employee was a resident of Ohio, but then moved to Georgia, a more employee-friendly jurisdiction. The Eleventh Circuit upheld summary judgment for the employee both on the non-compete agreement and on a misappropriation claim under the special Georgia rule that allows an employee to retain customer information in memory. Central to the

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\(^3\) The relevant portion of the Restatement concerning exceptions to the parties' choice of law specifies:

(2) The law of the state chosen by the parties to govern their contractual rights and duties will be applied, even if the particular issue is one which the parties could not have resolved by an explicit provision in their agreement directed to that issue, unless either

(a) the chosen state has no substantial relationship to the parties or the transaction and there is no other reasonable basis for the parties' choice, or

(b) application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue and...would be the state of the applicable law in the absence of an effective choice of law by the parties.

*Restatement (Second) of Conflict of Laws* § 187(2)(a)-(b).
court’s analysis on the forum selection clause was the fact that Georgia was the forum in which the action was first filed.⁴

- Pursuant to a 1999 amendment to the Louisiana covenant not to compete statute (La. Rev. Stat. Ann. § 23:921(A)(2)), choice of forum and choice of law clauses are enforceable only if expressly, knowingly, and voluntarily agreed to and ratified by the employee after the occurrence of the incident which is the subject of the civil action.

B. Consideration For Restrictive Covenant

Like most contracts, a covenant not to compete must include valuable consideration. Therefore, employers should include a statement of what consideration the employer provided to the employee in exchange for the employee’s agreement not to compete. The consideration necessary to support the contract varies from state-to-state.⁵

In some states, the covenant not to compete must be ancillary to an otherwise enforceable agreement.

Alex Sheshunoff Management Services, L.P. v. Johnson, 209 S.W.3d 644 (Tex. 2006). The Texas Supreme Court loosened the rules somewhat on covenants not to compete by overruling, in part, an earlier opinion which had held that an at-will employee signing a covenant not to compete was not bound by the covenant if the employer assumed no corresponding enforceable obligation at the “time of the signing.” See Light v. Centel Cellular Co. of Texas, 883 S.W.2d 642 (Tex. 1994). Under the new rule announced in Sheshunoff, an at-will employee’s non-compete covenant becomes enforceable when the employer performs the promises it made in exchange for the covenant. Here, the employer promised to disclose confidential information and provide specialized training to the employee and the employee promised not to disclose the information. The court held that such an agreement does not fail because it is “initially” illusory, but instead it becomes an enforceable unilateral contract at the time the employer actually provides the information or consideration promised. This holds true even if there is a long period between the time the employee signs the agreement and the time the employer provides the confidential information. Basically, the employer’s consideration is provided by performance and becomes non-illusory at that point, and the agreement (if otherwise reasonable in time, scope, and geographic region) becomes enforceable under the statute.


⁵ The adequacy of consideration is an issue of fact for the jury to decide. See, e.g., Central Adjustment Bureau v. Ingram, 678 S.W.2d 28 (Tenn. 1984) (court’s analysis indicates that adequacy of consideration is an issue of fact and, therefore, for jury to decide).
• Midwest Sports Mktg., Inc. v. Hillerich & Bradsby of Can., Ltd., 552 N.W.2d 254 (Minn. Ct. App. 1996). Court held that “if the covenant is not ancillary to an employment contract,” an employer must provide independent consideration for a non-compete agreement. In that case, the non-compete agreement was not ancillary to the original employment because, although the former employee had some idea he would have to sign such an agreement, the former employee was not presented with the terms of the agreement until two weeks after beginning employment.

In many states, if the employee signs a covenant not to compete after the employment relationship begins, the employer must provide separate consideration for the agreement. An employer may provide separate consideration by varying the terms or conditions of the employment agreement, by providing a pay raise, special training, employment benefits, or other advantages to the employee.

• Ikon Office Solutions v. Dale, 170 F. Supp. 2d 892, 896 (D. Minn. 2001), aff’d, 22 Fed.Appx. 647 (8th Cir. 2001) (applying Minnesota law, court held valid consideration did not support non-competition agreement restricting former employee from competing within 75 miles of city for period of one year after leaving employment, where employee signed agreement after beginning employment with predecessor employer without any additional benefit or consideration).

• Poole v. Incentives Unlimited, Inc., 548 S.E.2d 207, 209 (S.C. 2001). Court held that when a covenant not to compete is entered into after the inception of employment, separate consideration, in addition to continued at-will employment, is necessary for covenant to be enforceable under South Carolina law.

• Hopper v. All Pet Animal Clinic, 861 P.2d 531 (Wyo. 1993). Court held that Wyoming public policy favors requirement that covenant not to compete executed after creation of employment relationship be supported by separate consideration such as promotion, pay raise, special training, employment benefits, or other advantages for employee.

In other states, employers do not need to supply separate consideration for a covenant not to compete executed after the employment relationship begins. In these states, continued employment alone supplies adequate consideration for the agreement.

• Summits 7, Inc. v. Kelly, 886 A.2d 365 (Vt. 2005). Vermont Supreme Court held that continued employment alone is sufficient consideration to support a covenant not to compete entered into during an at-will employment relationship. The court found that a non-competition agreement presented to an employee at any time during the employment relationship is ancillary to that relationship and, thus, requires no additional consideration other than continued employment. As long as the employer does not act in bad faith by
terminating the employee shortly after the employee signs the covenant, legitimate consideration for the covenant exists.

- **Camco, Inc. v. Baker**, 936 P.2d 829 (Nev. 1997). Recognizing that there is “no substantive difference between the promise of employment upon initial hire and the promise of continued employment subsequent to day one,” the court held that an at-will employee’s continued employment is sufficient consideration for enforcing a non-compete agreement under Nevada law.

### C. Geographic Restrictions in Restrictive Covenant

Employers also should provide the geographic scope of the covenant not to compete in the agreement. Most states require the employer to specifically state in what geographic areas the covenant restricts the employee from competing with the employer. Importantly, the employer must ensure that the geographic area covered by the agreement is no greater than necessary to secure protection of the employer’s business interests.

- **MacGinnitie v. Hobbs Group, LLC**, 420 F.3d 1234 (11th Cir. 2005). Under Georgia law, a customer non-solicitation covenant must either have a specific territory contiguous with the area serviced by the employee, or be limited to only those customers with whom the employee had a business relationship during some period of the employment.

- **Maddog Software, Inc. v. Sklader**, 382 F. Supp. 2d 268, 283-84 (D.N.H. 2005). Restrictive covenant barring employee from competing with employer in entire northeastern section of the United States for three years following his termination was not executed by employer in good faith, precluding reformation of the covenant under New Hampshire law. Employer, which only had customers in Pennsylvania and New Jersey, did not offer explanation for the geographical restriction, and failed to offer any legitimate business reason for the covenant's three-year duration.

- **Camco, Inc. v. Baker**, 936 P.2d 829 (Nev. 1997). Court refused to enforce non-compete agreement which, not only limited competition within 50 miles of existing stores, but improperly limited competition within 50 miles of any area which was the “target of a corporate plan for expansion.” Because the “target” area was not an area in which the employer had established customer contacts and good will or even signed a lease or begun construction of a store, the agreement did not apply in those areas.

Despite this requirement, some states will enforce a covenant not to compete without a stated geographic restriction if a valid territorial limitation can be implied from the agreement.

- **Norlund v. Faust**, 675 N.E.2d 1142 (Ind. Ct. App. 1997). Court held that the use of territorial boundaries is only one method of limiting a non-compete agreement’s scope. When a non-compete agreement contains a restraint
• However, in *Ashland Chemical Inc. v. Lombardino*, 1993 WL 390147 (E.D. La. Sept. 23, 1993), aff’d, 15 F.3d 1079 (table) (5th Cir. 1994), the court held that an agreement restricting a former salesman from working for competitor of ex-employer “in territory in which [his] services were performed” was unenforceable. Louisiana law requires that such an agreement specify the parishes or municipalities in which the former employer conducts business and in which the former employee must refrain from competing. See La. Rev. Stat. Ann. § 23:921(A)(2). According to the court, since sales areas constantly change and are not ascertainable until an employee's termination, the salesman could not have known when he signed the agreement which parishes or municipalities were proscribed.

D. Duration of Restrictive Covenant

A restrictive covenant must provide the exact length of time the covenant restricts the employee from competing with the employer. Moreover, the employer must ensure that the length of time provided in the agreement is not longer than necessary to protect the employer's legitimate business interests.

• *Doubleclick, Inc. v. Paiken*, 402 F. Supp. 2d 1251 (D. Colo. 2005). Applying Colorado law, court found reasonable an 18-month non-competition agreement against former senior vice-president of merchandise services employed by firm engaged in providing cooperative data and analytical services for direct marketing businesses.

• *Mohanty v. St. John's Heart Clinic, S.C.*, 866 N.E.2d 85 (Ill. 2006). Illinois Supreme Court found restrictive covenants in physicians' employment contracts, precluding their “practice of medicine” within a two-mile and five-mile radius, respectively, of employer's offices, were not greater than necessary to protect employer and its owner's interests and, thus, were reasonable, even though physicians specialized in practice of cardiology. Cardiology, like other specialties, was inextricably intertwined with the practice of medicine, and employer's offices were in a large metropolitan area.

• *Fulford v. Drawdy Bros. Constr., Inc.*, 903 So.2d 1007 (Fla. Ct. App. 2005). Court found reasonable under Florida law a post-employment covenant not to compete executed by employee of a construction company which was limited to 18 months and three Florida counties. The court noted that the covenant provided reasonable protection to the former employer's legitimate business interests in its bidding process, its customer list, and the specialized industry training it had provided to the former employee.
E. Employer Protectable Interests

An agreement should include a statement of the interests that the agreement intends to protect from competition by former employees. In determining whether to enforce the agreement, most courts balance three interests: the interests of the employer; the interests of the employee; and the interests of the public from restricting competition. In making this determination, a clear statement of the employer’s protectable interests helps a court determine whether the restrictions in the agreement are reasonable. For example, employers have a legitimate business interest in protecting trade secrets, confidential and other proprietary information.

- **Enterprises, Inc. v. Del Rosario**, 143 P.3d 23 (Haw. 2006). Hawaii Supreme Court found that training that provides skills beyond those of a general nature is a legitimate interest which may be considered in weighing the reasonableness of a non-competition covenant. Other factors weighing in favor of a protectable business interest include trade secrets, confidential information, or special customer relationships.

- **Ex parte Caribe, U.S.A., Inc.**, 702 So.2d 1234 (Ala. 1997). Court upheld finding that non-compete agreement was enforceable against former employee because company had a protectable interest in pricing information, customer shipment histories, and trade routes. Although some of this information was contained in public records, the court determined that the information could not be sufficiently accessed by the public to deny the employer a protectable interest in the information.

- **Voorhees v. Guyan Machinery Co.**, 446 S.E.2d 672 (W.Va. 1994). Court held that enforcement of covenant would not protect legitimate business interests of employer. According to the court, the employer failed to identify a protectable interest where the only product manufactured by the subsequent employer represented less than one-percent of the former employer’s total sales.

- In **BFS Retail and Commercial Operations, LLC v. Smith**, 232 S.W.3d 756 (Tenn. Ct. App. 2007), the Tennessee Court of Appeals opined that a clause in a non-compete agreement, providing for the postponement of future employment with any company in competition with the employer for an eighteen-month period, could be justified based on the employee’s knowledge of confidential and proprietary trade secret information and supported by independent consideration. The question was not determinative of the issue on appeal, however.

Employers also have a predictable interest in customer lists, customer relationships and contacts.

- **Safety-Kleen Sys., Inc. v. Henkens**, 301 F.3d 931 (8th Cir. 2002). Applying Missouri law, the court held that a waste management company seeking to
enforce a restrictive non-compete agreement with a former customer service representative adequately established the likelihood of success on the merits to warrant issuance of a preliminary injunction. According to the court, the company presented sufficient evidence that its sales and service representatives were its principal customer contacts, that contacts with customers and knowledge of customers’ specific needs were important to obtaining and keeping business, and that the former employee developed hundreds of such contacts while employed by the company.

- **Concord Orthopedics Professional Association v. Forbes, 702 A.2d 1273 (N.H. 1997).** Court limited scope of non-compete agreement between physician and professional association. According to the court, although professional association had a legitimate interest in preventing physician from appropriating existing patients, non-compete agreement should not apply to new patients.

Regardless of the employer’s legitimate business interests, courts must balance the employer’s interest with the interests of the employee. A court may not enforce the agreement if the restriction forces undue hardship on the employee.

- **Modern Environments, Inc. v. Stinnett, 561 S.E.2d 694 (Va. 2002).** Court held that a covenant not to compete that prohibited a former employee from being employed in any capacity by the employer's competitor was unenforceable. The employer in *Modern Environments* presented no evidence of any legitimate business interest that was served by prohibiting the employee from being employed in any capacity by its competitor, and in the absence of any justification for imposing the restraint on the employee's ability to earn a livelihood, the employer did not carry its burden of showing that the restrictive covenant was reasonable and no greater than necessary to protect a legitimate business interest.

- **Montana Mountain Prods. v. Curl, 112 P.3d 979 (Mont. 2005).** Montana Supreme Court found unreasonable a 3-year, 250-mile radius noncompetition agreement executed by an employee of a business engaged in finishing products for a silversmith. The court held that the covenant was an unlawful restrain of trade because it would have prohibited former employee from engaging in her business.

Finally, a court may void a covenant that protects legitimate interests of the employer, but unreasonably affects the legitimate interests of the public. Typically, courts invoke the public interest exception to invalidate a covenant that restricts competition among professionals, such as physicians and attorneys.

- **Valley Medical Specialists v. Farber, 982 P.2d 1277 (Ariz. 1999).** Court held that the restrictive covenant in a medical practice's shareholder/employment agreement with a physician, prohibiting the physician from providing any and all forms of "medical care," including HIV-positive and AIDS patient care, for
three years within a five mile radius of any office maintained or utilized by the practice was unreasonable and unenforceable. The court noted that in light of the great public policy interest involved in covenants not to compete between physicians, such agreements will be strictly construed for reasonableness.

- However, in *Central Indiana Podiatry, P.C. v. Krueger*, 882 N.E.2d 723 (Ind. 2008), the Illinois Supreme Court held that noncompetition agreements between a physician and a medical practice group are not per se void as against public policy and are enforceable to the extent they are reasonable. To be geographically reasonable, the agreement may restrict only that area in which the physician developed patient relationships using the practice group's resources.

- In *Mohanty v. St. John's Heart Clinic, S.C.*, 866 N.E.2d 85 (Ill. 2006), the Illinois Supreme Court held that restrictive covenants in physician employment contracts are not void as a matter of public policy under Illinois law. The court found that restrictive covenants in physicians' employment contracts, imposing a three-year and five-year restriction, respectively, on their practice of medicine within limited geographic area, were necessary to protect employer's interests and, thus, reasonable, even though employer would allegedly be unable to handle its patient load with physicians' absence. It takes more than ten years for employer to establish itself as a successful cardiology practice, the practice of cardiology had become much more competitive since the physicians were hired, and barring physicians from the practice of medicine within the restricted area for the stated periods would not seriously diminish the number of cardiologists available to provide necessary patient care.

In California, non-compete agreements with employees are unenforceable by statute. *See* Cal. Bus. & Prof. Code § 16600 (declaring void contracts “by which anyone is restrained from engaging in a lawful profession, trade, or business”). Despite Section 16600, the Ninth Circuit Court of Appeals ignored California jurisprudence and developed the “narrow restraint exception,” enforcing restraints that prohibits only certain kinds of work or serving some customers. *See Campbell v. Trustees of Leland Stanford Jr. Univ.*, 817 F.2d 499 (1987). In *Edwards v. Arthur Andersen LLP*, 2008 Cal. LEXIS 9618 (Cal. Aug. 7, 2008), the California Supreme Court specifically rejected the “narrow restraint exception.” The court held that a non-competition agreement need not entirely prohibit an employee from engaging in his profession, trade, or business in order to constitute a "restraint" under Section 16600.

**F. Severability of Unenforceable Portions of Restrictive Covenant**

Restrictive covenants should include a severability clause stating that any unenforceable portion of the agreement is severable, or may be modified by the court and does not affect the enforcement of the remainder of the agreement. A properly worded severability clause will assist employers that operate in a state which will “blue pencil” a covenant not to compete. In those states, the courts may refuse to enforce a divisible portion of the agreement or may modify the covenant to make the entire agreement reasonable.
• *Compass Bank v. Hartley*, 430 F. Supp. 2d 973, 981 (D. Ariz. 2006). District court held that under limited circumstances a carefully crafted step-down provision is a permissible application of Arizona's blue-pencil rule. However, it must permit a court to cross-out some unreasonable sections in favor of more reasonable ones without rewriting those sections.

• *Stonhard, Inc. v. Carolina Flooring Specialists, Inc.*, 621 S.E.2d 352 (S.C. 2005) (holding non-compete agreement that did not contain a geographical limitation could not be reformed or "blue penciled" according to New Jersey law and then enforced in South Carolina; the court could not add entirely new term to which neither party had agreed, and lack of geographical limitation rendered the covenant unenforceable as against public policy).

• *Freiburger v. J-U-B Engineers, Inc.*, 111 P.3d 100 (Idaho 2005) (Idaho Supreme Court refused to alter engineering firm's overbroad non-compete covenant to render it reasonable and enforceable, as it would be necessary not only to strike some of the words, but also to add clauses relating to goodwill and relationships between former employee and firm's clients and defining the parameters of what services the former employee would be prohibited from providing to firm's clients).

**IV. ISSUES TO KEEP IN MIND WHEN DRAFTING COVENANTS NOT TO COMPETE**

• Is consideration sufficient given circumstances – pre-employment, post-employment?

• Are geographic restrictions reasonable based on actual duties and responsibilities of employee?

• Is duration of agreement no longer than necessary to protect legitimate business interests?

• Have you carefully defined the interests you want to protect?

• Have there been any changes at the company or in the employee’s job duties and responsibilities that necessitate a new agreement – employee recently received significant promotion, employee transferred to new office or region, change in ownership of company?

• Do you want non-compete agreement to be part of employment contract or should it be a separate agreement?
I. EXPANDING DEFINITION OF TRADE SECRETS

A. The Causes Of The Expanding Definition

There are many possible explanations for why trade secret law has become of increased importance and why the definition of what constitutes a trade secret is expanding. Some of these include:

1. The Supreme Court’s broad endorsement of trade secrets law. In concluding that the state law of trade secrets was not preempted by patent law, the Supreme Court, in *Kewanee Oil Co. v. Bicron Corp.*, 416 U.S. 470, 481-88 (1974), observed that protection of trade secrets furthers many significant social goals, including (i) the maintenance of standards of commercial ethics, (ii) the encouragement of innovation and invention, and (iii) the enhancement of economic efficiencies.

2. New technologies. It has been noted that patent and copyright law have often not kept pace with new technology, such as the development of computer software. Trade secret law offers immediate, albeit sometimes volatile, protection for these and other new technologies.6

3. Increased emphasis on economic efficiencies. Economic efficiencies have always been a part of trade secret law. Many of the more recent cases have, however, exhibited an increased tendency to focus on the economic consequences of protecting trade secrets; e.g., that protection often increases innovation and invention, and that trade secrets often need to be disseminated to employees or vendors to achieve those economic efficiencies.7

The principal cause for the expanding definition of trade secrets, however, appears to be the substitution of the definition contained in the Uniform Trade Secrets Act for the one

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6 See, e.g., 1 MELVIN F. JAGER, TRADE SECRETS LAW at § 1.01. The protection is volatile because it depends on the information remaining secret and not being readily ascertainable by proper means, such as “reverse engineering.” *Id.; Kewanee Oil*, 416 U.S. at 490-93 (concluding that trade secret law is not preempted by patent law because trade secret protection does not operate “against the world,” – i.e., it can be lost through disclosure or “reverse engineering”).

7 See, e.g., *DVD Copy Control Ass’n, Inc. v. Bunner*, 75 P.3d 1 (Cal. 2003) (purpose of trade secret law is to promote the sharing of knowledge, and the efficient operation of industry; it permits the individual inventor to reap the rewards of his labor by contracting with a company large enough to develop and exploit it); *Rockwell Graphic Sys., Inc. v. DEV Indus., Inc.*, 925 F.2d 174, 180 (7th Cir. 1991) (observing that trade secret protection is an important part of intellectual property, a form of property that is of growing importance to the competitiveness of American industry).
contained in § 757 of the *Restatement of Torts*. Since 1939,\(^8\) the *Restatement of Torts* § 757 has defined “trade secrets” as:

> [A]ny 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. . . . A trade secret is a process or device for continuous use in the operation of the business.\(^9\)

In 1979 the National Conference of Commissioners on Uniform State Laws promulgated the Uniform Trade Secrets Act (“UTSA”). Although the Commissioners made clear that the UTSA in general codified the basic common law of trade secrets – which was itself derived from § 757 – the UTSA also explicitly broadened the definition of trade secrets by dropping the “continuous use” requirement and by including “know how” as a possible trade secret. See 14 *Uniform Laws Annotated* at 434 (prefatory note) and 439 (comment to §1). The UTSA defines trade secrets as:

> [I]nformation, including a formula, pattern, compilation, program, device, method, technique, or process that:

(i) derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use, and

(ii) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.\(^10\)

**B. Factors Used to Define a Trade Secret**

*Restatement* § 757 still plays a large role in trade secret law. Even in states adopting the UTSA, the courts often look to the common law developed under § 757 to interpret various provisions of the UTSA. Of particular significance, in defining a trade secret most of those courts still use as their framework of analysis some variation of § 757’s six-factor test. That test looks to:

1) the extent to which information is known outside of the business;

2) the extent to which it is known by employees and others involved in his business;

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\(^8\) The sections relating to trade secrets were omitted from the *Restatement (Second) of Torts* (1978).

\(^9\) *Restatement of Torts* § 757 comm. b.

\(^10\) UTSA §1 (4).
3) the extent of measures taken by the employer to guard secrecy of the information;

4) the value of the information to the employer and his competitors;

5) the amount of effort or money expended by the employer in developing the information; and

6) the ease of difficulty with which the information could be properly acquired or duplicated by others.

Restatement § 757 comm. B.11

C. Examples of Particular Applications

The type of information for which trade secret protection may be sought can be parsed into roughly three categories: technological information, business information, and customer data. The ordering of these categories roughly corresponds to a court’s general willingness to grant trade secret protection: “Hard” technological data, such as chemical or manufacturing processes, is generally considered the paradigmatic example of a “trade secret,” whereas courts view much business and customer data as information that is either generally known or readily obtainable.

1. Technological Information

In the following cases, the courts held that the technological information was a trade secret:


- Salsbury Laboratories, Inc. v. Merieux Laboratories, Inc., 908 F.2d 706, 710-11 (11th Cir. 1989) (multi-step methods for vaccine found to be trade secrets; precise elements of process were known only to manufacturer and its employees who worked in confidence extensively in development of that vaccine, and steps in process had never been combined before in same manner).

In the following cases, the courts held that the technological information was not a trade secret:

• **BondPro Corp. v. Siemens Power Generation, Inc.**, 463 F.3d 702 (6th Cir. 2006) (process for insulating outer layer of copper coils by placing insulating material on mold was not shown to be trade secret when disclosed to manufacturer of electrical generator during negotiations; owner of alleged trade secret did not present court with details of execution or implementation of process).

• **LinkCo, Inc. v. Fujitsu Ltd.**, 230 F. Supp. 2d 492, 499 (S.D.N.Y. 2002) (system architecture for proposed software program was not a "trade secret," and thus could not be misappropriated. Court found that once software architecture system was reduced to a product, its architecture would easily be recognizable and therefore could not remain a secret. Because the software architecture could not remain a secret once it was marketed, it could not rise to the level of a trade secret.).

Courts also have protected as “trade secrets” information relating to machines and devices. A caveat is in order, however, because “reverse engineering” is a proper means of acquiring information, such protection may be easily lost if the machine is sold in the general market or to a competitor. *See, e.g., MicroStrategy Inc. v. Li*, 601 S.E.2d 580 (Va. 2004) (owner of a trade secret not entitled to prevent others from using public information to replicate product, nor may owner prevent others from making similar products which are not derived from trade secret – one of the primary purposes of trade secret protection is to encourage innovation and development, therefore law will not be employed to restrict legitimate competition); *Kadant, Inc. v. Seeley Machine, Inc.*, 244 F. Supp. 2d 19, 37-38 (N.D.N.Y. 2003) (trade secret law does not offer protection against discovery by so-called reverse engineering); *Micro Data Base Sys., Inc. v. Dharma Sys., Inc.*, 148 F.3d 649 (7th Cir. 1998) (under New Hampshire law, it is perfectly lawful for a competitor to buy a product embodying a trade secret and unmask the secret by reverse engineering).

2. **Business Information**

The UTSA contains no special provisions for business information. Under the UTSA, protectable information is defined generically as, *inter alia*, “compilations” or “programs.” *See UTSA § 1(4).* The courts generally conclude that business or marketing plans are not trade secrets, absent something “extra” such as that substantial expense was incurred or expertise used in generating the information on which the plan is based. *Compare LinkCo, Inc. v. Fujitsu Ltd.*, 230 F. Supp. 2d 492, 500 (S.D.N.Y. 2002) (information consisting simply of business possibilities or goals is not a trade secret), *Computer Care v. Service Systems Enterprises, Inc.*, 982 F.2d 1063, 1071-75 (7th Cir. 1992) (applying Illinois law, court held marketing and service strategy was not a trade secret – marketing strategy was either sufficiently obvious or easily duplicated), *Ashland Management, Inc. v. Janien*, 624 N.E.2d 1007, 1012-13 (N.Y. 1993) (investment strategy derivable from public disclosures not a trade secret), *with Amoco Production Co. v. Laird*,

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12 Several states, however, have modified the UTSA definition of trade secret to explicitly include business information, although to be protected that information still must derive independent economic value from not being generally known or readily ascertainable.
622 N.E.2d 912, 920-21 (Ind. 1993) (business plan for drilling based on information
developed by sophisticated microwave technology is a trade secret).

3. **Customer Data**

One of the most hotly litigated areas in trade secrets law involves the protection of
customer information.\(^1\) Data such as customer lists, pricing, and preferences is often
considered by the employer as offering it a distinct competitive advantage; yet, by its very
nature, such data (i) is frequently derived from publicly available information, and (ii)
usually has to be widely disseminated to be used. Further, as explained in the next section,
such data is often “transportable” to the next job by an employee as part of his retained
“general knowledge.”

Given the foregoing, the key factors in determining whether customer data will be
protected are: (i) whether the data was compiled through sources that are readily available or,
rather, entailed substantial expense; and (ii) whether the data sought to be protected involves
tangible items such as customer lists, or is simply information that is retained in the former
employee’s own memory as part of his “general knowledge” acquired on the job.

In *Fireworks Spectacular, Inc. v. Premier Pyrotechnics, Inc.*, 147 F. Supp. 2d 1057,
1066-67 (D. Kan. 2001), the district court found customer lists and a former employee’s
notes regarding customers which he made while soliciting sales for the plaintiffs were
protected trade secrets and that the former employee’s new business was liable for
misappropriation of plaintiffs’ trade secrets. In explaining its holding, the court stated:

> The lists and the notes derive economic value from the fact that they contain
> valuable customer information that is not generally known or readily
> ascertainable by persons in the fireworks industry. Plaintiffs invested a great
> amount of time, effort, and expense in developing their customer information
> – including hundreds of hours of “cold-calling.” While the information
> contained on the lists and the notes is ultimately ascertainable from public
> sources, it is not readily ascertainable from public sources: A third party
> wishing to duplicate the information could not do so without investing a
> significant amount of time, effort, and expense – similar to that which
> Plaintiffs invested. Moreover, Plaintiffs make efforts that are reasonable

\(^1\) A related area involves the protection of “customer goodwill” through devices such as non-
solicitation clauses. The need for such protection becomes acute when (i) customers have stable
relationships with their vendors; and (ii) the relationship is primarily handled through a salesperson,
who may become the “seller” in the eyes of the customer. When these characteristics are present,
courts are generally inclined to enforce non-solicitation clauses for the time that it takes a new
salesperson of the former employer to establish a relationship with those customers. See *Wright
manufacturer had protectable business interest in customer base and may legitimately restrict future
competition from former exclusive sales representative to protect company’s goodwill and relations
with customers that were developed on its behalf by former sales representative); see also Kutten &
Reams, EXECUTIVE AND PROFESSIONAL EMPLOYMENT CONTRACTS at § 3.06-07 (collecting cases).
under the circumstances to maintain the secrecy of the customer information. Plaintiffs limit the access of their lists to certain employees, and maintain a strict policy of keeping all customer information confidential.

Id. at 1066. See also Dodson International Parts, Inc. v. Attendorf, 347 F. Supp. 2d 997, 1010 (D. Kan. 2004) (as a general proposition, tangible customer lists and other information about customers may constitute a trade secret).

In the following cases the courts found that customer data was protectable as a trade secret:

- *Reeves v. Hanlon*, 95 P.3d 513 (Cal. 2004) (attorneys, who left former firm to establish their own, violated trade secret act by using secret client data to directly solicit clients of former firm for their own pecuniary gain to detriment of former employer).

- *Home Pride Foods, Inc. v. Johnson*, 634 N.W.2d 774 (Neb. 2001) (food service company's customer list, which contained information on customers who previously placed orders with company and the amounts of those orders, was "trade secret" under Nebraska Trade Secrets Act; customer list had independent economic value, was kept secret, and competitor paid $800 for a stolen copy).

- *Sethscot Collection, Inc. v. Drbul*, 669 So.2d 1076 (Fla. Ct. App. 1996) (although list of prospective customers was not protected as trade secret because it was readily ascertainable; list of active customers was protected because it included purchasing history not readily ascertainable by the public).

In the following cases, the courts found that customer data was not protectable:

- *ATC Distribution Group, Inc. v. Whatever It Takes Transmissions & Parts*, 402 F.3d 700 (6th Cir. 2005) (automobile transmission parts seller's customer lists were not trade secrets, under Kentucky law; identity of transmission shops named in lists could have been discovered from telephone book or similar legitimate source, and identities of parts buyers at each shop could have been discovered merely by calling shops and asking).

- *Iron Age Corp. v. Dvorak*, 880 A.2d 657, 663-64 (Pa. Super. 2005) (customer lists were available to competitors through legitimate means and, thus, could not be declared a trade secret; former employee testified that customer lists were widely known because companies in the safety shoe industry identified potential customers through public sources such as trade shows and the Internet, without substantial effort or expense).

secrecy, because information was readily available through independent development).

4. **Computer Programs**

States and the courts are in the process of determining whether computer programs constitute trade secrets or are otherwise protected from misappropriation. The examples below illustrate how different states have addressed the issue.

- Under Idaho’s Uniform Trade Secrets Act Idaho Code Ann. § 48-801(4), “computer programs” are included in the definition of a trade secret. Under the statute:

  A “computer program” means information which is capable of causing a computer to perform logical operation(s) and

  (a) Is contained in any media or in any format;

  (b) Is capable of being input, directly or indirectly, into a computer; and

  (c) Has prominently displayed a notice of copyright, or other proprietary or confidential marking, either within or on the media containing the information.

- A computer program is a trade secret under Florida's Uniform Trade Secrets Law "if it meets the two-pronged test for trade secrets in Fla. Stat. § 688.002(4). See Liberty Am. Ins. Group, Inc. v. Westpoint Underwriters, L.L.C., 199 F. Supp. 2d 1271, 1302 (M.D. Fla. 2001) (finding that plaintiff's insurance rating software, including its source code, qualified as a trade secret under Florida law – software had independent economic value because it was not known to and was not readily ascertainable by other persons who could derive economic value from its disclosure and plaintiff took reasonable steps to maintain secrecy of software, including its source code).

- Under Wisconsin law, computer programs, software, and the like are protected against various misuse by the Wisconsin Computer Crimes Act, Wis. Stat. Ann. § 943.70, which makes it a criminal offense for anyone to modify, destroy, access, take, copy, or disclose computer programs or supporting documentation.

- New York Penal Law § 156.30 makes it a felony to unlawfully duplicate computer related material. A person is guilty of unlawful duplication of computer related material when having no right to do so, he copies, reproduces, or duplicates in any manner:
1. any computer data or computer program and thereby intentionally and wrongfully deprives or appropriates from an owner thereof an economic value or benefit in excess of two thousand five hundred dollars; or

2. any computer data or computer program with an intent to commit or attempt to commit or further the commission of a felony.

N.Y. Penal Law § 156.30.

D. The Employee “General Knowledge” Limit

As noted above, there are limits on prohibiting the use of information, even if that information could arguably meet the criteria of being a “trade secret.” Virtually every state has a firmly established public policy favoring the “portability” of an employee’s “general skills, knowledge, and expertise.” The economic and social justifications for such a policy are significant:

Our society is extremely mobile and our free economy is based upon competition. One who has worked in a particular field cannot be compelled to erase from his mind all of the general skills, knowledge, and expertise acquired through his experience. These skills are valuable to such employee in the market place for his services. Restraints cannot be lightly placed upon his right to compete in the area of his greatest worth.


Despite the foregoing, there are some possible limits on an employee’s ability to use retained knowledge in subsequent employment. While “general knowledge” is not protectable, knowledge of “particular processes” may be. Typically, though, this limit applies only to the “technological” category of information, such as production processes -- i.e., there is often an implicit assumption that retained knowledge of customer and business information constitutes part of an employee’s own portable human capital. See, e.g., DeGiorgio v. Megabyte Int’l, 468 S.E.2d 367, 369 (Ga. 1996). But see Nowogroski Ins. v. Rucker, 944 P.2d 1093, 1096-97 (Wash. Ct. App. 1997) (UTSA draws no distinction between use of memorized customer information and use of written customer lists).
II. PROTECTION OF TRADE SECRETS

Trade secrets are not protected by the mere fact that they exist. Rather, both the UTSA and Restatement § 757 impose a duty on the employer to use efforts that are “reasonable under the circumstances” to maintain the secrecy of the information. “Protect it or lose it” is the operative principle. See UTSA § 1(4)(ii); § 757 comm. b; see Bacon v. Volvo Serv. Center, Inc., 597 S.E.2d 440, 443-44 (Ga. Ct. App. 2003) (because employer made no effort to protect confidentiality of its customer list, list could not qualify as trade secret under Georgia law); Liebert Corp. v. Mazur, 827 N.E.2d 909, 923-24 (Ill. Ct. App. 2005) (although customer lists were generated over a span of 35 years by discovering and developing relationships with appropriate buyers and thus were sufficiently secret to give sales representative competitive advantage, lists were stored on representative's server, each salesperson had a copy for his or her territory stored on an office computer, and there was no evidence that the sales representative took steps to require employees to sign confidentiality agreements, advise employees that the lists were confidential or label the information as confidential); Infrasource, Inc. v. Hahn Yalena Corp., 613 S.E.2d 144, 149 (Ga. Ct. App. 2005) (takeover target failed to take reasonable efforts to maintain secrecy of bid for future work; president of target himself disclosed the bid calculations and knew information would be transmitted to public utility, suitor, and suitor's sister corporation).

It is axiomatic that once a trade secret becomes public knowledge it is no longer a trade secret. For example, publication in a patent destroys the trade secret as patents are intended to be widely disclosed—that is the quid for the quo of the patentee's exclusive right to make and sell the patented device. On-Line Technologies, Inc. v. Bodenseewerk Perkin-Elmer GmbH, 386 F.3d 1133, 1141 (Fed. Cir. 2004) (noting that after patent has issued, information contained within it is ordinarily regarded as public and not subject to protection as trade secret). See also BondPro Corp. v. Siemens Power Generation, Inc., 463 F.3d 702 (7th Cir. 2006) (publication in a patent destroys a trade secret because patents are intended to be widely disclosed); Restatement (Third) of Unfair Competition § 39 cmt. f (1995) (“Information that is generally known or readily ascertainable through proper means … by others to whom it has potential economic value is not protectable as a trade secret. Thus, information that is disclosed in a patent or contained in published materials reasonably accessible to competitors does not qualify for protection [as a trade secret].”).

However, the mere fact that a trade secret is mentioned in a public document is not necessary controlling because no one may have noticed the document. See Hoechst Diafoil Co. v. Nan Ya Plastics Corp., 174 F.3d 411, 418 (4th Cir. 1999) (fact that document describing manufacturer's trade secret was inadvertently filed unsealed and remained in district court's public files for several months did not necessarily preclude trade secret protection); Gates Rubber Co. v. Bando Chem. Indus., Ltd., 9 F. 3d 823, 849 (10th Cir. 1993) (mathematical constants used in connection with computer program retained their nature as trade secrets, even though they were inadvertently disclosed during hearing on petition for permanent injunction; under Colorado law holder of trade secret is only required to exercise reasonable efforts to maintain secrecy, counsel for trade secret holder had monitored presence of observers in courtroom, and after hearing was completed permanent injunction hearing record was placed under seal); Compuware Corp. v. Serena Software Intern., Inc., 77
F. Supp. 2d 816 (E.D. Mich. 1999) (filing copy of computer software with federal copyright office, in connection with copyright application, did not mandate determination that software was no longer trade secret under Michigan trade secret law; extent to which information was known outside of owner's business was only one of several factors to be considered in determining trade secret protectability).

A. General Practices

Protection of trade secrets must be “reasonable under the circumstances.” UTSA § 1(4)(ii). Fortresses are not required; nonetheless, as a general matter, employers must: (i) limit access to the information, and (ii) provide notice of the information’s confidential nature. Some practices that courts and commentators have found to be significant are:

1. Having all employees dealing with confidential information sign confidentiality agreements;
2. Advising the employees of the confidential nature of the product they are working on;
3. Restricting dissemination of confidential material to those who need to know;
4. Physically securing buildings, equipment, etc.;
5. Placing proprietary notices on all important documents;
6. Securing the premises so that the general public does not have access to trade secret information;
7. Establishing the use of identity badges;
8. Establishing security audit measures and following them;
9. Keeping track of the number of copies made;
10. Assigning specific individuals and departments custodial accountability and usage rights;
11. Establishing a procedure for destroying documents;
12. Requiring that all materials containing trade secrets or confidential information be locked away at night;
13. Changing locks to doors, file cabinets, etc. on a regular schedule;
14. Establishing a review panel for all outside advertising and publication; and
15. Establishing a procedure to recover documents supplied to outsiders.

16. When dealing with electronically stored data that contains trade secrets or confidential information, make certain access is restricted by passwords that are tightly controlled and that protected information is stored in separate computer files from other corporate documents, etc.14

B. Use and Limits of Confidentiality Agreements

1. General Benefits

Confidentiality agreements are one of the most commonly used, and often the single most important means to protect trade secrets. Such agreements can be used to: (i) define what constitutes “confidential information;”15 (ii) put the employee on notice as to what information is considered confidential; and (iii) make explicit the employee’s obligations regarding that confidential information. See ConFold Pacific, Inc. v. Polaris Ind., Inc., 433 F.3d 952, 955 (7th Cir. 2006) (finding summary judgment appropriate where subject matter of confidentiality agreement is unambiguously limited, or extrinsic evidence on its meaning is sufficiently one-sided).

Confidentiality agreements also perform important evidentiary functions, such as demonstrating that the employer has taken actions “reasonable under the circumstances” to protect information. Equally significant, such agreements offer a simple means to put a subsequent employer “on notice” that the former employee has knowledge of and obligations regarding confidential information.

2. The During Versus Post-Employment Distinction

Confidentiality agreements have limits. Many employers extend the coverage of such agreements to include information that would not qualify as a “trade secret” -- classifying as “confidential,” for example, customer and business information that is easily discoverable or that has no independent, or a transitory, economic value. Whether this extended coverage will be given effect generally depends on whether the alleged violator was a current, or a former, employee.

If a current employee is involved, such extended coverage is usually effectuated under one or more different legal theories. For example, one common fact-pattern involves

14 See, Kutten & Reams, Executive and Professional Employment Contracts, at § 3.04 (listing same and collecting cases). See, e.g., The Agency, Inc. v. Grove, 839 N.E.2d 606 (Ill. Ct. App. 2005) (in addition to having employees sign confidentiality agreements, plaintiff protected its customer list by limiting computer access through the use of passwords, allowing only managers the ability to print client files, limiting internet and e-mail availability of the information, and keeping physical copies of the information in a file cabinet in an office in which permission was necessary to access the cabinet).

15 Specificity in drafting is important. Courts often find that general statements are insufficient to put an employee on notice that particular information is confidential. See Kutten & Reams, supra, at § 3.12 (collecting cases).
the employee who, before leaving, obtains or uses confidential information for his own benefit. In these instances, most courts will find such conduct to be a breach of fiduciary duty or the duty of loyalty. E.g., Salter v. Jameson, 736 P.2d 989, 991-92 (N.M. Ct. App. 1987) (employee who copied names of patients breached duty of loyalty); Eaton Corp. v. Giere, 971 F.2d 136, 141 (8th Cir. 1992) (employee duty of loyalty prohibits competing with employer while still employed). Similarly, an employee who “leaks” confidential information to a competitor will – along with that competitor – have also committed an unfair trade practice.

The analysis changes once the employee leaves. Although the former employee arguably still owes a limited, residual duty of loyalty not to use confidential information, see Restatement (Second) of Agency, § 396, most courts analyze this post-employment use under contract law -- i.e., is the confidentiality agreement enforceable simpliciter to the extent it purports to prohibit the use or disclosure of information that is not a “trade secret”? If the former employee is acting based on retained knowledge, such coverage runs afoul of the firmly established public policy that employees have the right to use their “general skills, knowledge, and expertise” acquired from a former job. In addition, as one commentator has flatly observed:

A non-disclosure agreement can never be used to protect general or public information, a mere variation thereof; the secrets of a particular trade; or a goal (as opposed to the process for achieving the goal)... Likewise, an employer cannot use a claim of trade secrecy to prevent an employee from using his or her general skills and ability.

Kutten & Reams, supra, at § 3.09 (collecting cases). Accordingly, most courts conclude that as between a former employee and employer, such agreements either cannot extend beyond the protection of “trade secrets,” or, even if such extended coverage were possible, such coverage would violate public policy.17

C. When the Employee Leaves

Once an employee gives notice, the soon-to-be former employer can take several common-sense steps to protect its interests:

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16 In imposing this duty, the Restatement (Second) of Agency likewise draws a distinction between “trade secrets” and “written lists” as opposed to “general information” in retained memory. The first cannot be used in subsequent employment, the latter can. Restatement, § 396 & comm. b. See e.g., Opteum Financial Services, LLC v. Spain, 406 F. Supp. 2d 1378, 1381 (N.D. Ga. 2005) (although nondisclosure clause with no time limit is unenforceable as to information that is not a trade secret, the Georgia Trade Secrets Act carves out an exception for written agreements that do not contain a time limit for maintaining the trade secret).

17 Notably, the foregoing public policy limits do not apply when businesses choose to enter into confidentiality agreements. See Concept, Inc. v. ThermoTemp, Inc., 553 So.2d 1325, 1326-28 (Fla. Ct. App. 1989).
1. Restrict employee’s access to confidential information;

2. Recover all company property and have employee acknowledge in writing that all property has been or will be returned;

3. Remind the employee of any contractual restrictions.

During the exit interview, the employer should:

1. Give the employee a copy of any non-disclosure agreements, employment contracts, etc. previously signed;

2. Collect any remaining company property and documents, and have the employee acknowledge in writing that all such property has been returned;

3. Ask the employee what he will be doing and where he will be working.

See generally, Kutten & Reams, *supra*, at § 5.03-04 (discussing same). Notably, whether the foregoing actions are taken is weighed in the mix to ascertain whether the employer took measures “reasonable under the circumstances” to protect its trade secrets.

D. Use of Warning Letters

“Warning letters” are used to inform subsequent employers that the former employee has knowledge of trade secrets, and to remind the former employee of his obligations. Because of the fact-specific nature of what constitutes a trade secret, such notice is often required to put the subsequent employer “on the hook” as a potential misappropriator. In addition, such notice may also be used to encourage cooperation between the subsequent and former employer, or, to the contrary, for the less salutary purpose of discouraging the subsequent employer from hiring or retaining the former employee.

Care is warranted in this area. A poorly worded or overly aggressive letter can result in substantial liability. For example, stating or even implying that the former employee has misappropriated trade secrets may be defamatory. Likewise, threats of litigation risk liability for intentional interference with contractual relations. Consequently, warning letters should be limited to informing the new employer that the former employee: (i) had access to trade secrets and confidential information, and, if applicable, (ii) has executed a confidentiality agreement. The former employer may also wish to state that it considers the covered information to be legally protected. Threats of litigation – particularly, threats based on the mere “fact of employment” – and allegations of wrongdoing should, however, be avoided.

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18 Absent their own direct misconduct, subsequent employers will be liable for use or disclosure of information derived from former employees only if they “knew or had reason to know” that (i) the information involved is a trade secret, and (ii) the former employee owed a duty to keep that information confidential. *See UTSA § 1(2)(ii); Restatement § 757(c) & comms. k-m.* Sometimes the nature of the information acquired and its source make the foregoing obvious; often it does not.
III. LIABILITY FOR MISAPPROPRIATION

A. The “Proper” Versus “Improper Means” Distinction

Unlike patent law, which protects from infringement “against the world,” and copyright law, which proscribes copying, trade secret law only prohibits the “misappropriation” of trade secrets. As the Restatement succinctly sums up:

The privilege to compete with others includes a privilege to adopt their business methods, ideas or processes of manufacture. Were it otherwise, the first person in the field with a new process or idea would have a monopoly which would tend to prevent competition. This privilege has some limitations, however. … It is the employment of improper means to procure the trade secret, rather than the mere copying or use, which is the basis of liability under the rule stated in this section.

Restatement, § 757 comm. a. Accordingly, the acquisition and use of trade secrets acquired through “proper means” is not proscribed. Proper means include:

1. Discovery by independent invention;
2. Discovery by “reverse engineering” that is, by starting with the known product and working backwards to find the method by which it was developed. The acquisition of the known product must, of course, also have been by a fair and honest means, such as purchase of the item on the open market for reverse engineering to be lawful;
3. Discovery under a license from the owner of the trade secret;
4. Observation of the item in public use or on public display;
5. Obtaining the trade secret from published literature. 19

B. Methods To Avoid Liability

There are two basic ways in which an employer may misappropriate another’s trade secret. One is to participate or acquiesce in improper conduct, such as theft, bribery, fraud and so forth. The second is to use or disclose trade secret information supplied by an employee that was obtained from a previous employment. See UTSA, § 1(1)-(2). Preventing the first type of misappropriation is relatively easy. The second type of misappropriation is more common yet far less obvious, making prevention more difficult.

19 UTSA § 1 comm.; see also, e.g., Merchant & Evans, Inc. v. Roosevelt Bldg. Products Co., 963 F.2d 628, 638 (3rd Cir. 1992) (trade secret law provides no protection against discovery by fair and honest means); Roboserve, Ltd. v. Tom’s Tools, Inc., 940 F.2d 1411, 1454-55 (11th Cir. 1991) (no violation when acquired trade secret through reverse engineering).
Some basic steps that an employer can take to reduce exposure for the second type of misappropriation include:

1. Before hiring an employee, the employer should ascertain (i) whether the new employee signed any confidentiality agreements; (ii) whether the new employee had access to confidential information; and (iii) what documents, if any, the new employee intends on bringing with him.

2. If possible, the new employer should also, prior to hiring, memorialize that it already has knowledge of the alleged trade secret.

See, Kutten & Reams, supra, at § 5.08 (discussing same). A risk-averse employer may also want to consider adopting the following policies:

1. Prohibit employees from bringing any documents or materials from prior employers;

2. Do not raid a competitor unless absolutely necessary;

3. Never let the former employee solicit his or her former co-workers;

4. Solicit employees from a variety of competitors, not just one;

5. Erect a workplace “barrier” between the employee and any work involving subject matter substantially similar to the alleged trade secret.

Difficult business judgments ultimately have to be made in this area. Former employers -- particularly if they are competitors -- have every incentive to define “trade secrets” broadly; often too broadly. Moreover, employees have the established right to use their “general skills, knowledge, and expertise” acquired from previous employment. The more similar the former employment, the more valuable those “general skills, knowledge, and expertise” will become -- and also the more likely that litigation will ensue. The best that an employer can do here is to engage in a particularistic cost-benefit analysis, weighing:

1. The likelihood of litigation (e.g., Is anyone threatening suit? Will your actions cause the former employer harm?); and

2. The probability of success (e.g., Does the claimed information appear to be a trade secret? Was it obtained from the employee’s retained memory or from a list or other document that was acquired from the former employer?); against

3. The benefits of hiring the employee and of using the challenged information.20

20 If the risks and benefits are both high, an employer may want to consider seeking a declaratory judgment before proceeding to use or disclose the challenged information.
C. “Inevitable Disclosure” Theory of Liability

Proof of misappropriation is often difficult; moreover, waiting until such proof develops means the trade secret may be lost through its disclosure and use. Accordingly, the UTSA protects employers from both the “actual or threatened misappropriation” of trade secrets. Former employers have used this to develop a means to prevent the former employee from working for a subsequent employer under an “inevitable disclosure” theory – i.e., that such disclosure and use cannot help but occur given the similarity of the work between the present and former employer.

The courts traditionally look at the following factors in deciding whether to apply the “inevitable disclosure” theory:

1. Level of position involved and information acquired - e.g., high level executive and marketing positions have access to critical confidential marketing and business information;

2. Similarity in job responsibilities between former employer and competitor;

3. Nature of industry, products and customers involved; and

4. Whether the former employee demonstrated a lack of trust through, e.g., misrepresentations when he changed jobs.

Among the courts that have considered the issue, the inevitable disclosure theory remains the subject of considerable disagreement. Compare PepsiCo, Inc. v. Redmond, 54 F.3d 1262, 1269 (7th Cir. 1995) (affirming injunction and holding that "plaintiff may prove a claim of trade secret misappropriation by demonstrating that defendant's new employment will inevitably lead him to rely on the plaintiff's trade secrets"), with Whyte v. Schlage Lock Co., 101 Cal.App.4th 1443, 1462 (Cal. Ct. App. 2002) (concluding application of inevitable disclosure doctrine "creates a de facto covenant not to compete and runs counter to the strong public policy in California favoring employee mobility"); LeJeune v. Coin Acceptors, Inc., 849 A.2d 451 (Md. 2004) (to recognize "inevitable disclosure" doctrine in this case would allow the former employer the benefit of influencing its former employee’s relationship with the new employer even though it chose not to negotiate a restrictive covenant or confidentiality agreement with its former employee). See also Comment, An Overview of Individual States' Application of Inevitable Disclosure: Concrete Doctrine or Equitable Tool?, 55 So. Methodist Univ. L. Rev. 621 (2002).

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21 UTSA § 2(a) (authorizing injunction for “actual or threatened” misappropriation). But see AutoMed Technologies, Inc. v. Eller, 160 F. Supp. 2d 915 (N.D. Ill. 2001) (more than conclusory allegations that employees will necessarily use trade secrets in their new positions is required); NewLeaf Designs, LLC v. BestBins Corp., 168 F. Supp. 2d 1039 (D. Minn. 2001) (to obtain injunctive relief there must be a high degree of probability of inevitable disclosure).
IV. ISSUES TO KEEP IN MIND CONCERNING THE PROTECTION OF TRADE SECRETS

- Carefully define what constitutes a trade secret based on the legal standards in your jurisdiction.

- Be rationale – don’t dilute what constitutes a trade secret by applying the trade secret moniker to any and all company and customer information.

- Remember to actually take the steps necessary to maintain secrecy of information (see list at Section II.A supra).

- Where appropriate, have employees sign a confidentiality agreement.

- Inform employees exactly what the company considers to be confidential information.

- Have you explicitly set out in the agreement the employee’s obligations regarding confidential information.

- If employee announces his intent to leave, take steps to protect company’s trade secrets. (see discussion at Section II.C supra).
MINIMIZING THE RISKS WHEN HIRING NEW EMPLOYEES

I. QUESTIONS TO ASK PROSPECTIVE EMPLOYEES

- Do you have, or have you had, an employment contract?
- Do you have a non-competition agreement or clause in your employment contract?
- Do you have a confidentiality agreement or clause in your employment contract?
- Do you have access to customer lists?
- Do you have access to any type of data that would generally be considered confidential by your employer or by your industry?
- Have you retained any confidential information that belongs to your employer?
- Have you provided us with any confidential information during the recruitment process?
- Will your departure from your employer directly result in specific and identifiable losses to the employer?
- Have you accessed or downloaded data from your former employer’s computer system since you left the company?
- Has anyone at your former employer emailed confidential information to you?
- Did you destroy or delete information from your employer’s computer system prior to leaving the company?

II. QUESTIONS FOR HUMAN RESOURCES DEPARTMENT

- Does the candidate's current employer have a record of enforcing non-competition/non-solicitation agreements?
- Do companies in this industry generally enforce non-competition/non-solicitation agreements and/or take other steps to protect confidential information?
• Are we hiring this candidate to work in direct competition with his current employer?

• Will the new position require the candidate to use arguably confidential information that he learned during his former employment?

• Have we hired any other employees from the same employer?

• Do we have plans to hire any other employees from this employer?

• Are we offering the candidate substantially more in compensation than he was paid by the former employer?

• Are we planning to provide incentives to the candidate that will specifically motivate her to take business from the former employer?

• Were we aware of the employee’s non-competition or non-solicitation agreement at the time we made the offer of employment?

• What is our relevant market position with regard to the former employer? Are we larger and more dominant in the market, relatively the same, or smaller?

III. AVOIDING OR LIMITING LIABILITY WHEN HIRING COMPETITOR’S EMPLOYEES

• Ask all applicants whether they have signed, or are otherwise subject to, any type of restrictive covenant.

• Have counsel review all identified agreements before making a hiring decision and/or an offer of employment.

• Determine applicable law and have the agreement analyzed under that law, including the time and scope of the restrictions and the extent to which those restrictions are likely to be enforced by a court.

• Determine whether you can employ the applicant and put him/her to work without violating the terms of the restrictive covenant or, at least, those provisions of the restrictive covenant that you reasonably anticipate may be enforced.

• Determine the potential damages the former employer might incur if the employee is working in violation of the restrictive covenant.

• Provide written instruction to the applicant warning him/her not to take or retain any customer lists or other type of information belonging to his/her
• Provide written instruction to the applicant that he/she should avoid any announcements or notices to customers or other third parties prior to ending his/her employment with the former employer.

• Provide written instruction to the new hire that he/she is under a duty not to disclose or use business strategies or other confidential information of his/her former employer, and establish mechanisms to answer questions and deal with potential conflict issues that may arise.

• Place restrictions on recruiting or hiring additional applicants from the former employer for a reasonable period following the hiring of the new employee to avoid claims of raiding or wrongful solicitation.

• Conduct periodic meetings with the new employee and his/her manager to ensure that written directives are being followed and that your company is not engaging in acts of unfair competition.

• Consider contacting the former employer to propose “buying out” any existing restrictive covenant and to obtain a release of potential claims.