CONFIDENTIALITY CLAUSES – SCOPE AND EFFECTIVENESS

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What is a “Trade Secret” v. What is “Confidential Information”?

Trade secret laws vary from state to state:

• Uniform Trade Secrets Act
  • Almost all U.S. jurisdictions
• Restatement (First) of Torts § 757 (1939)
• Restatement (Third) of Unfair Competition § 39 (1995)
• Defend Trade Secrets Act
“Trade Secret” and “Confidential Information” Defined

• Generally, a “trade secret” is information that:
  • is not generally known or readily ascertainable;
  • has independent economic value; and
  • subject to reasonable efforts to maintain secrecy

• Generally, confidential information has no independent economic value
Examples of Reasonable Efforts to Maintain Secrecy

- Controlled disclosure to employees or licensees
- Limiting access to confidential information to individuals with need to know
- Limiting access to confidential information in computer systems to those with need and passwords
- Signing confidentiality agreements or covenants
What Constitutes Protectable Confidential Information?
Varies From State to State
Confidential Information

3 Schools of Thought

• Confidential Information is only Protectable if it is a Trade Secret
  • Confidential Information is synonymous with Trade Secrets
• Confidential Information is Protectable and is Different from Trade Secrets
  • Typically, the information does not have independent economic value
  • However, owner has taken reasonable measures to maintain confidentiality
• Confidential Information is Different from Trade Secrets and Only Trade Secrets are Protectable
Confidential Information is Protectable if a Trade Secret

- Confidential Information is only Protectable if it is a Trade Secret
- Confidential Information and Trade Secret are synonymous
  - Massachusetts cases highlight that whether information is “Trade Secret” is outcome determinative
    - *United Rug Auctioneers, Inc. v. Arsalen*
    - *Take It Away, Inc. v. The Home Depo, Inc.*
    - *Flip Flop Shops Franchise Co., LLC v. Neb*
Confidential Information is Protectable and is Different From a Trade Secret

• Confidential information is protectable separate and apart from Trade Secrets
• Confidential Information does not rise to the level of Trade Secrets
• Confidential Information generally has no independent economic value
Confidential Information is Protectable and is Different From a Trade Secret

*Orthofix, Inc. v. Hunter*

- Court recognized three categories of business information: (1) trade secrets; (2) contractually protected “confidential information”; and (3) general skills and knowledge
- Trade secrets and contractually protected confidential information subject to protection
- *Saini v. Int’l Game Tech.*
  - Court issued PI to protect spirit of confidentiality agreement and prevent its breach
  - Court was not concerned whether information subject to confidentiality agreement were Trade Secrets
Confidential Information is Different From a Trade Secret and Only Trade Secrets are Protected

- Trade Secrets and Confidential Information are different and only Trade Secrets are afforded protection
- Viewed similar to covenants not to compete
  - Necessary to protect a legitimate interest and reasonable with respect to duration and geography
- Georgia Statute 2010
  - allows confidential information be kept as such indefinitely; and
  - Lifts limitations on geography and time restraints
Confidentiality Clauses in Franchise Agreements

Confidential Information includes (without limitation)

• The “System”
• Contents of Operations Manual
• Trade Secrets
• Training Manuals
• Operational Techniques
• Methods, formats, specifications, systems, procedures, sales and marketing techniques, knowledge, and experience in developing, operating, and managing the Franchised Business
• All other information deemed confidential by Franchisor, regardless of whether it is identified as “Confidential” by Franchisor
Confidentiality Clauses in Franchise Agreements

Hypothetical #1

BMN Pizza
BMN PIZZA

New York Style Pizza by the slice Pizza Concept ... Think Ray’s Pizza (the original)
• Trademarked “Always Hot and Crispy®”
• Detailed Brand Standards (Operations) Manual
• Detailed Training Manual
• Site Selection Procedures
• Proprietary recipes and unique pizza topping combinations
• Proprietary Financial Reporting Software and POS system
• Ovens with specific heating characteristics (not proprietary)
• Unique color scheme, design characteristics, menu, pizza names and floor plan
Franchisee (Runaway, LLC) in Boston

• Signed 10 year Franchise Agreement in January 2007
• Financially Challenged Franchisee through the Great Recession
• In 2009, began marketing campaign in Boston for “Always Hot and Crispy!” without Franchisor’s approval (in fact, Franchisor objected and sent Default Notice)
• Marketing campaign increased sales by 2X
Franchisee (Runaway, LLC) in Boston

- Franchisor took over “Always Hot and Crispy” advertising campaign system-wide in 2010
- Credited with saving system
- Franchisee allowed FA to expire
- In February 2017, Franchisee opens Runaway Pizza at the same location
- Franchisee returned POS, all Proprietary software, Brand Standards Manual, Training Manuals, signage and all other brand-specific materials
Runaway Pizza Operations

- Same Location
- Pizza by the Slice (New York style)
- Different POS system
- Different color scheme, but retained the same floor plan
- New Ovens, though materially the same
- Same suppliers
- Virtually identical topping combinations, menu, pizza names and recipes
BMN Pizza v. Runaway Pizza, LLC

Allegations in Complaint:
- Misappropriation of Trade Secrets
- Misappropriation of Confidential Information

BMN Argues
- All elements of System are Trade Secrets entitled to protection
- All elements of System are Confidential entitled to protection
- The following system elements are Trade Secrets or Confidential Information entitled to Protection
  - The System (Pizza by the Slice)
  - While color scheme is different, floor plan and design are identical
  - While ovens are different, the specifications of the ovens are identical
  - The Pizza recipes and names
  - The use of the same suppliers
Is the System a Trade Secret?

System (Pizza by the Slice)
- Little Caesar’s failed to provide proof that the “System” (Selling ready-for-pick-up, whole pizzas) was a trade secret
- Compare *Snelling & Snelling, Inc. v. Armel, Inc.* (employment agency system)
- Breakaway franchisee prohibited from operating competitive employment agency in violation of FA and improperly used trade secrets
Are Certain Elements of System a Trade Secret?

• Floor Plan
  • Reasonable efforts to maintain secrecy?
• Pizza Recipes
  • Reasonable efforts to maintain secrecy?
    • Actual Recipes
    • Same toppings
• Suppliers
  • Same identical supplies
  • Same suppliers?
• Other Elements of System
  • POS
  • Financial Reporting Software
Is the System Protected as Confidential Information?

• If it is a Trade Secret
• If you are in a state that protects Confidential Information separate and apart from Trade Secrets
  • Contractually Protected Confidential Information
  • Reasonable Measures Taken to Maintain Confidentiality
  • Not “General Skills and Knowledge”
• Generally, this inquiry includes:
  • Information Publicly Available?
  • Whether Zee could have been aware of the information if not for the relationship?
  • Whether Information gives Zee a “competitive advantage?”
  • Whether Zee had interest in protecting information to maintain competitive advantage?
System Protectable as Confidential Information?

• Publicly Available Information
  • Floor Plan and Layout design
  • Ovens
  • Pizza Toppings
  • Suppliers

• Non-publicly Available Information
  • Specific Ovens
  • Recipes
  • Specific Supplies
Hypothetical #2

BMN Optical
BMN Optical

Optical Store selling eyeglasses and sunglasses
• Franchisor licensed trademark and trade dress to franchisee
• Detailed Brand Standards in Operations Manual
• Required color schemes, countertops and display cases built by designated suppliers solely for System
• Proprietary financial software and POS Systems
• Required vision plan systems
Breakaway Franchisee, LLC

Franchisee, who is optician, signed 10-year franchise agreement
During year 5, franchisee shuts down
Immediately re-opens as Breakaway Vision
After copying information, Breakaway returns customer information
Franchisee returns POS, Operations Manual, signage and brand specific material
Breakaway continues to operate in same location
• interior the same
• color scheme the same
• same operations techniques, including marketing targeted at same customers
• sells same product
• uses same vision plans
BMN Optical

Franchise Agreement defines Confidential Information broadly
- All optical products, professional services, equipment, technologies and procedures relating to the System
- All systems of operation, services, programs, products, procedures, policies, standards, techniques, specifications and criteria which comprise or may comprise the System
- The operations manual
- All other components, requirements, standards, requirements and duties mandated by BMN
- Any other information designated confidential by BMN
Is the System and Elements of the System Trade Secret

- System of distinctive optical retail stores
  - Business practices and policies
  - Advertising
  - Methods of inventory and operation control
  - Color schemes, layout, equipment and design
  - Does not control practice of optometry or ophthalmology
- Floor Plan
- Suppliers
- Methods of Inventory and Operation Control
- Advertising
Hypothetical #3

BMN Smoothies
BMN Smoothies

• General nutrition business serving nutritional drinks and supplements
• Unique training, marketing and management techniques
• Unique and confidential recipes and formulas
• Use of confidential product mixes
• Uniform standards, specifications and procedures through confidential OPS Manual and closed intranet
• Unique appearance, floor plan and color scheme
• Ingredients for smoothies are posted on website and in stores
• Unique menu and names for smoothies
Organic Smoothies

• Former BMN Franchisee at 3 locations
• Close 2 locations; operates at 1 location (Organic Smoothies)
• Same general nutrition business
  • Sells organic only
• Uses proprietary blenders with unique software, measuring bowls and other items
• Same appearance, floor plan and color scheme
• Similar menu and smoothie names
• Accepts franchisor gift cards and marketing programs
Organic Smoothies

• Former Franchisee argues that nothing confidential or trade secret about smoothies
• Ingredients are not confidential
  • Disclosed to public
  • On boxes containing juices
  • On menu boards
• Equipment can be purchased anywhere
• Supplements may be purchased anywhere
Organic Smoothies

• Is the System a trade secret?
• Are the elements in the System Trade Secret?
  • Smoothies
  • Equipment
  • Operations
  • Advertising/Marketing campaigns
Practice Pointers

• Carefully analyze System for Trade Secrets
• Be specific in drafting “Confidential Information” definition of Franchise Agreement, Confidentiality and Non-Disclosure Agreements, Settlement Agreements
• Design Reasonable Measures to Maintain Confidentiality
Practice Pointers

• Ensure ALL persons to whom Confidential Information is entrusted are bound to confidentiality and non-disclosure
  • Franchisee
  • Owners of Franchisee
  • Management Personnel of Franchisee
  • Rank and File Franchisee Employee (Brand Standards Manual, Recipes, Specific sources of supply, Specific supplies, etc.)
    • See Little Caesar Enterprises, Inc. v. Sioux Falls Pizza Company, Inc.
    • Who are the parties to THIS agreement?
Confidentiality Clauses—Scope and Effectiveness

QUESTIONS?