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Protecting Trade Secrets

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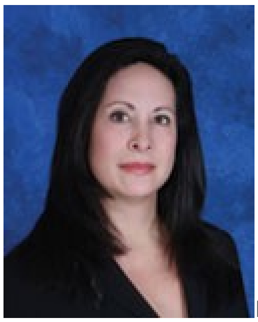
March 3, 2011
The Recorder



Nearly three years ago, the California Supreme Court handed down a decision that underscored California's longstanding prohibition of employee noncompete agreements, *Edwards v. Arthur Andersen, LLP*, 44 Cal.4th 937 (2008). While California employers are generally aware that "noncompetes" are unenforceable in California, many are still having employees sign employment documents containing unenforceable restrictive covenants, and others believe that they can restrict an employee's post-employment solicitation of former clients or customers. A good number of employers are still using old form employment agreements that contain restrictive covenants which are now clearly impermissible. Given the obstacles that exist in California, how can an employer with California employees protect its investment in its personnel and protect important and valuable proprietary information?

Any employer with California employees needs to understand that under California Business and Professions Code §16600, noncompete agreements are unenforceable, except when given in connection with the sale of the goodwill of business, the sale of a partnership interest, or the withdrawal from or dissolution of a partnership. Section 16600 provides: "[e]xcept as provided in this chapter, every contract by which anyone is restrained from engaging in a lawful profession, trade or business of any kind is to that extent void." Prior to the *Edwards* decision, California employers had taken some comfort in the fact that other states recognized the "inevitable disclosure" doctrine, which was invoked by employers when they claimed that an employee would "inevitably" use or disclose its trade secrets if that individual went to work for a competitor. In *Edwards*, the California Supreme Court expressly rejected the inevitable disclosure doctrine. Thus, in California, employers cannot rely upon the concept that employees can be constrained from working for competitors because they will be presumed to divulge their former employer's trade secrets.

In short, California employers should assume that their employees can and will work for competitors after leaving them. The savvy employer will take some or all of the following steps to minimize the damage that can be done by a departed employee.

First, California employers should require all employees to sign proprietary information or confidentiality agreements. These agreements should have been reviewed and revised after *Edwards*. The form of agreement used should not contain unenforceable noncompete provisions. At least one California appellate court has noted that the inclusion of unenforceable noncompete clauses may have the effect of discouraging employees from working for competitors because the employees mistakenly believe that the clause is enforceable. Inclusion of such clauses, which may have an intended chilling effect on employees' mobility, places employers at risk of claims under Business and Professions Code §17200 for unfair competitive practices.

Second, employers should take the time to carefully and specifically identify the types of unique information that the company considers to be its trade secrets, and where appropriate, the investment that the company has made in developing such information. Many employers err by using overly broad boilerplate definitions of "trade secrets" and "confidential information" in their employee agreements. In the event that a judge reviews the employer's proprietary information or confidentiality agreement, he or she will be evaluating whether the agreement simply and clearly identifies for the employees the type of information that is considered confidential or a trade secret. Judges are more likely to view favorably those agreements that are narrowly tailored to the company and the employment than those which are clear boilerplate forms.

With regard to customer lists, employers should identify in their confidentiality agreements the resources and time invested by the employer in identifying and developing customers and maintaining those relationships. A common issue in restrictive covenant litigation is whether the identity of clients or customers is a trade secret. A trade secret is information, including a formula, pattern, compilation, program, device, method, technique or process, that: (i) derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use, and (ii) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.

A common area of dispute is that of customer lists, but not all such lists will be trade secrets. For example, if a company's business is the provision of biotech clean room calibration and FDA compliance, the identity of biotech companies in the region that have clean rooms is information that most likely can be ascertained independently, by proper means (e.g., internet searches, biotech company websites). However, the details of pricing and of the services provided to such clients may well be trade secrets. In contrast, for a catering company, the identity of its clients who throw an annual catered holiday party is information that is likely not in the public domain and is not likely ascertainable by anyone who did not acquire the information from the catering company itself. Similarly, an interior designer may have a client who owns multiple homes and who redecorates frequently. The identity of this customer, the fact that she or he redecorates frequently, and the amounts spent are all types of information that are not readily available to the public at large, and which have economic value independent from not being known to other competing interior designers.

In order to support the claim that certain information is a trade secret, the employer must engage in reasonable efforts to maintain its secrecy. Some steps that employers might consider are the following: forbidding unrestricted guest access to areas in which trade secret information is kept; restricting access to trade secret documents within the company; and avoiding listing clients on company websites (if identity of customers is claimed to be a trade secret). In addition, employers may consider conducting employee training or briefing on the meaning of trade secrets and types of information the company considers its trade secrets; periodically republishing the terms of nonuse and nondisclosure of company trade secrets; and conducting exit interview briefings that specifically address the employee's knowledge of trade secrets and emphasize the fact that he is not to use that information on behalf of another company.

On the technological front, it may be prudent to periodically monitor employees' e-mail traffic; establish a policy prohibiting forwarding of documents containing trade secret information to personal e-mail addresses; and encrypt documents containing trade secrets with password protection.

When an employee who has had access to trade secret information suddenly resigns and goes to work for a competitor, the former employer should consider immediately segregating any hard drives or PDAs used by that employee and having them imaged by a third-party computer forensics business. The information gained from this analysis can reveal patterns of forwarding trade secret documents to the employee's personal address (or to others) and of deletions made by the departing employee. In some instances, deletions can be recovered, often yielding valuable information about the employee's activities immediately preceding the departure.

A final consideration for employers is the hiring of employees who have come from other competing businesses and who may have executed noncompetes. Noncompete agreements are enforceable in many other states, and most do not apply California law. Knowing before a hiring decision whether a candidate is bound by an out-of-state noncompete agreement can prevent headaches and costly litigation. If a key candidate does have a noncompete in place, a company may try to negotiate with the candidate's former employer.

If negotiation is out of the question, at the least, the company can plan for potential litigation and budget for the same. One appellate decision in California allowed a claim for wrongful termination in violation of public policy to proceed against an employer that fired its employee after learning that the employee had executed a noncompete agreement in favor of her previous employer. *Silguero v. Creteguard, Inc.*, 10 C.D.O.S. 9818. While this appellate decision is not binding on other appellate districts, employers should review the state of the law in their own districts and proceed accordingly.

Given the California Supreme Court's protective stance toward employee rights of mobility, the safest course of action is not to terminate an employee because he or she has a noncompete with a prior employer. However, if a prospective employee is known to have such an agreement with a former employer, a new employer may wish to consider addressing the matter in advance of hiring and perhaps consider entering into an indemnity agreement with the new employee, at least relating to the employee's cost of defending him or herself in litigation, should it occur. Before entering into such an indemnity agreement, the employer should seek legal counsel as to whether such an indemnity agreement would run afoul of Labor Code provisions requiring employers to reimburse their employees for the losses employees incur as a consequence of the employment.

In summary, employers with California employees should ensure that they are using proprietary information/confidentiality agreements that contain only enforceable provisions, and should ensure that they have targeted plans for identifying and protecting what they consider to be trade secrets. Having and actually implementing such a plan can help avoid business disruptions and expensive litigation battles down the road.

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