New York Law Journal

LITIGATION

Monday, November 24, 1997

Measures to Prevent Trade Secret Theft

Employers Can Take Precautions Before Litigation

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IT IS 5:00 on Friday afternoon, and Jane Smith, the head of sales and marketing for Acme Products & Services, Inc., has just resigned, informing her boss that she will start her new job – at Acme's fiercest competitor – the following Monday morning.

This is troubling news for Acme, because Smith had access to some of Acme's most sensitive and confidential business information. Even if Smith has not physically taken or copied any of Acme's files, what she carries in her head is extremely valuable to Acme's competition. Moreover, Smith never signed a non-disclosure or a non-competition agreement. Smith's boss figures there is nothing he can do now to prevent Smith from working for the competitor, or from using Acme's confidential information in her new job.

But perhaps there is. In New York -- as in most other states -- there are several legal theories available to an employer trying to protect itself against competition from an ex-employee, even where that employer did not obtain any formal contractual protection. This article catalogs the legal options available to the former employer, and outlines the precautions that the employer can take to strengthen its legal position.

In New York, a departing employee may take and use at her new place of employment any general skills or knowledge she acquired while working for the former employer, but not that employer's "trade secrets." Indeed, under New York law, an employer has a "'legitimate interest . . . in safeguarding that which has made his business successful and to protect himself against deliberate surreptitious commercial piracy.'"[1] Thus, an injunction will lie to protect against the threatened or actual misuse or disclosure of an employer's trade secrets.[2]

The New York courts have adopted the definition of trade secrets found in §757 of Restatement of Torts, comment b: "[A] trade secret is any formula, pattern, device or compilation of information which is used in one's business, and which gives him an opportunity to obtain an advantage over competitors who do not know or use it."[3]

The doctrine of inevitable misappropriation allows injunctions to be entered against former employees who do not take documents or other tangible materials with them, and may not even intend to use their former employers' secrets for any improper purpose.

A broad range of business information may qualify for trade secret status, including business plans and strategies,[4] customer lists and contact information,[5] sales reports[6] and pricing information.[7] Moreover, a trade secret may "exist in a combination of characteristics and components, each of which, by itself, is in the public domain, but the unified process, design and operation of which, in unique combination, affords a competitive advantage and is a protectable secret."[8]

The most important factor in determining whether information is a trade secret is whether the information has in fact been kept secret. Absolute secrecy is not required; however, an employer must have taken reasonable measures to protect the secrecy of the information.[9]

In order to succeed on a claim of misappropriation of trade secrets, a plaintiff must plead and prove not only that it possessed a trade secret, but also that the defendant used, or threatened to use, that trade secret in breach of an agreement, confidential relationship or duty, or as a result of discovery by improper means.[10] Where the defendant was the plaintiff's employee, the "confidential relationship or duty" test is met, because "the duty of an agent or employee not to use confidential knowledge acquired in his employment in competition with his principal is implicit in the relation. . . . It exists as well after the employment is terminated as during its continuance."[11]

Thus, even in the absence of a confidentiality agreement, departing employees have a duty to prevent the exploitation of information which they obtained as a result of the trust and confidence in which they were held by their former employer.[12]

In recent years, some of the most hotly contested trade secret cases have involved what is known as the doctrine of inevitable misappropriation. This doctrine allows injunctions to be entered against former employees who do not take documents or other tangible materials with them, and may not even intend to use their former employers' secrets for any improper purpose.

The inevitable misappropriation doctrine had its New York genesis in 1919, when the court in *Eastman Kodak Co. v. Power Film Prods., Inc.*[13] upheld a non-compete covenant and recognized that, while the employer had not established actual misappropriation of trade secrets, the departing employee would inevitably use the confidential information he possessed in order to perform his new job duties on behalf of a competitor. Indeed, the court stated, "the mere rendition of the services

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along the lines of his training would almost necessarily impart such knowledge to some degree. [The employee] cannot be loyal both to his promise to his former employer and to his new obligations to the defendant company."[14]

A 1995 decision by the Seventh Circuit, *Pepsico Inc. v. Redmond*,[15] established the inevitable misappropriation test which is now used, with minor variations, in a number of jurisdictions. Under this test, the employer may obtain an injunction preventing the former employee from working in the same or similar capacity for a competitor (for a reasonable period of time) if that former employer can demonstrate that: (a) the employee has knowledge of the plaintiff's trade secrets; (b) the employee's new job duties and the products, services or technology he is working on are so similar or related to those in the former position that it would be very difficult for him not to rely on or use his former employer's trade secrets in carrying out his new responsibilities; and (c) the employee, and/or the new employer, cannot be trusted to avoid using the former employer's trade secret information.[16]

Since *Pepsico*, several New York courts have issued injunctions based in whole or in part on the inevitable misappropriation doctrine. Most recently, in *DoubleClick Inc. v. Henderson*, Index No. 116914/97 (N.Y. Sup. Ct., Nov. 3, 1997), the court enjoined two former high-level employees of an Internet advertising company from launching their own competitive venture, or working for any other company in a competitive capacity, for a period of six months -- even though the court was not persuaded that either defendant had breached any express non-compete or confidentiality agreement with DoubleClick.[17]

Unfair Competition

In New York, a claim of unfair competition will lie against a former employee who has physically misappropriated confidential business information belonging to her former employer -- even if that information does not rise to the level of a trade secret.[18] The New York doctrine of unfair competition is broad and flexible, and encompasses any form of commercial immorality[19] Thus, in addition to the unauthorized physical taking of company documents, evidence of wrongful or fraudulent tactics may constitute unfair competition.[20]

Duty of Loyalty

New York law also prohibits an employee from "acting in any manner inconsistent with his agency or trust[,]" and requires the employee to exercise the "utmost good faith and loyalty" in the performance of his duties.[21] Although an employee may look for other employment, and even take "preparatory steps" towards establishing his own competitive business, he may not actually commence a competitive business, or solicit his employer's customers or other employees, while still on the payroll.[22] Nor may he use his employer's time or facilities to look for other employment, or to build his competitive business.[23]

Tortious Interference

If the departing employee has solicited the employer's customers, prospective customers or fellow employees, a tortious interference claim may lie. There are two types of tortious interference claims potentially available to an aggrieved employer: interference with existing business relations, and interference with prospective business relations. As to the former, an employer must prove: (a) the existence of a valid contract between the employer and a third party (typically a customer or an employee); (b) defendant's knowledge of the contract; (c) defendant's intentional interference with that contract resulting in its breach; and (d) damages.[24]

As to the prospective claim, the defendant must interfere with business relations existing between the plaintiff and a third party, either with the sole purpose of harming the plaintiff, or by means that are dishonest, unfair or in any other way improper. However, if the defendant's interference is intended even in part to advance his own competing interests, the prospective claim will fail unless the means employed were wrongful.[25]

Criminal Prosecution

In addition to the private causes of action outlined above, an employer may wish to notify federal prosecutors of the theft of trade secrets. The government may then prosecute the employee under the Economic Espionage Act of 1996, 18 USC §1832 (1996), which punishes as a felony the theft of trade secrets that are "related to or included in a product that is produced for or placed in interstate or foreign commerce." Federal prosecutors in many jurisdictions are actively applying the Act in cases ranging from an employee's sale of stolen proprietary information to a competitor, to the alleged theft of trade secrets by an outsider.[26]

While the causes of action discussed above may provide an employer with some recourse against a defecting employee, the employer can take many steps to protect its confidential information before litigation is initiated.

Maintaining Secrecy

An employer should take every precaution during the employment relationship to ensure that its trade secrets stay secret and that its employees understand their duties of loyalty and confidentiality. In this regard, many employers routinely require that all employees sign a confidentiality agreement. Not only do these agreements provide the employer with an additional cause of action in case of a breach, but they are also evidence of the employer's efforts to maintain the secrecy of the information described therein.

Many employers also ask their employees to sign agreements placing restrictions on their ability to compete in the field after leaving their jobs. Unless narrowly drawn and well tailored to protect the employers' proprietary, confidential or trade secret information, however, such agreements are unlikely to be enforced by New York courts.[27] In recent years, some courts appear to have overcome their traditional reluctance to enforce non-competes where the agreement provides that the former employer pay the departing employee her normal salary during the restrictive period.[28]

Other measures employers should take to protect their trade secrets are:

- reminding employees periodically (preferably by a written confidentiality policy that is circulated and or prominently posted) of their obligations to keep confidential information confidential;
- restricting access to confidential information to those employees (and third parties) who "need to know;"
- obtaining written confidentiality agreements from third parties who were furnished confidential information;
- stamping or marking confidential documents "CONFIDENTIAL" or the equivalent;
- password-protecting or otherwise restricting access to computer files and databases containing confidential information, and locking file cabinets containing such information during non-business hours; and

• avoiding public disclosure of arguably confidential information through display, publication (including website publication), advertising and the like.

The Exit Interview

Once an employee has resigned or announced an impending departure, the employer should arrange an exit interview with the employee.

The exit interview (which should be adopted as a company-wide policy) provides an opportunity to remind the employee of her duty to keep trade secrets confidential, to answer any questions the employee may have concerning that duty, and to obtain the employee's explicit agreement, if possible, to honor the duty. It also offers an employer an appropriate opportunity to recover all confidential documents (and other company property) in the employee's possession, and to question the employee about any confidential information which may be stored in her personal computer, on diskettes in her possession, or at home. Finally, it assists the employer in assessing whether the employee's new employment will pose any threats to the company's trade secrets.

The employer should document the interview, describing the exiting employee's statements regarding her new employment responsibilities, and regarding her duties to the ex-employer. The departing employee should be asked to sign the finished product for verification. At the interview, the employer may also ask the departing employee to sign an agreement acknowledging that she had access to confidential information, stating that all such information has been returned to the company, representing that no such information has been disclosed or improperly used to date, and agreeing that it will not be disclosed or improperly used in the future.

In order to ensure that the exiting employee returns all of the company's confidential information, the company may wish to have its designee help the employee collect her belongings. Her computer access should be restricted as soon she announces her departure. Further, she should be instructed to immediately return any company-issued laptop, diskettes, tapes or other computer equipment, and the contents of her files (including e-mail) should be reviewed promptly.[29]

After Departure

Once the employee has left her job, the company may want to send follow-up letters to both the former employee and her new employer. The letters should politely remind the former employee of her duties, while giving notice to the new employer of any confidentiality concerns. Naturally, these letters must be drafted with caution and should not contain any unfounded litigation threats or defamatory material.

Thereafter, the former employer should closely monitor any apparent shifts in the business activity of the new employer, such as the sudden adoption of new marketing strategies or large sales to the former employer's clients. The former employer may also wish to review the ex-employee's telephone records dating back several months to determine when she first began talking to the new employer, and how often the conversations occurred. Similarly, a review of current telephone records (or discussions with other employees) may reveal that the competitor is attempting to lure other employees to change jobs or disclose trade secrets.

If the former employer observes any of these developments or otherwise has reason to suspect that its trade secrets have been misappropriated, it should consider hiring a private investigator to help obtain concrete evidence of misappropriation. However, the investigator should be hired and used only under the direction of legal counsel, as a clumsy or overzealous investigation may lead to counterclaims for trespass, invasion of privacy, tortious interference, or even misappropriation of trade secrets.

The traditional law of contracts, trade secrets, and related torts, as well as the developing law of inevitable disclosure, can provide substantial protection for employers seeking to keep competitively sensitive information secret, and prevent ex-employees from using that information against them. In order to take full advantage of the law, however, employers must be both proactive during an employee's tenure, and reactive upon learning of the employee's intended departure.

(1) *Ecolab Inc. v. Paolo*, 753 F.Supp. 1100, 1110 (EDNY 1991) (citing *Reed, Roberts Assoc., Inc. v. Strauman*, 40 NY2d 303, 308 (1976)).

(2)Id. at 1110-11. See also *Lumex, Inc. v. Highsmith*, 919 F.Supp. 624, 633-34 (EDNY 1996) (threatened misappropriation).

(3) *Ashland Management Inc. v. Janien*, 82 NY2d 395, 407 (1993) (quoting Restatement of Torts §757, comment b).

(4) See *Health Management, Inc. v. Hotte*, 97-CV-3267, slip op. at 4 (EDNY Sept. 15, 1997).

(5) Id.; see also *Webcraft Techs., Inc. v. McCaw*, 674 F.Supp. 1039, 1043 (SDNY 1987).

(6) *Ecolab*, supra n.1, 753 F.Supp. at 1103, 1112.

(7) *Support Sys. Assocs., Inc. v. Tavolacci*, 135 AD2d 704, 705 (2d Dept. 1987); *DoubleClick Inc. v. Henderson*, Index No. 116914/97, slip op. at 9 (N.Y. Sup. Ct. Nov. 3, 1997).

(8) *Imperial Chem. Indus. Ltd. v. National Distillers and Chem. Corp.*, 342 F2d 737, 742 (2d Cir. 1965).

(9) *Ivy Mar Co. v. C.R. Seasons Ltd.*, 907 F.Supp. 547, 556 (EDNY 1995).

(10) Id.

(11) *Byrne v. Barrett*, 268 NY 199, 206 (1935).

(12) *Support Sys.*, supra n.7, 135 AD2d at 706; see also *DoubleClick*, supra n.7, slip op. at 9 n.2 (because defendants owed their former employer "a duty not to divulge confidential information," it was "not necessary" for the court to determine the viability of the confidentiality agreements defendants entered into).

(13) 179 NYS 325 (4th Dept. 1919).

(14) Id. at 330.

(15) 54 F3d 1262 (7th Cir. 1995).

(16) Id. at 1270-71.

(17) See also *Lumex*, supra n.2, 919 F.Supp. at 633-34; *Health Management*, supra n.4, slip op. at 5-6.

(18) *Leo Silfen, Inc. v. Cream*, 29 NY2d 387, 391-92 (1972) ("the unauthorized physical taking and exploitation of internal company documents for use in a competitor's business constitutes unfair competition").

(19) *Innovative Networks, Inc. v. Satellite Airlines Ticketing Ctrs., Inc.*, 871 F.Supp. 709, 730 (SDNY 1995).

(20) *Leo Silfen*, supra n.8, 29 NY2d at 392.

(21) *Lamdin v. Broadway Surface Adver. Corp.*, 272 NY 133, 138 (1936).

(22) *Frederick Chusid & Co. v. Marshall Leeman & Co.*, 326 F.Supp. 1043, 1059 (SDNY 1971).

(23) *Maritime Fish Prods. Inc. v. World Wide Fish Prods. Inc.*, 100 AD2d 81, 88 (1st Dept.), appeal dismissed, <=24> 63 NY2d 675 (1984).

(24) *Foster v. Churchill*, 87 NY2d 744, 749-50 (1996).

(25) *PPX Enterprises, Inc. v. Audiofidelity Enterprises, Inc.*, 818 F2d 266, 269 (2d Cir. 1987); *Entertainment Partners Group, Inc. v. Davis*, 198 AD2d 63, 64 (1st Dept. 1993).

(26) Dean Starkman, "Crime: Secrets & Lies: The Dual Career of a Corporate Spy," *Wall Street Journal*, Oct. 23, 1997, at B1, col. 3.

(27) *Reed, Roberts Assocs.*, supra n.1, 40 NY2d at 307; *American Broadcasting Cos. v. Wolf*, 52 NY2d 394, 403 (1981).

(28) E.g., *Maltby v. Harlow Meyer Savage, Inc.*, 166 Misc.2d 481, 483-84, 487 (N.Y. Sup. Ct. 1995), aff'd, 223 AD2d 516 (1st Dept. 1996).

(29) In *DoubleClick*, supra n.7, most of the evidence presented to the court on the preliminary injunction was retrieved from the office computer of one of the defendants.