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TRADE SECRET LAW THE EMPLOYMENT

HANDLING A MISAPPROPRIATION CASE

Given the increasingly transitory nature of the employment relationship and the digitally portable quality of business information, today's employment lawyer must be aware of both employees' and employers' obligations under trade secret law. Essentially, all counsel must be aware of the means to prevent and disprove misappropriation, and the employer's counsel will sometimes be called upon to file and support an action alleging misappropriation. Aside from patent, trademark, and copyright protection, there are two primary legal sources typically considered in litigation involving alleged misappropriation of an employer's trade secrets: (1) statutory trade secret law (the now broadly adopted Uniform Trade Secrets Act); and (2) bilateral contracts with employees. This article will discuss both of these sources and the related issues that arise in the event of alleged misappropriation.

MUTSA

The Michigan Uniform Trade Secrets Act (MUTSA) (a statute in often identical form in place in many jurisdictions around the U.S.) defines a trade secret as:

Information, including a formula, pattern, compilation, program, device, method, technique, or process, that is both of the following:

(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.

(ii) Is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.¹

The courts have recognized customer lists and information, costs, internal weaknesses, marketing and strategic plans, diagrams, survey data, prices and similar information as satisfying these criteria.²

MUTSA displaces any conflicting common law of trade secrets, so that decisions heavily relied upon by practitioners in the past such as *Hayes-Albion v Kuberski*³ (describing a common law/Restatement definition of trade secrets, prohibited misappropriation, and available remedies), have been expressly preempted by the statute.⁴

Practical proof issues in litigating misappropriation of trade secret cases (and in non-compete cases, where a reasonable competitive business interest must be established) arise in establishing the *confidential nature* of the information to be protected. Under the Uniform Trade Secrets Act (and also under common law cases on trade secrets), several confidentiality (secrecy) factors will be considered:

- the actual extent of measures taken by the employer to guard the secrecy of the information

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- the extent to which the information is known by others in the same business
- the ease or difficulty with which the information can be properly duplicated or acquired by others

Reasonable steps to guard the confidentiality of information could include (although relatively few employers employ all of the following):

- storage of information with locked, limited access
- need-to-know information access
- electronic key access to rooms/information
- clear marking of confidential information
- limited access of computer-stored information
- visitor restrictions, and other means of avoiding unnecessary disclosures, such as scrutiny of brochures and websites to prevent release of secrets
- employee policies on confidential information, or confidentiality, non-solicitation, (employee) anti-raiding, or non-compete agreements
- routine verification of confidentiality procedures
- routine employee reminders of confidentiality policy
- pursuit of departing employees with access to confidential information
- prohibiting removal of confidential information from company premises
- restricting copying of confidential information (numbering copies, etc.)
- conducting exit interviews

Proving Misappropriation

MUTSA essentially allows recovery or an injunction for “theft” or other “improper means” by which a trade secret is acquired.⁵ The statute also allows recovery against an entity that knew or should have known it was acquiring a trade secret stolen by someone else.⁶

Circumstantial Evidence

Not often is it the case that a former employee is caught red-handed either taking confidential information or disclosing it to others (although this may sometimes be provable with download histories from the

employee’s work or home computer or the company’s server or other records). As such, entitlement to injunctive relief often relies on circumstantial proof. Such proof may amount simply to laying out the obvious facts fairly, thus painting an inferential picture, such as the former employee’s new work for a head-to-head competitor selling similar/identical products, customers, or technologies.

The courts have recognized the need for circumstantial evidence under the doctrine of *inevitable disclosure*. In the lead case, *PepsiCo v Redmond*,⁷ the court entered an injunction against a former employee who was working for a competitor even in the absence of a non-compete where the executive was involved in marketing and financial planning at both his former and new company. The fact that he occupied a similar position at his new employer was significant to the court in that the court found that Redmond could not “compartmentalize” his knowledge of information and he could not help but rely on that information. The court concluded that Redmond would “inevitably disclose” trade secrets as prohibited under the Illinois Uniform Trade Secrets Act.

Inevitable disclosure factors under *Redmond* (not all are necessarily present in every case) include:

- the employee’s dishonesty as to his or her new employer or duties⁸
- the plaintiff employer’s ability to specify its trade secrets in court⁹
- the new employer’s opportunity and incentive to use the former employer’s information
- similarities between the former position and the new position, such that the departing employee will himself or herself

be in position to use and/or disclose the confidential information

“Memorized” Information

Although there is old, and somewhat bizarre, case law to the contrary, the Uniform Trade Secrets Act does not make a trade secret any less protectable because it is memorized.¹⁰

Remedies

MUTSA has a full range of available remedies. The Act allows for injunctions against “actual” or even “threatened” use (critical at the preliminary injunction stage), mandatory (affirmative) injunctions to protect secrets, imposition of royalty obligations, actual damages, unjust enrichment damages, and attorneys fees for willful or malicious misappropriation or bad faith pursuit or defense of a claim.¹¹

NON-COMPETITION/ NON-SOLICITATION/ NON-DISCLOSURE AGREEMENTS—A VIABLE MEANS OF PROTECTING TRADE SECRETS

Although an employee agreement is not at all necessary to support a trade secret misappropriation case (UTSA contains no such requirement and the courts have found no such requirement implied in the Act), trade secret law is often connected with enforcement of non-compete, non-solicitation, and confidentiality agreements, in that: (1) trade secret and non-compete violations often occur together, and (2) trade secret protection is a recognized basis for enforcing a non-compete.

Most states allow enforcement of non-competes under certain conditions, and since

FAST FACTS:

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- ✓ MUTSA essentially allows recovery or an injunction for “theft” or other “improper means” by which a trade secret is acquired.
- ✓ Confidentiality/non-disclosure agreements have had judicial approval for quite some time, having been considered an exception to Michigan’s antitrust laws.

1987 Michigan has permitted such restrictive covenants in employment contracts.¹² Whether a restrictive covenant is necessary essentially depends upon the improper damage a former employee could do to the employer after joining a competitor or related business—other than the mere fact of his or her competition. Thus, under the statute, such agreements are legitimately designed to prevent post-employment *unfair* competition by the departing employee.

Non-compete agreements are generally enforceable if they satisfy the four conditions set forth in MCLA445.774a:

- a. *The agreement has a reasonable geographic scope*—for example, the employer's service area, the location of the employer's clients, or the employee's assigned territory or clients. In some circumstances, even a nationwide non-compete is permissible.¹³
- b. *The agreement has a reasonable duration.* This element will vary by industry and employee. For example, six months may be appropriate in some circumstances, while one year or much longer may be more appropriate in other circumstances.¹⁴
- c. *The agreement is reasonable (sufficiently narrow) as to the line of work it prohibits.*
- d. *The agreement is designed to protect reasonable competitive business interests (e.g. trade secrets or goodwill).*

The Importance of Confidentiality Measures in Non-Compete/Non-Solicit Enforcement

A listing of possible confidentiality measures for trade secrets was provided supra in the discussion of the Uniform Trade Secrets Act. The reader is asked to employ these measures to protect the secrets in question and to lay the groundwork for any necessary litigation to prove and enjoin misappropriation. While this list will not be repeated here, one point bears emphasis: It is often such measures that make or break enforcement of a non-compete, in that courts look to how a party has cared for its "protectable interest"—often trade secrets—to determine whether irreparable harm is truly occurring.

Confidentiality/Non-Disclosure Agreements

Confidentiality/non-disclosure agreements have had judicial approval for quite some

time, having been considered an exception to Michigan's antitrust laws. Unlike non-compete agreements, confidentiality/non-disclosure agreements generally will be enforced without examination of their effect on competition. Nonetheless, observing the requirements of the Trade Secrets Act (see supra) will make the confidentiality agreement both more useful and likely to be enforced by injunction. Confidentiality agreements should be part of employment agreements/policies for any employer possessing confidential business information. Courts may require, however, as a condition of enforcement, a specific showing of how the employer is likely to be harmed. Even when enforced, the order will not ordinarily prohibit a departing employee from working at all for a new employer. Instead, the remedy will typically be a prohibition against the employee's use or disclosure of trade secrets. Thus, a non-compete agreement may be much more helpful, in that such an agreement, if enforced, may bar the new employment entirely and thus more effectively prevent disclosure of trade secrets.

THE DEPARTING EMPLOYEE

Once the employer is informed that an employee is terminating his or her employment, it is important to all concerned for the employer to conduct an exit interview with the departing employee. The interview should be conducted by someone experienced in exit interviews and sensitive to the information that should be ascertained and conveyed. It is helpful if this information is memorialized in an exit interview acknowledgement form signed by the departing employee. The exit interview form should elicit and confirm the following information:

A. The departing employee's new employer and the nature of the new employment. This is critical in determining whether any trade secret or confidential information is at risk and whether any restrictive covenants signed by the employee are implicated.

B. An acknowledgement by the departing employee on trade secrets or confidential information, and his/her obligations as they relate to that information. *The employee should be reminded that any subsequent use or disclosure is strictly prohibited.*

- Even if no proprietary information agreement was signed, employees should be reminded that they owe fiduciary obligations not to use or disclose confidential or trade secret information.
- It is also important to inform the departing employee of the types of information the employer considers to be a trade secret or confidential information. It is much less effective to tell a departing employee that he/she cannot use proprietary information without telling the employee at least generally what types of information are at issue.

C. An inventory should be prepared of the materials kept by the employee and those remaining with the employer, along with an acknowledgement by the departing employee that all copies of confidential documents and information have been returned.

Protection of the Departing Employee's Interests

Failure to conduct an exit interview can create practical problems and make it more difficult for the employer to seek post-termination injunctive and other relief, but the departing employee's interests are also served by sensitivity to the above concerns. The employee, in order to avoid a successful trade secret or other claim against him or her:

- should be honest about his or her new position and what it entails
- should take absolutely no company data or property with him or her
- should convey no memorized or other data to his or her new employer
- should comply with all agreements executed with his or her former employer

TRADE SECRET PROTECTION—EIGHT FINAL POINTERS

Eight guidelines as to cases involving protection of trade secrets and enforcement of non-competes and other agreements protecting trade secrets (to be considered both before and after litigation commences) are as follows:

Confidentiality Measures

The employer's serious and repeated efforts to police the confidentiality of its business information are a major issue in trade secret

and non-compete litigation. Because protection against loss or misuse of confidential information is often an excellent rationale for a non-compete agreement (the non-compete otherwise more arguably being a “naked restraint of competition” unenforceable under the anti-trust laws), it would be difficult to overemphasize the importance of confidentiality precautions. A list of such precautions is provided above. These precautions set the stage for the argument that sensitive information is “inevitably disclosed” to a competitor when an employee goes to a competitor.¹⁵

Strong Non-Competes

If the employer uses non-competes to protect trade secrets, under the court’s equitable powers, a judge may reduce (at least to a degree) the scope¹⁶ of the non-compete agreement. Thus, having a *reasonably* strong, albeit entirely defensible, agreement in place may well allow any court-reduced (“blue penciled”) non-compete to be more effective when enforced. The process of injunction is often at least partially a human process in which the judge attempts to fashion a “fair” remedy. Thus, starting the process with reasonably assertive non-compete provisions in place may allow the employer to be in a somewhat stronger position ultimately.

Scrutinize Subsequent Employee Agreements

The employer should scrutinize subsequent employee agreements (for example, new employment contracts, employee manuals, and acknowledgments) entered into after execution of a confidentiality, non-solicitation agreement, or non-compete. Such agreements may be attacked on the basis that they somehow “eliminate” the pre-existing non-compete or confidentiality agreement, so that all such documents must be examined to ensure that they continue the trade secret protective agreement’s provisions. One would think that it would be enough to place in the agreement provisions specifically extending the agreement beyond the termination of employment, but enforcement litigation sometimes raises the issue of whether the agreement survived the execution of an agreement “continuing” employment. For this reason (among others) any such later “agreements” should be reviewed by the employer’s Legal Department or counsel before execu-

tion. The employer may wish to add to the agreement a clause stating that the agreement can be modified or waived only by a specific writing signed by a designated high level (corporate) official.

Good Termination/Discipline Decisions

All of the usual human resources concerns as to the proper handling of supervision and discipline and the termination of an employee’s employment apply doubly in a trade secret misappropriation or non-compete situation, because it is de rigeur for the offending employee to claim that he or she was forced out of (constructively or actually discharged from) his or her employment by some misconduct on the part of the employer. Thus, the advantages of good human resources management and attempting to make reasonably sure that any misunderstandings are not the result of management’s actions often help in the defense of a claim of “constructive [or actual] discharge” in the trade secret and non-compete case.¹⁷

ONCE THE EMPLOYER IS INFORMED THAT AN EMPLOYEE IS TERMINATING HIS OR HER EMPLOYMENT, IT IS IMPORTANT TO ALL CONCERNED FOR THE EMPLOYER TO CONDUCT AN EXIT INTERVIEW WITH THE DEPARTING EMPLOYEE.

Extend any Non-Compete or Non-Solicitation Agreement in Cases of Non-Compliance

The employer should consider including a clause in any non-compete agreement itself *extending the effective date of the non-compete for the period of any non-compliance*. This would create in the agreement an understanding on the part of the offending employee that misconduct, whether concealed or otherwise, amounting to a violation of the non-compete would not be rewarded in the form of a court concluding that the non-

competer’s termination date is the same as it would have been otherwise. This would allow the employer to take greater advantage of cases such as *Therma-Tool v Borzym*,¹⁸ in which the court found that extension of the term of the non-compete for the period of non-compliance is a remedy available to the court (but not ordered there).¹⁹ Including an extension clause in the agreement would make application of this remedy more likely.

Immediately Obtain Documentation

Good contemporaneous electronic (and other) documentation serves well in any demonstration of the facts. The employee’s or employer’s hard drive often contains e-mails or records of file downloads that demonstrate whether the employee’s excuses for non-compliance or claims of innocence are factually valid. For example, computer files (which can be “undeleted”) often reveal (or fail to show) (a) the offending employee’s plans for departure; and (b) his or her exposure to or misappropriation of trade secrets or confidential data.

Consistently Enforce

The employer’s previous efforts to hold *other* former employees to account for suspected or actual trade secret violations are often scrutinized to determine the urgency and validity of the employer’s current claims. Lax enforcement in the past may well injure a current claim.

Act Swiftly

Similarly, the promptness of the employer’s response to the instant violation (and other violations) sends a powerful message as to whether an emergency justifying preliminary injunctive relief is presented or absent. When trade secret misappropriation occurs, injunctive relief should be pursued immediately. ♦



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FOOTNOTES

1. MCL 445.1902; MSA 19.902 (emphasis added).
2. See, e.g., *Merrill Lynch Pierce Fenner and Smith v Ran*, 67 F Supp 2d 764 (ED Mich 1999); *Courtesy Temporary Services v Camacho*, 222 Cal App 3d 1278, 1287, 272 Cal Rptr 352 (1990); *Pepsico v Redmond*, 54 F3d 1262 (CA 7, 1995).
3. 421 Mich 170, 364 NW2d 609 (1984).
4. See MCLA 445.1908 (“act [MUTSA] displaces conflicting tort, restitutionary, and other law of the state providing civil remedies for misappropriation of a trade secret”).
5. MCLA 445.1902.
6. *Id.*
7. 54 F3d 1262 (CA 7, 1995).
8. See *CMI International, Inc v Internet International Corp*, 251 Mich App 125, 134, 649 NW2d 808 (2002) (“duplicity” by employee).
9. See *CMI*, *supra*, at 134 (although at least at the preliminary injunction stage, the actual trade secrets themselves need not be disclosed; rather, the court must simply be satisfied of their *existence*. See *Allis Chalmers Mfg Co v Continental Aviation*, 255 F Supp 645, 654 (ED Mich 1966)).
10. See, e.g., *Stampede Tool Warehouse v May*, 272 Ill App 3d 580, 590, 651 NE2d 209 (1995) (“using memorization to rebuild a trade secret does not transform the trade secret from confidential information to non-confidential information”); *Nowogroski Ins v Rucker*, 137 Wash 2d 427, 448, 449, 971 P2d 936 (1999) (“the form of the information and the manner in which it is obtained are unimportant. . . the nature of the relationship and the employer’s conduct should be the determinative factors. The distinction places a premium upon good memory and a penalty upon forgetfulness, and it cannot be justified from either a logical or pragmatic point of view. . . [T]he modern trend is to discard the written/memorized distinction. The unfairness of the trial court’s ruling excluding damages for memorized trade secrets is highlighted in the present case where [defendants] engaged in essentially the same conduct and paid dramatically different damages based on the fact that [one defendant] claimed to have remembered his top 50 customers”).
11. MCLA 445.1903, 1904, 1905.
12. See MCLA 445.774a(1).
13. See *Superior Consulting v Walling*, 851 F Supp 839, 847 (ED Mich 1994).
14. See *Lowry Comp Products v Head*, 984 F Supp 1111, 1116 (ED Mich 1997).
15. See *Lowry Computer Products v Head*, 984 F Supp 1111, 1117 (ED Mich 1997); see also *Pepsico, Inc v Redmond*, 54 F3d 1262 (CA 7, 1995).
16. Such reductions in scope may occur as to geography, duration, or the nature of the competitive activity prohibited.
17. It is also a significant advantage to have a provision in the non-compete that states that the non-compete is effective regardless of whether the employee is terminated or resigns voluntarily or involuntarily, for cause or otherwise.
18. 227 Mich App 366, 575 NW2d 334 (1998).
19. See also *Superior Consultant Company v Bailey*, 2000 US Dist LEXIS 13051 (ED Mich 2000).