

TRADE SECRETS LAW & INVESTIGATIONS

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TRADE SECRETS LAW & INVESTIGATIONS

WHAT IS A TRADE SECRET?

In 2001, Price Waterhouse Coopers, the American Society for Industrial Security, and the U.S. Chamber of Commerce conducted a survey which found that thefts or misappropriation of company proprietary information caused Fortune 1000 companies to suffer between \$53,000,000 and \$59,000,000 in losses.

Advantages of trade secrets:

- Protection begins when the secret information is created.
- No fixed period.
- Lasts as long as the information remains secret.

Trade secret violations cause companies to suffer loss of:

- competitive advantage
- profits
- research and development costs
- royalties earned from licensing agreements
- opportunity to obtain licensing agreements.

California adopted the Uniform Trade Secrets Act, know as the California Trade Secret Act (“CTSA”).

A “trade secret” is defined as “information, including a formula, pattern, compilation, program, device, method, technique, or process” that:

- Derives independent economic value, actual or potential, from not being generally known to the public or to other persons who can obtain economic value from its disclosure or use; and
- Is the subject of efforts that are reasonable under the circumstances to maintain its secrecy. *Cal. Civil Code* § 3426.1(d)

TRADE SECRETS LAW & INVESTIGATIONS

Courts have also found the following may be construed as trade secrets:

- Blueprints
- stock-picking formula
- customer lists
- pricing information
- non-public financial data.
- an employer's strategic and marketing
- marketing research
- an employer's process technologies
- customer database
- computer software
- production technique

** "[Q]uality, sound and personality" of reporters *are not protected as trade secrets* and may be contracted away. Metro Traffic Control, Inc. v. Shadow Traffic

TRADE SECRETS LAW & INVESTIGATIONS

ELEMENTS OF TRADE SECRET PROTECTION

“Misappropriation” means:

- Acquisition of a trade secret of another by a person who knows or has reason to know that the trade secret was acquired by improper means;

or

- Disclosure or use of a trade secret of another without express or implied consent by a person who:
 - Used improper means to acquire knowledge of the trade secret;

or

- At the time of disclosure or use, knew or had reason to know that his or her knowledge of the trade secret was:
 - Derived from or through a person who had utilized improper means to acquire it;
 - Acquired under circumstances giving rise to a duty to maintain its secrecy or limit its use; or
 - Derived from or through a person who owed a duty to the person seeking relief to maintain its secrecy or limit its use;

or

- Before a material change of his or her position, knew or had reason to know that it was a trade secret and that knowledge of it had been acquired by accident or mistake.

In California, a trade secret must have:

- ***Value.***
- Reasonable efforts in maintaining its ***secrecy.***
- ***Value to a competitor*** who could put the information to beneficial use. Abba Rubber Co. v. Seaquist

TRADE SECRETS LAW & INVESTIGATIONS

**OTHER FACTORS THAT DETERMINE WHETHER A PIECE OF
INFORMATION IS A TRADE SECRET ARE**

1. Whether the information is known outside the business.
2. Extent of knowledge by employee inside the business.
3. Amount of money and effort spent in attaining the information.
4. Amount of time and expense to acquire or duplicate the information.

CUSTOMER LISTS

Generally, an employee's acts in the course of employment are in the legal sense, the employer's acts and are the employer's property. Disputes often arise when a former employee has knowledge of or uses a former employer's customer list or customer information.

The California Supreme Court established the following test to determine whether customer information is protected by trade secret law:

- (1) The information was confidential and not readily accessible to competitors;
- (2) The former employee solicited the customers of his former employer with intent to injure him;
- (3) The former employee sought out certain preferred customers whose trade is particularly profitable and whose identities are not generally known to the trade;
- (4) The business is such that a customer will ordinarily patronize only one concern;
- (5) The established business relationship between the customer and the former employer would normally continue unless interfered with. Aetna Building Maintenance Company v. West
 - Prospective customers commonly known to the trade or easily discovered through business directories or by observation not protectable. Aetna Building Maintenance Company v. West
 - Memory of former employee of particular preferences of employer's customers is not a trade secret. Mathews Paint Company v. Seaside Paint Company

TRADE SECRETS LAW & INVESTIGATIONS

- Customer list was not protectable, where the wholesaler's customers were easily ascertainable from telephone directories
- Customer list was not protectable because customers were dealers easily ascertainable by the advertising on their places of business and their business listings in telephone directories and similar directories.
- Customer list was not protectable because customers were principally hotels, restaurants, bakeries, butcher shops, roominghouses, and apartment buildings.
- An insurance agency's customer list is not protectable where information is known to other insurance companies and list can be easily duplicated from public telephone directories or public records.
- Evidence that company had invested time, money, and effort into developing lists will represent a valuable asset to the courts. Pasadena Ice Company v. Reeder.
- Written customers lists may be regarded as trade secrets when the nature of the industry permits the list to be kept secret and the list cannot readily be duplicated by independent means.
- Where identity of advertisers was not readily apparent to the public and could not easily be drawn from phone books or directories, court found the customer list to be protected.

COMPUTER INDUSTRY

Trade secret law has historically been a major influence in protecting information in the computer industry. Trade secret law can protect ideas and information that would otherwise not be protected under copyright and patent laws. In MAI Systems Corp. v. Peak Computer, Inc., the court ruled that computer software does qualify for trade secret protection but where the owner does not specifically identify these trade secrets, no protection will be found. In addition, trade secret law does not protect proprietary information from *reverse engineering*, *independent development*, or *accidental disclosure*.

- Reverse engineering: disassembling an object to determine its contents by reversing the efforts initially used to develop the object.

TRADE SECRETS LAW & INVESTIGATIONS

- Independent development: When two competitors develop the same product independent each other.
- Once a secret is disclosed, whether intentionally or inadvertently, the trade secret is lost.

Despite not making any efforts in keeping code as a secret, computer source codes are protectable. Even distribution of object code does not automatically result in a loss of protection. Generally, it is extremely rare that computer code would be misappropriated because of the amount of reverse engineering involved. Consequently, courts usually protect source codes, object codes, and programming manuals. Telex Corp. v. International Business Machines Corp.

Keys To Maintaining Trade Secret Protection for Computer Programs

- Limiting access to the information
- Adequate security measures including passwords
- Safeguarding tapes or software disks
- Confidential legend for software printout, documentation or packaging.
- Employment agreements which prohibits employees from disclosing proprietary information.
- Licensing the software instead of selling it.

BUSINESS PLANS, STRATEGIES, AND FUTURE PLANS

Information developed by the company for the future, such as business plans and strategies have been held by courts to constitute common law trade secrets in certain circumstances.

A. Information

Information in the form of business plans and strategies, must rise to the level of legally recognized “information.”

TRADE SECRETS LAW & INVESTIGATIONS

i. Information Not Present

- Idea, program, and plan to establish a business to manufacture, distribute, and sell ice commercially was not considered protected information because defendants still had to finance and develop the business, purchase equipments and facilities, and find customers. “The information is far removed from the actual operation of the ice business...” Leske v. Leske

ii. Information Present

- Business operations and “entire business plan” encompassing the research, development, production, sales, distribution, and marketing aspects met the “information” requirement of the state statute. Elm City Cheese Co. v. Federico
- Inventor’s compilation of “non-technical” information pertaining to electronic ballast technology which encompassed the plaintiff’s strategic plan, “entry strategy,” potential channels for distribution, information concerning the size and structure of the market, including prevailing methods of distribution, and research and analysis as to expected profitability met the “information” requirement. The court concluded that the plaintiff’s compilation of non-technical information was “not so lacking in specificity.” Nilssen v. Motorola, Inc.

B. Value

Value is an indispensable element of trade secret. A plan or strategy cannot be so common or easily ascertainable by those in the same field as the trade secret owner that it lacks value. Value will especially be found when the plan or strategy is novel, unique, or original, so that an economic advantage may be gained by the information.

Value Not Found

- Plans and strategies lacked economic value because they were “commonly known.” Noah v. Enesco Corp. In Electro Optical Industries v. White
- Pricing strategies and marketing plans of a firm that sold and serviced medical devices were “hardly a unique approach” and “a fairly common thing.” J.E. Hanger, Inc. v. Scussel
- Marketing information readily obtainable to anyone interested in starting an independent medical examination company in Alaska, did not have value. Further, defendant gained knowledge of such information during the regular course of her employment.” Western Medical Consultants, Inc. v Johnson

TRADE SECRETS LAW & INVESTIGATIONS

- Plaintiff's business plan, business strategies, market analysis information, sales strategy and marketing plan, and marketing work objectives were "generally known or readily ascertainable" Plaintiff failed to establish that the information in the identified documents is not published or readily ascertainable information to those in the field." Utah Medical Products, Inc. v. Clinical Innovations Associates, Inc.
- Sales strategies encompassing which identified potential customers and demonstrated the benefits of the product to potential customers failed to show value because "[f]or makers of wound-care products, the market is generally known." Plaintiffs provide no evidence that their advertising strategy had originality that separated it from others in the field." BioCore, Inc. v. Khosrowshahi
- A detailed forty page plus document, which included not only the product, but also target market segments and proposed advertising, prices structures, and distribution channels was not novel because vaginal moisturizers and lubricants similar to plaintiff's had been produced and marketed." Brandwynne v. Combe International, Ltd.

Value Found

- Plaintiff firm's business operations and business plan for a cheese manufacturing and sales company occupied a special place and a specialized niche market in the local industry, possessed a specialized business which accommodated the special needs of private label packers was of value. "[I]nformation that is generally known within an industry is not trade secret material." "The key . . . ease with which information can be readily duplicated without involving considerable time, effort or expense." Elm City Cheese Co. v. Federico

C. Secrecy

Reasonable measures must be implemented to preserve the secrecy of the business plan and strategy. Secrecy does not have to be absolute, but "reasonable" under the circumstances.

Secrecy Not Found

- Plaintiff's knowledge and expertise of how to develop business strategies, market products, and develop relationships with customers and suppliers was not reasonably kept in secrecy when confidentiality policies were "frequently disregarded in practice." "[E]ven after [plaintiff] brought this litigation, [he] continued to mail allegedly confidential documents to [defendant]." Alagold Corp. v. Freeman

TRADE SECRETS LAW & INVESTIGATIONS

- Evidence that the plaintiffs had most potential investors sign a copy of a confidentiality agreement when they received a copy of the Plaintiff's business plan was not enough to find secrecy. Most was not all according to the court. Motor City Bagels, L.L.C. v. American Bagel Co.

Secrecy Present

- Company that had publicly disclosed the information at issue, in its advertising and even in an article by the CEO to a legal publication was not information that was either private or secret. Lawfinders Associates, Inc. v. Legal Research Center
- Confidential agreement signed by employees which limited its employees from disclosing information for a period of one year, passwords, pass codes, loose-lips policy, and policy permitting only two [company] personnel to talk to the media was sufficient for a finding of secrecy. Cardinal Freight Carriers, Inc. v. J.B. Hunt Transport Services, Inc.
- Strategic and marketing plans were reasonably protected by restricting the number of people who had access to the confidential information, not permitting visitors to move through the plant building without escort, and requiring plaintiff and other high ranking employees to sign confidentiality agreements. La Calhene v. Spolyar

TRADE SECRETS LAW & INVESTIGATIONS

WHAT TO INVESTIGATE

Section 757 of the Restatement of Torts sets forth six factors for evaluating whether information is protected as a trade secret:

- The extent to which the information is known outside the company (the more the information is known outside the company, the less likely the information will be protected).
- The extent to which information is known by employees and others involved in the company (the more employees who know about the information, the less likely that the information will be protected).
- The extent of measures to guard the secrecy of the information.
- The value of the information to the company and its competitors.
- The amount of time, effort, and money expended by the company in developing the information.
- The ease or difficulty with which the information could be properly acquired or duplicated by others.

Questions to Consider

1. Was the information kept secret?
2. What measures were to keep the information secret? What matters is how accessible the information is to the company's competitors. The courts will consider the 1) general availability of the information; and 2) former employer's effort and expense in compiling it.
3. What value does the information have?
4. How will disclosing the information damage the company?
5. Will a competitor benefit from the information?
6. What expenses have been incurred in developing the information?
7. How much is known inside and outside the business?
9. What kinds of precautions were taken to safeguard the information?
 - a. Confidentiality Agreements: Letting employees know the significance in keeping the information confidential.
 - b. Employee Manuals: Provision that states the importance in keeping the information confidential and that disclosure of confidential information may be grounds for termination of employment.
 - c. Locking information in a safe.

TRADE SECRETS LAW & INVESTIGATIONS

- d. Security Measures including security guards and logbook of those entering or leaving the facility.
- e. Computer Security: Passwords to access information.
- f. Shredders

12. How long will it take a competitor to acquire or duplicate the information?

GOOD INVESTIGATIONS CAN LEAD TO A
PROTECTABLE TRADE SECRET

Every experienced trade secrets litigator knows the use of a good investigator may be the deciding factor in whether he wins or loses the case.

A. Evaluations

As discussed above, preventing of trade secret violations are two critical factors in a trade secrets case. An investigator can assist attorneys in evaluating whether security measures were taken in protecting the trade secret. Investigators can also help define the company's vulnerability to competitors.

B. Investigation

Rule 11 of the Federal Rules of Civil Procedure requires an investigation that allegations of trade secret violations are “well grounded in fact.” State laws also have similar requirements. Investigators are essential in deciding whether a trade secret has been misappropriated.

C. Evidence

Investigators can obtain evidence from an infringing party and find out whether there are co-conspirators involved in misappropriating the trade secret.

D. Compliance after Injunction

Once injunctions are handed down by the courts, investigators can monitor the defendants who continue misappropriating the trade secret.