

# Reducing the Chances of a Trade Secrets Lawsuit: How to Advise Your Business Clients

By Mark Punzalan



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**I**magine you are a business attorney representing a company that seeks your legal advice in the following scenarios.

*Scenario A:* Your client wants to hire certain employees of a competing business. The client merely wants to hire talented individuals in the same industry, and has no intention of learning or using the competitor's proprietary and confidential information. However, your client wants to prepare itself in case the competitor accuses your client of any wrongdoing. How do you advise your client?

*Scenario B:* After hiring those employees, your client receives a threatening cease and desist letter from the competing business. The letter alleges that in hiring the competitor's employees, your client has engaged in the misappropriation of the competitor's trade secrets. Your client asks for your advice on how to proceed.

In both scenarios, the attorney needs an understanding of trade secrets laws to advise the business client appropriately. While trade secrets issues often surround technology-related companies, businesses in any industry can get embroiled in a trade secret dispute. Indeed, nearly every business has some valuable information that it wishes to keep secret from the public—such as client lists or

marketing plans—and these pieces of information may be subject to trade secret protection.

However, many companies fail to consider trade secrets issues until they receive the cease and desist letter described above in Scenario B. Businesspeople from sole proprietors to C-suite-level executives<sup>1</sup> often have little understanding as to what makes a piece of information a trade secret, how to protect trade secrets, or how to prevent, or protect against, claims of trade secret misappropriation.

In today's competitive business world, companies often receive letters from competing businesses threatening a trade secret lawsuit when perhaps no misappropriation has actually occurred. The letter may be nothing more than an attempt to prevent the poaching of employees and to inhibit competition in that particular industry. California has a strong public policy of encouraging employee mobility among the workforce.<sup>2</sup> For this reason, agreements not to compete are generally void subject certain exceptions.<sup>3</sup> Moreover, California has a strong public policy in favor of open competition.<sup>4</sup> Meritless trade secret accusations can undermine both competition and employee mobility in the workforce.

Over the years, trade secrets lawsuits have become increasingly complex, costly, and time-consuming. These cases also often include an emotional component not seen in many other types of business disputes because



feelings of betrayal and anger often cloud the merits of the actual dispute. Although a trade secrets misappropriations lawsuit can never be fully prevented, companies that proactively implement appropriate policies and procedures can reduce the chances of facing a long and costly trade secrets misappropriation lawsuit.

## WHAT ARE TRADE SECRETS?

Generally, a trade secret refers to a “formula, pattern, compilation, program, device, method, technique, or process” or other information that:

- Is not generally known within the particular industry or the public;
- Is economically valuable because it is not disclosed to the public; and
- Is subject to reasonable efforts to maintain its secrecy such that its existence or content is not revealed.<sup>5</sup>

Trade secrets case law provides many examples of the types of information can be considered trade secrets, and the list is always evolving. Most trade secrets disputes have focused on the types of trade secrets associated with manufacturing and technology companies, such as manufacturing methods<sup>6</sup> and software source code.<sup>7</sup> One of the most famous trade secret examples is The Coca-Cola Company’s formula for its eponymous soda, a formula that the company has protected for decades and has led to billions of dollars in revenue.<sup>8</sup>

Non-technology companies also usually have some form of information deemed to constitute trade secrets. For instance, courts have found that customer and supplier lists<sup>9</sup> and financial and marketing plans<sup>10</sup> may be protectable as trade secrets. If a company has expended time and effort to identify customers with particular needs or characteristics, courts have held that such customer information can be protectable as a trade secret.<sup>11</sup> Generally, the more difficult it is to obtain the information and the more time and resources the employer has expended to gather the information, the more likely a court is to deem the customer information a trade secret.<sup>12</sup> Courts, however, are reluctant to protect customer lists if the information is “readily ascertainable” through public sources.<sup>13</sup>

However, trade secret law does not always provide easy answers, and courts generally review each piece of information on a case-by-case basis. Conceivably, any piece of business data that provides economic value by being kept secret could be protectable under trade secret laws. A recent case even suggests that a person’s LinkedIn contacts (if kept private) could also be considered a trade secret.<sup>14</sup> Unlike other types of Intellectual Property such as patents, copyrights, and trademarks, there is no formal registration process for trade secrets, and this lack of clarity may increase the potential for disputes.

## WHAT CONSTITUTES MISAPPROPRIATION OF TRADE SECRETS?

The theft or other misuse of trade secrets is commonly referred to as misappropriation. More specifically, misappropriation generally refers to the acquisition of another person or entity’s trade secrets by someone who knows or has reason to know that the trade secret was acquired improperly.<sup>15</sup> The most common type of misappropriation occurs where a person copies or removes trade secret information from a company without authorization.<sup>16</sup>

A plaintiff in a trade secret misappropriation may be entitled to significant remedies, including an injunction,<sup>17</sup> compensatory damages,<sup>18</sup> and exemplary damages.<sup>19</sup> A plaintiff may recover its attorney’s fees for “willful and malicious misappropriation.”<sup>20</sup> If a plaintiff brings a *bad faith* claim of misappropriation, however, a court may award attorney’s fees to the prevailing party.<sup>21</sup>

## PROTECTING AGAINST TRADE SECRET MISAPPROPRIATION CLAIMS

Business attorneys should advise their clients to remain cognizant of trade secrets issues at all times. But businesses that hire employees from direct competitors or within the same industry, as described above in Scenario A, should pay particular attention to trade secrets issues. In order to protect against a potential trade secret lawsuit, business attorneys should take the time to educate their clients about trade secret issues, particularly when the company hires employees from competing businesses.

A company should implement policies and procedures to limit disclosure of trade secrets both in the hiring process and while the new employee performs her



duties for the company. By creating and maintaining these policies, a company can reduce the chances of misappropriation and reduce the chances of facing a long, costly trade secret lawsuit. Although many established companies do not have any policies to maintain trade secret protection, it is never too late to review a company's trade secret policies, particularly if the company will continue hiring employees.

#### *—Identification of Trade Secrets*

Many business owners do not have a detailed understanding of trade secrets issues. A company should clearly identify and document information it believes constitutes its own trade secrets. This process should also include documenting the reasons the information constitutes a trade secret and the dates the trade secret came into existence. The company should also take the time to label any documents that contain this trade secret information with "CONFIDENTIAL" or "PROPRIETARY." If a competitor later alleges that its trade secrets were misappropriated, the company has a written record may help show that the information was in the new employer's possession before the new employee was hired.

#### *—Hiring New Employees*

When interviewing potential new employees who work or worked for a competitor, the company should ask candidates if they are subject to any restrictive agreements affecting their employment, such as Confidentiality Agreements or Non-Compete Agreements (the latter of which are generally unenforceable in California absent certain exceptions<sup>22</sup>). The company should document the prospective employee's responses.<sup>23</sup> If litigation subsequently ensues, the record of such responses may help to rebut a claim that the company "should have known" about any misappropriation.<sup>24</sup>

In interviewing the candidates, however, the company should be careful not to ask questions that may elicit the disclosure of items that the competing employer may treat as confidential. The company should avoid asking about proprietary information, and instead, should craft its questions to solicit only information about the candidate's responsibilities and accomplishments at the former employer, and not the competing employer's trade secrets. Again, a clear record of the questions asked and the responses given may help in the event of a future misappropriation lawsuit.

#### *—Written Agreements with New Employees*

When hiring a new employee, the company should obtain certain written acknowledgments from the employee. These written acknowledgments can help prevent misappropriation and show the company's attempts to discourage the misappropriation of trade secrets. If the company subsequently faces a trade secrets lawsuit, the existence of these policies can help defend against meritless claims of misappropriation and/or requests for attorney's fees.

As soon as the company hires the employee, the company should instruct, and have the employee acknowledge in writing, that she should not bring or otherwise disclose or use any property or confidential information from former employers or vendors. Additionally, the company should consider having new employees acknowledge in writing that no information of the former employer that is not already publicly available will be used in the new position. Again, while ensuring that the employee knows that she must ensure not to misappropriate her former employer's trade secrets, she must not misappropriate your client's trade secrets. The company should also make clear that among other remedies, the company may terminate the employee for using a former employer's confidential or proprietary information.

Companies should also consider requiring new employees to search their home computers, hard drives, and cloud storage servers for any information from their former employers. The company should ask employees to acknowledge in writing that they have performed such a search and have not found, or have deleted and will not use, any confidential information from the former employer. Because trade secrets laws may impose liability if the company "should have known" of a misappropriation, these policies can help show that the company had no knowledge, and no reason to have any knowledge, of trade secret misappropriation.

#### *—Training Employees*

Businesses should instruct their employees—both existing and new—about trade secret issues so that the employees understand what constitutes trade secret misappropriation, and that employees should not disclose or use the trade secrets of her former employers. Further, employees should be instructed not to use or disclose the trade secrets of the company—during and



after her employment. These steps could help limit the risk that an employee will use a former employer's trade secrets and could limit misappropriation of the company's own trade secrets if the employee later leaves for a different competitor.

#### *—Monitoring Employees*

In addition to the new employee's written acknowledgments, companies should also continually monitor employees to ensure that no misappropriation occurs during the employment. The company should consider implementing a policy that prohibits the saving and storage of any company documents on employee-owned computers and devices, and should prohibit the use of the employee's personal email accounts for any work-related communications. The company may even wish to preclude bringing employee-owned devices to work. Moreover, the company should consider providing access to files to employees on a "need to know" basis. Any files that may include trade secret information should only be shared only with the employees who need access to such information to perform their duties. Companies may also want to consider having an IT specialist monitor the employees' computers or devices to ensure that no information has been uploaded from external hard drives or cloud servers that do not belong to the company.

Moreover, especially if an employee deals with data similar to the data she handled with her former employer, the company should create written records of the employee's development and research. Ultimately, if the company is sued for trade secrets misappropriation and it possesses information substantially similar to the former employer's trade secrets, the company will have to address whether that particular piece of information was in the public domain or developed independently, because discovery of information by independent research and "reverse engineering" are not afforded protection as trade secrets.<sup>25</sup> Having clear, written records as to the employee's research and development can help weaken allegations that the information was misappropriated from the former employer.

#### *—Review and Revise Trade Secrets Policies*

Implementing trade secrets policies is a good start. However, it is not enough to simply create them and never review them again. As businesses evolve, the company's trade secrets also evolve. As such,

companies should revise their trade secrets policies on an annual basis.

## **RESPONDING TO THE CEASE AND DESIST LETTER**

Even if your client implements these practices, your client may still receive the threatening cease and desist letter discussed above in Scenario B. In the cutthroat world of business, it is not uncommon for businesses to send letters alleging trade secret misappropriation to intimidate and prevent competitors from poaching employees. Many times, the allegations are based on little to no evidence of any misappropriation.

In responding to the letter, a business attorney should take the accusations seriously and work with the client to determine whether the claims have any merit and to conduct an investigation if necessary. As part of this investigation, the company or the attorney should investigate whether the alleged trade secret information is in the public domain. Perhaps a simple Google search will show that the information alleged to be a trade secret is in the public domain and is not a secret at all. In addition to conducting a Google search, the investigation should include a review of Internet archive websites like archive.org, which provides archives to web pages that may no longer be in existence. Because trade secret protection necessitates that the information be kept *secret*, locating public disclosure of the information on a Web site may help weaken the trade secret claims.<sup>26</sup>

If the misappropriation claims have no merit, the response letter should demonstrate that the company has undertaken a good faith investigation of the claims and has found no evidence of misappropriation. A properly worded letter may be all that is necessary to avoid having to defend against a lawsuit or a request for an injunction. However, if the matter does proceed to litigation, the response letter can help show the company's good faith in addressing the trade secret misappropriation claims.

## **CONCLUSION**

Trade secrets disputes can affect every type of company, from large technology companies to small businesses. In particular, companies that hire employees from competing businesses may have an increased risk of facing a trade secret dispute. Companies should address these trade secrets issues



early on by implementing practices to reduce the chances of trade secret misappropriation. Moreover, implementing these practices may reduce the chance of facing a costly trade secret lawsuit down the road.

## ENDNOTES

- 1 “C-suite-level executives” are executives whose title starts with the letter “C,” such as Chief Executive Officer and Chief Financial Officer.
- 2 California courts consistently uphold the public policy of employee mobility and hold that “every citizen shall retain the right to pursue any lawful employment and enterprise of their choice.” *Metro Traffic Control, Inc. v. Shadow Traffic Network*, 22 Cal. App. 4th 853, 859 (1994).
- 3 Cal. Bus. & Prof. Code § 16600 (“Except 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.”).
- 4 *Hill Med. Corp. v. Wycoff*, 86 Cal. App. 4th 895, 900 (2001).
- 5 Cal. Civ. Code § 3426.1(a).
- 6 See *Brescia v. Angelin*, 172 Cal. App. 4th 133, 151 (2009) (specifications for the manufacturing process of pudding can be trade secrets).
- 7 See *Cadence Design Sys., Inc. v. AvantA Corp.*, 29 Cal. 4th 215, 218 (2002) (trade secret claims regarding software source code).
- 8 See “Does formula mystery help keep Coke afloat?” CNN.com, February 19, 2014 (<http://edition.cnn.com/2014/02/18/business/coca-cola-secret-formula/>).
- 9 *Morlife, Inc. v. Perry*, 56 Cal. App. 4th 1514, 1521-1522 (1997).
- 10 *PepsiCo, Inc. v. Redmond*, 54 F.3d 1262, 1267 (7th Cir. 1995).
- 11 *Morlife, Inc. v. Perry*, *supra*, 56 Cal. App. 4th at 1521-22.
- 12 *Id.*
- 13 *The Retirement Group v. Galante*, 176 Cal. App. 4th 1226, 1240 (2009).
- 14 See *Cellular Accessories for Less, Inc. v. Trinitas LLC*, 2014 WL 4627090, at \*4 (C.D. Cal. Sept. 16, 2014) (denying summary judgment in trade secrets misappropriation claim because issue of whether LinkedIn contact information constituted a trade secret was a disputed issue of material fact).
- 15 Cal. Civ. Code § 3426.2(b)(1). Disclosure or use of a trade secret without the owner’s express or implied consent also may constitute “misappropriation.” Cal. Civ. Code § 3426.2(b)(2).
- 16 *Altavion, Inc. v. Konica Minolta Sys. Lab. Inc.*, 226 Cal. App. 4th 26, 47-52, 65-66 (2014), *review denied*.
- 17 Cal. Civ. Code § 3426.2(a). The court, however, may instead order payment of a reasonable royalty if an injunction against future use would be unreasonable. Cal. Civ. Code § 3426.2(b).
- 18 Cal. Civ. Code §§ 3426.3(a) (damages for “actual loss”), 3426.3(b) (court may award “reasonable royalty”).
- 19 Cal. Civ. Code § 3426.3(c) (court may award exemplary damages of not more than twice the compensatory damages).
- 20 Cal. Civ. Code § 3426.4.
- 21 *Id.*; see also *Cypress Semiconductor Corp. v. Maxim Integrated Products, Inc.*, 236 Cal. App. 4th 243, 258-271 (2015) (touchscreen manufacturer’s trade secrets misappropriation claim was made in bad faith, and defendant was entitled to recover its attorney fees); *SASCO v. Rosendin Elec., Inc.*, 207 Cal. App. 4th 837, 845-848 (2012), *as modified on denial of reh’g* (attorney fees awarded to former employees against former employer that bought trade secrets misappropriations claims that were “objectively specious”). This “objectively specious” showing is a less stringent showing than “frivolous.” *Gemini Aluminum Corp. v. California Custom Shapes, Inc.*, 95 Cal. App. 4th 1249, 1262 (2002).
- 22 Cal. Bus. & Prof. Code § 16660.
- 23 The records of such responses should be retained whether or not the prospective employee is hired: Your client’s competitor could claim unlawful disclosure (“misappropriation”) occurred during the interview.
- 24 Cal. Civ. Code § 3426.1(b) (any “person” who acquires a trade secret of another—including an employer—can be subject to misappropriation claim if employer “knows or has reason to know” of the misappropriation).
- 25 Reverse engineering refers to the “starting with the known product and working backward to divine the process which aided in its development or manufacture.” *Kewanee Oil Co. v. Bicron Corp.*, 416 U.S. 470, 476 (1974). “Reverse engineering” is an accepted and lawful practice in industry.” *People v. Gopal*, 171 Cal. App. 3d 524, 533 (1985).
- 26 Even if a particular piece of information is in the public domain, the information may still be protected by some other form of Intellectual Property law, such as copyright, patents or trademarks. The client should not assume that all publicly available information may be used without restrictions. Whether the new employee’s information constitutes some other form is beyond the scope of this Article. However, the United States Patent and Trademark Office website contains a helpful summary of the differences between various forms of Intellectual Property. See <http://www.uspto.gov/trademarks-getting-started/trademark-basics/trademark-patent-or-copyright>.