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LABOR AND EMPLOYMENT LAW: THE BASICS*

*TRADE SECRETS, COVENANTS NOT TO COMPETE  
AND NON-SOLICITATION AGREEMENTS: BASICS*

**Enforcement of Trade Secret Rights and  
Noncompetition Agreements**

**-- and --**

**Defending Against a Trade Secret/  
Restrictive Covenant Case**

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# **ENFORCEMENT OF TRADE SECRET RIGHTS AND NONCOMPETITION AGREEMENTS**

## **I. INITIATION OF LITIGATION**

If an employer's confidential business information, proprietary technology or know-how becomes known in the industry, then the property loses its trade secret status and the protections afforded under the law. Therefore, the primary goal of an employer seeking to enforce its trade secret rights usually is to prevent the dissemination or misuse of such property. Given this objective and the difficulty in placing a monetary value on the loss of intellectual property, the trade secret case is typically litigated in the context of a preliminary injunction proceeding. The same is true in restrictive covenant cases, where the business interest at issue is usually either trade secrets or confidential business information, customer goodwill or the investment an employer has made in specialized training of employees.

As time is of the essence to achieve the employer's objective, preparation and strategic planning up-front are key to success in a trade secret case. This chapter explores factors to consider in deciding whether to commence litigation, important initial tactical decisions, fact-finding and initiation of the litigation.

### **A. To Sue or Not to Sue**

Weighing the pros and cons of a lawsuit prior to commencing litigation is highly advisable. First consider what is at stake. How valuable is the information, technology, know-how or other asset such as customer goodwill to the employer's business? Some information may have only temporary value, quickly becoming outdated, while other information may be of critical importance to the viability of the business. Similarly, evaluate the nature of the competitive threat. If, through a former employee or other individual entrusted with or having

access to proprietary data, it ends up in the hands of a principal competitor, the ramifications in the marketplace may be substantial.

Litigation can have an impact on the employer's public image and on employee morale, in both positive and negative ways. It can have the constructive effect of sending a strong signal to the work force and to the marketplace that the employer will take legal action to enforce and protect its rights -- whether those be contractual rights under a covenant not to compete or proprietary rights in trade secret information. A consistent policy and enforcement of such rights can serve as a strong deterrent to others who may be considering leaving to unlawfully compete. It may likewise discourage competitors from hiring employees subject to restrictive covenants or nondisclosure agreements.

On the other hand, litigating against a former employee may create the image of a corporate "bully." Labor problems may develop as a result of litigation, particularly if the dispute involves a member of a labor union. Some employees may view litigation as an effort on the part of the employer to deprive an individual of making a living and to restrict competition. Effective public relations can minimize these perceptions. Getting the right message out — that the objective is to protect proprietary information and know-how that are critical assets of the business — can dispel the "anti-competitive" misperception of such litigation.

Another business consideration is whether a lawsuit will drag the employer's customers into the dispute.

Because litigation is a public process, there is the risk of disclosure of trade secret information. Publicized litigation may pique a competitor's interest in the information. Care has to be given to establishing procedures such as protective orders and "in camera" review of evidence, to safeguard the confidentiality of proprietary information throughout the proceeding.

Consider the likelihood of prevailing in a lawsuit. The plaintiff in a trade secret case will be required to prove that the information or technology at issue is proprietary to the employer and not generally known in the industry or available to the public at large. The employer must show that it has taken reasonable measures to maintain the confidentiality of the information or know-how. Proper security measures, including well-drafted employment agreements containing nondisclosure covenants and covenants not to compete, are important — not only to protect the proprietary nature of the data or technology, but also to prevail in litigation.

A preliminary injunction action seeking to bar the use of trade secrets and confidential information or the breach of a restrictive covenant is an action in equity. Given the nature of the relief sought, courts will weigh equitable considerations such as how much time has passed since the employer knew or should have known of its claims and commencement of the litigation. A court may be less inclined to grant injunctive relief to a litigant who has "sat on his rights." Failure to respond promptly and appropriately to the actual or threatened misappropriation of trade secrets may create the impression that the information is not truly that valuable and, thus, discredit a claim of irreparable harm. Delay in responding to the misappropriation of trade secret information may also affect the "balance of the equities." Few equities, if any, lie initially with a disgruntled employee who has jumped ship, joined a competitor and taken confidential information or know-how with him in order to gain an unfair competitive advantage over his prior employer. However, with the passage of time, particularly if the competitor expends time, money and manpower to develop a new product line or technology using the misappropriated information or know-how, the equities arguably may begin to shift.

A court of equity will look to whether an employer has "clean hands," which raises the question of the employer's conduct. If the employer has engaged in wrongdoing with respect to the matters at issue, such as violation of antitrust laws or breach of any employment agreement

with a departed employee/defendant, such conduct may be an obstacle to obtaining equitable relief. Other equitable considerations may factor in, such as the circumstances of a former employee's termination. An employer who summarily discharges an employee for poor performance may have a difficult time establishing how it will be irreparably harmed if that individual is permitted to compete in violation of a restrictive covenant.

A preliminary injunction case is usually an expedited proceeding. As such, it can place significant time demands on management and other employees in terms of fact-finding, discovery and trial, which activities will be compressed into a short period of time, disrupting normal schedules and diverting time from regular business activities.

#### **B. Fact-Finding**

Thorough initial fact-finding is critical to preparing for and succeeding in litigation. Employers must promptly investigate suspected misappropriation of trade secrets, particularly if injunctive relief is sought. Under such circumstances, a search of a departed employee's office is advisable and may indicate whether company files or other information maintained by the departed employee is missing. If the individual used a computer, those computerized files should be checked. Certain software programs enable one to recover information that has been "deleted" from a computer. Records of computer usage may reveal recent unusual activity, such as the printing out of a large volume of information or access to computer files not normally used by the departed employee in the course of job performance. Likewise, records of duplicating activity should be checked. Interviews of a former employee's staff and co-workers may disclose important information. Telephone records, calendars, phone slips, expense reports and travel logs are other good sources of information. Records showing access by the departed employee to the employer's offices during off-hours may also be significant evidence.

Information about the new entity with which the departed employee has associated, such as the date of incorporation, location of business offices and financial status as shown in Dun & Bradstreet reports, should also be obtained.

### **C. Initial Tactical Decisions**

#### **1. Whether to Send a Warning Letter**

A question frequently asked is whether it is advisable to send a warning letter prior to initiation of a lawsuit. A letter may be appropriate in some cases, such as when a competitor may not be aware that a new hire is subject to a covenant not to compete with his prior employer. A letter also may serve the purpose of heightening a competitor's sensitivity to the proprietary concerns of another. Sending a warning letter prior to initiating legal proceedings also conveys to the court that the trade secret owner has made an effort to find a business solution to the problem before resorting to litigation. It may diminish or eliminate any negative inference that might otherwise be drawn from a delay in responding to a threatened misappropriation of trade secrets. The downside risk of such a communication is that it places the competitor on notice, enabling it to prepare for the possibility of litigation and possibly leading to the destruction of important evidence.

#### **2. Where to Sue**

Selecting the proper forum for bringing the lawsuit is another important tactical decision. If a contract is involved, there may be a forum selection clause which may dictate where and how disputes are to be resolved. Furthermore, an employment contract may include an arbitration clause requiring that disputing parties submit to arbitration.

Nonetheless, jurisdiction and venue rules may permit a choice of forum. A plaintiff usually wants to sue close to "home" in order to maximize the chances of success and reduce litigation expenses. Liberal long-arm statutes may facilitate the selection of a favorable forum.

Because time is of the essence in trade secret and restrictive covenant litigation, the differences in court dockets and calendar systems may be a significant factor in choosing a forum. An individualized calendar, where one judge decides the case and all preliminary matters, may be preferable to court systems that divide those functions. Similarly, a court with a fast-moving docket is usually preferable to one with a backlog of cases when seeking preliminary injunctive relief.

If there is diversity among the parties (i.e., the plaintiff is a resident of a state different from that of the defendants) and the amount in controversy exceeds \$75,000, the federal courts will have jurisdiction over the case. Federal court dockets in some states are less crowded than state court dockets, and discovery procedures are more established. Usually in federal court one judge will be assigned to hear the entire case. In state court different judges may preside over different phases of the litigation.

Some trade secret/restrictive covenant cases also involve violation of federal laws such as the Copyright Act or unfair competition under the Lanham Act. Such violations may provide another basis for bringing the lawsuit in federal court. In addition, owners of trade secrets can seek to prosecute under the Economic Espionage Act, 18 U.S.C. §§ 1831-39 — a criminal federal statute.

Once a decision is made to sue, counsel should act fast to select the forum. There is always the risk of the adverse party initiating litigation first — for example, by filing a declaratory judgment action seeking to void a covenant not to compete. By suing first, the adverse party may be able to control selection of the forum.

### **3. Whom to Sue**

Potential defendants in a trade secret/restrictive covenant case include the departed employee(s); any new competitive company or entity established by the departed employee(s);

the competing company who hired the departed employee(s) and/or was the recipient of trade secret information; and financial backers, "silent" partners or others acting in concert with the former employee(s).

**D. Temporary or Preliminary Injunctive Relief**

While the grant of a preliminary injunction is not dispositive of the case, practically speaking, it accomplishes the primary objective of the plaintiff, which is to stop the disclosure or use of proprietary information. In addition, success at the preliminary injunction hearing provides significant leverage and often leads to a resolution of the entire action. Conversely, if the preliminary injunction stage is unsuccessful, the trade secret may be lost, and chances of obtaining permanent injunctive relief at a final hearing on the merits, absent the discovery of new evidence, is diminished. The hearing on the motion for a preliminary injunction is therefore a crucial phase in the litigation.

In order to prevail in an action for preliminary injunctive relief in either federal court or state court, the moving party must show: 1) a likelihood of success on the merits of his or her claim; 2) irreparable harm to the moving party absent the injunctive relief; 3) that the balance of the equities weighs in favor of granting preliminary injunctive relief; and 4) that preliminary injunctive relief is in the public interest. Federal Rule of Civil Procedure 65, entitled Injunctions, governs preliminary injunctions and temporary restraining orders in federal court. Usually a party in a trade secret/restrictive covenant case pursues a preliminary injunction after expedited discovery.

In some cases, however, the misappropriation of trade secrets may present such a threat of irreparable harm that a temporary restraining order ("TRO") without notice to the other side is necessary. While a court can issue a TRO based on affidavits alone if it appears that immediate and irreparable harm may result before the adverse party can be heard in opposition, the entry of

such an *ex parte* TRO will accelerate the proceeding under the rules of most courts. For example, under the federal rules, a temporary restraining order expires within ten days unless extended by the court or by the consent of the parties. Thus, such immediate relief is short-lived and may result in a prompt hearing before much, if any, discovery can be taken.

As a practical matter, courts are reluctant to issue TROs without notice to the other side. The moving party must therefore be able to articulate a compelling reason why written or oral notice cannot be given and the nature of the harm that the moving party will sustain if notice is given. The federal rules require counsel to provide this information in federal court.

A party obtaining a preliminary injunction or temporary restraining order must file a bond with the court in an amount set by the court, which bond is for payment of damages suffered by any party who is found to have been wrongfully enjoined or restrained as a result of the entry of the injunction.

#### **E. Initial Pleadings**

A party may initiate a trade secret/restrictive covenant case by filing a complaint in the appropriate court. The complaint can be either verified or accompanied by affidavits setting forth facts sufficient to establish the plaintiff's entitlement of the relief being sought. The complaint should set forth the nature of the proprietary business interest at issue — whether technology or know-how, confidential business information, such as customer lists, pricing or goodwill; the investment made by the plaintiff to develop the know-how, information or goodwill developed over the years and the measures taken to maintain the information in confidence; the manner in which the defendant gained access to the information, whether through employment in a position of trust and confidence or some other confidential relationship or through improper means; and the irreparable harm that the plaintiff will suffer if the information is used or disclosed or if customer goodwill is diverted.

Causes of action typically available in trade secret/restrictive covenant cases include:

- 1) breach of employee's contract;
- 2) breach of employee's fiduciary and common law duties;
- 3) misappropriation of trade secrets and confidential information;
- 4) tortious interference with the former employer's contractual and business relations with the ex-employee (if a new employer is involved) and/or between the former employer and its customers or suppliers; and
- 5) unfair competition.

Another cause of action to include, if the facts warrant, is a count for civil conspiracy.

Prevailing on such a cause of action may offer recovery in addition to what one may recover for the underlying torts; e.g., joint liability, increased monetary damages and expanded injunctive relief. The courts have uniformly recognized four basic elements of a cause of action for common law civil conspiracy:

- (a) a combination of two or more persons/entities;
- (b) to establish an unlawful object or to accomplish a lawful object by the use of unlawful means;
- (c) overt acts in furtherance of the conspiracy; and
- (d) resulting injury to the plaintiff.

In terms of the prayer for relief, the complaint should seek injunctive relief, preliminary and then permanent, as well as damages and costs.

#### **F. Motion for TRO and/or Preliminary Injunction**

It is usually advisable to file a motion for a TRO and/or preliminary injunction with the complaint. The motion and proposed order should spell out the specific type of temporary or preliminary injunctive relief being sought. For example, in a trade secret case, a plaintiff may seek a preliminary injunction barring an individual or entity from further work in a particular

field or competitive business, or development of a certain product line or technology for a specific time period; barring the use or disclosure of certain information, know-how or technology; and requiring the return of all proprietary information of the plaintiff in any tangible form. In a restrictive covenant case, a plaintiff may seek a preliminary injunction barring a former employee from breaching the terms of a covenant not to compete; barring the solicitation of customers; and requiring notification to all customers of the injunction. An accounting is additional equitable relief that should be considered. The injunctive relief sought in the complaint should parallel the relief sought in the motion for the TRO and/or preliminary injunction and proposed order.

**G. Motion for Order of Court Directing Preservation of Documents, Software and Things**

An order requiring the preservation of relevant information from destruction or alteration is a useful tool. Such an order does not impose on a defendant any duty or burden beyond what is required by the rules of court and therefore is usually granted. It is a vehicle for conveying to the court the severity of the matter and possibly highlighting defendant's conduct to date, showing the reason why a bona fide concern exists that evidence of wrongdoing may be destroyed. The entry of such an order may deter a defendant from altering or destroying evidence such as computer-based data which can easily be deleted.

**H. Motion for Expedited Discovery and Proposed Order Setting Specific Dates for Depositions and Production of Documents**

Typically under the rules of court, discovery may not be taken for 30 to 45 days after the complaint has been filed by a plaintiff. An employer may need expedited discovery to develop facts for a preliminary injunction hearing. Discovery may be expedited only by order of court. Taking discovery quickly also realizes the advantages of surprise. If the defendant is forced to comply with discovery by way of giving testimony at a deposition and producing documents, it

diverts time the defendant might otherwise devote to unlawfully competing with the former employer.

### **I. Protective Orders**

Before discovery or trial, the former employer should ask for a protective order to ensure the continued confidentiality of any trade secrets or proprietary information. Such an order often creates a presumption or impression of the existence of confidential information. It also eliminates any objections to discovery based on the existence of trade secrets or confidential information.

Consider how restrictive the protective order should be — should information produced in discovery be available to the parties only, for designated representatives of the parties or for "attorneys eyes only"? One approach is to have a "two-tier" protective order providing for two different classifications of confidential information.

The protective order should address what is to be done at the end of the case with the confidential information produced by each side (usually such information is returned to the producing party or destroyed).

## **II. DISCOVERY IN A TRADE SECRET/COVENANT CASE**

### **A. Discovery Goals and Objectives**

As in all litigation, the plaintiff's foremost goal in discovery is to glean as much pertinent information as possible as quickly as possible to support its claims. Given the time-sensitive nature of trade secret/covenant cases, however, the pressure to achieve this goal can be intense and critical sources of information may be overlooked. It is essential, therefore, to have a clear picture of the elements of proof necessary to prove each claim and to focus discovery efforts on the most likely sources of information and documents to support those claims. Use of a written

discovery plan, which outlines the elements of the various causes of action and the proof needed to support them, may be extremely helpful.

## **B. Likely Motions**

Trade secret/covenant cases frequently require the immediate filing of a number of motions designed to speed the discovery process, to preserve evidence and to protect the confidentiality of information produced. The most common motions are: (1) to expedite discovery; (2) to preserve evidence; and (3) for a protective order.

### **1. Motion to Expedite**

Given the urgent nature of trade secret/covenant litigation, much discovery is likely to be conducted on an expedited basis. This, of course, will generally require the filing of a motion to expedite, either with or shortly after the filing of the complaint and injunction papers. Although many employers view such a motion as an afterthought, this is a mistake. A well-crafted motion to expedite can not only provide the court with a concise view of the events surrounding the litigation, but can also convey the urgency of the situation.

A motion to expedite should contain the following:

- a brief recitation of the pertinent facts surrounding the litigation;
- an explanation as to why discovery should be expedited and suggested time frames for the production of documents and the taking of depositions;
- a proposed form of order; and
- attached copies of proposed document requests, deposition notices and third-party subpoenas.

Before filing a motion to expedite, a company should have carefully considered and determined the types of information that it will seek and the sources of that information so that the request can be as specific as possible. The types and sources of information are discussed more fully in Part C below.

## **2. Motion to Preserve Evidence**

It is generally advisable to file a motion for preservation of evidence as soon as possible. This is particularly true where a company has reason to believe that information that has been stolen from it may be destroyed. It is also effective in casting doubt upon the motives and behavior of the defendants.

A motion for preservation simply asks the court to order that no relevant documents, computer data or other information in the possession or under the control of the defendants be destroyed, changed or altered during the period of time pending the litigation. This may prove to be particularly critical in cases involving theft or misuse of computer or other electronic data (see Part V below) which can be easily modified or deleted.

## **3. Motion for Protective Order**

Trade secret/covenant cases usually involve the entry of a protective order governing the treatment of documents produced during the course of discovery, either by agreement or motion. This is necessary because of the confidential and sensitive nature of the information involved. Moreover, a plaintiff company seeking relief against the misuse of its stolen confidential information will itself often be required to produce other business information that is also confidential. Similarly, courts may require defendants to produce not only the allegedly stolen information, but also other confidential information about business operations, and strategies, customers, processes and financial condition.

A protective order will outline the procedures for identifying and maintaining documents that are deemed to be confidential, as well as portions of deposition transcripts and court filings. It will also typically limit the persons who can see the documents produced. For example, it may allow only the outside attorneys and experts for the parties to see the documents, or it may provide for a slightly broader group, perhaps adding a specific number of business people and corporate counsel on each side. The identity of the persons permitted to see the documents

should be carefully considered. There is a need to balance the danger of allowing key business people on the opposing side to see a plaintiff company's confidential information against the need for a plaintiff company's own knowledgeable executives to review the information produced to evaluate the degree of the opponent's wrongful conduct.

Once a motion for protective order has been entered, plaintiff companies must follow its terms to avoid inadvertent waiver of a claim of confidentiality. All documents that a company wishes to designate as confidential should be clearly marked as such. Court papers that include confidential documents or deposition excerpts should be filed under seal. Filing under seal also lessens the chances of disclosure of confidential information through the media's review of court filings.

### **C. Sources and Types of Information**

Documents and information to support a plaintiff company's claim in a trade secret/covenant case may come from many sources. A critical one which is sometimes overlooked is the plaintiff company itself. Others include: (1) the ex-employee; (2) the new employer; and (3) any recruiter who may have been involved.

#### **1. The Plaintiff Company**

A company that has been victimized by the theft of trade secrets or the violation of a covenant is frequently so anxious to exact revenge on the opposition that it fails to focus on a fertile ground for support for its claims — its own files, which may provide potent ammunition.

Among the types of information that should be carefully gathered and reviewed are the following:

- (a) Documents and information that show the high level of trust and confidence placed in the ex-employee. This would include, for example, job descriptions or internal memos outlining the employee's duties and

responsibilities; any documents reflecting the employee's security level or degree of access to confidential information; and documents showing the employee's personal involvement in the development of the plans, strategies, products or customers in question.

- (b) Documents and information that show the ex-employee's agreement not to disclose confidential information, solicit employees or solicit customers. Included in this category are confidentiality agreements or covenants that the ex-employee may have signed; personnel manuals that the ex-employee may have received outlining the company's policies and expectations regarding the confidentiality of information; and the ex-employee's signed acknowledgment of receipt of the personnel manual.
- (c) Documents and information that may show pre-leaving wrongful conduct. The ex-employer should carefully review the ex-employee's expense and business records to determine whether he or she used company time or money to solicit employees or clients. These records may show, for example, that the employee interviewed for a position with the defendant competitor and charged travel expenses back to the plaintiff employer, or that he or she entertained clients for the purpose of having them switch their business to the new employer. In addition, remaining employees should be thoroughly interviewed to determine if there was improper solicitation.

## 2. Ex-Employee and New Employer

Among the categories of documents and information which should be sought from the defecting employee and his or her new employer are the following:

- (a) Documents or materials taken by the ex-employee from the plaintiff company. It is critical to determine the extent and timing of the removal of all confidential information from the plaintiff employer. Documents may reveal a gradual pre-planned misappropriation, which would tend to support a conclusion of bad motive. In cases involving more than one defecting employee, there may have been agreement and collaboration regarding the information to be taken and the method of taking it, as for example where a high-ranking employee who is subject to a covenant or confidentiality agreement attempts to have a lower-level employee not subject to the same restrictions steal the information or solicit the clients.
- (b) Documents or materials showing concerted action among ex-employees. In cases involving the defection of more than one employee to a competitor, it is often possible to establish the existence of a common plan or scheme to steal information, clients or other employees. Documents that may be relevant to this area of inquiry include calendars or date books which may show the timing of meetings and communications among the defecting group, simultaneous or closely timed offer letters, and internal documents of the new employer showing that the defectors were considered a "package deal."
- (c) Documents or information showing participation/agreement by the new employer. This would include such items as offer letters, employment contracts, file memos or correspondence which may tend to show that the

new employer began negotiating with the ex-employee long before he or she actually left the employ of the plaintiff company. In addition, there may be documents which show that the prospective new employer discussed the existence of the confidentiality agreement or covenant with the employee and knew of its contents, or that there was prior discussion of moving specific pieces of business or clients.

- (d) Documents or information showing the new employer's own efforts to protect its trade secrets, customers or market position. It is quite common for the new employer itself to use confidentiality agreements or covenants, which can often be used to undermine its position that it did not believe that there was any problem in hiring the ex-employee in question. These agreements often contain language similar or identical to that used by the plaintiff employer. In addition, the new employer's personnel manuals may contain language emphasizing that its own employees have access to confidential information and agree not to disclose it.
- (e) Documents or information showing the illicit use made of the stolen information. This category includes all files of the new employer that reveal new clients or pieces of business added as a result of the use of the stolen information, as well as any solicitation efforts in which the new employer may be engaged. It also includes such seemingly mundane items as date books and calendars, which may note client lunches or meetings at which ex-employees tried to solicit clients.

### **3. Recruiters**

If the competitor used a recruiter or headhunter to solicit the ex-employee, whether or not the recruiter is named as a defendant, the plaintiff company should seek discovery to the extent, nature and timing of the contacts between and among the recruiter, the ex-employee and the competitor. Also, the plaintiff company should search for the fees paid to the headhunter, information and objectives conveyed by the competitor to the headhunter regarding the position in question, the extent and nature of the headhunter's knowledge of any confidentiality agreement or covenant to which the ex-employee is subject, and whether the headhunter has been engaged to solicit other employees of the plaintiff company, which may support the concept that the competitor is engaging in a raid.

#### **D. Discovery of Computer and Electronic Data**

Misappropriating information that is stored on computer or using a computer to misappropriate information, is extremely common in trade secret/covenant cases. While the discovery of computer and electronic data is generally governed by the same rules applicable to other types of discovery, it often takes on an entirely new dimension given the nature of the information sought. In this regard, plaintiff companies should note the following points:

##### **1. Internal Investigation**

It is often possible to develop a highly accurate road map of a defecting employee's misappropriation of computer data, or misuse of computer access rights, by performing an immediate internal investigation of the ex-employee's computer usage preceding the departure. An individual (either within the company or hired from outside) with expertise in systems management should perform this investigation and thoroughly document all aspects of the following:

- (a) Accessing files not usually used. While most companies limit access to files by the use of passwords, it is not uncommon for certain employees (especially in smaller companies or who are relatively high-ranking) to have broad access rights. Under these circumstances, determine whether the ex-employee has accessed files which are not generally required for his or her daily work.
- (b) Unusually frequent computer usage. Determine whether the ex-employee has been accessing the network at an unusually frequent rate or at unusual times, as for example after hours.
- (c) Transferring files via modem. Determine whether the ex-employee has been transferring files from the computer network to a personal server and/or to a home computer via modem, especially for long periods of time and at unusual hours.
- (d) Laptop and home computer inventory. If the ex-employee has been provided with a laptop computer (or has had access to one), make sure that it is returned and immediately inventory its contents. Determine if there are any unusual files or signs of activity. In addition, it may be possible in discovery to require the ex-employee to produce any home computer for examination and analysis.

## **2. Discovery of Computer Data From Defendants**

In addition to determining the extent of any misappropriation of information via computer by means of an internal investigation, it is also critical to ascertain the extent to which the stolen computer data has been placed upon the system of, or used by, the competitor. In this regard, focus on the following:

- (a) Copying/transfer of stolen data to competitor's system. All of the competitor's pertinent computer records should be reviewed to determine whether and when any of the stolen data was copied or transferred onto its own system.
- (b) Destruction of data. In some instances, stolen data is copied onto a competitor's system or network and later deleted. Such deletion may evidence knowledge of the impropriety of having the data in the first place. It is important to ascertain whether and when any deletions occurred, again by reviewing pertinent records and by deposing the competitor's director of management information systems.
- (c) Back-up systems. The existence and functioning of the competitor's computer back-up system should be carefully studied to determine whether any of the stolen information still remains available to the competitor and how it can be retrieved.
- (d) E-mail. Like computer data bases, e-mail messages are also discoverable to the extent permitted by the rules that govern discovery generally. Because e-mail messages tend to be written informally and the writer often does not realize that they are potentially discoverable, e-mail messages often include information that would never be included in a formal memorandum. In addition, e-mail messages may remain on a company's data base even after they have been "deleted" by the reader.

Thus, a plaintiff company should specifically request the production of all e-mail messages (including deleted ones) pertaining to the litigation, since these may contain valuable

information not found elsewhere. Conversely, a plaintiff company should recognize that its own e-mail messages may be subject to scrutiny.

### **III. RELIEF AVAILABLE IN TRADE SECRET MISAPPROPRIATION CASES**

Following the misappropriation of a trade secret, a trade secret owner wants to limit the damage caused by the misappropriation. First, a trade secret owner will attempt to stop a misappropriator by seeking an injunction. If circumstances render the injunction an inadequate remedy, a trade secret owner will also seek monetary relief. A trade secret owner will attempt to recover the profits lost from the misappropriation as well as any profits that the misappropriator made from the trade secret.

The Uniform Trade Secrets Act ("UTSA"), the Lanham Trade-Mark Act, and common law provide trade secret owners with a variety of claims and theories upon which to obtain relief. Unfortunately, deciding upon an appropriate claim for damages, choosing the theory of liability, and proving damages are the some of the most difficult aspects of trade secret litigation. Trade secret misappropriation, unlike other causes of action, does not give rise to easily quantifiable damages. Rather, courts in trade secret misappropriation cases have great discretion in determining damage amounts.

First, this chapter will note the types of relief that a trade secret owner has available against a trade secret misappropriator. Usually, a trade secret owner will seek relief under several different theories of relief. This chapter will review the nature of these relief theories and when they are appropriate. Second, this chapter will explain the three primary theories under which trade secret owners seek monetary relief: legal, equitable, and market share theories as well as the method of proving entitlement to such relief.

## **A. Overview of Available Relief**

### **1. Injunctive Relief**

Injunctive relief provides trade secret owners with the greatest protection against trade secret misappropriators. An injured trade secret owner should first seek injunctive relief because monetary relief does not protect the trade secret owner's information. The trade secret owner must protect the trade secret to maintain the viability and competitiveness of the trade secret owner's business. Yet, if a misappropriator causes general dissemination of a trade secret, then an injunction is not effective and monetary relief is appropriate.

Because injunctions frequently serve as the only effective remedy, courts generally swiftly enjoin actual or threatened trade secret misappropriation. See Unif. Trade Secret Act § 2(a). However, the UTSA provides that "an injunction shall be terminated when the trade secret has ceased to exist." Id. In other words, courts terminate injunctions when the misappropriator could have developed the trade secret apart from the misappropriation.

Additionally, courts may continue a temporary injunction for a reasonable time. A reasonable extension period is the amount of time necessary to eliminate any commercial advantage that the misappropriator might otherwise derive from the trade secret. See K-2 Ski Co. v. Head Ski Co., Inc., 506 F.2d 471, 474 (9th Cir. 1974). Thus, an injunction may last forever or for the length of time that the misappropriator would have taken to develop or figure out the trade secret on its own. See id. (concluding that the court appropriately enjoined the company for the time period that it would need to develop its own product without the misappropriated trade secret information).

Another type of injunction involving a royalty payment may also be granted for the period during which use of the trade secret could have been prohibited. See UTSA § 2(b)

commentary at 450 (1990). In certain exceptional circumstances,<sup>1</sup> courts may grant this injunction allowing the misappropriator continued future use of the trade secret in exchange for reasonable royalty payment. This special situation arises when the misappropriator's future trade secret use will damage a trade secret owner but an injunction against future use is inappropriate. For example, if a third party reasonably relies in good faith upon acquisition of a misappropriated trade secret without reason to know of its prior misappropriation, then an injunction prohibiting future use would prejudice that third party.

## 2. Royalties<sup>2</sup>

The trade secret owner may request royalties where injunctive relief is not appropriate or as an alternative to quantified monetary damages for unauthorized use of a trade secret. See UTSA § 3(a). A "reasonable royalty"<sup>3</sup> differs from monetary damages because it is not a simple percentage of actual profits; rather, the fact finder determines the actual value of what the violator has appropriated. Metallurgical Industries, Inc. v. Fourtek, Inc., 790 F.2d 1195 (5th Cir. 1986) (calculating the reasonable royalty based on what the parties would have agreed to as a fair price for licensing the misappropriated trade secret). Methods for determining royalty amounts include reference to existing royalty agreements with other parties, existing license agreements, and hypothetical negotiations in an open market.

## 3. Unjust Enrichment

A claim for unjust enrichment is frequently appropriate as a supplemental claim for relief and generally is included along with other claims. See UTSA § 3(a); see generally Reingold v.

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<sup>1</sup> The official commentary of the UTSA § 2(b) envisions the following two exceptional circumstances: (a) an overriding public interest and (b) third party's reliance in good faith upon its acquisition of the trade secret without knowledge of the secret's prior misappropriation.

<sup>2</sup> The official comment to UTSA § 3(a) explains that a reasonable royalty serves as a general option, awarding monetary relief because of the misappropriator's past conduct. See UTSA commentary at 456 (1990).

<sup>3</sup> Courts require the trade secret owner to support the royalty amount demanded by competent evidence. See UTSA § 3 commentary at 456 (1990).

Swiftships, Inc. 210 F.3d 320 (5th Cir. 2000) (holding that courts may grant unjust enrichment in addition to relief for plaintiff's actual loss and that a general remedy law does not preclude unjust enrichment). Unjust enrichment is defined as "any quantifiable unjust benefit that is realized by the misappropriation and is not accounted for in the monetary damages or reasonable royalty calculations." See General Clutch Corp. v. Novikov, 10 F. Supp. 2d 124, 130-31 (D. Conn. 1998) (holding that the jury could reasonably find that a former employee was unjustly enriched in the amount of \$100,000 when he appropriated trade secrets).

#### **4. Exemplary Damages**

Courts grant exemplary or punitive damages when the misappropriator's conduct is willful or malicious. See UTSA § 3(b). Such damages are limited to twice the amount awarded under a claim for monetary damages. See *id.* An award of punitive damages is within the trial court's discretion and the amount of the award will not be reversed unless clearly erroneous. See UTSA § 3(b) commentary at 459 (1990) (noting that courts use clearly erroneous as the standard of review).

#### **5. Attorneys' Fees**

The Uniform Trade Secret Act provides that attorney's fees may be awarded to the prevailing party<sup>4</sup> in three specific circumstances: "(i) a claim of misappropriation is made in bad faith; (ii) a motion to terminate an injunction is made or resisted in bad faith; or (iii) willful and malicious misappropriation exists." UTSA § 4. The official commentary to the UTSA notes that courts determine whether to award attorney's fees as well as the amount of such award even if a jury has heard the case. UTSA § 4 commentary at 460 (1990).

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<sup>4</sup> Either the plaintiff or defendant may recover attorney's fees depending on who acted wrongfully in causing the lawsuit. UTSA § 4 commentary at 460 (1990). For example, attorney's fees may be awarded for reasons ranging from specious claims of misappropriation to a misappropriator's specious efforts to terminate injunctive relief. *Id.*

## **6. Prejudgment Interest or Lost Opportunity Costs**

A claim for damages may include prejudgment interest or lost opportunity costs. These damages consist of not only the royalty payments and monetary loss but also the foregone use of such monies between the time of misappropriation and the date damages are paid. Whether courts implicitly incorporate such costs into relief awards and whether courts will begin to include expressly these costs remains to be determined.

## **7. Tort Recovery**

In the case of a competitive tort such as trade secret misappropriation, the wrongdoer must answer for all consequences naturally resulting from the wrongful act whether or not they were anticipated or contemplated. See Broan Mfg. Co. v. Associated Distribs., Inc., 923 F.2d 1232, 1235 (6th Cir. 1991) (citing Aladdin Mfg. Co. v. Mantle Lamp Co. of Am., 116 F.2d 708, 716 (7th Cir. 1941)). Trade secret owners may recover compensation for all injury to their businesses which are naturally and proximately caused by the tortious act. See id. Business injuries include reputation, goodwill, loss of business, expenses incurred because of such tort, and all other elements of injury to the business.

### **B. Monetary Relief**

Courts may award only legal damages in trade secret cases or they can couple such damages with equitable relief. See UTSA § 3. However, if a trade secret owner seeks a monetary judgment only, courts will treat the claim as exclusively legal and grant a jury trial absent imperative circumstances. Dairy Queen, Inc. v. Wood, 369 U.S. 469, 479-80, 82 S. Ct. 894, 900-01 (1962) (holding that damages for trademark infringement claim required legal issues to be tried before a jury prior to the court deciding equitable remedy of injunction and noting that using the equitable terms of "accounting" rather than "damages" did not effect jury trial right). However, courts and juries can seldom measure damages with any assurance of accuracy and may not adequately compensate for loss. See Vermont Microsystems, Inc. v. Autodesk, Inc., 88

F.3d 142, 151 (2d Cir. 1996) (noting that trial courts receive great deference for their factual findings regarding damages because of the degree of uncertainty associated with establishing damages).

### **1. Relief Theories**

Although most courts associate trade secret litigation with equitable relief because injunctions generally serve as the most useful remedy, trade secret owners frequently seek relief based on multiple theories and courts no longer make a rigid distinction between these theories. Whether courts discuss monetary relief in terms of a legal, equitable, or market share theory, courts generally assess amounts based on the circumstances of the case in view of both trade secret owner's losses and the misappropriator's profits. See generally, Joel Eichengrun, "Remedying the Remedy of Accounting", 60 IND. L.J. 463 (1985) (discussing how most courts grant restitution for wrongdoer's profits without addressing the law-equity distinction).

#### **a) Legal Damages**

Courts calculate the trade secret owner's lost profits through methods that range from relatively straightforward to extremely complex. Courts often consider the following factors: (a) the nature of the misappropriated trade secret, (b) the businesses and degrees of competition of the trade secret owner and the misappropriator, (c) the length of time each has produced the goods which incorporate the trade secret, (d) research and development costs, and (e) size of the market as well as many other factors difficult to quantify. See Vermont Microsystems, Inc. 88 F.3d at 152 (noting that courts usually consider many factors when adjusting damages, such as the nature and extent of the misappropriator's use of the trade secret).

Because determining the amount of profits that the trade secret owner lost is so difficult, courts often consider more than just the traditional common law remedy of what damages the victim sustained. Tri-Tron Int'l v. A. A. Velto, 525 F.2d 432, 437 (9th Cir. 1975). Even in a legal action, the courts may measure damages based on the secret owner's lost profits

by looking to the benefit conferred on the misappropriator. See id. (awarding \$35,000.00 in actual damages and noting that the court should not only calculate the victim's lost profits but also the misappropriator's profits); see also Metallurgical Indus., Inc. v. Fourtek, Inc., 790 F.2d 1195, 1208 (5th Cir. 1986) (noting the importance of calculating the actual value of misappropriation of the trade secret and awarding a reasonable royalty). The benefits to the misappropriator can include direct profits on sales of products incorporating the misappropriated trade secret, reduced research and development costs, or other saved costs. See Int'l Indus., Inc. v. Warren Petroleum Corp., 248 F.2d 696, 699 (3d Cir. 1957) (analogizing trade secret misappropriation to patent infringement and using the comparison method to calculate defendant's actual advantage). Despite the difficulty in calculating trade secret owner's lost profits, courts can more easily measure monetary damages when the trade secret owner directly competes with the misappropriator. See Metallurgical Indus., Inc. v. Fourtek, Inc., 790 F.2d 1195, 1208 (5th Cir. 1986) (recognizing competitive posture as an important factor).

Courts allow trade secret owners to recover damages for the time period when the courts find the trade secret protected, plus any additional period when a misappropriator retains an advantage over good faith competitors because of the misappropriation. See UTSA § 3(a) commentary at 456 (1990); see also Carboline Co. v. Jarboe, 454 S.W.2d 540, 555 (Mo. 1970) (limiting the damages to the time period that the misappropriator could have discovered the trade secret).

Although a claim for actual damages and lost net profits can be combined with a claim for injunctive relief, if both claims are granted, the injunctive relief will ordinarily preclude a monetary award for the period during which the injunction is effective. See UTSA § 3(a) commentary at 456 (1990). Cf. Whiteside Biomechanics, Inc. v. Sofamor Danek Group, Inc., 88 F.Supp.2d. 1009, 1020 (Mo. 2000) (holding that an injunction against defendant's future sales

would be redundant because the lower court already granted monetary relief). Although courts do not allow double counting, courts generally permit recovery for both trade secret owner's actual losses and the misappropriator's unjust benefit to the degree the two do not overlap. See UTSA § 3(a) commentary at 456 (1990) (citing Tri-Tron Int'l, 525 F.2d at 437 (noting that courts assess damages according to wrongdoers' profits and victims' losses)).

**b) Equitable Damages**

The equitable counterpart of an action for damages at law is an accounting for profits. Courts should grant an accounting in the following circumstances: (1) the misappropriator was unjustly enriched, (2) the trade secret owner was injured by the misappropriation, or (3) if an accounting could have a deterrent effect upon the misappropriator. See Monsanto Chem. Co. v. Perfect Fit Prods. Mfg. Co., Inc., 349 F.2d 389, 394-96 (2d Cir. 1965); see generally W.E. Bassett Co. v. Revlon, Inc., 305 F. Supp. 581 (S.D.N.Y. 1969). However, an order for accounting is properly denied if an injunction alone will satisfy the equities. See Champion Sparkplug Co. v. Sanders, 331 U.S. 125, 132, 67 S. Ct. 1136, 1140 (1947).

In order for the trade secret owner to prove entitlement to an accounting for profits, the trade secret owner must first establish his injury by showing that a nexus exists between his losses and the misappropriator's gains. He must then show that the misappropriator actually made sales which involved the stolen trade secret. After proving the misappropriator's profits, courts presume that the trade secret owner's losses occur as a result of the misappropriator's gains. Once this prima facie case is made, the misappropriator carries the burden of proving there was no causal connection between his profits and his unlawful conduct. If the misappropriator is successful, the trade secret owner will be denied recovery of the defendant's profits. An unsuccessful misappropriator may be required to disgorge not only the profits of his wrongdoing, but may also be required to provide sales information or the names of

customers to the wronged owner. Profits owed by the misappropriator are net profits, after deduction of actual costs and other expenses.

In general, courts account for profits and grant equity awards under three theories: the compensation theory, the deterrent theory, and the unjust enrichment theory. See Basch Co., Inc. v. Blue Coral, Inc. 968 F.2d 1532, 1537-40 (2nd Cir. 1992) (discussing how courts award equitable relief based on the three theories); see also, Bundy Corp. v. Teledyne Industries Inc., 748 F.2d 767, 772 (2d Cir. 1984); Ideal World Marketing, Inc. v. Duracell, Inc. 997 F. Supp 334, 337 (E.D.N.Y. 1998). Courts have great discretion in determining the award of profits based on these theories and may adjust the award if profits prove to be inadequate or excessive. See Burger King v. Weaver, 169 F.3d 1310, 1321 (11th Cir. 1999). In fact, courts may make awards greater than what the court finds would adequately compensate the trade secret owner because of the deterrent and unjust enrichment theories. See id. However, a limit exists as to the amount courts may award after compensating the trade secret owner since awards cannot be remote or purely speculative. See Broan Mfg. Co. v. Assoc. Distribs., 923 F.2d 1232, 1235 (6th Cir. 1991).

Additionally, some courts hold that trade secret owners must meet further requirements to receive an accounting for profits under the deterrence and unjust enrichment theories. For example, some courts have held that deterrence alone does not justify an award of the misappropriator's profits. See Alpo Pet Foods, Inc. v. Ralston Purina Co., 913 F.2d 958, 968 (D.C. Cir. 1990) (stating that damages should not be awarded "for their sheer deterrent effect"). Therefore, these courts require a showing of (a) damage to the trade secret owner or (b) willfulness or bad faith on the part of the misappropriator. See id. Likewise, in order to recover under the deterrent or unjust enrichment theories, some courts require the trade secret owner to prove that the misappropriator willfully deceived the owner when the owner cannot

show actual damages to support an accounting of the misappropriator's profits on a compensation theory. See Basch Co. v. Blue Coral, Inc., 968 F.2d at 1532, 1539-40 (2nd Cir. 1992).

c) **Market Share Damages**

Market share theory of damages emerged relatively recently out of antitrust litigation and offers a new method of assessing damages based on business torts. It relies on the proposition that courts should evaluate the real injury sustained from the business tort by considering the company's position in the marketplace. Under this theory, courts measure damages by finding what the trade secret owner could reasonably have expected to attain absent the misappropriation based on the share of total market sales. In particular, the market share theory proves useful when the tort forecloses the trade secret owner from entering a new market or where sales fall below their reasonable expectations. Courts require trade secret owners to prove the fact that damage occurred only with reasonable, not absolute, certainty. See Broan Mfg. Co. v. Associated Distribs., Inc., 923 F.2d 1232, 1235 (6th Cir. 1991). Thus, the trade secret owner need only show the amount of damages with as much certainty as the nature of the tort and the circumstances of the case permit. See id.

2. **Proof of Damages**

a) **Actual Damages**

Courts assess damages at their discretion. But see UTSA § 3 commentary at 459 (1990) (stating that trial court has discretion to award up to twice the amount of actual damages and will not be reversed unless clearly erroneous). Courts classify the damages attributable to unfair competition, loss of goodwill, damage to reputation, and the like as unliquidated and calculate these damages based on the evidence presented on the business' prior experience and industry knowledge. To determine what the trade secret owner's financial position would have been absent the misappropriation, courts look to the following: (a) trade secret owner's business records prior to and after the misappropriation, (b) experience of comparable businesses not

otherwise affected by the misappropriation, or (c) expert opinion based on either. Although it may not be possible to make such estimates with any degree of precision, courts cannot base damages on guess, speculation, or conjecture. However, the owner's inability to prove actual damages does not preclude recovery in an accounting of profits realized from the misappropriator's unlawful sales.

Ordinarily the burden is on the trade secret owner, as plaintiff, to prove the amount of actual damages or unjust enrichment. See Weight Watchers Int'l v. Stouffer Corp., 744 F. Supp. 1259, 1288 (S.D.N.Y. 1990) (requiring plaintiff to prove defendant's sales). However, when sales information is under the control of the misappropriator, the burden is shifted to the misappropriator, as defendant, to prove the sales amounts. See Wesco Mfg., Inc. v. Tropical Attractions of Palm Beach, Inc., 5 U.S.P.Q.2d 1190, 1192 (11th Cir. 1987). A misappropriator may be accountable for profits even though the trade secret owner was not doing business in a particular market, particularly if the misappropriator, by his act, prevented the trade secret owner from competing in that market.

**b) Deductions**

Generally, courts require the misappropriator to account for net profits, which are the difference between gross income and the costs properly incurred in generating that gross income. Once the trade secret owner demonstrates the amount of gross profits, courts assume those profits are the result misappropriator's activity. The misappropriator then bears the burden of showing which portion of the profits is not attributable to the misappropriation.

For each particular cost or expense deducted from the wrongdoer's net profits, the misappropriator must prove (a) it was paid and (b) it is attributable to the unlawful sales. Allowable deductions may include the actual cost of materials, services, and labor incurred in producing the goods, reasonable waste, certain taxes, insurance premiums, building repairs,

depreciation, allocated percentages of overhead costs, and promotion and advertising costs. The cost of defending the suit is not deductible.

## **DEFENDING AGAINST A TRADE SECRET/ RESTRICTIVE COVENANT CASE**

### **I. INTRODUCTION**

Many businesses rely upon and maintain a competitive advantage in their respective markets because of the trade secrets and confidential data they have developed after significant expenditures of time and money. Because this type of information is vital to a company's livelihood, businesses aggressively seek legal redress to protect their trade secrets from threatened misappropriation and to preserve their rights to exclusively exploit this data. As trade secret litigation continues to become more prevalent, potential defendants should familiarize themselves with some basic defense strategies so that they will not be caught off guard if they are sued.

Although trade secret cases may be instigated by a myriad of factual scenarios, the two most likely types of defendants are: 1) the ex-employee who allegedly misappropriates trade secret information from an ex-employer, and 2) the ex-employee's new employer who stands to benefit from the ex-employee's alleged misappropriation. This article will suggest a few strategies and defenses which a defendant should consider when defending such a trade secret/covenant case.

### **II. BALANCING THE EQUITIES**

It is important to note at the outset that many courts resolve trade secret cases based on a balancing of the equities. It is therefore imperative that defendants who have taken documents or other material with them when they left their former employment return these items at the

earliest opportunity after the lawsuit has been filed and stipulate that they have maintained no duplicates in their possession. While the merits of plaintiffs' allegations will eventually be determined by the court, it is important for defendants to establish at the outset of litigation that they have "clean hands." During the course of litigation, defendants should make every effort to convince the court that they are the most deserving party when the equities are balanced.

Employers that have been sued because they hired plaintiffs' ex-employees should consider the feasibility of placing defendant employees on paid leaves of absence as soon as the lawsuit is filed. Although this may not be possible for small or start-up companies, and each company would have to consider the personnel and personalities involved, this proactive step would send a clear signal to the court that the defendant had "clean hands" and had no unfair competitive motive for hiring the employee at issue.

Defendants who are former employees or small start-up companies will usually benefit from a balancing of the equities analysis because they can point to the greater financial resources of plaintiffs and argue that the lawsuit is simply a method for plaintiffs to squelch competition. Courts are often receptive to a defendant who can establish that the plaintiff's lawsuit is grounded in some ulterior, anticompetitive motive. Similarly, courts will often refuse to enforce covenants not to compete or grant injunctive relief against defendants who can establish that such relief would effectively prohibit them from working in their profession or earning a living.

### **III. TAKE THE OFFENSIVE**

If defendants have the financial resources, they should strongly consider filing a counterclaim if they have reason to believe plaintiffs' allegations are pretextual. By taking the offensive, defendants may be able to divert plaintiffs' resources away from the trade secret aspects of the case. Ex-employees and their new employers who have been sued should consider

possible counterclaims, including abuse of process, tortious interference with contractual relations or prospective business advantage, libel, unfair competition and malicious prosecution.

If a lawsuit is a sham, serving only to stifle competition, it may be productive for defendants to file an antitrust counterclaim under federal law. By raising this federal question in a counterclaim, defendants will greatly expand the scope of discovery, thereby entitling them to request a broad range of documents from plaintiffs. Moreover, defendants will be entitled to treble damages if such an antitrust counterclaim is successful and may be entitled to remove the action to federal court. Traditionally, the Noerr-Pennington<sup>5</sup> doctrine has made it very difficult to sue plaintiffs under an antitrust counterclaim because plaintiffs are entitled to certain immunities from suit when they are simply exercising their first amendment right to petition the court. If plaintiffs file a lawsuit as a sham with anticompetitive intent, however, they will not be shielded by Noerr-Pennington immunity.

#### **IV. FORUM SELECTION**

Trade secret law is a product of common law, and a court will apply state law to resolve substantive legal issues. Because trade secret law varies greatly from state to state, forum selection is an important consideration. Unlike plaintiffs, defendants do not have the opportunity to investigate potential forums and choose the most favorable one, but every defendant should consider challenging plaintiffs' forum selection. Defendants should investigate the statutory and case law of the forum state and any other state that has significant ties to the litigation. If there is a strategic advantage to having the case moved, even logistically, defendants should at least verify that plaintiffs have chosen a forum that has proper venue for the case.

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<sup>5</sup> See United Mine Workers of Am. v. Pennington, 381 U.S. 657 (1965); Eastern R. Presidents Conference v. Noerr Motor Freight, Inc., 365 U.S. 127, reh'g denied, 365 U.S. 875 (1961).

Defendants should also review any contracts (such as employment agreements) which have any bearing on the litigation to determine if they contain choice of law or choice of forum provisions which may provide defendants with justification to have the case moved. If a state other than the forum state has law which favors defendants and arguably has more significant contacts to the litigation, defendants should research the forum state's conflict of laws rules to determine if some other state's trade secret laws may be applied.

Because there is so much disparity between states' trade secret laws, it is not uncommon for plaintiffs to take some liberties when selecting a forum in order to benefit from a particular state's law. The wary defendant should anticipate this strategy and avoid being "pigeon-holed" into a forum where the plaintiff has a strategic advantage based on state law.

## V. COUNTERING A COVENANT NOT TO COMPETE

Many trade secret cases involve covenants not to compete and employees who are sued when they begin their new employment allegedly in violation of the covenant. At the outset of such litigation, defendants should evaluate the consideration they received when they signed the covenants not to compete and review the reasonableness of the covenants' terms to determine if they are enforceable.

Covenants that were not signed at the commencement of employment must be supported by some type of additional consideration to be enforceable. Depending on state law, covenants would likely be enforceable if they were signed in conjunction with a promotion or pay raise, but if employees sign covenants not to compete after the commencement of their employment without receiving some additional consideration,<sup>6</sup> they would be unenforceable.

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<sup>6</sup> In some states, continued employment serves as adequate consideration.

Similarly, a covenant not to compete is unenforceable if its restrictions are unreasonable. Defendants should review their covenant's limitations in terms of geography, restricted activity and time. In order to assess the reasonableness of their covenant's provisions, defendants must have a thorough understanding of the industry in which they work so that they can accurately assess the reasonableness of the limitations. There are very few hard and fast rules to determine reasonableness because each decision is very factually specific. While in some industries a geographic restriction of a 25-mile radius may be unreasonable, a statewide restriction in an industry with a larger market may be enforceable. Similarly, the reasonableness of temporal restrictions will likely be determined by whether the particular industry has a dynamic technology or evolving customer base.

Defendants should argue, where feasible, that in light of the relevant industry, the restrictions are punitive in nature and serve to unfairly restrain competition. In determining the reasonableness of covenant provisions, courts will usually balance the equities and consider such things as the nature of the industry, the amount of time and effort plaintiffs expended in developing the trade secrets, whether defendants received legal counsel when they signed the covenant, the likelihood that defendants will be able to unfairly compete, whether defendants will otherwise be able to pursue their livelihood, etc.

Once a court determines that a restriction is unreasonable, it may refuse to enforce the entire agreement, simply strike the unreasonable provision and enforce the remaining provisions, or modify the unreasonable portions and enforce the covenant. Therefore, before defendants argue that a provision of their covenant is unreasonable, they should research the forum state's case law to determine if the court will modify or "blue-pencil" the agreement to make it enforceable. Defendants who are seeking to completely avoid their covenant's restrictions may choose not to argue that the covenant is unreasonable in a state where the courts liberally blue-

pencil such agreements. On the other hand, defendants who only desire to have the restrictions in their covenant "softened" to allow some minimal competition may argue that their covenant's restrictions are overbroad and unreasonable, thereby encouraging the court to blue-pencil the agreement to modify some of its strictest provisions.

Defendants may be able to bolster their defense if plaintiffs have been inconsistent in enforcing their covenants not to compete against other similarly situated ex-employees.

Defendants may be able to show that such selective enforcement is indicative of plaintiffs' anticompetitive motive.

If employers have not satisfied their obligations under the employment agreement (i.e., improperly terminated defendants), defendants may also argue that their employer failed to satisfy a condition precedent, and the covenant is therefore unenforceable. At a minimum, the employers' noncompliance with the terms of the agreement will be a factor when the court balances the equities of the case.

## **VI. FENDING OFF A PRELIMINARY INJUNCTION**

In most trade secret cases, plaintiffs will seek injunctive relief and often will ask the court to grant immediate relief in the form of a preliminary injunction or temporary restraining order. To be successful, plaintiffs must show that: 1) they will likely succeed on the merits of the case; 2) they will suffer irreparable harm if immediate relief is not granted; 3) a balancing of the equities favors their position; and 4) immediate relief serves the public interest.

For many defendants, the preliminary injunction hearing will determine their survival. Many defendants, especially new start-up companies, will not be able to survive if the court grants a preliminary injunction and orders them to maintain the status quo until the case is eventually tried.

If plaintiffs delayed in filing suit after they became aware of the alleged misappropriation, defendants should argue that plaintiffs should not now be entitled to special and immediate relief from the court because by their very actions plaintiffs have indicated that urgency was not critical. Additionally, defendants should make every effort to avoid a preliminary injunction by arguing that plaintiffs have failed to establish any one of the four requisite elements.

In a commercial setting, defendants may be able to establish that no irreparable harm is threatened by arguing that money damages would serve as an adequate remedy. This defense would be bolstered if there is an objective method or industry standard by which damages could be calculated. Unfortunately, many courts equate a company's loss of customers with a loss of goodwill which in many states constitutes irreparable harm.

Defendants should be as creative as possible when arguing that a balancing of the equities does not favor the granting of a preliminary injunction. By stressing factors that may win the sentiment of the court like the fragility of the defendant's business, the large amount of time and money the defendant expended in preparation of the process plaintiff seeks to enjoin and the relatively low threat to plaintiff's financial well-being, defendants may be able to tip the scale of equity in their favor.

Defendants should also argue that plaintiffs' likelihood of success on the merits is doubtful or questionable at best. If a covenant not to compete is at issue, defendants should argue that it is unenforceable on the grounds previously discussed. Generally, in a trade secret case, plaintiffs must prove that: 1) plaintiff owns the trade secret; 2) trade secrets were disclosed in confidence to defendants; and 3) defendants misappropriated the trade secrets and have or threaten to disclose them.

As a threshold, plaintiffs must therefore prove that they own trade secrets which are entitled to protection. Although each state has its own interpretation of what constitutes a trade secret, (e.g., some states consider customer lists to be trade secrets, while other states do not) plaintiffs must establish that they took adequate steps to safeguard their trade secrets from inadvertent disclosure. Because many defendants in trade secret cases are plaintiffs' ex-employees, they will be in good positions to critique the adequacy of plaintiffs' safeguards. If employers were lax in protecting their trade secrets by, for example, providing the data to vendors or customers, failing to enforce the use of passwords on its computer system or failing to lock files or rooms where confidential data was stored, defendants may successfully establish that plaintiffs have forfeited their rights to protect this information.

Defendants may also be able to establish that the information plaintiffs seek to protect is commonly known in the industry, easily obtainable through reverse engineering or was developed independently by defendants. If proven, the information would have no independent economic value, and most courts would not consider it to be trade secret information worthy of protection.

Plaintiffs also must prove that defendants have or threaten to misappropriate and use the trade secret. If plaintiffs have been able to conduct some discovery prior to the preliminary injunction hearing, and they have not uncovered any "smoking guns," defendants should argue that plaintiffs will not likely succeed on the merits because there is no evidence that misappropriation has occurred. At the preliminary injunction hearing, defendants should place themselves in a position to testify that they have none of plaintiffs' material in their possession and have no plans to misappropriate or use plaintiffs' trade secret information in the future.

Defendants that can avoid the granting of a preliminary injunction by convincing the court that plaintiffs have failed to prove at least one of the four required elements will have taken a giant step toward the successful defense of the trade secret case.

## **VII. CONCLUSION**

In trade secret litigation, defendants must be on their toes because the stakes are high and things happen quickly. Plaintiffs often seek expedited discovery in conjunction with their requests for preliminary injunctions, and there is little time for reflection and strategizing once the case is filed. Defendants should remember that they must take adequate steps to protect their trade secrets during discovery and insist on having a stipulated protective order in place before producing confidential information. Defendants should also resist, to the greatest extent possible, plaintiffs' efforts to inspect their premises. Defendants who can react quickly and who remember that the key to success is winning the balancing of the equities test will be formidable adversaries to plaintiffs in trade secret litigation.