

# Protecting Your Confidential Information Against Employee Misappropriation

## Overview of Non-Compete Litigation and Drafting Tips

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# Employee “Theft” Statistics: Misappropriation of Confidential Information

- *Wall Street Journal* recently reported results of survey regarding information theft by employees:
  - 50% of employees kept confidential information post-separation
  - 40% of employees plan to use confidential information in future employment
  - 60% say a co-worker has offered documents from a former employer
  - 52% of employees do not believe it is unlawful to use a competitor’s confidential business information
  - 68% of employees say their organization does not take preventative measures to protect confidential information



# Employee “Theft” Statistics: Misappropriation of Confidential Information

Research firm *Ponemon Institute* conducted survey of 3000+ individuals in six (6) industrialized countries and found:

More than 50% admitted they had emailed confidential business documents to their personal email address

More than 40% said they do so at least once per week

Nearly 40% of employees admitted they use file-sharing applications (such as Google Docs or Dropbox) in the cloud, without employer permission

More than 50% reported their company does not “strictly enforce” its policies

# Why is Employee Misappropriation a Problem?

- Technological advances make it easy
  - Internet and the cloud (drop boxes)
  - Portable file-sharing devices such as thumb drives, memory sticks, flash drives, external hard drives
- Globalization of business operations and markets and corresponding employee mobility
  - Competition for employees and customers
- Increased pressure to find competitive advantage
- Corporate espionage and cyber thieves

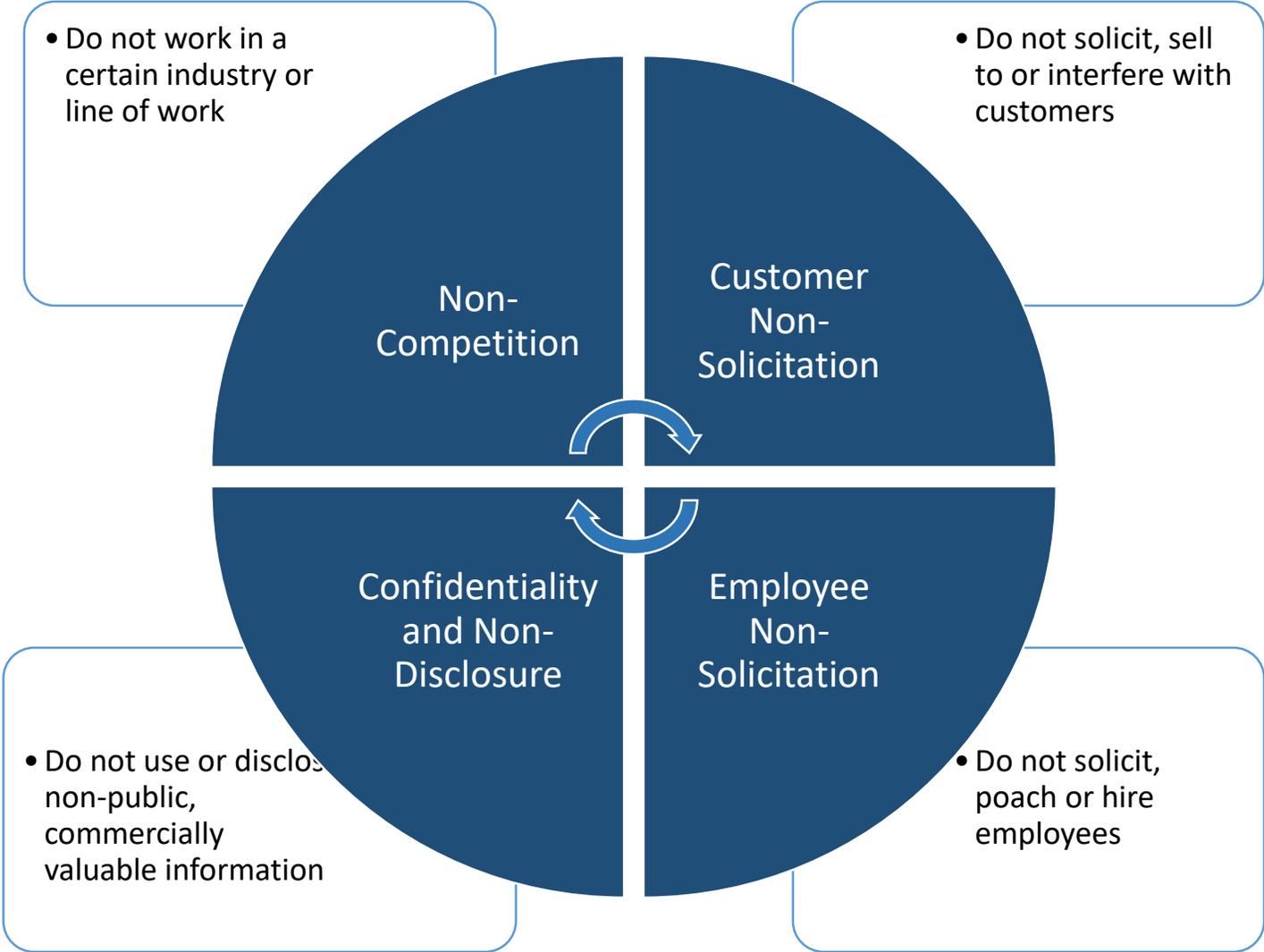
# What Information do Employees Misappropriate?

- **Commercially valuable information**
  - Customer and client information (identity, contact information, customer preferences, service history, etc.)
  - Employee information (contact information, salary, job duties, training materials)
  - Processes, systems and formulae
  - Operations and business plans
- **Anything that gives you a competitive advantage**

# How Do You Stop Misappropriation and Employee Theft?

- Proactive (pre-litigation, course of employment)
  - Agreements, contracts and restrictive covenants
  - Policies and procedures
  - Employee training
  - Reasonable measures to protect confidential information
    - Passwords, limited access, uniform enforcement
- Post-employment litigation
  - Enforcement of restrictive covenants
  - Statutory and common law claims
    - Illinois Trade Secrets Act
    - Computer Fraud and Abuse Act

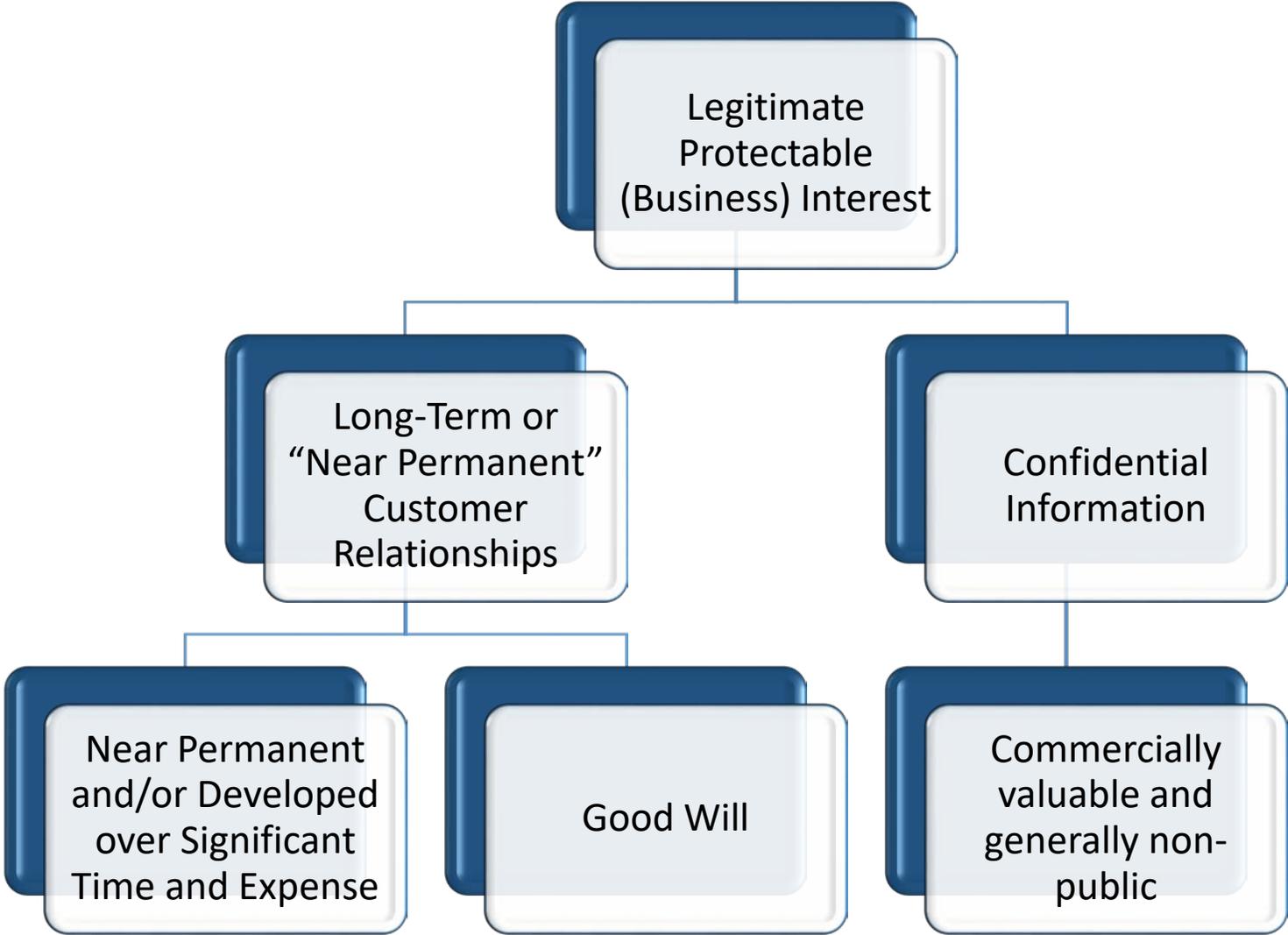
# What Are Employee Restrictive Covenants?



# General Overview: Restrictive Covenants

- State laws apply
  - Some states have statutory authority
  - Some states generally do not enforce non-competes
    - (e.g., California, Oklahoma and North Dakota)
- Enforcement is usually possible only where the restrictions are reasonable and narrowly tailored
  - Geography, time and activity
  - Some state laws or precedent offer presumptive guidelines on what is reasonable
- More enforceable when connected to the sale of a business or transaction
- In employment context, Courts are often hostile to covenants
- Restrictions must be designed to protect legitimate business interests (“protectable interests”)

# Legitimate Protectable Interest ≠ Desire to Stifle Competition



# Uniform Trade Secrets Act

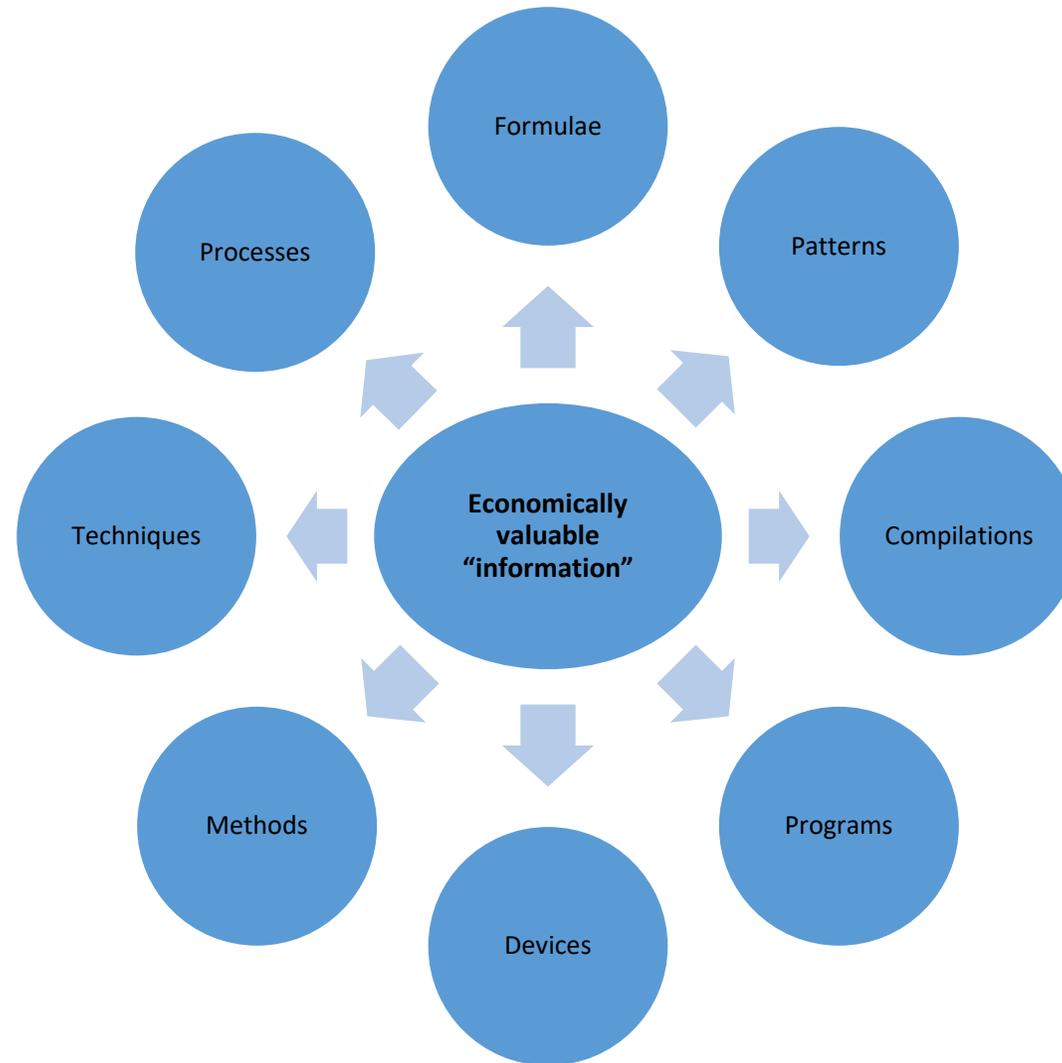
- The Uniform Trade Secrets Act (“UTSA”) provides statutory protection to trade secrets
- 48 states and 2 US territories (the U.S. Virgin Islands and District of Columbia) have adopted the UTSA, with some variations
  - The following states protect trade secrets under unique state statutes or under the common law: Massachusetts and New York.
- Cases preceding adoption of the UTSA are also relevant to interpreting it

# What is a Trade Secret?

Under the UTSA, a trade secret is information, including a formula, pattern, compilation, program device, method, technique, or process, that:

- (i) derives **independent economic value**, actual or potential, from **not being generally known** to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use, **and**
- (ii) is the subject of **efforts** that are reasonable under the circumstances **to maintain its secrecy**.

# What type of “information” may be protected?



# UTSA: Examples of Trade Secrets

The following may constitute trade secrets if economically valuable and not generally known:

- Customer lists (in certain circumstances)
- Customer preferences
- Business plans and operations data
- Formulae
- Manufacturing processes
- Material composition
- Computer software or computer code
- Engineering drawings
- Pricing, cost, margin and profit information
- Confidential data compilations
- Confidential bids
- Lab notebooks, meeting minutes (provided not open to public)
- Raw material identification and pricing of materials
- Testing and quality control procedures
- Confidential employee personnel information

# UTSA: Examples of Trade Secrets

Customer lists may qualify as trade secrets where:

- The list has been developed by the employer over a substantial period of time;
- The employer developed the list at great expense;
- The information is not available to the general public, competitors or all employees

# UTSA: Not Trade Secrets

Customer identities and lists readily obtainable through:

- Online directories;
- Trade publications; or
- Association memberships and directories

Pricing information freely disclosed to customers (as opposed to unique, undisclosed formula used to calculate price information)

# Additional types of “information” which may be protected

Examples of  
“information”  
held to be  
trade secrets:

- Customer and supplier lists and information about customers’ buying habits, etc. (if not publicly available and hard to decipher).
- Manufacturing methods:
  - Specifications for material and manufacturing processes.
  - Tolerances for mass-produced items, portions of which were patented.

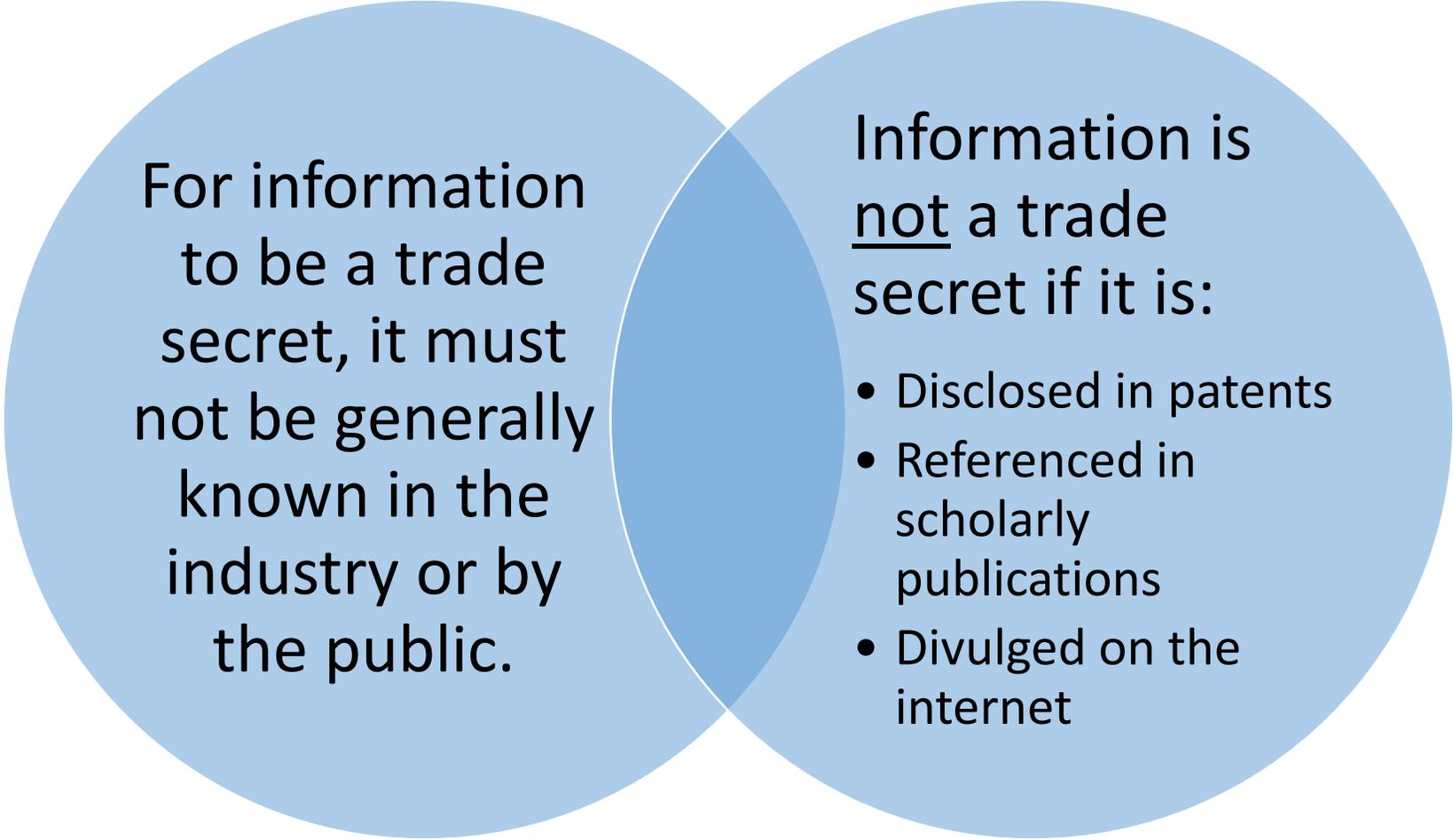
# Additional types of “information” which may be protected

Additional examples of “information” held to be trade secrets:

- Marketing and financing plans.
- Software source code and related information.
- The existence of licensing negotiations.
- Negative Information (information about what not to do or what doesn't work).
- Information obtained by reverse engineering another's trade secret.

Not all “confidential information” qualifies as a trade secret, but all trade secrets are confidential.

# “Secrecy” Key to Trade Secret Protection



For information to be a trade secret, it must not be generally known in the industry or by the public.

Information is not a trade secret if it is:

- Disclosed in patents
- Referenced in scholarly publications
- Divulged on the internet

# UTSA: Reasonable Efforts to Maintain Secrecy

Court decisions emphasize importance of proactive measures to maintain secrecy of information.

*Fail-Safe L.L.C. v. A.O. Smith Corp.*, 674 F.3d 889 (7th Cir. 2012)

- Confidentiality and non-disclosure agreements.
- Employees, vendors, visitors, co-venturers
- Security systems, locked interiors, guards
- Restrict computer access (user groups, limited authorization, passwords)
- Legends on documents: “Confidential” or “Trade Secret”
- Limit tours and other access
- Visitor sign-in log
- Compartmentalize information to those who “need to know”

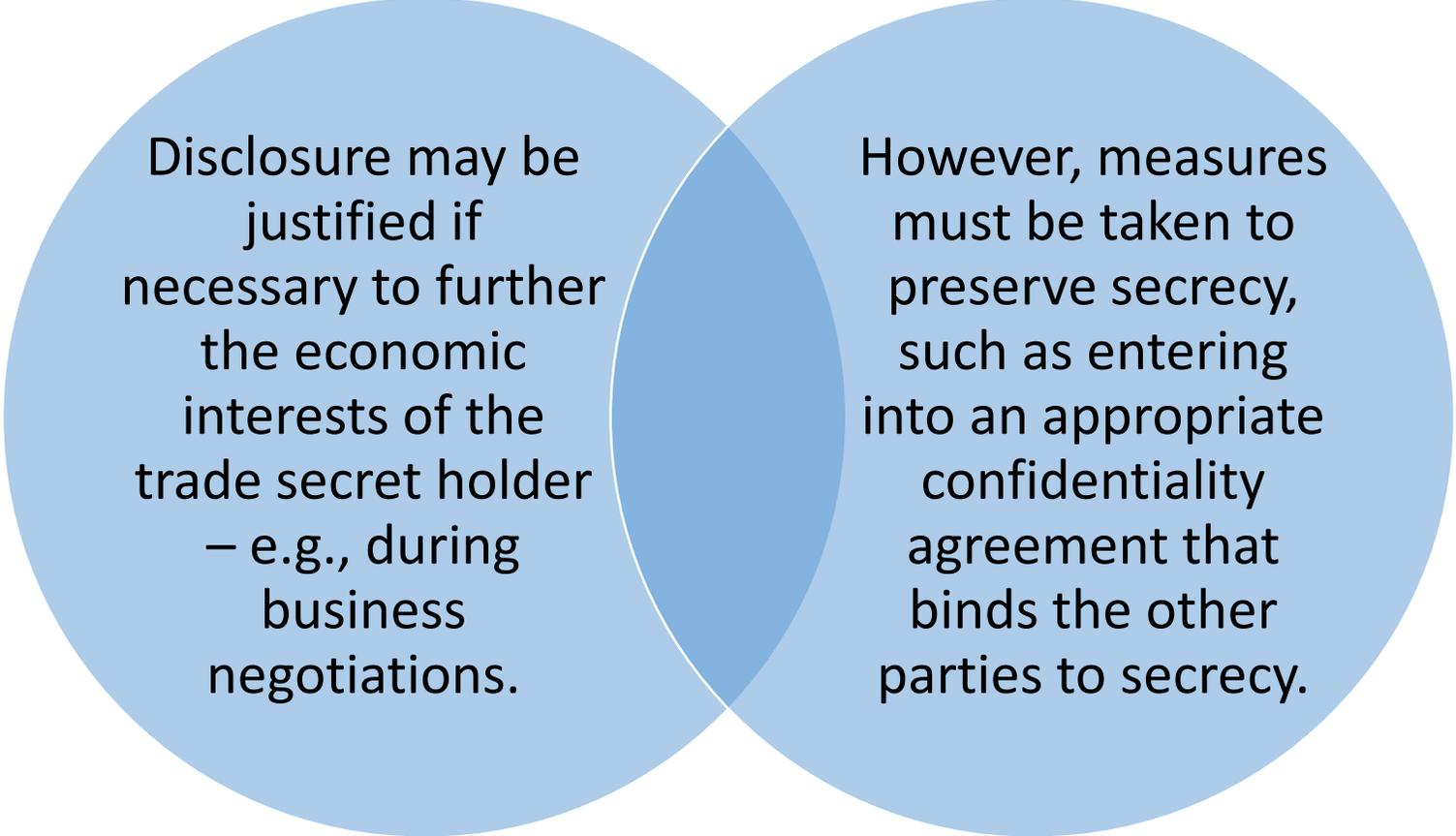
# “Secrecy” Requires Reasonable Efforts under the Circumstances

Statutory commentary defines “reasonable efforts” to maintain secrecy to include:

- advising employees of the existence of a trade secret,
- limiting access to a trade secret on “need to know basis,” and
- controlling facility access.

On the other hand, public disclosure of information through display, trade journal publications, advertising, or other carelessness may preclude protection.

# Limited Disclosure to Advance Economic Interest Okay If Precautions Taken to Protect Secrecy



Disclosure may be justified if necessary to further the economic interests of the trade secret holder – e.g., during business negotiations.

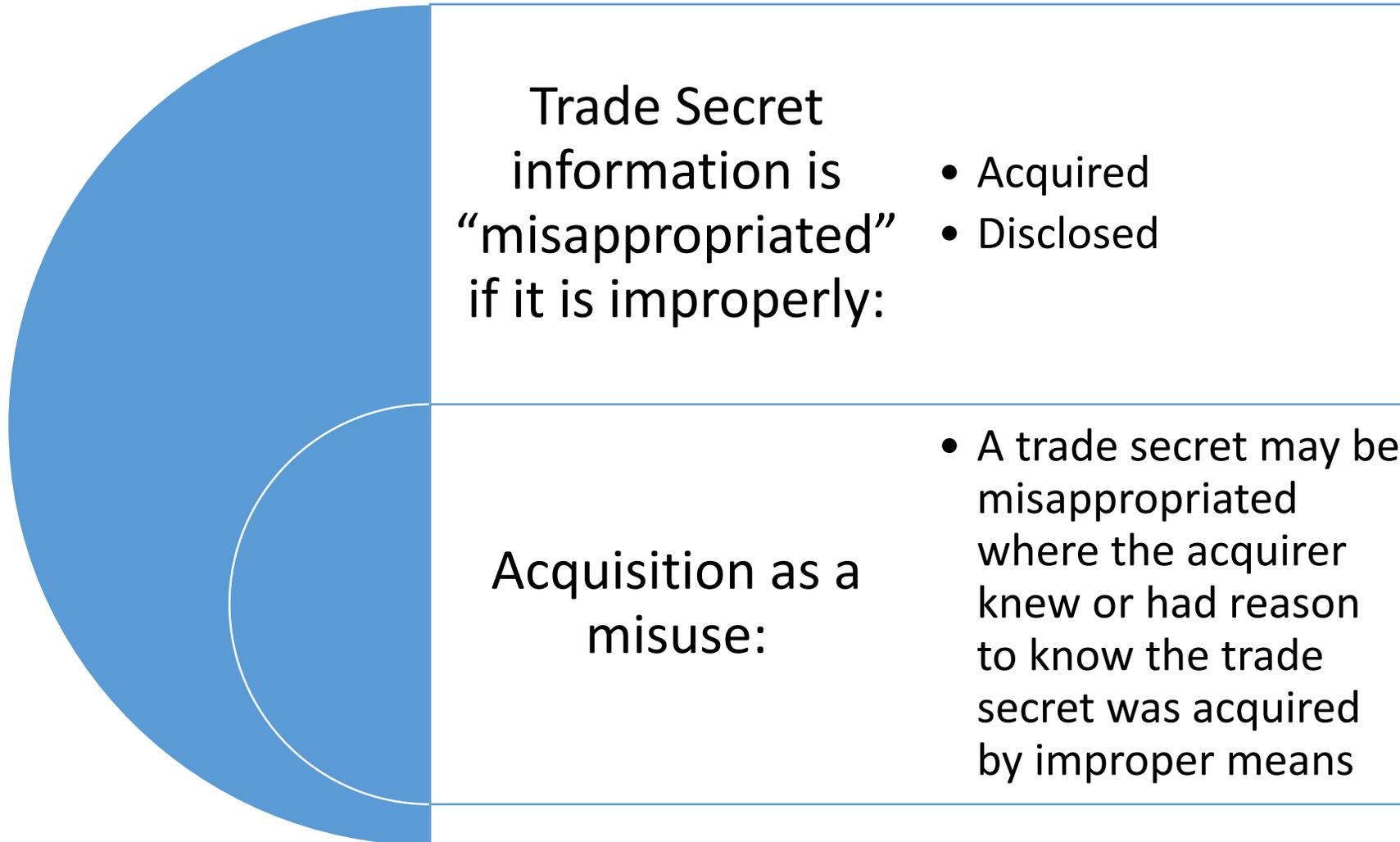
However, measures must be taken to preserve secrecy, such as entering into an appropriate confidentiality agreement that binds the other parties to secrecy.

# What is Trade Secret Misappropriation?

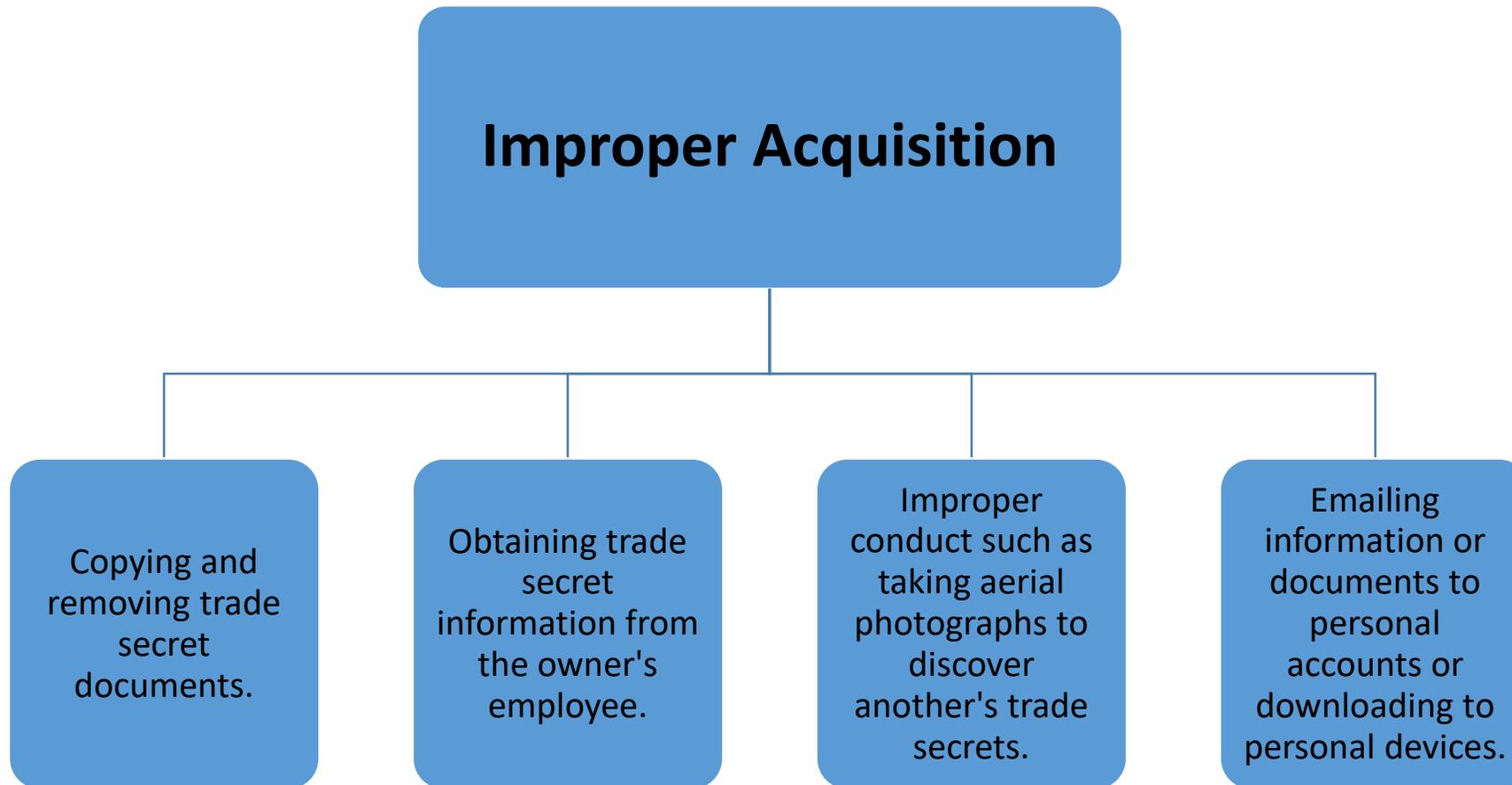
Disclosure or use of another's trade secret without consent constitutes misappropriation where acquirer:

- Used improper means to acquire trade secret;
- Knew or had reason to know at the time of the disclosure or use that the trade secret
  - Derived from a person who used improper means to get it;
  - Acquired it under circumstances giving rise to a duty to maintain its secrecy or limit its use; or
  - Derived from a person who owed a duty to maintain its secrecy or limit its use; **OR**
- Before a material change of position, knew or had reason to know that
  - Information was a trade secret; and
  - Knowledge of information had been acquired by accident or mistake

# UTSA: Misappropriation



# Common Types of Misappropriation



# How to Prove Improper Means for Misappropriation

A variety of evidence may be used to raise an inference of **improper use** given difficulty of direct proof, such as evidence that:

- The defendant had access to plaintiff's trade secret;
- The defendant's design mirrors the plaintiff's design;
- The defendant could not have discovered the intricate details of the plaintiff's design independently or through reverse engineering from publicly available material;
- The defendant's design configuration is one of many that were possible and matches the plaintiff's design; or
- The defendant designed the product in less time than typically required to complete the trial and error process of independent derivation or reverse engineering.

# UTSA: Improper Means

Improper means under the UTSA includes:

- Theft
- Bribery
- Misrepresentation
- Breach or inducement of a breach to maintain secrecy
- Espionage through electronic or other means

Improper means does not mean:

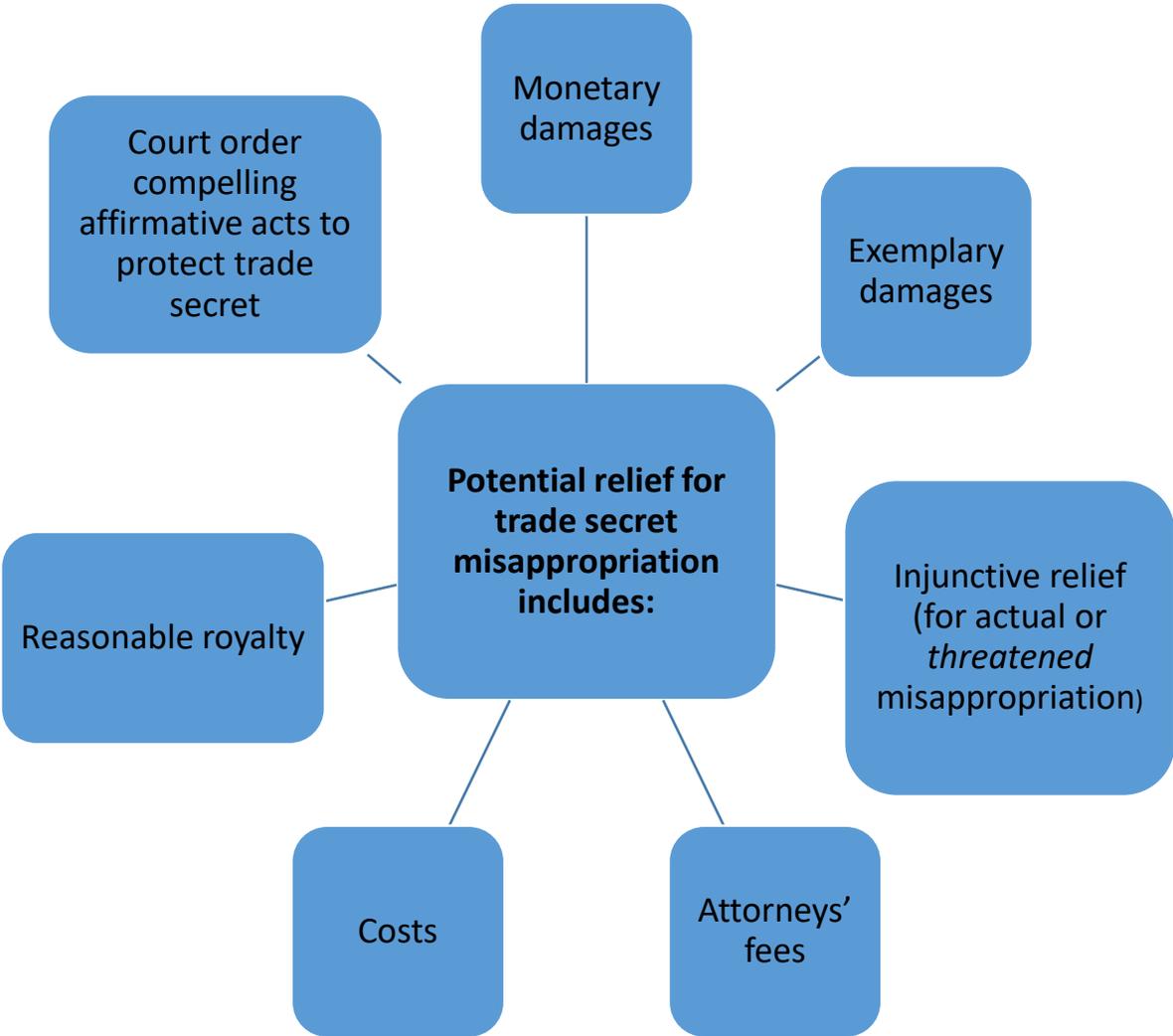
- Independent development

# Liability For Misappropriation

## Improper Disclosure:

- Liability even if disclosure is inadvertent because UTSA does not require intent.
- Liability even if did not directly or indirectly participate in acquisition of the trade secret.
- No need to show that defendant **used** the trade secret for liability to attach for improper disclosure

# UTSA: Trade Secrets Remedies



# Step-by-Step Guide to Non-Compete and Trade Secrets Litigation

- Phone call from client:

“High level employee is leaving to go to competitor!”

- Preliminary considerations:

- Did the employee have a non-compete?
- Did the employee have access to trade secrets?
- Did the employee misappropriate trade secrets?
- What is the jurisdiction?
- How important is employee?
- Are customers involved?
- Is it important enough to litigate?
- What is the risk of harm?

# Step-by-Step Guide to Non-Compete Litigation

## ■ Step 1: Compile and preserve factual information

- Interview business people
- Find out exactly what the employee's job entailed
  - What was the employee's relationship to customers?
  - Did the employee have access to confidential information?
    - *What kind?*
    - *Why is it important?*
    - *Is it non-public?*
- Identify the steps you take to protect confidential information
- Secure laptop, hard drive and devices
- Review employee's emails, internet and phone activity
- Begin organizing any information that may need to be produced in (expedited) discovery

# Step-by-Step Guide to Non-Compete Litigation

## ■ Step 2: Put a Story Together

*The narrative of “bad conduct” matters*

- Is the other company actually a competitor?
- Is the employee trying to solicit other employees or customers?
- Similar job position, duties or responsibilities as the competitor?
- Focus on “facts” highlighting the need to protect legitimate business interests
  - Any theft or misappropriation?

# Step-by-Step Guide to Non-Compete Litigation

- Step 3: File Pleadings to Enforce the Agreement
  - Complaint
  - Affidavits in Support of Complaint or Verified Complaint
  - Motion for Temporary Restraining Order (TRO)
  - Memorandum of Law in Support of TRO
  - Motion for Expedited Discovery and Discovery Requests
  - Notices of Motions
  - Bond
  - Motion for Preliminary Injunction

# Temporary Restraining Order Timeline



# Step-by-Step Guide to Non-Compete Litigation

- Step 4: Preliminary Injunction Evidentiary Hearing
  - Mini-trial on the merits
  - Live witnesses, deposition excerpts, exhibits
  - May need to utilize expert testimony
  - Could last 1 to 5 days

# Recent Developments in Restrictive Covenant, Trade Secrets and Non-Compete Law

- Two major Illinois court decisions in recent years have reshaped the analysis.
  - *Fifield v. Premier Dealer Services* muddied the waters as to the “consideration” analysis for non-competes
  - *Reliable Fire Equipment Co. v. Arredondo* broadened the concept of “protectable interests” – that is, what constitutes a legitimate business interest

# Recent Developments in Restrictive Covenant, Trade Secrets and Non-Compete Law

- What constitutes sufficient consideration in at-will employment relationships after *Fifield v. Premier Dealer Services, Inc.*, 993 N.E.2d 938 (Ill. App. Ct. 2013)
  - Employee entered into a two year post-employment non-competition agreement with his employer and resigned three months later to work for a competitor
  - The Illinois Appellate Court held that the non-competition agreement was unenforceable
  - The Court analyzed continued employment as consideration for a restrictive covenant under an *at-will* employment relationship

## *Fifield v. Premier Dealer Services, Inc.*

- In *Fifield v. Premier Dealer Services, Inc.*, the Illinois Appellate Court established:
  - When continued employment is the consideration for a restrictive covenant, there must be at least *two years* or more of continued employment to constitute adequate consideration.
  - This is true even if the employee voluntarily resigns
  - Court did not directly address fixed term employees but instead focused on at-will employment relationships

# *Fifield v. Premier Dealer Services, Inc.*

## ■ Implications for Employers

- Continued employment is not sufficient consideration for a restrictive covenant in an at-will relationship unless
  - there has been at least two years of continued employment
- Decision does not address the validity of restrictive covenants supported by other forms of consideration:
  - such as salary increases, bonuses or other cash payments granted at the time of, and in exchange for, the employee's signature on a non-competition or non-solicitation agreement

# Recent Developments in Restrictive Covenant, Trade Secrets and Non-Compete Law

- Enforceability of Non-Competition Agreements Under Illinois Law  
After *Reliable Fire Equipment Co. v. Arredondo* No. 11 IL 111871 (Ill. Dec. 1, 2011)
  - Illinois Supreme Court Clarifies the Applicable Standards for Enforcement of Restrictive Covenants
  - In particular, what are “protectable interests”?

# *Reliable Fire Equipment Case*

In *Reliable Fire Equipment*, the Illinois Supreme Court:

- Rejected lower court precedent questioning the application of the “legitimate business interest” test
- Reaffirmed the three-prong test used to assess the reasonableness of restrictive covenants
  - whether restraint protects a legitimate business interest;
  - whether it causes an undue hardship on employee; and
  - whether it will injure the public
- Clarified that “legitimate business interests” are not limited to confidential information and near-permanent customer relationships, but must be assessed case-by-case based upon the *totality of the circumstances*

# *Reliable Fire Equipment Case*

## *Prior to Reliable Fire Equipment:*

- Confusion in the appellate courts regarding whether employers were required to establish a legitimate business interest
- Only two legitimate business interests recognized by the courts:  
(1) confidential information; and (2) near-permanent customer relationships
- *Sunbelt Rentals, Inc. v. Ehlers*, 394 Ill. App. 3d 421 (4th Dist. 2009) went so far as to reject the legitimate business interest test altogether

# Background of *Reliable Fire Case*

- *Reliable Fire Equipment* involved the alleged breach of a non-competition agreement by two salespersons who formed a competing business while still employed
- Circuit court found the restrictive covenant unenforceable for lack of a “legitimate business interest”
- Appellate court affirmed
- Supreme Court reversed and remanded, finding the “legitimate business interest test” is still viable, but was misapplied by the trial court

# *Reliable Fire Equipment Case*

- *Reliable Fire Equipment* “emphatically” overruled *Sunbelt Rentals* and reaffirmed the legitimate business interest test as a component of the three-prong reasonableness standard
- The Supreme Court rejected the notion that “legitimate business interests” are limited to confidential information and near-permanent customer relationships
- Instead, “whether a legitimate business interest exists is based upon the totality of the facts and circumstances of the individual case”

# *Reliable Fire Equipment Case*

- The Legitimate Business Interest Test  
*After Reliable Fire Equipment*

- Factors to be considered:

- Employee's acquisition of confidential information
- Near-permanence of customer relationships
- Time and geographic scope of restrictions

“No factor carries any more weight than any other, but rather its importance will depend on the specific facts and circumstances of the individual case.”

# Reliable Fire Equipment Case

## ■ Implications for Employers

- *Reliable Fire Equipment* grants considerable discretion to trial courts in determining what constitutes a legitimate business interest
- Increased discretion may make it easier for employers to enforce non-competition agreements, assuming *Fifield* is satisfied
- However, increased discretion also means greater uncertainty:
  - “appellate court precedent for the past three decades remains intact but only as non-conclusive examples...”
  - “The same identical contract and restraint may be reasonable and valid under one set of circumstances, and unreasonable and invalid under another set of circumstances.”

# Drafting Enforceable Covenants: Best Practices

- Do not rely on “one size fits all” forms
- Know the applicable jurisdiction’s law
  - *Many states have peculiar requirements (e.g., Wisconsin, Texas, now Illinois) or guidance in precedent*
- Work to narrowly draft non-compete and non-solicit agreements at the outset
- Limit breadth to no more than necessary to protect the employer’s legitimate business
  - *Geography, time and activity*
- Evaluate “consideration” needed for enforceable agreement
  - *Continued employment may not be enough after Fifiield*

# Drafting Enforceable Covenants: Drafting Tips

- Include a severability clause
  - Provides that the invalidity of one provision shall not affect the validity of any other provision
- Include a “blue pencil provision”
  - Authorizes and requests any reviewing court to revise an otherwise overbroad restriction
- Acknowledge that the employee will be provided access to confidential information and/or trade secrets
  - May include this as an additional basis of consideration as well
- Include other acknowledgments of the legitimate interests of employer in protecting confidential information and/or trade secrets
- If employee is also signing an arbitration agreement, ensure it carves out an exception for injunctive relief

# Protecting Confidential Information – Preventative Measures

- Beyond non-competes and outright covenants, consider other measures:
  - Forfeiture for competition clauses (must be structured carefully so as to not forfeit “earned” compensation)
  - Confidentiality and non-disclosure provisions in handbooks
  - Stand-alone confidentiality and non-disclosure agreements
  - Training
  - Limited access to certain information “need to know basis”

# Considerations When Hiring

- Employers need to be careful when hiring candidates who have non-competition agreements with their former employers
  - Carefully assess the enforceability of the restrictive covenants
  - Gather background information regarding the individual candidate's work for the prior employer—but be careful there is no solicitation of confidential information or trade secrets
  - Counsel new employees in writing against soliciting near-permanent customers of their former employers
  - Consider *why* the company is interested in the candidate
  - Carefully consider whether to hire a candidate within the term of an enforceable non-competition agreement

# Thank You!

## Questions?

