

Cornell University
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Labor and Employment Law

*Trade Secrets, Covenants, and Employee Movement - Employee's Perspective*¹

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The Impact of Trade Secrets on Employees

In an effort to gain a competitive edge, companies frequently seek to develop strategies, processes, equipment or other information secret. These can take the form of chemical compounds (e.g., transparent aluminum), food recipes (e.g., Coca-Cola, Dr. Pepper), marketing and pricing plans, brake assemblies, or customer lists. Sometimes the information the companies claim to be confidential is unworthy of protection because the information is well-known. Sometimes, the information is a trade secret and worthy of protection under the law as a property interest.

In today's workplace, technology is advancing at break-neck speed. In addition, consumers are spending less. The mixture of these two factors is causing increased competition for the money that is being spent, and you have a recipe for employers willing to do almost anything to keep any competitive edge – or to gain one.

Employers frequently ask their employees to keep information gained while working for the company in confidence and not share it with those outside of the company. This usually takes the form of confidentiality agreements. These agreements tend to be broad in scope; however, courts in New York are only willing to enforce the agreement if it is reasonable. Asking an employee not to share the ingredient that makes a snack food irresistible is one thing; asking an employee not to share how long to cook a hamburger patty before flipping it to the other side is quite another. In one instance, a court may prevent an employee from working for a competitor; in the other, the court may void the confidentiality agreement entirely.

Even in the absence of a confidentiality agreement, a company can still prevent its employees from working at competitors if the employee has knowledge of the company's trade secrets. In such instances, a court may enjoin an employee from working for its employer's competitors, even if the employee has not inappropriately acquired knowledge of the trade

secret. Such an injunction can be devastating to the employee's ability to earn a living.

In these situations, the courts seek to strike a balance. On one side of the scale sits the employer who has spent time, money, and other resources developing information in order to gain a competitive edge in the marketplace. The ability to compete can be seriously jeopardized if such information is leaked to competitors. On the other side of the scale sits the employee who must work to survive. The employee has often developed skills over a long career in a particular field or trade. If the employee can never work for a competitor, his ability to earn a livelihood, and use those skills he developed to bargain for a better position, is severely curtailed. Forcing an employee to choose between staying at his current position or starting afresh in a completely different field is a form of forced labor that courts are unwilling to impose.

The purpose of this presentation is to examine the options available to an employee who is confined to confidentiality agreement, or – in the worst-case scenario – finds himself staring down the barrel of temporary restraining order preventing him from taking a new position at competitor of his former employer.

When Working with a Non-disclosure or Non-competition Agreement

To start, many employers these days require employees to sign agreements not to disclose confidential information with anyone outside of the company. These agreements are generally enforced if they are reasonable in scope and impose only those restrictions necessary to protect the employer.

The general rule in New York for restrictive covenants – whether non-compete, non-solicitation, or confidentiality agreements – is that they must be reasonable in scope both temporally and geographically. *See Columbia Ribbon & Carbon Mfg. Co. v. A-I-A Corp.*, 42 N.Y.2d 496, 339 N.E.2d 4 (1977). A covenant that prevents an employee from revealing confidential information is enforceable only if the information is actually confidential. If an

employer cannot demonstrate that the information it seeks to protect is confidential or that the information is unique or extraordinary, a court will not enforce the confidentiality agreement. *Genesis II Hair Replacement Studio Ltd. v. Vallar*, 251 A.D.2d 1082, 1083, 674 N.Y.S.2d 207, 208 (4th Dep't 1998). Generally, in order to demonstrate that information is confidential, the employer must meet the definition for a trade secret, "any formula, pattern, device or compilation of information which is used in one's business, and which gives him an opportunity to obtain an advantage over competitors who do not know or use it." R.3d Torts § 757 cmt. b. *See also Ashland Management v. Jainen*, 82 N.Y.2d 395, 402, 624 N.E. 1007, 1013 (N.Y. 1993); *and N. Atl. Instruments, Inc. v. Haber*, 188 F.3d 38, 44 (2d Cir. 1999). If the information is not confidential, an employer cannot prevent an employee from disclosing it.

Employers frequently attempt to prevent employees from disclosing customer lists. Such agreements are only enforceable, however, if the list is not obtainable from public sources. *CarpetMaster of Latham Ltd, v. Dupont Flooring Sys., Inc.*, 12 F. Supp. 2d 257, 262 (N.D.N.Y. 1998). However, if the customer list is comprised of information that is not ascertainable from outside sources and is based upon past dealings, the courts may find the information worthy of protection. *N. Atl. Instruments, Inc. v. Haber*, 188 F.3d 38, 44 (2d Cir. 1999); *John Hancock Mut. Life Ins. Co. v. Austin*, 916 F. Supp. 158, 164-65 (N.D.N.Y.1996).

For example, the customer list of a soy sauce distributor who services Chinese restaurants on Long Island is not worthy of protection because the restaurants can be found in the phonebook. However, a company that makes customized electronic devices that are made-to-order for specific engineers who work for defense contractors would have a customer list that a court would likely protect.

In the Absence of Any Signed Agreement.

It is possible for an employer to prevent its employees from working for competitors even

without forcing the workers to sign non-disclosure or non-compete agreements. These generally fall into two categories: (1) when the employee misappropriates information to compete with their former employer ; and (2) when it is inevitable that an employee would divulge confidential information while working for a competitor.

Misappropriation and the Duty of Loyalty

The easier case to deal with is the employee who uses information from a former employer specifically to compete with that employer. New York imposes upon employees a duty of loyalty not to use an employer's confidential information in competition with the employer if the competition climate is still occurring after the employment relationship has ended. *Byrne v. Barrett*, 268 N.Y. 199, 199, 197 N.E. 217, 218 (N.Y. 1935). Courts are more willing to enjoin a former employee from competing with his employer if the worker purposefully took information, such as files or confidential information. *UFG Int'l, Inc. v. DeWitt Stern Group, Inc.* 225 B.R. 51, 57-58 (S.D.N.Y. 1998) (dicta). Using an employer's confidential information to compete with that employer can result in a *permanent* injunction against the employee not to use the confidential information. *CTC Commc'ns, Inc. v. Bell Atl. Corp.*, 14 F. Supp. 2d 133, 144-45 (D. Me. 1998) (applying New York substantive law).

However, if the information is not confidential, an employee may utilize it when competing with the former employer. An employee who uses document templates developed by a former employer while working for a competitor has not breached the duty of loyalty if the documents were made available to the public. *Innovative Networks, Inc. v. Young*, 978 F. Supp. 167, 180-81 (S.D.N.Y.). Likewise, if an employee leaves with his rolodex of customer contacts, he has not violated his duty of loyalty if those customers' names were obtainable from other sources. *Id.*

The “Inevitable Disclosure Doctrine”

When dealing with a situation where an employer fears that an employee’s mere knowledge of confidential information will harm the business if the employee works for a competitor, courts look to the “inevitable disclosure” doctrine. This occurs when an employee develops intimate expert knowledge of an employer’s confidential information in a narrow technological field. If such an employee goes to work for a competitor in the same field in a substantially similar position, it is impossible for the employee to “forget” or refrain from relying upon the confidential information. *See EarthWeb, Inc. v. Schlack*, 71 F. Supp. 2d 299, 309 (S.D.N.Y. 1999). A descriptive analogy of the former employer’s predicament is “a coach, one of whose players has left, playbook in hand, to join the opposing team before the big game.” *PepsiCo., Inc. v. Redmond*, 54 F.3d 1262, 1270 (7th Cir. 1995). Such a doctrine is obviously quite devastating to an employee who is enjoined from *ever* working in competition with a former employer. As a result, absent evidence of actual misappropriation, it should be applied only in the rarest of cases. *EarthWeb, Inc. v. Schlack*, 71 F. Supp. 2d 299, 309 (S.D.N.Y. 1999). Factors a court will consider before enjoining an employee from working for a competitor are whether: (1) the employers in question are in direct competition providing the same or similar products or services; (2) the employee’s new position is virtually identical to the old one such that he could not fulfill his new job responsibilities without relying on his former employer’s trade secrets; and (3) the trade secrets are highly valuable to both employers. *Id.* at 310.

EarthWeb involved a former vice-president of content at the internet company EarthWeb, named Schlack, who sought to leave the company and work for a rival, ITWorld.com. His role at EarthWeb largely dealt with editing website content, as would his new role at ITWorld.com. EarthWeb sought to enjoin his employment at ITWorld on the basis that Schlack had access to trade secrets involving technology and licensing. The court refused to grant the injunction

because there was no evidence that Schlack's new position was involved in any areas where he would use the supposed trade secrets described by EarthWeb.

In *PepsiCo., Inc. v. Redmond*, 54 F.3d 1262 (7th Cir. 1995), a General Manager at Pepsi, Redmond, was courted to work for Quaker. Quaker produces "Gatorade" and Pepsi was launching its rival sport-drink "All Sport." Pepsi sought an injunction preventing Redmond from working for Quaker because he had intimate knowledge of Pepsi's "pricing architecture" goals for the upcoming sales year. The district court granted the injunction and the Seventh Circuit affirmed. The reason for the court's grant of the injunction was that if Quaker had access to the pricing architecture goals for the upcoming year, they could gain an advantage against Pepsi by designing its own pricing architecture to directly undercut Pepsi's efforts.

The decision in *PepsiCo* does not undermine the notion that inevitable disclosure should be used sparingly absent any evidence of deliberate misappropriation. The court in *PepsiCo* only enjoined Redmond from joining Quaker until the sales year ended. It further enjoined him from using any of Pepsi's trade secrets while employed at Quaker, but it allowed him to work once the imminent danger of the then-present sales year competition had passed.

Combating an Effort to Enjoin an Employee from Working for a Competitor

At the outset, a major determination is whether the employee in question signed a non-compete or non-disclosure agreement. An employee would be advised to try to negotiate terms into such agreements, if at all possible, to protect herself should a disagreement occur later. One provision might state that if a question arises as to whether the employee has violated the agreement by working for another employer, the former employer will continue to pay her salary until the matter is resolved.

If an agreement exists and the former employer is threatening to enjoin the employee, she can draw first blood by seeking a declaratory judgment that the agreement is unenforceable. Of

course, such a maneuver is probably cost-prohibitive for an individual. Should the employer file suit first and request a TRO to prevent the employee from working for a competitor, the employee could request the court to fashion the TRO so that she continues to receive a salary from her former employer until such time as the merits of the former employer's claim is determined. This was the nature of the TRO the district court fashioned in *EarthWeb*. Not only is such a move equitable, the possibility that an employer may have to continue paying the employee's salary *and* pay for its lawyers to argue the TRO and injunction might just bring the company to the bargaining table in quick fashion.

In the absence of any agreement, an employee can avoid being enjoined from working for a competitor by challenging that she did not have access to confidential information. If such an argument lacks merit, another strategy is to attack the confidential nature of the information. If the information is not a trade secret, the employer has no property interest in protecting it. Understandably, the more complex the technology and the greater the skill needed to work for an employer increases the chance that its information and processes will be held as a trade secret.

The burden is on the person seeking trade secret protection to prove the information is secret. *See Kaumagraph Co. v. Stampagraph Co.*, 235 N.Y. 1, 8, 138 N.E. 485, 487 (N.Y. 1923). Fortunately, this eases the burden on the individual employee somewhat who merely needs to counter the employer's claim. The factors a court considers when determining if information qualifies as a trade secret are:

- (1) the extent to which the information is known outside of [the] business;
- (2) the extent to which it is known by employees and others involved in [the] business;
- (3) the extent of measures taken by [the business] to guard the secrecy of the information;
- (4) the value of the information to [the business] and [its] competitors;
- (5) the amount of effort or money expended by [the business] in developing the information;
- (6) the ease or difficulty with which the information could be properly acquired or duplicated by others.

R.3d Torts § 757 cmt. b. *See also Ashland Management*, 82 N.Y.2d at 402, 624 N.E. at 1013.

If information is generally well-known, it obviously cannot qualify as a trade secret. However, simply because information is well-known in an *industry*, but other companies in the industry also keep it a secret, does not strip it of protection as a trade secret. *See Faiveley Transp. Malmö AB v. Wabtec Corp.*, 572 F. Supp. 2d 400, 404 (S.D.N.Y. 2008) *vacated on other grounds by* 559 F.3d 110 (2d Cir. 2009).

If an employee can demonstrate that everyone in the company knew the information that is alleged to be secret, it is less likely a court will find it worthy of protection. Information left unprotected on a centralized computer and accessible to everyone is not worthy of trade-secret status. *Downtown Women's Ctr., Inc. v. Carron*, 237 A.D.2d 209, 655 N.Y.S.2d 479 (1st Dep't 1997). If the information was known to only two engineers who worked in a secluded room, the information is more likely to be protected. If the employee can show that employees who had no need to know the information were familiar with it, the court will likely deny protection.

On the heels of general knowledge in the company, an employee can prevail if he can show the employer took no efforts to keep the information secret. One means of proof is if the employer never told the employees that the information was proprietary. *Millennium Expressions, Inc. v. Chauss Mktg. Ltd.*, No. 02 Civ. 7545 (JCF), 2007 U.S. Dist. LEXIS 22861 at *26 (S.D.N.Y. March 30, 2007). In addition, if previous employees were able to leave with the supposedly confidential information without suffering any recourse, the employer obviously did not view the information as terribly confidential. *Int'l Creative Mgmt., Inc. v. Abate*, No. 07 Civ. 1979 (PKL), 2007 U.S. Dist. LEXIS 22964 at *14 (S.D.N.Y. March 28, 2007).

There is little case law on attacking the value of the information to the business. Most likely because this element is tied to other factors such as the expense in developing the information and whether or not the information is obtainable from outside sources, (which is discussed below). Understandably, any employer willing to take a former employee to court to

protect the information will likely claim that the information is an extremely valuable asset to the business. This will be the claim that most individual employees will have difficulty countering unless they have evidence to the contrary. Moreover, if the employee can successfully disprove other elements, that can work to disprove the value of the information. Information that an employer does not take pains to protect is obviously not considered very valuable by that employer. After all, one keeps candy from the dime-store on the coffee table and jewelry from Tiffany's in the safe.

If the employer expended little or no effort or resources to develop the information, it is less likely to be held as a secret. An employer who merely bought a bakery, but spent no effort developing its recipes was not entitled to protect the recipes as trade secrets. *WGJ Holdings, Inc. v. Greenburg*, No. 07 Civ. 2742 (WHP), 2008 U.S. Dist. LEXIS 850 at *9 (S.D.N.Y. Jan. 8, 2008). As a result, an employer who is a subsequent purchaser of a company that developed the information is less likely to prevail on this point. However, if the employer paid a large amount specifically for the information at question, it proves the prior point that the information was valuable to the company.

Perhaps the greatest advantage to showing that information is unworthy of protection is by showing how it can be obtained by outside sources. This is usually why claims seeking protection for customer lists often fail. See *CarpetMaster of Latham*, 12 F. Supp. 2d at 262; *H. Meer Dental Supply Co. v. Commisso*, 269 A.D.2d 662, 664, 702 N.Y.S.2d 463, 465 (3d Dep't 2000). The fact that information can be obtained from outside sources can even prevent a customer list from achieving trade secret protection even if the list was developed at great expense. *Atmospherics, Ltd. v. Hansen*, 269 A.D.2d 343, 343, 702 N.Y.S.2d 385, 386 (2d Dep't 2000).

The fact that a trade secret can be discerned is its weakness, particularly when compared

to patent protection. *See Kewanee Oil Co. v. Bicron Corp.*, 416 U.S. 470 (1974). A trade secret can be legally discovered by a competitor using reverse-engineering whereas such a discovery does not allow a competitor to make use of patented information. *Id.* While an individual employee will rarely have the resources to demonstrate in court that information can be obtained through such a process as reverse-engineering, an employee can show that the employer sufficiently exposed the supposedly confidential information to the public to an extent that the information is easily discernable. *See Frink Am., Inc. v. Champion Rd. Mach. Ltd.*, 48 F. Supp. 2d 198, 207 (N.D.N.Y. 1999).

In short, the employer bears the burden of proving the information is proprietary and deserving of trade-secret protection. When faced with a situation of a client who is threatened with an injunction, their counsel should inquire about the alleged information with an eye toward countering the employer's argument that the information should be protected.

Even if a court determines that the employer's information is a trade secret, the injunction ordered should tailor specifically to protect the employer's secret and impose no greater restraint on the employee – unless the employee purposefully took proprietary information to compete with his former boss. As shown in *PepsiCo*, the employee may be enjoined for a period of time, but the courts are unwilling to completely prevent the employee from earning a living.

Conclusion

An employee signed to a restrictive covenant, whether regarding competition or non-disclosure, is not completely foreclosed from remaining desirable in the job market. Courts in New York do not enforce such agreements lightly and careful consideration is given the employee's ability to earn a livelihood.

When faced with a possible TRO or injunction, an employee can fight back immediately by asking the court that the former employer pay a salary while the TRO is in place. This

counter-attack ensures the employer will quickly seek a hearing on the merits, or may avoid the process all together.

When it comes to the merits of whether the information is confidential, the employee does enjoy the easier burden of merely attacking the employer's assertions regarding how secret the information is. There is no burden on the employee to prove there is no secret; although, a wise attorney would do so in any event.

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