

Trade Secrets: The Importance Of Evaluating Confidential Business Information On An On-Going Basis

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Most people engaged in business are aware that sensitive information they develop and use can be classified as a "trade secret" and entitled to certain protections under the law. One of the reasons "trade secret" protection is especially important is that it can apply to business information that does not otherwise constitute protectable intellectual property. For instance, items that may not be entitled to patent protection but that nonetheless have significant commercial value may be protected as trade secrets.

The potential breadth and flexibility of trade secret protection, however, may be lost on companies that, as a result, may lose protections to which they are entitled. Specifically, because such a broad range of sensitive business information may be classified as trade secrets without the necessity of resorting to the procedures required by some other forms of intellectual property, companies may not be thinking about exactly what trade secrets they have until they feel compelled to file a lawsuit.

Although there may be a tendency to avoid thinking critically about potential trade secrets, North Carolina law makes clear that companies that identify trade secrets with precision on an on-going basis will be in the best position to efficiently and effectively enforce their rights in the event the need to litigate arises. Specifically, the North Carolina courts have reinforced the requirement that a company filing a trade secrets lawsuit identify early on in the lawsuit, and with specificity, the alleged trade secrets that are the subject of the dispute.

The Broad Definition of Trade Secrets

The flexibility and potentially broad coverage of trade secret protection is evident from the definition of a trade secret. The North Carolina Trade Secrets Protection Act ("Act") defines a "trade secret" as:

[B]usiness or technical information, including but not limited to a formula, pattern, program, device, compilation of information, method, technique, or process that:

- a. Derives independent actual or potential commercial value from not being generally known or readily ascertainable through independent development or reverse engineering by persons who can obtain economic value from its disclosure or use; and

b. Is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.

N.C. Gen. Stat. § 66-152(3).

This definition can, and does, include a wide array of business information. Furthermore, unlike statutes governing other types of intellectual property, the Act contains no procedure requiring companies to apply or register for trade secret protection relating to specific items or information.

Due to the broad definition and lack of procedure associated with trade secrets, companies may not be asking themselves on a regular basis: "What information do we have that could be a trade secret?" Actively considering this question, however, is key to a company's ability to fully utilize the protections afforded under the Act.

If a company is not continually identifying its trade secrets, it may find itself in a situation where:

- The company knows a competitor is using the company's own "secret" or confidential information developed by it to compete against it;
- The company wants to bring a lawsuit to prevent its competitor from using this information; but,
- The company is not prepared to articulate exactly what information is included in the company's trade secrets and why that information is entitled to protection.

As the cases discussed below demonstrate, a company's inability to identify its alleged trade secrets with specificity early in the case will jeopardize its chances of stopping a competitor from using its confidential information to compete against it.

Consequences of Failing to Identify Trade Secrets: Case Studies

One good example of a North Carolina case illustrating the need to identify trade secrets with specificity involved a bank's claim for trade secret misappropriation against two former senior vice presidents who had left the bank after a merger. The former employees later accepted employment at a competing bank.

In its complaint, the bank alleged that the two former senior vice presidents had "acquired knowledge of [the bank's] business methods; clients, their specific requirements and needs; and other confidential information pertaining to [the bank's] business." The bank also alleged that the "'confidential client information' and 'confidential business information' constituted trade secrets as defined by the [Act]."

The North Carolina Court of Appeals found that the statements described above did "not identify with sufficient specificity...the trade secrets [the former employees] allegedly misappropriated." Due to this failure to identify specific trade secrets, the Court decided that it was proper to dismiss the bank's trade secrets lawsuit.

A second North Carolina case reached a similar result. In that case, a company that repairs and services jet engines brought a misappropriation of trade secrets claim against one of its former managers. The company made a general argument that the former manager had violated the Act by "wrongfully misappropriating and using [the company's] trade secrets." When pressed to identify the precise trade secrets allegedly misappropriated, the company's Executive Vice President testified that: "I don't know what he shared with anyone else. All I know is that he offered to share at least [our] business...information with third parties, including our customers' vendors and what we consider to be competitors."

The company's inability to identify the specific information that it believed to be trade secrets doomed its ability to prevent its former manager from using that information. The North Carolina Court of Appeals ruled that the company had no claim under the Act because it could not "identify the specific information which it

argues constituted trade secrets and that it claims [the former employee] misappropriated."

Properly Identifying Trade Secrets: A More Productive Case Study

A third case, decided by the United States District Court for the Middle District of North Carolina, provides an example of the type of specificity that does satisfy a company's burden to identify its trade secrets with particularity. In that case, the defendant was the former Vice President of Sales for the plaintiff company, a supplier of accessories for iPods®, MP3 players, and mobile phones. As Vice President of Sales, the defendant managed a team of employees that sold the company's products to customers such as Best Buy®. He terminated his employment with the plaintiff and started a competing company.

The plaintiff claimed that the former Vice President had misappropriated the plaintiff's trade secrets in furtherance of his efforts to compete with it. In identifying the trade secrets it claimed were misappropriated, the plaintiff put forth evidence that the former Vice President, at least, had:

- "[A]ppropriated [the plaintiff's] 2008 business plan as a template for the business plan" of the defendant's new competing company;
- "[S]ecretly distributed [the plaintiff's] confidential financial calculator, which [the plaintiff] used to evaluate the profitability of its products"; and,
- [P]repared a PowerPoint presentation "using select market data analysis that [the plaintiff] had identified and ordered from a third party."

The Court ruled that, with respect to the above items, the plaintiff had identified its alleged trade secrets with sufficient particularity.

The lessons from these cases are clear: companies need to know specifically:

- To what confidential information their employees have access; and,
- How they are using it.

Companies showing this level of vigilance will be in a far better position to protect their trade secret information in the event it finds its way to a competitor.

The Need to Actively Protect Trade Secrets: Another Reason Companies Need to Identify Potential Trade Secrets on an On-Going Basis

Also critical to the determination of whether particular information qualifies as a trade secret is whether the information has been "the subject of efforts that are reasonable under the circumstances to maintain its secrecy." Information will not meet the definition of a trade secret unless affirmative steps are taken by the company creating it to protect the secrecy of that information. Although it stands to reason that a company would want to guard the confidentiality of information it believes are its trade secrets, if it is not thinking actively about what trade secrets it has, it might not know what information it needs to protect and, as a result, be unable to prove what steps it actively took to protect it. The North Carolina cases addressing this issue, once again, demonstrate the importance of thinking actively about trade secrets.

For instance, in one case, the North Carolina Business Court focused on the fact that a company had not taken any efforts to protect the confidentiality of its rate information in finding the rate information was not a trade secret. Specifically, the Court focused on testimony explaining that "when a customer becomes aware of [the company's] rate schedule, the customer is not required to sign anything agreeing to keep that information confidential." The Court also observed that although the company "only communicates a quote or rate to its customer, it does not instruct that customer to refrain from sharing that rate information with others."

Finally, the Court found that the "rate information [was] kept in an unlocked file room, accessible to anyone" and that "anybody could access the information in the...rate files." Therefore, the Court ruled that the rate information was not entitled to trade secret protection.

On the other hand, the company in the third case discussed above had taken considerably more steps to guard the confidentiality of its trade secrets. Specifically, it required, among other things, that its employees attend ethics training sessions which addressed the importance of safeguarding sensitive business information, and it required employees to sign confidentiality agreements. The confidentiality agreements required that employees agree "not to disclose [confidential] information outside the company or even to make copies of it." Although noting that the company's efforts were not necessarily "robust," the United States District Court found them to be reasonable.

As these cases demonstrate, to obtain trade secret status for its business information, a company must be actively thinking about trade secrets on an on-going basis. This means not only identifying the trade secrets, but also taking steps to protect them. This may include, among other things:

- Requiring employees and customers to sign confidentiality and non-disclosure agreements;
- Limiting access to certain files; and,
- Educating employees as to what information needs to be kept confidential.

Conclusion

To ensure it is able to move quickly and effectively to stop a competitor from using its valuable and confidential business information, a company must be thinking actively about identifying and protecting the information on an on-going basis. If a lawsuit becomes necessary, the company will need to be prepared to identify early on what information its competitor is using that qualifies as trade secret information and what the company has done to protect that information. A company that actively identifies its potential trade secrets on a regular basis will be in the best position to do both.

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