Best Practices for Multistate Employers to Protect Their Confidential Information

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Introduction

Multistate employers face significant challenges when it comes to ensuring that their confidential information does not walk out the door with their employees in this age of high turnover and employee mobility. Having good policies and agreements in place is step one of a multi-step process for protecting that information. However, many employers stop at step one, which will not alone accomplish the intended goal. This session and article will address not only the policies and agreements that are needed, but what other steps to take in the workplace to protect that information and what can and should be done if despite best efforts, that information is taken by a rogue employee and given to a competitor. Before getting to practical advice however, we must examine the legal landscape addressing these issues, which spans trade secret law as well as laws governing employee mobility and restrictions on that mobility.


On May 11, 2016, the federal Defend Trade Secrets Act ("DTSA") was enacted\(^1\). This law expands on the Economic Espionage Act\(^2\), by providing a federal civil remedy for misappropriation of trade secrets. Prior to the enactment of the DTSA, victims of trade secret theft could only bring civil causes of action under state trade secret laws. These laws vary widely despite the fact that many states have enacted some formulation of the Uniform Trade Secrets Act ("UTSA"). The variations in state law led to significant forum shopping when it came to enforcement.

\(^1\) 18 U.S.C. § 1836(b).
The DTSA provides a federal civil cause of action covering any trade secret "related to a product or service used in, or intended for use in, interstate or foreign commerce." There is a three-year statute of limitations which is triggered on the date on which the trade secret misappropriation was discovered or "by the exercise of reasonable due diligence should have been discovered." State law statutes of limitations range from two to six years.

The availability of a federal trade secret cause of action certainly makes interstate trade secret disputes more efficient by reducing choice of law disputes that happen when it is uncertain which state's trade secret law should apply and also provides access to federal courts which are accustomed to addressing sometimes complex issues of formulations and technical information that is often necessary in these cases. However, the DTSA does not preempt state trade secret actions, so forum shopping and choice of law disputes will remain prevalent.

Under the DTSA, an owner of a misappropriated trade secret can bring a civil action if the product or service is used in or intended for use in interstate or foreign commerce. At a high level, to prove a cause of action, trade secret owners must prove (i) the existence of the trade secrets, and (ii) that they were misappropriated.

The DTSA defines trade secrets very broadly, and arguably more broadly than the UTSA. Under § 1839(3), trade secrets include "all forms and types of financial, business, scientific, technical, economic, or engineering information..." but only if there exist "reasonable measures to keep such information secret" and the information derives value from being kept secret. Misappropriation under the DTSA encompasses

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three types of acts: acquisition, disclosure, and use. Specifically, misappropriation is acquisition by someone who knows or has reason to know that the trade secret was acquired by improper means, or disclosure or use of a trade secret of another without express or implied consent.\textsuperscript{5}

Along with providing a federal cause of action, the DTSA affords victims of trade secret theft an ex parte seizure proceeding to prevent the propagation of misappropriated trade secrets. Such an order can be obtained only under "extraordinary circumstances." For a seizure order to issue, the trade secret owner must show, inter alia, that the accused party has actual possession of the trade secret and that an immediate and irreparable injury will occur without the seizure\textsuperscript{6}. This provision allows federal courts to impound trade secrets and avoid propagation or dissemination of a trade secret where there is risk of the defendant leaving the jurisdiction or evading the possibility of an order provided on notice.

Due to its ex parte nature and potentially harsh ramifications, the Act includes a variety of safeguards for the trade secret defendant. These safeguards include (i) a required showing of "extraordinary circumstances"; (ii) limitation to preventing propagation or dissemination; (iii) clear evidence that other forms of equitable relief are inadequate because the defendant is not expected to comply with the order; (iv) proof of immediate and irreparable injury; (v) an order that is the "narrowest seizure of property necessary"; (vi) seized materials taken into the custody of the court with no access; (vii) a date for a hearing within seven days of the order; and (vii) a requirement for security

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\textsuperscript{5} 18 U.S.C. § 1839(5).
\textsuperscript{6} 18 U.S.C. § 1836(b)(2).
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posted by the applicant for the order\textsuperscript{7}. Id. Courts have shown an understandable reluctance to employ the ex parte seizure provisions.

The Act also provides that parties who have been accused of trade secret theft will have a claim for damages as a result of any wrongful seizure and demand the return of any material that was wrongfully seized along with the trade secret information.

The Act provides immunity to employees who disclose trade secrets either to the government for the purpose of reporting or assisting in an investigation of a suspected violation of law, or in a complaint filed in a lawsuit or related proceeding if such a filing is made under seal. Also, an individual who files a lawsuit for retaliation by an employer for reporting a suspected violation of law may reveal the trade secret to his or her attorney and utilize the trade secret information in the proceeding if the person files any document containing the trade secret under seal and does not disclose the trade secret except under court order.

The whistleblower provision contains a notice requirement that applies to any employer that utilizes employment contracts that concern the use of trade secrets. The Act requires employers to "provide notice of the [whistleblower] immunity . . . in any contract or agreement with an employee that governs the use of a trade secret or other confidential information." The employer may instead, provide in the contract a cross-reference to a policy document provided to the employee that sets forth the employer's reporting policy for a suspected violation of law. Employers who neglect to comply with the Act's notice requirements lose the ability to recover exemplary damages and attorneys' fees under the DTSA in actions brought against employees or independent contractors who were not given the notice. This requirement applies to any new

agreements or revisions to agreements made as of May 11, 2016, the date of enactment of the Act. By now, most employers have added this language to all of their employee contracts that contain confidentiality agreements,

**The DTSA and Inevitable Disclosure**

The DTSA restricts the availability of injunctive relief to "prevent a person from entering an employment relationship" and provides that if an injunction were to place conditions on a person's employment, such restrictions must "be based on evidence of threatened misappropriation and not merely on the information the person knows." Further, as determined recently by the 10th Circuit, irreparable harm must be shown to obtain injunctive relief as the DTSA does not "allow a presumption of irreparable harm" because there is no mandated injunctive relief.\(^8\)

This provision effectively rejects the inevitable disclosure doctrine applicable in certain jurisdictions, whereby an employer can enjoin a former employee from working in a new job that would inevitably result in the use of the employer's trade secrets. Under the inevitable disclosure doctrine, an employer does not have to provide evidence of actual or threatened misappropriation of trade secrets, just the former employee's knowledge of such trade secrets. Various states allow use of the “inevitable disclosure doctrine” to show trade secret theft. Where allowed, courts will consider circumstantial evidence, including the level of competition, whether the two positions held by the employee are comparable, and any actions taken by the new employer to prevent use of trade secrets\(^9\). The doctrine has been criticized by some as effectively allowing courts to impose a non-compete on someone who never signed a non-

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\(^8\) See DTC Energy Grp., Inc. v. Hirschfeld, 912 F.3d 1263 (10th Cir 2018)

compete agreement. However, as those of us who practice in this area know, to show that a trade secret has actually been taken is a tall order, and the inevitable disclosure doctrine can be very helpful particularly in high tech workplaces.

Despite 18 U.S.C. § 1836(b)(3), at least one district court has clearly employed the doctrine of inevitable disclosure, albeit in the context of a motion to dismiss. From Molon, therefore, it appears as though an end-run around this provision of the DTSA may be possible -- claims may be filed and a motion to dismiss avoided based on the inevitable disclosure doctrine, which will allow the discovery that could turn up actual theft to be used in the context of an injunction.

**Restrictive Covenants**

The DTSA prohibits the issuance of an injunction which would "conflict with an applicable State law prohibiting restraints on the practice of a lawful profession, trade or business." So, this means that state laws relating to non-competes still trump the DTSA in terms of injunctive relief. The area of restrictive covenants is one where the multistate issue is most troublesome as states vary wildly in terms of whether a covenant is enforceable, what the valid consideration is for such covenant, what the employer interests are that provide a valid basis for the covenant and the specifics around what activity can be restricted and for how long.

To determine the reasonableness of restrictive covenants many courts look at whether the covenant protects a legitimate interest of the employer; whether the covenant imposes an undue hardship upon the employee; and whether the covenant is injurious to the public interest. Courts have identified several protectable employer

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interests, the most prevalent of which are the protection of customer relationships or goodwill and the prevention of disclosure of trade secrets or confidential information. In many states the obtaining of an injunction to prevent irreparable harm has become more difficult, and unless you can prove that a “bad act” has taken place, such as downloading of confidential information onto a thumb drive shortly before departure, courts have become more hesitant about precluding employees from being employed with a competitor in their chosen field. Non-solicits of customers, patients and clients are more likely to be enforced if the employer can show that there is confidential information regarding those relationships that it provided to its former employee or if it can show substantial investment in the relationship. What this means is that employers need to be more deliberate about what type of employee gets a non-compete/non-solicit, how specifically the employer interest is spelled out in the agreement, how narrowly the agreement is drawn, what is done at the workplace to actually safeguard confidential information and what records are kept regarding client/customer development.

When an employee subject to a narrowly drawn non-compete, with access to confidential information or who has customer relationships that were developed by the employer, leaves to join a competitor, the employer must immediately take steps to review forensically the employee’s computers to determine whether any confidential information has been taken. If a forensic report shows “bad acts” or if the employer gets information from a client of an attempted solicitation, then the analysis of whether to run into court to get an injunction can be made. In making that analysis the employer must ask itself the tough questions: is the information taken really confidential, what did I do
to safeguard it when the employee was employed, did I invest significantly in developing the customer relationships or were these contacts of the employee that pre-dated employment. All of these questions will impact the likelihood of obtaining an injunction, and given the cost of an order to show cause, it is vital that the answers are known prior to running to court.

Many employers choose to negotiate with the competitor, particularly if employees are tending to go back and forth between them. In such cases, the negotiation and ultimate agreement will involve specific products that the employee will be precluded from selling or working to develop or clients/customers who the employee will be precluded from servicing. Such agreements are becoming more common as the cost of litigation increases and the courts are wary of enforcing non-competes that entirely preclude employment with a competitor. Often a win in court is getting an order limiting what the former employee can do for the competitor – and negotiating that same “win” comes at a much lower cost.

Aside from the precedents that varies from state to state and the practices that vary from court to court, many states are enacting statutes that weaken the efficacy of these covenants. Choice of law in restrictive covenant drafting is therefore very significant. Where employers tend to overreach is the venue selection in the agreements – a court is much more likely to enforce a choice of law of a foreign state when the venue provision is fair to the employee. However, there are complications to this approach when the covenants violate public policy of the forum state, such as in California. In those situations, employers will continue to draft forum selection clauses that favor enforcement, even though there is a possibility that the clause will not be
enforced by the courts. Arbitration clauses and liquidated damages for breach are also some mechanisms being used in lieu of or in addition to the seeking of injunctive relief. Again, enforcement of liquidated damages clauses varies and proving damages in non-compete litigation is quite challenging, so while these clauses can be used as deterrents, they are not necessarily going to be helpful when coming before a fact finder.

**Recent Legislation**

1. There has been a wave of recent legislation and proposed legislation on restrictive covenant agreements in the last year or so. For example, while employers are well aware that California generally prohibits non-competes in the employment context (with certain exceptions), some employers had successfully contracted around this prohibition by incorporating choice of law provisions applying the law of other states to contract disputes. However, effective January 1, 2017, California Labor Code section 925, which applies to all contracts entered into after that date, voids any agreement that requires an employee who “primarily resides and works in California, as a condition of employment” to agree to a foreign venue and choice of law requiring the application of the law of another state. Significantly, Section 925 does not apply if the employee is represented by counsel who negotiates the terms of the forum selection or choice of law clause applicable to employment disputes.

The Massachusetts statute that went into effect on October 1, 2018, *MGL c.149, § 24L (added by St.2018, c.228, § 21)* limits the enforceability of certain non-competes in the employment context and codifies express requirements that agreements must meet to be enforceable. It requires garden leave and prohibits a venue provision that is
far from the employee’s place of residence. New consideration is required for a mid-
employment non-compete and they are prohibited for non-exempt employees.

Legislation limiting the use of restrictive covenants has also been recently
proposed in the following states and cities: Washington, Hawaii, Indiana, Maryland, New
Hampshire, North Dakota, South Dakota, Missouri, Virginia, Georgia, Pennsylvania,
New Jersey and New York City. Federally, the Workforce Mobility Act of 2018, Senate
Bill 2782 (2018), introduced in the U.S. Senate in April 2018 would be a national ban on
employers engaged in interstate commerce on requiring employees to enter into non-
competition agreements. In May 2018, this bill was referred to the Committee on Health,
Education, Labor, and Pension. A similar bill was introduced in the U.S. House of
Representatives in April 2018, H.R. 5631, and referred to the House subcommittee on
Regulatory Reform, Commercial and Antitrust Law in May 2018. No further actions
have been taken on either bill.

In my home state of New Jersey: Assembly Bill A1769, (the “Bill”) was introduced
in the New Jersey state assembly. The Bill as currently written would impose numerous
and significant restrictions on the enforceability of non-competition agreements. Some
of the more onerous provisions in the Bill are: (1) limitations on the duration of
agreements to one-year post-employment; (2) requirements that employers pay the
employee full wages and benefits during the duration of the enforcement of the
agreement, unless the employee was terminated for “misconduct” as defined therein;
(3) requirements that notice of the agreement must be given by the earlier of the time of
a formal offer of employment or 30 days before commencement of employment or the
effective date of the agreement; (4) requirements that the agreement must be limited in
scope to the geographic area where the employee provided services or had a material presence within the two years preceding the date of separation, and a prohibition of a restriction of the employee from working in states other than NJ; and (5) prohibition on blue-penciling (i.e. rewriting, striking, and modifying unenforceable provisions).

Moreover, the Bill would create a private right of action for employees to seek relief against an employer or person who allegedly violated the bill, and, if successful would permit the employee to recover compensatory damages, liquidated damages, and reasonable attorneys’ fees and costs.

Some areas that would remain consistent with the current common law in New Jersey governing restrictive covenant agreements include that agreements must be no broader than necessary to protect the business interests of the employer, and that agreements shall not be unduly burdensome on the employee, injurious to the public or inconsistent with public policy.

The Bill would broadly apply to restrictive covenant agreements, which it defines, in sum, as an agreement between an employer or employee in which the employee agrees not to engage in certain post-employment competitive activity. It is not entirely clear on the face of the Bill whether it would apply only to non-competes or whether it would apply to other types of restrictive covenant agreements, such as non-solicitation agreements; however, for the most part, the Bill focuses on non-compete provisions/agreements. If enacted it would not apply retroactively to agreements entered into before the date of enactment.

The theme of these proposed statutes is consistent; the rights of employers to restrict their employees’ mobility post-employment are being examined and narrowed.
We will see how many such laws actually become enacted in the near future as the statutory scheme would certainly impact how these issues are addressed and would compel companies to rely far more heavily on the trade secret statutes to protect their confidential information and customer relationships.

**Best Practices for Multistate Employers**

1. Review and update procedures for protecting trade secrets. In addition to helping prevent misappropriation, such procedures will help establish the existence of trade secrets too – note under the DTSA and state laws, having a valuable secret alone is not enough to establish that it is a trade secret because there must also be “reasonable measures” to keep it secret. Some of the issues to be addressed include:
   - What procedures are in place to maintain secrecy?
   - Who is allowed access and under what conditions?
   - Are all those allowed access under adequate contractual requirements to maintain secrecy?
   - Should additional protections be added (e.g., encryption, periodic training, door locks, etc.)?

2. For companies hiring new employees, especially from competitors:

   Ensure that they have no restrictive covenants to which they are subject. If they do, have them reviewed by counsel as to enforceability and have the prospective employee interviewed in terms of prior roles and access to confidential information (without delving into the specifics). At that point, steps can be taken to negotiate with a prior employer if necessary or if not, the new employer should:
   - Require them to sign agreements forbidding the use of confidential information or material, and confirming that they will not use or disclose anything from a prior employer;
   - Remind them of confidentiality obligations to former employers;
- Screen them from projects that might require use of their confidential know how; and
- Document efforts to help rebut allegations later.

3. Update restrictive covenant agreements frequently to ensure that they comply with state laws where employees are located with respect to consideration and scope and that they are narrowly drawn and define the interest that they are protecting. Provide notice to employees, contractors, and consultants, of the whistleblower provisions of the DTSA\textsuperscript{11}.

4. If an employee leaves your employ to join a competitor, conduct a forensic exam of his computer with a chain of custody, and document your efforts. If actions were taken that are in clear breach, contemplate injunctive relief and if not, consider a negotiation with the competitor over scope of employment.

In conclusion, this area of the law is ever shifting and multistate employers face unique challenges in monitoring both statutory shifts and shifts in attitudes of particular venues with respect to enforcement.

\textsuperscript{11} 18 U.S.C. § 1833(b)(1).