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A Murky Trade Secret Landscape: What Employers Can Do

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The Uniform Trade Secrets Act protects "trade secrets" — information that grants its owner a competitive advantage and of which the owner has taken reasonable steps to maintain its confidentiality[1] — from misappropriation. In order to create uniformity and predictability for businesses operating across state boundaries, all states but three — Massachusetts, New York and North Carolina — have adopted a version of the UTSA. Nearly all of these versions of the UTSA preempt common law tort claims of trade secret misappropriation,[2] but state courts have split on whether the UTSA also preempts such claims relating to "confidential information" that do not meet the definition of a trade secret. Regardless of where your state falls, employers can and should take steps to protect both trade secrets and confidential information.

The Arizona Judiciary — Casting Recent Support to the Minority View

On Nov. 19, 2014, the Arizona Supreme Court took the minority position, holding that Arizona's version of the UTSA does not displace misappropriation claims for confidential information that falls outside the statutory definition of "trade secret." The court stated, "If such broad displacement was intended, the legislature was required to express that intent clearly" and noted that "nothing" in the AUTSA "suggests that the legislature intended to displace any cause of action other than one for misappropriation of a trade secret." The ruling was handed down in Orca Communications Unlimited LLC v Noder, case no. CV-13-0351, and revived the plaintiff's unfair competition claim against Noder, its former president who had left the company to start a rival business.

States Continuing to Hold Steady in the Majority Position

Most courts ruling on this issue, including those in Ohio, California and several other states, have held that the UTSA displaces all common law tort claims related to misappropriation of information. For example, in Ohio, if a common law cause of action for misappropriation or unjust enrichment is "based entirely on factual allegations of misappropriation," it is subject to preemption under Ohio's version of the UTSA even if the information at issue is merely confidential and not a trade secret.[3] Such claims survive preemption only to the extent that they are "supported by an independent factual basis."[4]

Consequently, an employer faced with misappropriation of non-trade secret information has a tort cause of action only where the claim is based on separate facts.

Recommendations for Employers Facing the Majority Position

While the majority's stance places limits on employers' abilities to protect their confidential information, all is not lost. Employers can take targeted steps to protect their trade secrets and confidential information.

Build a Record to Satisfy the Definition of Trade Secret

The majority's position only affects common law tort claims for information that do not meet the definition of a trade secret; therefore, employers can protect their information by ensuring that — whenever possible — they satisfy the elements of the definition of a trade secret. A trade secret is confidential information (1) that provides its owner with a competitive advantage and (2) of which the owner has taken reasonable steps to maintain its confidentiality. Employers can establish the value of competitive advantage by offering qualified testimony, maintaining accurate business records and using expert appraisals when reasonable and necessary. While reasonable steps to maintain confidentiality are dependent upon the facts and circumstances of each employer, there are several methods that employers can use to demonstrate reasonable effort to protect:

1. Clearly and prominently label confidential information using language such as, "Confidential Information of Our Corp. not to be used without Our Corp.'s written permission";

2. Develop written privacy procedures and train employees on proper procedures. Such procedures should be outlined in employment agreements, employee handbooks, and/or topic-specific manuals;

3. Make certain that the privacy procedures of service providers (including website hosts, consultants, legal counsel, etc.) meet or exceed the company's own. If a service provider's procedures are insufficient, amend the service contract or sign a separate, additional agreement;

4. Limit distribution of private information to a "need to know" basis and record any suspicious behavior by individuals with access;

5. Ensure adequate information technology security, including: installing anti-virus software and firewalls; securing confidential files with passwords and encryption; and regularly monitoring the adequacy of existing measures in light of evolving technology;

6. Keep hard copies of sensitive information in properly secured cabinets;

7. Securely dispose of unwanted digital files by shredding, destroying disks, erasing hard drives, etc.;

8. Conduct exit interviews with departing employees to confirm that they have returned all confidential information and remind them of their future confidentiality responsibilities. If circumstances warrant, it can be beneficial to notify new employers of departing employees of those responsibilities; and/or

9. Consider having an external privacy audit completed.

Use a Nondisclosure and/or Confidentiality Agreement

The majority's position preempts claims for confidential information misappropriation to the extent that they are predicated on trade secret misappropriation facts. In order to protect confidential information that cannot otherwise satisfy the definition of a "trade secret," employers should use confidentiality/non-disclosure agreements to avail themselves of breach of contract actions for misappropriation of such information. Contracts can be used to more broadly define the types of information that cannot be disclosed and give rise to separate causes of action in contract. In fact, the UTSA carves out contract claims whether or not based upon misappropriation. Employers should take care to ensure that any agreement's scope is sufficiently broad to protect its interests. An ideal agreement would state that all nonpublic information is confidential — regardless of whether it is marked confidential and regardless of how it is disclosed — and specify a time period that covers the useful shelf-life of the information.

Conclusion

The Arizona Supreme Court's recent decision permitting common law tort claims for misappropriation of confidential information that do not fall under the definition of trade secret may indicate a trend toward state courts reconsidering their positions on this issue. While a majority of states continues to preempt such claims, employers can take steps in the meantime to lessen the impact of this stance on their abilities to protect their confidential information. Employers should (1) consider using nondisclosure and/or confidentiality agreements to avail themselves of contract remedies and/or (2) take care to establish that the information they seek to protect is a trade secret in the eyes of the law.

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[1] Section 1(4) of the UTSA defines a trade secret as: "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."

[2] Iowa, Nebraska, and New Mexico have not yet adopted the UTSA's Section 7(a) preemption clause. See Iowa Code §§ 550.1 to .7; Neb. Rev. Stat. §§ 87-501 to 87-507; N.M. Stat. Ann. §§ 57-3A-1 to -3A-7

[3] Glasstech, Inc. v. TGL Tempering Sys., Inc., 50 F.Supp.2d 722, 730 (N.D. Ohio 1999); Office Depot, Inc. v. Impact Office Products, LLC, 821 F.Supp.2d 912, 918 (N.D. Ohio 2011)

[4] Int'l Paper Co. v. Goldschmidt, 872 F.Supp.2d 624, 635 (S.D. Ohio 2012)
