



Legal Risk Management Tip
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TRADE SECRETS

You arrive to the office on Monday morning and face one of your worst nightmares. When you open your office door, there lays a resignation letter that your top employee slipped under the door late on Friday night. As the week goes by, more and more employees resign, so that by Friday your best team is gone. Next, you learn the team has set up a competing business across the street, which is quickly followed by client termination notices and account transfers. Before long, the departing team has taken many of your clients and millions of the firm's revenue dollars. Your immediate thought is to seek legal recourse. What you do next to protect your business and remaining employees may depend upon what you have done up to that point. If precautionary steps are taken to protect your proprietary information from misappropriation or theft by rogue employees, then California law offers several options.

If the firm can prove that its trade secrets are involved, California law offers the owner of the misappropriated trade secret a variety of remedies. The owner can ask a court to temporarily and/or permanently enjoin the one who misappropriated the trade secret from using it. The court may grant such an injunction upon a finding that a trade secret in fact existed - that is, has been misappropriated - and that its use will cause harm to the owner. In addition, the owner may recover damages for the actual loss caused by the misappropriation of a trade secret. The key to success is first establishing the existence of a trade secret. Otherwise, you will likely have little recourse and could suffer as a victim of a disloyal employee.

The California Uniform Trade Secrets Act Section 3426.1(d) defines a "trade secret" as information, including a formula, pattern, compilation, program, device, method, technique, or process that:

- (1) Derives independent economic value, actual or potential, from not being generally known to the public or to other persons who can obtain economic value from its disclosure or use; and
- (2) Is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.

The trade secret is the collective power of your employees' brains and hard work; it is something that has value to your firm. Generally, a trade secret involves something that you has developed at considerable effort, cost, and energy, and typically is not known to the general public.

In the financial services business, the two most common types of trade secrets involve those related to investments and those related to the sales effort. For example, analytical research methodologies, trade data, quantitative investment models, and algorithms may serve as your magical formula or "secret sauce" that makes your product or service unique. Clients are the backbone of your business, and without clients you cannot survive. So client and prospect lists,

and compilation of information related to clients and prospects, such as the information contained in a CRM program that summarizes meetings with clients, are all very valuable to your business, particularly if it is either impossible or sufficiently difficult to re-create without considerable burden. Employee compensation may be another. Because there are so many aspects of your business that make it special, your first protective measures are to identify and document your trade secrets.

What reasonable steps can you take to protect your trade secrets? Begin by ensuring that safeguards are instituted for getting into your offices, such as by a key and/or an electronic card or badge. Dependent upon the size of the firm and firm traffic, guests should have to sign in with a receptionist. Employees should escort all guests when walking about the office premises. Logging in to a computer should require a log-in ID and strong password. Access to more sensitive databases should require separate permissions approved by senior management. In addition, you must ensure you have adequate firewalls to protect your trade secrets from outside hackers.

These basic steps can protect access from the outside world, but what should you do to protect your trade secrets from those who already have access, such as your employees?

As a condition of employment, all employees should sign an agreement that includes various restrictive covenants to which employees must adhere during and after employment regarding use of confidential information, soliciting employees, and starting competing enterprises. This agreement, together with basic training on respecting trade secrets, will sensitize employees to your trade secrets, their importance to the well-being of your loyal employees, and the protocols for keeping trade secrets from winding up in the hands of a competitor.

In talking about this agreement, it is important to keep in mind the basic character of the document. Although it is a legal document with legal obligations and legal principles, it is more than that. It is a document that serves as a common standard of protection for your trade secrets; it is for all the people who work hard at your firm and who have hopes of building it into a thriving enterprise. Your desire to sustain your firm's intellectual capital well into the future lies behind this document. It is an important document that deserves everyone's full attention and support.

Now that you have taken steps to protect your trade secrets, how do you avoid being accused by other companies of misappropriating a firm's trade secret? It –can result from something as simple as a new employee arriving with a stack of client business cards accumulated from his or her old job. So when evaluating possible new hires, the last thing you want is to hire a lawsuit.

Here are some considerations of inquiries or requests to ask of prospects and new hires:

- Determine whether the prospect signed a confidentiality/proprietary agreement with a former employer and if so, request to see a copy.
- If a confidentiality or proprietary agreement does exist, review the agreement's obligations with the prospect and advise as to the firm's expectation of the adherence to its terms.

- As a condition of employment, have new hires represent and agree that they will not breach any agreement with any prior employers related to bringing or using the confidential, proprietary or trade secret information owned by any prior employers.
- If there is a possibility the prospect possesses proprietary or confidential information from a former employer, determine whether (i) the information is publicly available or (ii) your firm independently has developed the information already.
- If the information is neither public nor has been independently developed by your firm, your best course is to make no use of the information.

In your vision of building your organization, it is essential to have safeguards in place to protect the collective power of your employees' intellectual inventions and work product. The firm's trade secrets can be protected, but only if you take reasonable steps from the outset and remain vigilant.

For more information on these and other considerations, please contact us at info@jackolg.com, or (619) 298-2880. Also, please visit our website at www.jackolg.com.

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