



Trade Secrets and Noncompete Agreements: **WHAT YOU NEED TO KNOW**

Are The Crown Jewels in an Unlocked Safe? Best Practices For Ensuring That Trade Secrets Are Not Readily Ascertainable By Improper Means or By Departing Employees

November 12, 2009

Presented by:

David S. Sanders & John H. Douglas, Foley & Lardner LLP
Thomas E. Hartman, Hanger Orthopedic Group, Inc.



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- Hanger is the world's premier provider of orthotic and prosthetic patient care services, with approximately 670 patient care centers located in 45 states and the District of Columbia.
- Hanger employs over 3,700 employees, including approximately 1,100 practitioners.
- Hanger's common stock trades on the New York Stock Exchange under the symbol "HGR."

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Topics To Be Covered 6

- Trade Secrets defined
 - Employment Policies with respect to Trade Secrets
- Agreements with Employees
 - Noncompetes
 - Nonsolicitations
 - Confidentiality
 - Inventions Assignments
- Handling Departing Employees
 - Return (or Destruction) of Company Property and Information
 - Terminating Electronic Access
 - Actions Against Former Employees
- General Counsel's Perspective
 - Overall Corporate Strategy and Practical Implications
- Questions



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Trade Secrets

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- Statutory definition
- Uniform Trade Secrets Act
 - “Trade secret” means 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.
- 45 States and D.C., U.S. Virgin Islands have adopted; Massachusetts, New Jersey, New York and Texas have not
- State Law Standards May Differ Slightly
 - E.G. California has eliminated “and not being readily ascertainable by proper means by” prong

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Trade Secret – Yes or No?

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- Yes
 - Lists of actual customers
 - Marketing plans
 - “Negative” research
 - Formulas, recipes, processes, business methods
- No
 - Patented information
 - Telemarketing scripts

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Establishing “Secrecy”/“Economic Value”

- Secrecy
 - Advising employees of secrecy requirements
 - Limiting access to those with “need to know”
 - Requiring confidentiality / assignment agreements
 - Locked access / password protection
 - Periodic reminders (pop-ups)
 - Training on confidentiality – outset / periodically
 - Adequate security measures
- Economic Value
 - Key - Must not be known by competitors



Employee Handbooks

- Although Employee Handbook provisions cannot hurt, alone they will be sub-optimal
- At least get a signed acknowledgement of receipt
- Include a provision requiring (or suggesting) employee notice – even if conflicts with “at will” statement
- Problems
 - State laws differ on whether handbooks give rise to enforceable rights
 - Generally, when employees are employed “at will” and there is no writing, modifications can occur easily
 - Employers often want to disclaim contractual nature of employee handbook
- Bottom line – best to get a written agreement, i.e., **contract** for important terms



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Agreements with Employees

- Noncompetition Agreements
- Nonsolicitation Agreements
- Garden Leave Clauses
- Confidentiality Agreements (Nondisclosure Agreements)
- Inventions Assignment Agreements
- No-Hire Agreements
- Forfeiture for Competition Agreements (but not “straight” Forfeiture Agreements)

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Overview: The Law of Restrictive Covenants

- Common Law/Public Policy
- Noncompete Agreements
 - Context – Employment versus Others
 - Requirements – Time, Geography, Restricted Activities
 - Basic Contractual Requirements
 - Legitimate Business Interests
 - Touchstone: Reasonableness
 - Defenses

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Noncompetes: The Basics

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- Protectible Interest/Rule of Reason Approach
 - Is the restraint reasonably limited in terms of:
 - Time
 - Territory or market
 - Activity
 - Look at the employee's duties, location(s) and other relevant items (e.g., customer cycle). Be able to show reasonableness.
- Courts will generally go back to this element when assessing the reasonableness of a noncompete.

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General Guidelines

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- State/Jurisdiction Differences
 - Time
 - Employment
 - Sale of Business
 - Geography
 - Employment
 - Sale of Business
 - Reformation/Blue-Pencil Doctrine

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General Guidelines

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- Virginia – “employee of...”
 - “where Employee’s position and/or services involve or require the performance of duties substantially similar to those Employee performed for the Company”
 - “with a view toward offering or providing Competitive Services to such Company Customer or to the customers of such Company Referral Source”
- Stay away from gender-specific pronouns.
- Remember that one size does not fit all!

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Interplay between Geography and Business

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- Examples (Assume confidentiality provisions, reformation, savings and severability clauses and right to seek an injunction provisions are included):
 - Expansive geographic scope/narrow business description.
 - Limited geographic scope/general description of business.
 - Look at the definition/description of business.

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Interplay between Geography and Business

- Look at the maximum geographic scope if the locations are based on where an individual works (Connecticut).
- If an arbitration clause, is the right to seek an injunction for violation of non-compete/confidentiality included?
- No right answer – always come back to the protectible interest/rule of reason.



Basic Considerations

Protectible Interest/Rule of Reason Analysis

- How Courts/Juries View Non-Competes
- One Size Does Not Fit All
 - State/Jurisdiction Specific
 - 1. **Feel free to ask questions about any state’s law at any time**
 - Industry Specific (Internet business v. bricks & mortar)
 - Activity Specific (R&D v. salespersons)

This presentation does not convey the complexity of the laws of each state/jurisdiction. You should always do a “reality check” and research the actual case law of each state/jurisdiction. Other factors can also affect the analysis.



Impact of the Economy

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- Context: Balancing of the Harms
- Assessment of the Impact of the Economy
- Response to the Impact of the Economy

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Drafting Considerations

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- Definition of Business
 - Is it specific?
 - Will someone be able to determine what the company does from the document?
 - Does it contain dangerous “catch-alls?”
 - “Any business in which **[the Company/Employee on the Company’s behalf]** is engaged...”
- Customer-Based Restrictions
 - Prospective (Identified?) v. Actual.
 - Geographic limitation required?

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- Nonsolicitation of Customers/Referral Sources
 - Be careful – State-by-State
 - Dangerous: All Customers/Referral Sources of the Company (Regardless of Employee's Interaction with All Customers/Referral Sources)
 - Territory Required?
 - With whom Employee worked
 - For whom Employee had Oversight Responsibility
 - About whom Employee possesses Proprietary Information
 - Current Customers – what does that mean? Be Specific.
 - Recent Georgia Case
 - Prospective Customers – whether to include at all
 - Identified versus Unidentified

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Drafting Considerations

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- Nonsolicitation of Employees
 - Dangerous: All Employees of the Company (Regardless of Employee's Interaction with All Employees)
 - Territory Required?
 - With whom Employee worked
 - For whom Employee had Oversight Responsibility
 - About whom Employee possesses Proprietary Information
 - Employees at the Time of Termination or During a Fixed Period of Time Prior Thereto
 - Employees at the Time of Solicitation
- No-Hire Agreements
 - Similar Considerations as above
 - Tougher Standard

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Drafting Considerations

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- Confidentiality Agreements (Nondisclosure Agreements): Key Considerations:
 - Definition of Proprietary Information or Confidential Information (and exclusions)
 - The Company owns all Proprietary Information and Confidential Information
 - Employee shall not use or disclose...
 - Duration
 - Perpetual versus Wisconsin/Georgia
 - Trade Secrets versus Confidential Information
 - What happens if a court requires production of the Confidential Information
- Inventions Assignment Agreements

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Drafting Considerations

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- Return of all Company Property, including electronic and paper files (and all copies), mobile communication devices and electronic media
 - *Drafting Example: Employee agrees to preserve for the Company's exclusive use and deliver to the Company at the termination of Employee's employment, or at any other time the Company may request, all Company equipment and property (including, without limitation, tools, computers, mobile communication devices and furniture) and all memoranda, data, notes, plans, records, reports and other documents, whether in electronic, written or other form (and copies thereof), relating to the business of the Company which Employee may then possess or have under Employee's control.*

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Drafting Considerations

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- After-thought covenants
 - Additional consideration required?
 - Employee Transfers and/or Promotions (Massachusetts Example).
 - *Example: The parties acknowledge Employee's existing employment with the Company, and, upon the effectiveness of this Agreement, the parties wish to replace all prior employment agreements between the parties, including the Employment and Non-Compete Agreement, dated as of _____, 2009, between Employee and the Company, with this Agreement, which is executed in connection with Employee's promotion and an increase in Employee's compensation.*

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- Effect of Employer Termination of Employee
 - Breach
 - Cause v. without cause
 - New York
 - Pennsylvania

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Drafting Considerations

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- State Law
 - Where the employee lives or works; not Delaware.
 - Public policy argument.
- Forum Selection Clauses
 - An important consideration depending on the hardship to the employee.
 - Beware of the public policy argument.
 - Example: Employee hereby agrees that any claim or action regarding or relating to this Agreement shall be subject to the exclusive jurisdiction of the state courts of the [State/Commonwealth/District] of _____ or the federal district court for the _____ District of _____ and Employee hereby submits to the exclusive jurisdiction of said courts.

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Drafting Considerations

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- Alternative Dispute Resolution Clauses
 - Good or bad for enforcing non-competes?
 - Current Issues regarding Arbitration.
 - **Example 1:** *All disputes under this Agreement shall be submitted to and governed by binding arbitration with an arbitrator from the American Arbitration Association; except only that the Company may seek relief in a court of competent jurisdiction in the event of a claimed violation of Section _ [Non-Compete Section] or Section _ [Confidentiality/Inventions Section] of this Agreement.*
- **DO NOT USE IN CALIFORNIA**

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Drafting Considerations

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- **Example 2: Arbitration Agreement.** All disputes involving the application, interpretation or enforcement of this Agreement shall be submitted to and governed by binding arbitration with an arbitrator from the American Arbitration Association (“AAA”); except that the Company and Employee may seek relief in a court of competent jurisdiction in the event of a claimed violation or improper use of Section _ [Non-Compete Section] or Section _ [Confidentiality/Inventions Section] of this Agreement. Except with respect to any claimed violation or improper use of Section _ [Non-Compete Section] or Section _ [Confidentiality/Inventions Section], neither the Company nor Employee may invoke arbitration more than ninety (90) days after the invoking party knows, or should have known, sufficient information to give that party an understanding that the parties have reached an impasse on their respective positions regarding the application, interpretation or enforcement of any provision of this Agreement. Failure to invoke arbitration within that ninety (90) day period shall constitute a waiver of any such right. If either party invokes arbitration, the Company shall pay the initial AAA file-opening charge, and fees and costs shall be awarded in conformance with the applicable AAA rules.
- The AAA rules can be found at www.adr.org.

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Drafting Considerations

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- **Assignment**
 - Stock v. asset deals.
 - Example: This Agreement is intended to bind and inure to the benefit of and be enforceable by Employee and the Company, and their respective successors and assigns. Employee may not assign Employee’s rights or delegate Employee’s obligations hereunder without the prior written consent of the Company. The Company may assign its rights and delegate its duties hereunder without the consent of Employee to Permitted Transferees.

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- Statement that the Agreement is reasonable and not unduly harsh or oppressive
 - Reference to other gainful employment opportunities
 - **Example 1 (Broad Territory):**
 - *Employee agrees that the restraint imposed under this paragraph ___ is reasonable and not unduly harsh or oppressive and that, in the event that Employee is subject to the Non-Compete following the Employment Period, Employee would be able to find gainful employment within the Restricted Territory in the general field of _____, without providing the highly specialized _____ services and products that Employee is prohibited from providing during the Non-Compete Period.*
 - See long version in attached materials.
 - **Example 2 (Local Sales Route).**
 - See example in attached materials

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- Legal Effect/Attorney Review
 - Typeface, location in document. Make sure it is conspicuous.
 - **Example: Employee Acknowledgement.** *Employee acknowledges and agrees that Employee has been given ample time and fair opportunity to review this Agreement, to ask any questions Employee might have, to consult with an attorney or other professional and to suggest alternative provisions. Employee further states that Employee understands the meaning and import of the terms and provisions of this Agreement, that the Company has not unfairly or unduly influenced Employee to sign this Agreement and that Employee willingly and voluntarily enters into this Agreement as a condition of Employee's employment and for fair and reasonable consideration.*

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- Reformation and the Blue Pencil Doctrine - Three General Theories
 - All or Nothing
 - If the non-compete is a little overbroad, the whole non-compete is declared unenforceable.
 - Blue Penciling
 - The court deletes grammatically severable provisions only.
 - What does this mean?
 - Reformation
 - The court exercises broad powers to make the non-compete reasonable.

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- State/Jurisdiction Differences
 - Modification and Severability Examples
- Example 1 (Modification): If, at the time of enforcement of any provision of Section _ [Non-Compete Section], a court or arbitrator holds that the restrictions stated therein are unreasonable or unenforceable under circumstances then existing, the Company and Employee agree that the maximum period, scope or geographical area reasonable or permissible under such circumstances will be substituted for the stated period, scope or area.

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- **Example 2 (Severability):** *The parties agree that (i) the provisions of this Agreement shall be severable in the event that any of the provisions hereof are for any reason whatsoever invalid, void or otherwise unenforceable, (ii) such invalid, void or otherwise unenforceable provisions shall be automatically replaced by other provisions which are as similar as possible in terms to such invalid, void or otherwise unenforceable provisions but are valid and enforceable and (iii) the remaining provisions shall remain enforceable to the fullest extent permitted by law.*

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- Step-down Clauses: Are they worth the risk?
 - **Example:** *If, at the time of enforcement of any provision of Section _ [Non-Compete Section], a court or arbitrator holds that the restrictions stated therein are unreasonable or unenforceable under circumstances then existing, the Company and Employee agree that the maximum period, scope or geographical area reasonable or permissible under such circumstances shall be as follows: (1) the “Non-Compete Period” shall be amended by substituting the phrase “six (6) months” for “one (1) year” in Section _ [Non-Compete Section]; and (2) the geographic restriction shall be amended by substituting “thirty (30) mile radius” for “fifty (50) mile radius” in Section _ [Non-Compete Section], and, if the court or arbitrator finds “thirty (30) mile radius” to be unreasonable or unenforceable, “ten (10) mile radius” shall be substituted therefore.*

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New Developments/Specific Professions

- Recent Law Changes and Developments (e.g., Washington, Massachusetts, Texas, Oregon, Georgia, Louisiana, California)
- Possible Future Law Changes: Massachusetts

- Physicians
- Broadcasters
- Others

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Handling Departing Employees

- Assessing Risk
- Return (or Destruction) of Company Property and Information
- Terminating Electronic Access
- What Attorneys Need to Determine Whether to Proceed Against a Former Employee

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Departing Employees – Assessing Risk

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- Issues
 - How much does the person know?
 - Has employee give sufficient notice?
 - How strong are barriers to entry?
 - How amicable are circumstances surrounding departure?
 - How much is known about departing employee's intentions?
 - How technologically savvy is the employee?
 - Do circumstances suggest an intention to compete?
 - Suspicious computer activity
 - Other employees departing simultaneously?

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Return or Destruction of Company Property / Documents

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- Conduct Exit Interview
 - Present all applicable agreements and review
- Require Departing Employee to Sign An Affidavit / Certification?
 - Employee has returned all data/ property to company
 - Employee has not provided data to anyone except in the usual and ordinary course of duties
- If employee refuses to sign – further investigation warranted?

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Terminating Electronic Access

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- Best practice – Upon notice of departure, terminate (or at least begin limit or monitor) access to trade secrets and confidential information
- At least remind employee of his or her confidentiality obligations
- Recent Ponemon Institute Study
 - 59% of departing employees steal confidential info
 - 53% download to CD or DVD; 42% to USB; 38% send to personal e-mail account

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What Attorneys Need to Determine Whether to Proceed Against A Former Employee

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- Understanding of “Trade Secrets” at issue
- Written documents
 - Agreements, handbooks, certifications, affidavits
- Understanding of Circumstances
 - Reason for departure
 - Warning signals (detailed description of competitive activities, witnesses (who, what, when, where))
- Employee’s address and current employer address
- IT Audit
 - Results of any pre-departure monitoring
 - Results of post-departure inspection

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General Counsel's Perspective

- Determining the Company's Overall Strategy
 - The Need for Customization Versus the Cost of Customization
 - Executives versus Salespeople versus Regional and Local Managers
 - Automation of the Drafting Process
 - Litigation Cost-Benefit Analysis



General Counsel's Perspective

- Implementation of Company Strategy
 - Drafting Documents
 - Handling Departing Employees
 - Case-by-Case Analysis and the Company's Overall Message to Employees and Competitors
 - Are there damages? Can they be proven?
- Practical Implications



Summary

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- Drafting Tools to Protect Trade Secrets
- Handling Departing Employees

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Future Web Conference Series Dates

12/10/09: *Can the Toothpaste Be Put Back in the Tube? Preliminary Injunctions and Other Methods of Stopping Trade Secret Misappropriation and Violation of Noncompetes*

- **1/21/10:** *Enforcing and Litigating Across Borders, Including ADR*

www.tradesecretnoncompete.com

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