

Inevitable disclosure still not settled

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In the seminal case of *PepsiCo Inc. v. Redmond*, 54 F.3d 1262, 1269 (1995), the 7th U.S. Circuit Court of Appeals affirmed an injunction of a manager from working for a competitor for six months, where he was party to a confidentiality agreement but had no noncompetition agreement. Significantly, rather than finding that PepsiCo had to prove that he actually had misappropriated PepsiCo's trade secrets, the court noted the manager's knowledge of PepsiCo's strategic business information and held that a "plaintiff may prove a claim of trade secret misappropriation by demonstrating that the defendant's new employment will inevitably lead him to rely on the plaintiff's trade secrets." This principle has come to be known as the "inevitable disclosure doctrine."

Since then, the inevitable disclosure doctrine has developed erratically, so that, depending on the jurisdiction and the circumstances, it truly can be a double-edged sword.

Companies are frequently vulnerable with respect to their high-level executives: The executive necessarily has access to the company's trade secrets, but the executive's access to strategic information unfortunately makes the executive attractive to competitors. The inevitable disclosure doctrine developed out of such circumstances, and courts are most likely to apply the doctrine when the former and prospective employers are direct competitors, the employee possesses highly confidential information of great strategic value and the employee will occupy a substantially similar position.

The high-water mark for inevitable disclosure in New York was arguably reached in *DoubleClick Inc. v. Henderson*, No. 116914/97, 1997 N.Y. Misc. Lexis 577 (New York Co., N.Y., Sup. Ct. Nov. 5, 1997), when the court enjoined the defendants, who misappropriated the plaintiff's trade secrets, from competing against the employer for six months. The court noted that "[i]njunctive relief may issue where a former employee's new job function will inevitably lead her to rely on trade secrets belonging to a former employer." 1997 N.Y. Misc. Lexis 577, at 16. The national high-water mark for inevitable disclosure was reached with *PepsiCo*, discussed above.

Plaintiff-employers generally have invoked the inevitable disclosure doctrine for two purposes: to prevent the employee from working for a competitor when there is no noncompete agreement, or to show irreparable harm when there is no proof that the employee actually stole, or had yet used, trade secrets. Courts have been unpredictable in their application of the doctrine, however. Accordingly, employers can most effectively protect themselves against competition from former employees—and give themselves a fighting chance of obtaining injunctive relief—by requiring employees to sign confidentiality agreements and, where permitted by law, covenants not to compete, at the outset of employment.

One caveat is that some courts have found that having such agreements precludes application of the inevitable disclosure doctrine altogether. Another is that some states—California in particular—prohibit general noncompete agreements (as opposed to limited restrictive covenants) except in narrowly prescribed circumstances such as the sale of a business.

Restrictive covenants

It is clear that restrictive covenants are an employer's best tool for protecting its trade secrets against use by competitors. See *EarthWeb Inc. v. Schlack*, 71 F. Supp. 2d 299, 311 (S.D.N.Y. 1999) ("[A] written agreement that contains a non-compete clause is the best way of promoting predictability during the employment relationship and afterwards."), remanded, 205 F.3d 1322 (2d Cir.), judgment aff'd after remand, No. 99-9302, 2000 WL 1093320 (2d Cir. June 12, 2000) (table). Of course, the terms of the restrictive covenant should be reasonable, and the employer should leave some room for negotiation, where appropriate.

In recent years, courts generally have agreed that restrictions on competition after the end of the employment relationship should be established by clear agreement. Indeed, courts have refused to enjoin former employees from working for competitors when the employee has specifically avoided—or the employer has not required—signing

a restrictive covenant.

For example, in *Marietta Corp. v. Fairhurst*, 754 N.Y.S.2d 62 (N.Y. App. Div. 2003), the first New York state appellate court case to address inevitable disclosure, the employee signed a noncompete when hired, and refused to sign a new noncompete when the original covenant expired. The employee moved to a competitor, and the former employer sought an injunction to prevent the employee from working for the competitor. The court denied injunctive relief based on the absence of a restrictive covenant and the lack of evidence that the employee misappropriated trade secrets.

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In *LeJeune v. Coin Acceptors Inc.*, 381 Md. 288, 322 (Md. 2004), the Maryland Court of Appeals applied the inevitable disclosure doctrine to the Maryland Uniform Trade Secrets Act for the first time. The employee was responsible for the sale of vending machines, and had access to the company's sensitive pricing, marketing and sales strategies information. The employee misappropriated confidential information from the employer before joining the competitor, but did not sign a confidentiality agreement or restrictive covenant. The court refused to enjoin the employee from working for the competitor because "[t]o recognize 'inevitable disclosure' in this case would allow [the original employer] the benefit of influencing [the employee's] employment relationship with [the new employer] even though [the original employer] chose not to negotiate a restrictive covenant or confidentiality agreement with [the employee]." *Id.* at 322.

Confidentiality agreements

If an individual simply refuses to sign a restrictive covenant, the employer should consider-upon advice of counsel-refusing to hire the individual. However, if the employer hires-or continues to employ-an employee who has not signed a restrictive covenant, the employee should be required, at the outset of the employment, to sign a confidentiality agreement. Indeed, without such an agreement, the employer will have difficulty proving that its business information amounts to a trade secret, because the trade secret inquiry considers whether the employer has taken appropriate steps to protect the information from disclosure-and courts have been reluctant to confer trade secret status upon information that is not protected by a confidentiality agreement. See, e.g., *Jay's Custom Stringing Inc. v. Yu*, No. 01 Civ. 1690, 2001 U.S. Dist. Lexis 9298, at 17-18 (S.D.N.Y. July 5, 2001); *Liebert Corp. v. Mazur*, No. 1-04-2794, 2005 Ill. App. Lexis 310, at 28 (Ill. App. Ct. April 5, 2005).

One potential pitfall of requiring an employee to sign a confidentiality agreement-without a restrictive covenant-is that it may disqualify the employer from obtaining injunctive relief in the event of a breach. See, generally, *PSC Inc. v. Reiss*, 111 F. Supp. 2d 252, 256 (W.D.N.Y. 2000). In the 2003 *Marietta* case, the court refused to enjoin an individual from competing against his former employer because the employee was bound by a confidentiality agreement-but no restrictive covenant-and the court suggested that the employer may be limited to contractual damages: "While we agree that [the employee] was privy to confidential information, there exists a valid and enforceable confidentiality agreement which clearly anticipated that he may change his employment during its duration after acquiring plaintiff's confidential information [W]e fail to find any evidence of a breach of such agreement." *Marietta*, 754 N.Y.S.2d at 66.

Further, businesses employing executives who have signed confidentiality agreements-but not restrictive covenants-will be hard-pressed to invoke the inevitable disclosure doctrine to enjoin the executive from working for a competitor in many jurisdictions. Indeed, New York courts have made clear that an employer may not fashion an "implied-in-fact" restrictive covenant by binding the employee to a confidentiality agreement and later applying the inevitable disclosure doctrine to enjoin the employee from working for a competitor.

This is precisely what the former employer asked the court to do in *Marietta*. The *Marietta* court refused to grant such injunctive relief and noted that employers that wish to prevent employees from competing against them must bargain for such restrictions in a noncompete agreement, at the outset of the relationship or at such other time as is appropriate. It is also clear in New York that an employer may not invoke the inevitable disclosure doctrine to broaden the scope of an existing restrictive covenant. In *EarthWeb*, the court declined to broadly enjoin an individual from competing against a former employer, when the restrictive covenant they had agreed upon was narrow in scope. *EarthWeb*, 71 F. Supp. 2d at 310.

Courts requiring proof

Plaintiffs who endeavor to invoke the inevitable disclosure doctrine when there is no proof of misappropriation face an uphill climb, as New York courts have been reluctant to apply the inevitable disclosure doctrine under such circumstances. In *EarthWeb*, the court held that "[a]bsent evidence of actual misappropriation by an employee, the doctrine should be applied only in the rarest of cases." *EarthWeb*, 71 F. Supp. 2d at 310.

More recently, in *Colonize.com Inc. v. Perlow*, No. 03-CV-466, 2003 U.S. Dist. Lexis 20021, at 15-16 (N.D.N.Y. Oct. 23, 2003), a New York federal court refused to enjoin an employee from working for a competitor, based on the inevitable disclosure doctrine, because there was no evidence that he used or threatened to use the former employer's trade secrets: "Absent any wrongdoing that would constitute a breach under the non-compete agreement, mere knowledge of the intricacies of a business is simply not enough."

The same essential reasoning was applied by another New York federal court in *Tactica Int'l Inc. v. Atlantic Horizon Int'l Inc.*, 154 F. Supp. 2d 586, 608 (S.D.N.Y. 2001), where the court refused to apply the inevitable disclosure doctrine because, among other things, there was no evidence of "overt theft or actual misappropriation of either

trade secrets or confidential information." See also *Marietta*, 754 N.Y.S.2d at 65-66.

However, this approach by the New York courts fails to recognize the difficulty of proving actual theft or use of trade secrets of a former employer at the earliest stages of new employment with a competitor. Such evidentiary difficulty does not, however, demonstrate that irreparable harm is unlikely. And, to invoke an old adage, it's tough to put a trade secret back in the barn once it's out. Perhaps, given the right circumstances, inevitable disclosure will one day be recognized in New York and similar jurisdictions even absent proof of actual misappropriation. A limitation on the doctrine that does not allow for such application ignores the realities of the marketplace.

Courts outside New York have been inconsistent in applying inevitable disclosure to circumstances when there is no evidence of actual misappropriation. Recent decisions involving California, Michigan and Ohio law refused to apply the inevitable disclosure doctrine, absent evidence of misappropriation or bad faith. In *Whyte v. Schlage Lock Co.*, 125 Cal. Rptr. 2d 277, 294 (Calif. Ct. App. 2002), the court determined that "the inevitable disclosure doctrine cannot be used as a substitute for proving actual or threatened misappropriation of trade secrets." Similarly, in *Leach v. Ford Motor Co.*, 299 F. Supp. 2d 763, 775 (E.D. Mich. 2004), the court refused to apply inevitable disclosure when there was no evidence of "lack of candor" or "proof of . . . willingness to misuse trade secrets." In *Cintas Corp. v. Perry*, No. 03 C 8404, 2004 U.S. Dist. Lexis 17842, at 57 (N.D. Ill. Aug. 19, 2004), the court applied Ohio law and denied a preliminary injunction because "there is no evidence that [the employee] took or now possesses any confidential [original employer] information."

Courts not requiring proof

However, other courts, applying Iowa and Illinois law, recently have held that a showing of misappropriation or bad faith is not required to obtain injunctive relief under the inevitable disclosure doctrine. In *American Express Fin. Adv. Inc. v. Yantis*, 358 F. Supp. 2d 818 (N.D. Iowa 2005), for example, in enjoining the defendant from competing against his former employer, the court blurred any distinction between "inevitable disclosure" and "threatened misappropriation" under the Iowa Trade Secrets Act. The *Yantis* court, citing this act, baldly stated that "a plaintiff can prove trade secret misappropriation in violation thereof by proving inevitable disclosure." *Id.* at 833.

Similarly, in *Cacique Inc. v. V&V Supremo Foods Inc.*, No. 03 C 4230, 2004 U.S. Dist. Lexis 19839, at 48-50 (N.D. Ill. Sept. 29, 2004), the court denied a former employee's motion for summary judgment on the inevitable disclosure issue, even though there was no allegation of bad faith or misappropriation. In *YCA LLC v. Berry*, No. 03 C 3116, 2004 U.S. Dist. Lexis 8129, at 45 (N.D. Ill. May 6, 2004), the court inferred that while evidence of misappropriation may be helpful in proving inevitable disclosure, it may not be necessary. Of course, some of this relaxed application may be attributable to the fact that *Cacique* and *YCA* originate in the 7th Circuit, home of the *PepsiCo* case.

In sum, the legal landscape is unpredictable where the inevitable disclosure doctrine is involved. Employers are advised to gain a measure of protection by binding all appropriate employees-particularly high-level executives with access to confidential information-to confidentiality agreements and restrictive covenants at the outset of their employment. To maximize enforceability, employers should ensure that the terms of the agreements are reasonable and fit the particular level and type of employment at issue. While there may be some risk that a court may find that the presence of such agreements precludes, rather than supports, injunctive relief, the risk is much greater in their absence.

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