

Protection of Customer Lists and Other Trade Secrets

By Olivia Goodkin, Esq.

How does an employer protect its valuable trade secrets, like customer lists or business plans, when an employee is terminated or quits and goes to work for a competitor?

One solution is to include a "covenant not to compete" in a written employment agreement. Covenants not to compete prohibit employees from working for a competitor in a defined territory for an agreed length of time after they leave their current employment. The problem is that in California, covenants not to compete are **illegal**, except in narrow circumstances, namely, when the departing employee had a "material" ownership interest in the company and sold back that interest as part of his or her departure from the company.

What can be done then, if anything, to prevent a non-owner employee who knows valuable inside information from using it for the benefit of a competitor?

Fortunately, an effective trade secret program will prevent the employee from ever using confidential information for the benefit of a competitor, and lays the groundwork for a successful lawsuit, if necessary, to enforce the confidentiality of trade secrets. While a trade secret program does not prevent an employee from working for a competitor, it can effectively stop the employee from contacting your customers, or using confidential customer or pricing information. In essence, this will prevent the employee and his or her new employer from competing unfairly with you.

The law defines a trade secret as information that (1) derives independent economic value from not being generally known to the public; and (2) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.

Looking at the first part of the equation, it is obvious that technology and products in development could be trade secrets. Customer lists can qualify as trade secrets as well, even when the names of customers are public information. Customer lists become trade secrets when a company invests substantial time, effort and expense in *qualifying* the list of potential customers, by finding out the names of contact persons and the customer's preferences and specifications.

What about the second part of the equation? What are considered reasonable efforts to maintain the secrecy of proprietary information?

The requirement that a company take steps to keep its proprietary data secret presents the major pitfall for most companies, but is the one that is most easily met. In the case of sensitive product development information, or business plans of closely held companies, a court would expect that only certain personnel have access to that information, that it is password protected, that it cannot leave the premises, and it is not otherwise easily



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accessible. These policies ideally should be in writing, to provide proof to the court that the employees *know* of the value and confidentiality of the trade secrets.

With respect to customer records, such as contact names, prior orders, special pricing or specifications, again, this data should be limited to certain individuals. Announcements could be made at staff meetings regarding the fact that this information is considered a company trade secret.

Most easily, and importantly, a company should have every employee sign a confidentiality agreement.

I suggest a separate agreement (meaning, in addition to an employment agreement) that spells out the kind of information the company considers a trade secret. The agreement should also provide that the employee may never use or disclose the trade secrets to a third party or use it to the detriment of the employer, both while employed by the company and after employment ceases. If the employee has an employment agreement, the employment agreement should refer to the signing of a confidentiality agreement as a condition of employment. In addition, the employee handbook should contain the trade secret program, and all employees should sign an acknowledgment of the handbook.

A recently reported case confirms that signed confidentiality agreements constitute the "reasonable steps" required to keep trade secrets confidential. In the case of *ReadyLink Healthcare v. Jerome Cotton*, decided on February 14, 2005 by the California Court of Appeal, the court upheld an injunction preventing a former employee from soliciting employees and customers, and from using the former employer's trade secrets at his new job for a competitor.

Remember, even if employees sign the appropriate documents, the trade secret program will not work if the company allows trade secrets to be disclosed. The moral is that the employer must remain vigilant in guarding the information and disciplining employees who breach the agreement to keep trade secrets confidential.