



Using Confidentiality Agreements to Protect Your Business

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If you are just starting a business in the e-commerce arena, you may be painfully familiar with confidentiality agreements. As a litigator and business attorney, this area of the law is largely responsible for helping to put my kids through college. That means this is probably an area you want to stay away from, unless part of your new business plan involves spending a lot of time in court.

In the early days of my litigation practice, I dealt with the "garden variety" of commercial disputes, involving departing executives and key salesmen accused of taking a Rolodex® or other customer list, price sheet, supplier list, or other such "secret" information. In the last eight to ten years, however, a rapidly increasing percentage of these disputes has involved the computer industry.

YOU'RE EITHER WITH US, OR YOU'RE AGAINST US!

The typical scenario involves the departure of an employee who is later found to have started or become employed by a competing business. The attitude of the management of the former employer is that "you're either with us or against us." If you're not with us, the thinking of some employers quickly evolves as follows:

Stage 1 - Gee, we'll really miss old Bob.

Stage 2 - Gee, I wonder what old Bob was working on.

Stage 3 - I wonder why we didn't close that deal on Bob's old prospect.

Stage 4 - I wonder if Bob had something to do with us not getting that contract.

Stage 5 - It looks like Bob must have been talking to some competitors (insert in the alternative that Bob was doing something covert to start his own company on your company's time) while he was still getting paid by us.

Stage 6 - I don't see how Bob's new company could get that kind of business so quickly.

Stage 7 - I wonder if Bob used some of our information to help (insert in the alternative that Bob took company information to help his new company or help make his job with your competitor immediately successful).

Stage 8 - It looks like Bob must have used some of our confidential information to (insert in the alternative or cumulatively: reach our customers, or create that new product; or undercut our prices; etc.).

Stage 9 - It appears that Bob stole our trade secrets and is using them illegally to compete with us unfairly. I bet his laptop was loaded with our spread sheets and customer lists.

Stage 10 - We're going to sue Bob into oblivion, to teach him a lesson, as well as to send a message to our other employees not to mess with us.

Stage 11 - Boy, that retainer to the lawyer hurt, but we're going to crush Bob.

Stage 12 - Thank heavens we got that restraining order. That will teach him.

Stage 13 - I wonder what is taking so long. This is such a clear cut case of theft or our trade secrets.

Stage 14 - Wow, that was a long deposition. This has got all our people talking about this case instead of working on their job, including me. This is getting really inconvenient and expensive.

Stage 15 - I can't believe we had to turn over that information about our company. They're really putting us through the ringer over this. I hope our other competitors don't see that, not to mention our customers. We need to go on the offensive.

Stage 16 - How could we be so stupid to not label our files "confidential" or at least restrict access. I can't believe our customer lists aren't Trade Secrets and that Bob's lawyers are allowed to talk to our customers. I didn't want them involved. We could actually lose some business over this.

Stage 17 - It really looks bad that we had our restraining order removed. I don't think that judge understood just how important this information is to us. Bob is getting away with murder. Now he's probably laughing at us, along with our other competitors.

Stage 18 - Things are not going well with this suit. I'm spending way too much time on this, as are some of my key people. Bob's lawyers are going through our files and deposing our key people like we have no right to protect this information and our schedules don't make a difference. This is costing a fortune and we don't have anything to show for it.

Stage 19 - I've got to find a way to get rid of this. Maybe we can mediate or do something to just end this.

Stage 20 - The case "resolves" itself, either through a token payment by Bob, or with some language drawn up by the lawyers, indicating that neither side will illegally use information from the other or unfairly do "bad things" to the other.

This is, of course, an overgeneralized and dramatically shortened outline of some feelings by the initiating CEO of the former employer. These feelings are amplified if several employees have left in a fairly short period of time, going to the same start-up or other competitor. On the other hand, representing as many departing employees as former employers, I've often felt that my poor former employee client has been wrongly accused, if not unfairly prosecuted, merely to keep him or her out of the marketplace.

Usually, the former employer is the one with the money and the facts. If they can go in and get a quick restraining order keeping their departed employee from doing anything "in competition" with them, the money and time my client will have to devote to the fight is sometimes enough to literally run them out of town. I am not unfamiliar with a few local employers in the computer and technology arena who have a reputation for vindictive suits against almost every departing employee. They seem to do it merely because they have the money to "crush" these people and keep them out of the marketplace.

If you are departing from your computer industry employer to start a new company, you'd better be sure you know the drill on how to leave, what you can take with you, and how to conduct your new business, so as to minimize your chances of being sued. This sort of protracted litigation can be crushing, economically and psychologically, impacting not only you, but your family and others in your new work environment. If you are starting a new company, however, the economics are not on your side. Unlike your last employer, *Giant Technology, Unlimited*, you probably do not have sufficient assets to pursue extended litigation without sacrificing elsewhere.

In previous chapters we've discussed the need to leverage your talents in several areas by enlisting the help of others. It happens early in the start-up and will continue throughout its life cycle. Life is complicated. Business and competition is life on steroids, in many respects. The days have long passed when you could develop a great product or service, do a little marketing and then just sit back, waiting for customers to knock your doors down.

Today, with the ability to research products and services on the Internet, you not only have to develop a sound product or service, you also have to deal in a market arena where your competition could be anywhere and could emerge overnight. There have always been "spies" in the marketplace. Even in law school, one of the first cases you read about this sort of thing was an old case involving a company which sent a plane with a camera over a factory that was being built by a competitor. The court dealt with the issue of whether it was legal to copy the layout of an innovative factory which a business was trying to keep "under wraps," but which could be seen from the air. Suppose they had just hired away the project engineer instead.

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CAN YOU KEEP A SECRET?

These days, instead of flying over, your competition may have a tendency to "surf" all over you. We all know there is an incredible amount of personal information available on the Internet. This information bonanza may be even more true of businesses. While many are concerned with invasion of privacy, Web-based companies, looking for "content," are rolling out new and improved databases and search engines. These are often advertised as being tuned to provide you greater and more refined data about anything you would care to know. Generally, they fulfill this promise. My Web browser bookmarks files are ballooning with excellent Web sites where I can quickly find out all sorts of things I never thought would be accessible just a few years ago. The information brokers and professional Web searchers are even more frightening, in terms of what they can find out and how quickly they can do so.

At the same time, government entities are churning out incredible amounts of data filled Web pages, partially, it sometimes seems, simply to prove they are able to do so. Many of the early government Web sites were useless. Often the best thing you could find was an address or a phone number so you could try to reach a human. The next stage of development seemed to be one where the highest order of information was in the form of an index of information you could get by sending a letter or visiting the agency. This was sort of like driving to a branch library only to find out all they had inside was the card catalog. You still had to drive to the main branch to read a book.

Now, both private and public Web sites have started to realize that information is power. The more you have and control, the stronger you are. Faced with competition themselves, most of these sites have decided that they really need to provide some information, and they do now provide it. In doing so, they are putting things on the Web that most of us had no idea was even collected in a database including things that historically sat in inaccessible file cabinets in remote locations. They are also increasingly using online entry of new data by the public and other agencies. All this leads to much greater access to information, which might lead your competition to your business.

KEEPING IT PRIVATE

In starting a business, many of us soon realize we don't have all the answers. In fact, we may not even be sure if the business has a chance of succeeding. At this stage, a prudent entrepreneur will look for someone who may have the answer, whether it be a software programmer, engineer, someone able to manufacture a prototype or mold, accountant, potential investors, or perhaps even a lawyer.

Unfortunately, when I first meet with many entrepreneurial clients, they have already been to one or more "advisors" as they moved along their path from concept to conception. If their idea has some competitive advantage based upon secrecy, I find that very few have done everything they could have to maintain all the secrets. Many have taken several steps to shield certain critical elements of their concept or product from prying eyes, but they have typically left some sort of trail of information. This trail is often sufficient for even a novice "spy" to mine enough data to have a pretty good idea of what the client is up to. Fortunately for the

client, not everyone is out to get them.

Sometimes, however, it is the dishonest mold maker or the early temporary employee, who has relatively unrestricted access to your "secrets" simply because you are not yet sufficiently organized or informed as to what should be protected. Part of your business plan should be to identify what you will do or create that will defeat the competition in this market. If you can't identify such a competitive edge, you'd better rethink going into this business at all. If you can identify it, you'd better analyze how you'll protect it at all stages of development of your business.

There are several types of protection available to you in different situations. I'll go into them in greater detail in another chapter, but briefly, the key ones are copyrights, trademarks, service marks, patents, trade secret laws, non-competition agreements, non-disclosure agreements, and non-interference agreements. The computer industry has caused great concern with the issues of just what is subject to copyright protection, as well as whether aspects of computer programs, such as the graphical user interface or the ability to gain access to a particular portion of a Web site in "one click" is something on which a patent can be obtained. Domain name disputes, particularly as they are impacted by trademark law, are also something you want to be on the "right side" of if at all possible.

TAKE INVENTORY OF IMPORTANT YOUR INFORMATION

Short of hiring a patent or trademark lawyer to file an application for you, is there anything you can do to protect your important information? There certainly is. The first step is listed above. Take an inventory of what you have that is really something you want to protect. What is it that you have that you wouldn't want your competitors to know about? What is there about your business that gives you a competitive advantage over them? Conduct an audit of your business to determine if there are any databases, software programs, processes, or other aspects or assets of your business that are protectable in any fashion. At this stage you may want to consult with an attorney, or at least do some serious reading.

Fortunately, the Patent and Trademark Office has a great deal of informative advice available online at its Web site, <http://www.uspto.gov/>. Additionally, the Library of Congress site, <http://lcweb.loc.gov/copyright/> has information on copyright issues, where you can even read the Napster brief, as well as finding fill-in forms at: <http://www.loc.gov/copyright/forms/>.

The second step is to determine the best method of protecting what you have. Some things are best handled as a trade secret if they qualify for this status. To read up on this, visit the Web site of the legislative branch of the state you are concerned with. Locally, for instance, the Kentucky Trade Secret Act is available online through the Kentucky Legislative Research Commission at: <http://162.114.4.13/search.htm>. The comparable statute in Indiana is available by starting your search at <http://www.state.in.us/legislative/ic/code/index.html>. At these or other state sites, simply plug the words "trade secret" into the search box and a copy of the state statute or a listing of sections of the state act will come up. For other states, you might try <http://www.findlaw.com> or another legal search site to easily take you to online full text copies of that jurisdiction's statutes.

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Many companies make the mistake of feeling that any information they would like not to be made public must be a trade secret. In fact, the typical definition of a what qualifies as a trade secret, is fairly specific. Additionally, the information must also be the subject of efforts, which are reasonable under the circumstances, to protect and maintain its secrecy. This information must be something that is not commonly available to someone outside the business, and which was either compiled or developed in a somewhat unique manner. In other words, it is not just a phone book rehash. The company must also identify it, such as by marking it "confidential" or "trade secret," restrict access to it (i.e. lock and key or password if online), and typically keep it secure by other means. This is not something that is published, unlike a patent, which must be published.

Trade secrets can remain such indefinitely, as long as the information maintains its secrecy and competitive advantage. Patents have a limited duration and are certainly the target of reverse engineering. You should choose your method of protection carefully. Meanwhile, back to those employees. Aside from filing an application and pursuing litigation for infringement, is there anything else you can do?

The most common method to protect yourself is use of a NDA or non-disclosure agreement. This agreement typically states that the employee will not, directly or indirectly, tell anyone else about any protected information, learned during or as a result of employment with the company. This is particularly important in the computer industry. It is critical in the realm of consultants, who may be in and out of your business, and gives rise to a real problem area.

Large companies with big research and development divisions may be reluctant to sign any such agreement, simply because they cannot be sure that someone they are paying may not already be working on something like what it is that they would be agreeing not to come up with. The language in this situation must be carefully crafted to give them sufficient protection from themselves.

On the other hand, most consultants these days are smaller companies. In order to be competitive, they may have to join with others in what are sometimes called teaming agreements. By means of these teaming agreements, they join with other companies to jointly fulfill a contract they otherwise would not have the resources or skill sets to complete. In these situations, they must worry about their other team members learning too much about what both they and the end client may consider confidential information. The disclosure may be intentional, but in such a close working arrangement, it may very well be accidental. Walking around the IT department or the accounting office, it may be nearly impossible to not come into contact with sensitive data sitting on a desk or posted on a computer monitor. Agreements in this arrangement must be extremely carefully worded for the sake of all involved.

Another common problem with this sort of arrangement is that the most valuable employees are often at a customer site with a counterpart from another company, which is possibly a potential competitor, as well as with a customer who may soon find that it would probably have been more economical to have simply hired these wonderful employees of their contractor. This, of course, can lead to employee "theft," as these key individuals are offered

nasty fringe benefits like insurance, vacation days, and stock options that are actually worth something.

In this situation, you should have a "non-interference" clause in your agreement. This language simply states that your team members or your customer are prohibited, except through your company, from employing or in any way using the services of any of your employees for a certain time period after they enter into an agreement with you to do some work for them. Beware the situation where your customer sets up your key employee in his or her own consulting practice, but doesn't actually hire him as an employee. Again, the devil is in the details. Good language is important here.

Finally, to come full circle, we get back to the non-competition agreements. In the technology field, these are becoming more interesting all the time. Case law seems to be emerging indicating that shorter is better. From an employer's point of view, you have a tendency to want to restrict the ability of your employees to ever do anything which might remotely be considered competitive. In reality, most courts now consider that such agreements must be reasonably limited in their scope in several ways.

For instance, the CEO and janitor do not necessarily need the same length of time or geographic range for prohibited conduct. The period in which the employee may not compete must be reasonable. Although I've seen case law locally extending beyond five years, six months to a year is typically a more reasonable period to prohibit competition, unless attached to a business buy-out agreement. Many of the better non-competition agreements will prohibit general competition for one period of time, and for a relatively longer period of time if it is with the former employer's customers. The geographic area should be one which is demonstrably related to your actual market area, regional offices, or customer locations. If the individual signing the agreement is one with unique access to customers, it is typically more reasonable to restrict his future dealings with those customers in the same line of business as you are in, but not in a different and non-competitive field.

Finally, think about who you would have sign such a document and where it might be enforced. In some states, such as California, these types of agreements have essentially become contrary to public policy and are relatively more difficult to enforce than elsewhere. Foreign countries present their own set of situations. Certainly, you would want all key individuals in your company to sign such documents, including other founders and anyone with access to critical information. Remember that non-compete and non-interference agreements should have a relatively short duration to be enforceable, but non-disclosure agreements do not have such limitations. It is totally reasonable to permanently restrict disclosure of your confidential information, as well as to vigorously prosecute any violation of a trade secret action, if it is appropriate. The time to put all this into place is at the beginning of your business.

Planning for success in the Internet world involves planning to keep your trade secrets and other proprietary information away from anyone who can improperly use it against you. This is the "treasure" of your business. Would you leave money sitting on the counter at the reception desk? How about on your receptionist's monitor? Let's hope not, but you better go look anyway. Spend an hour looking around "your business" and see what is available for the

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picking. You may be surprised.

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