

# Protecting Trade Secrets



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## *A Review of Virginia's Statute*

by Scott Ford

There are many ways for a company to protect its confidential and valuable information from being accessed and used by competitors. Such methods include the registration of patents and copyrights as well as the use of carefully tailored restrictive covenants. These may be the best ways that a company can protect trade secret property. However, where no patent, copyright or restrictive covenants exists, or if this protection is later held to be invalid, most state legislatures have enacted statutes that protect trade secret property. These laws serve as alternatives in these circumstances or as a complementary cause of action.

Trade secret laws protect the owners of trade secrets “from the disclosure or unauthorized use of the trade secret by another to whom the secret has been confided under the express or implied condition of nondisclosure or nonuse”<sup>1</sup> and from “use of the secret by those who have obtained access to it by improper means.”<sup>2</sup>

### **History of the Virginia Uniform Trade Secrets Act**

Historically, regulation of the use and misappropriation of trade secrets was governed by common law principles, which had many jurisdictional variations. States gradually enacted laws with little unifor-

mity in language or application. The National Conference of Commissioners on Uniform State Laws, recognizing the commercial importance of state trade secret law to interstate business, approved and recommended for enactment in all the states the Uniform Trade Secrets Act (Uniform Act) in 1979.<sup>3</sup> The Uniform Act was amended in 1985 to further comport with these goals.

Forty-two states have now adopted the Uniform Act, with varying degrees of modifications. The Virginia General Assembly adopted the Virginia Uniform Trade Secrets Act in 1986 (VUTSA), with minor

deviations from the Uniform Act.<sup>4</sup> The VUTSA was modified in 1990 to reflect the 1985 amendments to the Uniform Act.

### Rationale for the Virginia Uniform Trade Secrets Act

The General Assembly's purpose in adopting the VUTSA was to achieve the delicate balance of, on the one hand, safeguarding innovation by companies and, on the other hand, to protect free and legitimate competition (such as the preservation of worker mobility when they have properly acquired knowledge and skills useful in the industry).<sup>5</sup>

The Supreme Court of Virginia has frequently restated the rationale of the VUTSA. The Court recently reiterated that one of the primary purposes of trade secret law "is to encourage innovation and development," but that it will not be used to "restrict legitimate competition."<sup>6</sup>

### Necessary Elements To Establish Cause of Action for Misappropriation of Trade Secrets

The VUTSA provides for injunctive and monetary relief for the actual or threatened misappropriation of trade secrets<sup>7</sup> and provides for recovery of attorneys' fees where the misappropriation is found to be willful and malicious.<sup>8</sup> To be in violation of VUTSA, the proponent must show that a trade secret exists and that the defendant misappropriated the trade secret. These determinations are questions of fact to be resolved by the fact finder.<sup>9</sup> The proponent bears the burden of proving the trade secret claim by a preponderance of the evidence.<sup>10</sup>

### Trade Secret

The statute very broadly defines what constitutes a trade secret. It includes information such as a "formula, pattern, compilation, program device, method, technique or process." It must have independent economic value from not being generally known and readily ascertainable by proper means by persons who could obtain economic value from its disclosure; and it must have been the subject of reasonable efforts to maintain its secrecy.<sup>11</sup>

To satisfy the independent economic value requirement, the trade secret property must give the owner some actual or potential competitive advantage. The Virginia courts have not specifically addressed the nature or extent of the competitive advantage required of the trade secret property for it to be afforded protection under the statute. However, the Seventh Circuit Court of Appeals, interpreting Illinois's enactment of the Uniform Act, stated that the act does not require the advantage to be substantial or significant. The court stated that it is sufficient that the owner merely have "an opportunity to obtain an advantage."<sup>12</sup>

The information must also not be generally known within the relevant industry or trade.<sup>13</sup> Information is not a trade secret if the principal persons who can obtain economic benefit from the information are aware of it.<sup>14</sup> The specific level of accessibility that would defeat protection under the statute has not been particularized. The information may be minimally available, such as through filing documents in open court, and still maintain its trade secret protection.<sup>15</sup> However, the information cannot be posted on the Internet, where it would be readily accessible to any interested individual.<sup>16</sup>

The statute also requires that the information must not be ascertainable through proper means. Proper means has been defined to include discovery by independent invention, reverse engineering, discovery under a license, observing the product or service on public use or display, and review of publicly available literature.<sup>17</sup>

If the information is readily ascertainable through a proper means, it will not receive trade secret protection. For example, if the information is licensed to a business for nonexclusive use, other businesses would have the opportunity to obtain the information through proper means and the business would not have the sufficient expectation of secrecy necessary under the statute to protect their interests.<sup>18</sup>

The "crucial" characteristic of a trade secret is that its secrecy is maintained.<sup>19</sup>

While the secrecy need not be absolute, the owner must act in a manner that reasonably assures the protection of the confidentiality of the information. The "owner of a trade secret may, without losing protection, disclose to a licensee, an employee or a stranger, if the disclosure is made in confidence, express or implied."<sup>20</sup>

Trade secret protection will not be provided if the owner does not take "reasonable precautions" to maintain the secrecy. If the information is disclosed to outsiders, including customers, who are under no obligation to maintain the confidentiality, the information will lose its trade secret protection.<sup>21</sup> Therefore, if the information is disclosed, even inadvertently, to others who are not under an obligation to protect its confidentiality, then the information loses its trade secret protection.

### Misappropriation

The plaintiff must prove that the defendant misappropriated the information. Trade secret law protects the owner of a trade secret from the disclosure or unauthorized use of the trade secret by another to whom the secret has been confided under the express or implied condition of nondisclosure or nonuse.<sup>22</sup> The law also protects the trade secret owner from use of the secret by those who have obtained access to it through improper means.<sup>23</sup>

"Improper means" includes "theft, bribery, misrepresentation, breach of duty or inducement of breach of duty to maintain secrecy, or espionage through electronic or other means."<sup>24</sup>

Improper acquisition, without any disclosure or use is sufficient to constitute a violation of the act. In *Smithfield Ham and Products Company Inc. v. Portion Pac Inc.*, the Court stated that the VUTSA "prohibits the improper acquisition of a trade secret, whether or not the secret is used in direct competition with the rightful owner." The Court stated that the purpose of the act is to protect the value of trade secrets as "an asset of the company," regardless of the competitiveness of the acquiring person.<sup>25</sup> The Court stated that the mere improper acquisition of trade

secret information by an outsider is sufficient to satisfy the misappropriation requirement of the statute because the value of the trade secret is diminished by the disclosure alone.<sup>26</sup> However, the determination of damages to be awarded under these circumstances can prove difficult. A

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recent circuit court decision did not award damages when the defendant had misappropriated plaintiff's trade secret but had not yet utilized the information.<sup>27</sup>

Proper acquisition with knowledge that the information had been previously obtained through improper means is sufficient to constitute a violation of the act.<sup>28</sup> The statute does not require that the defendant personally misappropriate the trade secret property; it merely requires that he or she had knowledge that information had been misappropriated at some point in the chain of custody leading to his acquisition.<sup>29</sup> If the individual properly acquiring the trade secret is unaware that it has previously been misappropriated, he or she is not liable under the statute for its mere possession without use or disclosure of the trade secret property. However, subsequent disclosure or use of the trade secret information has been held to constitute liability under the statute under this latter scenario.<sup>30</sup>

Finally, proper acquisition of trade secret information with subsequent misappropriated use or disclosure of the information constitutes a violation of the statute. In *Dionne v. Southwest Foam Converting & Packaging*,<sup>31</sup> a former employee obtained the trade secret—a polystyrene packaging product. This employee had substantially contributed to the development of this product. Upon leaving the corporation, the former employee started a competing business using the trade secret to manu-

facture the packaging material. The court held that, when the former employee obtained the trade secret, the circumstances gave rise to a duty to maintain its secrecy. In making its determination, the court considered the fact that the employee had signed a confidentiality

agreement with the company, knew it was a trade secret, and had a duty to maintain its secrecy. The key point to note with this case is that trade secrets belong to the employer, not to the employees contributing to the development of those trade secrets that are acting within the scope of their employment.

**Practical Considerations**

Companies that desire to take advantage of the VUSTA should be counseled on a few specific actions that increase the likelihood of protection of trade secret property by a court. First, strict protocol should be established that limits access to trade secret property to only those persons required to know of the trade secrets. These individuals should be asked to acknowledge in writing their understanding that the trade secret property has value and must be kept secret.

Second, the company should be instructed to maintain records that show the savings and competitive advantage achieved by the possession of the trade secret property.

Third, the value of the trade secret property and the critical need for secrecy should be communicated on a continuous basis—preferably in writing—to those individuals with knowledge of the trade secret property. If possible, password protection measures should be used by individuals allowed to access trade secret information.

***Microstrategy Inc. v. Li***

The Virginia Supreme Court's decision on September 17, 2004, in *Microstrategy Inc. v. Li* reiterated that the determination of whether certain information should receive trade secret protection is a very fact-specific inquiry.<sup>32</sup> This recent decision further suggests that expert opinions will likely be relied upon with greater frequency in trade secret cases into the future.

In *Microstrategy*, defendants were software engineers for Microstrategy and later left to work for a competitor, Actuate.<sup>33</sup> The products on which they had worked with each company had several overlapping components, including a source code, table structures and indexes, and programming language.<sup>34</sup> Plaintiff alleged misappropriation of Microstrategy's trade secrets. Defendants claimed that they relied upon their general knowledge and the principles learned in the course of their prior educational and professional experiences.<sup>35</sup>

Both plaintiff and defendants presented experts in computer science who reviewed the nature of each product's design and the overlapping components.<sup>36</sup> The Court exhaustively reviewed credibility of the witnesses and the development processes of each product. Despite the overlapping components between the products in areas of expertise in which defendants worked for Microstrategy prior to employment with the competitor, the Court held that defendants did not misappropriate Microstrategy's trade secrets, but rather utilized generally known computer science concepts in developing the competitor's product.<sup>37</sup>

The Court stated that the burden of proof is on the plaintiff to prove all elements of the cause of action that the defendants misappropriated a trade secret, and not on the defendants to prove that the information utilized in developing the product was independently derived.<sup>38</sup> This finding demonstrates the importance of using experts, as individuals attempt to claim trade secret protection over complicated and technical information.

### Other Potential Causes of Action

The preemption provision of the VUTSA precludes recovery under alternative theories of common law recovery in tort when it is clear that the information in question constitutes a trade secret as provided for in the statute.<sup>39</sup> However, alternative theories of recovery can be pleaded if there is reasonable dispute over the existence of a trade secret protection under the VUTSA.<sup>40</sup> The preemption provision will preclude common law claims only when they are premised entirely on a claim for the misappropriation of a trade secret.<sup>41</sup>

In addition to the VUTSA, the practitioner should examine other possible viable causes of actions in those cases involving misappropriation of trade secret property. Such other causes of action may include breach of fiduciary duty, fraud, tortious interference with contract and/or business expectancy, conversion, common law conspiracy, statutory conspiracy, breach of employment contract and violation of the Federal Computer Fraud and Abuse Act and/or the Virginia Computer Crimes Act.

### Conclusion

The VUTSA has proven to be an invaluable asset for companies to protect legitimate trade secret property that has independent economic value and has been the subject of reasonable efforts to maintain secrecy. Given the broad definition of what may qualify as a "trade secret," the practitioner is well served to consider this cause of action in those instances where proprietary and confidential information has been wrongly converted. ☺

Endnotes:

- 1 *Microstrategy, Inc. v. Li*, \_\_\_ Va. \_\_\_, 601 S.E.2d 580, 588 (2004) (citing *Kewanee Oil Co. v. Bicron*, 416 U.S. 470, 475 (1974)).
- 2 *Id.* (citing *Kewanee Oil Co.*, 416 U.S. at 475-76).
- 3 Special Committee on the Uniform Trade Secrets Act, REPORT TO THE CONFERENCE EXECUTIVE COMMITTEE, February 17, 1968; National Conference of Commissioners on Uniform State Laws, UNIFORM TRADE SECRETS ACT WITH 1985 AMENDMENTS (1985), available at <http://www.law.upenn.edu>.
- 4 VA. CODE ANN. § 59.1-336 *et seq.* The majority of the differences between the Uniform Act and VUTSA are formatting and grammatical. The VUTSA does, while the Uniform Act does not, however, place an absolute cap on punitive damages at \$350,000. *Id.* at §59.1-338(B).

- 5 *Dionne v. Southeast Foam Converting & Packaging, Inc.*, 240 Va. 297, 303 (1990).
- 6 *Microstrategy*, \_\_\_ Va. at \_\_\_, 601 S.E.2d at 588 (referencing *Kewanee Oil Co.*, 416 U.S. at 481).
- 7 VA. CODE ANN. §§ 59.1-337, -338.
- 8 *Id.* at § 59.1-338.1.
- 9 *Microstrategy*, \_\_\_ Va. \_\_\_, 601 S.E.2d at 589-90.
- 10 *Id.* at \*590 (quoting *Dionne*, 240 Va. at 303 n. 2).
- 11 VA. CODE ANN. § 59.1-336.
- 12 See *PepsiCo. V. Redmond*, 54 F.3d 1262 (7th Cir. 1995).
- 13 This is provided for in the UNIFORM TRADE SECRETS ACT § 1, 14 U.L.A. at 439 cmt. The VUTSA models this section of the code provision on the Uniform Act.
- 14 *Id.*
- 15 *Hoechst Diafoil Co. v. Nan Ya Plastics Corp.*, 174 F.3d 411 (4th Cir. 1999) (holding the information is merely available in the open court record, though it is accessible, it is not automatically deemed generally known). In this case, the 4th Circuit Court of Appeals was interpreting South Carolina's version of the Uniform Act. The court held that the plaintiff is "not legally precluded from succeeding on the merits of its misappropriation claim" solely because the document was publicly filed in court records. *Id.* at 419.
- 16 *Religious Tech. Ctr. v. Lerma*, 847 F.Supp. 260 (E.D.Va. 1995) (holding that information filed in open court and posted on the Internet qualified as generally known and did not receive trade secret protection).
- 17 UNIFORM TRADE SECRETS ACT § 1, 14 U.L.A. at 439 cmt.
- 18 *Avtec Systems, Inc. v. Peiffer*, 21 F.3d 568, 575 (4th Cir. 1994).
- 19 *Dionne*, 240 Va. at 302.
- 20 *Id.* (citing *Kewanee Oil Co. v. Bicron Corp.*, 416 U.S. 470 (1974) (stating the subject of a "trade secret may be novel in the sense that it is something that is not generally known in the trade or business, 'novelty, in the patent law sense is not required for a trade secret.'").
- 21 *Advanced Computer Services v. MAI Systems*, 45 F. Supp. 356, 370 (E.D.Va. 1994).
- 22 *Kewanee Oil Co. v. Bicron*, 416 U.S. at 475.
- 23 *Id.* at 475-76.
- 24 *Id.*
- 25 *Smithfield Ham and Products Company, Inc.*, 905 F.Supp. at 350.
- 26 *Id.*
- 27 *Alan J. Zuccari, Inc. v. Adams*, 42 Va. Cir. 132, \*5 (1997).
- 28 VA. CODE ANN. § 59.1-336.
- 29 *Id.*
- 30 *Tao of Systems Integration, Inc. v. Analytical Services & Material*, 330 F. Supp. 2d 668, 677078 (E.D.Va. 2004) (stating that "acquisition [without knowledge of prior misappropriation] alone is insufficient, the acquirer must disclose or use the trade secret to have committed misappropriation within meaning of the statute).
- 31 *Dionne*, 240 Va. at 299. In this case, the trade secrets at issue were "the processes, techniques, and other secrets learned" while under the duty to maintain confidentiality.
- 32 *Microstrategy*, \_\_\_ Va. \_\_\_, 601 S.E.2d at 589-90.
- 33 *Id.* at \*583-84.
- 34 *Id.*
- 35 *Id.* at \*585.
- 36 *Id.* at \*585-87.
- 37 *Id.* at \*590-91.
- 38 *Id.*
- 39 VA. CODE ANN. § 59.1-341. See *Stone Castle Fin., Inc. v. Friedman, Billings, Ramsey & Co.*, 191 F.Supp. 652, 659 (E.D.Va. 2002).
- 40 *H.E.R.C. Products, Inc. v. Turlington*, 2003 WL 23162378, \*5 (Va. Cir. Ct.).
- 41 *Smithfield Ham and Products Company, Inc.*, 905 F. Supp. at 348.



**Scott C. Ford** is a director of the firm McCandlish Holton and a member of its litigation department. He regularly counsels individuals and companies with a broad range of litigation matters, focusing on commercial litigation and workers' compensation. Ford currently serves on the Board of Governors for the Litigation Section of the Virginia State Bar. Ford gratefully acknowledges the assistance of Janet P. Van Cuyk, an associate with McCandlish Holton, in the preparation of this article.

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