

October 1, 2002

California Rejects Inevitable Disclosure Doctrine

On September 12, 2002, a California appeals court rejected the "inevitable disclosure doctrine," as being contrary to California law and policy. In *Schlage Lock Co. v. Whyte*, 2002 Cal. App. LEXIS 4634 (Cal. App. 4th Dist., Div. 3, Sept. 12, 2002), California broke rank with the majority of jurisdictions that have adopted some form of the doctrine.

The inevitable disclosure doctrine allows a trade secret owner - an employer - to stop a former employee from working for a competitor if it can demonstrate that the employee's new job duties will inevitably cause the employee to rely upon knowledge of the former employer's trade secrets. This doctrine applies even if the former employer cannot prove that the employee has taken or threatened to use trade secrets. And the doctrine allows a former employer to obtain an injunction prohibiting employment, not just the use of trade secrets.

The Facts

The case involves two fierce competitors, Schlage Lock Company (Schlage) and Kwikset Corporation (Kwikset), who became embroiled in litigation when J. Douglas Whyte (Whyte) left Schlage to work for Kwikset. Both Schlage and Kwikset manufacture and sell locks and related products, and vie intensely for shelf space at big box retailers such as The Home Depot. Whyte, as vice-president of sales at Schlage, was responsible for sales to The Home Depot and other large retailers. He signed a confidentiality agreement to protect Schlage's proprietary information and agreed not to disclose confidential information for personal or noncompany uses. He did not sign a covenant not to compete.

In February 2000, Whyte on behalf of Schlage participated in a "line review" with The Home Depot. During a line review, The Home Depot reviews its suppliers' product lines, pricing and marketing concessions, and ability to deliver product. It then uses this information to determine which products it will sell. As a result of the line review and Schlage's recommendations, The Home Depot decided to remove one of Kwikset's

brands of locks and expand Schlage's presence on its shelves. Impressed with Whyte's sales abilities, Kwikset offered Whyte a job. Whyte accepted a position as vice-president of sales for national accounts with Kwikset on June 3, 2000, with job duties substantially similar to those at Schlage.

Whyte's parting from Schlage was not amicable. Schlage contended Whyte disavowed the confidentiality agreement, stole trade secret information (including a copy on computer disk of the line review agreement with The Home Depot), and lied about returning company information. Schlage also claimed that Whyte left to revenge belittling comments made by Schlage's president. Whyte denied taking any trade secrets, claimed that the Schlage president vowed to destroy his career, and maintained that he reaffirmed the confidentiality agreement.

The Holding

The state trial court ultimately denied Schlage's request for permanent injunctive relief. Schlage appealed. Affirming, the appeals court first found that Schlage did identify information possessed by Whyte constituting trade secrets.

Turning next to the issue of whether Whyte engaged in actual or threatened misappropriation, the court noted that California law allows a court to enjoin "actual or threatened misappropriation" of a trade secret. While Schlage produced direct and circumstantial evidence suggesting that Whyte indeed took Schlage's trade secrets or destroyed evidence, the court was constrained by the applicable standard of review to interpret the facts favorably to the order denying the preliminary injunction. Thus, it concluded that the evidence failed to establish that Whyte threatened to or actually did misappropriate Schlage's trade secrets.

The big news of the case came next, when the court ruled that the doctrine of inevitable disclosure was **not** available to Schlage as an alternative to proof of actual or threatened misappropriation. The court noted that the leading case on

inevitable disclosure is *PepsiCo, Inc. v. Redmond*, 54 F. 3d 1262 (7th Cir. 1995), a case with facts "strikingly similar" to those of the present case. In *PepsiCo*, the Seventh Circuit enjoined a former employee from working for a competitor when it was evident that the former employee would inevitably rely on his former employer's trade secrets in his new job. The majority of other jurisdictions addressing the issue have also adopted some form of the doctrine.

But the public policy of California strongly favors employee mobility. The doctrine of inevitable disclosure creates a "*de facto* covenant not to compete" not negotiated by the parties but imposed after the employment contract is made, said the court. Further, covenants not to compete are generally prohibited by California law, and it is that law which governs the scope, meaning and validity of noncompetition agreements. Based on this and existing California law that protects trade secrets, the appeals court affirmed the order denying Schlage's application for a preliminary injunction and affirming Whyte's motion to dissolve the temporary restraining order.

Implications of the Decision

Even before this decision, finding ways to prevent former employees from using proprietary information has been tricky for employers doing business in California. And while this case rejects the doctrine of inevitable disclosure, there are things employers can do.

- (1) Be sure to identify and protect trade secrets at the outset.
- (2) If an employer suspects a former employee of misappropriation of trade secrets, it will need hard evidence of actual or threatened misappropriation in order to obtain injunctive or other relief. *Schlage Lock* rejects inevitable disclosure as an alternative to proof of actual or threatened misappropriation.
- (3) The court in *Schlage Lock* identified one important line of defense: having trade secret and nonsolicitation agreements that pass legal muster. "Under the circumstances presented in this case, an employer might prevent disclosure of trade secrets through, for example, an agreed-upon and reasonable nonsolicitation clause that is narrowly drafted for the purpose of protecting trade secrets." The court suggested that the injunction proposed by Schlage - preventing Whyte from selling door locks to The Home Depot - might have been acceptable if negotiated at the time the employment contract was made.

In addition to making sure nonsolicitation clauses are narrowly drafted, employers should also consider including a verification signed by the employee that he or she has read and understood the entire agreement and has been given the opportunity to consult with an attorney. Employers should also look to writing nonsolicitation clauses in "plain English."

- (4) Before asking employees to sign agreements containing nonsolicitation clauses, employers are urged to have employment counsel review the noncompete and trade secret language for enforceability. Based on recent cases, severability and choice of law provisions may not offer any protection if the noncompete clause is held to be invalid.

For further information, feel free to contact the authors of this Alert: Kurt A. Kappes, a partner in the firm's Sacramento office, and Steven B. Katz, a partner in the firm's Los Angeles office.

ATLANTA

One Peachtree Pointe
1545 Peachtree Street, N.E., Suite 700
Atlanta, Georgia 30309-2401
404-885-1500
404-892-7056 fax

BOSTON

Two Seaport Lane, Suite 300
Boston, Massachusetts 02210-2028
617-946-4800
617-946-4801 fax

CHICAGO

55 East Monroe Street, Suite 4200
Chicago, Illinois 60603-5803
312-346-8000
312-269-8869 fax

HOUSTON

700 Louisiana Street, Suite 3850
Houston, Texas 77002-2731
713-225-2300
713-225-2340 fax

LOS ANGELES

One Century Plaza
2029 Century Park East, Suite 3300
Los Angeles, California 90067-3063
310-277-7200
310-201-5219 fax

NEW YORK

1270 Avenue of the Americas, Suite 2500
New York, New York 10020-1801
212-218-5500
212-218-5526 fax

SACRAMENTO

400 Capitol Mall, Suite 2350
Sacramento, California 95814-4428
916-448-0159
916-558-4839 fax

SAN FRANCISCO

101 California Street, Suite 2900
San Francisco, California 94111-5858
415-397-2823
415-397-8549 fax

WASHINGTON, D.C.

815 Connecticut Avenue, N.W., Suite 500
Washington, D.C. 20006-4004
202-463-2400
202-828-5393 fax

BRUSSELS

Avenue Louise 500, Box 8
1050 Brussels, Belgium
(32)(2)647.60.25
(32)(2)640.70.71 fax

This newsletter is a periodical publication of Seyfarth Shaw and should not be construed as legal advice or a legal opinion on any specific facts or circumstances. The contents are intended for general information purposes only, and you are urged to consult a lawyer concerning your own situation and any specific legal questions you may have. For further information about these contents please contact your Seyfarth Shaw attorney.