



## Trade Secrets Group Client Alert: Inevitable Disclosure is not the Law in California

Ending years of uncertainty about California trade secrets law, the California Court of Appeal, on September 12, 2002, issued a decision that clearly rejects the doctrine of inevitable disclosure as “contrary to California law and public policy,” and strongly suggests that California employers protect their trade secrets with “enforceable” noncompetition agreements.

The inevitable disclosure doctrine permits a trade secret owner to prevent a former employee from working for a competitor, despite the owner's failure to prove that the employee has taken or threatens to use trade secrets. The doctrine has been adopted in many states, but until now, California courts had not addressed it.<sup>1</sup>

In *Schlage Lock Company v. Whyte* (02 C.D.O.S. 9466), the Court of Appeal has held unambiguously, “we reject the inevitable disclosure doctrine. We hold this doctrine as contrary to California law and public policy because it creates an after-the-fact covenant not to compete, restricting employee mobility.” The case presents not only a long-anticipated statement of California law regarding the doctrine of inevitable disclosure, but also an enlightening analysis of California's trade secret law.

### A Textbook Trade Secrets Case

*Schlage* is a classic trade secrets controversy. Mr. Whyte was vice-president of sales for Schlage, who had signed a confidentiality agreement. He was responsible for selling to national accounts including “big box” retailers like Home Depot. Schlage's “fierce competitor” is Kwikset. Kwikset also sold to Home Depot, and when its president learned of Mr. Whyte's skill in dealing with that customer, he offered him a job. In June 2000, Whyte accepted the position as vice-president for national accounts of Kwikset, but continued to work at Schlage for two weeks and did not notify Schlage of his intended departure. During that two week period he continued to attend confidential meetings with Home Depot.

When Whyte did announce his departure, Schlage's president contends that he disavowed the confidentiality agreement, stole trade secret information and lied about returning company information. Whyte denied all of these allegations and contended that in the exit interview the president of Schlage vowed to destroy his career.

Whyte's duties at Kwikset were substantially similar to those at Schlage. His defection ignited what the court called a “firestorm of litigation.” Schlage sued Whyte in Colorado but failed to win an injunction on an inevitable disclosure theory. Whyte filed a suit in California for interference with contract and declaratory relief. In the California action Schlage won a temporary restraining order restraining Whyte from using or disclosing 20 categories of trade secret information and ordering him to return any such information in his possession. Whyte did return a “kitchen-sized garbage bag” of shredded documents and another bag containing seven destroyed floppy discs and nine destroyed zip discs. After discovery and a hearing, the California Superior Court for Orange County denied Schlage's application for a preliminary injunction, stating that the information Schlage sought to protect was not trade secrets.

### The Court Examined the Trade Secrets

Schlage and its parent company Ingersoll-Rand appealed. In reviewing the lower court's decision, the Court of Appeal first addressed the question of whether or not the 20 categories of trade secrets identified by Schlage were defined with sufficient particularity to be trade secrets under California Civil Code Section 3426. These categories of mostly business information ranged from “information about Schlage's new products” through pricing, profit margins, costs, pricing concessions, promotional discounts, advertising allowances, volume rebates, market research data and strategy, one-, three-, and five-year strategic plan documents, finishing processes, and material process technologies, as well as personnel information.

The Court of Appeal determined that based upon the descriptions of the alleged trade secrets contained in the temporary restraining order, and the discussion of the trade secrets in declarations and deposition testimony before the court, most categories of what Schlage claimed to be its trade secrets were in fact protectible as trade secrets. One exception was new product information, which was so broad as to encompass both secret and public information. This is one of the first reported California decisions to articulate a standard of review under Code of Civil Procedure Section 2019(d), part of the trade secrets statute.

<sup>1</sup> In 1999 the California Court of Appeal commented in passing and without explanation that the inevitable disclosure doctrine is the law in California, but that case, *Electro-Optical Industries, Inc. v. White* Civ. No. B133110, 1999 Cal. App. LEXIS 1042 (Cal. Ct. App. 1999) withdrawn 2000 LEXIS 3536 (Ca. 2002) was subsequently de-published by the California Supreme Court and therefore is not authority or citable precedent.

### The Court Examined Alleged Misappropriation

The court then considered whether Whyte engaged in actual or threatened misappropriation, noting that the evidence on this point was “neatly divided”. Schlage argued that Whyte had access to its trade secrets; that he had vowed to get even with Schlage's president; he concealed his planned departure and attended confidential meetings with Home Depot; renounced his confidentiality agreement; lied about destroying Schlage confidential information; and retained copies of Schlage information which he later returned. Whyte denied these charges and argued that there was no direct evidence of his misappropriating or threatening to misappropriate trade secrets. He claimed that he destroyed everything he had containing Schlage confidential information before he resigned, and pointed out that Kwikset had instructed him not to disclose any Schlage trade secrets.

While expressing some skepticism about the credibility of the declarations, the appellate court found that it may not re-weigh the evidence. It therefore concluded that the evidence established that Whyte did not threaten to or actually misappropriate trade secrets.

### Inevitable Disclosure is not the Law

The Court of Appeal then turned to the question of whether inevitable disclosure is the law in California. The court noted that the facts of this case were similar to those in the leading case on inevitable disclosure, *Pepisco, Inc. v. Redmond*, 54 Fed. 3d. 1262 (7th Cir. 1995) (decided under Illinois law), but that no published California decision has accepted or rejected the doctrine. Two federal district courts applying California law recently have concluded that inevitable disclosure is not the law of the state, but their determinations are not binding on state courts.

The court held “we are free to consider the inevitable disclosure doctrine, and we reject it.” It went on to examine decisions from other states that both accept and reject inevitable disclosure and found that the decisions that reject the doctrine “correctly balance competing public policy of employee mobility and protection of trade secrets.” The “doctrine permits the employer to enjoin the former employee without proof of the employee's actual or threatened use of trade secrets, based upon an inference. . . that the employee inevitably will use his or her knowledge of those trade secrets in the new employment. The result is not merely an injunction against the use of trade secrets, but an injunction restricting employment.”

The court found that such an injunction would contradict California public policy in favor of employee mobility, and Business and Professions Code Section 16600, because it “creates a de facto covenant not to compete.” Under Section 16600, employee covenants not to compete generally are void.

The court found that the real problem with the kind of covenant not to compete imposed by the inevitable disclosure doctrine is “its after-the-fact nature.” The doctrine imposes a non-compete after the employment contract is made and therefore alters the employment relationship without the employee's consent.

Interestingly, the court also noted that 40 years ago the California Supreme Court recognized that covenants not to compete may be enforceable notwithstanding Business and Professions Code § 16600 if “necessary to protect the employer's trade secrets.” *Muggill v. Reuben H. Donnelley Corp.* (1965) 62 Cal.2d. 239 at 242, and that Business and Professions Code § 16600 generally does not invalidate non-solicitation agreements.

While emphasizing that its rejection of the inevitable disclosure doctrine is “complete,” the decision strongly suggests that an employer may use an “enforceable” covenant not to compete (which it did not define) including a non-solicitation clause, to prevent disclosure of trade secrets. Presumably this would have to be created at the inception of or during the employment relationship.

Even if Schlage is not appealed to the California Supreme Court, we will be waiting for more litigation on inevitable disclosure and non-solicitation agreements as the courts continue their efforts to clarify these issues.

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