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INTELLECTUAL PROPERTY

How Trade Secret Audits Can Safeguard Your Intellectual Property

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Trade secrets are an important and valuable form of intellectual property that companies all too often overlook until faced with misappropriation, frequently by a departing employee or a third party the company believed it could trust. Once a trade secret is at risk, a company must answer tough questions in deciding what to do next: Is this information really a trade secret? Do we have enough internal protections? Have we done enough to protect the trade secret when we've shared it with third parties? The answers to these questions ultimately determine whether the company has a viable remedy for the theft of this type of intellectual property.

If your company has information that is not protected by a patent, copyright, or trademark, but that is valuable to any aspect of your business and treated as confidential, you likely have information you are knowingly or unknowingly seeking to protect as a trade secret. We recommend performing regular trade secret audits to ensure your trade secrets are adequately protected and that, should the worst happen, you are able to recover any damages.

What is a Trade Secret Audit?

A trade secret audit is a process by which an auditor performs an evaluation of your company's information and potential trade secrets. The auditor will work with you to identify your company's trade secrets and then observe and evaluate the current protections in place. If necessary, the auditor will suggest and oversee the implementation of additional protocols and procedures to protect your trade secrets from misappropriation and will ensure that you have plans for the most effective enforcement of your trade secret rights.

Does My Company Have Trade Secrets?

The first step of a trade secret audit is determining whether you have trade secrets to protect. Identifying what information a company considers to be a trade secret can be surprisingly complicated, and often reveals differing opinions among people about how certain information should be treated. Coming to a consensus within an organization is critical to ensuring appropriate protection. Contrary to popular opinion, a trade secret does not need to be a large part of your business to be protectable. Companies often overlook smaller processes, procedures, or data they use for day-to-day operations. This information may be protectable and should be evaluated for its trade secret value as well.

Both federal and state laws now protect trade secrets from misappropriation. The Defend Trade Secrets Act (DTSA), a federal law passed in 2016, defines a trade secret as all (1) information;[1] (2) that the owner has "taken reasonable measures to keep such information secret;" (3) and by which the owner obtains potential or actual economic value "from not being generally known" or "readily ascertainable." (18 USC § 1839(3)).

New York State common law generally defines a trade secret as "any formula, pattern, device or compilation of information which is used in one's business, and which gives [the business] an opportunity to obtain an advantage over competitors who do not know or use it." *Ashland Mgmt. Inc. v. Janien*, 624 N.E.2d 1007, 1013 (NY 1993). New York uses a six-factor balancing test to determine whether something is a trade secret: (1) the extent to which the information is known outside of the company; (2) how the information is treated internally; (3) the extent of measures taken by the company to protect the secrecy of the information; (4) the value of the information to the company and its competitors; (5) the amount of effort or money expended by the company in developing the information; and (6) the ease or difficulty for others to independently acquire the information. Although no one factor is determinative, courts often focus on whether a holder has taken reasonable steps to protect the secrecy of the information at issue. Simply put, to qualify as a trade secret, information must actually be secret.

Given this, it is critical to evaluate your potential trade secrets under state and federal law to ensure you have all appropriate protections in place. A trade secret audit will address any information that your company believes to be valuable and not commonly known and help evaluate how that information can and should be protected.

What Steps Can My Company Take to Protect Its Trade Secrets?

Once a trade secret audit reveals that a company has trade secrets worth protecting, an auditor can recommend certain internal and external steps the company should take to ensure that protection. Many of these recommendations are company-specific rather than one size fits all, as courts considering whether protections are adequate often consider whether those protections are reasonable under the circumstances. The appropriate protections can vary depending on factors such as the type of information at issue as well as the size and resources of the trade secret holder.

In terms of determining appropriate internal protections, an auditor will often conduct an evaluation of internal policies, enforcement of those policies, existence and substance of employee agreements, agreements with independent contractors, non-disclosure agreements, and physical and technical barriers to information. While companies often have relevant policies and agreements in place, many have not been updated recently. For example, to preserve certain rights under the DTSA (including the right to get exemplary damages and attorney fees in certain situations), in any contract or agreement addressing trade secrets or other confidential information, an employer is now required to inform its employees of their protection from liability for confidentially disclosing a trade secret to the government or in court filings. (18

[1] Information includes "forms and types of financial, business, scientific, technical, economic, or engineering information, including patterns, plans, compilations, program devices, formulas, designs, prototypes, methods, techniques, processes, procedures, programs, or codes, whether tangible or intangible, and whether or how stored compiled or memorialized physically, electronically, graphically, photographically, or in writing."

USC § 1833 (b)(3)). Employment agreements entered into or updated after May 11, 2016 should comply with this section.

A company seeking to protect its trade secrets should also ensure those employees with access to the relevant information have "bought in" to the company's trade secrets. This can involve advising the relevant employees regarding the value of the trade secrets, the importance of adequate protection, and the potential consequences of failing to follow appropriate safeguards. A company can also ensure better protection of its trade secrets by limiting the number of internal people with access to that information.

Besides evaluating internal protections, an auditor will assist a company in evaluating its policies and practices regarding disclosing trade secrets to third parties. In a perfect world, a company would not disclose its trade secrets to a third party without first entering into a non-disclosure agreement. While this is not practical in all circumstances, prior to disclosure, a company should thoughtfully balance the necessity of disclosure of the trade secret, the feasibility of having a non-disclosure agreement or other confidentiality agreement in place, the context of the disclosure, the particular third party at issue, and possible alternatives. This will help to ensure that an informed choice has been made and that disclosures absent non-disclosure agreements are limited to the extent possible. Given that a company's protections are only as strong as the protections of the third parties receiving the trade secret information, companies should also evaluate their relationships with third parties to make sure that their secrets are being maintained.

In addition to purposeful disclosures, a company should also consider and seek to limit accidental disclosure or access to trade secrets by visitors in the company's facilities. Potential methods of doing so include careful documentation of all visitors, restricting visitor access, and requiring visitor confidentiality agreements.

To aid with internal and external protection of trade secrets, another worthwhile consideration is designating a person responsible for "owning" the company's trade secrets, who will then be charged with working with in-house and outside counsel, determining and maintaining the identity of the company's trade secrets, and updating policies as necessary. Having a go-to person can help ensure that the issue does not end up swept under the rug when other pressing or competing concerns (such as the desire to quickly close a large business deal) arise.

What Steps Can My Company Take to Protect Other's Trade Secrets?

One additional consideration during a trade secret audit is how a company is treating inbound trade secrets. Companies often have not thought carefully about how they are using or protecting trade secrets received from third parties. A careful, thought out policy regarding incoming trade secrets can help protect your company from allegations that you have not handled inbound trade secrets appropriately.

Conclusion

It is important for companies to identify and protect their intellectual property, including trade secrets. To obtain the best outcome, trade secret protection should be purposeful and well planned. A trade secret audit is an important first step to achieving this objective. Harter Secrest & Emery intellectual property litigation attorneys are happy to help with this evaluation and the implementation of appropriate

safeguards to ensure that your trade secrets are not misappropriated in the first place and if they are, give you a better chance of recovering. For more information, contact a member of the intellectual property team at 585.232.6500, 716.853.1616, or visit www.hselaw.com.

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