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Trade Secret Protection Terms in Rep Agreements

By Eric Engel
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legally speaking

This is the second of two articles covering the subjects of restraint of trade and trade secrets. This article examines trade secret protection.

Yet another potential hurdle in the rep's efforts to avoid or limit the principal's desire to restrain post-termination competition arises in the form of the need to protect trade secrets, which is recognized in some manner by every state. Most states have adopted statutes that are based on the Uniform Trade Secrets Act (UTSA), and as of 2016 there is a new federal Defense of Trade Secrets Act, so there are some common features of trade secrets laws across the United States. Laws protecting trade secrets can indirectly give teeth to non-competition terms in principal-rep agreements, because even states with the strongest public policies against restraints of trade may allow restraints that are reasonably necessary to protect the trade secrets of the principal.

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Many principals' "standard" agreements include some term with the ostensible purpose of protecting the principal's trade secrets. Like non-compete clauses, the trade secret terms are often lopsided in favor of principals, attempting to cast unspecified “information, knowledge, methods, processes” and more as “trade secrets” or, even less specifically, “confidential and proprietary information” of the principal. The term “trade secrets” conjures uncertain images — does it encompass product engineering specifications, the identities of customers and contacts, customer preferences, prices and costs? Any of those can be trade secrets, but not everything that a principal may decree to be a trade secret is one.

In general, a trade secret can be any information that “derives independent economic value, actual or potential, from not being generally known to the public or to other persons who can obtain economic value from its disclosure or use,” provided that the owner took reasonable measures to maintain its secrecy. Most states include the additional UTSA qualification that the trade secret cannot be “readily ascertainable by proper means,” which restricts trade secrets to those that competitors or others could not develop themselves fairly easily. Interestingly, California does not include this restriction in its definition of trade secrets, which means that even though California has the broadest policies against contractual restraints of trade, it also has a somewhat broader view of what can be protected as a trade secret. That is important because trade secret protection can become a principal’s back-door method of creating an enforceable agreement restricting a rep’s ability to compete after termination, even under the rep-friendly laws of a protective state such as California.

A simple list of customers may or may not qualify as a trade secret in itself, but a more detailed compilation of information about customers, contact persons, product or service specifications, purchasing history, purchasing terms, and particularized customer preferences will often qualify as a trade secret. This type of trade secret information, to which a rep often has at least some access during the term of a sales representative agreement, may be protected by a principal in any state, regardless of the state’s laws against restraints of trade.

The scope of what information can be protected is always very fact-specific to the circumstance. A contract term that vaguely and generally recites that all manner of undifferentiated information “may be trade secret or otherwise confidential and proprietary,” or reciting items that are obviously public information and not trade secrets, might be so broad as to be largely useless for the principal. But a more narrowly and carefully drawn contract term identifying particular types of information as being trade secrets can be influential to a court — it can help the principal show both that certain information is a trade secret and that it was subject to reasonable efforts to maintain its secrecy through a contract term restricting its use. The terms of a trade secrets clause in a principal’s contract therefore are important considerations when a rep is considering what his or her competitive options will be after the termination of the relationship.

Trade Secrets

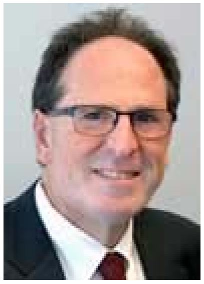
Generally, wrongful misappropriation of a trade secret is the acquisition, use or disclosure of a trade secret of another, without consent, when the trade secret information was obtained by improper means or through someone under a duty to maintain its secrecy. Wrongful misappropriation of trade secrets can result in not just monetary damages, but also court-ordered injunctions barring further use or disclosure of the trade secret, including soliciting customers through use of such trade secrets. Because it is difficult to determine if trade secrets were used, an injunction like that may effectively inhibit all solicitation of particular groups of customers. Even in a protective state like California, courts have entered injunctions barring outright all solicitation of a former principal's customers when there is strong evidence of misappropriation of the principal's trade secret customer information.

The risks to a rep are real even in states such as California that broadly prohibit restraints of trade, because all states have strong policies against unfair competition through misappropriation of trade secrets. Savvy principals, therefore, are careful to include in their agreements well-considered trade secret preservation terms that can serve to restrain the former rep from using the principal's information to aid post-termination solicitation of the same or even new customers on behalf of a competitor.

The rep's concerns about trade secret terms should not be limited to the risk that the principal will ultimately win and get a big damages judgment against the rep. The protection of trade secrets has particular impact because in some circumstances, immediately after a case is filed temporary injunctions can be sought in court that can last throughout the case. Cases asserting trade secret misappropriation and seeking immediate injunctions can be fast, furious and expensive. Injunctions to protect trade secrets can extend to the principal's competitors using the services of the rep, and in more extreme circumstances even extend directly to customers.

The mere threat by the principal that it can make such claims can cause considerable disruption of the rep's efforts to transition to a competing principal and to continue to work with customers previously serviced by the rep. If the principal pursues the claims, the rep will suffer expense and distraction to defend in order to avoid an adverse outcome, even if the principal ultimately does not prevail. Although the principal's trade secret contract terms likely will not in themselves determine the outcome, the better the principal's trade secret clause the greater the credibility of such threats to the rep, competitors and customers.

For all these reasons, the terms of trade secret protections in the principal's sales representative agreement can be quite important to the rep's ultimate ability to succeed after termination of the agreement. For the same reason, stronger trade secret terms can give the principal more leverage before termination, because the principal can plausibly assert that there will be significant restraints on the rep's ability to service competitors in the future. This dynamic requires a careful balance of each circumstance, which is another reason that reps are well-advised to seek counsel before signing the sales representative agreement.



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