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## **LITIGATING NON-COMPETITION AND TRADE SECRETS CASES**

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## Litigating Non-Competition and Trade Secrets Cases

### I. Pre-Litigation Activity

Frequently, conduct of the employer and the employee at the end of the employment relationship will substantially influence the prospect and outcome of anti-competition litigation.

- A. **Employer**: The employer should focus on gathering information and communicating expectations. This is best done with standard “exit” procedures.
- Conduct an exit interview to gather information about why the employee is leaving, where s/he is going, what s/he will be doing. Identify, inventory and obtain confidential and proprietary information including hard copy and electronic files, and electronic storage devices. Document and obtain acknowledgment.
  - Provide employee with a new copy of any non-competition and/or confidentiality agreement.
  - Provide new employer with a copy of any relevant contracts.
  - Communicate concerns to employee and new employer.
  - Use IT to investigate/capture suspected computer activity.
- B. **Employee**: The employee should provide as little information as possible, avoid misconduct and “take the high road.”
- Politely decline participation in an exit interview and submit a simple resignation letter.
  - Make sure all confidential and proprietary information has been returned prior to departure.
  - Consider sending a letter from or in connection with an attorney discussing new situation, non-compete obligations, unenforceability and/or non-applicability and/or intention to comply with all or some restrictions.
  - Announce new employment if desirable.<sup>1</sup>
  - Remember that evidence of bad faith can and will be used against you.

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<sup>1</sup> There is a common law right to announce new employment. *See, e.g., Alexander & Alexander Benefits Servs., Inc. v. Benefit Brokers & Consultants, Inc.*, 756 F. Supp. 1408, 1413 (D. Or. 1991); *Ed Nowogroski Ins., Inc. v. Rucker*, 137 Wn.2d 427, 440 n.4, 971 P.2d 936 (1999) (“Solicit’ . . . means: ‘To appeal to (for something); to apply to for obtaining something; to ask earnestly; to ask for the purpose of receiving . . . .’ By contrast, “[m]erely informing customers of one’s former employer of a change in employment, without more, is not solicitation.”) (quoting *Morlife, Inc. v. Perry*, 66 Cal. Rptr. 2d 731, 737-38 (Cal. App. 1997)).

C. **Attorneys**: Gather and understand all relevant facts; evaluate client risk tolerance.

- What is employer's business and how did employee fit in?
- What is departing employee's new business and what is his/her job?
- How do the businesses/jobs differ?
- How does the market work within the industry? What drives sales?
- What economic advantage does the employer derive from "threatened" interests, i.e. — customer relationships, trade secrets.
- Consider waiver issues.
- Explore the Internet for published information about employers, old and new. Look for alleged "trade secrets" on the web.
- Discuss risk: legal, financial, practical (e.g., customer relations, disclosure of confidential information).
- Consider agreement to limited restrictions.

As soon as possible, company counsel should understand and be able to articulate precisely how the departing employee is or will compete UNFAIRLY with the employer. Avoid getting caught up in the process and continually revisit this question as facts develop.

## II. Analytical Framework

It cannot be too strongly stated and restated that every case depends on its own peculiar circumstances. In sailing the above seven seas more Ships of Justice have gone down for failure to sense the treacherous reefs of generality than for any other reason.

*Arthur Murray Dance Studios of Cleveland, Inc. v. Witter*, 105 N.E.2d 685, 693 (Ohio Ct. of Common Pleas 1952).

### A. Non-Competition Agreements

A covenant, restraining an employee on termination of employment from competing with his former employer, is valid if it is reasonable, in view of all circumstances of the particular case, as to the employer, as to the employee, and as to the public. *See, e.g., Perry v. Moran*, 109 Wn.2d 691, 700, 784 P.2d 224 (1987), *modified on reconsideration*, 111 Wn.2d 885, 766 P.2d 1096 (1989). The construction and legal effect of a covenant not to compete, including its "reasonableness," is a question of law. *Id.*

Before deciding to litigate, an employer must determine (1) whether the departing employee is engaging in conduct prohibited by the agreement; (2) whether the agreement is

enforceable; and (3) whether legitimate protectable interests are actually threatened by conduct alleged.

**1. Is the Employee Engaging in conduct Prohibited by the Agreement?**

A seemingly obvious inquiry; sometimes too readily assumed or completely overlooked.

**2. Is the Agreement Enforceable?**

**a. Consideration**

The general rule in Washington is that consideration exists for a non-compete agreement if the employee enters into a non-compete agreement when he or she is first hired. *Wood v. May*, 73 Wn.2d 307, 310-11, 438 P.2d 587 (1968); *Racine v. Bender*, 141 Wash. 606, 609, 252 P. 115 (1927); *Knight, Vale & Gregory v. McDaniel*, 37 Wn. App. 366, 368, 680 P.2d 448, review denied, 101 Wn.2d 1025 (1984).

Restrictive covenants entered into after the beginning of employment require consideration beyond continued employment.

A noncompete agreement entered into after employment will be enforced if it is supported by independent consideration. *Rosellini v. Banchemo*, 83 Wn.2d 268, 273, 517 P.2d 955 (1974); *Schneller v. Hayes*, 176 Wash. 115, 118, 28 P.2d 273 (1934). Independent, additional, consideration is required for the valid formation of a modification or subsequent agreement. There is no consideration when “one party is to perform some additional obligation while the other party is simply to perform that which he promised in the original contract.”

*Labriola v. Pollard Group, Inc.*, 152 Wn.2d 828, 834, 100 P.3d 791 (2004), citing *Banchemo*, 83 Wn.2d at 273.

There is limited authority for the proposition that a restrictive coverage is not enforceable if an employer breaches the employment agreement within which it is contained. See *Parsons Supply, Inc. v. Smith*, 22 Wn. App. 520, 523, 591 P.2d 821 (1979), citing *Tennessee Adjustment Service v. Miller*, 370 S.W.2d 696 (Tenn. Ct. App. 1964).

**b. Scope**

A covenant not to compete should be no greater in scope than is necessary to protect the business or good will of the employer. *Knight, Vale & Gregory*, 37 Wn. App. at 370. To the extent that the scope of a particular provision is broader than necessary, the court has discretion to rewrite the contract to make it reasonable. See *Sheppard v. Blackstock Lumber Co.*, 85 Wn.2d 929, 540 P.2d 1373, 1377 (1975) (reversing and remanding trial court’s grant of summary judgment for employer to determine whether a modification could render the contract enforceable).

### 3. Are Protectable Interests Actually Threatened?

#### a. Customer Relationships/Goodwill

Goodwill associated with the relationship between the customer and departing employee is a protectable interest.

In the broadest sense the restriction is nothing more than to prohibit respondent from taking appellant's clients with him when he severs his connection with appellant, or to perform services for those so intimately connected with such clients as to be fairly classified as his future clients. That such a requirement so accords with common honesty between men, and a failure to observe it leads to such direful results, is so well established that it seems strange that it should be contended that one engaged in a position where confidence is the basis of the relation between client and the employee, and that confidence results through the employer, and is the foundation stone of his business, then the employee may, disregarding his employer's rights, visit ruin upon him.

*Racine*, 141 Wash. at 611.

“Customer hold” cannot be assumed, however, and has been described as a “much-abused, much-misunderstood and much-misapplied theory”. *Arthur Murray Dance Studios*, 105 N.E.2d at 705-09.

Mere customer contact and nothing more doesn't always bring the customer so completely under the employee's spell that the customer will automatically move with the employee wherever the employee goes . . . Assuredly, the customer contact theory has its place, but it should be put in its place and kept in its place. Just to shout ‘customer contact’ does not justify an injunction. All customer contacts are not contagious any more than are all ailments.

*Id.*; see also *Racine*, 141 Wash. at 613-14 (analysis is factually dependent upon the nature of the employee-customer relationship).

In evaluating whether “customer hold” is a protectable interest in any given case. Consider:

- the quality and quantity of contact between employee and customers; and
- the extent to which the employee-customer relationship will actually influence a customer's purchase decisions in the industry.

Ultimately, the question is whether personal relations between employee and the employer's customer are “such as to enable the employee to control, in whole or in part, the business of such customers as a personal asset.” *Arthur Murray Dance Studios*, 105 N.E.2d at 706 (emphasis in original).

## **b. Trade Secrets, Confidential and Proprietary Information**

Employers have a protectable interest in their trade secrets, confidential and proprietary information. This is true with or without an enforceable non-compete agreement. *See Ed Nowogroski Ins., Inc. v. Rucker*, 137 Wn.2d 427, 440, 971 P.2d 936 (1999); Uniform Trade Secrets Act, RCW 19.108 (“UTSA”).

To be protectable, confidential information need not qualify as a “trade secret” under the UTSA. *See Boeing Co. v. Sierracin Corp.*, 108 Wn.2d 38, 48, 738 P.2d 665 (1987). Moreover, a duty of confidence can arise based upon a confidential relationship, irrespective of statute or written agreement. *See Island Air, Inc. v. La Bar*, 18 Wn. App. 129, 566 P.2d 972 (1977).

Enforcement of non-competition provisions is often justified based upon an employees’ access to trade secrets or confidential information during his or her employment. The theory is that 1) the employer has some secrets (business or trade) which are essential to its business and which were disclosed to the employee in confidence in the course of his or her employment; 2) the secrets are of such a character that if disclosed to a rival they would seriously prejudice employer; and 3) if employee is allowed to work for a rival there would be imminent, real danger of those secrets being disclosed to and confiscated by the rival. Whether or not an employer’s interest in protecting confidential information or trade secrets is actually threatened depends upon the facts of any given situation. The doctrine of “inevitable disclosure” is discussed more fully below.

## **c. Non-Protectable Interests: Skill, Training**

While defection of a key employee to a competitor will usually result in a loss of business for the employer and/or advantage to the competitor, it is not always actionable. Prevention of ordinary (as opposed to unfair) competition is not a legitimate protectable interest. Thus, an employer cannot restrict activity of a former employee based upon his or her training or skill, even if the training or skill is acquired or increased through experience or instruction received in course of work for the employer. *Copier Specialists, Inc. v. Gillen*, 76 Wn. App. 771, 774, 887 P.2d 919 (1995); *Perry v. Moran*, 109 Wn.2d at 702. Courts will scrutinize the objective of an employer seeking to enforce a restrictive covenant and reject attempts to stifle ordinary competition, retain or punish an employee. *See Arthur Murray*, 105 N.E.2d at 700-01.

## **4. Does the Restriction Create Undue Hardship for the Employee or the Public?**

Public policy requires courts to “carefully examine” covenants not to compete notwithstanding an employer’s legitimate business interest. *See Knight, Vale & Gregory*, 37 Wn. App. at 370. The Washington Supreme Court has recognized that promises not to compete may constitute an illegal restraint of trade in violation of the Constitution. *See, e.g., Sheppard v. Blackstock Lumber*, 85 Wn.2d at 931-32. Restrictions on future employment are reasonable (and valid) only if they are (1) no greater than required for the protection of the employer; (2) do not impose undue hardship on the employee; and (3) are not injurious to the public. *Id.* The burden of proving reasonableness rests with the employer. *Id.*, at 933.

Although there is no case law on the issue, it is likely that courts would consider the current economy in evaluating the effect of restrictive covenants on departing employees and their families.

## **B. No Agreement Required**

### **1. Claims for Violation of the Uniform Trade Secrets Act**

Claims for violation of the Uniform Trade Secrets Act may be pursued simultaneously with contractual and common law confidentiality claims. *Boeing Co. v. Sierracin Corp.*, 108 Wn.2d at 48.

#### **a. Defining a Trade Secret**

The Uniform Trade Secrets Act, RCW 19.108, was adopted in Washington in 1981 and codifies the basic principles of common law trade secret protection. *MAI Sys. Corp. v. Peak Computer, Inc.*, 991 F.2d 511, 520 (9th Cir. 1993). Under the act, a plaintiff can obtain injunctive relief or damages for threatened or actual misappropriation of trade secrets, irrespective of the existence of a written contract. *See Boeing Co. v. Sierracin Corp.*, 108 Wn.2d at 46; *Machen, Inc. v. Aircraft Design, Inc.*, 65 Wn. App. 319, 324, 828 P.2d 73, review denied, 120 Wn.2d 1007 (1992), overruled on other grounds by *Waterjet Technology, Inc. v. Flow Intern. Corp.*, 140 Wn.2d 313, 323, 996 P.2d 598 (2000); *Nowogroski*, 137 Wn.2d at 437.

The Uniform Trade Secrets Act defines a trade secret as:

[I]nformation, including a formula, pattern, compilation, program, device, method, technique, or process that:

(a) Derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use; and

(b) Is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.

RCW 19.108.010(4). “While the definition of a trade secret is a matter of law ... the determination in a given case whether specific information is a trade secret is a factual question.” *Nowogroski*, 137 Wn.2d at 436.

Trade secrets need not exist in printed form. The *Nowogroski* court found that an employee violated the UTSA by soliciting his former employer’s customers based upon memorized customer list. *See id.*, at 449-450.

To be a “trade secret” under the UTSA, information must be “novel” in the sense that the information must not be readily ascertainable from another source. *Spokane Research & Defense Fund v. City of Spokane*, 96 Wn. App. 568, 983 P.2d 676 (1999), review denied, 140 Wn.2d 1001 (2000); *Boeing Co. v. Sierracin Corp.*, 108 Wn.2d at 49; *Buffets, Inc. v. Klinke*, 73 F.3d 965, 967-68 (9th Cir. 1996); *Mccallum v. Allstate Prop. and Cas. Ins. Co.*, 149 Wn. App. 412,

204 P.2d 944 (2009) (Allstate’s strategies and procedures for handling claims were not unique and disclosure would provide unfair advantage to competitors.) However, a new combination of features, even if it includes elements already generally known, may constitute a protectable trade secret. *Boeing Co. v. Sierracin Corp.*, 108 Wn.2d at 50 (“trade secrets frequently contain elements that by themselves may be in the public domain but together qualify as trade secrets.”). *See also, Össur Holdings, Inc. v. Bellacure, Inc.*, 2006 WL 2401269 (W.D. Wash. Aug. 18, 2006).

Knowledge that would be common to anyone with the employee’s experience in an industry is not a protectable trade secret. *Nowogroski*, 137 Wn.2d at 441-442; *Cudahy Co. v. Am. Labs., Inc.*, 313 F. Supp. 1339, 1343 (D. Neb. 1970). In *Cudahy*, the employer claimed that its former employee’s knowledge and expertise on production and marketing of animal byproducts for pharmaceutical purposes, data on profits and cost of production, and detailed customer lists were trade secrets. The court disagreed:

. . . Mr. Jackson has a wealth of knowledge and expertise in the production and marketing of Cudahy’s pharmaceutical products. Plaintiff’s attempt to tie the skill and experience of Mr. Jackson to documented data thereby hoping to gain the classification of that data as a trade secret is simply not well founded. Such general data would be common knowledge to anyone of Mr. Jackson’s experience and would not be particular to Cudahy. As previously stated, *the status given trade secrets is not to be used as a sword to prevent employees from rendering their services based on knowledge and experience, to somebody other than one employer. That is exactly what plaintiff would accomplish if its claim of trade secret as to these items were successful.*

*Id.* (emphasis added).

#### **b. Actual or Threatened Misappropriation and the Inevitable Disclosure Doctrine**

To obtain an injunction under the UTSA, the plaintiff must prove actual or “threatened” misappropriation. *See* RCW 19.108.020.<sup>2</sup> Plaintiffs also seek UTSA injunctions based upon the common law doctrine of “inevitable disclosure”. The inevitable disclosure doctrine anticipates disclosure or use of trade secrets in certain competitive situations where it is unlikely that the employee could perform his or her new duties without such disclosure or use. “Threatened” and “inevitable” disclosure are not necessarily the same thing. The UTSA codifies common law tort claims and related case law implies that “threatened” disclosure involves an element of intent on the part of the would-be misappropriator. The inevitable disclosure doctrine may not.

The original doctrine of inevitable disclosure had nothing to do with employee intent. Instead, it was premised upon the fact that it would be humanly impossible for an employee to “forget” trade secrets where they would be beneficial to performance in his or her new job.

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<sup>2</sup> “Misappropriation” is defined to require “disclosure,” “use” or “acquisition” and does not include destruction of trade secrets where no evidence of unfair competition exists. *North Pacific Crane Co. v. Bear*, 2009 WL 1925888 (Wash. App. July 6, 2009)(unpublished).

Numerous courts have enjoined employees from working for a competitor in a capacity likely to lead to the disclosure of trade secrets, despite an express finding of good faith. *See, e.g., Weed Eater, Inc. v. Dowling*, 562 S.W.2d 898, 902 (Tex. App. 1978); *Marcam Corp. v. Orchard*, 885 F. Supp. 294, 297 (D. Mass. 1995); *FTC v. Exxon Corp.*, 636 F.2d 1336, 1350 (D.C. Cir. 1980) (“[I]t is very difficult for the human mind to compartmentalize and selectively suppress information once learned, no matter how well-intentioned the effort may be to do so”)<sup>3</sup>

Notwithstanding the doctrine’s original form, many courts applying inevitable disclosure do consider the departing employee’s intent to misappropriate. The most famous inevitable disclosure case is a good example. In *PepsiCo, Inc. v. Redmond*, a high ranking employee (Redmond) had vast knowledge of competitively sensitive information. He defected from PepsiCo (All Sport, Lipton tea, Ocean Spray) to Quaker Oats (Gatorade, Snapple) to assume a similar marketing position, at a time when the two companies were in fierce competition with each other over their respective sports drinks and “new age” beverages. The court enjoined Redmond from working in his new position for six months and from disclosing any trade secrets to his new employers thereafter. In rendering its decision, the *PepsiCo* Court specifically referenced and relied upon a finding of bad faith on Redmond’s part, including a “lack of forthrightness” and “out and out lies” which “[led] the court to conclude that defendant Redmond could not be trusted to act with the necessary sensitivity and good faith under the circumstances . . . .” 54 F.3d 1262, 1270-71 (7th Cir. 1995).

Thus, when we couple the demonstrated inevitability that Redmond would rely on [PepsiCo’s] trade secrets in his new job at Quaker with the district court’s reluctance to believe that Redmond would refrain from disclosing these secrets in his new position (or that Quaker would ensure Redmond did not disclose them), we conclude that the district court correctly decided that PepsiCo demonstrated a likelihood of success on its statutory claim of trade secret misappropriation.

54 F.3d at 1271.

A lack of trustworthiness on the part of the departing employee will undoubtedly affect the mix of fact upon which a finding of threatened or inevitable disclosure is based. Courts finding “threatened” or “inevitable” disclosure continue to emphasize bad faith of the defendants in either case. *See, e.g., Maxxim Med., Inc. v. Michelson*, 51 F. Supp. 2d 773, 787 (S.D. Tex.) (a defendant employee’s “lack of forthrightness” and “out and out lies” supported a finding of inevitable disclosure), *rev’d on different grounds*, 182 F.3d 915 (5th Cir. 1999) (Table) ; *Novell, Inc. v. Timpanogos Research Group, Inc.*, 46 U.S.P.Q.2d 1197, 1215-17 (Utah Dist. 1998) (“cavalier attitude” of defendant employees toward their former employer supported finding of inevitable disclosure).

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<sup>3</sup> California, like Washington, has also adopted the UTSA, but rejects the doctrine of inevitable disclosure because the “intent” element is missing. In *Bayer Corp. v. Roche Molecular Sys., Inc.*, 72 F. Supp. 2d 1111 (N.D. Cal. 1999), the court found that a drug company which had formerly employed a marketing manager was not entitled to a preliminary injunction preventing the new employer’s misappropriation of trade secrets absent showing of likelihood that it would be able to prove actual or threatened use or disclosure, as required to prevail on merits under UTSA law. In light of California policy favoring employee mobility, the mere theory of inevitable disclosure, without evidence of the manager’s intent to disclose secrets, was not sufficient. *See id.*, at 1120.

No Washington case expressly addresses the inevitable disclosure doctrine, although a decision by Judge Burgess in the Western District of Washington includes a statement that the theory would likely be “embraced”. See *Lam Research Corp. v. Deshmukh*, 157 Fed. Appx. 26 (9th Cir. 2005) (citing *Solutec Corp. v. Agnew*, 88 Wn. App. 1067, 1997 WL 794496 (Dec. 30, 1997) (unpublished)). In *Solutec*, the court enjoined employees from manufacturing certain edible apple waxes that would compete with those of their former employer based upon assumption that the employees would be using processes and/or formulas which were proprietary trade secrets of the former employer. There was no discussion of facts relating “intent” or bad faith. Reliance on the inevitable disclosure doctrine, while not explicitly referenced, was implied.

The inevitable disclosure doctrine can effectively turn the UTSA into a non-compete agreement for an employee that never signed one by prohibiting competitive employment. Perhaps this is why intent so often becomes an issue in the “inevitable disclosure” cases. It is also a compelling argument to avoid injunctive relief based upon inevitable disclosure, particularly if it is coupled with a showing of good faith on the part of the employee and other employee-friendly facts to skew the equitable balancing act of the court.

[P]rotection given to trade secrets is a shield, sanctioned by the courts, for the preservation of trust in confidential relationships; it is not a sword to be used by employers to retain employees by the threat of rendering them substantially unemployable in the field of their experience should they decide to resign. This shield is not a substitute for an agreement by the employee not to compete with his employer after the termination of employment.

*E.W. Bliss Co. v. Struthers-Dunn, Inc.*, 408 F.2d 1108, 1112 (8th Cir. 1969); see also *EarthWeb, Inc. v. Schlack*, 71 F. Supp. 2d 299, 311 (S.D.N.Y. 1999)(declining to “re-write the parties’ employment agreement under the rubric of inevitable disclosure and thereby permit [plaintiff] to broaden the sweep of its restrictive covenant”).

### **c. Remedies**

Injunctive relief is available for actual or threatened misappropriation. RCW 19.108.020(1). Courts may impose a royalty for future use of trade secrets if prohibition is unreasonable. RCW 19.108.020(2). In lieu of or in addition to injunctive relief, the plaintiff may recover damages for actual loss caused by misappropriation. RCW 19.108.030(1). Unlike the plaintiff in cases involving restrictive covenants, a UTSA plaintiff may recover damages based upon unjust enrichment of the defendant, so long as those damages are not duplicative of the plaintiff’s actual loss. See *id.* In a case of willful or malicious misappropriation, exemplary damages and attorney’s fees are available. See RCW 19.108.030(2) and (3). Attorney’s fees are also available to the prevailing party where claims or defenses are alleged in bad faith. See RCW 19.108.030(3).

## **2. While Employed: Breach of Fiduciary Duty/Duty of Loyalty**

An employee’s duties during employment may form the basis of a post-employment claim if offending conduct took place before the end of the employment relationship.

An employee's "fiduciary duties" include a duty of loyalty, confidence, and non-competition during the term of the employee's employment. *While employed by the employer*, an employee: (1) must act solely for the benefit of the employer in all matters connected with the employee's employment; (2) has a duty not to disclose or use the employer's trade secrets; and (3) may not operate a competing business . . .

An employee breaches the employee's fiduciary duties to the employer if, *while employed by the employer*, the employee solicits the employer's customers, diverts business away from the employer, lures away co-workers to a competing enterprise, fails to disclose matters adverse to the employer that impair the employee's duty of loyalty, takes undisclosed payments from a third party who is doing business with the employer, or divulges the employer's confidential information to others.

*NTSI Corp. v. Nelson*, 131 Wn. App. 1010, 2006 WL 119119, 2006 WL 5849268 (Jan. 17, 2006) (unpublished) (emphasis added); *see also* Restatement (Second) Agency § 393(e).

Failure to disclose is not, in and of itself, a breach of an employee's fiduciary duties. Breach is judged by the nature of the underlying act and disclosure is required only for activity that is harmful to the employer. *Cudahy*, 313 F. Supp at 1346-47.

Importantly, preparing to compete is not a breach of the duty of loyalty:

'The mere planning, without more is not a breach of an employee's duty of loyalty and good faith to his employer.' *Cowley v. Anderson*, 159 F.2d 1 (10th Cir. 1947); *Keiser v. Walsh*, 73 App. D.C. 167, 118 F.2d 13 (1941); *Metal Lubricants Co. v. Engineered Lubricants Co.*, 411 F.2d 426 (8th Cir. 1969); *National Rejectors, Inc. v. Trieman*, 409 S.W.2d 1 (Mo. 1966); Restatement, Agency 2d, § 393, comment (e). Admittedly the mere decision to enter into competition will eventually prove harmful to the former employer but because of the competing interests of allowing an employee some latitude in switching jobs and at the same time preserving some degree of loyalty owed to the employer the mere entering into competition is not enough. It is something more than preparation which is so harmful as to substantially hinder the employer in the continuation of his business. Obviously then each case must be decided upon its own facts. Because of the competing interests the actionable wrong is a matter of degree. 'No ironclad rules as to the type of conduct which is permissible can be stated, since the spectrum of activities in this regard is as broad as the ingenuity of man itself.' *Bancroft-Whitney v. Glen*, *supra* [411 P.2d 921, 935 (Cal. 1966)].

*Cudahy Co.*, 313 F. Supp. at 1346.

Frequently, however, actual solicitation of customers, suppliers and other employees will begin while the employee is still employed, creating causes of action based upon the departed employee's breach of fiduciary duty. Damages include discouragement of profits, wages paid,

attorneys fees and costs. *See NTSI, supra*. A future employer can be vicariously liable for a future employee's breaches of fiduciary duty if it knowingly benefits from the future employee's conduct. *See Thola v. Henschell*, 140 Wn. App. 70, 164 P.3d 524 (2007).

### **III. Filing a Lawsuit — Procedural Information and Other Considerations**

#### **A. Initial Considerations**

Most non-compete and trade-secret cases are determined at the preliminary injunction stage. The preliminary injunction motion is an expedited, expensive, high-stakes proposition which is often undertaken with limited knowledge regarding the operative facts and limited opportunity to take a breath and re-evaluate. Prevailing party attorney's fees provisions in non-compete agreements can substantially increase financial risk, and inhibit settlement after the injunction hearing, regardless of outcome.

Prior to filing (and for the defendant, immediately in response) consider whether, more favorable law of another jurisdiction should be applied. California law is particularly good for the departing employee. Consider whether it makes sense to name the new employer as a defendant with a tortious interference or breach of fiduciary duty claim. *See e.g., Island Air, Inc. v. La Bar*, 18 Wn. App. 129, 143, 566 P.2d 972 (1977); *Thola, supra*. Consider the effect that the additional party might have on litigation costs and fee recovery. Finally, devise a strategy to protect confidentiality of documents used in litigation, if appropriate.

#### **B. TRO/Preliminary Injunction**

##### **1. Applicable Procedural Rules**

###### **a. CR 65, FRCP 65: Injunctions**

65(a): Preliminary Injunction

65(b): Temporary Restraining Order, Notice; Hearing; Duration

- specific requirements for grant w/o notice
- to grant w/o notice "irreparable" injury finding required
- w/o notice - not to exceed 14 days
- adverse party may move to dissolve on 2 days' notice (or less per the court)

65(c): Security

- bond required "except otherwise provided by statute" "for payment of such costs and damages as may be incurred or suffered by any party who is found to have been wrongfully enjoined or restrained"

65(d): Form and Scope

- specificity required

- binding only upon parties and agents, officers, employees, etc. to the extent that they receive actual notice

65.1: Security — Proceedings Against Sureties

- provides authority/procedure for collection of damages against the bond

**b. King County LR 65: Injunctions**

- Motion for TRO may be brought in *ex parte*,
- Calendaring requirement: “Prior to appearing in the Ex Parte and Probate Department on a motion for a temporary restraining order, the moving party shall obtain a date for hearing on the motion for preliminary injunction from the trial department to which the case is assigned. The hearing shall be set in conformance with the timing requirements of CR 65(b).” LR 65(b)(2)

**c. CR 43(e)(2): Taking of Testimony, Evidence on Motions, For Injunctions, etc.**

- Moving party on motion to dissolve an injunction based upon affidavits must serve the adverse party with the affidavits at least 3 days prior to the hearing.
- At a hearing to dissolve an injunction, oral testimony shall not be taken without court permission and notice of such permission served upon the adverse party at least 3 days before the hearing.

**2. Substantive Burden**

Injunctive relief is an “extraordinary remedy” designed to prevent serious harm. *Tyler Pipe Indus., Inc. v Dep’t of Revenue*, 96 Wn.2d 785, 796, 638 P.2d 1213 (1982). An injunction should not be issued in a doubtful case, nor where material facts are in dispute. *Isthmian S.S. Co. v. Nat’l Marine Eng’rs’ Beneficial Ass’n*, 41 Wn.2d 106, 117-18, 247 P.2d 549 (1952).

To obtain a preliminary injunction, the plaintiff must show (1) A well grounded fear of immediate invasion of a clear legal or equitable right; and (2) That acts about which it complains have, or will result in substantial, actual [and irreparable] injury. *Tyler Pipe*, 96 Wn.2d at 791.<sup>4</sup> The plaintiff must prove likelihood of success on the merits of its claims. *Rabon v. City of Seattle*, 135 Wn.2d 278, 285, 957 P.2d 621 (1998). The plaintiff has the burden of proof and if it fails to establish any one of the requirements for injunctive relief, its request must be denied. *Kucera v. Dep’t of Trans.*, 140 Wn.2d 200, 210, 995 P.2d 63 (2000).

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<sup>4</sup> Compare *Boeing Co. v. Sierracin Corp.*, 108 Wn.2d 38, 738 P.2d 665 (1987) (no showing of irreparable injury required). Practically speaking, however, courts are reluctant to enjoin an employee from working in his or her chosen profession where monetary damages may be sufficient to compensate any loss to the former employer. See, e.g., *Merrill Lynch v. Stidham*, 658 F.2d 1098, 1102, n.8 (5th Cir. 1981).

The purpose of an injunction is not to protect a party from mere inconvenience or speculative and insubstantial injury. *Tyler Pipe*, 96 Wn.2d at 796; *King County v. Port of Seattle*, 37 Wn.2d 338, 345, 223 P.2d 834 (1950). Defendants may find that their best way to resist preliminary injunctions is to capitalize on the likelihood that their former employer will not have the ability to prove a likelihood of damage with sufficient specificity so soon after the employee's departure. Without concrete proof of likely damage, the plaintiff cannot show likelihood of prevailing on merits. Injunctive relief should be denied.

### **C. Confidentiality and Protective Orders**

There is inherent potential for disclosure of confidential information in litigation of non-competition and trade secret cases. The former employer, and any prospective one, will likely have confidentiality concerns. Arguments supporting and imposing injunctive relief will necessarily involve disclosure of sensitive business information which can effectively undermine the very basis of a lawsuit seeking to prevent disclosure of the information. In *E.I. du Pont De Nemours Powder Co. v. Masland*, 244 U.S. 100, 37 S. Ct. 575 (1917), the U.S. Supreme Court upheld an injunction preventing a defendant in trade secret litigation from disclosing alleged trade secrets to its experts or witnesses.

Constitutional principles of public access to information that forms the basis of the decisions made by our courts make it very difficult to seal documents. Arguments and rulings regarding confidential information can have an effect on the outcome of litigation for plaintiff and defendant. The parties should develop a strategy for addressing allegedly confidential information before litigation begins to facilitate expedited discovery that may be required for a preliminary injunction hearing without compromising relative positions.

The USTA has a specific provision that would appear to mandate confidentiality in litigation without any finding of trade secret status:

In an action under this chapter, a court shall preserve the secrecy of an *alleged* trade secret by reasonable means, which may include granting protective orders in connection with discovery proceedings, holding in-camera hearings, sealing the records of the action, and ordering any person involved in the litigation not to disclose an alleged trade secret without prior court approval.

RCW 19.108.050 (emphasis added).

Regardless of what the former or prospective employer does procedurally to preserve confidentiality, employees should be very careful. Even if an employee disagrees as to the confidential nature of any given information, careless handling of that information in the face of the employer's stated concern can be used to support an inference of bad faith and negatively affect the outcome of the underlying dispute or worse, constitute an independent violation. An employee using allegedly confidential information to defend non-competition or trade secret litigation should consider a GR 15 motion, where appropriate, requesting that certain documents or information used in connection with pleadings be reviewed in camera and/or sealed.

## **D. Obtaining Fees from the Bond**

Injunction bonds are required under RCW 7.40.080 for the purpose of securing damages or costs which may accrue in connection with an injunction or restraining order:

No injunction or restraining order shall be granted until the party asking it shall enter into a bond, in such a sum as shall be fixed by the court or judge granting the order, with surety to the satisfaction of the clerk of the superior court, to the adverse party affected thereby, conditioned to pay all damages and costs which may accrue by reason of the injunction or restraining order.

RCW 7.40.080. *See also* CR 65(c) (“[N]o restraining order or preliminary injunction shall issue except upon the giving of security by the applicant, in such sums as the court deems proper, for the payment of such costs and damages as may be incurred or suffered by any party who is found to be wrongfully enjoined or restrained.”)

A TRO or preliminary injunction is wrongful if the restraint was erroneous in the sense that it would not have been ordered had the court (or commissioner) been presented all the facts. *See Knappett v. Locke*, 92 Wn.2d 643, 647, 600 P.2d 1257 (1979)

Attorney’s fees are damages recoverable by the party who successfully resists a wrongful injunction. *See Parsons Supply, Inc. v. Smith*, 22 Wn. App. 520, 524-25, 591 P.2d 821 (1979) (citing *Berne v. Maxham*, 82 Wash. 235, 144 P. 23 (1914); *Talbot v. Gray*, 11 Wn. App. 807, 525 P.2d 801 (1974), *review denied*, 85 Wn.2d 1001 (1975); RCW 7.40.080; CR 65(c)). “If the injunction is denied at a preliminary hearing, the general rule applies without qualification.” *Id.* at 525. The reason for the rule is to discourage parties from seeking unnecessary injunctive relief prior to a trial on the merits. *See White v. Wilhelm*, 34 Wn. App. 763, 774, 665 P.2d 407, *review denied*, 100 Wn.2d 1025 (1983).

To ensure that the bond serves its intended purpose, the defendant should follow these rules:

### **1. Make Sure the Bond Is Adequate**

Be prepared to support a request for a large bond at the TRO or preliminary injunction hearing with specific proof of likely damage, including fees. Absent proof of malicious prosecution, the defendant’s ability to recover damages against a bond in connection with a wrongfully issued TRO or injunction is limited to the face amount of the bond plus interest. *See, Fisher v. Parkview Props., Inc.*, 71 Wn. App. 468, 477, 859 P.2d 77 (1993).

### **2. Always Bring a “Motion to Dissolve”, Before Dissolution Otherwise Occurs**

Always frame your pleading as a “Motion to Dissolve the TRO [or Preliminary Injunction]” and seek dissolution prior to the time that the TRO or injunction will either expire on its own, or be resolved by a trial on the merits.

Case law suggests that general rule allowing fees as damages in connection with dissolution of a TRO or injunction may not apply where the defendant does not actually “cause”

dissolution of the TRO or injunction by preliminary hearing. “Merely appearing for the purpose of resisting the issuance of a preliminary injunction is not the equivalent of a motion resulting in the dissolution of a preliminary injunction.” 15 Wash. Prac. § 44.13, and see *White Pine Lumber Co. v. Aetna Indem. Co.*, 42 Wash. 569, 571-572, 85 P. 52 (1906).

Moreover, prevailing in a trial on the merits will likely eliminate the defendant’s ability to obtain fees from an injunction bond.

The commonly accepted rule is that reasonable compensation paid as counsel fees, paid in procuring the dissolution of an injunction, may be recovered in an action on a bond. 2 High, Inj. (3d Ed.) § 1685. But counsel fees thus allowable must be those connected with the motion, *or other similar proceeding* for the dissolution of the injunction, and do not cover the general expenses of defending the merits of the action. *Newton v. Russell*, 87 N.Y. 527; *Trapnell v. McAfee*, 77 Am. Dec. 158; *Bustamente v. Stewart*, 55 Cal. 115; *Porter v. Hopkins*, 63 Cal. 53. Inasmuch as no motion for the dissolution of the injunction appears to have been made in this case, but it was allowed to stand until the action was tried upon its merits, and simply failed because of the decision upon the merits, under the foregoing authorities, no attorney’s fees could be recovered.

*Donahue v. Johnson*, 9 Wash. 187, 190-91, 37 P. 322 (1894). See also, *Parsons Supply*, 22 Wn. App. at 520, and *Kitsap County Bank v. United States Fid. & Guar. Co.*, 90 Wash. 12, 155 P. 411 (1916) (Attorneys fees, to be allowable in action on injunction bond, must be connected with motion or other proceeding for dissolving injunction, and not for defending action on its merits).

The plaintiff, of course, should be mindful of the law where the defendant has allowed a TRO to lapse on its own or the preliminary injunction hearing has been consolidated with trial. Even where there is a prevailing party attorney’s fee provision, preventing recovery of fees and costs incurred in the TRO/preliminary injunction battle can give the losing party leverage to negotiate a settlement in lieu of continued litigation.

### **3. Form and Authority for Motion**

The motion is for an assessment against the bond surety (e.g., “Motion for Assessment of damages against ABC Insurance Company as Surety for Plaintiff re: Temporary Restraining Order Bond No. 0123458”). It should be made pursuant to CR 65.1, which provides in pertinent part:

Whenever these rules require or permit the giving of security by a party, and security is given in the form of a bond or stipulation or other undertaking with one or more sureties, each surety submits himself to the jurisdiction of the court and irrevocably appoints the clerk of the court as his agent upon whom any papers affecting his liability on the bond or undertaking may be served. His liability may be enforced on motion without the necessity of an independent action.

#### **IV. Arguing Policy and Equity**

In addition to arguments based upon consideration and scope in relation to the plaintiff's protectable interests, a departing employee will frequently have policy-based arguments based upon his own interests and the interests of society at large.

##### **A. Necessary for Protection of Legitimate Interest or an Unlawful Restraint of Trade—Counterclaims Under the Consumer Protection Act**

Contracts having the tendency to fix prices or to restrain trade “will be sustained when the restriction is, under the circumstances of the particular case, reasonable in reference to the interests of the parties, and reasonable in reference to the interests of the public . . .” *Fisher Flouring Mills Co. v. Swanson*, 76 Wash. 649, 658, 137 P. 144 (1913). When they are not reasonable, promises not to compete can be an illegal restraint of trade in violation of the Constitution. *See, e.g., Sheppard v. Blackstock Lumber*, 85 Wn.2d at 931-32.

Defendants should consider counterclaims for violation of the Consumer Protection Act based upon overly broad contractual terms as an unlawful restraint of trade. *See* RCW 19.86.030 (“Every contract, combination, in the form of trust or otherwise, or conspiracy in restraint of trade or commerce is hereby declared unlawful”). The actions of an over-reaching employer may have the effect of dissuading ordinary, lawful competition by employees who believe restrictive covenants are enforceable. Attorney’s fees, costs and treble damages are available, creating significant leverage for the employee in appropriate cases. *See* RCW 19.86.030.

##### **B. Balancing the Equities—Personal and Public Harm, Unclean Hands**

The court can invoke principles of relative fairness and harm to deny equitable relief even where a plaintiff may clearly be entitled to damages. The court may thus favor a defendant who has acted in good faith and would likely be prohibited from earning a living and feeding his/her family if an otherwise valid non-compete is enforced or inevitable disclosure of a trade secret is assumed. If the plaintiff is a huge corporation, unlikely to suffer great damage, the argument is all the more compelling, particularly with respect to injunctive relief. The current economy has obvious implications in this analysis.

Special issues arise when a non-compete agreement between an employer and employee restricts the activity or choice of a third party. The public policy concern is particularly poignant in cases involving a patient’s right to do business with a particular medical professional. Health care providers have a fiduciary relationship with their patients. *See Loudon v. Mhyre*, 110 Wn.2d 675, 679, 756 P.2d 138 (1988). The sanctity of the relationship is enforced by the physician-patient privilege. *See* RCW 5.60.040(4). Application of anti-competitive restrictions under the circumstances go beyond the employee — affecting public policy and the patient’s right to choose.

Once again, the relative good faith of the parties and “unclean hands” is a controlling principle in equity. Where the employee has engaged in misconduct, the decision to enjoin may be easy. *See, e.g. IDS Life Ins. Co. v. SunAmerica*, 958 F. Supp. 1258, 1282 (N.D. Ill. 1997),

*vacated in part*, 136 F.3d 537 (7th Cir. 1998) (“The public has an interest in preventing unfair competition, commercial piracy, misleading solicitations, and in safeguarding the confidentiality of financial records . . . The public has no interest in destroying contracts, rewarding theft, and encouraging unethical business behavior.”) On the other hand, an employee who is terminated for questionable reasons and pursued by a vindictive and irrational employer certainly has equity on his or her side, notwithstanding violation of an otherwise valid non-compete.

### C. Waiver and Estoppel in an Electronic Age

Key to designation of a protectable trade secret is the plaintiff’s reasonable efforts to maintain secrecy. RCW 19.108.010(4)(1). If the information is ascertainable from another legitimate source it is not a trade secret. RCW 19.108.010(4)(1); *Boeing Co. v. Sierracin Corp.*, 108 Wn.2d 38, 49, 738 P.2d 665 (1987).

In *Buffets, Inc. v. Klinke*, 73 F.3d 965 (9th Cir. 1996), the court found that a buffet restaurant chain’s job manuals were not subject to reasonable efforts to maintain their secrecy and were not trade secrets under Washington law where employees were allowed to take job manuals home and keep them, and were not advised of the manuals’ status as secrets, nor of security measures that should be taken to prevent their being obtained by others. *Id.*

Electronic storage and communications systems in the workplace obviously up the ante. “Trade secrets” are easily downloaded onto flash drives, laptops and home computers, attached to email and uploaded through the Internet. “Confidential” and “proprietary” information often shows up on blog sites, for all of the world wide web to see. “Reasonable efforts” to maintain secrecy may necessarily include policies to ensure security of confidential and proprietary information and accompanying practices relating to enforcement.

In fact, employers may soon find that they have an affirmative duty to monitor electronic communications in the workplace for, among other things, the purpose of insuring trade secret protection. In 2002, the Seventh Circuit Court of Appeals said this:

The laptops were [the employer’s] property and it could attach whatever conditions to their use it wanted to. They didn’t have to be reasonable conditions; but the abuse of access to the workplace computers is so common (workers being prone to use them as a medium of gossip, titillation, and other entertainment and distraction) that *reserving a right of inspection is so far from being unreasonable that failure to do so might well be thought irresponsible.*

*Muick v. Glenayre Electrs.*, 280 F.3d 741, 743 (7th Cir. 2002) (emphasis added). *See also Curto v. Med. World Commc’ns*, 2006 WL 1318387 (E.D.N.Y. May 15, 2006), where the court found that a lack of enforcement of a company computer policy with periodic surveillance undermined the effect of the policy itself.

Waiver and estoppel have always been meaningful defenses in non-competition and trade secret cases. An employer who gives up its contractual and/or statutory rights with respect to one employee may be hard pressed to justify enforcement against another. Where it knows or

should know that proprietary information is at risk, and fails to act, trade secret protection will undoubtedly fail.

Defendants in trade secret cases should consider discovery of electronic documents and electronic communications policy and practice relevant to issues of trade secret status, waiver and estoppel. Strategically speaking, even the prospect of invasive electronic discovery, particularly on an expedited basis, can create significant settlement leverage for the employee.

## Recent Stokes Lawrence Results

- Obtained preliminary injunction order enforcing non-competition, non-solicitation and non-disclosure agreement against high-level former employee who had begun working for competing software company.
- Obtained dismissal of non-compete/non-solicitation action against departed employee and new employer, based upon proof that customer relationships belonged to employee and “confidential information” was nothing more than knowledge common to anyone with employee’s experience in the industry.
- Obtained dismissal of non-compete/non-solicitation action against departed employee and new employer, based upon proof that new employer had different capabilities, a different customer base and was not a true competitor.
- Achieved settlement protecting client’s trade secrets from use by former business partner that began developing competing products.
- Achieved settlement invalidating non-competition agreement with union employee and allowing employee to work on competing projects with new employer.
- Achieved settlement requiring departed employee and his new employer to obtain pre-approval for solicitation and new business through a blind database containing list of client’s “off limits” customers.
- Obtained TRO against departing officer of company enforcing non-compete, non-interference with customers and employees, non-disclosure of confidential information and subsequently incorporated provisions of TRO into a settlement agreement.
- Obtained Court Order narrowing client’s post-employment restraint and allowing him to remain employed with new employer.

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