



# When customer lists are not trade secrets

*Making the case of whether a former employee has unlawfully solicited former customers*

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[Ed. Note: This is Part 2 of an article that first appeared in *Plaintiff Magazine*, May 2011, regarding the Uniform Trade Secrets Act (UTSA) and Business & Professions Code section 16600.]

## Hypothetical

Your client worked for her former employer – a catering company – for several years, during which time she provided services to its customers. Her former employer’s customer list consisted primarily of the theatre departments in all of the colleges located in the tri-county area. Your client had already known many of the customers before she entered the catering industry, as she had been a private drama instructor and taught in many of the local colleges’ theatre departments.

While working for the catering company, she was given the passcodes to the computer files, which contained a substantial amount of detailed information about customers and prospective customers that the company had developed over the last 15 years. Such information related to customers’ dietary restriction information, favorite appetizers and main courses, popular drinks, decoration requests, and other catering-related personalized information. The company had given her broad authority to use the company computer for her work-related administrative responsibilities. Some of these responsibilities included regular communication with all of the customers.

Shortly after she was hired, and every year thereafter, she was required to sign a non-solicitation agreement that stated: “For a period of eighteen months after my termination, I agree not to call, solicit, or take away any of Employer’s clients or prospective clients with whom I have had any dealings as a result of my employment by Employer.”

The company terminated her and a few other employees two months ago claiming that it needed to reduce its staff. Yet, it replaced her and her colleagues, who were all 55-years old or older, with five new workers all under the age of 25-years old. She brought a suit against them for discrimination under FEHA.

At the end of her last day at work, she sent out an e-mail from the company computer addressed to all of the company’s customers and prospective customers stating that her employment relationship with the company had ended, but that she would be starting her own catering company within the next month or two. In the same e-mail, she told all of the customers to check the local news and college bulletins for advertisements of her new catering company that would be opening soon.

In the first month after her termination, she posted advertisements in the local news sources that served the tri-county area. She also posted flyers on all of the bulletin boards located in every theatre, English, and art department in all of the colleges located in the tri-county area. She received a large number of calls and e-mails from prospective customers seeking to hire her catering company for their upcoming events. Some of these prospective customers included

many of the theatre departments that had been long-time patrons of her former employer’s catering company.

Your client’s former employer discovered that some of its customers and prospective customers had contacted your client to avail themselves of her catering company’s services. So, in order to keep her from servicing them, her former employer has filed a counterclaim against her asserting, among other claims, breach of contract and seeking injunctive relief from the court to keep her from soliciting its customers and prospective customers.

## **How will your client defend the injunction?**

Your client’s former employer may not be granted injunctive relief under contract law, but it may be granted injunctive relief under tort law. This is because in California, any contract that restrains trade is invalid unless it falls within a statutory exception to California’s Business & Professions Code section 16600. Since the non-solicitation agreement that your client signed is a contract restraining trade that does not fall within a statutory exception, it may not serve the basis for the injunction. (*Thompson v. Impaxx, Inc.* (2003) 113 Cal.App.4th 1425, 1429; *Dowell v. Biosense Webster* (2009) 179 Cal.App.4th 564, 577.) But, the tort theory of trade secret misappropriation may provide a proper ground for the injunction.

UTSA (Uniform Trade Secrets Act) is codified in the California Civil Code sections 3426 et seq. Under UTSA, a court may grant an injunction to prohibit actual or threatened trade secret misappropriation. (Civ. Code, § 3426.2(a).) For the relief to be granted, your client’s former



employer will need to show that (1) its customer list constitutes a trade secret, and (2) that the customer list has been misappropriated, or is under the threat of being misappropriated.

If your client is able to successfully defend against this first issue – and show that the customer list is not a trade secret (for a discussion of what constitutes a “trade secret” refer to the first article in this series), then the inquiry of trade secret misappropriation ends there. The court will deny the requested injunctive relief. However, if the customer list is found to constitute a trade secret, then your client must show that she has not misappropriated the customer list.

#### **What is misappropriation?**

There are three main types of misappropriation – improper acquisition, non-consensual disclosure, and nonconsensual use. (Civ. Code, § 3426.1(b); *Whyte v. Schlage Lock Co.* (2002) 101 Cal.App.4th 1443, 1457.) The essence of each of them is wrongful conduct. (See, Civ. Code, § 3426.1(b).) In figuring out whether conduct is wrongful, courts engage in fact-intensive inquiry, and they may rely on direct and circumstantial evidence. (*Whyte v. Schlage Lock Co.* (2002) 101 Cal.App.4th 1443, 1457.) Two of the three types of misappropriation will be discussed in this article – improper acquisition and nonconsensual use.

#### **What is improper acquisition?**

Misappropriation includes the “acquisition of a trade secret of another by a person who knows or has reason to know that the trade secret was acquired by improper means.” (Civ. Code, § 3426.1(b)(1).) Given this definition, in order for your client to have improperly acquired her former employer’s customer list, she must have (1) knowledge of the customer list, (2) acquired the customer list, and (3) used improper means to acquire the customer list.

• **Knowledge of the Customer List:** It is possible that an employee does not have knowledge of the trade secret that is the subject of the employer’s trade secret misappropriation claim. The employee’s

ignorance will defeat a claim that the employee improperly acquired the trade secret. This is because for improper acquisition of a customer list to be found, an employee must have knowledge of the customer list. (See *Silvaco Data Systems v. Intel Corp.* (2010) 184 Cal.App.4th 210.) Along the lines of having knowledge of the customer list, she must also know that she is not in rightful possession of the customer list. (*Cypress Semiconductor Corp. v. Superior Court* (2008) 163 Cal.App.4th 575.) If she does not have knowledge of the customer list or if she thinks that she rightfully possesses the customer list, then she could not have improperly acquired the customer list.

• **Acquired the Customer List:** Sometimes, there will be no proof of actual theft or conversion of a customer list. All that there may be is evidence that the employee had access to the customer list. For instance, when an employee has passwords to computer files or has keys to a file cabinet, then she is said to have access. Access alone does not equal acquisition. In *Dowell v. Biosense Webster* (2009) 179 Cal.App.4th 564, 577, the court looked unfavorably upon treating “access to information purporting to be trade secrets” as sufficient evidence for enforcing a restraint on trade, such as enforcing an injunction such as the one here that the former employer seeks to enforce against your client.

Similarly, the fact that an employee received a customer list does not mean that she acquired it. In *Silvaco Data Systems v. Intel Corp.* (2010) 184 Cal.App.4th 210, the court explained that receipt of a customer list is not acquisition of a customer list because receipt connotes obtaining an item by inadvertent means whereas acquire suggests that one took affirmative steps to obtain the item. (*Ibid.*)

Just because a former employee had access to the information from a customer list, and then she later finds herself in an employment position that is substantially identical to the one she held while working for her former employer, does not mean that she has misappropriated

the customer list. The idea that a former employee may be guilty of misappropriation on this basis is known as the inevitable disclosure doctrine.

The inevitable disclosure doctrine provides that showing that a former employee will “inevitably” rely on her former employer’s customer list in her new position can be the basis for proving trade secret misappropriation. (*Whyte v. Schlage Lock Co.* (2002) 101 Cal.App.4th 1443.) However, California courts will not recognize this doctrine because it would hinder employee mobility by keeping them from being able to move from one employment position to another position just because they may have had access to trade secrets. (See *ibid.*)

• **Acquired the Customer List through Improper Means:** Civil Code section 3426.1(a) defines improper means to “include theft, bribery, misrepresentation, breach or inducement of a breach of a duty to maintain secrecy, or espionage through electronic or other means. Reverse engineering or independent derivation alone shall not be considered improper means.”

A former employee may deny the allegations that he or she employed improper means. Such a denial may be enough to controvert any claim by the former employer that the employee had engaged in wrongful conduct to obtain the customer list for the purposes of denying injunctive relief. For example, in *Whyte v. Schlage Lock Co.*, (2002) 101 Cal.App.4th 1443, the court denied the request for injunctive relief where the employer alleged a variety of facts that pointed to the former employee having used improper means to obtain the customer list. (*Ibid.*) Specifically, the former employer claimed that the employee had access to the customer list, stated that he wanted to “get even” with the former employer’s president, concealed the fact that he was planning to leave the company in order to attend some of the confidential company meetings, lied about returning some of the company’s confidential information, lied about whether he destroyed



the information, and sent e-mails to his personal e-mail address with the company's confidential information. (*Whyte v. Schlage Lock Co.* (2002) 101 Cal.App.4th 1443, 1457.) The former employee needed to only deny these allegations, and the court resolved the dispute in the former employee's favor. (*Ibid.*)

#### **What is nonconsensual use?**

Besides improper acquisition, misappropriation also includes the non-consensual use of a trade secret. (Civ. Code, § 3426.1(b)(2).) When an employee uses information from a trade secret customer list to solicit customers without the consent of her employer, then that employee may be found liable for misappropriation. (See e.g., *MAI Systems Corp. v. Peak Computer, Inc.* (1993) 991 F.2d 511.) Since an employee may start her own business that directly competes with her former employer's business, it is important for her to understand what conduct may amount to misappropriation. (See *Matull v. Cloutier* (1987) 194 Cal.App.3d 1049, 1054.)

Some conduct does not count as misappropriation under the nonconsensual use option of the three trade secret misappropriation options. When an employee merely announces to customers, including trade secret customers, that she is leaving her employer and starting her own new venture, she has not misappropriated the customer list, as such announcements are considered fair competition, and the purpose of UTSA is to prohibit unfair competition that arises from trade secret misappropriation. (See *MAI Systems Corp. v. Peak Computer, Inc.* (1993) 991 F.2d 511.) In *Hilb, Rogal, & Hamilton Insurance Servs. v. Robb* (1995) 33 Cal.App.4th 1812, 1822, the court found that the employee had not engaged in solicitation when he, while still employed, informed a few of his former employer's clients that he would no longer be employed at the same company, even though the customers contacted him after seeking to switch their services to his new company. (*Id.* at 1821.)

Sometimes, an employee may make an announcement and then take extra steps to gain the patronage of their former employer's customers. In such cases, courts have found that the employee may not seek shelter under the mere announcement rule. In *American Credit Indemnity Co. v. Sacks* (1989) 213 Cal.App.3d 622, 636, the court found that the "employee's letter went beyond appropriate professional announcement of new business affiliation and constituted solicitation of [a] customer list." In *MAI Systems Corp. v. Peak Computer, Inc.* (1993) 991 F.2d 511, the conduct went beyond mere announcement when a former employee had called his former employer's customers after recognizing their names in a list provided to him while working for his new employer. (*Ibid.*) He went and visited those same customers personally and tried to get them to leave the former employer and sign up with his new employer. (*Ibid.*) The court found such conduct to be solicitation. (*Ibid.*)

The key conduct that a court will look for in finding the presence of solicitous conduct is whether the former employee "personally petitions, importunes and entreats customers to call [on her] for information about the better products or services that [she] may provide." (*Robert Half International, Inc. v. Murray*, 2008 WL 2625857 \*6 (E.D. Cal.)) A court found solicitation where an employee actually took with her a printout of her former employer's customers names (note that she may be also be found liable for misappropriation under the improper acquisition option); she used this list to call certain customers with which she had developed close and personal relationships; she gave them her contact information; she delivered marketing material to them; and she asked them how she can earn their business. (*Id.* at \*2 and \*7.)

#### **Did your client misappropriate her former employer's customer list?**

Although your client had access to the customer list and received it from her former employer, these two types of

passive acts do not amount to acquisition. Plus, she was always in rightful possession of the customer list, so she may defeat an improper acquisition claim right off the bat. When she sent the e-mail out to the customers, she had obtained their contact information from the customer list to which her employer provided her broad access. She was also granted broad authority to use the computer, and the information therein, in order to keep the employer's customers updated. She was also given all of the passcodes to all of the computer files and programs. Given these facts, she cannot be found to have acquired the customer list through improper means.

The other type of misappropriation discussed above was nonconsensual use. A court will probably find that your client did not use information from the customer list to solicit her former employer's customers. For one, the e-mail that she sent would likely be viewed as a mere announcement, because she just stated that her employment was ending and that she would be starting her new business so keep watch of the advertisements. She did not carry out any more aggressive or persuasive tactics, such as personally visiting customers, telling them that her catering company's services were better, or trying to convince them that they should switch to her company.

With regard to her advertising efforts, she did not use any information from the customer lists for advertising. Her employer may argue that she used the information from the customer list regarding customer locations – that is, the majority of her former employer's customers were located in the theatre departments of the local colleges in the tri-county area, and she specifically posted flyers in those departments. However, she can just deny that she used customer list information when she posted the flyers, and in doing so point to the fact that that her past connection with the local colleges, from her days working as a drama instructor, was the reason she



targeted the local colleges. Plus, she can state that the customers may have called her as a result of the corpus of other advertisements she posted, since after all, she did advertise in all of the local news sources.

Since you have a solid argument to convince the court that your client did not engage in any wrongful conduct in using the information from the customer list in order to solicit her former employer's customers and prospective customers, a court would likely find that she has not misappropriated her former employer's list. On the other hand, it is not inconceivable that a court could find that your client crossed the line. A court could find she used the company computer for a nonconsensual use in that not only did she rightfully announce her departure, but she also solicited customers by stating she was starting her own catering company and to check local college bulletins for advertisements regarding that business. (*See MAI Systems Corp. v. Peak Computer, Inc.*, *supra* at 521, 522.) In that case, the former employee actually made calls on the customers, but a court could find that asking the customer to watch for the ads was improper. Therefore, it would be unwise to advise your client to engage in this precise con-

duct if she sought your advice prior to sending the announcement. A better approach would be to only mention she was leaving the company to start her own business.

### Conclusion

Employees often sign non-solicitation agreements with their employers, and these employees do not realize that such agreements may violate Business & Professions Code section 16600 as invalid restraints on trade. The issue of whether a non-solicitation agreement violates section 16600 may arise in the context of a FEHA discrimination claim in which the former employee is being countersued by the former employer because of her interactions with its customers and prospective customers.

When the former employer countersues seeking legal remedies, it will also likely seek equitable remedies, such as injunctive relief, to keep the former employee from engaging in certain types of conduct with its customers and prospective customers. The former employee must be prepared to defend against the injunction by knowing the types of legal issues that may arise when a court is looking at whether she has misappropriated a customer list that is a trade secret.



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