

## **The Brave New World of Employee Mobility: The Corporate Duty To Identify, Value and Protect Trade Secrets**

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For an increasing number of publicly-traded companies outside the traditional technology sector, a steadily increasing percentage of their value is comprised of intangible assets including Intellectual Property and trade secrets. The single largest threat to a company's trade secrets originates from current and former employees. With the increase of globalization, technology and employee mobility, the ability to protect trade secrets from disclosure to competitors is of paramount importance to maintaining and increasing market share. Even the smallest innovation now leads to product differentiation, and time to market has never been more critical to the bottom line. Intellectual property management systems will not effectively protect trade secrets unless they address the realities of worker mobility.

The Sarbanes-Oxley Act ("SOX") illustrates the perils to corporations that fail to devote sufficient attention to protection of trade secrets. One of SOX's central goals is the accurate valuation and protection of all of a company's assets. With respect to the protection of trade secrets, there is a growing consensus that one SOX provision deserves special attention in light of the SEC's compliance guidance relating to that provision. As a general matter, Section 404 requires management to document, test and certify the effectiveness of internal controls over financial reporting. Although the relationship between internal controls and trade secret protection is not clear from the face of Section 404, the SEC's compliance guidelines identify safeguarding of assets among the internal controls that must be verified. The SEC defines "internal control over financial reporting" to include procedures that provide reasonable assurances regarding "prevention or timely detection of unauthorized acquisition, use or disposition of the issuer's assets that could have a material effect on the financial statement."

There is no distinction made between "tangible" and "intangible" assets. A sizable portion of a corporation's intangible assets would surely qualify as trade secrets, provided (1) the assets contain commercially valuable information or data not generally known to the public, (2) they have a value derived, at least in part, from the exclusive possession of the information, and (3) reasonable efforts have been made to keep them confidential.

To the extent that a company's trade secrets, if subject to improper acquisition, disclosure or use, could have a material effect on the financial statements, then Section 404 would seem to create corporate obligations with respect to identification, valuation and protection of those trade secrets. But even for companies not governed by SOX, the same concerns exist and in many cases may be more pronounced. The success of early stage and less mature companies may be even more dependent on identification and protection of trade secrets than larger entities' whose

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shares are publicly traded. And it is likely that all companies owe a fiduciary duty to their shareholders to protect valuable trade secrets.

Nevertheless, oftentimes senior management does not fully appreciate the scope of their obligations as it relates to protecting trade secrets. Most notably, a failure to even account for a corporation's trade secrets necessarily means that the corporation probably has not instituted effective measures to protect the confidentiality of the unidentified assets.

The three largest problem areas are: (1) failure to identify, inventory and value trade secrets; (2) failure to institute internal controls regarding confidentiality; and (3) failure to protect trade secrets when employees depart. Similarly, corporations need to protect against the porting of third party trade secrets into the company when new hires arrive.

Several NASDAQ and S & P 500 companies are currently trending towards internal reviews of and modifications to their trade secret programs. Experienced trade secret counsel are also devising state of the art procedures tailored towards specific industries designed to help maximize protection of Intellectual Property, including trade secrets. At minimum, every company should institute the following processes, which in many cases, will not be sufficient to adequately identify and protect trade secret information.

- Create an internal committee to identify and account for key corporate trade secret data
- Institute controls to ensure the confidentiality of the trade secret data, including limiting who may access core trade secret data and monitoring access
- Institute processes to ensure that external candidates do not violate their confidentiality obligations to their current employers
- Require new hires to execute and abide by Confidential Information Agreements
- Develop policies about use of external storage devices with company laptops, transmission of company data to private Web email accounts, and usage of Instant Message Software
- Require departing employees to execute a Certification detailing what external computer media they used while employed and reminding them of their obligations not to copy, retain, disclose or use trade secret data in tangible or intangible form
- For sensitive or high-risk departures, create a forensic image of the departing employee's hard-drive and maintain a library of such images
- Institute policies to protect outsiders from accessing trade secrets.

It is further recommended that corporations conduct audits on at least an annual basis to assess the status of their trade secret programs and protections. Continued improvements and modifications will no doubt be required.