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Taking the Offensive to Protect Trade Secrets

Law360, New York (August 31, 2010) -- Although lawsuits involving trade secret disputes within the entertainment industry are often resolved confidentially, recent matters have garnered national attention.

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In April, a former IMG Worldwide Inc. sports agent defected to Creative Artists Agency, allegedly taking more than 7,000 privileged files on his laptop with him and destroying key documents pertaining to clients and salaries.

In June, Universal Locations, which provides location rentals for studios and networks, claimed that two former employees stole its trade secrets and provided them to a competitor. Universal maintains a database with listings of over 5,000 properties, which includes customer names, pricing, profiles and contact information.

Disputes involving trade secrets are commonplace in the entertainment industry and take a variety of forms. Given the cross-pollination and close relationships in the industry, employees frequently move from one company to another.

Unscrupulous employees heading to a competitor have a motive to walk out the door with the keys to their former employer's kingdom, taking confidential information such as client phone numbers and e-mails, contract expiration dates, deal terms and other sensitive information. And the relentlessly expanding technology world makes theft of such information easier than ever before. Trade secret disputes arise in other contexts as well, such as contract disputes between writers and studios, pitch meetings and marketing ventures.

Thus, trade secret litigation among industry players is common. Trade secrets are typically defined as information that (1) derives independent economic value from not being generally known to the public, and (2) are the subject of reasonable efforts to maintain secrecy. Information for which trade secret protection is often sought includes client lists, business plans, contracts, research, cost and pricing information, employee lists, and the identity of key vendors and suppliers.

In evaluating the "independent economic value" prong of the test, courts typically look to whether the information is readily accessible to competitors. For example, information publicly available or posted on the Internet is not protected. Some companies unwittingly waive trade secret status by posting, on their own website, information about clients, pricing and other matters.

Other factors relevant to showing independent economic value include whether the information was obtained by lengthy and expensive effort, the extent to which the information contains particular facts and whether the information was built up over time, with ingenuity and labor. When information qualifies as a trade secret, it can be protected in perpetuity. This is true even when an employee becomes acquainted with the information through personal relationships developed while working for the employer.

To satisfy the “reasonable efforts to maintain secrecy prong,” a variety of steps can be taken. Companies should require all those with access to confidential information, including employees, vendors and contractors, to sign a nondisclosure agreement. The agreement should define what the company considers “confidential information” and should prohibit unauthorized disclosure during and after the relationship.

In addition, companies should restrict access to confidential information and segregate such information in locked cabinets. The information should be accessible only on a “need to know” basis, and individuals with the right to access the information should be identified in writing, in advance. The information should be marked as confidential, to the extent possible. Confidential information stored on computer systems or located in the virtual “cloud” must be protected with passwords that require periodic resetting. The company should also require employees to return all trade secret information upon termination of employment. The company’s information technology department should monitor computer use to identify potential misappropriation in advance and ensure that no trade secret information is downloaded, copied or otherwise misappropriated by a departing employee.

Despite taking these steps, companies often find themselves embroiled in trade secret litigation, typically seeking to enforce the terms of a nondisclosure agreement. Most nondisclosure agreements contain a “loser pays” attorneys' fees provision, which provides that in the event of a lawsuit, the losing party must pay the prevailing party’s attorneys' fees. Historically, this has not been a significant concern for defendants, as insurance policies typically indemnify attorneys' fees. Plaintiffs, on the other hand, have historically lacked the ability to insure against the defendant’s potential attorneys' fees.

This scenario was exemplified in Ken Shamrock’ s recent contract dispute with Zuffa LLC, the parent of the Ultimate Fighting Championship, over his high-profile rematch with Tito Ortiz. Zuffa prevailed at trial, and in knockout punch-style, the judge ordered Shamrock to pay Zuffa $175,000 in legal fees, based on a “loser pays” contract provision. Parties seeking to protect trade secrets will find themselves in a similar situation, as they will be the party on the offense. And any company doing business for more than a few years in the entertainment industry stands more than a fair chance of having to sue to protect its trade secrets.

Parties suing to enforce nondisclosure agreements have a new option, however, in the form of plaintiff’s contract litigation insurance (PCLI). PCLI is a first-of-its-kind insurance policy that protects a plaintiff from paying its adversary’s fees after losing at trial or summary judgment. By removing the risk of attorney’s fees, a PCLI policy can be instrumental in shifting leverage in the typical trade secret dispute, and should be considered a key element in any trade secret protection strategy. PCLI insurance also allows companies to budget for unexpected litigation expenses.

Companies in the hypercompetitive entertainment industry must be ever-vigilant to protect against the risk of trade secret theft. This risk, however, can be managed. Nondisclosure agreements, sound internal policies, proactive IT monitoring, and an insurance policy that levels the playing field for plaintiffs are critical steps that can make the difference between survival and extinction.

--By Spencer Hamer, Michelman & Robinson LLP, and Kevin Martin (pictured), Sonoma Risk Insurance Agency

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