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LEGAL ISSUES

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Cases of Note — Trade Secrets — Nondisclosure Agreements — Non-compete Clauses

by **Bruce Strauch** (The Citadel) <strauchb@citadel.edu>

Decision Insights, Inc. v. Sentia Group, Inc., United States Court of Appeals for the Fourth Circuit, 2009 U.S. App. LEXIS 2654.

Decision Insights, Inc. (DII) developed software called a “Dynamic Expected Utility Model” (“EU Model”) which became the primary asset of the company. EU Model is an analytical tool used in preparing negotiating strategies. It assesses risk, compares different operating positions and trade-offs among the alternatives. Since 1989, **DII** has used the EU Model and owns the assets, copyright, and all proprietary rights.

Gary Slack and **Dr. Bruce Mesquita** developed the EU Model from scratch. **Slack** is on **DII**’s board; **Mesquita** is no longer with the company.

In 1998, **Carol Alsharabati** was hired to make modifications to the EU Model. She signed a confidentiality agreement. Curiously, she had absolutely no computer training, but admits gaining valuable experience while with the company.

Is it that easy? So why are we not software magnates?

Around 2001, **Mark Abdollahian** and three others — **Kugler**, **Efird** and **Scott** — who had worked with **Alsharabati** — left **DII** to form **Sentia Group**. All but **Kugler** had signed Trade Secret Nondisclosure Agreements (“Agreements”) and **Efird**’s had a non-compete clause.

Are you following all these players? It’s only semi-important in the case. Although the dynamics of folks jumping ship and going into competition holds its business interest.

The original plan was to obtain a software license from **DII** and operate in a separate territory. After all, one of them had signed a non-compete agreement. But **Sentia** could not reach agreement with **DII**.

Deciding to develop their own version of the software, **Sentia** sought legal counsel and were advised that no one who had had access to the **DII** code be involved in the task. If this was not possible, the new code should bear no resemblance whatsoever to the EU Model.

And they had better document every step in the development process.

As so many clients do, **Sentia** ignored counsel’s advice and hired **Alsharabati** to do the work. And she did so in the record time of six weeks.

DII claimed the software is identical to the EU Model and sued for breach of contract, misappropriation of trade secrets and other theories not of interest to us here.

Litigation

So far so good. But then **DII** got sloppy in the discovery process and failed to identify its trade secrets with specificity or differentiate them from what is public knowledge. **Sentia** asked for sanctions, so **DII** scrambled about and identified its entire source code (i.e., mathematical equations) as a total compilation that was the big trade secret and twelve major components that were each secrets as well.

Sentia huffed and puffed about that, and **DII** was ordered to produce “all algorithms, block flow diagrams, narratives” associated with the development of EU Model. And **Sentia** was awarded attorney’s fees for its efforts in acquiring this information.

DII said the software was over fifteen years old and they didn’t have the algorithms. Reverse engineering would cost in the range of \$100,000. The magistrate judge brought them all in again and said if the stuff didn’t exist, then it didn’t. And imposed sanctions of \$13,256.25.

Ouch.

Sentia moved for summary judgment based on the failure of **DII** to meet the burden of establishing trade secrets. **Sentia** won this, and **DII** appealed.

The Appeal – Trade Secrets

The state of Virginia defines a “trade secret” as “information including but not limited to a formula, pattern, compilation, program, device, method, technique or process, that:

1. 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

2. Is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.” Va. Code. § 59.1-336.

The key is secrecy rather than novelty. **Dionne v. Southeast Foam Converting & Packaging, Inc.**, 240 Va. 297, 397 S.E.2d 110,113 (Va. 1990). “Novelty in the patent law sense, is not required for a trade secret.” **Trandes Corp. v. Guy F. Atkinson Co.**, 996 F.2d 655, 664 (4th Cir. 1993).

Thus the whole secrecy issue is fact-intensive and very much a jury question. **Hoechst Diafoil Co. v. Nan Ya Plastics Corp.**, 174 F.3d 411, 419 (4th Cir. 1999). **DII** said its software is a compilation within which there are twelve specific functions, any or all of which are protected trade secrets. Which — see the requirements above — is a complex question of fact. The Fourth Circuit agreed and remanded to the district court.

Trade Secret Nondisclosure

Abdollahian and others signed agreements not to disclose **DII**’s proprietary information. They assigned work product to **DII** and agreed to return all confidential stuff when they left. The district court basically ignored this saying there was no evidence of breach because there was no evidence of any trade secrets.

Since the Fourth Circuit had sent the trade secret issue back for a jury trial, then this was reversed as well.

Kugler had never executed his nondisclosure agreement but a letter from him to **DII** stated he would never make improper use of confidential information. **DII** said they would never have shared anything with him without such an understanding.

The absence of a writing does not mean there was no binding agreement. It is a question of intent. If the parties have a meeting of the minds — and part of the understanding was that a written contract would be executed — then “...there results an obligatory contract which neither party is at liberty to repudiate.” **Manss-Owens Co. v. H.S. Owens Son**, 129 Va. 183, 105 S.E. 543, 547 (Va. 1921) (quoting **Boisseau v. Fuller**, 96 Va. 45, 30 E.E. 457 (Va. 1898).

Well, those dates seem to make that established law. But the cases do distinguish this from

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Questions & Answers — Copyright Column

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QUESTION: *A court library has recently had discussions with an attorney about the copyright status of state court briefs. The attorney believes that briefs are copyrightable and that Lexis, Westlaw infringe when they include briefs in their databases without permission. The library maintains that state court briefs are public information and not subject to copyright. Is there a difference in U.S. government works and state government documents?*

ANSWER: Section 105 of the *Copyright Act* says that works produced by the federal government are not copyrightable. Because the *Act* is a federal statute, it is silent as to the status of state documents. Many states claim copyright in their documents or at least in some of them. The *Copyright Office Compendium* says that state statutes and court reports are not copyrightable. The question, of course, is whether briefs filed in a state court are government documents.

If the brief is for the state as a party to the litigation, and the brief is prepared by attorneys who are state employees, the brief is likely to be a government document, so the answer as to whether it is copyrighted or not will depend on whether the state claims copyright in its documents. If, however, the brief is one written by a private attorney for a private party to the litigation, then the brief may well be copyrighted. Some attorneys and law firms do claim copyright in their briefs and are particularly unhappy with services such as **Lexis** and **Westlaw** which sell copies of their briefs.

To my knowledge, there are no cases on this issue, and the legal authorities seem to say only that there *may* be copyright in briefs. Another possibility, of course, is that in filing the brief with a court, that brief becomes public domain as a part of the court record, but

this does not appear to be a very strong argument. Public domain is certainly the best argument from an open government type argument, however. But consider the following. A song writer has not published a particular song, but it is introduced into evidence in a court in a case concerning the ownership of the copyright. Clearly, introduction of the song into evidence in court does not make that song public domain. Analogizing to briefs would mean that they do not become public domain just because they are filed in court. Unfortunately, this is one area where there is no clear answer.

QUESTION: *A teacher in a nonprofit educational institution music therapy program is interested in the use of sheet music and printed scores in that program and asks whether fair use, the Teach Act or other statutes and regulations apply. What are the guidelines for students who routinely download sheet music to learn and bring into lessons and music therapy clinical sessions?*

ANSWER: If these music therapy sessions are for teaching students to be music therapists, then the Guidelines on the Educational Use of Music apply. They are available at: <http://www.unc.edu/~uncclng/music-guidelines.htm>. The guidelines cover both the reproduction of music recordings as well as sheet music for educational purposes but for study not for performance. General fair use also applies. For performance and display of nondramatic music in a face-to-face classroom, the section 110(1) exception applies and permits the performance if the purpose is for instruction and the other conditions are met. If the class is a transmitted or online class, then the **TEACH Act** permits the performance. Neither of these sections apply to reproducing sheet music though. If the music is to be performed,

it is a good idea to ask students to make sure that they examine the copyright notice on the sheet music on the Web and make sure that there is no restriction on downloading for performance.

QUESTION: *Many libraries are lending eBooks on a Kindle. Is this infringement to lend a Kindle loaded with copyrighted books acquired from Amazon?*

ANSWER: The **Amazon** license agreement was last updated in February 2009, see <http://www.amazon.com/gp/help/customer/display.html?nodeId=200144530>, and is silent about lending **Kindles** loaded with purchased eBooks. One part of the license states: "Upon your payment of the applicable fees set by **Amazon**, **Amazon** grants you the non-exclusive right to keep a permanent copy of the applicable Digital Content and to view, use, and display such Digital Content an unlimited number of times, solely on the Device or as authorized by **Amazon** as part of the Service and solely for your personal, non-commercial use. Digital Content will be deemed licensed to you by **Amazon** under this Agreement unless otherwise expressly provided by **Amazon**." Library lending is for personal, non-commercial use.

When librarians have contacted **Amazon** to request clarification, the answers received are not clear. As the library lending of **Kindles** becomes more prevalent, it is likely that the license agreement will be redrafted to deal with this type of use. Online license agreements that are clearly written and easily located on a Website tend to be upheld by courts. Further, a library would be considered to have more knowledge than an individual user might, so the license agreement is more likely to be upheld.

A recent *Library Journal* (<http://www.libraryjournal.com/article/CA6649814.html>) article pointed out the mixed messages that **Amazon** has provided on this matter. At this point, however, with the online license not mentioning lending of the devices, there appears to be no reason that a library could not lend **Kindles** to users.

QUESTION: *Can a touchscreen smartboard be used for story time in a public library?*

ANSWER: As phrased, this is a technology question and not a copyright one. Use of the technology itself presents no problems on the copyright front. However, if one reproduces works to be displayed on the smartboard, then the same issues are present as with photocopying or with displaying images. If the question contemplates displaying all of the words of the story on the screen to help with reading and/or including the illustrations, this is reproducing an entire work and probably is infringement. If permission is sought from the publisher, it is likely that permission would be granted.

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a situation where no one intended to be bound until a formal execution of a written contract. At any rate, we certainly have a nice question of fact as to what their minds met upon.

Non-competition Clause

Efird entered into an agreement to not compete with **DII's** "precise" business for a period of two years. Virginia law examines these contracts on a basis of (1) limiting the scope to what is reasonably necessary to protect legitimate business interests of the employer, and (2) not unduly oppressing the employee in his efforts to earn a living. *Blue Ridge Anesthesia & Critical Care, Inc. v. Gidick*, 239 Va. 369; 389 S.E.2d 467, 470 (Va. 1990).

These covenants are not favored as they are restraints on trade and are strictly construed against the employer including putting the burden of proof of reasonableness on him. See *Grant v. Carotek*, 737 F.2d 410, 411-412 (4th Cir. 1984).

The district court found the agreement was "broader than necessary" to protect **DII's** legitimate interests. But this was premised upon the belief that **DII** had no trade secrets. "The possession of trade secrets and confidential information is an important consideration in testing the reasonableness of a restriction on competition." *Meissel v. Finley*, 198 Va. 577, 95 W.E.2d 186, 191 (Va. Ct. App. 1956).

And the sanctions got vacated as the parties had a genuine dispute as to how to identify trade secrets, and the district court was muddled on the issue. 🐼