

STATE OF NORTH CAROLINA
COUNTY OF MECKLENBURG

IN THE GENERAL COURT OF JUSTICE
SUPERIOR COURT DIVISION
FILE NO. 07-CVS-21932

COVENANT EQUIPMENT CORPORATION,)
D/B/A WHOLESALE FORK LIFTS,)

Plaintiff
Vs.

FORKLIFT PRO, INC., BUCKY W. CALDWELL,)
FORKLIFT PRO, INC. &)
TIMOTHY SMITH and WILLIAM CARNIE,)

Defendants.)

PLAINTIFF'S
MEMORANDUM OF LAWs
IN OPPOSITION TO
DEFENDANT CALDWELL'S
MOTION TO DISMISS

Plaintiff submits this Memorandum of Law in Opposition to Defendant Bucky W. Caldwell's Motion to Dismiss dated May 2, 2008.

PROCEDURAL BACKGROUND

Caldwell has moved pursuant to Rule 12(b)(6) of the North Carolina Rules of Civil Procedure to dismiss the Plaintiff's Sixth Cause of Action, a claim against Caldwell for breach of the nondisclosure provision of the Noncompetition Agreement (attached to Defendant Caldwell's Memorandum of Law as Exhibit A).

UNDISPUTED MATTERS

Plaintiff does not dispute the following assertions by defense counsel:

1. When ruling on a 12(b)(6) motion, this Court can consider documents specifically referred to in the Complaint, including in this case the Noncompetition Agreement. (Caldwell Memorandum p. 2, citing *Oberlin Capital L.P. v. Slavin*, 147 N.C. App. 52, 554 S.E. 2d 840 (2001)).

2. When construing a motion to dismiss under Rule 12(b)(6), this Court must construe the Complaint liberally, treating every allegation as true. (Caldwell Memorandum, p. 2, citing *Dixon v. Stuart*, 85 N.C. App. 338, 354 S.E. 2d 757 (1987)).

3. The Noncompetition Agreement is to be construed in accordance with South Carolina substantive law. (Caldwell Memorandum P. 3., citing §11 of the Noncompetition Agreement).

ARGUMENT

The South Carolina Trade Secrets Act Authorizes Nondisclosure Agreements with Unlimited Duration and Territory.

Defendant Caldwell's Motion to Dismiss is based solely upon the South Carolina Court of Appeals' decision in the case of *Carolina Chem. Equip. Co., Inc. v. Muckenfuss*, 322 S.C. 289, 471 S.E. 2d 721 (S.C. App. 1996). However, *Muckenfuss* is not applicable to the present action due to amendments to the South Carolina Trade Secrets Act, (SCTSA) S.C. Code Ann. §39-8-10, et. seq., made by the South Carolina legislature the year after the *Muckenfuss* decision. As set forth below, the Court in *Muckenfuss* found that the disputed nondisclosure covenant was unenforceable because it was unlimited in time and territory. *Id.* at 294-95; 471 S.E. 2d at 723-24. The SCTSA was amended to specifically allow nondisclosure agreements unlimited by time or territory the year following the decision. S.C. Code Ann. §39-8-30 (A) and (D) (1997).

The amended South Carolina statute reads in pertinent part:

§39-80-30. Trade secrets; employees' obligation to refrain from disclosing; civil actions and remedies.

(A) A trade secret endures and is protectable and enforceable until it is disclosed or discovered by proper means.

....

(D) A contractual duty not to disclose or divulge a trade secret, to maintain the secrecy of a trade secret, or to limit the use of a trade secret, ***must not be considered void or unenforceable or against public policy for lack of a durational or geographical limitation.***

S.C. Code Ann. §39-8-30 (1997) (emphasis added). Commentators attributed the legislative changes to the SCTSA to the *Muckenfuss* decision:

Any employer who uses a non-disclosure covenant as an added layer of protection received a rude shock in 1996 from the South Carolina Court of Appeals holding in *Carolina Chemical Equip. Co. v. Muckenfuss*, 322 S.C. 289, 471 S.E. 2d 721 (Ct. at App. 1996). The *Muckenfuss* court struck down, for the first time, a non-disclosure covenant for being unlimited in time and territory.

The General Assembly wasted no time in overturning this decision. The South Carolina Trade Secrets Act (S.C.T.S.A.) (citations omitted), made clear that non-disclosure agreements were not voided for lack of durational or geographic limitations.

A. Kilgore & Charles N. Griffin, III, *Trade Secrets in South Carolina: New Act Changes Outlook for Employers*, 9 S. Carolina Lawyer 20, 21 (1998) (attached hereto as Exhibit "A").

The instant Confidentiality Agreement is not overly broad and does not prohibit Caldwell from engaging in fair competition with the Plaintiff.

Defendant Caldwell maintains that the nondisclosure provision in the Noncompetition Agreement has the practical effect of a covenant not to compete and therefore, pursuant to the holding in *Muckenfuss*, should not be enforced because of its unlimited geographic scope and duration. (Caldwell Memorandum, pp. 5-7). This argument fails not only because of the legislative changes to the SCTSA authorizing such unlimited agreements, but also because the present nondisclosure provision does not prevent Caldwell from competing with the Plaintiff. The nondisclosure provision only

prohibits Caldwell from disclosing "non-public, proprietary or confidential information" to un-associated third parties. (Noncompetition Agreement para.4).

The provision protecting confidential information from disclosure by Defendant Caldwell is contained in paragraph 4 of the Noncompetition Agreement which is part of the Asset Purchase Agreement (APA) wherein the Plaintiff purchased the assets of Wholesale Forklifts, Inc. from Defendant Caldwell and his wife (referenced as "Sellers" in the Noncompetition Agreement along with Wholesale Forklift, Inc.). The Noncompetition Agreement sets forth the parties' agreement whereby the Plaintiff paid \$60,000 for two forms of competitive protection from the Sellers: (1) a 2-year time period during which the Sellers would not compete with the Plaintiff in a specifically defined geographical area and would not solicit Plaintiff's customers, employees or independent contractors (Noncompetition Agreement, paras 1-3); (2) the Seller's agreement to maintain the confidential information of the Plaintiff without time or geographical limitation (Noncompetition Agreement, para.4).

The rationale for the two types of afforded protection is set forth in the third paragraph of the background statement to the Noncompetition Agreement which reads:

Therefore, the parties hereto are entering into this Agreement for the purposes of preserving the proprietary rights, going business value and good will of the Business by making certain that during the non-compete period (hereinafter defined) and in the Restricted Territory (hereinafter defined) the Sellers do not compete with the Purchaser and the Business, and Sellers do not use such non-public, confidential and proprietary information, contacts and the Sellers' know-how to compete with the Purchaser and the Business.

The nondisclosure provision in paragraph 4 of the Noncompetition Agreement states in pertinent part that the Sellers will not:

(i) disclose or furnish any non-public, proprietary or confidential information obtained from or relating to the Business, the Seller or the Purchaser to any third party not associated with the Business, the Seller or the Purchaser as an officer, director, shareholder, or employee.

(NonCompetition Agreement, paragraph 4.)

Caldwell maintains that the definition of "Business" set forth in the Noncompetition Agreement is not limited to the "business of the Plaintiff or Wholesale Fork Lifts, Inc." (Caldwell Memorandum, p. 5) and is so broad that enforcement of the Nondisclosure Provision would prohibit Caldwell from competing with the Plaintiff at all. This argument, however, fails for two reasons: First, it is clear from the context of the wording that the term "Business" in the nondisclosure provision is referring to confidential information obtained by Caldwell during the time that he was an owner of Wholesale Forklift, Inc. and during the time that he worked as an employee after selling the assets of the Company to the Plaintiff. The Definitions section of the Noncompetition Agreement specifically contemplates use of the proper context when interpreting the agreement:

1D. Definitions. In addition to the other terms defined elsewhere in this Agreement, *unless the context shall expressly or by necessary implication indicate to the contrary*, as used herein, the following terms shall have the following meanings:

(Definitions Paragraph, Noncompetition Agreement p.2)(emphasis added) Such context for the term "Business" is apparent in the Background Statement at the beginning of the Noncompetition Agreement which specifically acknowledges the Sellers' (Mr. and Ms. Caldwell) contributions to the success of the "Business" and their creation of "personal good will with the customers of the Business". (Noncompetition Agreement Background Statement, paragraph 2). Obviously, this language is referring to the

Business purchased by the Plaintiff and not the generic field of "the wholesale forklift industry" as argued by Caldwell (Defendant Memorandum, p 7). Indeed, Plaintiff makes no allegation in its Sixth Cause of Action that Caldwell has disclosed confidential information obtained from generic sources outside of Plaintiff's Business. Furthermore, Plaintiff would clearly lack standing to assert a claim for disclosure of confidential information not obtained from or owned by the Plaintiff.

Secondly, even if this court were to adopt the broad definition of "Business" asserted by Defendant Caldwell, he provides no basis for his assertion that it would somehow prevent him from competing in the wholesale forklift industry. The nondisclosure provision prevents only the disclosure of "non-public, proprietary or confidential information". It's unclear how this would require Caldwell to "erase from his mind all of the general skills, knowledge and expertise acquired through his experience" as he asserts (Caldwell Memorandum, p. 7).

Although Defendant Caldwell relies on the Muckenfuss, supra holding in asserting that the present nondisclosure agreement is overly broad, the court was dealing with a much broader nondisclosure provision in that action. The provisions in that case read in pertinent part:

[Muckenfuss] agrees to not divulge any trade secrets of the Corporation. Trade Secrets means any knowledge or information concerning any process, product or customer of the corporation and more generally any knowledge or information concerning any aspect of the business of the Corporation which could, if divulged to a direct or indirect competitor, adversely affect the business of the corporation, its prospects or competitive position. Seller shall not use for his own benefit any trade secret of the Corporation in any manner whatsoever.

Carolina Chem. Equip. Co., Inc. vs. Muckenfuss, 322 S.C. 289, 293-294, 471 S.E. 2d 721, 723 (S.C. App. 1996). This prohibition is much broader than the provision

protecting confidential information in the present action. Whereas Defendant Caldwell is prohibited only from disclosing or furnishing "non-public, proprietary or confidential information", Mr. *Muckenfuss* was prohibited from divulging or using "any knowledge or information concerning any aspect of the business of the Corporation which could... adversely affect the business of the corporation, its prospects or competitive position."

**Defendant Caldwell has acknowledged that the Nondisclosure Agreement is
Reasonable**

Finally, paragraph 6 of the Noncompetition Agreement specifically provides that the parties to the Agreement find the restrictions to be "reasonable". Also, in that paragraph, Caldwell agreed that if any provision of of the Agreement were to be found unenforceable, the Agreement would be amended to such extent as the court may judicially determine or indicate to be reasonable. Should this Court find that the term "Business" as used in the nondisclosure provision in paragraph four of the Noncompetition Agreement is too broad because of the definition of "Business" contained in the Agreement, paragraph six would authorize striking the term "Business" from paragraph four. This would still prevent Caldwell from disclosing confidential information obtained from the Seller (Wholesale Forklift, Inc.) or the Purchaser (Covenant Equipment Corporation).

CONCLUSION

Defendant Caldwell's reliance on the decision in Muckenfuss as support for his Motion to Dismiss Plaintiff's breach of contract claim is misplaced. The lack of durational or geographical limitation for the protection of the Plaintiff's confidential information was specifically authorized by South Carolina Statute the year after the Muckenfuss decision.. S.C. Ann. 39-8-30(D) (1997). The Nondisclosure provision which the Muckenfuss court addressed was much broader than the one in the instant case, prohibiting use of any information obtained from the Company which could adversely affect its business. The restriction in the present action only prohibits Caldwell from using "non-public, proprietary or confidential information". Plaintiff respectfully requests that this Court deny the Defendant Caldwell's Motion to Dismiss.

Respectfully submitted, this 22 day of May, 2008.

s/ Rex C.Morgan
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CERTIFICATE OF COMPLIANCE

I do hereby certify that the foregoing PLAINTIFF'S MEMORANDUM OF LAW
IN OPPOSITION TO DEFENDANT CALDWELL'S MOTION TO DISMISS complies
with Rule 15.8 of the General Rules of Practice for the North Carolina Business Court.

This 22 day of May, 2008.

s/Rex C. Morgan

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CERTIFICATE OF SERVICE

I, Rex C. Morgan, do hereby certify that a copy of the foregoing document was served upon the parties entitled thereto by placing same in the United States mail, postage prepaid and addressed as follows:

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This the 22 day of May, 2008.

s/Rex C. Morgan
Rex C. Morgan

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FEATURE: TRADE SECRETS IN SOUTH CAROLINA: NEW ACT CHANGES OUTLOOK
FOR EMPLOYERS

By Phillip A. Kilgore and Charles N. Griffin III

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TEXT:

[*20] In the information age, our economy is now global, heavily dependent on technological advantage and ultimately, more competitive. Businesses compete for market share, as well as the tools of productivity -- namely capital and labor. Because of rivalry for the most skilled employees, or perhaps because of the inherent mobility of modern society, employers often find it difficult to achieve workforce stability.

Although the departure of knowledgeable and skilled employees reduces productivity, the biggest risk is the potential loss of the business information they may take with them. When a competitor hires away a valuable employee, a frequent motivation is to acquire what that person knows about the former employer's business -- not necessarily what the employee can do. Whether by design or inadvertence, former employees often pass along confidential information -- such as production methods, product formulas and customer lists -- to their new employers.

The manifest value of confidential business information led courts to recognize a common law right to protect trade secrets. Employers also began to use secrecy agreements, known as nondisclosure covenants. Often associated with its disfavored cousin, the covenant not to compete, a nondisclosure covenant does not prohibit an employee from working in the same field, but attempts to prevent the former employee from divulging the former employer's confidential information.

In 1992, the General Assembly codified laws protecting trade secrets by passing the Uniform Trade Secrets Act (UTSA), *S.C. Code Ann. §§ 39-8-1 et seq.* (Law. Co-op. Supp. 1992). This statute recognized a uniform private right of action for misappropriation of trade secrets, but left intact an employer's right to contract for stricter secrecy standards through nondisclosure covenants.

Any employer who uses a nondisclosure covenant as an added layer of protection received a rude shock in 1996 from the South Carolina Court of Appeals' holding in *Carolina Chemical*

Equipment Co. v. Muckenfuss, 322 S.C. 289, 471 S.E.2d 721 (Ct. App. 1996). The *Muckenfuss* court struck down, for the first time, a nondisclosure covenant for being unlimited in time and territory.

The General Assembly wasted no time in overturning this decision. The South Carolina Trade Secrets Act, (SCTSA) -- *S.C. Code Ann. §§ 39-8-10 et seq.* (Law. Co-op. 1976) (effective May 21, 1997) <<http://www.lpittr.state.sc.us/bills/285.htm>> -- made clear that non-disclosure agreements were not void for lack of durational or geographic limitations.

In addition to addressing the *Muckenfuss* anomaly, the SCTSA built on the evolution of trade secret law -- starting with South Carolina common law through the passage of the UTSA -- to create a useful and powerful ally for South Carolina employers.

COMMON LAW TRADE SECRET PROTECTIONS

The Supreme Court of South Carolina recognized the modern view of trade secret protection in *Lowndes Prod., Inc. v. Brower*, 259 S.C. 322, 191 S.E.2d 761 (1972). According to the *Lowndes* court, the initial issue to be determined in a trade secret misappropriation case is not whether information has been misappropriated, but, rather, whether the information is a trade secret. *Id. at 324-25, 191 S.E.2d at 764*. The *Lowndes* court adopted the prevailing definition of "trade secret" found in the original Restatement of Torts:

[*22] A trade secret may consist of any formula, pattern, devise, or compilation of information which is used in one's business and which gives him an opportunity to obtain an advantage over competitors who do not know or use it. It may be a formula for a chemical compound, a process of manufacturing, treating or preserving materials, a pattern for machine or other devise, or a list of customers.

Id. (citing Restatement of Torts § 757 cmt. b (1939)). The opinion of the *Lowndes* court shed little light on why the information at issue in that case constituted trade secrets.

Once a party establishes that its business information constitutes a trade secret, the inquiry turns to whether the party took reasonable steps to protect its trade secret. *Id. at 327, 191 S.E.2d at 765*. Stated otherwise, an "[i]ntent to keep an idea or particular fact a secret is [an essential element for protecting a trade secret]." *Id.* (citation omitted). The *Lowndes* court considered the following factors:

- Were employees required to sign employment contracts, secrecy agreements or non-competition clauses?
- Were employees admonished concerning the secrecy of the information?
- Were terminated employees reminded to maintain secrecy?
- Did the employer have sufficient plant security including, for example, sign-in systems, badges, locked doors, fencing, restricted access to the plant by outsiders and limited access within the plant by general employees to sensitive areas?

Id. at 327-28, 191 S.E.2d at 765-66. Because the plaintiff in *Lowndes* failed to show that it had taken adequate precautions to protect its trade secrets, the court did not reach the final element of a trade secret misappropriation case, whether there was a misappropriation.

In *Wilkes v. Pioneer American Ins. Co.*, 383 F. Supp. 1135 (D.S.C. 1974), the U.S. District Court for the District of South Carolina elaborated on the definition of trade secret. The *Wilkes* court acknowledged the standard definition of trade secret in the original Restatement, which requires that the information or device be "secret" -- competitors must not know to use the information or device. *Id. at 1139* (citing Restatement of Torts § 757 cmt. b (1939)). The court in *Wilkes* noted, however, that "the fact that part, or even eventually all, of the components of a trade secret are matters of public law or public knowledge does not prohibit [claiming the entire combination as a trade secret]." *Id. at 1140.*

Stated otherwise, "piecing together, in retrospect, bits of information which had been disclosed in a variety of places and which *as a combination* were not clearly matters of public knowledge will not allow avoidance [by the disclosing party] of the consequences of a breach of confidence." *Id.* (emphasis in original) (citation omitted).

The importance of the *Wilkes* decision, however, in the development of South Carolina's common law on trade secrets, is its explanation of "misappropriation," an element of a trade secret claim not addressed in *Lowndes*:

[I]t is the breach of confidence by unauthorized disclosure . . . which is the gravaman [sic] of trade secret cases. The complete public disclosure of a trade secret admittedly destroys the legal effectiveness of, or prevents the creation of, any confidential relationship based upon the secret, the breach of which is the very essence of a trade secret action. However, the disclosure must be such as to make the "secret" so obvious as to render meaningless the confidential relationship.

Id. at 1140 (emphasis in original) (citations omitted). The need for the existence of a confidential relationship as an important aspect of the misappropriation element had been explained in an earlier district court case:

[A] confidential relationship is the keystone of a trade secret action. The relationship of employer-employee is not by itself sufficient to create a confidential relationship. There must be an express understanding as to the confidential nature of the information or the circumstances must be such that the employee is aware of the confidence placed in him by the employer.

Future Plastics v. Ware Shoals Plastics, 340 F. Supp. 1376, 1384 (D.S.C. 1972) (citations omitted).

In 1991, the Fourth Circuit added the final major development to trade secret common law in South Carolina, a wrinkle soon to be the central issue in *Muckenfuss* and the new South Carolina Trade Secrets Act. In *Woven Electronics v. The Advance Group*, Nos. 89-1580, 89-1588, 1991 U.S.

App. LEXIS 6004 (4th Cir. Apr. 15, 1991) (per curiam), the court emphasized the importance of a nondisclosure agreement in demonstrating the employer's intent and efforts to keep an idea or process secret.

The *Woven Electronics* court affirmed the district court's finding that the plaintiff's manufacturing [*23] process was a trade secret, even though much of the basic technology involved in the process was in the public domain. *Id.* at 8. Relying on the principles announced in *Lowndes*, the Fourth Circuit noted that "a trade secret may exist solely in the manner in which a group of items is put to use, even though each of the items is itself within the public domain." *Id.*

Significantly, the plaintiff in *Woven Electronics* had required its employees to sign a nondisclosure agreement, unlike the employer in *Lowndes*. The defendant in *Woven Electronics* argued that the agreement was overbroad, because, *inter alia*, it contained no geographical or temporal restrictions on its duration. The Fourth Circuit observed that, in South Carolina, noncompetition agreements must be reasonable from the standpoint of geographic and durational limits, but concluded that nondisclosure agreements should be treated differently.

"Though South Carolina courts have not addressed this specific question, other courts have recognized the important distinction between noncompetition agreements and nondisclosure agreements." *Id.* at 12. The court held that "[a] nondisclosure agreement may be valid even though it contains no time or place restrictions." *Id.* at 13. The nondisclosure covenant was deemed valid and, therefore, was important evidence of the employer's efforts to maintain the secrecy of its ideas.

THE UNIFORM TRADE SECRETS ACT OF 1992

Trade secret common law received a legislative *imprimatur* in South Carolina in 1992 with the adoption of the Uniform Trade Secrets Act (UTSA). *S.C. Code Ann. §§ 39-8-1 et seq.* (Law. Co-op. Supp. 1992) (effective June 15, 1992). Two years earlier, the National Conference of Commissioners on Uniform State Laws had proposed the UTSA. The overwhelming popularity of the UTSA was apparent from the fact that 38 states had already passed the UTSA by the time South Carolina joined the ranks in 1992.

The UTSA contained significant improvements over the Restatement of Torts and, in many respects, the common law of South Carolina. For example, the UTSA omitted the Restatement's requirement, accepted in *Lowndes*, 259 S.C. at 327, 191 S.E.2d at 764, that the trade secret be in the "continuous use in the operation of a business." *See id.* § 39-8-1(4)(i). The new legislation also expanded the scope of ideas subject to protection to include those which derive independent economic value, both "actual or potential," from not being in the public domain. *Id.* The UTSA also increased liability by expanding the definitions of "improper means" and "misappropriation." *See id.* § 39-8-1 (1) to (2).

Finally, the UTSA codified the common law duty of the owner of the trade secret, requiring that the trade secret owner's efforts to maintain secrecy be "reasonable under the circumstances." *See id.* § 39-8-1(4)(ii). This test seemed to leave intact the *Lowndes* criteria for evaluating the adequacy of an employer's efforts to protect its trade secrets.

The UTSA was a marked improvement over trade secret common law founded on the Restatement: at the minimum, employers could now point to statutory rights to assist in protecting trade secrets. Unfortunately, the UTSA did not clarify the difference between nondisclosure

covenants and covenants not to compete. The lines of difference between these two contract forms became even more obscure after a South Carolina Court of Appeals decision in early 1996.

CAROLINA CHEMICAL EQUIPMENT CO. V. MUCKENFUSS: A TEMPORARY DIVERSION

In *Carolina Chemical Equipment Co. v. Muckenfuss*, 322 S.C. 289, 461 S.E.2d 721 (Ct. App. 1996), the plaintiff alleged the defendant, a former shareholder and employee, had disclosed trade secrets to his new employer, claiming trade secret misappropriation and breach of a contract not to divulge any trade secrets. *Id.* at 293-94, 461 S.E.2d at 722-23.

In striking down the "Covenant Not to Divulge Trade Secrets," the court held the covenant to the same legal standard imposed on a covenant not to compete, reasoning that it "would substantially restrict [the former shareholder's] competitive employment activities" and would "basically [have] the effect of a covenant not to compete." *Id.* at 294-95, 471 S.E.2d at 723-24.

From this conclusion, the court justified subjecting the nondisclosure agreement to the same sort of strict scrutiny applied to noncompetition covenants (i.e., is the restriction: reasonably limited in time and geography; necessary to protect the employer's legitimate business interests; not unduly harsh and oppressive in curtailing the employee's legitimate efforts to earn a livelihood; and supported by sound public policy?) *Id.* at 294, 471 S.E.2d at 723. These are the criteria that enable courts, sitting in equity, to determine the enforceability on what is in essence a "sound discretion of the court" standard.

By opening up nondisclosure agreements to such considerations, the court set the stage for collateral attacks on secrecy agreements, otherwise legitimately entered into between employers and employees. Predictably, the *Muckenfuss* court found the agreement unlimited in time and territory, and greater than [*24] necessary to protect any legitimate business interests of the former employer.

Judge Cureton's dissent provided a different analysis. He rejected the defendant's argument that a nondisclosure covenant should be subject to the same strict standard as a covenant not to compete, because public policy demands that nondisclosure covenants be given more latitude. Judge Cureton considered nondisclosure covenants "valid and enforceable under certain circumstances even though they are unlimited as to time and place." *Id.* at 302, 471 S.E.2d at 727 (Cureton, J., dissenting).

Although Judge Cureton favored removing nondisclosure covenants from the analytical framework for noncompetition covenants, he clearly leaned toward some judicial scrutiny of such agreements. He stated that, "[a]s a matter of fairness, an ex-employer should be protected from having its trade secrets misappropriated unless the 'granting of such protection will unduly hamstring the exemployee in the practice of his occupation.'" *Id.* (citation omitted).

It remains to be seen to what extent courts will subject nondisclosure covenants to this type of "fairness critique" after the sound repudiation by the legislature of the time and place criteria announced in the *Muckenfuss* majority opinion. In any event, Cureton's dissent provided the impetus for correction, soon forthcoming from the General Assembly.

THE NEW SOUTH CAROLINA TRADE SECRETS ACT

Partly in response to *Muckenfuss* and partly in response to other shortcomings in the body of trade secret law, the General Assembly passed and the Governor signed the South Carolina Trade

Secrets Act (SCTSA) into law earlier this year. *S.C. Code Ann. §§ 39-8-10 et seq.* (Law. Co-op. 1976) (effective May 21, 1997) <<http://www.lpitr.state.sc.us/bills/285.htm>>.

The SCTSA imposed several major changes to South Carolina trade secret law. For one, the General Assembly explicitly overruled *Muckenfuss*. The new Act provides "[a] contractual duty not to disclose or to divulge a trade secret, to maintain the secrecy of a trade secret, or to limit the use of trade secrets must not be considered void or unenforceable or against public policy for lack of a durational or geographical limitation." *See id.* § 39-8-30(D).

By eliminating these limitations from a nondisclosure covenant, the General Assembly clearly recognized the public policy in favor of these covenants, in contrast to the general disapproval of covenants not to compete.

The SCTSA also strengthened trade secret protections themselves. For the first time, for example, employees now have a statutory duty not to disclose their employer's trade secrets, regardless of whether a nondisclosure agreement has been signed:

[e]very employee who is informed of or should have reasonably known from the circumstances of the existence of any employer's trade secret has a duty to refrain from using or disclosing the trade secret without the employers' permission independently of and in addition to any written contract of employment, secrecy agreement, noncompete agreement, nondisclosure agreement, or other agreement between the employer and the employee.

See id. § 39-8-30(B).

The SCTSA also codified the broad meaning of trade secrets developed in *Lowndes* and *Woven Electronics*. The SCTSA specifically included in the definition of trade secret the concept in *Woven Electronics* that a protected idea may consist of a single fact or a series of items, even though the fact or items may be within the realm of public knowledge. *Compare id.* § 39-8-20(5)(b) ("The collective effect of the items and procedures must be considered [*25] in any analysis of whether a trade secret exists and not the general knowledge of each individual item or procedure."), *with Woven Electronics*, 1991 U.S. App. LEXIS 6004 at 8 ("[A] trade secret may exist solely in the manner in which a group of items is put to use, even though each of the items is itself within the public domain.").

The SCTSA also broadened the definition of a trade secret to include a wider range of information such as a "product," "system," "design," "prototype," "procedure" and "code." *S.C. Code Ann. § 39-8-20(5)(a)*. By removing limits to the type of information that may be a trade secret, protections under the new SCTSA can expand with technology advances and encompass ideas in forms one cannot imagine today.

The SCTSA also elaborates on and expands the remedies provided by the UTSA. The UTSA provided that "[d]amages can include both the actual loss caused by misappropriation and the unjust enrichment caused by misappropriation that is not taken into account in computing actual loss." *S.C. Code Ann. § 39-8-3* (Law. Co-op. Supp. 1992). While retaining this language, the SCTSA

more specifically declares that "[a] complainant *is entitled* to recover actual damages for misappropriation of trade secrets." *S.C. Code Ann. § 39-8-40(A)* (emphasis added).

The SCTSA adds language to the injunction provisions that potentially extends the length of available injunctive relief. Both the SCTSA and the UTSA require injunctive relief to end when the trade secret has ceased to exist, but both allow an injunction to continue for an "additional reasonable period of time in order to eliminate commercial advantage that otherwise would be derived from the misappropriation." *S.C. Code Ann. § 39-8-2* (Law. Co-op. Supp. 1992); *S.C. Code Ann. § 39-8-50(A)*. The SCTSA, however, now directs that: "[s]uch reasonable period of time *shall take into account* the average rate of business growth *that would have been gained* from nonmisappropriated use of the misappropriated trade secret." *S.C. Code Ann. § 39-8-50(A)* (emphasis added).

Application of this broad definition potentially allows employers to seek injunctive relief for a much longer time than previously was available. By demonstrating injury to its business growth, an employer now can obtain an extension of injunctive relief, proportional to the duration of the injury.

The SCTSA protects trade secrets that are in dispute in litigation, requiring a court to determine whether there is a "substantial need" by the party seeking discovery of information designated by its holder as a trade secret, before allowing the discovery to proceed. *See id.* § 39-8-60(B). The court can choose to have an *in camera* hearing, issue a protective order or condition the production of trade secret information on the posting of an appropriate bond.

In yet another major change, the Act creates criminal penalty provisions similar to those found in the Federal Economic Espionage Act of 1996, Pub. L. No. 104-294, 110 Stat. 3488. Criminal penalties range from a maximum fine of \$ 100,000 to a maximum prison sentence of 10 years. *See id.* § 39-8-90(A). These provisions require a court to issue a protective order if the court finds that a trade secret may be disclosed during a criminal trial.

THE END RESULT (FOR NOW)

The new SCTSA provides enhanced protection of trade secrets for employers. As with most legislation, however, the SCTSA is not perfect, and employers still must take affirmative steps to protect themselves from potential economic harm.

An employer with valuable trade secrets should require employees to sign nondisclosure agreements that clearly designate unique devices, formulas, processes or procedures as trade secrets. Doing so will make it more difficult for an employee to argue that he or she did not know or could not have known that the information was a trade secret.

Finally, conducting technical and business information audits can help an employer identify potential trade secrets and plan for their protection. Just as safety audits protect the health and well-being of its employees, a company should perform information audits to protect its own economic health and well-being.

Legal Topics:

For related research and practice materials, see the following legal topics:
 Contracts LawTypes of ContractsCovenantsLabor & Employment LawEmployment RelationshipsEmployment ContractsConditions & TermsTrade Secrets & Unfair

Competition Noncompetition & Nondisclosure Agreements Trade Secrets Law Federal & State
Regulation Common Law

GRAPHIC:

PHOTO 1, no caption, Photo by George Fulton; PHOTO 2, no caption