

STATE OF NORTH CAROLINA }
 }
ALLEGHANY COUNTY }

IN THE GENERAL COURT OF JUSTICE
SUPERIOR COURT DIVISION
09 CVS 157

NAPCO, INC.,
Plaintiff,

v.

PBM GRAPHICS, INC.,
Defendant.

**MEMORANDUM OF LAW IN
SUPPORT OF PLAINTIFF'S
MOTION FOR PRELIMINARY
INJUNCTION**

The Plaintiff, Napco, Inc. (“Napco”), by and through its counsel, hereby submits the following memorandum of law in support of its previously filed Motion for Preliminary Injunction against the Defendant, PBM Graphics, Inc. (“PBM”).

BACKGROUND FACTS

Plaintiff Napco is a trade finish and specialty packaging company based in Sparta, North Carolina. Founded 32 years ago, Napco has developed a high degree of skill and knowledge in printing and creating highly complex packaging products, with a level of finishing quality against which most commercial printers cannot compete. Napco has a long history of producing innovative products that it sells to other companies (including Defendant PBM), in some cases for resale in

the mass commercial market, in other cases for use in packaging consumer goods, and in still other cases for use as sales aids and presentation materials.

By early 2008, PBM had negotiated a contract with The Upper Deck Company to produce “memorabilia cards,” a type of sports card that has a piece of game-used sports memorabilia, such as a swatch of a jersey or a sliver of a broken bat, embedded into it. These innovative products are highly collectible because of their authentic game-used nature, their substantial weight, and the guarantees of authenticity they carry.

Because of the need to handle and embed different types of materials at critically close tolerances, production of these memorabilia cards is considerably more complex than production of a normal sports card. Many of the printing processes, such as registration, gluing, and trimming, are made more difficult by the thickness of the product and the variety of materials being used. The most significant manufacturing problem to be solved, however, was Upper Deck’s exacting quality standard, which required essentially zero-tolerance conditions.

In February 2008, faced with a lack of ability to produce the cards on Upper Deck’s timetable and to Upper Deck’s specifications, PBM asked Napco to develop and implement processes through which Napco would produce the

memorabilia cards as a subcontractor.¹ During the next four months, Napco's expert design, production, and sales teams were focused almost exclusively on this project, which promised to be the largest single project Napco had ever undertaken, even though it was well within Napco's capabilities. Until June 2008, Napco was repeatedly assured that large orders would be placed for the cards, as long as satisfactory products could be produced. While PBM did pay for some customized tooling and supplied some sample materials for development, PBM's contributions to the project were a small fraction of the expenditures necessary to bring the project to fruition.

During the development process, PBM employees asked to enter the facility and observe the process on several occasions, on the pretense that such inspections were needed to assure Upper Deck of progress, to assure quality control, and to inspect Napco's security facilities. During this process, PBM employees demanded to learn every detail of the new processes that were being developed, under the guise of maintaining quality assurance. Simultaneously, PBM used the information gained from its inspections to purchase and provision equipment to enable it to produce memorabilia cards on its own using Napco's trade secrets.

¹ This arrangement apparently did not include informing Upper Deck that Napco would be involved in production, although Napco was told that Upper Deck was aware that an unnamed subcontractor would be assisting in production.

Each time PBM employees entered the Napco facility, they signed a statement acknowledging that they may be exposed to trade secrets and agreeing not to use anything they learned to the detriment of Napco. *See* Exh. A. PBM is now in breach of that agreement and has continued to use Napco's trade secrets to PBM's benefit and Napco's detriment, without authorization.

STANDARD OF DECISION

North Carolina's trade secret law specifically authorizes preliminary injunctions against use or disclosure of a trade secret:

Except as provided herein, actual or threatened misappropriation of a trade secret may be preliminarily enjoined during the pendency of the action and shall be permanently enjoined upon judgment finding misappropriation for the period that the trade secret exists plus an additional period as the court may deem necessary under the circumstances to eliminate any inequitable or unjust advantage arising from the misappropriation.

G.S. § 66-154(a). Alternatively, a court may condition continuing use on nondisclosure and payment of a reasonable royalty for the use. *See id.*

A preliminary injunction should issue "(1) if a plaintiff is able to show likelihood of success on the merits of his case and (2) if a plaintiff is likely to sustain irreparable loss unless the injunction is issued, or if, in the opinion of the Court, issuance is necessary for the protection of a plaintiff's rights during the

course of litigation.” *Ridge Community Investors, Inc. v. Berry*, 293 N.C. 688, 701 (1977).

ARGUMENT

The following facts, applicable to the analysis herein, are established through the affidavit of James R. Proffit, President of Napco, attached hereto as Exhibit B, and are in several cases confirmed in PBM’s answer to the complaint:

- That PBM approached Napco to produce memorabilia cards because it was unable to produce them in-house at a quality level that met Upper Deck’s demanding standards;
- That Napco spent hundreds of person-hours developing methods, techniques and formulations specifically to meet the needs of the Upper Deck project;
- That PBM continually requested information not only on the progress of the development project, but also on precisely how the goals were being achieved, under the guise of needing assurances that the product would meet Upper Deck’s standards;
- That PBM constantly promised that large orders would be made once the quality of the product was acceptable;
- That PBM demanded that Napco arrange to install a security system in Napco’s production facility to prevent the theft of valuable memorabilia,

which would only be present if Napco were manufacturing memorabilia cards;

- That each time PBM employees entered the Napco facility, they signed an acknowledgement, attached as Exhibit A, that states they agreed certain processes were trade secrets, and that they would not use these processes to Napco's detriment; and
- That once Napco had solved all of the production problems associated with the cards, PBM began producing the cards in-house on a timetable too short to permit independent development of those manufacturing processes.

See Exh. B.

I. Napco is highly likely to succeed on the merits of its action.

The first requirement for a court to issue a preliminary injunction is to determine whether the plaintiff has a reasonable likelihood of success on the merits. *See Ridge Community Investors*, 293 N.C. at 701. Napco is seeking a preliminary injunction on its claim for misappropriation of trade secrets. An act of trade secret misappropriation with respect to any given information requires that the information constitute a "trade secret" and that the act meet the definition of "misappropriation," as those terms are defined by statute. *See* G.S. § 66-152. A statutory prima facie case for misappropriation of trade secrets requires evidence of

actual or constructive knowledge of the trade secret status of the information, plus unauthorized acquisition, disclosure, or use. *See* G.S. § 66-155.

A. The processes Napco developed meet the statutory definition of trade secrets.

The Trade Secrets Protection Act defines “trade secret” as

business or technical information, including but not limited to a formula, pattern, program, device, compilation of information, method, technique, or process that:

- a. Derives independent actual or potential commercial value from not being generally known or readily ascertainable through independent development or reverse engineering by persons who can obtain economic value from its disclosure or use; and
- b. Is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.

G.S. § 66-152. North Carolina courts have identified six important factors in determining whether information meets the statutory definition of “trade secret”:

(1) the extent to which information is known outside the business; (2) the extent to which it is known to employees and others involved in the business; (3) the extent of measures taken to guard secrecy of the information; (4) the value of information to the business and its competitors; (5) the amount of effort or money expended in developing the information; and (6) the ease or difficulty with which the information could properly be acquired or duplicated by others.

Area Landscaping, L.L.C. v. Glaxo-Wellcome, Inc., 160 N.C. App. 520, 525 (2003)

(internal citations omitted).

Napco's production processes for the cards, particularly including its novel registration procedure and its glue formulation, meet each and every one of the factors of the six-factor test.

With regard to the first factor, Napco has established that these processes were developed by Napco in response to a need that PBM specifically identified and advised Napco it could not fulfill, and that those processes were not disclosed or advertised outside Napco. *See* Exh B, ¶¶ 4, 7-10. Outside Napco, the only persons who had access to the information were PBM employees who had signed confidentiality acknowledgements. *See* Exh. A.

With regard to the second factor, because Napco never entered actual production of the cards, only Napco's management and production design staff were aware of the particulars of the processes. All Napco employees are obligated to confidentiality as a condition of their employment. *See* Exh. C, pp. 37-38.

With regard to the third factor, Napco undertakes several measures to guard the secrecy of its information. Every person not a Napco employee who enters the facility is required first to sign an acknowledgement of trade secrets in the form provided in Exhibit A, and with that form a copy of the North Carolina Trade Secrets Act is provided for review. The building maintains commercially reasonable security measures. Employees are obligated in Napco's Employment Handbook to maintain confidentiality and warned of possible legal action if they

fail to do so. *See* Exh. C, p. 37. Napco employees are prohibited from being in Napco facilities other than during their assigned work periods. *See id.*, p. 36. Napco maintains a strict no-trespassing policy for non-employees. *See id.*

With regard to the fourth factor, the value of the information was in the use of the information to fulfill a multi-million-dollar contract with Upper Deck. Napco's expectations based upon PBM's promises of order volume were that this project would add approximately one million dollars annually to Napco's bottom line. This project would also have allowed Napco to hire numerous additional production workers. Additionally, the exclusivity afforded by the secret nature of this information would have increased the value of the project to Napco, because PBM would not have been able to have similar work performed by other companies. Furthermore, Napco would have a competitive advantage in seeking other work requiring similarly precise registration—but only if PBM is compelled to honor its obligation of confidentiality and nonuse.

With regard to the fifth factor, Napco expended hundreds of person-hours working on this project, including devoting a substantial portion of its manager-level production and design staff to the project for a four-month period—time that Napco could have used developing other business. *See* Exh. B, ¶ 21. Napco additionally expended sums of money that it cannot recover, as it expected to, because it has been deprived of the profits associated with the project.

With regard to the sixth factor, it is respectfully pointed out that PBM sought out Napco's assistance in solving its problems, then methodically copied Napco's solutions. PBM is a sophisticated business with years of industry experience, part of a large publicly held company. If developing these solutions were easy, PBM would never have asked for Napco's specialized expertise in this area. As it is, Napco took some four months to develop novel, successful production processes, which PBM began using immediately.

All of these factors, then, weigh heavily in favor of a finding that that Napco's technical processes for producing memorabilia cards are trade secrets.

B. PBM's use of Napco's secret processes constitutes misappropriation of trade secrets.

Misappropriation requires the "acquisition, disclosure, or use of a trade secret of another without express or implied authority or consent, unless such trade secret was arrived at by independent development, reverse engineering, or was obtained from another person with a right to disclose the trade secret." G.S. § 66-152.

Far from having express or implied authority or consent to use the methods for their own account, PBM was expressly prohibited, in an acknowledgement signed by its employees, from using those methods. *See* Exh. A. Moreover, PBM acted to obtain access to the information under false pretenses (by claiming a need

for assurances that the cards were being manufactured to Upper Deck's standards) and with false promises (of large orders, bolstered by a demand for increased factory security). *See* Exh. B, ¶¶ 11-15. PBM may have acquired the information for a reasonable (if pretended) purpose, but that purpose was limited to quality control and progress purposes. PBM's use of the trade secret information was not authorized. *See* Exh. B., ¶¶ 14, 22.

Neither could PBM have arrived at Napco's secret information through independent development, reverse engineering, or authorized third-party disclosure. These cards required highly sophisticated, highly engineered production solutions that required substantially all of the creative resources of Napco, a firm specializing in this kind of production, for a four-month period, yet PBM began production almost immediately once Napco had the solution in hand. *See* Exh. B, ¶¶ 6, 19; *see also* PBM Answer, ¶ 30 (admitting that PBM has been supplying memorabilia cards to Upper Deck "since as early as July of 2008"). The cards leave few clues to an outside observer as to how they were manufactured, and therefore are not susceptible of reverse engineering. *See* Exh. B, ¶ 19. Finally, the only persons who had knowledge of the trade secret were Napco employees, who were obligated to confidentiality through their employment, and PBM employees, who were obligated to confidentiality through their acknowledgement of the trade secrets. *See* Exh. C, p. 37; Exh. A.

Napco will be able to show each of the factual matters upon which the merits of the case rest through the testimony of eyewitnesses and through numerous documents (including, without limitation, communications between Napco and PBM personnel regarding the project). It is strongly likely to succeed on the merits of its case.

C. Napco has established a statutory prima facie case on its claim for misappropriation.

Additionally, Napco has established, and will at trial be able to establish with substantive evidence, a statutory prima facie case of misappropriation of its trade secrets. The Trade Secrets Protection Act provides:

Misappropriation of a trade secret is prima facie established by the introduction of substantial evidence that the person against whom relief is sought both: (1) Knows or should have known of the trade secret; and (2) Has had a specific opportunity to acquire it for disclosure or use or has acquired, disclosed, or used it without the express or implied consent or authority of the owner.

G.S. § 66-155. As demonstrated above, PBM had full awareness of the trade secret status of Napco's production processes for the memorabilia cards, and signed acknowledgements of that status. Moreover, PBM has already admitted that it began producing memorabilia cards in July 2008—mere days after Napco provided PBM with detailed information about its final solution to implement those processes.

II. Irreparable harm will result from continuing to allow Defendants unfettered use of Napco's trade secrets.

In considering a preliminary injunction in a case regarding a non-compete clause in a salesperson's contract, the North Carolina Supreme Court has said:

It is a basic principle of contract law that one factor used in determining the adequacy of a remedy at law for money damages is the difficulty and uncertainty in determining the amount of damages to be awarded for defendant's breach. Thus, "injury is irreparable where the damages are estimable only by conjecture, and not by any accurate standard." ... This Court has further held that "[t]o constitute irreparable injury it is not essential that it be shown that the injury is beyond the possibility of repair or possible compensation in damages, but that the injury is one *to which the complainant should not be required to submit or the other party permitted to inflict*, and is of such continuous and frequent recurrence that no reasonable redress can be had in a court of law."

A.E.P. Industries, Inc. v. McClure, 308 N.C. 393, 406-07 (1983) (emphasis in original) (internal citations omitted). Napco has a right under the law to keep and benefit from trade secrets it has developed. The methods and techniques themselves have value so long as they are not generally known. Since PBM willfully broke the word it repeatedly acknowledged—and with permission copied the acknowledgement system for its own use²—there is little reason to expect it will not further disclose the techniques.

² See Complaint, ¶ 25. In its answer, PBM has denied doing so, a fact that is easily ascertained through discovery, offered only to show PBM's understanding of the standard to which it is held, not its acts.

Moreover, PBM's use of Napco's trade secrets is a continuing harm; every memorabilia card it manufactures using Napco's trade secrets represents an act of trading upon Napco's hard-earned intellectual property, without Napco's participation in the rewards of its work. Such damages might be possible to calculate, but the impact of the loss of that revenue upon Napco's value as a going business concern and concomitantly upon its ability to do other work that leverages its investment into the development of this technology into other areas, is difficult to calculate. Such an injury is surely not one to which Napco should be required to submit as PBM grows rich from Napco's property.

Moreover, as this litigation progresses, PBM, unless enjoined, has ample opportunity to destroy the possibility of Napco achieving a substantial portion of the relief it is ultimately seeking. "The very nature of a trade secret mandates that misappropriation will have significant and continuous long-term effects. The party wronged may forever lose its competitive business advantage or, at the least, a significant portion of its market share." *See Barr-Mullin, Inc. v. Browning*, 108 N.C. App. 590, 597 (1993). The North Carolina Supreme Court has, in its own words, "consistently adhered to the proposition that where the principal relief sought is a permanent injunction, it is particularly necessary that the preliminary injunction issue." *A.E.P. Industries*, 308 N.C. at 408. Such has been the law for more than a century:

It is generally proper, when the parties are at issue concerning the legal or equitable right, to grant an interlocutory injunction to preserve the right *in statu quo* until the determination of the controversy, and especially is this the rule when the principal relief sought is in itself an injunction, because a dissolution of a pending interlocutory injunction, or the refusal of one, upon application therefor in the first instance, will virtually decide the case upon its merits and deprive the plaintiff of all remedy or relief, even though he should be afterwards able to show ever so good a case.

Cobb v. Clegg, 137 N.C. 153, 158-59 (1904).

CONCLUSION

Though it is an extraordinary remedy, a preliminary injunction is manifestly necessary and appropriate to carry out the intentions of the Legislature in providing this form of protection to North Carolina businesses. In view of all of the foregoing, the Plaintiff respectfully urges the Court to recognize the essential nature and value of Napco's work to develop these processes, the egregious violation by PBM not only of the Trade Secrets Protection Act but also of any reasonable standard of business ethics in appropriating the processes to its own use, and the necessity of protecting these secrets on an ongoing basis to ensure that Napco, when it prevails, has a trade secret left to practice.

Respectfully submitted this the 8th day of September, 2009.

THE HARRINGTON PRACTICE

By: /s/ James M. Harrington

James M. Harrington, N.C. State Bar No. 30005

E-mail: jharrington@hprac.com

Glen A. Cipriani, N.C. State Bar No. 36683

E-mail: acipriani@hprac.com

Russell B. Niemyer, N.C. State Bar No. 38400

E-mail: rniemyer@hprac.com

Attorneys for the Plaintiff

The Harrington Practice

10130 Mallard Creek Road, Suite 110

Charlotte, NC 28262-6001

Telephone: 704-315-5800

Facsimile: 704-625-9259

CERTIFICATE OF SERVICE

The undersigned hereby certifies that the foregoing paper is being served on the date indicated upon counsel of record for the Defendant by transmitting same as electronic mail, with the consent of same, to the following address:

Robert D. Mason, Jr. – rmason@wcsr.com

Date: September 8, 2009

/s/ James M. Harrington