

Protecting and Enforcing Franchise Trade Secrets

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Franchise businesses regularly rely upon confidential and proprietary information, including protectable trade secrets. In fact, the core of a franchisor's business lies in the distinctive franchise system developed by the franchisor for operation of its particular business concept. A franchise system derives competitive and economic value precisely because it is not generally known by the public. This allows a franchisor to license the system for use by franchisees (along with identifying trademarks) for a fee.

Yet, protecting franchise trade secrets can be easier said than done. Enforcing trade secret rights requires proof (1) that the information making up the trade secrets is not generally known or readily ascertainable and has economic value, and (2) that reasonable means have been taken to keep the information secret. A well-prepared franchisor can significantly improve its chances of successfully protecting its trade secrets and other confidential information, and thus protecting the core value in its business for the benefit of it and its franchisees.

Trade Secret Laws

The *Restatement (Third) of Unfair Competition* defines *trade secret* as "any information that can be used in the operation of a business or other enterprise and that is sufficiently valuable and secret to afford an actual or potential economic advantage over others."¹ Today, most states (forty-two out of fifty) and the District of Columbia have adopted some form of the Uniform Trade Secrets Act (UTSA), with variations from state to state.² The UTSA defines *trade secret* and *misappropriation of trade secrets* and identifies available remedies.

The UTSA defines *trade secret* as information, including a formula, pattern, compilation, program, device, method, technique, or process, that:

(i) 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

(ii) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.³

Thus, economic value and secrecy are the key concepts in determining whether particular information qualifies as a trade secret. First, the information must not be generally known to, or readily ascertainable by proper means by, the public or competitors. If the information can be ascertained by proper means, then it does not qualify as a trade secret. *Proper means* includes independent invention, reverse engineering, observation in public use, and information from published literature.⁴ By contrast, *improper means* is defined in the UTSA to

include "theft, bribery, misrepresentation, breach or inducement of a breach of duty to maintain secrecy, or espionage through electronic or other means."⁵ Second, the information must derive independent economic value from not being generally known or readily ascertainable. Third, the one claiming the trade secret must make reasonable efforts to maintain the secrecy of the information. This requires only efforts that are "reasonable under the circumstances," and courts should not require "extreme and unduly expensive procedures be taken to protect trade secrets."⁶

The *Restatement of Torts* identifies six useful factors to consider in determining whether particular information constitutes a trade secret: (1) the extent to which the information is known outside of the business, (2) the extent to which it is known by the employees and others involved in the business, (3) the extent of measures taken to guard the secrecy of the information, (4) the value of the information to the business and to competitors, (5) the amount of effort or money expended in developing the information, and (6) the ease or difficulty with which the information could be properly acquired or duplicated by others.⁷

The UTSA prohibits misappropriation of a trade secret.⁸ Essentially, a trade secret has been misappropriated if it has been acquired by improper means⁹ or if it has been disclosed or used by a person who at the time of disclosure or use knew (or had reason to know) that the trade secret had been acquired under circumstances giving rise to a duty to maintain its secrecy or limit its use.¹⁰

The remedies available under the UTSA for misappropriation of a trade secret include injunctive relief to prevent actual or threatened misappropriation;¹¹ damages, which can include a plaintiff's actual loss as well as the defendant's unjust enrichment resulting from the misappropriation;¹² and attorney fees if the misappropriation is willful and malicious.¹³ Plaintiffs pursuing trade secret lawsuits frequently seek preliminary injunctive relief to prevent a defendant from disclosing or using the secret information pending a full trial on the merits. A number of courts have held that the misappropriation of trade secrets creates a presumption of irreparable injury, entitling a plaintiff to injunctive relief.¹⁴

A claim for misappropriation of trade secrets is a tort and is available regardless of the presence or absence of any contract restricting disclosure or use of trade secret information. However, many types of agreements (including franchise, employment, and consulting agreements) commonly contain provisions restricting or limiting a party's rights to disclose or use confidential information, including trade secrets. Such a contract may provide the owner of confidential information with a claim for breach of contract for the improper disclosure or use of the information, in addition to a tort claim. Furthermore, as dis-

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Practice Pointer

What Is a Trade Secret?

Economic value and secrecy are the key concepts in determining whether particular information qualifies as a trade secret. The Restatement of Torts (Section 757, cmt. b) identifies six useful factors to consider in determining whether something is a trade secret:

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

cussed below, the presence of such contractual terms can be evidence that strengthens a claim for misappropriation of trade secrets.

Trade Secrets and Franchising

A franchisor may own a variety of types of trade secrets and confidential information. Much of the value of a franchise business is in the franchise system, i.e., the particular business systems, methods, and/or formats, product information, formulas or recipes, and operational standards and procedures that have been developed by the franchisor (generally through a substantial investment of time and money) and that are licensed to the franchisee for a fee. In fact, the franchising business model is unique in that it is based upon having one business entity (the franchisor) allow numerous independent businesses (the franchisees) to replicate details of the franchisor's business systems. To facilitate this replication, the franchisor must necessarily release to the franchisee the very information, much of it secret, that gives it economic and competitive advantages. Because of this necessary disclosure and because trade secrets are destroyed if they become known by the public or competitors, extra efforts must be made in the franchising context to protect against improper disclosure of franchise trade secrets and confidential information.

To help protect a franchisor's franchise system and other

confidential and proprietary information, franchise agreements generally prohibit franchisees from disclosing or using confidential information about the franchise business (including trade secrets) outside of the operation of the franchisee's business. In addition, many franchisors (and some franchisees) have their own employees, consultants, and suppliers sign confidentiality agreements (sometimes referred to as nondisclosure agreements) prohibiting use and disclosure of confidential information outside of their work for the franchise business.

Benefits of Protecting Trade Secrets

It should be noted that protecting franchise trade secrets and confidential information benefits franchisees as well as the franchisor. Franchisees would lose much of the economic value of their businesses if the information they rely upon to operate their franchise became publicly available such that others could easily duplicate the franchise business and then compete with actual franchisees.

Despite a franchisor's best efforts to protect trade secrets and confidential information, actual or perceived misappropriations will occasionally arise. A typical scenario involves a current or former franchisee, or a former employee of the franchisor, that opens a competing business with many of the same or similar components, products, services, and/or operating standards as those offered, provided, or followed by the franchise business. In the context of these and similar disputes, courts have recognized the following types of trade secrets: (1) business systems, formats, or methods;¹⁵ (2) franchise manuals;¹⁶ (3) business plans and strategic information;¹⁷ (4) product information, recipes, and formulas;¹⁸ (5) customer and supplier information;¹⁹ (6) prospective franchisee information;²⁰ (7) new product development plans;²¹ and (8) proprietary computer software and technology.²² However, whether these potential components of a franchise business will be found to amount to a trade secret in a particular case is a fact-specific inquiry that depends on the law in the applicable jurisdiction and on the strength (or weakness) of the evidence presented.

Instructive Trade Secret Cases

As indicated above, almost any type of business information potentially can be protected as a trade secret. However, protecting franchise trade secrets is not always a simple matter; it depends on the law of the particular jurisdiction and, even more importantly, on the facts underlying and evidence presented in a particular case. The number and nature of the several elements involved in proving the existence and misappropriation of a trade secret create potential pitfalls for the unwary or unprepared. The following discussion analyzes a sampling of cases in which franchisors have been successful, and unsuccessful, in enforcing claimed rights to trade secrets and confidential information.

Business Systems, Methods, and Formats

A unique system, method, or format is often at the heart of a franchise business. A business system or method that is unique and economically valuable should qualify as a trade secret if appropriate and effective steps have been taken to protect the

secrecy of the system.

For example, in *Tan-Line Studios, Inc. v. Bradley*, Tan-Line was in the business of operating and franchising tanning studios.²³ Defendant Bradley was engaged as a consultant by Tan-Line and subsequently used confidential information learned during his work for Tan-Line to open a competing tanning studio. Among other claims, Tan-Line alleged a claim for theft of its trade secrets.²⁴ Tan-Line contended that its trade secret consisted of its particular method of conducting a tanning studio business, including “employee recruitment and training, studio layout, cash control, advertising, accounting, marketing, promotion, and site selection,” which incorporated “knowledge and information gained concerning the success and value of different approaches to the various aspects of the indoor sun tanning business.”²⁵

Interestingly, Bradley did not dispute that he had appropriated certain information from Tan-Line but claimed that this was not actionable because the information did not amount to trade secrets.²⁶ The court disagreed. Relying on Pennsylvania law, which had adopted the *Restatement of Torts*’s definition of a trade secret,²⁷ the court held that Tan-Line’s “entire methodology for conducting a tanning studio constitutes a trade secret.”²⁸ In doing so, it found that Tan-Line’s methodology detailed more specific information than what could be found in general industry manuals or reports, which it considered as evidence that the information at issue was not generally known.²⁹ Accordingly, the court found Bradley liable for, among other things, theft of trade secrets and awarded monetary damages to Tan-Line.³⁰

The *Tan-Line* case illustrates that a franchise system or method made up of a series of individual components can qualify as a trade secret even if some of the individual components by themselves would not qualify, if the compilation takes an understandable and economically valuable form.³¹ The court’s holding in this regard is not an anomaly.³² In a recent case, the U.S. Court of Appeals for the Tenth Circuit explained that “information can be a trade secret notwithstanding the fact that some of its components are well-known.”³³ In that case, the court reversed the district court’s holding that a business system consisting of an infant swimming program was not a protectable trade secret. The court held that the program was protectable, even though it included common components some of which could be perceived by anyone observing the swimming class, explaining that “[a] trade secret can exist in a combination of characteristics and components each of which, by itself, is in the public domain, but the unified process, design and operation of which, in unique combination, affords a competitive advantage and is a protectable secret.”³⁴ Very similar language has been used by other courts, including the Second³⁵ and Fifth³⁶ Circuits.

Processes May Well Be Trade Secrets

For franchise restaurant businesses, the individual components of producing a sandwich, hamburger, or slice of pizza may not easily be said to involve secret information or know-how. However, the entire system for preparing and serving food could be the lifeblood of the franchise business. This was the case in *Quizno’s Corp. v. Kampendahl*, where the court held that Quizno’s system of producing sandwiches would likely constitute a trade secret.³⁷ After Quizno’s terminated Kampendahl’s franchise agreement, Kampendahl opened Bob’s Deli, a sandwich shop located in the same shopping center location as his previous Quizno’s franchise restaurant.³⁸ Quizno’s moved for a preliminary injunction to enforce a noncompete provision in the franchise agreement and to prevent the use by its former franchisee of a substantially similar menu, nearly the exact recipes used by Quizno’s, and signs that the defendant had used while a Quizno’s franchisee and continued to display after the change to Bob’s Deli.³⁹

Under Colorado law, noncompete covenants are prohibited with two exceptions, one being for the protection of trade secrets.⁴⁰ The former franchisee argued that this exception could not apply because making a sandwich was too simple a notion to constitute a trade secret. The court disagreed, finding that the ex-franchisee’s interpretation was “excessively narrow” and that the ex-franchisee was not merely making sandwiches but was, rather, “using recipes, menus, signs, and ovens

initially approved as part of a Quizno’s business strategy.”⁴¹ The court also noted that the franchisee had acknowledged in the franchise agreement that the Quizno’s system constituted a trade secret.⁴² Accordingly, the court held that the noncompete covenant was likely to fit within the

trade secret exception⁴³ and preliminarily enjoined the former franchisee from operating the competing sandwich shop.⁴⁴

A variety of other types of business systems, formats, or methods have been found to constitute trade secrets. A comprehensive system for setting up and operating an advertising circular business, captured in a detailed manual, was found to be a protectable trade secret,⁴⁵ as was a detailed step-by-step system designed to assist people to quit smoking.⁴⁶ A franchisor’s business system for operating an employment agency, which included the operation, techniques, and methods of training employees, was protected by the court, relying in part on the terms in confidentiality and noncompete agreements between the franchisor and franchisee.⁴⁷

Trade Secrets Must Be Unique

However, courts will not hesitate to deny trade secret protection where the franchisor has not presented adequate evidence to show that the system for which protection is sought is unique in the relevant industry or based on specialized

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knowledge, or has failed to prove reasonable efforts to preserve the secrecy of information making up the system.

For example, in *I Can't Believe It's Yogurt v. Gunn*, the franchisor terminated the defendant's franchise agreements for failure to pay royalties and marketing fees, but the former franchisee continued to operate a store that sold frozen yogurt using some of the franchisor's business systems and the same store layout.⁴⁸ The franchisor brought a claim for misappropriation of trade secrets.⁴⁹ The franchisor asserted its trade secrets were contained in its operations manual and encompassed the entire "business system" of the store, including the strategic layout and design of the store, "accounting procedures, the proper use of yogurt machines, the proper handling of yogurt mix, register procedures, inventory management, labor cost management, waste tracking, percentage yield, budgeting, interviewing and hiring and suggestive selling."⁵⁰

However, after a bench trial, the district court held that the plaintiff/franchisor failed to prove the existence of any protectable trade secret information. The court noted that the founder of I Can't Believe It's Yogurt (ICBIY) testified that he did not know whether other businesses used the same or similar procedures, and it held that the franchisor "failed to provide evidence that its procedures are sufficiently different to constitute a trade secret,"⁵¹ that "[t]he information claimed to constitute trade secrets is generally known or readily ascertainable," and that "[m]uch of the information claimed as trade secrets is taught at business schools."⁵² Furthermore, the court held that the franchisor failed to present sufficient evidence of precautions taken to guard the secrecy of its purported trade secrets. Although the franchise agreement contained confidentiality provisions, ICBIY's business procedures were disclosed to all people who attended "Yogurt University," including managers and employees, who were never required to sign a nondisclosure agreement.⁵³ Furthermore, the franchisor divulged much of the same information, such as products or recipes, that it claimed to be confidential through a publication for its franchise owners called "The Talon," without any statement that the information should remain confidential.⁵⁴ Based on the specific evidence presented, the court declined to recognize any trade secrets in the franchisor's business system, although it was well aware that "a system can constitute a trade secret, even though individual components of such system may not qualify as such."⁵⁵

Trade Secrets Must Be Kept Confidential

In *Frosty Bites, Inc. v. Dippin' Dots, Inc.*, Dippin' Dots (DDI) had offered its then retail dealers the opportunity to become Dippin' Dots franchisees.⁵⁶ Eight dealers who declined this offer subsequently established a business to sell a similar competing product called Frosty Bites.⁵⁷ DDI sued for misappropriation of trade secrets, claiming that during the development of the Frosty Bites business, DDI's former retail dealers had provided their business partners with confidential and proprietary information regarding DDI manufacturing, distribution, and storage techniques.⁵⁸ Specifically, DDI contended that "modifications and refinements to its manufacturing, packing, storage, shipping, and distribution techniques over the years encompass 'approximately 100 different combinations of trade secrets.'"⁵⁹

However, the court granted summary judgment to the defendants, holding that DDI failed to take reasonable steps to maintain the secrecy of its alleged trade secrets.⁶⁰ In particular, the court noted that employees "routinely discarded storage bags and boxes in public trash bins without restrictions on the methods of disposal"; that a corporate videotape, temporary Internet posting, and other written materials disclosed the alleged trade secret information; and that DDI allowed "general unrestricted observance" of the information.⁶¹ Additionally, although DDI dealers and franchisees were required to sign trade secret confidentiality agreements, the court found the agreements deficient in that they did not identify what constituted DDI's trade secrets.⁶²

Customer and Supplier Information

In *American Express Financial Advisors, Inc. v. Yantis*,⁶³ Yantis, a former franchisee, abruptly terminated his relationship with the franchisor, American Express, and joined a competitor. American Express sued for breach of the franchise agreement, misappropriation of confidential information, conversion, and unfair competition and sought a preliminary injunction to prevent the use of its confidential information, including customer lists and records, financial plans and inventories, and computer software.⁶⁴

In determining whether to grant a preliminary injunction, the court considered the likelihood of American Express succeeding on the merits of its claim. In considering whether the alleged confidential information was protectable, the court analyzed whether it could qualify as a trade secret.⁶⁵ The court first held that American Express was likely to prevail on its misappropriation claim because the client information at issue fell within the legal definition of a trade secret under Iowa law.⁶⁶ The client files and financial information were economically valuable because they "obviously would be helpful to [its] competitors and would require cost, time and effort to duplicate." American Express had taken reasonable steps to protect this information through (1) a franchise agreement that prohibited the franchisee from divulging, other than in the operation of the franchised business, "any confidential information, or trade secrets, including, without limitation, Client names, addresses and data and know-how concerning the methods of operation of the System and the business franchised hereunder" and that included a one year nonsolicitation clause prohibiting Yantis from soliciting any American Express clients that he had contacted, serviced, or learned about while a franchisee, and (2) Yantis's agreement to require his employees to sign a confidentiality agreement restricting disclosure of the confidential information.⁶⁷

In determining whether to grant the preliminary injunction, the court held that without an injunction American Express would suffer irreparable harm because "[m]oney damages will not adequately compensate [American Express] for any damages it suffers due to the loss of its clients" and "the customers and employees Yantis solicited to leave AEFA with him will be permanently lost."⁶⁸ As for the balancing of equities (or harms), the court was persuaded that the evidence weighed in favor of granting the preliminary injunction because the franchisee was simply being forced to comply with the terms of

the franchise agreement that he signed. Thus, the court granted American Express's request for a preliminary injunction.⁶⁹

In *Great Expectations Franchise Corp. v. V.L.P. Enterprises, Inc.*, the court granted a preliminary injunction to a franchisor against its former franchisee that continued to operate a Great Expectations franchise after termination, thereby infringing the franchisor's trademarks and misappropriating trade secret information.⁷⁰ The franchisor operated and franchised a "public social introduction service" (i.e., a dating service) and claimed trade secret rights in its computer software packages and its membership lists, which included member names, profiles, videos, and photographs.⁷¹ The court agreed and found that the production of both the software and the membership lists required considerable effort and was a valuable asset to the franchisor.⁷² The court also found that the franchisor had taken reasonable steps to protect its trade secrets because it directed its franchisees to establish procedures to safeguard the use of the information.⁷³

Supplier information compiled by a franchisor also can constitute trade secrets. As with customer information, supplier information will not be protected if it merely consists of names, phone numbers, addresses, and other general information that can be easily obtained. However, such information can be protected as trade secrets if there is something specific and unique about the compilation of the information. In *Proimos v. Fair Auto Repair, Inc.*, the Seventh Circuit held that although "suppliers of parts may be discovered by looking in a book . . . the reliability of these suppliers and the terms on which they may be induced to deal may be valuable secrets."⁷⁴

Business Plans and Marketing Information

Camp Creek Hospitality Inns, Inc. v. Sheraton Franchise Corp. involved the unusual situation in which a franchisee brought a claim against its franchisor for misappropriation of the franchisee's trade secrets.⁷⁵ However, the principles illustrated by the case apply equally to a more traditional franchisor claim. The franchisee, Camp Creek, operated a Sheraton Inn franchise under the name Sheraton Inn Atlanta Airport. Several years later, Sheraton granted another franchise, Sheraton Gateway Hotel, Atlanta Airport, in the same geographic area as Camp Creek's hotel. Camp Creek alleged that the manager of the Gateway hotel, who formerly worked for the franchisor and in that capacity had access to confidential information regarding Camp Creek, including Camp Creek's "occupancy levels, average daily rates, discounting policies, rate levels, long term contracts, marketing plans, and operating expenses," used this information to compete directly against the Camp Creek hotel.⁷⁶ Accordingly, Camp Creek asserted that Sheraton misappropriated confidential information by improperly allowing Gateway, a competing franchisee, to come into possession of that information.⁷⁷

The district court granted summary judgment in Sheraton's favor, finding as a matter of law that there had been no misappropriation of trade secrets.⁷⁸ On appeal, the Eleventh Circuit Court of Appeals reversed, holding that Camp Creek had presented sufficient evidence that the information constituted a trade secret to raise an issue of fact to be tried.⁷⁹ Specifically, Camp Creek presented expert testimony that the type of information at issue was

closely guarded in the hotel industry, thus evidencing its economic value, and that a competitor could not have compiled the information by legitimate means.⁸⁰ Next, the court considered whether the information had been misappropriated. Although Camp Creek had voluntarily provided the information to Sheraton, which then passed it on to another of its franchisees, Camp Creek had released the information with the understanding that it would be kept confidential, as evidenced by an affidavit signed by a Sheraton representative noting that the information would be "kept in strict confidentiality."⁸¹ The Eleventh Circuit held that this presented a question of fact as to whether Camp Creek's efforts to maintain the secrecy of its customer information were reasonable under the circumstances and whether Sheraton had misappropriated the information through improperly diverting information acquired under legitimate circumstances.⁸²

As a final matter, the court addressed Sheraton's argument that Camp Creek failed to present evidence of losses caused by the misuse of the confidential information.⁸³ The court relied on a provision in the Georgia Trade Secrets Act that provided for the award of a "reasonable royalty in the event that the plaintiff cannot prove damages or unjust enrichment by a preponderance of the evidence."⁸⁴ The court also pointed out that injunctive relief would be appropriate to prevent the competitor Gateway hotel from continuing to misuse Camp Creek's confidential information to compete for business.⁸⁵

Product Information, Recipes, and Formulas

A crucial element of many franchise businesses is an important recipe, product, or formula. Part of the protectable information in the *Quizno's* case was the franchisor's recipes and process for the production of the sandwiches themselves.⁸⁶ The injunction granted by the court, among other things, prevented the former franchisee's use of nearly identical recipes in the production of sandwiches at his new deli. Such a goal is consistent with previously discussed case law that protects information whose components may be widely known but in combination present a unique, economically valuable advantage.

Perhaps the paramount example of a product formula trade secret is the formula for Coca-Cola, which has been protected for nearly 100 years. Despite the fact that most of the ingredients are public knowledge, the ingredient that gives Coca-Cola its distinctive taste is a secret combination that is only known by two people within the company.⁸⁷ Additionally, the company has gone far beyond "reasonable efforts" to maintain the secrecy of its formula because "[t]he only written record of the secret formula is kept in a security vault at the Trust Company Bank in Atlanta, Georgia, which can only be opened upon a resolution from the Company's Board of Directors."⁸⁸ Similarly, Colonel Sanders' secret recipe for Kentucky Fried Chicken was found to be a protected trade secret.⁸⁹

By contrast, common recipes, formulas, and information that are either publicly available or easily duplicated do not qualify for trade secret protection. In *In re Arthur Treacher's Franchise Litigation*, the court, due in large part to lack of evidence and contradictory evidence presented, held that the franchisor's food preparation process was neither unique nor secret.⁹⁰ Specifically, the court stated that "there is no evidence, other than the above testimony, that the temperature at

which plaintiff fries food, or the length of time the food is immersed in oil, or the length of time the food is held after frying, is a trade secret of plaintiff's or is even any different from the process used by plaintiff's competitors."⁹¹ The court noted that "probably thousands" of current and former employees knew about the cooking process and that the franchisor failed to enforce a confidentiality clause in its agreement or to take other steps to ensure the secrecy of its process. As a final slap, the court concluded that "anyone with a modicum of intelligence" could determine with relative ease the information claimed as secret.⁹²

Lessons Learned

As the case law illustrates, protecting franchise trade secrets and confidential information can be easier said than done. If a franchisor does not jump through the right hoops, both before and after a lawsuit is filed, it may find it difficult to protect its trade secrets. However, a well-prepared franchisor can significantly improve its chances of successfully protecting its trade secrets and confidential information, and thus protecting the core value in its business, by (1) taking steps long before litigation is filed to identify its trade secrets and confidential information and taking affirmative steps to preserve the secrecy of such information; and (2) if litigation to enforce trade secret rights becomes necessary, presenting appropriate evidence to persuade the court and/or jury that the information qualifies as a trade secret and was misappropriated by the defendant.

Prelitigation Steps

Although it may seem obvious, the first necessary step to protecting trade secrets is to identify the information within the franchise system and business that constitutes a trade secret. A franchisor cannot appropriately safeguard its trade secrets until it identifies what its trade secrets are. Focus on franchisor-developed information or compilations of information that is unique, is competitively sensitive, has significant value, and has been protected by reasonable security measures.

Second, draft your franchise agreement in a way that improves your chances of protecting trade secrets and other confidential information. The agreement should define and identify, at least generally, the trade secrets and confidential information that have been developed by the franchisor and that are being provided to the franchisee as part of the franchise system or franchise training or standards. Have the franchisees acknowledge that this information is not generally known in the industry and is beyond their own present skills or experience and that to develop it themselves would be expensive, time-consuming, and difficult. Include provisions (1) limiting the franchisee's right to disclose the trade secrets-confidential information within the context of operation of the franchisee business to those with a reason to know, and (2) prohibiting use outside of the franchise business or after termination of the franchise agreement. Require franchisees to take reasonable steps to preserve the confidentiality of the trade secret information (which could include getting key employees to sign confidentiality agreements), and require them to return to the franchisor, upon termination or expiration of the agreement, all copies of the franchise manual and

all other written materials containing trade secret and confidential information.

Third, have the franchisor's employees, officers, and consultants sign confidentiality agreements acknowledging the confidentiality of various information and prohibiting or limiting disclosure of such information.

Fourth, take other reasonable steps to preserve the secrecy of trade secrets and confidential information. Mark all written information containing trade secrets and confidential information as confidential. Limit access to trade secrets-confidential information to employees with a reason to know in the performance of their job duties. Similarly, require franchisees to limit access to their employees who have a reason to know. Require employees to sign nondisclosure agreements, as discussed above. In franchisee and employee training, emphasize the confidentiality and proprietary nature of the franchisor's trade secrets. Finally, refrain from identifying trade secrets-confidential information in public materials such as in the Uniform Franchise Offering Circular, on the franchisor's website, or in promotional or marketing materials.

Proving a Trade Secret Claim

If a franchisor needs to file a lawsuit to protect against perceived misappropriation of its trade secret information, it will need to present evidence to support each element of a trade secret claim.

First, the franchisor must identify with reasonable particularity the trade secret(s) that it seeks to protect in the litigation. Under some circumstances, there may be a trade-off between the number of trade secrets alleged and the likelihood of protecting any individual trade secret. Resist the urge to overdesignate information as trade secrets, which may detract from the strength of claims for the more valuable pieces of trade secret information. However, be inclusive enough to protect information that you have good arguments for being both valuable and secret.

Although the complaint filed in the lawsuit should identify the general types of trade secret information alleged to be misappropriated, a detailed identification of the trade secret information should be saved for discovery or for a preliminary injunction hearing, under some type of protective order that will preserve the confidentiality of the information. You do not want to destroy the secrecy of the information by publicly identifying it in the lawsuit!

Second, present evidence that the information at issue is not generally known to, or readily ascertainable by proper means by, the public or competitors. At a minimum, this would usually involve testimony that the information was developed by or on behalf of the franchisor, was not and is not available from public sources, is unique, and is not generally known to the public or competitors. Remember that a business system made up of a useful compilation of individual components of information can qualify as a trade secret even if some or all of the individual components themselves would not qualify because they are generally known to the public or competitors. Expert witness testimony may be helpful, as it was in the *Camp Creek* case, in proving that the information

at issue is not generally known by others in the industry. Proof of contractual provisions in which franchisees, employees, or others acknowledged the confidential and proprietary status of information and agreed to limit disclosure and use of the information can also be persuasive evidence (although usually not sufficient in itself).

Third, the franchisor must offer evidence to establish the economic importance or value of the trade secrets. This generally is not too difficult in a franchise context and can be satisfied by evidence (1) of the amount of time and money it took the franchisor to develop its franchise system or other confidential information, and (2) that franchisees are willing to pay for the right to learn and use the system and other secrets.

Fourth, the franchisor must present evidence that it has taken reasonable steps to protect the secrecy of the information. What is reasonable depends on the nature of the information and the circumstances. Evidence to support this could include the presence of confidentiality and nondisclosure provisions in franchise, employment, consultant, and supplier agreements; labels of "CONFIDENTIAL" or "SECRET" on written materials; limitations imposed on access to or use of particular information; and efforts to physically protect the security of information by keeping it in a secure place and/or safeguarding it on the company's computers.

Fifth, the franchisor must prove that the defendant(s) misappropriated the trade secret by acquiring it by improper means or disclosing or using it in violation of a duty or obligation to maintain its secrecy or limit its use. It is rare that a plaintiff has direct evidence of trade secrets misappropriation, although the availability of modern forensic computer technology now makes this easier to be done if the information resided on and was taken from a company's computers. More often than not a plaintiff must rely on developing persuasive circumstantial evidence of misappropriation. This can include proof of a combination of factors: the defendant's access to the plaintiff's information at issue; the defendant's suspicious activity, such as increased interest in certain information or activity at odd times or on weekends; failure to return equipment or materials upon termination or expiration of an employment or a franchise agreement; and the similarity between the plaintiff's business enterprise or process and the new business enterprise or process of the defendant or of the defendant's new employer.

Given the numerous evidentiary hurdles to successfully proving a trade secrets misappropriation claim, the franchisor should consider pursuing related claims that may be easier to prove. Review any applicable contracts for provisions that may have been breached. For example, if a franchisee agreed in his franchise agreement not to disclose or use certain specified information outside of his franchise business, then proof of his use of that information in relation to a competing business might be found to amount to a breach of contract without the need to prove that the information amounted to a trade secret.

Finally, consider the relief to seek in the litigation. If the information alleged to be misappropriated is of particular value to the franchisor's business and the business would be substantially harmed if it is successfully misappropriated, the franchisor probably will want to move for a temporary

restraining order or a preliminary injunction. The standard for obtaining emergency injunctive relief varies somewhat by jurisdiction but generally requires a showing that (1) the plaintiff is likely to succeed on the merits of its trade secret claim; (2) the plaintiff would be irreparably harmed (i.e., harmed in a way that cannot be adequately compensated through money damages) without an injunction; (3) the balance of equities favors an injunction, in that the risk of harm to the plaintiff without an injunction is not outweighed by the harm to the defendant if the injunction is granted; and (4) the public interest would not be harmed by an injunction. Although irreparable injury is generally presumed if a court concludes that a plaintiff is likely to prevail on its trade secret claim, a plaintiff still will want to submit evidence of the types of competitive harm that it may sustain if the misappropriation is not enjoined. For permanent relief, a plaintiff will generally seek a permanent injunction and an award of money damages.

Conclusion

Protecting and enforcing franchise trade secrets and confidential information protects the value of a franchise business for the benefit of the franchisor and its franchisees. Although there is no secret formula ensuring protection of trade secrets under all circumstances, following the suggestions in this article will significantly improve a franchisor's chances of successfully protecting its trade secrets and confidential information, including its chances of prevailing on a trade secrets claim in court if that becomes necessary.

Endnotes

1. RESTATEMENT (THIRD) OF UNFAIR COMPETITION § 39 (1995).

2. Those states that have not adopted the UTSA are Massachusetts, New Jersey, New York, North Carolina, Pennsylvania, Tennessee, Texas, and Wyoming. Massachusetts has a trade secret statute that is not modeled on the UTSA. *See* MASS. GEN. LAWS ch. 266, §§ 30(4) & 60(A); *see also id.* at ch. 93, § 42. The other seven states protect trade secrets under common law legal principles. *See, e.g.,* Carl A. Colterlyahn Dairy, Inc. v. Schneider Dairy, 203 A.2d 469, 472-73 (Pa. 1964).

3. UTSA § 1(4), 14 U.L.A. 437 (1990).

4. *Id.* § 1 cmt.

5. *Id.* § 1(1).

6. *Id.* § 1 cmt.

7. RESTATEMENT OF TORTS § 757, cmt. b (1939), 8 UTSA § 1(2).

9. *Improper means* is defined to include "theft, bribery, misrepresentation, breach or inducement of a breach of duty to maintain secrecy, or espionage through electronic or other means." *Id.* § 1(1).

10. Section 1(2) of the UTSA defines *trade secrets misappropriation* as follows:

(i) acquisition of a trade secret by another person who knows or has reason to know that the trade secret was acquired by improper means; or (ii) disclosure or use of a trade secret of another without express or implied consent by a person who (A) used improper means to acquire knowledge of the trade secret; or (B) at the time of disclosure or use, knew or had reason to know that his knowledge of the trade secret was (I) derived from or through a person who had utilized improper means to acquire it; (II) acquired under circumstances giving rise to a duty to maintain its secrecy or limit its use; or (III) derived from or through a person who owed a duty to the person seeking relief to maintain its secrecy or limit its use; or (C) before a material change of his [or her] position, knew or had reason to know that it was a trade secret and that knowledge of it had been acquired by accident or mistake.

11. *Id.* § 2.

12. *Id.* § 3.
13. *Id.* § 4.
14. *See, e.g.,* Deutsche Inv. v. Riverpoint Capital, 2002 U.S. Dist. LEXIS 16147 (S.D. Ohio 2002); Specialty Chems. & Servs., Inc. v. Chandler, 9 U.S.P.Q.2d 1793 (N.D. Ga. 1988).
15. *See, e.g.,* Tan-Line Studios, Inc. v. Bradley, 1 U.S.P.Q. 2d. 2032, 2038–39 (E.D. Pa. 1986) (finding the “entire methodology” of franchised tanning salon’s business to be a trade secret); Snelling & Snelling, Inc. v. Armel, Inc., 360 F. Supp. 1319, 1321 (W.D. La. 1973) (franchisor’s employee and personnel training methods entitled to trade secret protection); *see also* SmokEnders, Inc. v. Smoke No More, Inc., 184 U.S.P.Q. 309 (S.D. Fla. 1974) (holding that detailed methods of group therapy to help people quit smoking qualified for trade secret protection).
16. *See, e.g.,* Gold Messenger, Inc. v. McGuay, 937 P.2d 907, 911 (Colo. Ct. App. 1997) (franchisor’s manual contained trade secret information and had value as a trade secret); SmokEnders, Inc. v. Smoke No More, Inc., 184 U.S.P.Q. 309, (S.D. Fla. 1974) (the court found that the plaintiff’s franchise manual had been “vital to the commercial success” of the plaintiff and was “valuable property”).
17. *See, e.g.,* Camp Creek Hospitality Inns v. Sheraton Franchise Corp., 139 F.3d 1396, 1410 (11th Cir. 1998) (information concerning the Inns’ occupancy levels, rates pricing policies, marketing plans, and operating expenses qualified as trade secrets); PepsiCo, Inc. v. Redmond, 54 F.3d 1262, 1265–71 (holding in a nonfranchising context that PepsiCo’s strategies for marketing, manufacturing, production, packaging, and distribution were trade secrets).
18. Recipes and formulas are arguably the most important trade secret for food and beverage companies. The formula for Coca-Cola has been a protected trade secret for 100 years. *See* Coca-Cola Bottling Co. v. Coca-Cola Co., 107 F.R.D. 288, 294 (D. Del. 1985). *See also* KFC Corp. v. Marion-Kay Co., 620 F. Supp. 1160, 1172 (S.D. Ind. 1985) (finding that KFC’s “secret seasonings” were trade secrets); *cf.* Khrel v. Baskin Robbins Ice Cream Co., 1979 U.S. Dist. LEXIS 10530 (C.D. Cal. 1979) (in an antitrust case, noting that the “formulae and recipes for manufacturing Baskin Robbins ice cream products are highly guarded secrets, divulged only to Baskin Robbins licensed area franchisors who are bound to maintain their confidentiality”).
19. *See, e.g.,* Am. Express Fin. Advisors, Inc. v. Yantis, 358 F. Supp. 2d 818 (N.D. Iowa 2005) (finding a likelihood of success on the merits of claim under Iowa Trade Secrets Act where customer lists and records had been misappropriated). Several states include customer lists in their definition of a trade secret. *See, e.g.,* GA. CODE § 10-1-761(4). As for supplier information, *see* Proimos v. Fair Auto. Repair, Inc., 808 F.2d 1273, 1276 (7th Cir. 1987) (although suppliers may be found by looking in a book, “the reliability of these suppliers and the terms on which they may be induced to deal may be valuable secrets”).
20. *See, e.g.,* Re/Max of Am. v. Viehweg, 619 F.Supp. 621, 626 (E.D. Mo. 1985) (finding confidential lists of potential franchisees to be trade secrets).
21. *See, e.g.,* Static Control Components, Inc. v. Darkprint Imaging, Inc., 135 F. Supp. 2d. 722, 727–28 (M.D.N.C. 2001) (denying motion to dismiss of defendant corporation that had hired away five of plaintiff’s former employees to directly compete in toner business and finding that plaintiff corporation could prove misappropriation of trade secrets for, among other things, specialized knowledge in the “development of toner”); Merck & Co. Inc. v. Lyon, 941 F. Supp. 1443, 1457 (M.D.N.C. 1996) (holding Merck’s supply agreement and projected launch dates of new drug constituted trade secret information).
22. *See, e.g.,* Rivendell Forest Prods., Ltd. v. Georgia-Pacific Corp., 28 F.3d 1042, 1046 (10th Cir. 1994) (recognizing proprietary computer software as a trade secret). Additionally, several states include computer software in their definition of a trade secret. *See, e.g.,* ALA. CODE § 8-27-2(1)(b).
23. 1986 U.S. Dist. LEXIS 27754, at *2 (E.D. Pa. Mar. 25, 1986).
24. *Id.* at *16.
25. *Id.* at *19.
26. *Id.* at *17.
27. *See id.* (“The Pennsylvania courts have adopted the definition of a trade secret set forth in the *Restatement of Torts* § 757 comment b (1939)”).
28. *Id.* at *21.
29. *See id.* at **23–24.
30. *See id.* at **37–38.
31. *See id.* at *20.
32. *See, e.g.,* Ferrolite Corp. v. General Aniline & Film Corp., 207 F.2d 912, 921 (7th Cir. 1953) (“Although the inference from the evidence that many major elements of plaintiff’s process are shown in the prior art teachings is tenable, the combination of these elements into a complicated production process amounted to a trade secret.”). *See also* Rohm & Haas Co. v. Adco Chem. Co., 689 F.2d 424, 433 (3d Cir. 1982) (pointing out that
- [t]he trade secret law of Pennsylvania and New Jersey is directly contrary to the legal conclusion drawn by the district court. The law of these states provides that even though each and every element of plaintiff’s Process is known to the industry, the combination of those elements may be a trade secret if it “produces a product superior to that of competitors.”)
33. Harvey Barnett, Inc. v. Shidler, 338 F.3d 1125, 1129 (10th Cir. 2003) (citation omitted).
34. *Id.* (quoting Imperial Chem. Indus., Ltd. v. Nat’l Distillers & Chem. Corp., 342 F.2d 737, 742 (2d Cir. 1965)).
35. *Imperial Chem. Indus.*, 342 F.2d at 742.
36. Water Servs., Inc. v. Tesco Chems., Inc., 410 F.2d 163, 173 (5th Cir. 1969).
37. 2002 U.S. Dist. LEXIS 9124, at *19 (N.D. Ill. May 21, 2002).
38. *Id.* at *6.
39. *Id.* at **7–8.
40. *See id.* at **12–13, 18–19.
41. *Id.* at *20.
42. *Id.* at *19.
43. *Id.* at *20.
44. *Id.* at *23.
45. Gold Messenger v. McGuay, 937 P.2d 907, 911 (Colo. Ct. App. 1997).
46. SmokEnders, Inc. v. Smoke No More, Inc., 184 U.S.P.Q. 309, U.S. Dist. LEXIS 6183 (S.D. Fla. Oct. 21, 1974)
47. Snelling & Snelling, Inc. v. Armel, Inc., 360 F. Supp. 1319, 1320–21 (W.D. La. 1973).
48. 1997 U.S. Dist. LEXIS 14480 (D. Colo. April 15, 1997).
49. *Id.* at *56.
50. *Id.* at **3–4, 10.
51. *Id.* at *58.
52. *Id.*
53. *Id.* at **5, 59.
54. *See id.* at **6, 59.
55. *Id.* at *60.
56. 2003 U.S. Dist. LEXIS 8472, at *4 (N.D. Tex. May 19, 2003).
57. *Id.*
58. *Id.*
59. *Id.* at *13.
60. *Id.* at *15.
61. *Id.* at **13–14.
62. *See id.* at *14.
63. 358 F. Supp. 2d 818 (N.D. Iowa 2005).
64. *Id.* at 824–25.
65. *See id.* at 831.
66. *Id.*
67. *Id.*
68. *Id.* at 835.
69. *Id.*
70. Bus. Franchise Guide (CCH) ¶ 11,434 (D.D. Cal. Jan. 9, 1998).
71. *Id.* at 30,780.
72. *Id.* at 30,781.
73. *Id.*

74. 808 F.2d 1273, 1276 (7th Cir. 1987).
75. 139 F.3d 1396 (11th Cir. 1998).
76. *See id.* at 1410.
77. *See id.* at 1412.
78. *See id.*
79. *See id.* at 1411.
80. *See id.*
81. *Id.*
82. *Id.* at 1412 (citing O.C.G.A. §§ 10-1-761(1), 10-1-761(2)(B)(ii) (II) & (III)).
83. *See id.*
84. *Id.* (citing O.C.G.A. § 10-1-763(a)).
85. *See id.*
86. *See* Quizno's Corp. v. Kampendahl, 2002 U.S. Dist. LEXIS 9124, **19–20 (N.D. Ill. May 21, 2002).
87. *See* Coca-Cola Bottling Co. v. Coca-Cola Co., 107 F.R.D. 288, 289 (D. Del. 1985).
88. *Id.*
89. *See* KFC Corp. v. Marion-Kay Co., 620 F. Supp. 1160, 1163 (S.D. Ind. 1985)
90. 537 F. Supp. 311, 319 & 322 (E.D. Pa. 1982).
91. *Id.* at 322.
92. *Id.*