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California's Fourth District Court of Appeal in *The Retirement Group, Inc. v. Galante* issues new opinion spotlighting the pitfalls and hazards of trade secret litigation.

The *Retirement Group, Inc. v. Galante*: A Lesson in Avoidable Consequences

By Dylan W. Wiseman and Aaron D. Crews

The Court of Appeal for the Fourth District of California recently issued its opinion in *The Retirement Group, Inc. v. Galante*, 2009 WL 2332008, a trade secrets case where the plaintiff, The Retirement Group, Inc. (TRG) alleged several of its former employees had misappropriated TRG's trade secrets and were using them to solicit TRG's customers. While the opinion adds little to the current body of California law governing trade secrets and post-employment restraints on trade, it provides glaring examples of problems facing trade secret litigants, which can be avoided through proper planning and making careful tactical decisions.

Background and Outcome

To understand fully the significance of the court's holdings, some background regarding the factual and procedural basis of TRG's claims is necessary. TRG was founded in the early 1990s and operated as a Broker/Dealer of financial products and a Registered Investment Advisor. In its capacity as a Registered Investment Advisor, TRG utilized independent contractors who were licensed by the Securities and Exchange Commission (SEC) to sell securities and provide investment advice to its customers.

In the summer of 2008, one of TRG's founders announced he was leaving TRG and would be joining a competitor, Monarch Retirement & Investments (Monarch), which had been founded by a handful of independent contractors formerly employed by TRG. Shortly after this defection, another one of TRG's independent contractors, defendant Galante, also ended his relationship with TRG and joined Monarch. Upon leaving TRG and joining Monarch, the independent contractors began contacting their former clients to let them know that they had changed firms, and they began providing those clients with the forms necessary to move their business to Monarch and its affiliated Broker/Dealers and Advisors.

TRG responded by filing a lawsuit alleging that the independent contractors had misappropriated confidential customer information contained on TRG's secure database, that the confidential information constituted TRG's trade secrets, and that the independent contractors were using the confidential information to solicit existing customers of TRG to leave TRG and transfer their accounts to Monarch, as well as to solicit prospective customers.

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TRG then sought and obtained a preliminary injunction that enjoined the Advisors from engaging in numerous categories of conduct, including:

> **Category 3:** "[u]sing in any manner TRG information found solely and exclusively on TRG databases. [However,] [s]imilar information found on servers, databases and other resources owned and operated by other entities or businesses is excluded from the injunction[;]" and
>
> **Category 4:** "[d]irectly or indirectly soliciting any current TRG [customers] to transfer any securities account or relationship from TRG to [Advisors] or any broker-dealer or registered investment advisor other than TRG[.]"

After it obtained the preliminary injunction, TRG filed contempt papers asserting that the defendants had violated the injunction by, among other things, "continu[ing] to contact [TRG customers] in an effort to solicit their business ... even after three, *ex parte* hearings to stop this conduct and despite TRG's counsel's numerous letters advising [Advisors] that this conduct would not be tolerated."

In response, the defendants opposed the motion and appealed the fourth category of the injunction on the ground it violated the rules established by the California Supreme Court in *Edwards v. Arthur Andersen L.L.P.*,[1] and was beyond the relief otherwise authorized by California law.

On appeal, the California Court of Appeal agreed with the defendants, and ruled that Category 4 of the Preliminary Injunction violated California Business & Professions Code section 16600 and the rules set forth in *Edwards*. Accordingly, the court ordered the trial court to:

> [V]acate the preliminary injunction and enter a new and different injunction deleting the language enjoining Advisors from "directly or indirectly soliciting any current TRG customers to transfer any securities account or relationship from TRG to defendants or any broker-dealer or registered investment advisor other than TRG."

Lessons to Be Learned

1. Do Not Overreach when Seeking a Preliminary Injunction.

For parties litigating claims of trade secret misappropriation, one of the most important lessons found in *The Retirement Group* opinion is the court's identification of the danger inherent in overreaching when proposing an order granting a preliminary injunction.

As set forth above, the injunction entered by the trial court contained several categories of conduct in which the defendants were prohibited from engaging. By including Category 4 in the proposed order granting the preliminary injunction, TRG injected reversible error into the process, thereby opening itself up to an appeal.

The time and attorneys' fees necessary to defend against the defendants' appeal could have been avoided through a more conservative proposed order that omitted Category 4 altogether. This is especially true in light of the fact that:

> ... Category 3 already protects against Advisors' use of TRG's trade secrets, [and] we are unable to perceive how Category 4 can have any additional operative effect except to bar solicitations not involving the use of trade secret information, and the latter type of competition appears to constitute the type of conduct sanctioned by *Edwards*.

Accordingly, parties prosecuting claims of misappropriation of trade secrets are well advised to seek narrow preliminary injunctions that are carefully crafted to prevent the misuse of trade secret information and preserve the status quo pending a trial on the merits of the claims.[2]

2. Make Certain to Protect Against the Use of Trade Secret Information Which Is Known to or Memorized by the Defendants.

In ruling that Category 4 violated California Business & Professions Code section 16600 the court noted:

> The bedrock of TRG's argument appears to be that the trial court properly enjoined Advisors from soliciting TRG's customers

> because the trial court necessarily concluded that the only way Advisors could have known the names and contact information of TRG's customers to enable Advisors to solicit such persons was if Advisors had misappropriated trade secret information found solely and exclusively on TRG's databases. However, TRG did not dispute that its secure database employed security measures sufficient to prevent downloading of its contents, thus undermining the factual basis for this assertion. More importantly, TRG did not dispute that the names of (and contact information for) existing customers were readily available to Advisors from independent third party sources such as Schwab or SSN, thereby obviating TRG's claim that the names and contact information of existing customers constituted protectable trade secret information. Although TRG peremptorily asserts the names and contact information of customers were protectable trade secrets notwithstanding the availability of that information to Advisors from third party databases, TRG cites no pertinent law supporting that claim.

Such language from the court strongly suggests that despite citing to *Morlife, Inc. v. Perry*,[3] TRG failed to argue that in addition to taking, using, and or disseminating its hardcopy and electronic files, the defendants should also be prohibited from using their memories of TRG's trade secret information to compete against it. Accordingly, TRG should have argued that California law prohibits the defendants from using their memories of TRG's trade secrets (*i.e.*, its client information) to identify that information using "independent third party sources."

3. Carefully Select Legal Battles Involving Customer Non-Solicitation Clauses.

The court in TRG reiterates that under California law customer non-solicitation clauses are enforceable only where the customer identities are entitled to protection as trade secrets. However, for reasons that remain unclear, TRG conceded that the names and identities of its customers were generally known through independent third-party sources, and thus according to the court were not protected as trade secrets. Rather than focus on protecting its intellectual property, TRG opted to argue that the customer non-solicitation clause could be enforced even where the customer identities were not protected as a trade secret. Citing well established California law, the court stated "[I]t is not the solicitation of customers, but instead the unfair competition and misuse of trade secret information that may be enjoined."

Exacerbating its problems, TRG failed to argue that whether customer information can be found through "independent third party sources" is immaterial to its protection under California law as a trade secret.[4] Instead, TRG apparently conceded that issue, which proved to be fatal to the merits of its claims.

Conclusion

Parties prosecuting and defending against claims of trade secret misappropriation must make certain they fully understand the significant nuances of this area of the law. A complete understanding of the current state of the law is absolutely vital, and even small gaps in one's knowledge can prove to be damaging to even the strongest case. While *The Retirement Group* adds little to the body of law, it underscores the risks of not making well-considered, tactical decisions in trade secret litigation matters.

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[1] 44 Cal. 4th 937 (2008).

[2] See Cal. Civil Code § 3426.2; Cal. Civ. Proc. §§ 525-533.

[3] 56 Cal. App. 4th 1514, 1520 (1997) ("to afford protection to the employer, the information need not be in writing but may be in the employee's memory").

[4] Cal. Civil Code § 3426.1(d).