TRADE SECRETS

What are they and How do You Protect Them?

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The authors of this article have been retained in the evaluation of insurance agencies for over 20 years. Many of those evaluations involve disputes between parties such as former employees and the agencies from which they were departing and taking confidential information with them in order to solicit the insurance clients of the agency.

Other assignments have involved bankruptcy, tax matters, the sale of books of business, internal perpetuation acquisitions, mergers and other non-disputed events that occur eventually in the life of every insurance agency.

It is important to identify what can be a “trade secret” and why trade secrets are the most valuable asset of an agency, and therefore worthy of protecting their confidentiality. The insurance industry speaks in terms of “books of business” or “expiration” or “customer lists.” Federal and State Courts have ruled that “expiration” is property and, as a body of information that is contained in the files of each individual insurance agent’s accounts, are worthy of protection. In placing a value on an insurance agency, it is the “trade secrets” (i.e. the book of business, customer lists, etc.) that embodies the true value of an agency.

Just how does an insurance agency, or any other service firm, protect their time and resources in developing the knowledge of individual accounts that, if revealed, would benefit a competitor? The answer begins with a properly drafted employment agreement with their employees and producers.

The employment agreement or producer agreement should address the issue of confidentiality of information in order to prevent a former employee from misappropriating confidential information and using it in an unauthorized manner to the agency’s detriment. Those same agreements must be equitable for both parties. It must balance the agency’s desire to protect its trade secrets and confidential information, and the departing employee’s wish to stay in the business of his/her common calling and use their innate skills in pursuing their insurance career with another employer.

An agency’s employment agreements and producer agreements should also include well crafted non-competition or non-piracy provisions that meet the test of the jurisdiction(s) in which the agency operates. The specific requirements and limitations of such restrictive covenants are not addressed in this article, but are a subject closely related to the protection of trade secrets and confidential information.

What is the “confidential information” or “trade secrets” that should be protected, and how does it play a part in providing the employer a competitive advantage? Some information about any insurance account is available in the public domain, such as the firm’s web site, advertisements and other sources of information. That type of information is generally not confidential information, nor worthy of protection as “trade secrets”.

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What are Trade Secrets?

A trade secret may consist of any formula, pattern, device or compilation of information which is used in one’s business and which gives one 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, or a list of customers. A trade secret is a process or device for continuous use in the operation of the business.

When money and time are invested in the development of information and procedures that are not generally known, trade secret protection issues exist. Further, when an effort is made to keep information from competitors, trade secret protection is warranted.

Trade secrets are not limited to secret formulas. In fact, “absolute secrecy” is not a prerequisite, only “substantial secrecy” is required. The definition of trade secrets is very broad, and may include any of the following:

- Customer or client lists, billing information, customer and client preference information and contact lists
- Pricing information and marketing plans
- Computer programs and data compilations
- Training and service manuals
- Vendor information

The exact language by which a “trade secret” is defined varies by state. However, there are three factors that are common to such definitions. A trade secret is some sort of information that:

- Is not generally known to the public.
- Confers some sort of economic benefit on its holder.
- Is the subject of reasonable efforts to maintain its secrecy.

Some of the factors courts consider when determining whether information is a trade secret are:

- The extent to which the information is known outside of the agency
- The extent to which it is known by employees and others involved in the agency
- The extent of measures taken by the agency to guard the secrecy of the information
- The value of the information to the agency and its competitors
• The amount of effort and/or money expended by the agency in developing the information
• The ease or difficulty with which the information could be properly acquired or duplicated by others

How Do You Protect Your Trade Secrets?

A company must carefully plan and implement an organized program, which identifies its trade secrets, and then take steps to protect against their misappropriation. The company will then be in a position to demonstrate to a court of law the measures taken to protect its trade secrets by documenting the program.

At a minimum, a trade secrets protection program involves the establishment of internal security procedures that should include:

• A written policy of confidentiality included in employee procedures manuals and employment practices guidelines, emphasizing that all internal communications should be handled in strictest confidence.
• The company’s confidentiality standards in employee training and educational programs.
• A process where customer lists, client information and other trade secrets are distributed only on a need-to-know basis, and marked “confidential” where possible.
• Execution of well-drafted Confidentiality/Non-Disclosure Agreements by all employees, producers and independent contractors.
• Security codes or barriers in the company’s data processing computer systems and other management records that are revised on a regular basis to prevent infiltration.
• Storing confidential information in a secure manner and shredding documents when no longer needed.

In our view, the best way to demonstrate the information that is confidential is to examine an insurance account and identify the information that an agency has spent time and money developing that is not readily available to a competitor, and that gives the agency an advantage over a prospecting agency. So here is an offering of some questions regarding what the agency knows about an insurance account that could qualify as “confidential information” of the agency, and thus, be worthy of trade secret protection:

• What is the ownership of the insured, and who among the owners controls the insurance program?
• Who is in control of the company today, and who will control it in the future?
• What is the financial condition of the insured?
• Who are the insured’s major clients and/or vendors?

• Does the insured require specific coverage modifications to meet the contracts they normally execute with its customers?

• What is the claims history of the insured?

• Has the insured had any lawsuits filed against them, and what is the nature and current status of those lawsuits?

• What loss control measures has the insured initiated?

• Does the insured manufacture products, or modify or assemble the products of others?

• What are the products or services of the insured that cause major exposures?

• What is the history of the insured’s workers’ compensation and/or general liability modifiers?

• Does the insured carry products liability and/or professional liability coverage?

• Does the insured have a need for contingent business interruption coverage?

Vigilance Is Required

While the confidential information and trade secrets you need to protect may be as simple as customer lists and client information, it is very important to take effective steps to protect the information from misappropriation.

Consult with an attorney that is well-versed in matters of confidentiality, non-disclosure and employment practices to assist you in devising and implementing an information protection program.

Should you encounter a breach, or threatened breach, act expeditiously to retain competent counsel to take action to protect your competitive advantage. A trade secret, once lost, is gone forever.

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