

Winter 2001

Protecting Your Trade Secrets: The Basics

by Renee Inomata

Most companies — no matter how big or small — have business information that they consider crucial to their success. Some of this information may be entitled to protection as a trade secret.

What Is A Trade Secret?

Although trade secrets may take the form of anything from a formula to a customer list to a manufacturing process, generally, they are defined as secret or confidential information that gives the company an opportunity to obtain an advantage over competitors who do not know or do not use such trade secrets. Thus, public information and information generally known in the industry are not trade secrets.

The Law

In Massachusetts, trade secrets are protected by common law (law created by the courts as opposed to the legislature) and by a statute allowing multiple damages for victims of trade secret theft or misappropriation. Additionally, trade secret theft may be subject to criminal punishment of up to five years in jail and/or a fine of up to \$25,000.

Under the Economic Espionage Act (EEA), trade secret theft may also constitute a federal crime. Individuals found guilty of stealing trade secrets face penalties of up to ten years of imprisonment and/or \$500,000 in fines. Corporations found guilty of trade secret theft may be fined up to \$5 million.

Keeping Trade Secrets Secret

As the essential characteristic of a trade secret is secrecy or confidentiality, a

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company should take certain steps in order to obtain the maximum benefits of trade secret protection.

1. Identify Trade Secrets

First, a company should clearly and specifically identify its trade secrets. Once the trade secrets are identified, the company should take steps to keep the trade secrets secret or confidential.

2. Take Appropriate Security Measures

The company should adopt reasonable security measures to ensure that the trade secrets are kept secret and confidential. Some common precautions include the following:

- limit the number of individuals who have access to the trade secret;
- to the extent possible, keep the trade secrets under lock and key;
- change passwords on computers in random intervals;
- establish and enforce document control procedures, including marking documents containing trade secrets "CONFIDENTIAL," numbering copies that are distributed, and requiring the destruction of outdated or extra copies; and
- restricting the use of trade secrets outside of the office, including through e-mail or on home computers.

3. Have Individuals Sign Confidentiality Agreements

The company should endeavor to have anyone to whom the trade secret is

disclosed, or to whom it is simply accessible, sign a confidentiality agreement. For example, employees, consultants, independent contractors, vendors, and potential buyers should be required to sign a confidentiality agreement in order to protect the trade secrets to which they may have access, even though the company may not intentionally disclose a trade secret to such individuals. The confidentiality agreement should contain the following:

- a description of the trade secrets of the company;
- an acknowledgment that the company's trade secrets are valuable assets of the company;
- an acknowledgment that trade secrets may be disclosed to or accessible to the individual;
- an agreement by the individual that he/she will not disclose or use such trade secrets; and
- an acknowledgment that an appropriate remedy for disclosing or using the trade secret without the authorization of the company is an injunction preventing further disclosure or use of such information.

Finally, upon the termination or resignation of an employee of the company, the company should conduct an exit interview with the departing

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Real Estate Brokers: Saying Too Much Can Work to Your Disadvantage

by Jay S. Gregory

“The time to stop talking is when the other person nods his head affirmatively but says nothing.”

Henry S. Haskins

Real estate brokers, like most professionals, have increasingly been the target of litigation over the last decade. In most instances, a broker is sued as a result of something he or she allegedly said in a sales transaction. Most lawsuits involve a buyer's claim that the property he or she purchased is materially different than the broker represented it to be. Common subjects of such claims include leaky roofs, water infiltration in basements, and defective septic systems.

The three basic theories of broker liability are based upon misrepresentation or failure to disclose information. They include:

- **Deceit** - To show deceit, a buyer must prove that the broker intentionally made a material misrepresentation — all the while knowing that the representation was false — in order to make the sale. The buyer also has to prove that he or she relied upon the misrepresentation to his or her detriment and suffered damages as a result.
- **Negligent Misrepresentation** - This is similar to deceit, but here the broker is unaware that the representation he or she made was false.
- **Massachusetts Consumer Protection Act** - This law prohibits a broker from engaging in unfair or deceptive trade or practice. It does not require a showing of intent.

The Whole Truth

Brokers can easily minimize the risk of being sued by being careful in what they say (or do not say) about a property. One

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helpful rule of thumb is, quite simply, that brokers should always tell the truth. When a buyer asks a question, the broker should respond only with information that he or she knows, and should state the source of the information. For instance, if a buyer asks whether there was water seeping into the basement, a broker can say that there is no seepage “based upon the information provided by the seller.”

Of course, if a broker does not have any information, he or she should say so rather than guessing. That the purchaser might consider the broker ill-informed is preferable to being sued because he or she speculated on the answer.

For example, if a buyer asks whether a home suffers from termite infestation and the broker has no information one way or the other, the broker should say as much. If the buyer closes on the property and thereafter learns that the home suffers from a significant termite infestation, the broker is not responsible for any misrepresentation. On the other hand, if the broker responded to the buyer's question by saying, “I don't know but I will get right on it and get an answer to you,” the broker may have created a potential claim for negligence if he or she doesn't follow through. Further, if a buyer does not ask the broker about the condition of the home and the broker does not volunteer any information, the broker is not liable.

Liability attaches only to a broker's misrepresentations of *facts* as opposed to mere opinions, speculation, puffery, or sales talk. For example, there is a significant difference between a broker saying that the roof on a home is five years old and telling the buyers that they will love the home once they buy it.

He Said, She Said

Most lawsuits against brokers concern questions of what a broker said to a buyer. Therefore, such cases often come down to one person's recollection versus another's. A broker can be as careful as possible and religiously abide by the guidelines set forth above, yet still find him or herself a defendant in a lawsuit. A broker may take pains to qualify and attribute statements of fact and never venture beyond what he or she knows concerning a property. However, a buyer may have a significantly different memory of what the broker said.

Although there is no sure-fire way to guard against another person's faulty memory, there are some steps that a broker can take to protect him or herself. First, write it down. A broker should make notes to his or her file to summarize the buyer's inquiries and her responses. Second, develop good habits. If a broker makes it a habit to restrict representations concerning a property to information contained in a seller's disclosure statement, then evidence of this “habit” can be used as a good defense in a lawsuit. Remember, an ounce of prevention is worth a pound of cure!

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employee to identify and retrieve trade secret information in his/her possession and to remind him/her of his/her continuing obligations to keep such information secret and confidential. Additionally, in those situations where the employee is leaving to become employed by a competitor, the company should notify the subsequent employer that the departing employee had access to the company's trade secrets and is under a continuing obligation to maintain the secrecy and confidentiality of such information.

Although complete protection of trade secrets is not a guarantee, following the steps described above can minimize the risk that trade secrets will be stolen or misappropriated and can maximize the company's legal protections and remedies.

The Electronic Signatures Act: Big Business Bonanza or No Big Deal?

by Maria E. Recalde

Since the advent of the Internet in the early 1990s, the centuries-old rules governing contracts have been stretched to the limits. In fact, it has become increasingly obvious that those rules simply are not up to the task of regulating contractual relationships in the Digital Age. Contract disputes have cropped up that were barely even foreseeable a decade ago. Can you enter into a contract on the Internet or by e-mail? If you do online business with someone on the other side of the country and a dispute arises, can they sue you there? If so, what states' law applies?

But perhaps the biggest question courts have had to grapple with is whether there can even be a valid contract when the only record of it is electronic (as opposed to the traditional requirement that most contracts be in writing). In June 2000, Congress passed and President Clinton signed a new law that answers that question in the affirmative. In short, the Electronic Signatures in Global and National Commerce Act (E-Sign) gives electronic signatures the same legal effect as traditional signatures on a piece of paper. Some have touted E-Sign as the most important piece of technology legislation ever. But is it truly revolutionary, or is it all just hype?

E-Sign Basics

E-Sign generally states that no contract, signature, or record can be challenged as lacking legal effect solely because it is in electronic form. The main limitation placed on electronic contracts is that they must be in a form that allows the parties to the contract to retain and reproduce them without fear that they will be altered or otherwise tampered with. Beyond that, the Act

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takes a more or less "hands-off" approach on the issue of the specific technologies that companies can use in entering into contracts electronically.

In addition to validating online contracts, E-Sign also validates the online delivery of notices and records to consumers who have given their affirmative consent to accept them electronically. Under the Act, however, consumers retain the right to withdraw their consent and insist upon paper documentation. Moreover, the Act enumerates a number of situations where electronic communications will not suffice (e.g., any notice of cancellation of utility services or health or life insurance or any recall notice).

What's the Big Deal?

Being able to enter into contracts electronically has many possible benefits for businesses. To start with, E-Sign simply minimizes confusion over the legal effect of electronic signatures. In the last few years, many (but by no means all) of the states passed their own laws on the subject. The problems, however, were numerous.

First, businesses located in states that did not have a law on the subject had no assurances that electronic signatures would be upheld in the courts. Second, the laws in different states often conflicted on crucial points, including such basic provisions as what types of electronic signatures were acceptable. So if a business in one state wanted to enter into a contract with a business or consumer in another state, there was often confusion over how to make sure the contract was legally enforceable.

That uncertainty acted as a disincentive for businesses to enter into contracts electronically. E-Sign is intended to remedy these and other problems surrounding the use of electronic signatures by establishing a uniform standard for these transactions.

Another big benefit of E-Sign is that it has the potential to dramatically speed up the process of entering into certain standard agreements. Insurance companies, for example, foresee a time when they will offer consumers the chance to go through the entire application and approval process online and dramatically reduce the time required to approve and issue the policy.

As these and more substantial paperless transactions become commonplace, the hope is that businesses will see a dramatic reduction in the costs of printing, copying, mailing, and storing paper documents. Warehouses full of documents that companies are required to retain may eventually be kept on a simple computer server.

So What's the Catch?

The big catch is that the technologies required to use electronic signatures, notices, and disclosures to their full potential just are not in place yet. Part of the problem is that there are many competing technologies that simply are not compatible with each other. So if a company uses one technology and another business or consumer only has access to a different technology, they probably will not be able to complete a transaction electronically. In addition, companies that want to use electronic contracts, notices, and disclosures will have to develop the systems necessary to comply with the Act's requirement that the records be tamper-proof.

On the other hand, many feel that the uniformity offered by E-Sign will inspire the development of new technologies and uniform technological standards. The law is finally catching up with the technology. Only time can tell how long it will take for the technology standards to be comprehensive and consistent enough to take advantage of that fact.

Massachusetts Tax Saving Opportunity for S Corporations

by Howard D. Medwed

Many S corporations that do business in Massachusetts pay an entity level Massachusetts income tax on 3% of the net income if their gross receipts exceed \$6 million (or, worse yet, at 4.5% if the gross receipts exceed \$9 million). This tax is almost voluntary. Late in 1999, the Massachusetts tax authorities ruled that this tax was not due from an S corporation that: (1) was organized in the form of a Massachusetts business trust; and (2) acted as a holding company for an operating corporation which filed an election to be a so-called qualified subchapter S subsidiary (or Qsub). Such a holding company files a federal tax return as an S corporation treating the income of the Qsub as its own.

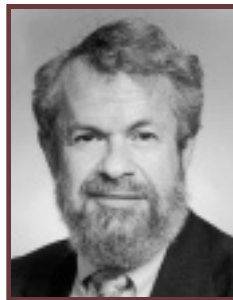
Massachusetts taxes business trusts at individual income tax rates using federal taxable income as the base. Massachusetts shareholders of business trusts that are federal S corporations pay no Massachusetts tax on their shares of the trust's federal S corporation income. The end result is that the Massachusetts business trust and its Massachusetts shareholders pay no more federal tax than they would if no business trust were involved. This means that, if a 3% or 4.5% tax were being imposed, a substantial Massachusetts tax saving is realized.

How Does It Work?

This saving involves a relatively simple reorganization. The reorganization involves the following steps:

(1) Form a Massachusetts business. (The business trust indenture and by-laws should attempt to mirror the

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governance and other provisions of the existing S corporation's set-up.)

(2) Elect to classify the business trust as a corporation for federal tax purposes by filing a simple tax form in timely fashion.

(3) Have all of the existing S corporation's shareholders contribute all of their shares of S corporation stock to the capital of the new business trust in return for an equivalent number of business trust shares.

(4) Elect to have the old business corporation be treated as a Qsub by filing a simple tax form in timely fashion.

That's it basically. No operating assets are transferred; the business operates as if nothing happened. However, as with any significant transaction, it is useful to review all of the consequences which might arise, such as its effects on shareholder agreements, banking arrangements, and major contracts as well as its effects on out-of-state shareholders and branches. It is important that the S corporation's accountant be involved as well. He may have information that the shareholders and officers do not have.

What Are the Risks?

The biggest risks are sloppy execution and bringing shareholder conflicts to the fore. The tax forms must be filed in timely fashion (generally 2 1/2 months

Focus

Focus is published three times a year by Burns & Levinson LLP for clients and friends of the firm. This newsletter provides general information and does not constitute legal advice.

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after the trust is organized), and all shareholders — including disgruntled minority shareholders — must cooperate. If some shareholders are not Massachusetts residents, then this transaction may not be beneficial to the non-residents. As with any major transaction it must be thoroughly analyzed before it is undertaken.

If you think you may benefit from this tax saving opportunity or have any questions about how to arrange your affairs so as to pay lower taxes or to simplify your tax compliance obligations, please call your Burns & Levinson attorney.

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