

## Key Trade Secret Developments Of 2016: Part 1

By Randy Kahnke, Kerry Bundy, Tyler Young and Elsa Bullard, Faegre Baker Daniels LLP

*Law360, New York (December 14, 2016, 4:56 PM EST) --*

The year 2016 brought significant developments in trade secret law, the most important of which was the passage of the long-awaited federal Defend Trade Secrets Act. The passage of a federal trade secret law was a watershed event, and its effect is already being felt in the courts. In the few months since the act took effect, litigants have already asserted DTSA claims in more than 75 federal cases. In the years to come, in-house counsel and private practitioners should look for the DTSA to reshape trade secret law in numerous respects, both expected and unexpected.

Given the far-reaching implications of the DTSA, we devote part one of this two-part series (part two will publish in January) to five noteworthy aspects of the DTSA: (1) its history and goals; (2) the key provisions in-house counsel and private practitioners should know; (3) the controversial ex parte seizure provision; (4) emerging trends in the case law applying the DTSA; and (5) important questions the courts will have to address in the years to come. In part two of this two-part series, we will highlight other significant developments in trade secret law, including the passage of the European Directive.

A takeaway summarizing key issues and guidance appears at the end of each topic.

### Trade Secrets Join the Federal Club: The DTSA's Path to Law

Trade secrets have historically been the exception to America's national system of intellectual property laws. For more than a century, federal laws have regulated and governed the other major forms of intellectual property — patents, copyrights and trademarks — while trade secrets were regulated almost exclusively by state law. But in recent years, legislators increasingly recognized the need for a uniform national trade secret law. In fact, in recent years introducing federal trade secret legislation that ultimately fizzled became something of an annual congressional routine.[1]

But all of that changed this year. On May 11, 2016, President Obama signed the DTSA into law.[2] As discussed in greater detail in the next section, the DTSA amends the Economic Espionage Act of 1996 to improve the ability of businesses to address trade secret theft by creating a federal civil cause of action and expanding the scope of available remedies.[3] The DTSA received broad bipartisan support in Congress — passing unanimously in the Senate and by a 410-to-2 vote in the House of



Randy Kahnke



Kerry Bundy

Representatives.[4]

According to a report issued by the Senate Judiciary Committee, the DTSA was intended to protect and encourage future innovation, economic growth and job creation, while at the same time protecting the rights of third parties and minimizing disruption to normal business operations.[5] It remains to be seen whether, in application, the DTSA strikes the desired balance.

*Takeaway: the DTSA passed with overwhelming bipartisan support in a time of legislative gridlock. The passage of the DTSA highlights the consensus that trade secrets are an incredibly valuable category of intellectual property and robust legal mechanisms are needed to protect them.*

## **The DTSA's Key Provisions**

The DTSA is a lengthy and complicated piece of legislation that alters federal law in many respects. This section provides an overview of the significant provisions of the DTSA (with the exception of the ex parte seizure provision, which we discuss at length in section 3) that in-house counsel and private practitioners should bear in mind.

### *DTSA Creates a Federal Cause of Action but Preserves Pre-Existing State Laws*

Before the DTSA, trade secret plaintiffs were frequently limited to litigating in state courts, unless they met the requirements for federal diversity jurisdiction, or were able to allege other claims that raised a federal question. The DTSA provides trade secret owners — in most cases — with a federal cause of action and a federal forum to enforce their trade secret rights. This also means that nationwide service of process is available, which may be significant in cases that require swift action to address misappropriation.

The DTSA promises to increase consistency in how trade secret rights are protected, but it will not eliminate state-by-state variation entirely. Unlike other federal intellectual property laws (e.g., patent, trademark, copyright), the DTSA does not preempt conflicting state laws.[6] Accordingly, trade secret owners may decide to seek relief under the new federal standard or under their state's pre-existing law (or both).

### *DTSA Includes Safeguards to Protect Employees and Whistleblowers*

The DTSA authorizes courts to award traditional remedies, like monetary damages and injunctions, but the act bars courts from entering injunctions that would interfere with a worker's ability to pursue a chosen career. For example, an injunction under the DTSA may limit the type of work someone with knowledge of trade secrets can perform, but only if there is actual evidence of threatened misappropriation.[7] In other words, the DTSA did not explicitly authorize injunctions against former employees based on "inevitable disclosure." As noted above, however, the DTSA does not preempt state law, including state law regarding inevitable disclosure.

The DTSA also allows whistleblowers to disclose trade secrets to a federal, state or local official in connection with reporting a violation of law.[8] The DTSA also allows employees subject to retaliatory employment actions to use their employer's trade secret information in litigation, so long as the trade secret information is filed under seal.[9]

*DTSA Requires Employers to Give Employees Notice of Their Rights Under the Act, or Surrender the*

## *Opportunity to Pursue Exemplary Damages*

One of the more important aspects of the DTSA for employers to note is the requirement that employers provide notice of the above-described immunity provision to their employees.[10] Employers who fail to give the required notice will be precluded from receiving exemplary damages or attorneys' fees in a suit against an employee under the DTSA.[11] This provision applies only to confidentiality agreements or policies put in place after adoption of the DTSA — i.e., after May 11, 2016.

*Takeaway: The DTSA expands the legal options available to trade secret owners. Trade secret owners should consider whether to bring a misappropriation claim under federal or state law. Trade secret owners should also consider updating their confidentiality agreements to notify employees and contractors of their rights under the DTSA.*

## **Ex Parte Seizure Orders**

In addition to a federal cause of action, the DTSA also gives plaintiffs access to a powerful litigation tool to protect their trade secrets: ex parte seizure orders. In other words, the DTSA authorizes courts, in certain limited circumstances, to issue an order — without notifying the defendant — allowing law enforcement to seize the stolen trade secrets.[12] This aspect of the DTSA is intended to address the risk that trade secret thieves will flee the country or disseminate trade secrets when they learn of a court action. It is also the most controversial aspect of the DTSA.

Some commentators criticized earlier versions of the DTSA because of the risk that ex parte seizure orders could be abused. In response, the DTSA was revised to include a variety of procedural safeguards limiting the availability of ex parte seizure orders. For example, to grant an application for a civil seizure, a court must first find that (a) an immediate and irreparable injury will occur; (b) the harm to the person requesting the order outweighs the interests of the individual against whom the order would be sought, or third parties affected by the order; and perhaps most significantly (c) that the need could not be satisfied with an injunction under Rule 65 of the Federal Rules of Civil Procedure.[13] The court must also find that the plaintiff has made an adequate showing that the information is a trade secret and the person against whom the order is sought misappropriated or conspired to misappropriate that secret.[14]

The DTSA also imposes a series of procedural requirements on courts when issuing ex parte seizure orders. For instance, the DTSA requires the court to address a number of elements in the seizure order, including finding that the seizure is the narrowest necessary to accomplish the required goal.[15] The statute also requires the court to set a date for a hearing and mandates that the court take necessary action to protect the seized materials from being disclosed to the public or destroyed or damaged while in the custody of the court.[16]

Despite these protections, critics remain concerned about the civil seizure provision. For example, some argue that the statute's failure to define what "property" is subject to ex parte seizure renders the seizure provision impermissibly vague.[17] One significant question is whether "property" includes things like a company's computer source code, the seizure of which could have devastating effects on a business.[18] The DTSA does require that courts order the narrowest seizure necessary to protect the stolen trade secrets, but critics argue that this still could be a very serious imposition on a business.[19] Critics have also voiced concerns that the ex parte nature of the seizure orders makes them inherently and unfairly pro-plaintiff.[20]

*Takeaway: Trade secret owners should consider whether to take advantage of the DTSA's ex parte seizure provisions, and lawyers should carefully monitor the way in which courts apply this potentially vital remedy.*

## **Emerging Trends in the DTSA Case Law**

Courts are now issuing a steady stream of orders related to DTSA claims. Because the act is only a few months old, these orders are largely limited to rulings on motions to dismiss and motions for injunctive relief, but trends in the ways litigants and courts are applying the DTSA are beginning to emerge.

The clearest trend is that plaintiffs are now asserting both DTSA claims and state-law claims for misappropriation of trade secrets simultaneously. Because the DTSA did not preempt state trade secret laws, it is unsurprising that litigants are adopting a belt-and-suspenders approach: using the DTSA to gain access to federal court while continuing to pursue state-law trade secret claims. What is more interesting is that courts, for the most part, have not addressed substantive differences between the DTSA and applicable state trade secret laws. Instead, in most cases, courts have noted similarities between these laws and conducted a combined analysis based on cases applying state trade secret laws.

### *Motions to Dismiss*

Courts have both granted and denied motions to dismiss DTSA claims.[21] Two of these decisions, both from Illinois, addressed a perennially litigated issue: how specifically must a plaintiff describe the trade secrets at issue.

In *Mission Measurement Corp. v. Blackbaud Inc.*, the defendants argued that the plaintiff's trade secret claims failed because the plaintiff did not "specifically identify the exact trade secrets at issue in this lawsuit." [22] The court rejected the defendants' proposed standard, citing past Illinois federal cases — cases that were based on state trade secret laws — and confirmed that plaintiffs need only describe the trade secrets in general terms. The *Mission Measurement* plaintiff had described its trade secrets as: "(1) a specialized Outcomes Taxonomy; (2) a method for collecting standardized data; (3) a method for calculating grantee impact; (4) software design specifications; (5) impact reports and analytics; and (6) business models for selling access to metrics databases." *Id.* The court concluded that this list, combined with the allegations related to the parties' joint-development relationship, and the dates and ways the plaintiff had shared this information with the defendants, was sufficient to plead a DTSA claim. Interestingly, in denying the motion, the court made no distinction between the DTSA claim and the state-law trade secret claims.

A day later, on the other end of the spectrum, another court in the Northern District of Illinois issued an order dismissing a 96-page, 29-count complaint that was "verbose and full of circular and repetitive allegations." *Chatterplug Inc. v. Digital Intent LLC*, No. 1:16-CV-4056.[23] The court dismissed the complaint with leave to refile, in part, because it failed to "provide Defendants with the general contours of the alleged trade secrets." *Id.* at \*3. Again, the court did not differentiate between the state and federal trade secret claims in its order.

Two courts have also addressed the DTSA's effective date and what it means for pleading a trade secret claim.[24] In each case, the court held that the DTSA applies only if there was some violating conduct that occurred after the act's effective date. In *Adams Arms LLC v. Unified Weapon Systems Inc.*, for example, the court interpreted the DTSA to include continuing misappropriation that began prior to the act's effective date, but continued after the effective date.[25] The court contrasted the language of the

DTSA with the language of the Uniform Trade Secret Act that expressly excluded misappropriation that began prior to the effective date and continued after the effective date. The court held that the DTSA requires only that “an act,” in the singular sense, occur after the effective date.

### *Temporary Restraining Orders and Preliminary Injunctions*

Courts have also applied the DTSA in the context of motions for TROs and preliminary injunctions. Again, courts have not yet grappled with the differences between the substantive elements of a DTSA claim versus a state-law trade secret claim.

The first TRO granted under the DTSA was issued by a California federal court in *Henry Schein Inc. v. Cook*.<sup>[26]</sup> In that decision, the court created a framework for assessing the likelihood of success on the merits — for both a DTSA claim and a state-law claim — that other courts have followed. Specifically, the court compared the key language at issue in the DTSA and the California Uniform Trade Secrets Act, specifically the definition of the term acquisition by “improper means.” Finding the relevant language identical, the court analyzed the two claims together, without distinguishing between the DTSA and California law. Other courts that have considered a TRO or preliminary injunction motion have similarly found the language of the DTSA and the state law at issue so similar that they could be considered together under that state’s prior case law.<sup>[27]</sup>

Perhaps the most interesting injunction decision was issued by a Colorado federal court in *Engility Corp. v. Daniels*.<sup>[28]</sup> In that case, the plaintiff sued several of its former employees, who had started their own independent contracting firm. Engility sued under both the DTSA and the Colorado Uniform Trade Secrets Act (“CUTSA”) and moved for a preliminary injunction seeking, among other protections, an order barring defendants from accepting any work from Northcom, one of Engility’s clients.

The court did not distinguish between the DTSA and the CUTSA when analyzing several issues related to the plaintiff’s likelihood of success on the merits. But when the court turned to the issue of whether the defendants should be enjoined from accepting business from Northcom it focused on the DTSA, because the federal act provided more specific guidance than Colorado law. The court considered two restrictions on injunctions in the DTSA: (1) 18 U.S.C. § 1836(b)(3)(A)(i)(I), which precludes injunctions that would “prevent a person from entering into an employment relationship,” and (2) 18 U.S.C. § 1836(b)(3)(A)(i)(II), which forbids an injunction that would “conflict with an applicable State law prohibiting restraints on the practice of a lawful profession, trade, or business.” *Id.* at \*10.

As to the first restriction, the court determined that an “employment relationship” would not include an independent-contractor relationship, and thus did not apply to defendants’ potential relationship with Northcom. *Id.* In assessing the second restriction, the court looked to Colorado law, which presumptively invalidates noncompete agreements, with an exception for the protection of trade secrets. Even though there was no noncompete agreement at issue in the case, the court found that the Colorado statute related to noncompete agreements was “applicable State law prohibiting restraints on the practice of a lawful profession, trade, or business,” that had to be considered in the court’s injunction analysis. Ultimately, the court concluded that the requested restrictions did not conflict with applicable state law and granted the preliminary injunction, including the restrictions related to Northcom, but required the plaintiff to post a \$1 million bond.<sup>[29]</sup>

*Takeaway: In several early decisions, courts have not distinguished between DTSA and state-law trade secret claims and have relied heavily on earlier decisions applying state trade secret laws. This emerging trend may change, but it suggests that the DTSA may not be as effective in increasing nationwide*

*uniformity in trade secret law as its proponents had hoped.*

### **Unanswered Questions Raised by the DTSA**

As with any major new legislation, there are many questions about the DTSA that remain to be answered by future court decisions. Here, we highlight three open questions that trade secret practitioners should monitor carefully.

First, will the DTSA achieve its goal of creating greater uniformity in the protection of trade secrets? If courts continue to analyze DTSA and state trade secret laws together, without distinguishing between the two sources of law, and with heavy reliance on cases applying state law, it seems unlikely. There is no clear right answer to this question because the DTSA does not provide a guide to its own interpretation. In other words, the DTSA does not say whether its provisions should be interpreted based on pre-existing state law or on some yet-to-be-crafted independent federal law. If courts interpret the DTSA based on state law, it is possible that state-by-state variation will emerge regarding key aspects of trade secret law that the DTSA does not address in detail, including what types of information can qualify as a trade secret and what kinds of conduct can qualify as misappropriation. But on the other hand, the overwhelming majority of state trade secret laws are based on the Uniform Trade Secrets Act, so reliance on state law is unlikely to lead to significant splits in federal law.

Second, how will courts apply the DTSA's ex parte seizure provision? In particular, how will courts apply the restriction that ex parte seizure orders can be granted only when a traditional injunction or TRO would be ineffective? If courts apply this restriction aggressively, it could render the DTSA's most controversial provision largely ineffective.

Third, how will courts apply the DTSA's "interstate commerce" limitation? It is tempting to oversimplify and say that the DTSA created a federal cause of action for trade secret misappropriation across the board. But in fact the DTSA authorizes trade secret claims only if they are "related to a product or service used in, or intended for use in, interstate or foreign commerce." It is easy to conjure hypotheticals that test this limitation: for example, does the DTSA apply to negative know-how information (i.e., information about processes, steps or ideas that do not work) sufficiently related to a product or service used in interstate commerce? This issue is doubly significant because it may result in a plaintiff losing not only its DTSA claim but its access to a federal forum.

*Takeaway: The case law applying the DTSA is still in its infancy and many important questions remain unanswered today. Although the DTSA was intended to increase uniformity, there is the potential that the answers to these questions will vary from state to state. Trade secret practitioners should therefore monitor the courts' guidance regarding the meaning of the DTSA carefully.*

---

*Randy E. Kahnke and Kerry L. Bundy are partners and Tyler A. Young and Elsa M. Bullard are associates in the Minneapolis office of Faegre Baker Daniels LLP.*

*The opinions expressed are those of the author(s) and do not necessarily reflect the views of the firm, its clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.*

[1] <http://www.law360.com/articles/745872/10-key-trade-secret-developments-of-2015-part-2>

<http://www.law360.com/articles/603592/top-10-trade-secrets-developments-of-2014-part-1>

[2] President Obama Signs S. 1890 – Defend Trade Secrets Act, The White House (May 11, 2016), <https://www.whitehouse.gov/photos-and-video/video/2016/05/11/president-obama-signs-s1890-defend-trade-secrets-act>.

[3] S. Rep. No. 114-220, at 2-3 (2016).

[4] United States Congress Passed DTSA, Defend Trade Secrets Act, Nat'l L. Rev. (May 2, 2016), <http://www.natlawreview.com/article/united-states-congress-passed-dtsa-defend-trade-secrets-act>.

[5] S. Rep. No. 114-220, supra note iii.

[6] 18 U.S.C. § 1836(b)(2)(A)(i).

[7] 18 U.S.C. § 1836(b)(3)(A).

[8] 18 U.S.C. § 1833(b)(1)(A).

[9] 18 U.S.C. § 1833(b)(2).

[10] 18 U.S.C. § 1833(b)(3)(A).

[11] 18 U.S.C. § 1833(b)(3)(C).

[12] 18 U.S.C. § 1836(b)(2)(A)(i).

[13] 18 U.S.C. § 1836(b)(2)(A)(ii).

[14] 18 U.S.C. § 1836(b)(2)(A)(ii)(IV).

[15] 18 U.S.C. § 1836(b)(2)(B).

[16] 18 U.S.C. § 1836(b)(2)(B)(v), (C), (D).

[17] Professors' Letter in Opposition to the Defend Trade Secrets Act of 2015, supra note 23.

[18] Id.

[19] Id.

[20] Id.

[21] See, e.g., *Unum Grp. v. Loftus*, No. 4:16-CV-40154-TSH, 2016 WL 7115967 (D. Mass. Dec. 6, 2016) (denying motion to dismiss with no substantive discussion of the DTSA claim); *Chatterplug, Inc. v. Digital Intent, LLC*, No. 1:16-CV-4056, 2016 WL 6395409 (N.D. Ill. Oct. 28, 2016) (granting motion to dismiss with leave to refile); *Mission Measurement Corp. v. Blackbaud, Inc.*, No. 16 C 6003, 2016 WL 6277496 (N.D. Ill. Oct. 27, 2016) (denying motion to dismiss); *Adams Arms, LLC v. Unified Weapon Sys., Inc.*, No. 8:16-CV-1503-T-33AEP, 2016 WL 5391394 (M.D. Fla. Sept. 27, 2016) (denying motion to dismiss);

HealthBanc Int'l, LLC v. Synergy Worldwide, Inc., No. 216CV00135JNPPMW, 2016 WL 5255163 (D. Utah Sept. 22, 2016) (granting motion to dismiss); Dazzle Software II, LLC v. Kinney, No. 16-CV-12191, 2016 WL 6248906 (E.D. Mich. Aug. 22, 2016) (granting motion to dismiss DTSA claim with option to seek leave to amend and re-plead the claim); M.C. Dean, Inc. v. City of Miami Beach, Florida, No. 16-21731-CIV, 2016 WL 4179807 (S.D. Fla. Aug. 8, 2016) (granting motion to dismiss with leave to refile).

[22] 2016 WL 6277496, at \*5 (N.D. Ill. Oct. 27, 2016).

[23] 2016 WL 6395409, at \*2 (N.D. Ill. Oct. 28, 2016)

[24] See Adams Arms, LLC v. Unified Weapon Sys., Inc., No. 8:16-CV-1503-T-33AEP, 2016 WL 5391394, at \*7 (M.D. Fla. Sept. 27, 2016) (denying the motion to dismiss but limiting the DTSA claim to disclosures of trade secrets after the effective date of the DTSA); Dazzle Software II, LLC v. Kinney, No. 16-CV-12191, 2016 WL 6248906 (E.D. Mich. Aug. 22, 2016) (dismissing a DTSA claim with leave to re-plead and include allegations of conduct post-dating the effective date of the DTSA).

[25] 2016 WL 5391394, at \*7.

[26] 2016 WL 3212457 (N.D. Cal. June 10, 2016) (granting a TRO); see also Henry Schein, Inc. v. Cook, No. 16-CV-03166-JST, 2016 WL 3418537 (N.D. Cal. June 22, 2016) (granting a preliminary injunction but with more limits than the initial TRO).

[27] See, e.g., Phyllis Schlafly Revocable Trust v. Cori, No. 4:16CV01631 JAR, 2016 WL 6611133, at \*2-3 (E.D. Mo. Nov. 9, 2016) (“The elements of Plaintiffs’ trade secret misappropriation claims under the DTSA and M[issouri ]UTSA are essentially the same.”); Earthbound Corp. v. MiTek USA, Inc., No. C16-1150 RSM, 2016 WL 4418013, at \*10 (W.D. Wash. Aug. 19, 2016) (considering the likelihood of success under the DTSA and the Washington Uniform Trade Secrets Act simultaneously); Panera, LLC v. Nettles, No. 4:16-CV-1181-JAR, 2016 WL 4124114, at \*4 (E.D. Mo. Aug. 3, 2016) (“Although the Court’s analysis has focused on Panera’s Missouri trade secrets claim, an analysis under the Defend Trade Secrets Act would likely reach a similar conclusion.”); GTO Access Sys., LLC v. Ghost Controls, LLC, No. 4:16CV355-WS/CAS, 2016 WL 4059706 (N.D. Fla. June 20, 2016), report and recommendation adopted, No. 4:16CV355-WS/CAS, 2016 WL 4059676 (N.D. Fla. July 27, 2016) (considering together alleged trade secret violations under the DTSA and Florida Uniform Trade Secrets Act).

[28] 2016 WL 7034976 (D. Colo. Dec. 2, 2016).

[29] *Id.* at \*11-12.