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Top 10 Trade Secret Developments Of 2013: Part 2

Law360, New York (January 23, 2014, 12:59 PM ET) -- The year 2013 brought significant developments in trade secret law, both in the U.S. and abroad. In-house counsel and private practitioners should consider trends that promise to shape further developments in the years ahead.

In part 1 of this two-part series, we highlighted five in particular: (1) expanding federal power being brought to bear on trade secret law; (2) Europe's progress toward a uniform framework for trade secret protection (3) the U.S. International Trade Commission's authority to protect U.S. companies from foreign acts of misappropriation; (4) Taiwan's crackdown on trade secret misappropriation by foreign countries such as South Korea and China; and (5) the continuing disagreement among U.S. courts regarding the Uniform Trade Secret Act's preemption of claims for misappropriation of confidential information that does not rise to the level of a trade secret.

In part 2, we highlight five more: (1) continuing litigation over social media accounts; (2) a lack of uniformity in the tests for "bad faith" under the Uniform Trade Secrets Act; (3) the unwillingness of some courts to recognize inevitable disclosure as a standalone cause of action; (4) the risk of drafting overly broad confidentiality agreements; and (5) the risk or promise of large damages awards in trade secret cases.

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

6. For Employers, Lengthy Litigation Over Employees' Social Media Accounts

Social media continues to be a hot topic, as employers tangle with former employees over the ownership of social media accounts. One case, filed in 2011, involved an employee who created a Twitter account to promote company services that eventually reached approximately 17,000 followers.[1] After being fired, the employee changed the Twitter handle and continued to use the account despite the company's protests. The parties eventually settled in January 2013, although the employee reportedly was able to keep the disputed account.

Another recent case involved a contentious and protracted lawsuit over a former employee's LinkedIn account.[2] The employee sued after the company locked her out of the LinkedIn account and changed the contact information to that of her replacement. In April 2013, after more than a year of litigation, the court held the company liable on three of the employee's state-law claims, although it awarded zero damages due to the employee's legally insufficient damages theories. Interestingly, the court specifically noted the lack of any policy informing employees that the company owned their LinkedIn accounts. Had such a written agreement existed, the company might have avoided a lengthy and expensive litigation battle in the first place.

Takeaway

Companies using social media accounts for marketing purposes should draft written policies unambiguously defining the ownership and control of the social media accounts employees use for business purposes.

7. Nonuniform Tests for "Bad Faith" Under the Uniform Trade Secrets Act

The Uniform Trade Secrets Act — and most of the states adopting it — permit a court to award attorney's fees when the plaintiff brings a misappropriation claim "in bad faith." Courts have offered competing tests for conduct constituting the "bad faith" necessary to support a fee award.

A state appellate court in Pennsylvania recently analyzed and rejected one such test — but offered little clarity on an appropriate test to replace it.[3] The case arose after two neighbors contracted to sell flagstone art — that is, images transferred onto pieces of flagstone — with one couple paying commissions to use the other couple's transfer process. After the recipient couple stopped paying commissions but continued using the process to make and sell flagstone art, the other couple sued for trade secret misappropriation. The trial court denied injunctive relief, holding that the process was in the public domain.

Undeterred, the plaintiffs refiled the complaint, again alleging trade secret misappropriation, and the defendants sought attorney's fees for a misappropriation claim "made in bad faith." The plaintiffs eventually withdrew the trade secret claim but prevailed on a separate claim, and the trial court rejected defendants' request for attorney's fees.

The Pennsylvania Superior Court reversed the trial court's denial of attorney's fees. It noted that both parties and the trial court analyzed "bad faith" under a two-part test adopted in California state courts and in multiple federal district courts, including the Western District of Pennsylvania: "(1) the objective speciousness of the claim and (2) subjective misconduct by the plaintiff in making the claim."[4]

But it also recognized that a majority of other state courts had not adopted a uniform test, instead analyzing claims of "bad faith" under pre-existing tests drawn from their state's law. The court declined to adopt the two-part test, but it also offered no test to replace it. And because the parties and the trial court relied on the rejected test, the court concluded that the trial court had abused its discretion in denying attorney's fees.

Takeaway

Attorney's fees may be available to a party facing a trade secret misappropriation "made in bad faith." But that party must first identify the proper test to be used — and recognize that the two-part test popular in federal district courts may not suffice in state courts.

8. Limiting Inevitable Disclosure

In August 2013, the U.S. District Court for the Southern District of New York reaffirmed New York's hostility toward the inevitable disclosure doctrine. In Janus et Cie v. Kahnke, the plaintiff bought suit against a former employee, who took a "very similar position" at Janus' competitor.[5] Of particular concern to the plaintiff was a customized account management system that Kahnke created, which

contained key customer information, as well as financial, marketing, and new product information.

The principal question in Janus was whether an injunction or claim could lie if there was an allegation of "inevitable disclosure" but no allegation of wrongdoing. Answering decisively in the negative, the court explained that Janus had made "the extraordinary request that the Court be the first to recognize the inevitable disclosure of trade secrets as a stand-alone claim in a complaint bereft of any allegations that Kahnke misappropriated trade secrets or breached a non-compete agreement."[6]

Explaining that "[d]isovery here would be a fishing expedition through a competitor's files," the court dismissed Janus' complaint in its entirety and held that application of the inevitable disclosure doctrine under New York law is limited to "instances where there is evidence of actual misappropriation of trade secrets, or where plaintiff asserts a claim for breach of a non-compete agreement."[7] The Janus court also reaffirmed the position of New York courts that inevitable disclosure is a theory applicable only to preliminary injunctive relief — not a standalone cause of action.

In a similar case, the Georgia Supreme Court held that the inevitable disclosure doctrine "is not a[n] independent claim under which a trial court may enjoin an employee from working for an employer or disclosing trade secrets."[8] The court in Holton v. Physician Oncology Services LP recognized that courts in other jurisdictions, such as the Seventh Circuit, have held that a plaintiff may base a trade secret misappropriation claim on inevitable disclosure, but it declined to follow those cases.[9]

The court also declined to address whether the inevitable disclosure doctrine could be used to support a claim for misappropriation of trade secrets and remanded to the trial court for consideration of the plaintiff's claims of actual or threatened misappropriation. Thus, while it is clear that inevitable disclosure is not a standalone claim in Georgia, the status of the doctrine — as a theory — remains unclear.

Takeaway

In some states, the mere inference — or likelihood — of use or disclosure will not support a claim for trade secret misappropriation, absent other allegations of misconduct or breach of contractual obligations.

9. Drafting Reasonable Confidentiality Agreements

Drafters of employee confidentiality agreements should take careful note of a New Jersey appellate court decision from September 2013. In UCB Mfg. Inc. v. Tris Pharma Inc., the court, applying New York law, held that a confidentiality agreement was unenforceable because it was overly restrictive in time and scope, did not further a legitimate business interest, was contrary to established public policy, and was unduly burdensome on the plaintiff's former employee.[10]

The case began when the plaintiff pharmaceutical company's lead cough syrup formulator, Tu-Hsuing Tu, left the company and joined a direct competitor, Tris Pharma. After hiring Tu, Tris released the first generic version of one of UCB's profitable cough syrups and immediately captured 70 percent of the relevant product market. UCB sued Tu and Tris for misappropriation of trade secrets, breach of Tu's confidentiality agreement with UCB, and unfair competition. Tu's confidentiality agreement with UCB required that he not disclose "secret or confidential information," which it defined very broadly with a long, nonexhaustive list of examples.[11]

Noting that New York law is "highly restrictive" as applied to confidentiality and other anti-competitive agreements, the court held that Tu's confidentiality agreement was unenforceable because it was overbroad and did not protect a legitimate business interest of UCB[12] The court explained that the list of information to be protected was so exhaustive as to include "every phase of Tu's work experience" and that the agreement purported to restrain Tu for the remainder of his career.[13]

Because UCB voluntarily abandoned its trade secret claim, did not seek to protect confidential customer information (which is afforded greater protection under New York law), and did not show that Tu's services were truly special or unique, the court concluded that UCB had no legitimate business interest in protecting the allegedly disclosed information under New York law.

The court also noted that "much of the information alleged to be confidential is disclosed on the [product's] label and patent, or is susceptible to reverse engineering."[14] Finally, the court held that the confidentiality agreement was overly burdensome on Tu because its broad terms would render him a "virtual hostage[]" of his employer by prohibiting him from working in a field that was his specialty.[15] On these grounds, the court affirmed the grant of summary judgment in favor of defendants.

Takeaway

While it is tempting to define "confidential information" quite broadly in employment agreements, UCB serves as a cautionary tale against overzealous drafting. Drafters of confidentiality agreements should consider whether the agreements will effectively prevent specialized employees from continuing to work in their field for a new employer.

10. The Trend Continues: Large Trade Secret Awards Are Here to Stay

On July 22, 2013, the Minnesota Court of Appeals affirmed a $630 million arbitration award against Western Digital Corporation over allegations of trade secret misappropriation.[16] The suit arose when Sining Mao left hard-drive manufacturer Seagate to accept a position with its competitor, Western Digital, in 2006. Seagate sued Western Digital and Mao in district court seeking injunctive relief to prevent Mao's disclosure of trade secrets. The district court granted defendants' motion to compel arbitration pursuant to Mao's employment agreement with Western Digital.

In 2011, the arbitrator found that Mao had fabricated documents intended to prove that three of the trade secrets had been publicly disclosed and that there was "no question that Western Digital had to know of the fabrications."[17] As a sanction for defendants' misconduct, the arbitrator precluded "any evidence by Western Digital and Dr. Mao disputing the validity" or use of certain trade secrets in question and entered a judgment against defendants for misappropriation.

The arbitrator awarded damages of $525 million plus pre- and post-award interest of more than $109 million. Upon Seagate's motion to confirm the arbitration award, however, the Minnesota district court reversed the arbitrator's decision, finding that the arbitrator failed to fully consider Western Digital's defenses.

Reversing the district court and remanding for entry of an order confirming the arbitration award, the Minnesota Court of Appeals explained in July that "[t]he district court erred by determining that the arbitrator did not have authority to impose sanctions."[18] The court of appeals also stated that the district court should not have reviewed the merits of the arbitration decision.

This is the third-largest trade-secret award on record.

Takeaway

Private practitioners and in-house counsel should be mindful of potential liability given the trend toward massive trade secret awards.

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[1] PhoneDog v. Kravitz, No. C 11-03474, 2011 U.S. Dist. LEXIS 129229 (N.D. Cal. Nov. 8, 2011).

[2] Eagle v. Morgan, No. 2:11 Civ. 4303, 2013 US Dist LEXIS 34220 (E.D. Penn. March 12, 2013).

[3] Krafft v. Downey, No. 476 WDA 2012, 2013 Pa. Super. LEXIS 734 (Pa. Super. Ct. May 17, 2013).

[4] Id. at *19-20.

[5] 2013 U.S. Dist. LEXIS 129686 (S.D.N.Y. Aug. 29, 2013)

[6] Id.at 6.

[7] Id. at 11.

[8] Holton v. Physician Oncology Services, 2013 Ga. LEXIS 414 (GA May 6, 2013).

[8] Id. at *3 (citing Pepsico Inc. v. Redmond, 54 F.3d 1262, 1269 (7th Cir. 1995)).

[10] 2013 N.J. Super. Unpub. LEXIS 2126 (N.J. Super. Aug. 27, 2013).

[11] Id. at *7.

[12] Id. at *22.

[13] Id.

[14] Id. at 24.

[15] Id. at *27.

[16] Seagate Tech. LLC v. Western Digital Corp., 834 N.W.2d 555 (Minn. App. 2013).

[17] Id. at 558.

[18] Id. at 560.
