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Considerations When Invoking The Recently Enacted DTSA

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President Barack Obama signed the Defend Trade Secrets Act of 2016 into law on May 11, 2016. Prior to its enactment, many questioned its need: the Uniform Trade Secrets Act had been adopted in every state except New York and Massachusetts, and had served its purposes well.[1] Others criticized certain provisions of the proposed legislation, especially the availability of an ex parte seizure of property.[2] However, the DTSA is now law, and it is time to consider how the statute as enacted affects a trade secret owner's litigation decisions.

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The act's most important feature is the creation of a federal civil cause of action for trade secret misappropriation. See 18 U.S.C. § 1836(b)(1), (c). Because the DTSA does not preempt state laws, see 18 U.S.C. § 1836(f),[3] a plaintiff suing for misappropriation now has the option of (1) bringing both federal and state claims in federal court (invoking the court's supplemental jurisdiction on the state claims); (2) bringing state claims (or state and federal claims) in state court; or (3) filing parallel actions. Moreover, because the DTSA was enacted in part as a result of threats from international economic espionage, the legislation expressly reaches the foreign conduct of U.S. corporations.

The new law, therefore, addresses both misappropriation by insiders (typically departing employees who violate a contractual business relationship) and misappropriation by outsiders (competitors or others stealing business secrets and intelligence, often through cyber-misappropriation).

The DTSA plainly benefits plaintiffs. The DTSA does not require a plaintiff to identify with particularity, prior to discovery, the disputed trade secrets, a significant advantage to companies claiming misappropriation but reluctant to disclose at the commencement of litigation the trade secrets that were allegedly misappropriated.[4] Further, the statute adds theft of trade secrets to the definition of racketeering activity under the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. § 1961(1)(b).

Companies that sue under the act have a number of available remedies, including traditional injunctive relief; the recovery of both actual damages and the defendant's unjust enrichment (so long as the latter is not used to calculate the former), or, in the alternative, a reasonable royalty; exemplary damages when the trade secrets have been “willfully and maliciously” misappropriated; and attorneys’ fees. See 18 U.S.C. § 1836(b)(3). Note, however, that an employer cannot recover exemplary damages or attorney fees without notice to employees of their whistleblower rights under the DTSA.[5]

In a somewhat controversial provision, the DTSA also allows a plaintiff to seek an ex parte seizure of property. Ex parte seizures, however, may only be granted in “extraordinary circumstances,” 18 U.S.C. § 1836(b)(2)(A)(i), based on “specific facts” justifying the seizure, id. § 1836(b)(2)(A)(ii), and “describ[ing] with reasonable particularity the matter to be seized,” id. § 1836(b)(2)(A)(ii)(VI). The applicant must demonstrate, among other things, that a mere injunction against disclosure or use of the information would be insufficient, because “the party to which the order would be issued would evade, avoid or otherwise not comply with such an order.” Id. § 1836(b)(2)(A)(ii)(I).

Perhaps most importantly, the definition of the term “trade secret,” borrowed from the Economic Espionage Act (EEA), is expansive.[6] To qualify as a trade secret for purposes of the DTSA, the information must satisfy two statutory conditions: (1) the owner must have taken “reasonable measures to keep such information secret”; and (2) the information must “deriv[e] independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable through proper means by, another person who can obtain economic value from the disclosure or use of the information.” 18 U.S.C. § 1389 (3) (A), (B). This is a marked difference from the threshold for protection under some state trade-secret laws.

For example, both Massachusetts and New York have adopted a multifactor balancing test, and require the “continuous use” of a trade secret. See J.T. Healy & Son Inc. v. James A. Murphy & Son Inc., 260 N.E.2d 723, 729 (Mass. 1970); Ashland Management Inc. v. Janien, 624 N.E.2d 1007, 1013 (N.Y. 1993).

Nonetheless, there are important threshold matters to consider before invoking the DTSA. Unlike most state trade secret statutes, a lawsuit may be brought only by the “owners” of trade secrets. [7] The term “owner” is not defined in the statute. While federal trade secret law elsewhere broadly defines the term, [8] the definition of the term “owner” for purposes of the DTSA remains to be developed through the case law.

In addition, the act applies only to trade secrets related to products or services “used in, or intended for use in, interstate or foreign commerce.” 18 U.S.C. § 1836(b)(1). If a product or service is only available in intrastate commerce, the statute may not confer jurisdiction.

Finally, a private action under the DTSA must be commenced within three years after the misappropriation was discovered, or by the exercise of reasonable diligence should have been discovered. Id. § 1836(d). [9]

Plaintiffs should be aware that, insofar as injunctive relief is at issue, the DTSA will not provide a means of circumventing unfavorable state law. Under the DTSA, an injunction is barred when applicable state law “prohibit[s] restraints on the practice of a lawful profession, trade or business”; and when the injunction would limit employment based “merely on the information the person knows.”[10] Equitable relief, accordingly, will be influenced by state law. Some state laws broadly reject restraints on employment. In California, Cal. Bus. & Prof. Code § 16600 unequivocally provides that: “[E]very contract by which anyone is restrained from engaging in a lawful profession, trade or business of any kind is to that extent void.”

The DTSA also does not adopt the “inevitable disclosure doctrine,” at least in the context of equitable relief. See 18 U.S.C. § 1836(b)(3)(A)(i)(I). Under that doctrine, a plaintiff may prove trade secret misappropriation by demonstrating that a “defendant’s new employment will inevitably lead [the defendant] to rely on the plaintiff’s trade secrets.”[11] The doctrine has been rejected in some states,[12] accepted in some,[13] and there are states, such as New York, where its status is not clear.[14] See generally Ryan M. Wiesner, Comment, A State-by-State Analysis of Inevitable Disclosure: A Need for Uniformity and a Workable Standard, 16 Marq. Intell. Prop. L. Rev. 211 (2012). In states recognizing inevitable disclosure, it can be helpful in establishing a defendant‘s trade secret liability and plaintiff’s entitlement to injunctive relief.

The DTSA, therefore, will aid U.S. companies seeking to protect their trade secrets from misappropriation. However, because trade secret law has generally been developed through common law rulings, there is little current federal trade secret jurisprudence outside the criminal provisions of the EEA. Developing such a body of law will take time, and federal courts will likely look to state law for guidance.

In the meantime, companies should review their confidentiality, nondisclosure and intellectual property agreements — with a particular focus on the forum selection clause, and the new whistleblower immunity notice requirement discussed above — and assess how the new legislation can help them, should litigation occur. Whether a company relies on federal or state law (or both) will depend on a number of factors, including the favorability of state law, the need for nationwide subpoena power, and discovery options. Those with a need for the ex parte seizure provisions, with complex litigation that involves multiple states or crosses international boundaries, likely will choose the federal forum. On the other hand, the availability of well-established state law, and favorable state statutes of limitations, may favor state causes of action.

Most plaintiffs, no doubt, will combine federal and state claims in one federal court action, as the plaintiff recently did in Henry Schein Inc. v. Cook, No. 16-cv-03166 (JST), ___F. Supp. 3d ___, 2016 (N.D. Cal. June 10, 2016), the first decision in which the new federal statute was cited. In Schein, the employer alleged that a former employee took confidential customer information with him to a competitor. The complaint filed in federal district court included a federal claim for misappropriation of trade secrets under the DTSA, as well as seven state law counts, including claims under the California Uniform Trade Secrets Act, the California Unfair Competition Law, and state law governing breach of contract. The court found jurisdiction under the DTSA, 28 U.S.C. §1331 (federal question), and 28 U.S.C. § 1367 (supplemental jurisdiction over the state law claims). The court also granted, in part, an ex parte application for a temporary restraining order. (Ex parte relief under the DTSA was not sought).

Schein was a federal court action. Companies should be aware, however, that when a DTSA cause of action is joined with state claims in state court, the defendant will consider removing the case to federal court, pursuant to 28 U.S.C. § 1446(b)(3). Removal may, or may not, be in a plaintiff’s interest. Further, the DTSA, which does not preempt state law claims, applies “with respect to any misappropriation of a trade secret ... for which any act occurs on or after the date of enactment of this act.” This means that a company considering amending its currently pending state court complaint, to add the new federal cause of action, should consider that the federal claim will give the defendant the option of removal to what may be, from the plaintiff’s standpoint, a less favorable forum.

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[1] See Christopher B. Seaman, The Case Against Federalizing Trade Secrecy, 101 Va. L. Rev. 317 (2015).

[2] See Eric Goldman, Ex Parte Seizures and the Defend Trade Secrets Act, 72 Wash. & Lee L. Rev. Online 284 (2015).

[3] State trade secret statutes that preempt state common law claims remain enforceable. The Connecticut Uniform Trade Secrets Act, Conn. Gen. Stat. § 35-57(a), for example, provides that unless otherwise agreed by the parties, the statute preempts tort and restitutionary claims as well as “other law of this state pertaining to civil liability for misappropriation of a trade secret.” The California Uniform Trade Secrets Act preempts causes of action “based on the same nucleus of facts as trade secret misappropriation.” K.C. Multimedia Inc. v. Bank of America Tech. & Operations Inc., 90 Cal. Rptr. 3d 247, 264 (Ct. App. 2009). The law is unsettled, however, as to how the nucleus of facts test is to be applied. Compare Silvaco Data Systems v. Intel Corp., 109 Cal. Rptr. 3d 27, 48-49 (Ct. App. 2010), disapproved on other grounds by Kwikset Corp. v. Superior Court, 51 Cal. 4th 310 (2011) (CUTSA preempts claims based on proprietary or confidential information that do not rise to the level of trade secrets as defined by the statute), with Leatt Corp. v. Innovative Safety Tech. LLC, No. 09-cv-1301-IEG (POR), 2010 WL 2803947, at *6 (S.D. Cal. July 15, 2010) (claim remains viable if it alleges something more than trade secret misappropriation), and Angelica Textile Services Inc. v. Park, 163 Cal. Rptr. 3d 192, 203 (Ct. App. 2013) (no preemption unless the claim is based on the taking of information that ultimately is determined by the court to be a trade secret, an issue that usually cannot be resolved on a motion to dismiss).

[4] In California, for example, plaintiffs bringing a trade secret misappropriation action are required to identify the allegedly stolen trade secrets with “reasonable particularity” before discovery commences. Cal. Civ. Proc. Code § 2019.210. See Loop AI Labs Inc. v. Gatti, No. 15-cv-00798-HSG (DMR), __F.3d__, 2016 WL 3654378, at *2 (N.D. Cal. July 6, 2016) (plaintiff must “identify or designate the trade secrets at issue with ‘sufficient particularity’ to limit the permissible scope of discovery.”). The requirement “prevents plaintiffs from using the discovery process as a means to obtain the defendant’s trade secrets.” Id. at *3 (internal quotation marks omitted). As one court has observed, this provision of California law favors defendants. See Perlan Therapeutics Inc. v. Super. Ct., 101 Cal Rptr. 3d 211, 228-29 (Ct. App. 2009).

[5] The act grants immunity from civil and criminal liability (under both federal and state law) to employees (defined as including consultants and independent contractors) who make a confidential disclosure of a trade secret, whether directly or indirectly, to a government official or a private lawyer solely for the purpose of reporting or investigating a suspected violation of law. The DTSA requires employers to provide notice of the statutory immunity in any contract or agreement with an employee (or consultant or independent contractor) that governs the use of a trade secret or other confidential information. The notice requirement applies to all relevant contracts entered into, or updated, on or after May 12, 2016. See 18 U.S.C. § 1833(b)(3)(A).

[6] The term “trade secret” includes “all forms and types of financial, business, scientific, technical,

economic or engineering information, including patterns, plans, compilations, program devices, formulas, designs, prototypes, methods, techniques, processes, procedures, programs or codes, whether tangible or intangible, and whether or how stored, compiled or memorialized physically, electronically, graphically, photographically or in writing.” 18 U.S.C. § 1839(3) (2016).

[7] See DTM Research LLC v. AT&T Corp., 245 F.3d 327, 332-33 (4th Cir. 2001) (“[F]ee simple ownership in its traditional sense is not an element of a trade secrets misappropriation claim in Maryland.”); Jasmine Networks Inc. v. Superior Court, 103 Cal. Rptr. 3d 426, 429 (Ct. App. 2009) (“Despite the impressive efforts by Marvell’s counsel to conjure up a ‘current ownership rule,’ we find no support for such a rule in the text of the CUTSA, cases applying it, or legislative history.”).

[8] See 18 U.S.C. § 1839(4) (defining “owner” as including “the person or entity in whom or in which rightful legal or equitable title to, or license in, the trade secret is reposed.”).

[9] Section 6 of the UTSA provides a three-year statute of limitations, with a discovery rule, but many states have adopted different limitations periods. See, e.g., Me. Rev. Stat. Ann. tit. 10, § 1547 (2016) (five-year limitations period); Official Code of Ga. Ann. §10-1-766 (2016) (five years); Ohio Rev. Code § 1333.66 (2016) (four years); Ala. Code § 8-27-5 (2016) (two years). While the states are split on whether trade secret misappropriation constitutes a continuing tort, allowing the limitations period to commence each time the trade secret is used, the DTSA provides that a continuing misappropriation constitutes a single misappropriation claim. 18 U.S.C. § 1836(d).

[10] 18 U.S.C. § 1836(b)(3)(A)(i)(I), (II).

[11] PepsiCo. Inc. v. Redmond, 54 F.3d 1262, 1269 (7th Cir. 1995).

[12] The doctrine has been rejected in states such as California, Maryland, Virginia and Louisiana. See Les Concierges Inc. v. Robeson, No. C-09-1510 MMC, 2009 WL 1138561 (N.D. Cal. April 27, 2009) (applying California law); LeJeune v. Coin Acceptors Inc., 849 A.2d 451 (Md. 2004); Gov. Tech. Servs. Inc. v. Intellisys Tech. Corp., 51 Va. Cir. 55 (1999); Tubular Threading Inc. v. Scandaliato, 443 So. 2d 712, 715 (La. Ct. App. 1983).

[13] The doctrine has been recognized in several states, including Arkansas, Delaware, Illinois, Utah, North Carolina, Connecticut, New Jersey and Washington. See, e.g., Cardinal Freight Carriers Inc. v. J.B. Hunt Transportation Services Inc., 987 S.W.2d 642, 646 (Ark. 1999); E.I. duPont de Nemours & Co. v. Am. Potash & Chem. Corp., 200 A.2d 428, 431 (Del. Ch. 1964); Strata Mktg. Inc. v. Murphy, 740 N.E. 2d 1166 (Ill. App. Ct. 2000); Nat’l Starch & Chem. Corp. v. Parker Chem. Corp., 530 A.2d 31 (N.J. Super. Ct. App. Div. 1987) (per curiam); Aetna Retirement Services Inc. v. Hug, No. CV9704799745, 1997 WL 396212, at *10 (Conn. Super. Ct. June 18, 1997); Novell Inc. v. Timpanogos Research Grp. Inc., 46 U.S.P.Q.2d (BNA) 1197, 1215 (Utah Dist. Ct. Jan. 30, 1998); Solutec Corp. v. Agnew, 88 Wash. App. 1067 (1997).

[14] See EarthWeb Inc. v. Schlack, 71 F. Supp. 2d 299, 310 (S.D.N.Y. 1999) (“[T]he inevitable disclosure doctrine treads an exceedingly narrow path through judicially disfavored territory. Absent evidence of actual misappropriation by an employee, the doctrine should be applied in only the rarest of cases.”); Janus et Cie v. Kahnke, No.12 Civ. 7201(WHP), 2013 WL 5405543, at *2 (S.D.N.Y. Aug. 29, 2013) (holding 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 the plaintiff asserts a claim for breach of a non-compete agreement.”).