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PRESIDENT SIGNS “DEFEND TRADE SECRETS ACT OF 2016”: FEDERAL JURISDICTION FOR TRADE SECRET ACTIONS

Introduction. For many years, litigants have had original federal court jurisdiction for Patent, Trademark and Copyright cases, but the fourth major area of Intellectual Property law — Trade Secrets — has been governed by state law with no federal court jurisdiction. No longer. On May 11, 2016, President Obama signed the “Defend Trade Secrets Act of 2016” to “provide a single, national standard for trade secret misappropriation with clear rules and predictability” in federal court. The new law can be found at 18 USC §§ 1836 and 1839. Now trade secret holders have their choice of either state law or federal forums for filing their claims, and those threatened with a trade secret claim have the option of filing a preemptive declaratory judgment case in federal court.

Background. Claims for trade secret theft originally developed from common law cases and Restatement pronouncements in the area of torts and unfair competition. The ABA approved the Uniform Trade Secret Act (“UTSA”) in 1979, and currently 46 states have adopted all or substantially all of the UTSA, providing for state court jurisdiction for trade secret theft. Alabama and North Carolina have adopted some of the USTA language, while Massachusetts and New York follow either the Restatements or common law.

In adopting the uniform act, many states made material changes to their own UTSA. For example, in California the legislature adopted certain pleading rules for identification of trade secrets prior to obtaining discovery (CCP § 2019.210). California also determined that certain elements of the trade secret claim which under the UTSA would have to be established by the plaintiff, instead would be affirmative defenses on which the defendant has the burden of proof. The result, according to the sense of Congress and some practitioners, was a patchwork of differing state laws and a lack of uniformity in the elements and enforcement of the actions.

Congress passed the Defend Trade Secrets Act (“DTSA”) in part to recognize the importance of trade secrets to the United States business community and economy, and to address the fact that trade secret theft has become increasingly common across the United States and around the world. The DTSA now provides a standardized claim, in federal court, to address trade secret theft. And while based in large part on UTSA substantive provisions previously enacted by the states, the DTSA provides an important new seizure remedy for trade secret holders and a declaratory judgment right for those accused of trade secret theft. The new act also raises many questions which will have to be addressed by the federal courts.

Critical Points. Here are the key points to know regarding the DTSA:

- Substantive Similarities with the UTSA. The underlying elements of this new federal cause of action follow the UTSA. For example, the DTSA repeats the key definitions of “misappropriation” and “improper means” from the UTSA but provides a broader definition of “trade secret.” The Remedies section of the DTSA borrows heavily from the UTSA, providing for a “reasonable” injunction or in exceptional circumstances a reasonable royalty “for no longer than the period of time for which such use could have been prohibited” — hence referencing the trade secret “head start” concept from state law jurisprudence. Monetary awards are available in the form of actual loss to the plaintiff, unjust enrichment to the defendant, or a reasonable royalty. Finally, as with the UTSA, the DTSA provides for exemplary damages of up to two times the compensatory award and attorneys’ fees in the event of willful and malicious misappropriation. The DTSA applies to misappropriation occurring after the enactment, with the same three year statute of limitations as the UTSA.

Thus, other than reconciling the differences in the various states’ enactments and as noted below, the DTSA should not result in significant changes to the substantive law of trade secrets. We would assume that while they build their own body of case law, the federal district and circuit courts will initially follow and adopt persuasive decisions from the state courts where the same or similar trade secret elements or concepts are construed or involved.

- Civil Seizures. In a key difference from the UTSA, the DTSA provides for an elaborate Civil Seizure procedure, including “in extraordinary circumstances,” *ex parte* applications for seizure of property by federal law enforcement officials where it can be established that the defendant “would destroy, move, [or] hide” the property if given notice. A seizure order will only be granted if the applicant can show a likelihood of success on the merits of the trade secret claim, similar to the injunctive standard under Rule 65. Any property seized under this procedure shall be taken into custody by the court, with no access provided to either the plaintiff or the defendant, and a hearing on the seizure shall be held within seven days. The plaintiff will be required to post security for the seizure and will be liable for damages, not limited to the amount of the security, for wrongful seizure. The court may also appoint an independent special master to examine and isolate the alleged trade secrets, facilitating the return of excessively seized property.

This seizure section appears to be one of Congress’ prime motivations for passing the DTSA: providing a speedy and powerful federally sanctioned remedy to immediately stop further theft and distribution of trade secrets in the United States and beyond — even without notice. Note that under California law, *ex parte* temporary restraining orders are available in trade secret cases under Code of Civil Procedure Section 527 where facts can be established that requiring notice would result in irreparable injury. But the specific trade secret seizure procedure provided by the DTSA — under the authority of a federal marshal and the court — provides an especially dramatic and sweeping tool, particularly when facing imminent foreign espionage and theft. Indeed, the DTSA requires the Attorney General to report to Congress about the “scope and breadth of the theft of trade secrets of United States companies occurring outside of the United States” and the extent of involvement by foreign governments, instrumentalities and agents.

- No Inevitable Disclosure. Critically, the DTSA appears to prohibit application of the “inevitable disclosure doctrine” to these federal trade secret claims. Many of the UTSA state courts have adopted law allowing a plaintiff seeking an injunction to avoid having to establish actual or threatened misappropriation of trade secrets where it appears that a former employee will “inevitably” use his or her former employer’s trade secrets in a new job. These cases normally involve former employees working in the same field or technology on a competitive product where it can be established that the employee should not be trusted. An inevitable disclosure injunction will normally prevent the former employee from working on the competitive product for the time necessary to protect the trade secrets. A majority of the UTSA states have adopted the inevitable disclosure doctrine in some form although California, Virginia and Florida have rejected it.

In the Senate’s consideration of the DTSA, Senator Dianne Feinstein added a provision to the bill that precludes an injunction which prevents “a person from entering into an employment relationship” based on “the information the person knows” as opposed to actual or threatened misappropriation. The DTSA also prohibits injunctions that conflict with state law restraints on profession, trade or business, such as California’s Business & Professions Code Section 16600. In other words, the inevitable disclosure doctrine should not be available under the DTSA as a substitute for proof of actual or threatened misappropriation.

- No Preemption of UTSA Claims; Dual Claims/Forums for Trade Secrets. The DTSA does not preempt the states’ enactments of trade secret laws under the UTSA or otherwise. Thus, an aggrieved trade secret holder will be able to choose its forum: filing a UTSA claim in state court or a DTSA claim in federal court, perhaps with an alternative state law count. In a standard trade secret case not involving foreign theft or the extraordinary need for immediate seizure, we believe that most trade secret holders will continue to opt for filing in state court. Normally, injunctive relief is more readily available in state court, and these courts may offer the advantages of faster calendars, simpler procedural and pretrial rules, and non-unanimous juries. Federal judges are also more likely to grant motions to dismiss and motions for summary judgment. These differences may make a state court trade secret forum more attractive, especially where immediate civil seizure is not required.

- Declaratory Judgment Action. In one of its most important — and largely overlooked — benefits, by establishing a federal cause of action for trade secret misappropriation, the DTSA may provide grounds for a person or company threatened with a trade secret suit to immediately file a declaratory judgment action in federal court. Pursuant to the Declaratory Judgment Act, “In a case of actual controversy within its jurisdiction ... any court in the United States ... may declare the rights and other legal relations of any interested party seeking such declaration ...” 28 U.S.C. § 2201(a). While declaratory judgment actions are common in patent and trademark litigation — especially after the Supreme Court eased the threshold to include any case with a “substantial controversy ... of sufficient immediacy and reality” in *MedImmune, Inc. v. Genentech, Inc.*, 549 U.S. 118,127 (2007) — the DTSA now provides a declaratory judgment path for potential trade secret defendants to initiate a federal action in their choice of forum.

While trade secret holders may opt to continue to file cases in more lenient state courts, a former employee or its new employer, threatened with a trade secret claim may now elect to file a preemptive suit in its local federal court under the DTSA. For example, if the former employer is from a jurisdiction which adheres to the inevitable disclosure doctrine, on receipt of a demand letter a former employee and/or its new company may choose to immediately file a case in federal court under the DTSA. The decision to start litigation and bring an immediate DJ action is always difficult, and competing venue motions often will be fought. But when faced with an imminent state court UTSA claim, the prospect of curtailing the application of the inevitable disclosure doctrine or other state court theories and/or securing a local federal court makes the DTSA a powerful weapon.

- Preemption of Alternative Civil Claims? Federal judges will have to grapple with many of the same issues that state courts have had to consider and are still considering. The UTSA provides for preemption of tort or other non-contractual civil remedies for misappropriation of trade secrets (UTSA § 7), although not all states have adopted these provisions. For example, in California, civil common law claims for unfair competition, interference, conversion, etc. are preempted if they arise out of the same facts as the claim for misappropriation of trade secrets. (*Silvaco Data Systems v. Intel Corp.*, 184 Cal.App.4th 210, 241 (2010).) Alternative claims for breach of contract, express civil statutory claims and criminal claims are not preempted.

The DTSA has no corollary to the UTSA preemption language. Existing law under 18 USC § 1838 to which the DTSA was appended expressly states that there will be no preemption of other civil remedies for misappropriation of trade secrets. Does this mean that in federal court a plaintiff could assert both a claim under the DTSA and these alternative common law claims, but could not assert these other claims in California state court? The better view may be that the state UTSA law preempts these alternative common law causes of action based on the same misappropriation facts regardless of the forum or whether a DTSA claim is brought.

- Identification of Trade Secrets? California and some federal courts have adopted strict pleading rules for identification of trade secrets prior to the plaintiff obtaining discovery. This requirement seeks to avoid “fishing expeditions” by a plaintiff who files suit but wishes to craft its definition of the trade secrets based on what discovery shows the defendant is doing. California and other courts require filing this disclosure under seal before discovery and before any injunctive relief may be considered or granted. (C.C.P. Section 2019.210.) The trade secrets must be disclosed with “particularity,” often leading to intense and prolonged battles at the beginning of the case as to the adequacy of the identification. Will these strict pleading requirements also be required in California federal courts construing the DTSA? Will they spread across the country? Significantly, the Senate Report accompanying the DTSA states that before granting *ex parte* seizures, courts will likely “require applicants to describe the trade secret . . . with sufficient particularity so that the court may evaluate the request.”

Conclusion. The newly enacted DTSA federalizes the last major area of Intellectual Property law: Trade Secrets. In the process, the act provides a powerful and swift Civil Seizure remedy, designed to counteract imminent domestic and international theft, distribution of trade secrets, and espionage. Absent such extraordinary circumstances, trade secret holders may prefer to rely on established UTSA state law and state courts for standard trade secret claims. But those threatened with a trade secret case in an unfriendly state law jurisdiction now have the important tool of bringing a preemptive declaratory judgment action under the DTSA in federal court.

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