Managing Intellectual Property™

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The Defend Trade Secrets Act: A Year Later

by **James Pooley**

The Defend Trade Secrets Act has been in effect for a year, with more than 300 complaints filed in that time. James Pooley looks back on how the law has performed and analyses which issues need to be clarified.

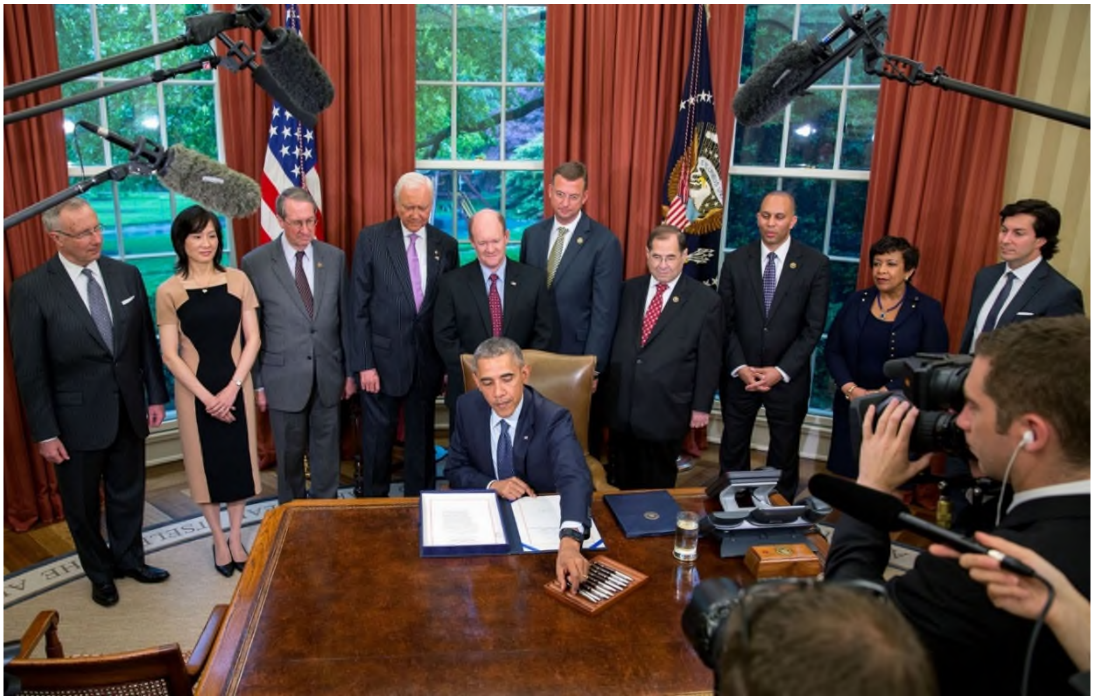
On May 11 2016 President Obama signed into law the Defend Trade Secrets Act (DTSA), capping several years of hearings and negotiations that eventually led to an almost-unanimous vote in Congress. The primary aim of the statute was to provide industry with the option of asserting civil claims for trade secret misappropriation in federal courts. Although trade secret law had traditionally been the province of the states, their varying rules and procedures were seen as increasingly mismatched to the needs of businesses that operate in the global, information-based economy. Allowing cases to be filed in federal court was expected to increase the effectiveness of protecting data assets.

The basic approach was to adopt the standard definitions and remedies provided in the Uniform Trade Secrets Act (UTSA), which since 1979 had been embraced (although with variations) by 47 of the 50 states. As a result, the new law also aligns very well with Article 39 of the 1995 Agreement on Trade-Related Aspects of Intellectual Property (TRIPS), which also was patterned on the UTSA. As with most legislative efforts, however, some special concerns led to the enactment of unique provisions.

1 MINUTE READ

The Defend Trade Secrets Act came into effect a year ago, for the first time giving trade secret holders the option of filing misappropriation claims in US federal courts. Its launch has been smooth, calming initial fears about potential abuse of its ex parte seizure provisions. The traditional state law system for enforcement remains intact, and is the preferred forum for localised disputes. But for cases involving actors at the national or international level the new platform provides clear advantages, and over 300 complaints have been filed. The DTSA's whistleblower protections may have been weakened by a court decision that refused to dismiss an action against a reporting employee. But in general there have been few surprises, with federal courts interpreting and applying the new law consistently. Major issues remain for clarification, chiefly the extent to which the DTSA will apply to acts of misappropriation occurring outside the US.

The most hotly debated of these was a procedure to permit ex parte applications for orders to seize items that contain a trade secret. In an environment where valuable data can be downloaded to a small device and taken across borders, industry wanted a quick remedy when evidence surfaced that such a theft was threatened. But adapting a process that has worked well in the context of counterfeit goods turned out to be awkward, since separating the improper from the legitimate is harder to do with information. In the end, Congress agreed on a number of strict requirements and limitations designed to prevent abuse, looking much like the restrictions which over the years have been placed on the use of Anton Piller orders.



President Obama signs the Defend Trade Secrets Act on May 11 2016

A second special feature was the creation of an exception for whistleblower disclosures, by granting immunity under state or federal trade secret law to any individual employee, contractor or consultant who reports in confidence to the authorities information about wrongdoing within an organization. This provision was animated by a lack of reliable protection under current laws, whose ambiguity tended to discourage reporting of crimes. But its focus on law enforcement stood in contrast to the near-simultaneous adoption by the EU of a much broader whistleblower exception in the Trade Secrets Directive.

Another change from the UTSA, reflecting a concern about labour mobility, places a limitation on what sort of injunctive relief judges can issue against departing employees. The so-called “inevitable disclosure doctrine,” under which an employee might be blocked from taking on an identical job for a direct competitor, was rejected. Instead, federal courts may place conditions on a new job – such as working in a different area of the company – but only based on evidence of the employee’s behaviour from which it can be inferred that the former employer’s secrets are at risk of misuse.

What can we observe from the first year’s experience with this new option for trade secret litigation? In general, the law appears to be performing as intended, although in some areas, such as whistleblower protections, it has been rough going. Ex parte seizures have not proved the scourge that critics feared. While federal filings are popular, state courts remain even more so, and probably for good reason. And some intriguing and impactful questions remain so far unanswered.

Take-up meets expectations

Since the DTSA came into effect there have been over 300 cases filed, with a few dozen rulings on early-stage issues. Because direct filing in federal court was not previously available, there are no comparative statistics. But most experienced practitioners observe that the take-up has been substantial, confirming the assumption that businesses would often choose federal protection if they had the choice. However, many more cases continue to be filed in state courts, where localised disputes – imagine an insurance agent moving across town to another brokerage, for example – are handled effectively.

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Indeed, the generally enthusiastic early adoption of the DTSA may not continue for the long term. Although cases involving actors and witnesses in other states or countries will usually benefit from a federal forum, due to common rules and nationwide service of process, federal courts are not always the best place for a plaintiff to file a trade secrets claim. In part this is because in the federal system a case is assigned to a single judge for the duration, so the judge tends to focus on early disposition. In contrast, most state court systems divide and distribute their work, and early motions tend to be resolved by one judge letting the case continue through to a trial before a different one.

Pleading the case

In trade secret cases, at the outset the plaintiff typically has more speculation than evidence about what has happened and the extent to which its information is in peril. Since the US has a tradition of very broad discovery rights, courts long ago settled into an approach for handling this information asymmetry by allowing cases to be filed based on a reasonable suspicion that misappropriation has occurred, with discovery left to fill in the gaps. When the DTSA was new, concern was expressed that federal courts might apply a "heightened pleading standard" required typically in cases of fraud. That fear has not played out, however, as the few courts where initial pleadings were challenged on that basis have rejected the argument and confirmed that a short statement of facts demonstrating a "plausible" theory of liability is enough.

In other ways, however, the tendency of federal courts to closely examine pleadings has shown up in the early DTSA decisions. In one case, a motion to dismiss was granted for failure expressly to plead that the trade secrets related to a product or process in interstate commerce, which is practically speaking a low bar but nevertheless a jurisdictional requirement under the statute. In another case, however, a judge dismissed a complaint for failure to plead in sufficient detail the basis for the plaintiff's assertion that it had made "reasonable efforts" to protect its secret information. While that is also a necessary element under state laws, most state courts have allowed plaintiffs to plead it with very little evidentiary support.

To date we have not seen the courts address in any comprehensive way the basic question of how trade secrets – which are the only IP right not described through a government registration process – are to be defined in litigation. Because the scope of discovery depends to a great extent on understanding exactly what is the subject matter of the dispute, we can probably expect this issue to emerge over time as a common subject for early case management.

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On one aspect of DTSA pleading there seems to be clear agreement: when a complaint alleges misappropriation that was complete before the statute became effective, the DTSA does not apply. However, if the complaint alleges new acts of misappropriation in the same transaction, the DTSA will apply to those acts, while the prior acts will be covered by relevant state law.

Ex parte seizures

While the legislation was pending before Congress, some opponents, primarily academics, expressed concern that the provisions for ex parte seizures would become “routine” and subject to abuse by powerful trade secret holders to extract unjustified settlements. In actual practice those fears have not been realised. Very few plaintiffs have even requested this extraordinary form of relief, and it has been granted publicly in only two cases, with another two reportedly under seal.

Indeed, because one requirement of the procedure is that “normal” injunctive relief provided under Federal Rule 65 is demonstrably insufficient, the effect seems to have been to focus attention of the courts on that process. It turns out that Rule 65 in practice is broader and more flexible than some had imagined. As some DTSA cases have shown, where the proof is strong, plaintiffs may be able to secure the functional equivalent of an ex parte seizure under pre-existing authority: judges can issue immediate orders to restrain misuse and disclosure, and even to require surrender of devices containing secrets.

Extraterritorial reach

Federal statutes are presumed to operate only within US territory unless it clearly appears that Congress intended otherwise. The DTSA legislation did not contain an express statement of extraterritorial effect. But anyone reading the bill as it was passed would probably conclude that Congress wanted it to apply to foreign misappropriation of domestic commercial secrets. The bill included a section on the “Sense of Congress” stating that “[t]rade secret theft occurs in the US and around the world, and, wherever it occurs, harms the companies that own the trade secrets and the employees of the companies.” Another section required regular agency reports on the “scope and breadth of the theft of trade secrets of US companies occurring outside of the US” and what can be done to “reduce the threat of and economic impact caused by” such foreign theft.

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As an alternative to considering those strong but indirect statements from Congress, courts might turn to a portion of the pre-existing Economic Espionage Act of 1996 (EEA), the federal criminal statute that was amended to allow for the provisions of the DTSA. The EEA includes a provision expressly declaring its extraterritorial effect, but only when an “act in furtherance of the offense” occurred in the US or the “offender” was a US citizen or permanent resident. Because these terms are normally used to apply only to criminal laws, one could argue that the section does not apply to civil claims, or that if it does the reach of the DTSA is similarly restricted by required connections to the US.

So far only one court has touched on the issue of extraterritorial effect of the DTSA, and it read the EEA provision as applying equally to the civil claim. However, it was a collateral issue in the case and did not receive close analysis. Given the prevalence of foreign misappropriation, coupled with the potentially more powerful remedies now available in federal court, we can expect this issue to be squarely addressed before long. Answering the question whether the DTSA applies fully, conditionally, or not at all to conduct outside the US could have a profound effect on cross-border litigation over trade secrets.

Employee mobility

The DTSA's limitation on judicial power to restrain departing employees from accepting a new position has so far received close attention in only one case, but with clear effect. An executive working for a defence contractor took a job with a competitor serving the same government agency. When his former employer sought an injunction that would prohibit his doing business for that agency, the court found that such a restriction in theory would not amount to an impermissible restraint on accepting employment. And although the DTSA also forbids injunctions in conflict with state law protecting labour mobility, the applicable state rule provided an exception when necessary to protect trade secrets. The court's order granting injunctive relief stands as an example of the DTSA's effective balance of legitimate, competing interests.

Relation to state laws

The vast majority of cases filed so far under the DTSA have coupled that claim with a parallel misappropriation claim under the law of the state in which the federal court sits. In some cases the two laws may have meaningfully different standards, depending on the extent to which that state's law varies from the DTSA. A common example would be the limitations period, which is three years under the DTSA but can extend to as long as five or six years under some state laws. Other variations include the availability of royalties as an alternative to injunction, the definition of what constitutes a trade secret, and allowable damage theories. No federal court has yet expressed that this simultaneous assertion of different laws to cover the same claim is problematic; however, we are still in the early stages of most DTSA cases, and as they proceed closer to trial we can expect to see courts require elections or otherwise resolve the conflict.

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Other state laws are often asserted along with a trade secret claim. Enforcement of a noncompetition contract or other restrictive covenant is a common example. But where alternative legal theories can be asserted under state law for what amounts to the theft of information – business torts such as conversion, breach of confidence and unfair competition – the issue becomes potentially more complicated. That is due to a section in the UTSA that declares the "displacement" of such claims in favour of the single statutory cause of action. Most states have interpreted this section broadly, making it impossible in those states to assert the alternative claims. When the DTSA was being considered, some commentators speculated that federal courts hearing DTSA claims might allow the displaced theories because the DTSA itself has no similar “displacement” provision. But in the only case that has directly confronted the issue, the court reasoned that alternative claims displaced by the law of the relevant state could not be revived merely by bringing them together with a DTSA claim in federal court.

Whistleblowers

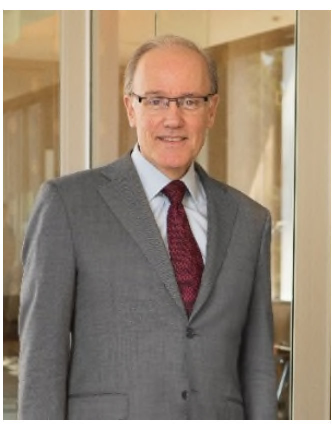
Protection for whistleblowers under the DTSA was expressed as “immunity” from liability under any state or federal trade secret laws. That term has special significance under US Supreme Court decisions, requiring that district courts promptly determine whether a defendant enjoys the privilege and if so dismiss the case. However, most immunities are immediately apparent by a person’s undeniable status, such as a government official. DTSA immunity is qualified not only by the requirement that the individual disclose information in confidence to law enforcement or to an attorney, but that the disclosure be made “solely” for the purpose of “reporting or investigating a suspected violation of law.”

In the only case that has construed this provision, the employee had taken confidential documents and provided them to his attorney, who asserted that he was reviewing them for possible disclosure to the authorities. The employer filed for an injunction requiring the documents to be returned, and the employee moved to dismiss on grounds of immunity. The judge issued an order that the documents be surrendered to the court, and he refused to dismiss the case, noting that it was not possible on the record to conclusively determine that reporting to law enforcement was the employee’s “sole” objective.

Critics of the decision have argued that immunity must be determined as a first priority, and that it undercuts the purpose of the statute to subject a whistleblower to any litigation risk or expense. Some have suggested that courts will develop a procedure similar to that used in connection with challenges to personal jurisdiction, in which discovery is allowed only on the relevant predicate facts, which then can properly inform a motion to dismiss.

The year ahead

Trade secret owners and their counsel appear to have embraced the DTSA eagerly, seeing in the federal forum a familiar and more reliable environment for resolving disputes. But even though one case has already gone to trial (resulting in a verdict for the plaintiff), most cases are still in relative infancy. As they mature we can expect substantial progress in the developing federal jurisprudence. If all goes well, federal courts will influence not only each other but also the continuing development of state laws that closely align with the DTSA, leading to the greater harmony and efficiency in trade secret enforcement that Congress intended.



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© James Pooley 2017. The US Senate Committee on the Judiciary invited him to testify and provide drafting advice about the proposed Defend Trade Secrets Act. His testimony is available here.