The Secret's in the Sauce: The Defend Trade Secrets Act and the Ideal Recipe for Federal Trade Secrets Legislation

By Cynthia Arato and Erin Millender

Introduction

The Defend Trade Secrets Act ("DTSA") is here. The United States Congress' latest effort to pass federal trade secret legislation finally succeeded on May 11, 2016. The Defend Trade Secrets Act of 2015 (now 2016)[1] passed the Senate and the House by overwhelming majorities on April 4th and April 26, 2016 (respectively) and President Obama's swiftness in signing the bill into law evidences the "high priority" his administration has placed on mitigating and combating the theft of trade secrets.[2] Industry representatives have lauded the DTSA as a step forward in "improving the efficiency and predictability of litigation and allowing companies to create one set of best practices to protect their intellectual property in every jurisdiction."[3] Others, including a broad coalition of legal scholars, claim that it will create greater ambiguity, cause procedural delays, and potentially stymie competition and innovation.[4] Prior to its passage, the Senate bill was amended to respond to some of these critiques.

The DTSA will co-exist alongside the Uniform Trade Secrets Act ("UTSA"), as that Act has been adopted (and, at times, modified) by 48 of 50 states in this country and common law.[5] New York State is one of the holdouts, having opted to rely on a body of common law that diverges from the UTSA in certain ways, and New York law thus differs from the DTSA in its own unique ways.

The DTSA will provide litigants with a new avenue to redress trade secret misappropriation, and new worries for defendants in trade secret actions.

Provisions of the DTSA

The DTSA amends the existing Economic Espionage Act of 1996 ("EEA"), which criminalizes the theft of trade secrets, to establish a private, civil cause of action for trade secret misappropriation. Most of the provisions of the DTSA mirror the UTSA, including the definitions of trade secrets and misappropriation. The DTSA borrows the definition of trade secrets set forth in the EEA, namely commercial information that the owner has taken reasonable measures to keep secret and that derives independent economic value from being unknown to the public. The definition covers "all forms and types" of information, including financial, business, scientific, technical and intangible information, as well as information stored electronically. The DTSA provides for civil action for "misappropriation" of a trade secret by "improper means" and for the improper disclosure or use of the secret. "Improper means" include theft, bribery, espionage and other tortious or illegal conduct. Legal means such as reverse engineering are explicitly carved out.

As with UTSA, a trade secrets owner under the DTSA is entitled to recover his actual damages, including the loss of value of a trade secret due to its dissemination, as well as damages for unjust enrichment and reasonable royalties. Additionally, like the UTSA, under the DTSA courts may award exemplary damages up to double the amount of the actual loss and/or attorneys' fees if the violation is deemed to be willful and malicious.

The DTSA includes a carve-out to protect whistleblowers. Individuals who disclose trade secrets to attorneys or government officials for the purpose of reporting illegal activity are immune from liability under the Act. Employers must provide employees, including independent contractors and consultants, with notice of this immunity in any contract or agreement concerning confidential information. An employer who fails to provide that notice will be barred from recovering exemplary damages and attorneys' fees from any employee to whom such notice was not given.

The most extensive and controversial provision of the DTSA grants federal courts the authority to issue an *ex parte* seizure order over any property used to commit or facilitate a violation. Although this provision is similar to seizures available under the Lanham Act, the initial draft of this provision kicked off a fire-storm of controversy, and S. 1890 now makes this remedy available only in extraordinary circumstances upon a showing of: (i) immediate and irreparable harm to the applicant that would outweigh harm caused to other parties if the order were granted, (ii) the inadequacy of other equitable remedies, (iii) a likelihood of success on the merits and (iv) a likelihood that notice would lead to destruction or concealment of the matter sought. Under this new law, a hearing on *ex parte* seizures must be held within seven days after the order is granted. In addition, seizures are not allowed where they might put undue constraints on employment or when disclosures are made in court filings. Finally, the law also provides a cause of action to defendants who have been wrongfully subjected to *ex parte* seizure of information assets so that they may be compensated for any resulting injury. The *ex parte* application may extend only to material that is in the actual possession of the wrongdoer and must describe that material with reasonable particularity. The requested seizure may not be publicized. While TROs are available under state procedures, it would be highly unusual for a state court to take custody over property in the manner envisioned by the DTSA.

Under the DTSA, trade secrets owners will have three years from the date on which the misappropriation was discovered, or should have been discovered by the exercise of reasonable diligence, to initiate claims. The law will not preempt existing state law claims, but will provide trade secret owners with a choice of pursuing claims under either state or federal law. The DTSA will not cover theft implicating purely intrastate commerce.

Critique of the DTSA

Critics of the DTSA have challenged various aspects of the law itself (though some of the criticisms were addressed by the amendments to the 2015 bill) and the concept of federal trade secrets protection generally. First, they argue that federal legislation is not necessary to achieve uniformity in trade secrets law. Despite differences in the states' enactments of the UTSA, they contend that the laws are substantially similar. They cite a record of success in combating trade secret theft by both employees and non-employees and insist there is no evidence that state causes of action are insufficient to protect the interests of legitimate trade secret owners. Rather than encouraging greater uniformity, they believe that a federal law which does not preempt state law will add ambiguity and confusion to a system that already benefits from high predictability for businesses and their attorneys.

Second, they contend that the DTSA raises complex questions of jurisprudence that will undermine the certainty and consistency that already exist. Although the DTSA is intended to combat international theft, the critics argue that the DTSA does not provide for jurisdiction over, or enforcing judgments against, foreign entities. Thus, for multinational corporations and others doing business in foreign markets, the promise of greater efficacy in pursuing wrongdoers may be illusory. Even in interstate commerce, they note that the jurisdictional clause purporting to authorize the DTSA under the Commerce Clause of the United States Constitution is untested and that trade secrets that do not move in interstate commerce, such as customer lists, may not be covered.

The remaining objections concern behavior in the marketplace. Critics argue that opportunists—so-called trade secret trolls—could use the Act to stifle competition and/or prohibit public and regulatory access to information. Start-ups and small businesses especially could be vulnerable to larger competitors with deep pockets engaging in costly legal gamesmanship to force them out of contention.

The Law of Trade Secrets in New York

Companies doing business in New York will likely have more adjustments to make than most to adapt to the new regime. Unlike the 48 states that have been operating under some version of the UTSA, New York is governed by common law rules developed by the state's courts.

While both the UTSA and New York common law are grounded in the Restatement (First) of Torts § 757 (1939), New York law allows trade secrets claims to be brought under contract and breach of fiduciary duty theories. Thus, a party seeking to initiate a claim for theft of trade secrets in New York must first identify which cause of action is most appropriate.

The UTSA sets forth a standard three-year statute of limitations on all trade secrets claims. In New York, timing will turn on the gravamen of the cause of action, with a three-year limit being applicable to actions concerning injury to property under CPLR § 214(4) and a six-year limit applicable to contract claims under N.Y. CPLR § 213(2). Under the UTSA, the limitations period accrues upon the discovery of the misappropriation, giving a plaintiff access to the full benefit of the statutory period. Under New York law, the claim accrues when the defendant first discloses or makes use of the information (although the date of accrual may be extended where the "defendant has kept a secret confidential but continued to use it for commercial advantage.")[6] Thus, by the time a trade secret owner discovers the misappropriation she may find herself having run out of time to assert her preferred theory.

The laws differ in how a trade secret is defined. The UTSA defines trade secrets broadly as economically valuable information subject to reasonable efforts to maintain secrecy. New York looks to the Restatement, which sets forth the following six-factor test:

(1) the extent to which the information is known outside the business;

(2) the extent to which those involved with the business know the information;

(3) the extent to which measures are taken to protect the information's secrecy;

(4) how valuable the information is;

(5) the expense and/or difficulty involved in developing the information; and

(6) the difficulty with which others could develop the information.

New York courts have varied in which of these they choose to emphasize. Some courts apply the test in full. Others focus on the third factor and interpret it more strictly than under the UTSA. Under the UTSA, in general, a party must take precautionary measures to prevent disclosure that are "reasonable under the circumstances." Trade secret status is not lost until the information becomes common knowledge within the community or industry in which it is profitable. Under New York law, trade secret status may be lost once the information passes to any person who does not owe the owner a duty to protect the confidentiality of the information. This makes the development and use of confidentiality agreements with employees, investors, vendors and other business partners vital to maintaining trade secret protection in New York (although a duty may be inferred from the relationship of the parties). Additionally, under New York law the trade secret must be in continuous use in the business as opposed to a single event.

New York courts and the UTSA define "misappropriation" and "improper use" consistently with one exception. New York characterizes as "improper use" the acquisition of trade secrets in a manner that offends standards of commercial ethics, even where no independent wrongful conduct was involved. The UTSA does not include that violation.

Finally, the UTSA provides for the recovery of attorney fees and one of its comments states that patent law is followed in allowing a judge to award fees even in a jury trial. Awards of fees under the UTSA may start tracking the recent patent case, in which the U.S. Supreme Court ruled that fees could be warranted where a case "stands out from other with respect to the substantive strength of a party's litigating position…or the unreasonable manner in which the case was litigated."[7] Fees are not available under New York common law. The UTSA also provides for exemplary damages of up to two times actual damages, and such damages are difficult to obtain under New York law.

Conclusion

Information assets, increasingly in intangible or electronic form and developed at significant cost, have come to form the core of our modern economy. Variations in state laws can pose a challenge for companies seeking to establish a robust and comprehensive plan to protect those assets from sophisticated threats both internal and external. This new federal trade secrets legislation will hopefully offer an optimal mix of rights and remedies for misappropriation of trade secrets, resulting in more efficient, less costly litigation. Companies and their counsel would do well to carefully consider the differences among the existing laws in jurisdictions where they transact business given the changed landscape.

Endnotes

1. Similar bills were introduced in the 113th Congress—the Defend Trade Secrets Act of 2014 (S. 2267) and the Trade Secrets Protection Act of 2014 (H.R. 5233)—but were never enacted. The recently enacted bill is S. 1890.
2. Statement of Administration Policy, S. 1890—Defend Trade Secrets Act of 2016, Office of Mgmt. & Budget, Exec. Office of the President (April 4, 2016), *available at* https://www.whitehouse.gov/sites/default/files/omb/legislative/sap/114/saps1890s_20160404.pdf.
3. Statement of Thomas R. Beall, Vice President and Chief Intellectual Property Counsel Corning Incorporated, to the U.S. Senate Committee on the Judiciary, December 2, 2015, *available at*: http://www.judiciary.senate.gov/imo/media/doc/12-02-15%20Beall%20Testimony.pdf.
4. *See, e.g.*, Professors' Letter in Opposition to the Defend Trade Secrets Act of 2015 from Eric Goldman et al. to the Hon. Charles E Grassley, the Hon. Robert W. Goodlate, the Hon. Patrick J. Leahy and the Hon. John Conyers, Jr. (November 17, 2015), *available at* https://cyberlaw.stanford.edu/files/blogs/2015%20Professors%20Letter%20in%20Opposition%20to%20DTSA%20FINAL.pdf; *see also*, Sharon K. Sandeen, DTSA: The Litigator's Full - Employment Act, 72 Wash & Lee L. Rev. Online (November 30, 2015), *available at*: http://scholarlycommons.law.wlu.edu/wlulr-online/vol72/iss2/5/.
5. *See, e.g.*, Sid Leach, Anything but Uniform: A State-By-State Comparison of the Key Differences of the Uniform Trade Secrets Act, October 23, 2015, *available at* http://www.swlaw.com/assets/pdf/news/2015/10/23/How%20Uniform%20Is%20the%20Uniform%20Trade%20Secrets%20Act%20-%20by%20Sid%20Leach%20-%20AIPLA%20paper.pdf.
6. *Andrew Greenberg, Inc. v. Svane, Inc.*, 36 AD3d 1094, 1096 (3d Dep't 2007).
7. *Octane Fitness, LLC v. ICON Health & Fitness, Inc.*, 134 S. Ct. 1749, 1756 (2014).

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