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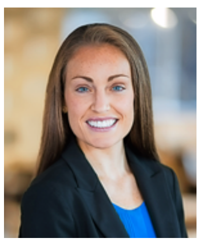
TRADE SECRETS

The Defend Trade Secrets Act and Post-Employment Restrictive Covenants



BY LARRY L. TURNER AND CHLOE KEATING LEIGH

On May 11, 2016, President Barack Obama signed the Defend Trade Secrets Act of 2016 (DTSA), the most significant trade secret reform in decades. After years of bipartisan negotiation, the law established uniform protections for trade secret owners across the United States. Unlike most legislation in today's political climate, the DTSA received overwhelming support in both houses of Congress.

After brief debate and slight emendation by the Senate Judiciary Committee, the Senate unanimously approved the DTSA by a vote of 87 to 0. Just weeks later, the bill was passed in the House of Representatives by a vote of 410 to 2. The bill was then swiftly signed by President Obama, becoming Public Law No. 114-153.

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However, will its application be as harmonious in federal civil cases across the country? Or will civil cases in this area continue to be a crafty and delicate balance of the facts of each individual case?

I. The Need for Federal Legislation

Trade secrets touch nearly every sector of the U.S. economy, particularly within the technology, financial, health, manufacturing, automobile, agriculture and military industries. The cost of intellectual property theft to American businesses has been estimated at more than $300 billion each year, and the need for sufficient trade secret protection will only become more pressing as technology advances. COMM'N ON THE THEFT OF AM. INTELLECTUAL PROPERTY, REPORT OF THE IP COMMISSION 11 (2016). Although Congress criminalized trade secret theft in 1996 with its enactment of the Economic Espionage Act (EEA), trade secret holders seeking civil remedies for misappropriation could find relief exclusively at the state level. *See* 18 U.S.C. § § 1831–1839 (2012).

While 48 states have adopted some form of the Uniform Trade Secret Act (UTSA), significant divergences, in both interpretation and enforcement, persist among them. Moreover, trade secret owners forced to litigate in local state courts when the misappropriation at issue transcends state and national boundaries often find themselves in a cumbersome and costly process that rarely furnishes them the relief necessary. A federal cause of action could provide a much needed alternative to the inconsistencies and inefficiencies that accompany 50 separate enforcement regimes.

II. DTSA Remedies and the Public Policies It Reflects

In a section titled ''Civil Proceedings,'' the DTSA provides both legal and equitable relief. 18 U.S.C.A. § 1836 (West 2016). For ongoing harm, the default remedy is an injunction. Despite the financial burdens American businesses have borne, as well as the commercial advantages to be gained by ensuring trade secret confidentiality, some members of Congress did fear that imparting courts with broad discretion in issuing injunctive relief may constrain employee mobility—a public policy strongly favored and passionately protected in some states.

A. Employee Mobility

Striking a delicate balance between these interests—worker mobility and trade secret protection—is a familiar exercise for federal and state lawmakers alike. For example, in the debates preceding the passage of the EEA, certain legislators sought to safeguard those seeking ''to capitalize on their lawfully developed . . . abilities'' from EEA prosecution. *See* S. Rep. No. 104-359, at 12 (1996). Their efforts manifested in the EEA's exclusion of general skills, knowledge and experience in the act's definition of ''trade secret.'' *See* 18 U.S.C. § 1839(3) (2012). In the courts, the results of this balancing act have proven more variable. Since the holding by the U.S. Court of Appeals for the Seventh Circuit in *PepsiCo, Inc. v. Redmond*, courts have frequently confronted employers' requests to enjoin employees from working for a competitor because the demands of their new positions would inevitably lead them to rely on trade secrets learned from their previous employment. *PepsiCo, Inc. v. Redmond*, 54 F.3d 1262, 1269 (7th Cir. 1995).

The Senate Judiciary Committee's report on the DTSA highlighted the differing stances courts have taken on the issue, labeled the ''inevitable disclosure'' doctrine. Some states—including California, Louisiana, Maryland and New York—have flatly rejected the doctrine, describing it as ''a de facto covenant not to compete'' ''that runs counter to [their states'] public policy favoring employee mobility.'' *See Whyte v. Schlage Lock Co.*, 125 Cal. Rptr. 2d 277 (Cal. App. 4th 2002) (citing California's stance on the issue as well as similar positions in other states). These courts require that plaintiffs offer evidence of threatened or actual misappropriation before granting such a request. *Id.* In other jurisdictions, courts issue injunctions with nothing more than the employer's mention of the proprietary information in his employee's possession. *See, e.g.*, *Liebert Corp. v. Mazur*, 827 N.E.2d 909, 927 (Ill. App. Ct. 2005).

Accordingly, while some congressmen feared that the bill would conflict with state laws granting greater protection to employees, the bill also had to address the more stringent remedies available to victims of misappropriation at the state level. Sen. Dianne Feinstein (D-Calif.) fashioned an amendment to address the first concern, which now stands as a statutory limit on courts' injunctive power. S. Rep. No. 114-220, at 8 (2016) (''[S]ome members, including Senator Feinstein, voiced concern that the injunctive relief authorized under the bill could override state-law limitations that safeguard employee mobility . . . .''); *see* 18 U.S.C. § 1836(3)(A)(i)(I)–(II). The DTSA, as codified, precludes a court from granting an injunction if doing so would ''prevent a person from entering into an employment relationship''; place a condition on employment based ''merely on the information the person knows''; or ''otherwise conflict with an applicable State law prohibiting restraints on the practice of a lawful profession, trade, or business.'' 18 U.S.C. § 1836(3)(A)(i)(I)–(II).

To quell the concerns of ''inevitable disclosure'' endorsers, Feinstein cited Section (2)(f) of the bill, which ''provides that the [law would] not 'preempt any other provision of law.' '' S. Rep. No. 114-220, at 16. As the Senate Judiciary Committee assured, ''the remedies provided in Section (3)(A)(i)(1)(I) are intended to coexist with, and not . . . influence[] or modify applicable State law governing when an injunction should issue.'' *Id.*; *see also* 18 U.S.C.A. § 1838 (''[T]his chapter shall not be construed to preempt or displace any other remedies, whether civil or criminal, provided by United States Federal, State, commonwealth, possession, or territory law.'').

Nevertheless, Feinstein's ''merely on the information the person knows'' language will demand that those seeking injunctive relief on the federal level demonstrate more than simple exposure to persuade a court that enjoining a departing employee is the appropriate measure. Litigants bringing or defending such requests should find the standards courts apply in states that have disavowed the inevitable disclosure doctrine more instructive than those in jurisdictions embracing it. Moreover, the DTSA is a further reason for employers who wish to enforce post-employment restrictive covenants to draft them narrowly.

B. Whistle-Blower Protection

Concerns over employee mobility did not absorb all discussion during the DTSA debates. Sens. Patrick Leahy (D-Vt.) and Chuck Grassley (R-Iowa) identified another public policy that trade secrets tend to compete with: whistle-blower protection. As a result of their proposed amendment, the DTSA carves out special protections for whistle-blowers. More specifically, the law immunizes those who disclose trade secrets ''in confidence to a Federal, State, or local government official . . . or to an attorney'' when done ''solely for the purpose of reporting or investigating a suspected violation of law.'' 18 U.S.C.A. § 1833(a)(1)(A). To promote the flow of information between prospective whistle-blowers and regulatory entities, the DTSA requires employers to notify employees of their statutory immunity ''in any contract or agreement with an employee that governs the use of a trade secret or other confidential information.'' *Id.* § 1833(a)(3)(a). Failure to provide notice precludes the recovery of exemplary damages and attorneys' fees in any lawsuit later filed against the employee. *Id.*

Only time will reveal the methods and factors courts will use to weigh these important public interests. But, for now, employers interpreting Congress's sweeping endorsement of trade secret protection as an invitation to contractually limit the circumstances under which their employees may disclose proprietary information should tread lightly. Recent Securities and Exchange Commission orders indicate that the government's commitment to protect and encourage whistle-blowing may tip the scales in favor of disclosure.

Insights from SEC Adjudications

In 2011, Congress amended the Dodd-Frank Wall Street Reform and Consumer Protection Act by adding Section 21F, which not only prohibits employment-related retaliation against whistle-blowers, but also provides them with financial incentives and various confidentiality guarantees. 15 U.S.C. § 78u-6 (2012). To further Congress's aims, the SEC adopted Rule 21F-17, which states that ''[n]o person may take any action to impede an individual from communicating directly with Commission staff about a possible securities law, including enforcing, or threatening to enforce, a confidentiality agreement.'' 17 C.F.R. § 240.21F-17 (2016). In three recent administrative orders, the SEC has squarely addressed the legality of employers' use of confidentiality agreements to limit employee disclosure of proprietary information. The SEC's analyses in these cases may provide employers with insight as to the legal limits on contractual strategies to protect trade secrets.

In *In re KBR*, the SEC addressed whether the requirements of a confidentiality agreement issued to KBR employee-witnesses during internal investigations complied with Rule 21F-17. *In re KBR, Inc.*, Exchange Act Release No. 74619, 2015 WL 1456619 (Apr. 1, 2015). As summarized by the SEC order, as part of KBR's compliance program, it would first investigate any allegations of illegal or unethical practices internally by interviewing employees associated with the charges. To ensure the secrecy of the information revealed during the interviews, KBR would require that witnesses sign a confidentiality statement agreeing and acknowledging that they were ''prohibited from discussing . . . the subject matter . . . [of] the interview, without the prior authorization of the Law Department.'' *Id.* ¶ 6. It would also inform employees that any ''unauthorized disclosure . . . may be grounds for disciplinary action up to and including termination of employment.'' *Id.*

Although the SEC could cite to no instance in which the confidentiality agreement at issue impeded a KBR employee from communicating directly with commission staff, it found that the agreement impermissibly obstructed employees ''from discussing the substance of their interview[s with the SEC] without clearance from KBR's law department.'' *Id.* ¶ 7. Coupled with the penalties faced for unauthorized disclosure, the SEC ruled that KBR violated Rule 21F-17.

In its attempt to reach a settlement, KBR amended its confidentiality statement, adding language explicitly notifying employees that nothing prohibited them ''from reporting possible violations of federal law or regulation[s] to any governmental agency or entity.'' *Id.* ¶ 8. The revision also stated that employees would not need the authorization of the law department prior to reporting, nor were they required to inform the company of the substance of their disclosures. *Id.* The SEC accepted KBR's offer, but only after issuing a $130,000 fine and demanding that KBR make ''reasonable efforts'' to communicate its modifications to the employees who had already signed the agreement. *Id.* ¶ 10.

In a later decision, *In re Health Net*, the SEC assessed Health Net's severance agreement, which required that departing employees waive their ''right to file an application for award for original information submitted pursuant to Section 21F-17.'' *In re Health Net, Inc.*, Exchange Act Release No. 78590, 2016 WL 4474755 ¶ 8 (Aug. 16, 2016). In a separate section of the contract, Health Net did expressly inform employees of their right to file charges and participate in governmental investigations, but it supplemented this clause with a stipulation that any financial benefit associated with furnishing information before or during such proceedings would be relinquished. Although Health Net eventually removed the language specifically mentioning Rule 21F-17, it never omitted the agreement's more general waiver. Similar to its discussion in *KBR*, the commission began its analysis by underscoring Congress's clear commitment to encouraging and protecting whistle-blowing. *Id.* ¶ ¶ 2–3. After characterizing Rule 21F-17's financial incentive as a ''critical component to the Whistleblower Program,'' the SEC found Health Net's waiver in conflict with the goals underlying the 2011 amendment. *Id.* ¶ ¶ 2, 14. After fining Health Net $340,000, the SEC agreed to settle so long as the company notified its former employees that they were not prohibited from seeking and obtaining whistle-blower awards. *Id.* ¶ 13.

Lastly, in *In re BlueLinx Holdings*, the commission addressed the legality of BlueLinx's severance, separation, settlement and termination agreements. *In re BlueLinx Holdings Inc.*, Exchange Act Release No. 78528, 2016 WL 4363864 (Aug. 10, 2016). Although the particular language varied among the forms, each precluded the disclosure of confidential information or trade secrets unless compelled to do so by law or other legal process. Even under those circumstances, the agreements required that employees notify the company or obtain the written consent of its legal department before doing so. *Id.* ¶ 7. An addendum to some of the agreements later informed employees of their right to file charges with regulatory enforcement agencies, such as the SEC, but not without demanding waiver of ''any monetary recovery in connection with . . . such [proceedings].'' *Id.* ¶ 14. In light of what it characterized as a statutory and regulatory framework designed to encourage whistle-blowing, the Commission concluded that the agreements' notification requirements, waiver of available financial rewards and wholesale prohibition of volunteering information violated Rule 21F-17. *Id.* ¶ 19. Pursuant to its settlement with the SEC, BlueLinx agreed to add to its agreements a section titled ''Protected Rights.'' The paragraph notified employees of their right to ''communicate with any Government Agencies[,] . . . [to] participate in any investigation or proceeding . . . conducted by a Government Agency,'' and to ''receive an award for information provided to any Government Agency.'' *Id.* ¶ 20.

Collectively, these orders indicate that while the DTSA mandates only notification of immunity, the SEC may require that employers inform their employees of much more. To comply with both the DTSA and Dodd-Frank, employers should explicitly and conspicuously apprise employees of their whistle-blower immunity, refrain from using overly restrictive or punitive language when delineating the circumstances surrounding employee disclosure of proprietary information and, finally, eliminate any waiver of the awards available under Section 21F.

III. Conclusion

Despite Congress's near unanimous acknowledgment of a national need to protect trade secrets, employers embracing this fact to justify contractual restrictions on employee mobility or limitations on information disclosure must proceed cautiously. First, the statutory qualifications imposed on the DTSA's remedies align with the policies in states that favor open competition and employee mobility. Second, the SEC's vow to encourage and protect whistle-blowers tempers employers' efforts to proactively restrict opportunities for disclosure.

The passage of the DTSA constitutes an exciting development in the fields of intellectual property and employment law, but how much it assists trade secret owners remains to be seen. Employers will have to exercise caution in drafting covenants and releases, while being selective in their enforcement efforts, in order to take full advantage of this new law.

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