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## Considering Potentially Case-Dispositive Factors in Deciding Whether to Bring a Federal or State Trade Secret Claim After the New Defend Trade Secrets Act



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**T**he Defend Trade Secrets Act of 2016 (DTSA), enacted on May 11, 2016, modernizes and strengthens trade secret law (15 PVLR 907, 5/2/16). One key feature is that trade secret owners now have the option to pursue civil remedies under federal law. DTSA amends and augments the federal criminal provisions under the Economic Espionage Act of 1996 (EEA) by adding new civil provisions and remedies. See generally M. Krotoski, *Landmark Law Bring New Remedies and Protection for Trade Secrets*, Bloomberg BNA, Pat-

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ent, Trademark & Copyright Journal (15 PVLR 1189, 6/13/16) (15 PVLR 1189, 6/13/16).

Before the federal law was enacted, state law offered the *exclusive* civil remedy for trade secret owners. Forty-seven states along with the District of Columbia, Puerto Rico and the U.S. Virgin Islands have enacted some form of the Uniform Trade Secret Act (UTSA).

Under the new law, federal district courts now hold “original jurisdiction” over federal civil trade secret actions filed under DTSA. See 18 U.S.C. § 1836(c). As a result, trade secret owners can “rely on a national standard to efficiently protect their intellectual property.” 162 CONG. REC. S1635 (daily ed. Apr. 4, 2016) (statement of Sen. Amy Jean Klobuchar). As noted in the Senate Report, “[a]s trade secret owners increasingly face threats from both at home and abroad,” DTSA “equips them with the tools they need to effectively protect their intellectual property and ensures continued growth and innovation in the American economy.” S. Rep. No. 114-220 at 15, 114th Cong., 2d Sess. 3 (2016) (same) [hereinafter DTSA Senate Report].

Significantly, by allowing civil trade secret claims to be heard in federal court, DTSA does not preempt state trade secret laws. Instead, DTSA “offers a complementary Federal remedy if the jurisdictional threshold for Federal jurisdiction is satisfied.” H.R. Rep. No. 114-529 at 5, 114th Cong., 2d Sess. 1-2 (2016) (noting civil provisions were added to the EEA) [hereinafter DTSA House Report]. Under DTSA, trade secret owners now have a choice of remedies under federal or state trade secret law. The question this article explores is which remedy is best for a particular case.

### I. Considering ‘Case-Dispositive’ Variations in Trade Secret Laws

In the congressional debate, one of the reasons for the need for a national trade secret standard was that many state trade secret laws had variations despite being premised on UTSA. As the Senate Report observed, “[a]lthough the differences between State laws and the UTSA are generally relatively minor, they can prove case-dispositive.” DTSA Senate Report, at 2. Normally departures from a uniform statute are considered to be intentional.

For example, California’s trade secret law, known as the California Uniform Trade Secrets Act (CUTSA) which became effective in 1985, is based on UTSA but

like other states it has its own variations. See CAL. CIVIL CODE § § 3426-3426.11. California law requires that “before commencing discovery relating to the trade secret, the party alleging the misappropriation shall identify the trade secret with reasonable particularity.” CAL. CIVIL CODE § 2019.210. This unique provision codified California case law. As another example, a handful of states adopted the 1979 version of UTSA, before the 1985 amendments were made, including Arkansas, Connecticut, Delaware, Indiana, Louisiana, Minnesota, North Dakota and Washington.. Specifically, the 1985 amendments clarified the scope of available injunctive relief, included a reasonable royalty as an alternative form of damages, clarified UTSA’s effect on other civil remedies as well as criminal remedies, and more clearly specified UTSA’s effective date. See UNIFORM TRADE SECRETS ACT WITH 1985 AMENDMENTS § § 2(b), 3(a), 7, 11 (1985).

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Because of these variations, the applicable trade secret laws must be considered to highlight relevant differences or requirements in pursuing trade secret remedies. In some instances, the variations may be case-dispositive.

## II. Factors on the Choice of Trade Secret Remedies

Whether federal or state trade secret remedies are appropriate depends on the facts and legal circumstances of the particular case. A variety of factors should be considered in making this determination on a case-by-case basis. This article presents a non-exhaustive list of factors that trade secret owners may wish to consider:

### A. Satisfying Federal Jurisdiction

A threshold issue is whether federal jurisdiction can be established.

Initially, to bring a federal trade secret claim under DTSA, the jurisdiction requirement must be satisfied. The “complementary” federal remedy is available so long as the misappropriation involves a “trade secret” that “is related to a product or service used in, or intended for use in, interstate or foreign commerce.” 18 U.S.C. § 1836(b)(1) (emphasis added).

For most trade secrets, this interstate or foreign commerce jurisdictional requirement will likely be satisfied. However, there may be some misappropriations that are too localized in nature to meet this jurisdictional requirement. For example, the misappropriation of a customer list may not meet this jurisdictional requirement if all of the customers are located within the same state.

### B. Misappropriation Across Jurisdictional Lines

Was the misappropriation local or did it involve the removal or transfer of trade secrets to other jurisdictions?

State trade secret law may provide an effective remedy for local misappropriation. Once the trade secret is removed to other jurisdictions, however, federal law typically will provide a more effective and efficient means to obtain evidence in other jurisdictions.

One of the reasons Congress passed DTSA was to address the common problem and obstacles that arise in seeking a remedy after a trade secret is taken to other jurisdictions. As the House Report explained, “trade secret theft today is often not confined to a single state. The theft increasingly involves the movement of secrets across state lines, making it difficult for state courts to efficiently order discovery and service of process.” DTSA House Report, at 4; see also 162 CONG. REC. S1627 (daily ed. Apr. 4, 2016) (statement of Sen. Orrin Hatch) (noting the “far more efficient” federal discovery procedures).

Consider a couple of examples. While the process to obtain a deposition of a witness in another state can require multiple court orders and lengthy delays, federal jurisdiction instead offers nationwide subpoena service power. See Fed. R. Civ. P. 45(b)(2) (“A subpoena may be served at any place within the United States.”). Similarly, multiple state court orders may be necessary to subpoena records. In contrast, federal courts have broader discovery authority including for evidence located in other jurisdictions. See, e.g., *Société Nationale Industrielle Aérospatiale v. U.S. Dist. Ct. S.D. Iowa*, 482 U.S. 522, 541 (1987). Depending on the facts and circumstances, the federal avenue may result in less costly litigation, greater efficiencies, and time savings.

### C. Need for a Limited Court Order to Seize Trade Secrets

How important is prompt recovery of the stolen trade secrets?

DTSA provides for a new powerful tool to recover trade secrets in limited circumstances. This option does not exist under state law. If the recovery of trade secrets may be accomplished under this option, then this factor may militate toward filing in federal court.

Under DTSA, in “extraordinary circumstances,” and upon a proper showing, a trade secret owner can request an *ex parte* seizure order to seize “property necessary to prevent the propagation or dissemination of the trade secret,” or “to preserve evidence.” 18 U.S.C. § 1836(b)(2)(A)(i); DTSA House Report, at 9; DTSA Senate Report, at 5-6. Examples may include when “a defendant is seeking to flee the country or planning to disclose the trade secret to a third party immediately or is otherwise not amenable to the enforcement of the court’s orders.” DTSA House Report, at 10; DTSA Senate Report, at 6. The seizure is executed by law enforcement, and the seized items are brought within the custody of the federal court, pending a hearing within seven days with all parties present. 18 U.S.C. § § 1836(b)(2)(E), 1836(b)(2)(D), 1836(b)(2)(B)(v).

In many trade secret cases, recovery of the trade secrets is among the highest priorities. DTSA provides a new avenue under federal law to seize trade secrets promptly upon a proper showing.

### D. Statute of Limitations

What are the time limitations for filing a civil claim under the applicable statute of limitations?

The statute of limitations for DTSA’s federal right of action is three years “after the date on which the mis-

appropriation with respect to which the action would relate is discovered or by the exercise of reasonable diligence should have been discovered.” 18 U.S.C. § 1836(d). DTSA’s statute of limitations matches the three year period under UTSA and many other states. See UTSA, § 6; see also CAL. CIV. CODE § 3426.6.

Some states have enacted statute of limitations periods that are longer than that of DTSA. For example, Vermont enacted a six-year limitations period (VT. STAT. ANN. TIT. 12, § 523); Georgia, Illinois and Missouri enacted a five-year limitations period (GA. CODE ANN. § 10-1-766; 765 ILL. COMP. STAT. 1065/7; MO. ANN. STAT. § 417.461); and Nebraska, Ohio, and Wyoming have enacted a four-year limitations period. (ME. REV. STAT. ANN. TIT. 10, § 1547; NEB. REV. STAT. ANN. § 87-506; OHIO REV. CODE § 1333.66; WYO. STAT. ANN. § 40-24-106)Alabama, by contrast, enacted a limitations period shorter than that of DTSA—only two years (ALA. CODE § 8-27-5). Depending on when the misappropriation occurred, the time to file a civil claim could make a difference in a particular case.

DTSA further provides that for statute of limitations purposes a continuing misappropriation constitutes a single claim of misappropriation. See 18 U.S.C. § 1836(d). The UTSA § 6 uses the same standard, and has been adopted by some other states. See, e.g., CAL. CIV. CODE § 3426.6. However, other states have not adopted the continuing misappropriation standard, and some states have adopted different standards concerning continuing misappropriation as it applies to multiple persons. Depending on the facts of the case, this issue may determine whether a civil trade secret claim is timely filed.

## E. Information Qualifying as a Trade Secret

Does the misappropriated information satisfy the definition of a trade secret?

Some courts have noted that a trade secret “is one of the most elusive and difficult concepts in the law to define.” *Lear Siegler, Inc. v. Ark-Ell Springs, Inc.*, 569 F.2d 286, 288 (5th Cir. 1978) (applying the Illinois Trade Secrets Act, 765 ILCS 1065/1 *et seq.*). Whether particular information qualifies as a trade secret may turn on the specific statutory definition that is applied.

Generally, trade secrets include three parts: (1) non-public information; (2) protected by reasonable measures; and (3) the information derives independent economic value from not being publicly known. See 18 U.S.C. § 1839(3) (definition of trade secret); see also DTSA House Report, at 2 (noting three parts to a trade secret). On the first element, some trade secrets are more likely to satisfy the trade secret definition. For example, source code, algorithms, formulas or recipes typically qualify as trade secrets. However, whether customer lists qualify as a trade secret usually depends on the specific facts; customer lists are considered to lie “on the periphery of the law of trade secrets and unfair competition.” *Nationwide Mut. Ins. Co. v. Mortensen*, 606 F.3d 22, 28 (2d Cir. 2010) (citation and quotation omitted) (9 PVL 768, 5/24/10).

Many states have variations to decide what information qualifies as a trade secret. For example, some states, such as Missouri, apply six factors “to determine whether information constitutes a trade secret.” *Secure Energy, Inc. v. Coal Synthetics, LLC*, 708 F. Supp. 2d 923, 926 (E.D. Mo. 2010). Other courts have noted that these six factors, which derive from the Restatement

(First) of Torts, are “common law factors” that may be used “as instructive guidelines for ascertaining whether a trade secret exists” but that the state statutory language “makes no reference to these factors as independent requirements for trade secret status.” *Learning Curve Toys, Inc. v. PlayWood Toys, Inc.*, 342 F.3d 714, 722 (7th Cir. 2003).

The federal definition of a “trade secret” (for criminal and civil cases) is “based largely” on UTSA, but the federal definition is broader in two significant respects. H. Rep. No. 104-788 at 12, 104th Cong., Sess. 12 (1996). First, the federal definition is more explicit in enumerating the types of information that may qualify as a trade secret. The federal definition 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). Second, the federal definition expressly covers “intangible” information.

Other variations exist among state trade secret laws. For example, some state laws expressly list “computer programming instruction or code,” computer software, cost data, customer lists, drawings, financial data, “technical and non-technical data,” a prototype and other specific forms of information under the trade secret definition. Given these variations, this issue should be carefully assessed to determine if it would make a difference.

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## F. Sufficient Proof of ‘Reasonable Measures’ Protecting the Trade Secret

Would satisfying the “reasonable measures” requirement make a difference under applicable federal or state law?

The federal definition of a trade secret requires that “the owner thereof has taken reasonable measures to keep such information secret.” 18 U.S.C. § 1839(3)(A). A similar reasonable “efforts” requirement applies under the UTSA definition of a trade secret. UTSA § 1(4)(ii). The failure to establish “reasonable measures” to protect the trade secret can result in the dismissal of a trade secret claim. Whether a trade secret owner can prove that “reasonable measures” were employed to protect its secrets is typically a factual question.

Depending upon the circumstances of a case, the evidence required to meet this element could turn on the applicable trade secret law. For instance, in *United States v. Chung*, the U.S. Court of Appeals for the Ninth Circuit interpreted the “reasonable measures” requirement under EEA and noted that “[s]ecurity measures, such as locked rooms, security guards, and document

destruction methods, in addition to confidentiality procedures, such as confidentiality agreements and document labeling, are often considered reasonable measures.” *United States v. Chung*, 659 F.3d 815, 825 (9th Cir. 2011) (10 PVL 1509, 10/17/11). In upholding a conviction under EEA, the Ninth Circuit ruled there was sufficient evidence that a company had taken “reasonable measures” with respect to its trade secret documents. Even though “none of the documents was kept under lock and key,” the company had “implemented general physical security measures for its entire plant,” reserved the right to search its employees’ belongings and cars, required its employees to sign confidentiality agreements, and marked at least some of the documents at issue as proprietary. *Id.* at 827.

Any differences between the “reasonable measures” requirement under DTSA and state trade secret law should be considered to see if they could prove to be “case-dispositive.”

### G. State Laws Regarding Restraints on Trade

What state laws apply regarding restraints on trade that may impact injunctive relief?

DTSA places two restrictions on the federal court’s injunctive authority that “reinforces the importance of employee mobility,” based on an amendment added during consideration in the Senate Judiciary Committee. DTSA Senate Report, at 9; DTSA House Report, at 12. As explained in the Senate Report, “Provided an order does not [1] prevent a person from entering into an employment relationship or [2] otherwise conflict with applicable State laws prohibiting restraints on trade, a court may grant an injunction to prevent any actual or threatened misappropriation.” DTSA Senate Report, at 8; *see also* 18 U.S.C. § 1836(b)(3)(A)(i).

The remedies under this language “are intended to coexist with, and not to preempt, influence, or modify applicable State law governing when an injunction should issue in a trade secret misappropriation matter.” DTSA Senate Report, at 9. The content of the restriction therefore depends on the applicable state law.

For example, some states—including California, Montana, Oklahoma and North Dakota—specifically restrict the enforcement of noncompete agreements because these states have policies that preserve maximum employee flexibility, except in limited circumstances. CAL. BUS. & PROF. CODE § 16600; MONT. CODE ANN. § 28-2-703; N.D. CEND. CODE § 9-08-06; OKLA. STAT. TIT. 15, § 217. DTSA will not interfere with a state law prohibiting application of the inevitable disclosure doctrine which has been used to prevent a former employee from being employed with a competitor if the position would “inevitably” result in the use of the trade secrets. *See, e.g., Whyte v. Schlage Lock Co.*, 101 Cal. App. 4th 1443, 1462, 125 Cal. Rptr. 2d 277, 293-94 (Ct. App. 2002) (rejecting the inevitable disclosure doctrine under California law).

Based on state law variations, under some circumstances, a conflict or choice of state law issue may be presented. For example, if the terms of an agreement fail to specify which state law applies, the court may be required to address this issue. The consequences of the applicable state laws regarding restraints on trade should be fully assessed.

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### H. Protecting Trade Secrets During Litigation

Are the stronger protections to safeguard trade secrets during litigation under DTSA needed for the case? If this is a significant factor, federal law may be appropriate.

In several key respects, DTSA builds on protections under EEA to safeguard trade secrets during litigation. *First*, a federal court may issue a protective order “and take such other action as may be necessary and appropriate to preserve the confidentiality of trade secrets.” 18 U.S.C. § 1835. Many state laws also provide for protective orders. *See, e.g., CAL. CIV. CODE* § 3426.5.

*Second*, DTSA also establishes new rights for trade secret owners to protect against the disclosure of a trade secret during litigation. A court may not authorize the disclosure of trade secret information “unless the court allows the owner the opportunity to file a submission under seal that describes the interest of the owner in keeping the information confidential.” 18 U.S.C. § 1835(b).

*Third*, for materials seized under the new federal *ex parte* seizure provision, DTSA provides that “a party or a person who claims to have an interest in the subject matter seized may make a motion at any time, which may be heard *ex parte*, to encrypt any material seized or to be seized under this paragraph that is stored on a storage medium.” 18 U.S.C. § 1836(b)(2)(H).

*Fourth*, in cases involving the government, EEA already allows an interlocutory appeal for review of an adverse disclosure ruling by a court. *Id.* § 1835(b)(1). This provision, which has helped protect against the disclosure of trade secrets in federal criminal cases, will provide for appellate review of any court ruling ordering disclosure of a trade secret in criminal cases. This extra level of court review helps prevent against disclosure of trade secret information.

### I. Damages

What damages are recoverable for the trade secret misappropriation?

The recovery of damages may be case-dispositive. DTSA authorizes damage awards for the actual loss and any unjust enrichment caused by the trade secret misappropriation. 18 U.S.C. § 1836(b)(B)(3)(i). When the determination of actual loss is not feasible, a court may award a reasonable royalty “for no longer than the period of time for which such use could have been prohibited.” 18 U.S.C. § 1836(b)(3)(B)(ii). The legislative history highlights a preference for remedies that first halt the use and dissemination of the trade secret and then make available appropriate damages. *See* DTSA Senate Report, at 9.

Other states vary on the method of determining damages including the circumstances for a recovery of a reasonable royalty. For example, Virginia only allows

for the use of a reasonable royalty where the plaintiff “is unable to prove a greater amount of damages by” either actual loss caused by misappropriation and the unjust enrichment. *See* VA. CODE ANN. § 59.1-338(A). California allows for the “payment of a reasonable royalty” only “[i]f neither damages nor unjust enrichment caused by misappropriation are provable.” CAL. CIV. CODE § 3426.3(b).

Other states, by contrast, are more permissive in allowing for the recovery of a reasonable royalty. Oregon specifies that “[a] complainant is entitled to recover damages adequate to compensate for misappropriation,” and further provides that trade secret damages “shall not be less than a reasonable royalty for the unauthorized disclosure or use of a trade secret.” OR. REV. STAT. ANN. § 646.465(1)-(2). Similarly, Ohio provides that in lieu of measuring trade secret damages by other methods, damages “may be measured by imposition of liability for a reasonable royalty that is equitable under the circumstances considering the loss to the complainant, the benefit to the misappropriator, or both.” OHIO REV. CODE ANN. § 1333.63(A).

Given the importance of obtaining a meaningful remedy, consideration of the applicable measure of damages remains a significant factor.

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## J. Exemplary Damages

Is there a significant likelihood of recovering exemplary damages?

DTSA provides that when there is a willful and malicious misappropriation of a trade secret, a court may award exemplary damages not exceeding twice the compensatory damages awarded. 18 U.S.C. § 1836(b)(3)(C), (D). This provision is based on UTSA. Other states have adopted a comparable provision. *See, e.g.,* CAL. CIV. CODE § 3426.3.

While some trade secret laws do not provide for exemplary damages, a few provide for exemplary damages in an amount equal to actual damages, and other state laws provide for a greater recover of exemplary damages. *See, e.g.,* LA. REV. STAT. ANN. § 1433; MICH. COMP. LAWS ANN. § 445.1904. Ohio, for instance, permits exemplary damages in an amount not exceeding three times the compensatory damages award. OHIO REV. CODE ANN. § 1333.63(B). In addition, the statutory law of other states (including North Carolina, Mississippi, Vermont, Missouri and Montana) places no limits on the amount of exemplary damages that may be recovered for trade secret misappropriation. *See e.g.,* N.C. GEN. STAT. § 66-154(c); MISS. CODE ANN. § 75-26-7(2); VT. STAT. ANN. TIT. 9, § 4603(b); MISS. STAT. ANN. § 417.457(2); MONT. CODE ANN. § 30-14-404(2).

## K. Other Substantive and Procedural Differences

An analysis of other substantive and procedural differences between federal and state law may be case dispositive. Additional examples, including some noted in the legislative history of DTSA, may include:

- **Party Burden**—Identifying which party has “the burden of establishing that a trade secret is not readily ascertainable.” *See also* DTSA Senate Report, at 2 (noting as a potentially “case-dispositive” factor).
- **Innocent Acquisition Rights**—Determining “whether the owner has any rights against a party that innocently acquires a trade secret.” *See also id.* (noting as a potentially “case-dispositive” factor).
- **Pleading Requirements**—Confirming the ability to satisfy certain pleading requirements, such as CUTSA statutory requirement that “before commencing discovery relating to the trade secret, the party alleging the misappropriation shall identify the trade secret with reasonable particularity.” CAL. CIV. PROC. CODE § 2019.210. This pleading requirement does not apply under DTSA and other state trade secret laws.
- **Discovery Protections**—Protecting against the discovery of the trade secret (such as demonstration of a “substantial need”) before disclosure may be granted. *See, e.g.,* S.C. CODE ANN. § 39-8-60(b).

## L. Local Practice Issues

Finally, each court has local rules and practices that must be complied with. These rules and practices may impact the manner and timing of discovery or impose specific requirements in trade secret cases. As an example, the local rules for the U.S. District Court for the Northern District of California address sealing requests for trade secrets, and the court includes a model protective order to protect trade secrets.

Additionally, some particular state or federal courts have delays in the ability to hear a case due to a lack of judges or other factors. These local practice issues should be assessed concerning discovery and the timing for the case to be considered in selecting an appropriate forum for a remedy.

## III. Conclusion

One of the benefits of the new federal law is that it gives trade secret owners the choice on whether to pursue federal or state civil remedies. Trade secret owners can consider and elect which remedy may be most efficient and effective. This election enhances deterrence and the likelihood of obtaining an appropriate remedy.

As this article has shown, this assessment should be made on a case-by-case basis recognizing that state trade secret laws “vary in a number of ways and contain built-in limitations.” DTSA House Report, at 4. Some of the variations, either substantive or procedural, may be case-dispositive. In fact, trade secret owners may elect to pursue simultaneous remedies in federal court under both DTSA and its state law counterpart using the supplemental jurisdiction of federal courts. *See* 28 U.S.C. § 1367 (supplemental jurisdic-

tion). This article has surveyed a non-exhaustive set of factors that will weigh in the balance of this important decision.