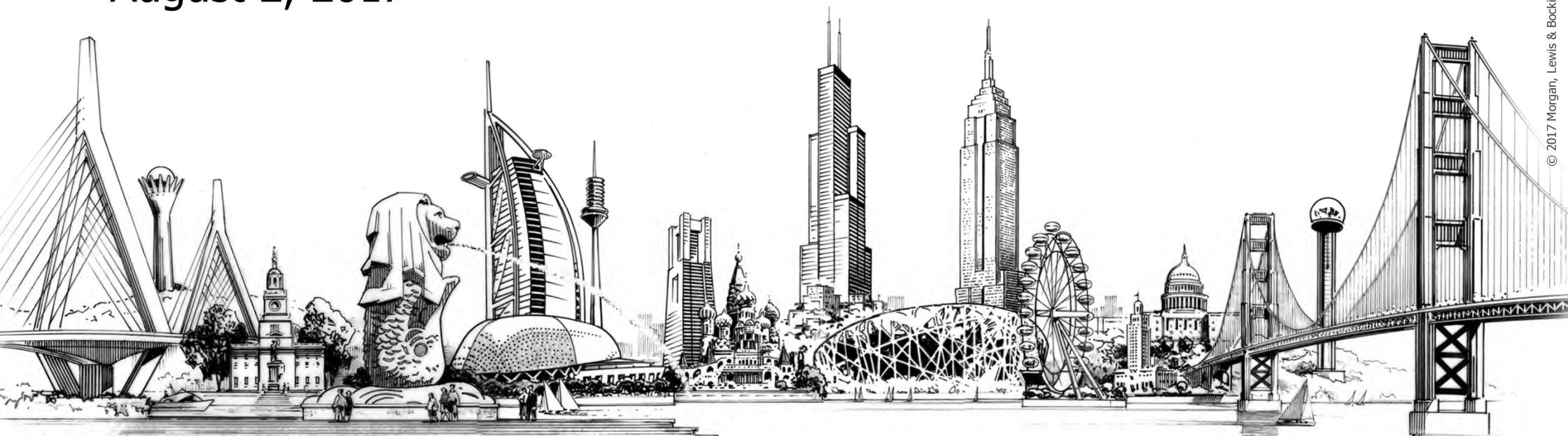


Morgan Lewis

TRADE SECRETS AND NONCOMPETITION DOING BUSINESS IN THE GOLDEN STATE WEBINAR SERIES

Debra Fischer
Chris Banks
Seth Gerber

August 2, 2017



SECTION 01

THE RULE AGAINST NONCOMPETES IN CALIFORNIA AND COMPANIES' EFFORTS TO CIRCUMVENT IT

Provisions Not to Compete Are Unenforceable in California

- In general, covenants not to compete are illegal and unenforceable in California under California Business and Professions Code section 16600. An employer's use of a covenant not to compete may also constitute an act of unfair competition in violation of California Business and Professions Code section 17200.
- California courts have applied section 16600 not only to invalidate absolute prohibitions on the exercise of a profession, trade, or business, but also to invalidate restrictive covenants that prevent an employee from doing business with a former employer's past or prospective clients.

Provisions Not to Compete are Unenforceable in California (cont'd)

- There are three statutory exceptions to section 16600:
 - covenants not to compete are permissible in contracts involving the sale of goodwill of a business;
 - in the dissolution of a partnership; and
 - in the dissolution or sale of a limited liability company.
- California does *not* have a “narrow-restraint” exception to its prohibition on covenants not to compete.

There Is No “Trade Secrets” Exception to Section 16600

- Language in some California cases suggests a “trade secrets exception” to section 16600’s prohibition on covenants not to compete. Based on language of one California Court of Appeal case, some employers use provisions that prohibit employees from soliciting the employers past or prospective customers through the use of trade secrets.
- However, cases suggesting the existence of a trade secrets exception were decided prior to the California Supreme Court’s seminal ruling in *Edwards*, which provided that “[n]oncompetition agreements are invalid under section 16600 in California, even if narrowly drawn, unless they fall within the applicable statutory exceptions of sections 16601, 16602, or 16602.5.”
- California courts also generally determine that it is redundant to have both a trade secrets provision and a provision protecting trade secrets in connection with the solicitation of clients; such provisions are not “necessary to protect the employer’s trade secrets,” and will not be enforced. *D’sa v. Playhut, Inc.*

A Choice of Law Clause Will Not Allow Employers to Circumvent California Public Policy in Favor of Employee Mobility

- Employers may try to avoid application of section 16600 by including a choice-of-law clause providing for application of the laws of a jurisdiction that enforces covenants not to compete, or permits them so long as they are reasonable in scope.
- This tactic is unlikely to be successful in California courts. Under the Restatement (Second) of Conflict of Laws, the court first determines if 1) the chosen state has a substantial relationship to the parties or the transaction, or 2) there is “any other reasonable basis for the parties’ choice of law.” If either test is met, the court then considers “whether the chosen state’s law is contrary to a fundamental policy of California.” If there is a fundamental conflict, the court determines whether California has a materially greater interest than the chosen state; if it does, the choice-of-law clause will not be enforced.

A Choice of Law Clause Will Not Allow Employers to Circumvent California Public Policy in Favor of Employee Mobility (cont'd)

- Courts have routinely held that section 16600 reflects a strong public policy of California and generally apply California law where California employees are involved.
- An employer would likely have greater success enforcing a forum selection clause. However, courts in other forums may still invalidate a choice-of-law provision based on California's strong public policy in favor of employee mobility. *See Ascension Ins. Holdings, LLC v. Underwood* (Del. Ch. Jan. 28, 2015).
- However, at least one court outside of California has enforced a choice of law provision in an employment agreement with a California employee containing a non-compete provision, in spite of California's public policy to the contrary. *See MCS Servs., Inc. v. Coronel* (Md. Cir. Ct. Mar. 4, 2008).

Courts in California May Enforce a Forum Selection Provision, Even Where the Chosen Forum Permits Covenants Not to Compete

- California State Courts

- Forum selection clauses are presumptively valid under state law. When a forum selection clause appears in “a contract entered into freely and voluntarily by parties who have negotiated at arm’s length, . . . forum selection clauses are valid and may be given effect, in the court’s discretion and in the absence of a showing that enforcement of such a clause would be unreasonable.” In general, the party opposing enforcement of a forum selection clause bears the burden of proving why it should not be enforced.
- But, California courts will refuse to defer to the selected forum if to do so would substantially diminish the rights of California residents in a way that violates the state’s public policy. Where the claims at issue are based on unwaivable rights created by California statutes, the burden of proof shifts, and the party seeking to enforce the forum selection clause bears the burden to show that litigating the claims in the contractually designated forum will not diminish in any way the substantive rights afforded under California law. *Verdugo v. Alliantgroup LP*.

Courts in California May Enforce a Forum Selection Provision, Even Where the Chosen Forum Permits Covenants Not to Compete (cont'd)

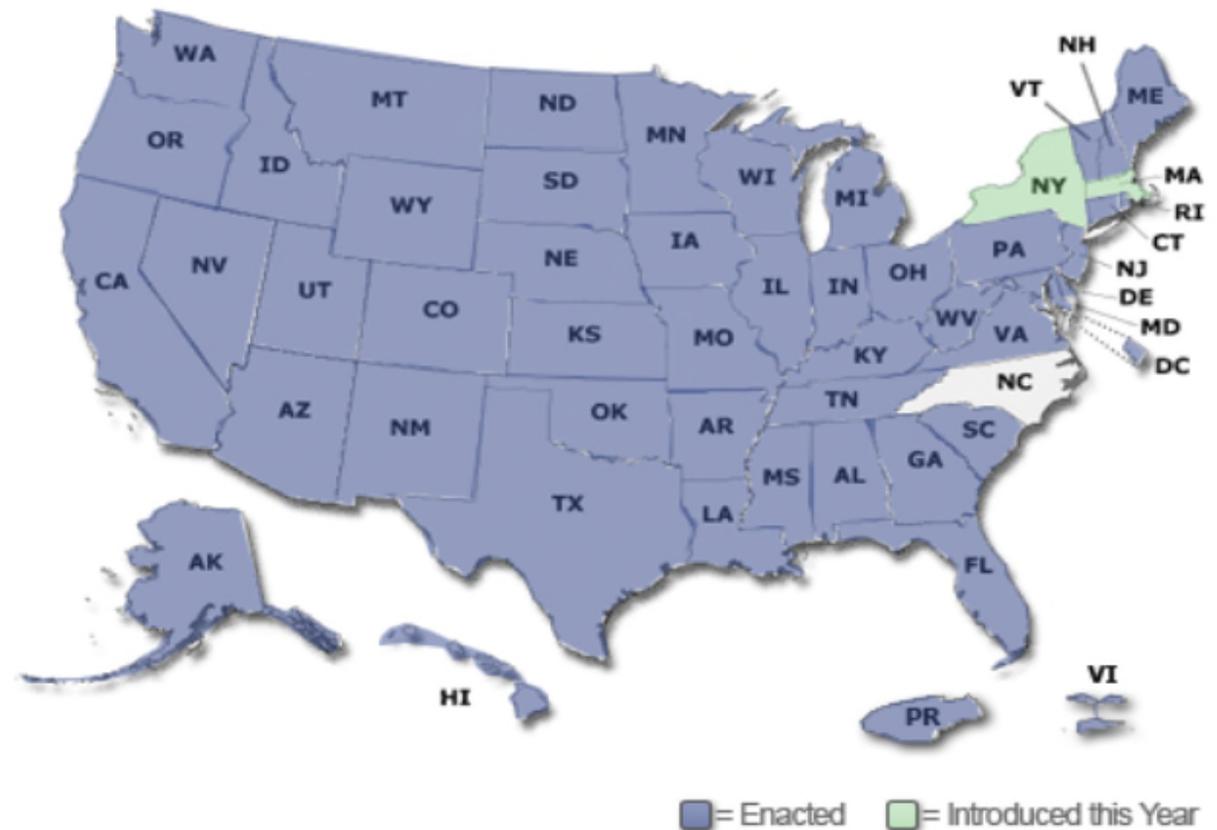
- California Federal Courts
 - Federal courts in California have generally enforced forum selection clauses in covenant not-to-compete cases. Federal courts have been particularly receptive to enforcing forum selection clauses after the Supreme Court's decision in *Atlantic Marine Constr. Co., Inc., v. U.S. Dist. Ct. for the W.D. of Tex.*, 134 S.Ct. 568, 581 (2013), which held that "a valid forum-selection clause [should be] given controlling weight in all but the most exceptional cases."
 - Under federal law as applied by California district courts, a forum selection clause is prima facie valid and enforceable unless the party challenging enforcement shows that the clause is unreasonable.
- Effect of California Labor Code Section 925, effective 1/1/17 – prohibits employers from requiring California employees to enter into non-California choice-of-law or choice-of-forum provisions as a condition of employment

SECTION 02

TRADE SECRET LAW OVERVIEW: UTSA, CUTSA, AND DTSA

Uniform Trade Secrets Act (UTSA)

- Uniform Law Commissioners (1979)
 - Amended (1985)
- 47 States
 - California – CUTSA
 - Also DC, Puerto Rico, and Virgin Islands
 - Non-UTSA States
 - Massachusetts
 - New York
 - North Carolina
- Variations among the states
 - Procedural
 - Substantive



2016: Federal Defend Trade Secrets Act (DTSA) Became Law

- Amends Economic Espionage Act of 1996
 - Federal criminal statute
- New federal civil right of action
 - New tools and protections
 - Addresses digital trade secret issues

One Hundred Fourteenth Congress
of the
United States of America

AT THE SECOND SESSION

*Began and held at the City of Washington on Monday,
the fourth day of January, two thousand and sixteen*

An Act

To amend chapter 90 of title 18, United States Code, to provide Federal jurisdiction for the theft of trade secrets, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the “Defend Trade Secrets Act of 2016”.

SEC. 2. FEDERAL JURISDICTION FOR THEFT OF TRADE SECRETS.

(a) IN GENERAL.—Section 1836 of title 18, United States Code, is amended by striking subsection (b) and inserting the following:
“(b) PRIVATE CIVIL ACTIONS.—

“(1) IN GENERAL.—An owner of a trade secret that is misappropriated may bring a civil action under this subsection if the trade secret is related to a product or service used in, or intended for use in, interstate or foreign commerce.

“(2) CIVIL SEIZURE.—

“(A) IN GENERAL.—

“(i) APPLICATION.—Based on an affidavit or verified complaint satisfying the requirements of this paragraph, the court may, upon ex parte application but only in extraordinary circumstances, issue an order providing for the seizure of property necessary to prevent the propagation or dissemination of the trade secret that is the subject of the action.

“(ii) REQUIREMENTS FOR ISSUING ORDER.—The court may not grant an application under clause (i) unless the court finds that it clearly appears from specific facts that—

“(I) an order issued pursuant to Rule 65 of the Federal Rules of Civil Procedure or another form of equitable relief would be inadequate to achieve the purpose of this paragraph because the party to which the order would be issued would evade, avoid, or otherwise not comply with such an order;

“(II) an immediate and irreparable injury will occur if such seizure is not ordered;

“(III) the harm to the applicant of denying the application outweighs the harm to the legitimate interests of the person against whom seizure would be ordered of granting the application and

DTSA Is Complementary to State Law Claims

114TH CONGRESS } 2d Session	HOUSE OF REPRESENTATIVES	{ REPORT 114-529
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DEFEND TRADE SECRETS ACT OF 2016		
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APRIL 26, 2016.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed		
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Mr. GOODLATTE, from the Committee on the Judiciary, submitted the following		
R E P O R T		
[To accompany S. 1890]		

The Act's definition of misappropriation is modeled on the Uniform Trade Secrets Act, versions of which have been adopted by [47] states. The Act does not pre-empt these state laws and offers a complementary Federal remedy if the jurisdictional threshold for Federal jurisdiction is satisfied. The Act defines misappropriation

Trade Secrets Defined

- (1) Nonpublic information
- (2) Subject to “reasonable measures” to protect the information
- (3) Independent economic value from not being publicly known

18 U.S.C. § 1839(3)

Misappropriation of Trade Secrets

- Acquisition, disclosure, or use by **improper means** and without consent
 - Misrepresentation, breach or inducement of breach of duty to maintain secrecy
 - **Not** improper if readily ascertainable, reverse engineer, independent development
- Person knows **or has reason to know**:
 - Acquisition was made by **improper means**
 - Acquisition was made by mistake or accident **and** the person had knowledge before the material change in position

Remedies for Misappropriation

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"(II) an immediate and irreparable injury will occur if such seizure is not ordered;

"(III) the harm to the applicant of denying the application outweighs the harm to the legitimate interests of the person against whom seizure would be ordered of granting the application and

"(3) REMEDIES.—In a civil action brought under this subsection with respect to the misappropriation of a trade secret, a court may—

- Award damages, assessed by:
 - Actual loss and unjust enrichment (to the extent they are not duplicative); or
 - Reasonable royalty
 - California state claim: May be awarded by a court for unauthorized use of a trade secret, but only if actual loss and unjust enrichment are "unprovable"
 - Federal claim: Plaintiff's election; for use or disclosure; presumably jury decision
- Grant an injunction
- Award exemplary damages & attorney fees

Remedy for Misappropriation: Injunctive Relief

- Types of Injunctions:
 - Prevent actual or threatened misappropriation
 - Require affirmative actions to protect the trade secret
 - Condition future use of the trade secret upon payment of a reasonable royalty (in exceptional circumstances)
- Restrictions on Injunctive Relief – The Feinstein Amendment:
 - Cannot prevent person from entering employment relationship or impose conditions on employment without **“evidence of threatened misappropriation”**
 - Cannot be premised “merely on the information the person knows,”
i.e., no inevitable disclosure doctrine
 - Cannot “conflict with an applicable State law prohibiting restraints on the practice of a lawful profession, trade, or business”
 - *i.e.*, California Bus. & Prof. Code § 16600

Preliminary Equitable Relief: TROs and Injunctions

- California law
 - Cal. Civ. Code 3426.2(a)
 - TRO and preliminary injunction available
 - Expedited discovery
- Federal Rule of Civil Procedure 65
 - TRO available if the plaintiff demonstrates that, absent the order, it will suffer “immediate and irreparable injury, loss or damage”
 - TRO may be granted ex parte
 - TRO may provide for seizures and preservation of evidence
- Question – DTSA’s practical impact on these remedies?

DTSA Seizure Orders

- TRO inadequate
- Immediate and irreparable injury will result without seizure
- Balancing harm
- Likelihood of success
- Describe matter to be seized with “reasonable particularity” and identify location for seizure
- Risk that the trade secret may be destroyed, moved, hidden, or otherwise inaccessible with notice
- Applicant has not publicized requested seizure
- Damages available for wrongfully obtained seizure orders

Remedy for Misappropriation: Exemplary Damages & Attorney Fees

- A court may award **exemplary damages** not exceeding twice the compensatory damages awarded when there is a **willful** and **malicious** misappropriation of a trade secret.
- A court may also award **attorney fees** when:
 - there is a willful and malicious misappropriation of a trade secret, or
 - the claim of misappropriation was made in bad faith, or
 - the motion to terminate an injunction was made in bad faith, or
 - the motion to terminate an injunction was opposed in bad faith.

Whistleblower Protections & Notice Requirements

- Congress specifically protected certain whistleblower activities from criminal or civil liability
 - Reporting of suspected violations of law
 - Employee retaliation lawsuits
- Notice of the whistleblower immunity must be provided to “employees” in their contracts “governing the use of a trade secret or other confidential information” or a relevant “policy document”
 - Does not apply to contracts entered into before 5/11/2016
 - “Employee” is defined to include “any individual performing work as a contractor or consultant for an employer”
- Consequence for failure to comply
 - No exemplary damages
 - No attorney fees for a federal misappropriation claim
 - Possibly other consequences?

The Notice Requirement — 18 U.S.C. § 1833(b)(3)

(3) NOTICE.—

(A) IN GENERAL.—An employer shall provide notice of the immunity set forth in this subsection in any contract or agreement with an employee that governs the use of a trade secret or other confidential information.

(B) POLICY DOCUMENT.—An employer shall be considered to be in compliance with the notice requirement in subparagraph (A) if the employer provides a **cross-reference** to a **policy document provided to the employee that sets forth the employer's reporting policy for a suspected violation of law**.

...

(D) APPLICABILITY.—This paragraph shall apply to **contracts and agreements that are entered into or updated after** the date of enactment of this subsection.

How to Comply with the Notice Requirement

- Include the following language in all agreements with employees, consultants, and contractors:

Notice of Immunity For Confidential Disclosure Of A Trade Secret To An Attorney, The Government Or In A Court Filing In Particular Circumstances

Federal law provides certain protections to individuals who disclose a trade secret to their attorney, a court, or a government official in certain, confidential circumstances. Specifically, federal law provides that an individual shall not be held criminally or civilly liable under any federal or state trade secret law for the disclosure of a trade secret under either of the following conditions:

Where the disclosure is made (i) in confidence to a Federal, State, or local government official, either directly or indirectly, or to an attorney; and (ii) solely for the purpose of reporting or investigating a suspected violation of law; or

Where the disclosure is made in a complaint or other document filed in a lawsuit or other proceeding, if such filing is made under seal. *See* 18 U.S.C. § 1833(b)(1)).

Federal law also provides that an individual who files a lawsuit for retaliation by an employer for reporting a suspected violation of law may disclose the trade secret to the attorney of the individual and use the trade secret information in the court proceeding, if the individual (A) files any document containing the trade secret under seal; and (B) does not disclose the trade secret, except pursuant to court order. *See* 18 U.S.C. § 1833(b)(2).

SECTION 03

**FILING ACTIONS AND REASONABLE MEASURES
FOR EMPLOYERS**

State vs. Federal Court

California Uniform Trade Secrets Act

- CUTSA claims are typically filed in California Superior Court
- CUTSA claims may be litigated in federal court based on diversity or supplemental jurisdiction or when combined with other causes of action that arise under federal law

Defend Trade Secrets Act of 2016

- DTSA provides for a private right of action in federal court if the trade secret is related to a product or service used in, or intended for use in, interstate or foreign commerce
- DTSA does not preempt state laws and provides a complementary federal remedy (i.e., you can pursue CUTSA and DTSA claims in a federal action)

Some Key Considerations (Rutter guide)

- Temporary restraining orders (TROS) are available in federal and state court
- Seizure orders are available in extraordinary cases under DTSA
- No preemptory challenge in federal court vs. one preemptory challenge in state court
- Cases proceed much slower in federal court
- No general denial in an answer in federal court
- No discovery before a scheduling conference in federal court
- Mandatory disclosures in federal court (i.e., witnesses, documents, damage computations, and liability insurance)
- More limited discovery in federal court
 - Relevancy as to a claim or defense must be proportional to the needs of the case
 - Typically limited to 10 depositions per side
 - 25 interrogatories in federal court vs. 35 or more in state court
- Can summarily adjudicate *part* of a claim or defense in federal court vs. summary adjudication of claims or defenses in state court
- 75-day notice requirement in state court for motions for summary judgment
- Differences in juries:
 - 6 to 12 jurors in federal court vs. 12 jurors in California superior court
 - Unanimous verdict in federal court vs. three-fourths of jurors in California

Reasonable Efforts to Protect Secrecy (CACI Jury Instruction No. 4404)

- To establish that the information is a trade secret, the plaintiff must prove that it made reasonable efforts under the circumstances to keep it secret.
- “Reasonable efforts” are the efforts that would be made by a reasonable person/business in the same situation and having the same knowledge and resources as the plaintiff, exercising due care to protect important information of the same kind.
- Extraordinary measures are not required.
- Every business does not need to implement the same measures for protection.

Reasonable Measures (CACI Jury Instruction No. 4404)

- Confidentiality markings
- Educating of employees/Employee handbooks
- Limiting of access to certain employees
- Restricted/secure areas
- Confidentiality or nondisclosure agreements
- Efforts to protect specific information
- General efforts to protect business information
- Availability of other measures that were not utilized to protect the information
- Other factors (such as building security cameras and electronic key card access to the premises)

Case Study:

Earthbound Corporation v. MiTek USA, Inc., 2016 WL 4418013 (W.D. Wash. Aug. 19, 2016)

- Former employee allegedly did the following:
- Accessed 23 files, connected a USB drive, and accessed Dropbox;
- Attempted to access Earthbound's network after resigned;
- Installed an app called OneDrive onto a computer to drag files into cloud storage;
- Installed an app called SmartSwitch to transfer content from a Samsung mobile device to a new smartphone;
- Accessed documents post resignation through a Google Drive account; and
- Forwarded work emails and documents from a Dropbox account to personal email account.

A Mobile Workforce: Modern Reasonable Measures

Companies must balance what is practical with the need to protect confidential and trade secret information.

- Provide company issued laptops, tablets, and smartphones
- Require passwords and encryption
- Enable firewalls
- Monitor internet usage
- Lock down or log USB drive usage/external hard drives
- Prohibit use of private emails for work
- Prohibit installation of unapproved software and applications
- Audit computers
- Require user IDs for photocopiers
- Install Data Loss Prevention (DLP) software (addresses web apps such as Dropbox, Google Apps or Salesforce)
- Install software to monitor and block unauthorized emails and attachments
- Install forensic and e-discovery software
- Require exit protocols/shut down access

USB Devices, Emails, and Dropbox: Examples of Options to Protect Your Information

USB Devices

- Block access
- Allow read but not write access to USB devices
- Allow read and write access to USB devices
- Establish justification protocol
- Monitor key files
- Use forensic tools

Emails

- Block access to private emails
- Monitor emails with keywords and attachment size
- Establish justification protocol
- Monitor key files
- Use forensic tools

Dropbox

- Block access
- Establish corporate Dropbox account
- Establish justification protocol
- Monitor key files
- Use forensic tools

Biography



Debra Fischer has practiced employment law and unfair competition/trade secret litigation for more than 25 years, successfully trying cases in both California state and federal courts as well as in arbitration. Debra regularly counsels employers in all aspects of employment law compliance, risk avoidance, and crisis management, with a particular focus on advising clients on issues and disputes that arise when employees change employment.

Debra L. Fischer

Partner

Century City

T +1.310.907.1111

debra.fischer@morganlewis.com

Biography



Seth M. Gerber is a trial lawyer whose practice focuses on trade secrets and business litigation. Seth has tried cases in state and federal courts, including both jury and bench trials, as well as in alternative dispute resolution forums. He was named one of the top 20 lawyers in California under the age of 40 in 2011 by the Los Angeles and *San Francisco Daily Journal*.

Seth M. Gerber

Partner

Century City

T +1.310.255.9111

seth.gerber@morganlewis.com

Biography



Christopher J. Banks

Partner

San Francisco

T +1.415.442.1364

christopher.banks@morganlewis.com

Chris Banks is a trial lawyer who helps companies from startups to the Fortune 500 solve problems concerning unfair competition, trade secret misappropriation and data security, employee departures, wage and hour disputes, and other labor and employment matters. He also advises on intellectual property rights, technology licensing and development arrangements, and breach of fiduciary duty and other business torts. His accomplishments include serving as lead trial counsel for Japanese pharmaceutical company Asahi Kasei Pharma Corp. in a three-month trial that resulted in the largest contested jury verdict in the United States for 2011. In 2014, he helped uphold that judgment on appeal to the California Supreme Court, with Asahi Kasei recovering more than \$523 million.

THANK YOU

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