

SECOND EDITION

TRADE SECRETS

Law and Practice

DAVID W. QUINTO
STUART H. SINGER

OXFORD

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Law and Practice

Second Edition

David W. Quinto

Stuart H. Singer



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Acknowledgments

My interest in addressing the strategies and tactics peculiar to trade secret litigation grew out of the move-countermove strategizing my former partner, Warrington S. Parker, engaged me in during our defense of a major trade secret misappropriation lawsuit a few years ago. Our client had hired several research-and-development employees from a single competitor within a short period. All were subject to noncompete agreements but they hailed from different states and countries. They were hired to work in California, which holds almost all noncompete agreements unenforceable. The trade secrets they knew overlapped with patents the competitor had obtained. In many instances, they had supported the development of products our client did not manufacture. The information they knew could potentially be useful in manufacturing our clients' products in areas where the two companies did compete, however. The suit thus provided abundant opportunities to raise "what if?" questions. And, after the competitor incurred \$35 million in fees solely to establish only that one chemical formula was taken but never used, it provided cause to think about what could have been done to prevent an enormously wasteful expenditure of legal fees only to establish that there was no there, there.

Four persons deserve enormous credit for all that may be good in this book. The first is my co-author, Stuart Singer, a former president of the *Harvard Law Review*, a former U.S. Supreme Court clerk, and a current member of the LawDragon 500 Best Lawyers in America. Stuart is an extraordinarily talented trial lawyer and, ever since we met during our first year of law school, has been an even more extraordinary friend. Stuart not only expressed immediate enthusiastic encouragement for the project upon hearing of it but allowed me to talk him into contributing his enormous intellect and courtroom experience to it. The chance to collaborate with Stuart was a wonderful thrill.

My Quinn Emanuel partner, Harry Olivar—also a former editor of the *Harvard Law Review*—skillfully edited the drafts of the first and second editions and, remarkably, almost persuaded me that there was nothing he more enjoyed doing.

Maeda Riaz, a former *Loyola of Los Angeles International and Comparative Law Review* editor employed by Quinn Emanuel, tirelessly researched numerous questions Stuart and I raised and cheerfully performed cite-checking,

proofreading, and editing duties as well. Stuart and I could not have completed the first edition without her contributions.

Dale Jachlewski researched numerous issues for the second edition, grinned every time he dropped off copies of case printouts for me to review, and persuaded Lexis/Nexis to provide free research services.

In addition, I would be remiss if I failed to note that numerous Quinn Emanuel partners also contributed research, insights and suggestions. They included John Quinn, Jon Cederberg, Faith Gay, Robert Juman, Scott Lawson, Fred Lorig, Dale Oliver, Tom Pease, and Chris Tayback. I also owe a big “Thank you!” to all the members of the Quinn Emanuel Los Angeles office word processing staff, including especially, Pamela McKenna, for typing and retyping each edition of the book through multiple drafts, edits, and revisions.

Finally, I offer a special note of thanks to Lexis/Nexis for contributing research services used in researching this edition of *TRADE SECRETS: Law and Practice*.

David W. Quinto

My initial involvement with the project occurred when Oxford University Press asked me to review a proposal for a book on litigating trade secret cases. I was enthusiastic, not just because I knew David would do a superb job, but because I had previously looked for a concise practical guide to the subject.

Later, I was surprised, flattered, and tempted when David invited me to join him in co-authoring the work. There is no litigator of intellectual property matters in the country that I have greater respect for than David Quinto, who has been involved in some of the most meaningful trade secret disputes (think *GM v. Volkswagen*) and protected some of the most important intellectual properties (think “Oscar”). The fun of working with my good friend, and David’s willingness to undertake the lion’s share of the work, made the offer irresistible.

David deserves the overwhelming share of credit for the conception and execution of what, hopefully, will be a helpful guide. David, thanks for the opportunity to work together. I’d like to thank Pascual Oliu, a summer associate attending Harvard Law School, who assisted on research for the second edition. I would also like to thank my colleagues at Boies, Schiller & Flexner (especially Carlos Sires, Robert Silver, Ted Normand, and Joshua Riley) with whom I have worked on cases involving trade secrets and related matters and whose insights and talents I not only benefit from every day, but have drawn upon here.

Stuart H. Singer

Authors' Note

We wrote this book to benefit litigators who may only occasionally encounter a trade secret misappropriation claim, as well as in-house counsel who wish to take prophylactic measures to keep their clients out of trade secret disputes and challenge critically courses of action proposed by outside counsel if and when litigation does occur. We have identified the critical questions that arise in trade secret disputes. Many are unique to trade secret disputes. They include strategic concerns that relate to the desirability of seeking criminal prosecution before or during the pendency of a civil suit; bringing suit in a state that has adopted the Uniform Trade Secrets Act (UTSA) as opposed to one that still follows the Restatement (First) of Torts; bringing suit in a state that enforces noncompete agreements as opposed to one that does not; bringing suit in a state that recognizes the “inevitable disclosure” doctrine as opposed to one that rejects the doctrine; bringing suit in a state that requires the early identification of the plaintiff’s alleged trade secrets; or bringing suit in a state with a narrow view of the extent to which ancillary claims are preempted by the UTSA.

Similarly, we address such tactical concerns as whether a plaintiff should allege trade secret misappropriation at the outset or seek to amend its complaint to allege misappropriation later; whether it should allege misappropriation of all, or only a subset, of the secrets it believes were misappropriated; what ancillary claims should be alleged and how they might affect the likelihood that the case will be heard in federal, as opposed to state, court; and whether the plaintiff can circumvent battles related to the enforceability of restrictive covenants and the adequacy of its trade secrets identification.

We also change hats and approach the same issues from the defendant’s perspective, discussing the countermeasures it can take, the affirmative defenses unique to trade secret litigation it can assert, the type of discovery it can beneficially pursue, whether to seek to enforce an arbitration provision, and the places where it can find experts likely to puncture the plaintiff’s claim that its information is a trade secret.

In addition, we provide practical suggestions for minimizing the possibility that departing employees will take trade secrets with them and improving the employer’s litigation posture in the event they do. Similarly, we provide

practical advice intended to reduce the risk that litigation will ensue if a company hires its competitor's employees.

In doing the foregoing, we have above all attempted to identify questions and propose solutions in a practical manner. What we have not done is attempt to write a treatise that neutrally and thoroughly lays out the principles of trade secret law. That work has already been done. The most comprehensive treatise in the field is Roger M. Milgrim's *Milgrim on Trade Secrets* (Matthew Bender 2007). A more accessible resource for the ordinary practitioner is James M. Pooley's *Trade Secrets* (Law Journal Press) (updated biannually). It offers a concise and lucid exposition of all areas of trade secrets law. Also of great value to a practitioner is Melvin F. Jager's *Trade Secrets Law* (Thomson/West 2002, with supp. 2008), which contains a wealth of state-specific statutes and case law discussions.

This edition improves upon the first edition, we hope, through the inclusion of a new section on presumptions, inferences and burden-shifting; an expanded arbitration section; and discussions of the latest developments in the evolving areas of Computer Fraud and Abuse Act interpretation and damages and UTSA preemption of state law claims.

As always, responsibility for any errors rest with the authors. We will be flattered if readers think highly enough of the book to let us know of any errors they find or suggestions for improvement they have.

DWQ and SHS
January, 2012

About the Authors

David W. Quinto helped found Quinn Emanuel Urquhart & Sullivan, an international trial firm known for handling complex, high-profile cases. He has successfully represented numerous “Fortune 500” companies in intellectual property matters, is a World Intellectual Property Organization domain name dispute resolution panelist, and is principally responsible for protecting the intellectual property rights of the Academy of Motion Picture Arts and Sciences. He has previously authored a treatise analyzing the application of tort law to the Internet entitled *Law of Internet Disputes* (Aspen Law and Business, 2002) and a chapter in *Trade Marks at the Limit* (Edward Elgar Publishing, 2006). He is annually voted a Southern California Super Lawyer and has been included in LawDragon’s 500 Leading Lawyers in America. He attended Harvard Law School.

Stuart H. Singer is a partner with Boies, Schiller & Flexner, LLP, a firm specializing in complex, high-stakes litigation. As a trial lawyer for over 25 years, Mr. Singer has successfully handled many significant and complex cases before judges, juries, arbitration panels, and appellate courts throughout the United States. He has won trials for major businesses in Florida, New York, California, Georgia, and Colorado. His practice has included intellectual property and trade secret matters, as well as antitrust, securities, RICO, and constitutional law cases. Mr. Singer has been included in LawDragon’s 500 Leading Lawyers in America, as well as in *Best Lawyers in America* and *Chambers U.S.A. Guide to Leading Lawyers for Business*. Mr. Singer is a member of the American Law Institute and has spoken widely before professional audiences on litigation topics. He attended Harvard Law School, where he was elected president of the *Harvard Law Review*, and from 1981 to 1983, served as a law clerk at the United States Supreme Court for Associate Justice Byron R. White.

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In the civil arena, trade secret protection in the United States is provided almost exclusively under state law.¹ As of early 2008, 48 American jurisdictions (including Washington, D.C., and the U.S. Virgin Islands), had adopted either the Uniform Trade Secrets Act substantially as drafted in 1979 or the Uniform Trade Secrets Act substantially as amended in 1985. (The Act, as amended, will be referred to herein as the UTSA).² Massachusetts has trade

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1. The exception to the rule that the civil trade secret misappropriation actions are exclusively the creature of state law is the ability to bring proceedings before the International Trade Commission (ITC). The ITC has determined that misappropriation of trade secrets is an unfair trade practice pursuant to § 337 of the Trade Act of 1974, 19 U.S.C. § 1337. *See* Chapter 2(C)(3), *infra*. As discussed in Chapter 6, various federal (and state) criminal statutes potentially apply to the theft of trade secret information.
 2. **Alabama:** ALA. CODE §§ 8-27-1 to 8-27-6 (2007); **Alaska:** ALASKA STAT. §§ 45.50.910–45.50.945 (2007); **Arizona:** ARIZ. REV. STAT. §§ 44-401 to 44-407 (2007); **Arkansas:** ARK. CODE §§ 4-75-601 to 4-75-607 (2007); **California:** CAL. CIV. CODE §§ 3426–3426.11 (2007);

secret protection statutes that were not modeled after the UTSA;³ North Carolina's statute is only loosely based on the 1979 version of the UTSA;⁴ and New York, New Jersey, and Texas have no statutes at all.⁵ That is not to say that trade secret misappropriation is permissible in those states; rather, it means only that trade secret misappropriation there is governed by common-law principles, as enunciated in the *Restatement (First) of Torts* (1939). The *Restatement (Third) of Unfair Competition* (1995) provides an important, more current, view of trade secret law, relevant both to states that have adopted the UTSA and those that provide common-law protection.⁶

Colorado: COLO. REV. STAT. §§ 7-74-101 to 7-74-110 (2007); **Connecticut:** CONN. GEN. STAT. §§ 35-50 to 35-58 (2007); **Delaware:** DEL. CODE ANN. tit. 6 §§ 2001-2009 (2007); **District of Columbia:** D.C. CODE ANN. §§ 36-401 to 36-410 (2007); **Florida:** FLA. STAT. ANN. §§ 688.001-688.009 (2007); **Georgia:** GA. CODE ANN. §§ 10-1-760 to 10-1-767 (2007); **Hawaii:** HAW. REV. STAT. ANN. §§ 482B-1 to 482B-9 (2007); **Idaho:** IDAHO CODE ANN. §§ 48-801 to 48-807 (2007); **Illinois:** 765 ILL. COMP. STAT. ANN. §§ 1065/1 to 1065/9 (2007); **Indiana:** IND. CODE ANN. §§ 24-2-3-1 to 24-2-3-8 (2007); **Iowa:** IOWA CODE ANN. §§ 550.1-550.8 (2006); **Kansas:** KAN. STAT. ANN. §§ 60-3320 to 60-3330 (2006); **Kentucky:** KY. REV. STAT. ANN. §§ 365.880-365.900 (2007); **Louisiana:** LA. REV. STAT. ANN. §§ 51:1431-51:1439 (2007); **Maine:** ME. REV. STAT. tit. 10, §§ 1541-1548 (2007); **Maryland:** MD. CODE ANN., COM. LAW §§ 11-1201 to 11-1209 (2007); **Michigan:** MICH. COMP. LAWS ANN. §§ 445.1901-445.1910 (2007); **Minnesota:** MINN. STAT. ANN. §§ 325C. 01-325C. 08 (2007); **Mississippi:** MISS. CODE §§ 75-26-1 to 75-26-19 (2007); **Missouri:** MO. ANN. STAT. §§ 417.450-417.467 (2007); **Montana:** MONT. CODE ANN. §§ 30-14-401 to 30-14-409 (2007); **Nebraska:** NEB. REV. STAT. §§ 87-501 to 87-507 (2007); **Nevada:** NEV. REV. STAT. ANN. 600A. 010-600A. 100 (2007); **New Hampshire:** N.H. REV. STAT. ANN. §§ 350-B: 1 to 350-B: 9 (2007); **New Mexico:** N.M. STAT. ANN. §§ 57-3A-1 to 57-3A-7 (2007); **North Dakota:** N.D. CENT. CODE §§ 47-25.1-01 to 47-25.1-08 (2007); **Ohio:** OHIO REV. CODE §§ 1333.61-1333.69 (2007); **Oregon:** OR. REV. STAT. §§ 646.461-646.475 (2005); **Oklahoma:** OKLA. STAT. ANN. tit. 78, §§ 85-94 (2007); **Pennsylvania:** 12 PA. CONS. STAT. ANN. §§ 5301-5308 (2007); **Rhode Island:** R.I. GEN. LAWS §§ 6-41-1 to 6-41-11 (2007); **South Carolina:** S.C. CODE ANN. §§ 39-8-10 to 39-8-130 (2006); **South Dakota:** S.D. CODIFIED LAWS §§ 37-29-1 to 37-29-11 (2007); **Tennessee:** TENN. CODE ANN. §§ 47-25-1701 to 47-25-1709 (2007); **Utah:** UTAH CODE ANN. §§ 13-24-1 to 13-24-9 (2007); **Vermont:** VT. STAT. ANN. tit. 9, §§ 4601-4609 (2007); **Virginia:** VA. CODE ANN. §§ 59.1-336 to 59.1-343 (2007); **Washington:** WASH. REV. CODE ANN. §§ 19.108.010-19.108.940 (2007); **West Virginia:** W. VA. CODE ANN. §§ 47-22-1 to 47-22-10 (2007); **Wisconsin:** WIS. STAT. ANN. § 134.90 (2006); **Wyoming:** WYO. STAT. ANN. §§ 40-24-101 to 40-24-110 (2007); **U.S. Virgin Islands:** 11 V.I. CODE ANN. §§ 1001-1010 (2007).

3. **Massachusetts:** MASS. ANN. LAWS ch. 93, §§ 42-42A (1975).

4. **North Carolina:** N.C. GEN. STAT. §§ 66-152 to 66-157 (1981).

5. **New York:** See *Sofitel, Inc. v. Dragon Med. & Scientific Commc'ns, Inc.*, 118 F.3d 955, 968 (2d Cir. 1997); **New Jersey:** See *Rohm & Haas Co. v. Adco Chem. Co.*, 689 F.2d 424, 429-31 (3d Cir. 1982); **Texas:** See *Hurst v. Hughes Tool Co.*, 634 F.2d 895, 896 (5th Cir. 1981).

6. See discussion of RESTATEMENT (THIRD) OF UNFAIR COMPETITION (1995) at Chapter 1(B), *infra*.

A. The Majority Rule: “Trade Secret” as Defined by the UTSA

The UTSA provides the following imprecise definition of the types of information that are subject to its protection:

“Trade Secret” means information, including a formula, pattern, compilation, program, device, method, technique, or process, that:

- (i) derives independent economic value, actual or potential from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use, and
- (ii) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.

The elements of the statutory definition are, for the most part, interpreted broadly.

1. Meaning of “Information”

Virtually any type of information is potentially protectable under the UTSA.⁷ This is also true under the *Restatement (Third) of Unfair Competition*, which defines a “trade secret” simply and broadly:

A trade secret is any information that can be used in the operation of a business or other enterprise and that is sufficiently valuable and secret to afford an actual or potential economic advantage over others.⁸

7. The Founding Fathers envisioned that each state would be free to enact its own laws in any area not reserved by the U.S. Constitution for the federal government. The individual states were encouraged to act as social laboratories, experimenting to see which laws worked best. However, the demands of interstate and international commerce require that there be predictability and consistency in the law from state to state. To that end, the National Conference of Commissioners on Uniform State Laws—a nonprofit, unincorporated association of lawyers, legal scholars, and other professionals—has crafted a series of “universal” laws (partnering with the American Law Institute on the Uniform Commercial Code), anticipating their adoption by a large number of states. Because such laws, including the UTSA, are intended to be uniform in their application, it follows that cases from other jurisdictions interpreting the UTSA have substantial precedential value. That principle is reflected in Section 8 of the UTSA, which provides that “this [Act] shall be applied and construed to effectuate its general purpose to make uniform the law with respect to the subject of this [Act] among states enacting it.” Regrettably, not all states that have adopted the UTSA have adopted Section 8.

8. RESTATEMENT (THIRD) OF UNFAIR COMPETITION § 39 (1995).

As explained by the Iowa Supreme Court:

There is virtually no category of information that cannot, as long as the information is protected from disclosure to the public, constitute a trade secret. We believe that a broad range of business data and facts which, if kept secret, provide the holder with an economic advantage over competitors or others, qualify as trade secrets.⁹

Or, as Judge Richard A. Posner has explained:

A trade secret is really just a piece of information (such as a customer list, or a method of production, or a secret formula for a soft drink) that the holder tries to keep secret . . . , so that the only way the secret can be unmasked is by [unlawful activity].¹⁰

Under the common law (and as specified in the *Restatement (First) of Torts* Section 757, comment b), information has to be in actual use, and usually in continuous use, to be protectable as a trade secret.¹¹ Because the UTSA defines “trade secret” as information that derives independent economic value, “actual or potential,” from not being generally known, the UTSA does not require actual use of trade secret information by the plaintiff.¹²

The classic example of information that has value even though it is not in actual use is “negative know-how,” or knowledge of what does not work. Such information derives independent economic value because its disclosure to a competitor could potentially allow the competitor to avoid fruitless research approaches and shorten the competitor’s time to market with a

9. *Economy Roofing & Insulating Co. v. Zumaris*, 538 N.W.2d 641, 647 (Iowa 1995).

10. *ConFold Pac., Inc. v. Polaris Indus.*, 433 F.3d 952, 959 (7th Cir. 2006) (citations omitted).

11. See RESTATEMENT (FIRST) OF TORTS § 757 cmt. b (1939) (requiring actual use of the secret in a trade or business).

12. The “actual use” requirement survives in New York, at least with respect to cases involving the submission of ideas that are not in actual use. For example, in *Hudson Hotels Corp. v. Choice Hotels Int’l*, 995 F.2d 1173, 1176–77 (2d Cir. 1993) (abrogated in part as stated in *Nadel v. Play-by-Play Toys & Novelties, Inc.*, 208 F.3d 368, 379 (2d Cir. 2000)), the Second Circuit overturned the denial of the defendant’s summary judgment motion directed to the concept for a small-sized upscale hotel room having an unusual design. Similarly, in *Boyle v. Stephens, Inc.*, No. 97CIV. 1351(SAS), 1997 WL 529006, at *4, 44 U.S.P.Q.2d (BNA) 1138, 1142 (S.D.N.Y. Aug. 26, 1997), *aff’d*, 21 Fed. Appx. 76 (2d Cir. 2001), the court held that the submission of an idea to an investment banker for a new form of derivative security could not be recognized as a trade secret because New York does not recognize marketing concepts and new product ideas as trade secrets; moreover, a trade secret must be used both secretly and continuously in commerce to qualify for protection.

In an unpublished opinion, the Fourth Circuit held that, under Massachusetts law, for information to qualify as a trade secret it must be in continuous use in the plaintiff’s business. See *Trimless-Flashless Design, Inc. v. Thomas & Betts Corp.*, 34 Fed. Appx. 913, 2002 WL 970428 (4th Cir. 2002).

competing product.¹³ *The Restatement (Third) of Unfair Competition*, which attempts to add definition to the UTSA, explains:

Some early cases elevated use by the trade secret owner to independent significance by establishing such use as an element of the cause of action for the appropriation of a trade secret. Such a “use” requirement, however, imposes unjustified limitations on the scope of trade secret protection. The requirement can deny protection during periods of research and development and is particularly burdensome for innovators who do not possess the capability to exploit their innovations. The requirement also places in doubt protection for so-called “negative” information that teaches conduct to be avoided, such as knowledge that a particular process or technique is unsuitable for commercial use. Cases in many jurisdictions expressly renounce any requirement of use by the trade secret owner. It is also rejected under the Uniform Trade Secrets Act.¹⁴

Comment h to the *Restatement (Third) of Unfair Competition* Section 39 further explains that imposing a “use” requirement could deny trade secret protection to ideas, thus leaving only claims for breach of an express or implied contract as potential remedies for an idea theft.

Unlike the requirement for patentability, information need not be novel to be protectable. In this regard, “[t]he scope of protectible [*sic*] trade secrets is far broader than the scope of patentable technology.”¹⁵ A trade secret may be a device or process that is anticipated in the prior art or that constitutes a mere mechanical improvement. A trade secret may also consist of information known to competitors, provided that it is not “generally known.”¹⁶ Although the language of the USTA is worded in terms of general public knowledge, it makes sense to focus upon the knowledge held by competitors in the field. If the principal entity that could obtain economic benefit from the information is aware of it, there is no trade secret.¹⁷

A trade secret may include elements that are in the public domain if the trade secret itself constitutes a unique, “effective, successful and valuable integration of the public domain elements.”¹⁸ Information may be protectable as

13. See *Gillette Co. v. Williams*, 360 F. Supp. 1171, 1173 (D. Conn. 1973); *Courtesy Temporary Serv., Inc. v. Camacho*, 222 Cal. App. 3d 1278, 1287–88, 272 Cal. Rptr. 352, 357–58 (1990) (extending protection to list of customers that had not purchased the plaintiff’s services); see also *Metallurgical Indus., Inc. v. Fourtek, Inc.*, 790 F.2d 1195, 1202–03 (5th Cir. 1986) (dictum).

14. RESTATEMENT (THIRD) OF UNFAIR COMPETITION § 39 cmt. e (1995) (citation omitted).

15. *CVD, Inc. v. Raytheon Co.*, 769 F.2d 842, 850 (1st Cir. 1985).

16. UTSA § 1 (1985).

17. See UTSA § 1 (1985) (Commissioners’ cmt.).

18. *Rivendell Forest Prods., Ltd. v. Ga.-Pac. Corp.*, 28 F.3d 1042, 1046 (10th Cir. 1994); See also *Metallurgical Indus., Inc. v. Fourtek, Inc.*, 790 F.2d 1195, 1202 (5th Cir. 1986) (“[A] trade secret can exist in a combination of characteristics and components, each of which, by itself, is in the public domain, but the unified process, design and operation of which is unique