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A Year in Review: What's New in the World of Trade Secrets and Non-Competes

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Agenda

1. Developments Regarding Restrictive Covenants, Trade Secrets, and Choice of Law Issues
2. Legislative Update
3. Questions and Answers

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What's New in the World of Restrictive Covenants?

What is Adequate Consideration for a Restrictive Covenant?

Illinois

Fifield v. Premier Dealer Services, Inc. (Ill. App. Ct. 2013)

Absent other consideration, two years of employment is required for *any* restrictive covenant to be deemed supported by adequate consideration

- even where the employee signed the restrictive covenant as a condition to his employment offer and
- even where the employee voluntarily resigned.

IL S.Ct. declined to weigh in.

No other IL appellate court has done so.

What is Adequate Consideration for a Restrictive Covenant?

Illinois

- Federal district judges in Chicago disagree as to whether *Fifield* is binding
- *Montel Aetnastak, Inc. and Montel Inc. v. Kristine Miessen et al*. (N.D. Ill. Jan. 28, 2014) (Castillo, J) – *Fifield* not binding
- *Instant Technology, LLC v. DeFazio et al*. (N.D. Ill. May 2, 2014) (Holderman, J.) – *Fifield* is binding

Stay Tuned.

What is adequate consideration for a restrictive covenant?

Pennsylvania:

Socko v. Mid-Atlantic Systems (PA Super. 2014)

- At-will salesman in the basement water proofing industry signed a non-compete after he was already employed.
- Court reiterated that "when the restrictive covenant is added to an existing employment relationship, . . . to restrict himself the employee must receive a corresponding benefit or a change in job status."
- Because mere continued at-will employment is not consideration under PA law, court refused to enforce agreement.

“Material change” defense still alive and well in MA

- Restrictive covenant not enforceable if employee’s job duties, compensation or employment relationship substantially change between signing and time employee left company.
- Doctrine originated in MA in 1968; not directly adopted by other states.
- Doctrine reiterated in two recent MA decisions: *Intepros, Inc. v. Athy* (MA Super. 2013) and *Rent-A-PC, Inc., d/b/a SmartSource Computer & Audio Visuals v. March* (D. MA 2013).

Limits on Corporate Competition: Different Analysis?

- *Owens Trophies, Inc. f/k/a R.S. Owens and Company, Inc. v. Bluestone Designs & Creations, Inc. and Society Awards* (N.D. Ill. 2014)
- Company agreed not to provide Emmy Awards to any other person or entity.
- When it did so anyway, it was sued for allegedly violating the not-compete.
- Defendant argued that the non-compete was unenforceable because not supported by a legitimate business interest.
- Court held that an agreement between corporations not to engage in certain competitive activities is not analyzed like an employer/employee non-compete.
- Rather, because no imbalance of power, contract enforceability is analyzed like any other arms-length transaction.

NY Court Declines to Enforce "No Hire" Agreement

- *Reed Elsevier Inc. v. Transitions Holding Co., Inc.* (SD NY 2014)
- At issue: an employee non-poach agreement between two companies entered as a result of a prior settlement.
- The Court refused to enforce the non-hire agreement.

Four legitimate interests in New York

In New York, there are four legitimate interests that may support a restrictive covenant:

- protection of trade secrets
- protection of confidential customer information
- protection of the employer's client base
- protection against irreparable harm where the employee's services are unique or extraordinary.
- Court held that the plaintiff could not show any of these "legitimate business interests."
- Court rejected the argument that risk of employee attrition should be considered a legitimate interest.

Solicitation: Distinction Between Officers and Non-officers?

Xylem Dewatering Solutions, Inc. (Ill. App. 5th Dist. 2014)

- Defendants asked customers and suppliers of their current employer "what they 'thought' about" the defendants' formation of a new, competitive business.
- But, defendants never "actually solicited any business or sold goods and services" to their then-employer's customers on behalf of their new business until they had resigned and started the new business.
- Defendants "agreed that those conversations were intended to persuade" customers and suppliers "to eventually do business with" their new business.

Solicitation: Distinction Between Officers and Non-officers?

IL Appellate Court held that it was not an abuse of discretion for the trial court to conclude that these conversations were merely "preliminary actions" that did "not rise to the level of a breach of an *ordinary* employee's duty of loyalty." (emphasis added).

Solicitation: Distinction Between Officers and Non-officers?

Distinction drawn between the duty of loyalty owed by ordinary employees and corporate officers

- ✓ Ordinary employees are permitted "to plan and outfit a competing corporation so long as they do not commence competition"
- ✓ Corporate officers are prohibited from "actively exploit[ing] their positions within a corporation for their own personal benefit" or "hinder[ing] the ability of a corporation to continue the business for which it was developed"

Injunction Bonds: Federal Court

- FRCP gives court great discretion when setting amount of injunction bond:

- "[t]he court may issue a preliminary injunction or a temporary restraining order only if the movant gives security *in an amount that the court considers proper* to pay the costs and damages sustained by any party found to have been wrongfully enjoined or restrained." (FRCP 65 (c))

Injunction Bonds: different state approaches

States take different approaches:

- IL – no bond is required
- IN – bond is required in an amount sufficient "for the payment of such costs and damages as may be incurred or suffered by any party who is found to have been wrongfully enjoined or restrained."

Injunction Bonds: different state approaches

- *Donald Moss v. Progressive Design Apparel, Inc.* (IN App. Ct. 2014) – reversed token injunction bond of only $100; enforced literal words of the applicable IN rule of civil procedure

- Moral of the story: be prepared to argue about the bond.

Can Your Cease and Desist Letter Lead to a Tortious Interference Claim?

Rick Bonds v. Philips Electronic North America, (E.D. MI, January 21, 2014)

- Cease and Desist letters are "standard operating procedure" in most cases involving trade secret misappropriation.
- Many responsible companies that receive a Cease and Desist letter will promptly investigate and return any confidential material that found its way into its systems. They may also terminate the employee who brought the stolen material over.
- In *Rick Bonds v. Philips Electronic*, an employee sued his former employer for tortious interference based on a Cease and Desist letter Philips sent to the employee's subsequent employer that resulted in the employee's termination.
- The Court dismissed the employee's tortious interference claim against Philips because the Cease and Desist letter was sent in furtherance of a legitimate business interest in protecting its confidential information.

Can Your Cease and Desist Letter Lead to a Tortious Interference Claim?

- Lessons: Employers should feel comfortable sending appropriate Cease and Desist letters to former employees and, when appropriate, subsequent employers, as long as there is a good faith basis for the letter and a legitimate business interest at stake.
- Cease and Desist letters must be carefully drafted to avoid opening the door to claims for defamation or tortious interference. Avoid gratuitous or disparaging comments that could evidence malice and emphasize the business interest that is at stake as a result of the employee's alleged conduct.

"Fire, Ready, Aim": The Danger of Employer Overreaching When Asserting a Misappropriation Claim

FLIR Systems, Inc. v. William Parrish, et al., 174 Cal. App. 4th 1270 (2009)

- FLIR commenced a misappropriation of trade secrets action against two former officers in 2006.
- After denying FLIR's motion for injunctive relief, the court found that FLIR brought the action in bad faith and awarded defendants $1.6 million in attorneys fees.
- The employees then sued FLIR for malicious prosecution, as well as FLIR's counsel Latham & Watkins.
- The malicious prosecution case against L&W was initially dismissed on statute of limitation grounds, but was reinstated on appeal in 2014.

“Fire, Ready, Aim”: The Danger of Employer Overreaching

- The court allowed the malicious prosecution claim to proceed even though the court in the underlying case had previously denied the employees’ summary judgment motion seeking dismissal of the misappropriation claim.
- Lesson – Suing former employees without a solid basis and/or for strategic purposes can backfire and have serious -- and costly -- repercussions.
- Before asserting a misappropriation claim, employers should be sure there is a good faith basis for the claim and that it is not being pursued simply to achieve a competitive advantage.

Be Careful When Pleading Trade Secret Misappropriation Claims That Could Be Preempted by the Copyright Statute

Jobscience, Inc. v. CV Partners, Inc., et al. (N.D. CA, January 9, 2014)

- Plaintiff sued software licensee and newly formed company for theft of propriety software code.
- In addition to a misappropriation claim, plaintiff also asserted a Copyright infringement claim.
- After finding that plaintiff stated a valid copyright claim, the Court *dismissed* the trade secret misappropriation claim on preemption grounds.
- As a result, the plaintiff was limited to a copyright infringement claim which provides plaintiffs very limited monetary relief unless the stolen material was registered with the Copyright Office *at the time of infringement*.

Possible copyright preemption of trade secrets claims

- Lessons: Employers should be aware of other IP claims that might preempt state law misappropriation of trade secret claims.
- Preemption might be avoided by including alternative state law claims that are qualitatively different than the misappropriation/copyright claim, such as breach of duty of loyalty.
- Employers can also avoid preemption by asserting misappropriation claims based on material that does not fall within the scope of the Copyright statute, such as customer lists, business strategies and customer preferences.
- Employers should also consider whether certain proprietary material (e.g., software code, proprietary material) can be registered with the Copyright Office for additional protection and to preserve its ability to recover damages under the Copyright statute if the material is taken.

The Computer Fraud and Abuse Act ("CFAA"): Still No Consensus Among Federal Circuits

- The CFAA imposes civil liability when a defendant fraudulently obtains anything of value by accessing a protected computer "**without authorization**" or by exceeding "**authorized access.**"

- The CFAA is a powerful tool for employers when an employee misappropriates information from the employer's computer system.

- There are two conflicting interpretations among the courts regarding the CFAA that will determine if a CFAA claim can survive a motion to dismiss:

The Computer Fraud and Abuse Act ("CFAA"): Still No Consensus Among Federal Circuits

- *Interpretation No. 1* - The CFAA is limited to "hacking" cases and is not applicable to employees who had authority to access a computer, even if the employee abused that access by stealing information.

-OR-

- *Interpretation No. 2* - The CFAA applies any time an employee ***exceeds*** his or her authorization by using information unlawfully or in violation of company policy, even if the employee was otherwise authorized to access the computer.

CFAA update

- *MOCA Systems Inc. v. Barnier* (D. Mass., Nov. 12, 2013). Some district courts may choose to defer the issue if the district court is in a Circuit that has not already ruled on the issue, particularly where the pleading could support a CFAA claim under either interpretation.
- Lesson: Until there is a definitive ruling by the US Supreme Court, the correct interpretation of "authorized access" under the CFAA is still up in the air. Before asserting a CFAA claim, employers should be sure to check the applicable law in the relevant Circuit to determine if a CFAA claim will survive.
- If at all possible and the facts permit, draft CFAA claims to address both scenarios to minimize the chance of dismissal.

California Court of Appeals Clarifies Scope of California Uniform Trade Secrets Act ("CUTSA")

Angelica Textile Services, Inc. v. Park, 220 Cal. App. 4th 495 (2013)

- While the California Uniform Trade Secrets Act ("CUTSA") preempts tort claims that are based on the same operative facts as a CUTSA claim, CUTSA does not preempt contract claims based on a breach of confidentiality agreement.
- CUTSA also will not preempt tort claims that are related to misappropriation of trade secret claims if the theory of liability is independent from a misappropriation claim -- e.g. a breach of duty of loyalty, or conversion of proprietary (non-trade secret) information.
- California Code Section 16600 does not invalidate non-compete provisions that impose limitations on employees' conduct while employed.
- Lessons: Despite California's well known prohibition against post-employment restrictive covenants, California courts will still hold employees liable for misappropriation of trade secrets, as well as breaches of the duty of loyalty.

Reminder: Misappropriation of Trade Secrets Is Not Just a Tort; It Can Also Lead to A Lengthy Prison Sentence

United States v. Yihao Pu (N.D. Ill. 2014)

- Citadel, LLC sued former employee Yihao Pu after discovering that Pu stole Citadel's proprietary computer code for quantitative trading. Citadel also brought the matter to the federal authorities who arrested Pu in 2011.
- Co-Worker Sahil Uppal was then arrested for his participation in the misappropriation by transferring the stolen code to Pu's computer.
- Uppal was also charged with obstruction of justice because he tried to conceal the misappropriation by removing computer equipment from Pu's apartment and dumping it in a canal.
- Uppal has pleaded guilty to the criminal charges and now faces a 20-year prison sentence.
- Lessons: A cover-up will invariably make things worse.
    - It is almost impossible to steal data without leaving some forensic breadcrumbs behind.

Choice of Law

- Drafting
  - What choice of law to designate in the restrictive covenant agreement?
- Tactics
  - Where to file suit to enforce restrictive covenant?

New York Appellate Court Found Florida Restrictive Covenant Statute "Truly Obnoxious

Brown & Brown v. Johnson (NY 4th Dep't 2014)

- Held that Florida choice of law provision violated New York public policy.
- Florida statute prohibits consideration of hardship imposed on employee and provides covenant must be construed to provide protection to all legitimate business interests of party seeking enforcement.

Choice of Law a Big Issue When Dispute Has California Connection

Brunswick Corporation v. Thorsell (N.D. Ill. 2014)

- Former employer headquartered in Illinois sued California resident in Illinois federal court.
- Non-compete would have been unenforceable under California law.
- Court denied motion to dismiss for improper venue, citing Thorsell's connections to Illinois and Illinois choice of law provision in agreement.

Suing Employee in Home State of Corporate Headquarters Not Always Easy

Baanyan Software Services, Inc. v. Hima Bindhu Kuncha (N.J. Appellate Division 2013)

- Former employer with New Jersey headquarters sued Illinois resident in New Jersey.
- Court lacked personal jurisdiction over Illinois resident - never actually worked in or visited New Jersey nor performed work for any New Jersey based clients.
- No purposeful availment.

Legislative Update

- Federal private right of action for trade secret theft?
- Massachusetts legislative efforts.

Federal: Defend Trade Secrets Act of 2014 (S. 2267) and Trade Secrets Protection Act (H.R. 5233)

- Seek to amend Economic Espionage Act.
- Expands upon bills proposed in 2013 which were not passed.
- Would create private right of action by which companies could sue under federal law for trade secret theft.

Is Momentum on the Side of a Federal Trade Secrets Law?

- Bipartisan legislative support.
- Strong support from businesses and trade groups.
- High profile trade secret thefts and prosecutions in the news. Perception that U.S. economy is vulnerable to trade secret thefts from abroad.
- Desire to standardize laws on trade secrets. Most states have some form of the Uniform Trade Secrets Act and/or common law.

Organized Efforts in Opposition to Federal Trade Secrets Law

- Opposition letter of law professors in the intellectual property and trade secret fields:
  - Existing state law is sufficiently uniform and effective
  - Creation of parallel, redundant and damaging law; and
  - Unintended consequences: anti-competitive results, increased risk of accidental disclosure of trade secrets, and damage to collaboration among businesses and mobility of labor.

Massachusetts

- Hotbed of legislative efforts in the trade secrets / non-compete area.
- So far, no results.

Massachusetts Non-Compete Legislation

- Governor Deval Patrick proposed bill to make non-compete agreements unenforceable, with some exceptions.
- Compromise bills:
  - Ban use of non-competes for non-exempt workers,
  - Require advance notice and consideration for non-competes proposed after start of employment,
  - Create presumptions regarding reasonableness of duration and scope of non-compete agreements.

Massachusetts Trade Secret Legislation

- Effort to adopt Uniform Trade Secrets Act in Massachusetts in 2014.
- New Uniform Trade Secrets Act bill has already been proposed for consideration in 2015 session.

Be In The Know

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OIG Warns Pharmaceutical Manufacturers of Improper Part D Beneficiary Coupon Use

by Constance Wilkinson, Alan Arville, and Benjamin Zegarelli

October 2014

On September 19, 2014, Inspector General ("OIG") safeguards to prevent M coupons may not be comp 30 pharmaceutical compa and the pharmacy claims study found that these s written disclaimers and w pharmacy, and (2) while manufacturers use inaccu

Simultaneously with the is stating that manufacture programs do not induce f drugs over generics.[2] The identified deficiencies in

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Whistleblowers Rewarded Again by SEC and the Judiciary

September 10, 2014

By Stuart M. Gerson; Frank C. Morris, Jr.; and Meghan F. Chapman*

On August 29, 2014, two whistleblower developments of particular interest to health care and life science entities emerged from the Securities and Exchange Commission respectively. The SEC, through its 0 to a compliance professional who that led to an enforcement action ts the first time that the agency has a compliance professional.

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Massachusetts Now Requires Employers to Provide Domestic Violence Leave

September 18, 2014

By Barry A. Guryan and Kate B. Rhodes

Massachusetts has enacted a law requiring employers with 50 or more employees to grant employees "domestic violence leave." The law, entitled "An Act [R]elative to [D]omestic [V]iolence," was approved by Governor Deval Patrick on August 8, 2014, and took effect immediately.

Under this new law, employers with 50 or more employees must provide employees with up to 15 days of paid or unpaid leave in any 12-month period if:

- the employee, or a family member of the employee, is a victim of "abusive behavior";
- the employee is not the perpetrator of the abusive behavior against the employee's abused family member; and
- the employee is using the leave from work to do any of the following:
  - seek or obtain medical attention, counseling, victim services, or legal assistance;

EPSTEIN BECKER GREEN **Take 5** VIEWS YOU CAN USE LABOR AND EMPLOYMENT

e July 2014 issue of *Take 5*, "Five Labor and Employment Issues Faced by Health re Employers," was written by **Michael F. McGahan**, a Member of the Firm, and sociates **D. Martin Stanberry** and **Daniel J. Green.**

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September 2014 Immigration Alert

Approval of isk of Union

Sixth Circuit Expands the Liability of Health Care Employers for Sponsorship Costs

USCIS Expands H-1B Eligibility for Nurses

Obama Administration Warns ACA Sign-Ups to Provide Proof of Legal Status

California Supreme Court Expands Rights of Immigrants Working in that State

OSC Issues Technical Assistance Regarding Employer's Receipt of Excess Documentation During the Form I-9 Process

OSC Settles Immigration-Related Discrimination Claims Against Staffing Agency

Colorado Employers Must Use New Affirmation Form Starting October 1, 2014

Silicon Valley Man Receives 10-Month Sentence for H-1B Fraud

DOS Issues October 2014 Visa Bulletin

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I. Sixth Circuit Expands the Liability of Health Care Employers for Sponsorship Costs

On August 20, 2014, the U.S. Court of Appeals for the Sixth Circuit issued its decision in *Kutty v. U.S. Department of Labor*, No. 11-6120 (6th Cir. 2014) ("*Kutty*"). In *Kutty*, several foreign physicians sued the

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Questions?