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Trade Secret litigation on the rise in California: How ADR can help

By Elizabeth D. Laporte

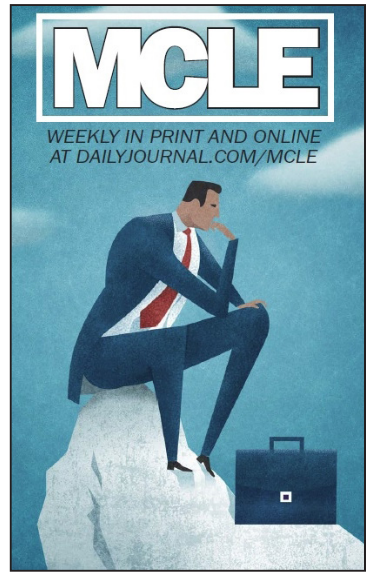
Trade secret litigation in California is growing, in both volume and impact. The second-largest plaintiffs' verdict in 2019 was $845 million, which was awarded to ASML, a Dutch semiconductor chip processing software company, in its case against XTAL, a company founded by two ex-employees of the plaintiff's subsidiary in Santa Clara who allegedly worked in secret for XTAL using stolen trade secrets to get a head start in development and siphon off a major customer contract. *ASML US Inc. v. XTAL Inc*. Another large verdict was a $66-million jury award, including a worldwide injunction, given to a San Jose LED manufacturer that sued a company for allegedly poaching its top scientist so that it could transfer its technology to China. *Lumileds LLC v. Elec-Tech International Co. Ltd*. In these types of cases, plaintiffs have the advantage of being able to craft a compelling narrative of theft — most commonly, former employees surreptitiously appropriating the plaintiff company's trade secrets for their own benefit in a rival venture — and to overcome employees' general freedom to switch employers under California law, which voids almost all noncompete agreements (Bus. & Prof. Code Sec. 16600) and does not recognize the doctrine of inevitable disclosure. *Schlage Lock Company v. Whyte*, 101 Cal. App. 4th 1443 (2002). Moreover, trade secrets do not expire automatically; they allow broad protection without disclosure, unlike copyrights and patents.

The 2016 enactment of the federal Defend Trade Secrets Act, or DTSA, led to an increase in trade secret cases in federal courts nationwide and in California, where they are usually joined with claims under the state's Uniform Trade Secrets Act, or UTSA. Meanwhile, other intellectual property litigation has generally held steady or, as is the case in the patent arena, slowed down as challenges to patents have increased at the Patent Trial and Appeal Board in the wake of the Leahy-Smith America Invents Act that took effect in 2012 and new restrictions on patentability set forth in *Alice Corp. v. CLS Bank International*, 573 U.S. 208 (2014), and its progeny. Patent litigation has not gone away, and the trend of higher awards for plaintiffs who succeed in proving both infringement and willfulness likely reflects not only the obvious — the awarding of enhanced damages — but the added power of the story of wrongdoing.

At the same time, defendants have powerful weapons to stall and ultimately defeat trade secret claims, including California's requirement that the plaintiff disclose its trade secrets with reasonable particularity at the outset before any discovery; the requirement to take reasonable steps to protect trade secrets; the need to meet the threshold for trade secret, as opposed to merely confidential, information; the inability to file for copyright or patent protection of intellectual property and simultaneously protect it as trade secret; and the UTSA's three-year statute of limitations. For example, one of the top defense outcomes occurred in a summary judgment ruling against a charge of misappropriation of a tele-audiology software application, based on the inventor's copyright application for the same technology without redaction, which constituted public disclosure of the purported trade secret — although finding those materials required an old-fashioned search of physical records at the copyright office. *Manchester v. Sivantos GmbH*, 2:17-cv-05309 (C.D. Cal., July 19, 2017).

In Section 2019.210 of the Code of Civil Procedure, California has codified the requirement to define a trade secret at issue with "reasonable particularity" before starting discovery related to that trade secret, after the California 2nd District Court of Appeal established that requirement "to separate it from matters of general knowledge in the trade or of special knowledge of those persons who are skilled in the trade, and to permit the defendant to ascertain at least the boundaries within which the secret lies." *Diodes v. Franzen*, 260 Cal. App. 2d 244, 253 (1968). The purpose of this requirement is fourfold: to guard against meritless complaints, to prevent a plaintiff from using discovery to ferret out a defendant's trade secrets, to help frame discovery and to let a defendant form well-reasoned defenses early in the case. *Advanced Modular Sputtering, Inc. v. Superior Court*, 132 Cal. App. 4th at 833-34 (Cal. Ct.App. 2005).

Federal courts in California routinely enforce this requirement as to UTSA claims brought in federal court, even though it is not required under federal pleading rules. Moreover, although the federal counterpart does not contain such an express requirement, the trend in federal courts in California appears to be to extend it to DTSA claims as well. *See, e.g.*, *AlterG, Inc. v. Boost Treadmills LLC*, 338 F.Supp.3d 1133 (N.D. Cal. 2019).



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Most trade secret cases start out with disputes over the adequacy of the disclosure and sometimes even end that way, with the court dismissing the trade secret claim with prejudice after first allowing some rounds of amendment. Indeed, the parties often engage in a prolonged iterative process in which the plaintiff falls short initially but gets leave to amend and adds some specificity, but not enough, and the court sustains the defendant's challenge again until the plaintiff finally crosses the threshold. On the one hand, the plaintiff has legitimate concerns about revealing too much about its trade secrets to an adversary that may not have complete information, as well as disclosing them on the public docket, defeating its purpose of safeguarding confidential information — although the latter may be addressed by sealing portions of the description. *See, e.g.*, N.D. Cal. Local Rule 79-5 (Parties may ask the court to seal trade secret and privileged information provided the request is narrowly tailored). In addition, the plaintiff benefits from maintaining the flexibility to adjust its claims as it learns more about what information the defendant is using and how in the course of discovery. Conversely, the defendant has a legitimate stake in preventing expensive and time-consuming discovery on non-meritorious claims and tailoring its defense to what is really at issue. And the defendant benefits from requiring the plaintiff to crystallize its theories early in the case so it cannot adjust them to fit what discovery reveals and the court's rulings. Therefore, a prolonged tug-of-war over the adequacy of the description often ensures. Still, the parties should be wary of wearing out the court's patience, whether with excessive incrementalism on the plaintiff's side, resulting in a denial of leave to amend after several rounds, or with overly aggressive insistence on excessive detail on the defense side. And plaintiffs that have other valid claims, such as a breach of a nondisclosure agreement, may decide to plead them alone at the outset and add a trade secret claim only after some discovery.

The court has considerable discretion in determining how specifically the alleged trade secrets must be set forth; excruciating detail is not required, but rather a reasonable disclosure that furthers the purposes of the statute. *See, e.g.*, *Advanced Modular Sputtering, Inc. v. Superior Court*, 132 Cal. App. 4th at 833-35. The amount of detail needed varies with the nature of the trade secret; for example, the more technically complex, as many Silicon Valley companies' trade secrets are, the more specificity may be required to fairly disclose the boundaries. In general, courts frown on placeholders such as alleging in general terms confidential information that includes, but is not limited to, certain business information, some of which constitutes trade secrets. For example, the court in *Zoom Imaging Solutions Inc. v. Roe*, the U.S. District Court for the Eastern District of California held: "Because the list of Confidential Information is not exhaustive, and because the trade secrets are an unknown subset of the indefinite Confidential Information, plaintiff does not sufficiently identify anything." 2019 WL 5862594 (E.D. Cal., Nov. 8, 2019). Similarly, I held that the plaintiff failed to meet the standard of reasonable particularity when it used lengthy highlighted passages in multiple documents that it relied on as describing trade secrets without clarifying which portions of the highlighted material constituted which trade secrets, while reserving the potential to point to unspecified combinations of ideas in the highlighted materials as constituting trade secrets. *ScaleMP, Inc. v TidalScale, Inc.*, 18-cv-04716-EDL (N.D. Cal., March 15, 2019).

In the other common scenario for trade secret litigation, in which two companies explore or commence a business relationship — such as collaborating to develop a technology or a license agreement that allows access to confidential information, and then have a falling out — there is typically a nondisclosure agreement that may well provide details about the nature of the trade secrets at issue. Attaching such an agreement may help satisfy the disclosure requirement. *See, e.g.*, *Alta Devices, Inc. v. LG Electronics, Inc.*, 343 F. Supp.3d 868, 881 (N.D. Cal. 2018) (citation omitted). As this situation often arises when a newer, smaller venture partners with a large, established company, which then purportedly steals a trade secret, the plaintiff may also benefit from recasting the story of David and Goliath, with a scrawny inventor being taken advantage of by a rich behemoth.

Disputes about whether a plaintiff has taken sufficient steps to protect its trade secret information and whether the purported trade secrets are in fact commonly known, at least to one skilled in the art, arise frequently. Perfection in protecting their confidentiality is not required, as it would bring many businesses to a halt if employees were required to treat all trade secrets like key pieces of source code, kept in a secured clean room with limited access. But at least reasonable precautions are required, such as signed confidentiality agreements for employees, suitable reminders, restrictions on access, and encryption and password protection. Bring-your-own-device policies present challenges, making such measures even more important. Conversely, a defendant may be able to show that former employees actually had permission to take purported secret information with them — or at least did so without objection—or that the information is now in the public domain (e.g., somewhere on the internet). Independent development is another defense, so it behooves defense counsel to delve into any such evidence and preserve it.

Another point of contention in some trade secret litigation is the issue of preemption. Attempting to base claims on proprietary information that falls short of the statutory definition of a trade secret may fail as preempted by the UTSA. *See, e.g.*, *SunPower Corp. v. SolarCity Corp.*, 2012 WL 6160472 at *9 (N.D. Cal., Dec. 11, 2012) (Claims based on proprietary information that does not qualify as a trade secret under the UTSA are superseded unless (1) the information constitutes property under positive law, based on qualitatively different grounds than trade secret law; or (2) the claims allege a materially distinct kind of wrongdoing than under a UTSA claim).

The statute of limitations is another frequent defense, and it may turn on when the plaintiff should have known of the theft, even though it was done stealthily. Indeed, this issue went to the jury in February 2020 before trial on the merits, with the plaintiff surviving the challenge to proceed to the next phase after nearly two days of jury deliberations. *Halpern v. Uber Technologies, Inc.*, CGC-15-545825 (S.F. County Sup. Ct., filed March 15 2015).

Damages is another area of dispute and innovation. For example, in the *ASML* litigation, the plaintiff used a model against the defendant, which had not yet successfully monetized the purloined technology, that was based on the advantage of avoiding research and development costs.

Given the potential for expensive and prolonged litigation, and the loss of confidentiality due to the requirement to describe trade secrets with reasonable particularity, alternative dispute resolution through early mediation — even pre-suit — or arbitration can be more cost-effective and provide more assurance that the trade secrets at issue and other confidential information will not become public, as well as avoid reputational harm from allegations of thievery. Mediation can facilitate a business solution not available through litigation that protects the legitimate interests of both sides. Arbitration can potentially save time and money. The parties can also select a mediator or arbitrator with relevant experience, such as familiarity with complex business cases involving sophisticated technology. Even in cases where litigating in court is preferable, as when a party prefers to seek early injunctive relief, appointment of a special master or discovery referee, who has more time to devote to resolving the parties' discovery disputes than an overburdened judge, may be advantageous.

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