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Recent federal developments in trade secrets

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Federal courts have seen a significant increase in the number of trade secret misappropriation cases filed since passage of the Defend Trade Secrets Act ("DTSA"). This alert discusses trends and developments in DTSA and other federal trade secret litigation.

The Defend Trade Secrets Act

In May 2016 Congress authorized the Defend Trade Secrets Act, a federal civil cause of action for trade secret misappropriation.[1] Since then, federal courts have seen a notable uptick in the number of trade secret misappropriation cases filed: more than 1,000 DTSA cases have been filed in federal district courts. This trend promises to continue as companies combatting trade secret theft become more familiar with the opportunities afforded to them under the DTSA.

Prior to passage of the DTSA, trade secret misappropriation claims could only be brought under state law, which varied widely. An earlier attempt to bring uniformity to this area, the Uniform Trade Secrets Act (UTSA) of 1979, failed to harmonize state trade secret laws because of spotty adoption and inconsistent interpretation across jurisdictions. While the DTSA does not preempt the UTSA or state law, it has changed the landscape of trade secret litigation by giving parties the ability to file lawsuits in federal court for trade secret theft.

District Court filings and outcomes

Thus far, the DTSA has not had the effect of concentrating trade secret litigation filings among a small number of district courts, as has happened in other federal intellectual property practice areas. The top district courts for trade secret litigation filings—including California, New York and Illinois—are generally popular districts, and no district court hears more than 10% of trade secret cases. This is not surprising given that very few appellate courts have addressed the DTSA at all to date, and only a limited body of federal case law interpreting the DTSA currently exists. However, geographical trends will likely emerge once more DTSA cases make their way through the courts.

[1] See our prior alert, "President Obama signs Defend Trade Secrets Act, providing federal jurisdiction for trade secret misappropriation," available here.

Similarly, there have been very few judgments on the merits yet for DTSA misappropriation claims, and those outcomes have been evenly split, with claimants most often prevailing on default or consent judgments, and defendants faring better at summary judgement or judgment on the pleadings.[2] However, in today's global, data-driven economy, trade secret litigation will undoubtedly continue to be a hot area, driven by the risks associated with increased employee mobility and electronic document storage capabilities. Thus, businesses should keep close watch on the continuing development of DTSA jurisprudence.

Recent decisions

Below we summarize some recent holdings in DTSA and trade secret cases.

Yellowfin Yachts, Inc. v. Barker Boatworks, LLC

The Eleventh Circuit's recent decision in *Yellowfin Yachts, Inc. v. Barker Boatworks, LLC*[3] underscores the requirement for companies to employ sufficient measures to safeguard the trade secret information for which they are going to seek protection. In this case, Yellowfin Yachts, a high-end boat manufacturer, hired Kevin Barker in 2006 as a vice president of sales. While Yellowfin presented him with an employment agreement containing confidentiality provisions, Barker never executed it. Barker left Yellowfin in 2014 to found a competing boat manufacturing company, Barker Boatworks. On his last day at Yellowfin, Barker downloaded hundreds of files from Yellowfin's server, including "detailed purchasing history and specifications for all of" its customers and related manufacturing information.

Yellowfin sued Barker in the United States District Court for the Middle District of Florida for trade dress infringement as well as for misappropriation of trade secrets under the Florida Uniform Trade Secrets Act. The district court granted summary judgment to Barker on all claims, which the Eleventh Circuit affirmed. With respect to the trade secrets claim, Yellowfin alleged that its trade secrets fell into two categories: (i) its "Source Information," which included the identities of, and the terms and conditions under which it does business with, its various suppliers and (ii) its "Customer Information," including each customer's contact information and detailed purchasing history and specifications. Under the statute, a "trade secret" is defined as information that derives independent economic value from not being generally known to and readily ascertainable by other persons who can obtain economic value from its use or disclosure and is the subject of reasonable efforts under the circumstances to maintain its secrecy.

The court found that the source information did not constitute a trade secret because the identities of Yellowfin's suppliers were well known and the prices it negotiated with them were based on its volume of purchases or included discounts based on its lengthy relationships with suppliers, neither of which would provide a newer, smaller boat company independent economic value. The court also concluded that because Barker learned about production costs during the ordinary course of his employment with Yellowfin, he was thus free to use that knowledge to try to secure a similar discount in his new role.

With respect to the customer information, the court found that Yellowfin failed to reasonably protect the information. Even though the customer information was accessible by fewer than 5% of the company's employees, required a username and password for access and was not accessible by

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[2] See Trade Secret Litigation Report 2018, Lex Machina, a LexisNexis Company, July 2018, p.8.

[3] No. 17-11176 (11th Cir. Aug. 7, 2018)

or shared with third parties, the court found that Yellowfin "compromised the efficacy of these measures" by encouraging Barker to keep the customer information on his cellphone and personal laptop, not marking the information confidential, nor instructing Barker to secure the information on his personal devices or instruct him to return or delete the information when he left the company. Thus, the court found, Yellowfin "effectively abandoned all oversight in the security of the" customer information.

While this case did not arise under the DTSA, the DTSA imposes a nearly identical requirement on owners to maintain the secrecy of trade secret information. This case underscores the critical importance for companies to take adequate steps to safeguard their trade secret information, including limiting the ability of employees to access such information via personal devices.

Seattle Sperm Bank, LLC v. Cryobank Am., LLC

By contrast, a federal court in Washington recently refused to dismiss a complaint for violation of the DTSA, finding that the plaintiff sufficiently maintained the secrecy of information that derived its value from not being generally known to other companies in the industry.

In the case, *Seattle Sperm Bank, LLC v. Cryobank Am., LLC*,[4] plaintiff Seattle Sperm Bank ("SSB") alleged that two individual defendants who were former employees of SSB had misappropriated SSB's trade secrets when they left SSB to open a new sperm bank, defendant Cryobank America, LLC ("Cryobank"). SSB alleged that the two former employees, who had obtained a business license to operate Cryobank more than a year before leaving SSB, had copied more than 1,500 documents from SSB's servers onto a removable hard drive in the six months before their departure. Among the allegedly copied documents were 67 Standard Operating Procedures ("SOPs") and 149 forms prepared by SSB to comply with U.S. Food and Drug Administration ("FDA") rules and regulations for the operation of a sperm donor and cryobank business. SSB filed a complaint alleging violations of, *inter alia*, the DTSA and the Washington Uniform Trade Secrets Act.

Defendants moved to dismiss the complaint, claiming that SSB had not sufficiently alleged what "reasonable measures" it had taken to keep the information at issue secret, as required by the DTSA.[5] The court disagreed, finding that SSB's limiting of network access to employees in "important roles," and its requirement that employees sign an acknowledgment of having reviewed an employee handbook containing its trade secret confidentiality policy, constituted reasonable measures to maintain secrecy. The court also found that the information at issue —particularly the SOPs — satisfied the DTSA's definition of a trade secret as deriving independent economic value from not being generally known to others who can obtain economic value from it,[6] because any new company in the sperm bank industry would need to obtain or develop SOPs to be in compliance with federal regulation. On this basis, the court allowed the DTSA and state trade secret claims to go forward.

Dunster Live, LLC v. Lonestar Logos Mgmt. Co

Finally, in its first decision under the DTSA, the Fifth Circuit recently ruled that the DTSA does not permit a defendant to recover attorney's fees as a "prevailing party" when a plaintiff obtains a

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[4] No. C17-1487 (W.D. Wash. Aug. 9, 2018).

[5] 18 U.S.C. § 1839(3)(A).

[6] 18 U.S.C. § 1839(3)(B).

dismissal without prejudice of the claim. In *Dunster Live, LLC v. Lonestar Logos Mgmt. Co., LLC*,[7] plaintiff and defendants were members of a limited liability company. Plaintiff sued defendants for violation of the DTSA after defendants formed a new company and allegedly stole proprietary software and a database from plaintiff. After the court denied plaintiff's request for a preliminary injunction, plaintiff sought the court's permission to dismiss the case without prejudice, stating that it no longer wished to pursue its DTSA claim, the only basis for federal jurisdiction. The court allowed the dismissal over defendants' objection. Planitiff subsequently filed a nearly identical lawsuit in state court.

Defendants then sought an award of attorney's fees under the DTSA, which provides that "if a claim of misappropriation is made in bad faith, which may be established by circumstantial evidence, a motion to terminate an injunction is made or opposed in bad faith or the trade secret was willfully and maliciously misappropriated, [a court may] award reasonable attorney's fees to the prevailing party."[8] The district court denied the fee request, finding that defendant was not a "prevailing party" because plaintiff could resurrect its claims and prevail at a later date. The Fifth Circuit affirmed the ruling, holding that a dismissal without prejudice does not make any party a "prevailing party." The court rejected defendants' argument that such a ruling would allow plaintiffs to evade paying attorney's fees by seeking a dismissal without prejudice "once a plaintiff realizes the suit is doomed," noting that a district court could deny a request for dismissal made in bad faith and that Rule 11 sanctions would also serve as a deterrent to such conduct. Moreover, the court noted that allowing bad faith alone to support a fee award would render the statute's phrase "prevailing party" meaningless and would also be inconsistent with courts' interpretation of the same phrase in numerous other federal statutes. The court finally rejected defendants' argument that they should separately be deemed a "prevailing party" because they defeated plaintiff's request for a preliminary injunction. However, the court disagreed, explaining that "prevailing party status ordinary requires being ahead when the final whistle blows in a case, not at halftime," and that the denial of an injunction merely preserves the status quo.

Takeaways

As the number of DTSA cases filed continues to grow, companies must take precautions to protect themselves and their investors:

- *Yellowfin* reminds companies to take adequate steps to safeguard their trade secret information, including limiting the ability of employees to access such information via personal devices.
- *Seattle Sperm Bank* reinforces the need for companies to take reasonable steps to protect their trade secrets, which should include requiring employees to sign acknowledgments of the company's trade secret policies and restricting employee access to information on a need-to-know basis.
- *Dunster* defines "prevailing party" under DTSA and sheds light on when fee recovery may apply.

Experienced counsel who are part of Nixon Peabody's Trade Secrets Team will continue to monitor developments and are available to assist you in prosecuting or defending DTSA claims.

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[7] No. 17-50873 (5th Cir. Nov. 13, 2018).

[8] 18 U.S.C. § 1836(b)(3)(D).

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