

Trade Secret Bill Resolves 'Inevitable Disclosure' Controversy

Law360, New York (February 17, 2016, 10:43 AM ET) -- The Defend Trade Secrets Act (S.1890) would for the first time allow trade secret plaintiffs to file their cases directly in federal court. The proposed law was favorably reported out of the Senate Judiciary Committee on Jan. 28, but with an important amendment protecting the right of employees to change jobs. Specifically, the bill requires that there be evidence of threatened misappropriation to justify an injunction putting limits on what an ex-employee can do. Although some might see this as reinforcing some states' (particularly California's) rejection of the "inevitable disclosure doctrine," its practical effect instead should be to reframe the discussion away from that abstract doctrine and toward the kind of evidence necessary to prove a threat.



James Pooley

Forty-seven states have adopted the Uniform Trade Secrets Act. The injunction provisions of the UTSA permit a court to enjoin "actual or threatened misappropriation" of a trade secret. In 1995, the Seventh Circuit decided *Pepsico v. Redmond*,^[1] approving a temporary injunction against a senior marketing executive, who had lied about his future plans, from starting work in the same position for a direct competitor. The court explained that the UTSA allowed an injunction when the "defendant's new employment will inevitably lead him to rely on the plaintiff's trade secrets." This abstract phrase, detached from the facts of the case, came to be known as the "inevitable disclosure doctrine." And because it was assumed to mean that employees could be enjoined merely because of how much they knew, it was widely condemned within California and other jurisdictions where policy and law strongly favor of mobility of labor.

"Inevitable disclosure" as an alternative to proving "threatened misappropriation" was rejected with strident language in *Whyte v. Schlage Lock*.^[2] But in *Central Valley General Hospital v. Smith*,^[3] another California court considered the question that *Whyte* had left unanswered: what evidence would be necessary to infer a "threat" under the UTSA. It concluded that while merely knowing the secret information was not enough, courts could intervene, for example, if the defendant had previously misappropriated trade secrets, or intended to misappropriate, or had refused to return confidential materials. In other words, bad behavior could provide the necessary inference of a threat.

In other states, where courts were presented with facts similar to *Pepsico* — that is, where the defendant had behaved in a way that made it unlikely he could be trusted — injunctions were sometimes issued, and judges called what they were doing an application of "inevitable disclosure." See, e.g., *Barilla America Inc. v. Wright*.^[4] As a result, commentators gradually settled into using the phrase without closely inquiring how it was being applied, and dividing jurisdictions according to whether they embraced or rejected "inevitable disclosure," without questioning its meaning. California and a few other states were said to have rejected the doctrine, while many others had accepted it. But even in the

states where it was accepted, judges almost always applied it only in cases where there was some evidence of bad behavior. See, e.g., *Bimbo Bakeries USA Inc. v. Botticella*.^[5]

In other words, a false conflict had been created, and the evil that the Whyte court had railed against was mostly a phantom menace. But because the received wisdom was that inevitable disclosure could restrain someone from taking a new job without any evidence to support the inference of a threat, opponents concluded that employee mobility was protected only in California or in other states that had rejected the "doctrine." And so when the DTSA was proposed last year, using precisely the same injunction language as the UTSA, they expressed concern that it might allow federal judges sitting in those jurisdictions to ignore state court rulings and apply the inevitable disclosure doctrine to enjoin an employee from taking a new job only because they knew too much. This was true even though the DTSA was expressly non-preemptive and had added language prohibiting an injunction that would "prevent a person from accepting an offer of employment under conditions that avoid actual or threatened misappropriation."

After the Judiciary Committee held its hearing on the DTSA in early December, we continued to hear concern that this language would not be sufficient to protect employees from "inevitable disclosure" injunctions. Stanford Professor Mark Lemley and I then suggested a different approach, one that would direct federal judges to determine the existence of a threat based on the employee's behavior rather than on what he or she knew. In the recently approved "substitute" bill, new language proposed by Sen. Dianne Feinstein, D-Calif., prohibits any injunction against "entering into an employment relationship" and requires that "conditions placed on such employment shall be based on evidence of threatened misappropriation and not merely on the information the person knows."

Other amendments to the DTSA have also improved it, including bringing the limitations and enhanced damages provisions into line with the UTSA, tightening up the already strict requirements for an ex parte seizure order, and creating a new and important exception to protect whistleblowers who need to disclose confidential information in order to report a crime to the authorities. But in terms of widespread impact on the greatest number of trade secret cases, the Feinstein amendment stands out, because it would establish a national standard reflecting the value of employee mobility. Rather than arguing about abstractions or labels, and without affecting any state law or policy on noncompete agreements, courts will apply the statutory language that allows injunctions against threatened misappropriation, focusing on the quality of evidence needed to prove a threat.

In the process, we may have banished the ghost of inevitable disclosure.

—By James Pooley

James Pooley is a Silicon Valley-based adviser, intellectual property litigator and information security expert who testified before the Senate Judiciary Committee on the Defend Trade Secrets Act. His most recent book is "Secrets: Managing Information Assets in the Age of Cyberespionage."

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[1] 54 F.3d 1262 (7th Cir. 1995).

[2]101 Cal. App. 4th (2002).

[3]162 Cal. App. 4th 501 (2008).

[4]2002 U.S. Dist. LEXIS 12773, *25-26 (S.D. Iowa 2001).

[5]613 F.3d 102, 118 (3d Cir. 2010).

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