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Changes On the Horizon for

Trade Secret Misappropriation

Proposed federal legislation will add protections beyond current state laws and potentially alter the role of state courts.

Trade secrets are the only major type of intellectual property not civilly protected by federal law. That, however, may be about to change. Bills creating a new federal cause of action for trade secret misappropriation were introduced in 2014 in both chambers of Congress. While neither passed – the Senate bill (the “Defend Trade Secrets Act of 2014”) stalled in the Judiciary Committee, while the House version (the “Trade Secrets Protection Act of 2014”) made it out of the Judiciary Committee, but did not receive a full House vote – both bills received wide bipartisan support with no major opposition and were reintroduced this year.

Today, the Uniform Trade Secret Act (UTSA) is the only civil enforcement mechanism for trade secret owners, and because it differs from state to state, trade secret owners have difficulty instituting nationwide non-disclosure policies and cannot protect their trade secrets in the federal courts. One of the goals of federal trade secret legislation is to provide uniformity by bringing trade secrets into line with the other types of intellectual property already protected by federal statute (*e.g.*, patents, copyrights, trademarks and trade dress), thus providing both a consistent standard for non-disclosure policies and access to the federal courts.

If and when the proposed federal legislation becomes law (and most be-

lieve it is just a matter of time), the role of state courts, including Delaware’s courts, in the development of trade secret jurisprudence will likely change dramatically.

Delaware State Courts: A Long History of Trade Secret Misappropriation Cases

In 1979, the Uniform Law Commission drafted the UTSA,¹ which was subsequently adopted, in whole or in part, by almost every state. However, Delaware state courts were deciding significant trade secret cases and developing substantive trade secret law long before the UTSA was enacted. In the 1950s, the Delaware Court of Chancery recognized that certain patterns and drawings “constituted know-how of the type that the law treats as a prop-

erty right” and enjoined the defendant from using them.²

The next decade saw the extension of these protections to the employee/employer relationship. For example, in *E. I. duPont de Nemours & Co. v. Am. Potash & Chem. Corp.*, the employer sought a temporary restraining order and preliminary injunction to stop a former employee from disclosing its trade secrets and “undertaking any employment” that related to the manufacturing process comprising the plaintiff’s trade secrets.³ The Court of Chancery did so, notwithstanding that there was no covenant not to compete.

The 1970s marked the beginning of the rise of computer technologies. In one case, the Court of Chancery permanently enjoined a defendant from using drawings that disclosed the design for the plaintiff’s “compact minicomputer[].”⁴ In doing so, the court rejected the defendant’s argument that the minicomputer was reverse engineered, finding instead that the defendant had relied upon plaintiff’s design drawings.

Over the next two decades, the increasing sophistication of computer and chemical technologies led to a number of significant trade secret decisions in Delaware. In *Bunnell Plastics, Inc. v. Gamble*,⁵ the court granted a permanent injunction against a former employee who signed a non-compete agreement which demanded he not disclose “any confidential information or any other material related to the business or operation of [the plaintiff corporation].” Despite this agreement, the defendant disclosed information regarding a chemical coating for pulp and paper rollers to a company he founded. The court upheld the non-compete agreement and enjoined the defendant’s use of plaintiff’s trade secrets for two years, finding that the covenant to protect the trade secrets was reasonable with regard to time, geography and subject matter.

In another case, *Technicon Data Systems Corp. v. Curtis 1000 Inc.*,⁶ the court preliminarily enjoined the defendant corporation from misappropriat-

ing the plaintiff’s claimed trade secrets related to its product – the “Medical Information System” – a computerized system that stored, transmitted and displayed hospital data.

In 1994, the Court of Chancery decided *Miles Inc. v. Cookson America, Inc.*,⁷ a case that illustrated the court’s ability to fashion specific and significant equitable remedies to protect trade secrets. The defendant corporation hired several of the plaintiff’s ex-employees and misappropriated many of the plaintiff’s trade secrets regarding processes to manufacture “high performance pigments.” The court found that several of the pigment processes were “inextricably connected” to the “defendant’s manufacture” of the high performance pigment and issued production injunctions with regard to these pigment processes.

The production injunctions, one of which lasted three years, prohibited the defendant from manufacturing the high performance pigment related to the misappropriated pigment process, even if the defendant was able to discover a legally permissible pigment process to manufacture the high performance pigment during the period of the injunctions.

In 1999, the Court of Chancery granted injunctive relief in *Merck & Co., Inc. v. SmithKline Beecham Pharmaceutical Co.*,⁸ finding that the defendants misappropriated the plaintiff’s trade secrets regarding a “process for producing a vaccine to prevent varicella (commonly known as chicken pox).” In fashioning a remedy, the court noted that “the development of a commercial process” typically “takes many years,” and in this case, the defendant gained “a time advantage of three to five years as a result of its misappropriation.” Accordingly, the court enjoined the defendant “from marketing its varicella vaccine in the United States or Canada for a period of three years from the date it receive[d] approval to market its vaccine in those countries.”

More recently, the Delaware Superior Court and the Court of Chancery have issued several significant trade secret de-

isions. In 2002, the Superior Court of Delaware held that a doctor misappropriated trade secrets when he improperly solicited patients from his former employer using the former employer’s protected “super bills,” which were written compilations of patient data.⁹

In a 2006 case, *W.L. Gore & Associates, Inc. v. Wu*,¹⁰ the Court of Chancery granted additional injunctive relief to the plaintiffs, supplementing the permanent injunction to which the defendant had already consented. Specifically, the court enjoined the defendant, a former scientist-employee of plaintiff, from working with any polymers with which he worked during his employment for 10 years, and also enjoined him from working with any “TFE-containing polymers” for a period of five years. The court relied on the defendant’s “lack of trustworthiness and the likelihood of inevitable disclosure” in reaching its determination. A few years later, the court held the defendant, Wu, in contempt of court for failing to abide by the terms of that injunction and ordered him to pay a “fine of \$5,000 per day” until he demonstrated compliance with the injunction.¹¹

In 2010, in *Agilent Technologies, Inc. v. Kirkland*,¹² the Court of Chancery found that three defendants, each a former employee of the plaintiff, had improperly taken plaintiff’s trade secrets with them to their new employer. The trade secrets related to technologies used to create “particles and solvents for use in reversed phase high performance liquid chromatography columns.” In addition to awarding more than \$4.5 million for unjust enrichment and lost profits, the court granted injunctive relief requiring, *inter alia*: (1) the return of all property of plaintiff, including any “copies or records” derived therefrom; (2) a prohibition against conducting research on or disclosing the trade secrets; and (3) the withdrawal of pending patent applications that dealt with the misappropriated technology.

Unquestionably, Delaware state courts have had a significant impact on

the development of trade secret law. Whether Delaware's courts continue to have such an impact will be determined, in large part, by how the federal trade secret legislation on the horizon ultimately fares.

A Potential Federal Trade Secret Misappropriation Law

The proposed federal trade secret legislation does not differ significantly from the Delaware Uniform Trade Secret Act (DUTSA) or the decisional law discussed above with respect to the requirements for trade secret protection and the acts that would constitute misappropriation.¹³

The proposed legislation would, however, remake the procedural landscape. To start, the proposed federal legislation would create original federal jurisdiction, but would not preempt state trade secret claims. Trade secret owners would therefore have to choose between pursuing a misappropriation action in state court, based solely on state law, or in federal court, based on federal law or a combination of federal and state law. That may be a difficult choice, given several key differences between the proposed federal legislation and the current trade secret laws in most states, including Delaware, which are largely based on the Uniform Trade Secret Act.

Like most states, the DUTSA has a three-year statute of limitations. The proposed federal legislation has a five-year statute of limitations, creating a two-year window when only a federal claim could be asserted by a trade secret owner.

The proposed federal legislation also provides for punitive damages for willful and malicious misappropriation of up to three times actual damages, whereas the UTSA limits punitive damages to two times actual damages.

However, the most controversial provision of the proposed federal legislation provides for the *ex parte* seizure of property "necessary to preserve evidence" or to "prevent dissemination of the trade secret," if the trade secret owner can show "clearly ... from specified facts" that: (1) injunctive re-

lief under Federal Rule of Civil Procedure 65 is inadequate; (2) the plaintiff will suffer "immediate and irreparable injury"; (3) the harm to the plaintiff outweighs the harm to both the defendant and any third parties who may be affected by the order; (4) the plaintiff is likely to show both misappropriation and that the defendant is in possession of the trade secret; (5) a particular description of the subject of the seizure and its location; (6) the defendant would move, hide or destroy the materials if notice were provided; and (7) the plaintiff has not "publicized" the requested seizure.

The proposed legislation does provide for some constraints on the breadth of an *ex parte* seizure order. For instance, a court may limit any *ex parte* order by minimizing disruption to the defendant, issuing specific legal and factual findings, holding a hearing within seven days, and requiring that the plaintiff post an appropriate bond. Further, a court may protect the defendant from "publicity" relating to the seizure order "by or at the behest of the person obtaining the order." And, if the defendant is somehow damaged by the seizure order, the defendant can recover lost profits, loss of good will, punitive damages and reasonable attorney's fees through a cause of action for a "wrongful or excessive seizure."

Perhaps the most distinguishing feature of the proposed federal legislation when compared to the UTSA are provisions addressing the theft of trade secrets occurring abroad. Not surprisingly, U.S. companies doing business abroad and multinational companies are increasingly concerned with protecting their intellectual property. Under the proposed federal legislation, within one year of the enactment of the legislation, and biannually thereafter, the Attorney General shall submit to the House and Senate Judiciary Committees a report addressing, among other things, the scope and breadth of trade secret thefts occurring outside the U.S.; whether those thefts are being sponsored by foreign governments or other foreign instrumentalities; the

economic threat posed by such thefts; the status of foreign trade secret laws or other protections available to U.S. and multinational companies; the ability and limitations of trade secret owners to prevent the misappropriation of their trade secrets outside the U.S. and to enforce any judgment against foreign entities for theft of trade secrets; and a recommendation of additional actions that could be taken by the legislative and executive branches of the federal government to further protect the trade secrets of U.S. and multinational companies doing business abroad.

These reporting requirements, if enacted into federal law, are seen by some as a crucial, first step in addressing foreign misappropriation in the U.S. courts.

Criticisms of Proposed Federal Trade Secret Misappropriation Legislation

Critics of the proposed federal trade secret legislation argue that an effective and uniform body of trade secret law already exists and, therefore, a federal law is unnecessary.¹⁴ However, a federal trade secret statute likely would not alter the substantive law of trade secrets. Rather, a federal statute would only enhance the protective procedures available to a trade secret owner (*e.g.*, seizure orders, longer statute of limitations, increased punitive damages cap, additional protection for companies doing business abroad). Proponents of a federal trade secret law argue that any fear of inconsistency between state and federal law is overstated.

Critics of the proposed federal legislation also point to the *ex parte* seizure provision, arguing, among other things, that the provision is unnecessary because litigants already can request preliminary relief in trade secret cases, that *ex parte* seizure orders will be granted too frequently, thereby causing defendants undue harm, and that it will be difficult for a trade secret owner to show that the preliminary relief available under Rule 65(b) of the Federal Rules of Civil Procedure is inadequate and, therefore, the rem-

edy of *ex parte* seizure is superfluous. They also argue that the “protection from publicity” requirement is unclear and necessitates a level of secrecy about court rulings that is unprecedented.

Supporters of the proposed legislation respond that such concerns are unfounded, given that similar seizure provisions already exist in other federal statutes directed at protecting trademark owners from counterfeit use of their registered marks. Moreover, as detailed above, the procedures for obtaining an *ex parte* seizure order are far more onerous than the requirements for obtaining a temporary restraining order.

Perhaps most importantly, the *ex parte* seizure order is a remedy of last cause. Courts are often reluctant to grant such relief in the trademark area, and typically only do so when injunctive relief is insufficient. And, in the event a seizure order is wrongfully obtained, punitive damages would be available to remedy any harm to the defendant.

Critics of the proposed federal legislation also argue that it could be used for anti-competitive purposes, in that injunctions granted under a federal trade secret law would not be limited to the lead time advantage of the party accused of misappropriation. Such interminable injunctions could impede fair competition, employee mobility and innovation.

Proponents of the legislation counter that judges are better situated to determine the appropriate length of an injunction in any particular case, and that setting the duration of injunctions by statute would restrict that flexibility in a negative way.

Accidental disclosure of trade secrets is another concern espoused by critics of the legislation. They argue that a federal trade secret statute would give rise to more challenges to subject matter jurisdiction. That, in turn, would require earlier disclosure of the trade secrets in dispute in order to establish their existence and a jurisdictional basis. In trade secret actions in state courts, plaintiffs frequently delay identifying and disclosing the alleged

trade secrets to avoid the risks inherent in the exchange of confidential information. Critics contend that the proposed federal legislation would enable defendants to demand earlier disclosure of the alleged trade secrets, resulting in a greater risk of inadvertent disclosure.

Supporters of the federal legislation view the disclosure issue differently. Avoidance of inadvertent disclosure is a reason plaintiffs delay identifying alleged trade secrets, but it may not be the most significant reason. Indeed, a plaintiff may obtain a strategic advantage by delaying the identification of the alleged trade secrets until after it has taken discovery of the defendant and, presumably, learned more about what proprietary information the defendant may be using.

Some courts view this delay by plaintiffs as prejudicial to defendants, and require earlier identification of alleged trade secrets to level the playing field. Accordingly, proponents of the proposed federal legislation argue that earlier identification of alleged trade secrets will happen regardless of any increase in challenges to subject matter jurisdiction.

How Federal Trade Secret Misappropriation Law Will Impact State Courts

New trade secret bills were introduced in both the House and the Senate in July 2015. Those bills are substantially similar to the trade secret bills introduced in 2014. Given the broad bipartisan support and lack of significant opposition to those 2014 trade secret bills, passage of a federal trade secret statute in 2015 is a realistic possibility, if not a probability. If and when that occurs, the part played by state courts in the development of trade secret law may change dramatically.

Multiple factors, including the appeal of truly uniform trade secret and misappropriation standards, a longer statute of limitations, the ability to obtain higher punitive damages and the *ex parte* seizure procedure, will create a strong incentive for plaintiffs to file trade secret misappropriation claims in

the federal courts.

As a result, the role of state courts – including the important role played by the Delaware state courts to date – in the development of substantive trade secret law may change significantly in the very near future. ♦

FOOTNOTES

1. See generally UNIF. TRADE SECRETS ACT (amended 1985), 14 U.L.A. 437, *et seq.* (1979).
2. *Gronemeyer v. Hunter Mfg. Corp.*, 106 A.2d 519 (Del. Ch. 1954).
3. 200 A.2d 428 (Del. Ch. 1964).
4. *Data Gen. Corp. v. Digital Computer Controls, Inc.*, 357 A.2d 105 (Del. Ch. 1975).
5. C.A. No. 5913, 1980 Del. Ch. LEXIS 629 (Del. Ch. Sept. 24, 1980).
6. C.A. No. 7644, 1984 Del. Ch. LEXIS 588 (Del. Ch. Aug. 21, 1984).
7. C.A. No. 12,310, 1994 Del. Ch. LEXIS 221 (Del. Ch. Nov. 7, 1994).
8. C.A. No. 15443-NC, 1999 Del. Ch. LEXIS 242 (Del. Ch. Aug. 5, 1999).
9. *Total Care Physicians, P.A. v. O'Hara*, C.A. No. 99C-11-201, 2002 Del. Super. LEXIS 493 (Del. Super. Ct. Oct. 29, 2002).
10. C.A. No. 263-N, 2006 Del. Ch. LEXIS 176 (Del. Ch. Sept. 15, 2006).
11. *W.L. Gore & Associates, Inc. v. Wu*, C.A. No. 7964, at 5 (Del. Ch. Nov. 2, 2012).
12. C.A. No. 3512-VCS, 2010 Del. Ch. LEXIS 34 (Del. Ch. Feb. 18, 2010).
13. Unless stated otherwise, references to the potential or new federal law refer to a new law in the form of the Defend Trade Secret Act of 2014, H.R. 5233.
14. Criticisms of the proposed federal law come mainly from the “Professors’ Letter in Opposition to the ‘Defend Trade Secrets Act of 2014’ (S. 2267) and the ‘Trade Secrets Protection Act of 2014’ (H.R. 5233).”

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