

Understanding Calif.'s Nuanced Trade Secrets Law

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Trade secrets practice in California is an outlier, despite the fact that the state is among the vast majority that has adopted the Uniform Trade Secrets Act. California's particularities arise in significant part out of a notably strong protection for the rights of employees to practice their professions in a manner of their choosing, even by competing against former employers. Increasingly, practitioners need to be aware of these nuances in navigating California litigation.

Parrish v. Latham & Watkins LLP

A recent appellate case highlights the potential pitfalls of relying on non-California specific trade secrets law. On Aug. 27, 2014, the California Court of Appeal, Second District, reversed a trial court's decision to throw out a malicious prosecution case against Latham & Watkins. See *Parrish v. Latham & Watkins*, 229 Cal. App. 4th 264 (2014).



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Latham represented the plaintiffs — former employers of two individuals who had left to start their own competing business — in a lawsuit for misappropriation of trade secrets. Latham used, among other things, the theory of inevitable disclosure, under which it can be inferred that a departing employee who has knowledge of employer trade secrets would necessarily use them in a new business.

The appellate court reinstated the malicious prosecution lawsuit because, among other reasons, California does not recognize the inevitable disclosure doctrine. As a result, the former employees demonstrated a “reasonable probability of prevailing on the element of lack of probable cause” on the original trade secrets claim. On Sept. 25, 2014, the court granted a petition for rehearing, which will be argued in early January 2015.

Whatever the outcome on rehearing, *Parrish* is noteworthy in highlighting the very distinctive nature of trade secrets law in California. Along with 46 other states, the District of Columbia, the U.S. Virgin Islands and Puerto Rico, California has adopted the UTSA. It has been on the books here for three decades. “[I]ts general purpose [is] to make uniform the law with respect to the subject of this title among states enacting it.” Yet, it is increasingly clear that trade secrets practice in California is, nevertheless, fundamentally *sui generis*.

Inevitable Disclosure? Not So Inevitable

Take inevitable disclosure, at issue in Parrish. In many states, such as Illinois, Minnesota, New Jersey and Ohio, inevitable disclosure is a viable theory. Inevitable disclosure can be a powerful tool for plaintiffs because trade secret misappropriation can otherwise be difficult to prove; an employer may know an employee jumped to a competitor and is now doing very similar work for someone else, but not be able to prove directly that he or she took or used trade secrets. Inevitable disclosure, under certain circumstances, allows for an inference of misappropriation without such direct evidence.

In California, however, as reflected in Parrish, inevitable disclosure is not available. Lacking concrete evidence, the plaintiffs in Parrish argued — unsuccessfully — that the former employees “must be planning” to use former employer trade secrets. In allowing the malicious prosecution claim to survive, the appellate court held that “Latham sought an obviously anti-competitive injunction based on the speculative possibility that the former employees’ product might violate its client’s trade secret rights further supports the conclusion that no reasonable attorney would have believed this case had merit.”

In California, plaintiffs thus must do more to ensure they have sufficient evidence of actual or threatened misappropriation. For example, they may need to rely on employee exit interviews or forensic examination of former employees’ computers to establish the taking of employer information. Defendants, for their part, should seek to develop the theme that the plaintiff’s theory of the case is nothing but an attempt to stifle legitimate competition through an impermissible inevitable disclosure theory.

Increased Discovery Hurdles for Plaintiffs

Discovery in California trade secrets actions presents a second idiosyncrasy. Under California Code of Civil Procedure Section 2019.210, plaintiffs in trade secrets cases must “identify the trade secret with reasonable particularity” before discovery can begin. Guidance from the courts on the precise contours of this requirement has been scarce. For instance, what exactly is “reasonable particularity?” Will a judge allow discovery to proceed on the nontrade secrets claims in the meantime? Answers to these questions remain unsettled and in practice, therefore, vary case-to-case.

What is clear is, in California trade secrets cases, plaintiffs are subject to an additional procedural hurdle that can delay their case. For example, plaintiffs may be forced to disclose to the court and other parties details about a secret marketing strategy before discovery has even begun in order to distinguish their trade secret from general industry knowledge. The Section 2019.210 requirement also provides defendants with an additional weapon in their arsenal to attack trade secret claims from the outset. By focusing courts on potentially overbroad trade secret designations early on, defendants have an immediate opportunity to argue that the trade secrets at issue are in fact publicly available or otherwise not proprietary.

Preempting Other Claims Involving Information Theft

A third California particularity may be the most significant. The UTSA contains a provision stating that the statute preempts “other civil remedies” that are “based upon misappropriation of a trade secret.” In other states, courts have generally construed that provision to mean that common law claims for trade secret misappropriation are preempted, but that other claims survive if they are based on a different theory of liability. For example, a claim for breach of fiduciary duty arising out of the taking of trade

secrets would not be preempted under this standard because the liability is based on the breach of a fiduciary duty, not the theft of trade secrets itself. Courts have also often held that preemption does not apply if the allegedly misappropriated information does not actually turn out to be trade secret.

By contrast, the recent California appellate cases on this issue have set forth a very different interpretation. Nontrade secrets claims here will be preempted any time they share a “nucleus of facts” with the trade secrets claim. This distinctive preemption jurisprudence arises out of a slight variation in the language of the California’s UTSA.

The precise scope of UTSA preemption in California is uncertain, but it is clearly very broad — it is being used to block claims even for the misappropriation of nontrade secret business information and has resulted in the dismissal of a number of tort claims including conversion, breach of duty of confidence, unfair competition, breach of fiduciary duty and interference with contract.

Attorneys for plaintiffs in California court must be aware of how preemption can limit the ability to present alternative legal theories (breach of contract claims are advisable because they are not preempted pursuant to an explicit statutory carveout). Defense counsel, on the other hand, have a powerful additional tool to narrow the case.

Courts Guided By Protecting Employee Mobility

A low tolerance for restricting competition is the common denominator for these three unique characteristics of California trade secrets law. This solicitude for employee mobility is reflected most explicitly in the prohibition of noncompete contracts under California Business and Professions Code Section 16600. But it also underlies trade secret law — by imposing extra limitations on bringing or proving up claims for the taking of business information and, therefore, protecting the employee’s right to compete except when a trade secret claim can be made out.

Concern for protecting employee mobility helps explain why and how trade secret practice in California deviates from the norm. Returning to our three examples, the UTSA preemption has been construed in California to mean that at least in some circumstances, the taking of nontrade secret but still arguably confidential employer information is not actionable. Employees thus may be allowed to take with them to a competitor information from a former employer, so long as it is not a trade secret.

Section 2019.210 restricts a former employer’s ability to bring a broad trade secret claim without a detailed threshold identification of the purported trade secrets so that the employer cannot seek discovery, learn what the employee took and claim those items to be trade secrets retroactively. And inevitable disclosure was rejected as a viable doctrine specifically because it imposes de facto noncompetes on departing employees. Courts concluded that the doctrine would give the employer a contractual benefit it never paid for, while unfairly binding the employee to a provision without negotiation or consideration.

Cautionary Tale for Practitioners

Parrish is the latest example of California courts’ increasing unwillingness to forgive practitioners for failing to appreciate the distinctive nature of California trade secrets law. The California Court of Appeal previously determined that citations to out-of-state authority about UTSA preemption “are not persuasive in construing California’s unique statute.” Parrish takes this reluctance one step further. After Parrish, it is no longer simply that non-California arguments or authority might be rejected. Now,

depending on the outcome on rehearing, a failure to appreciate California-specific nuances might be considered frivolous or even bad faith.

Trade secret misappropriation is a rapidly expanding practice area nationwide. The UTSA's adoption by almost every state was intended to provide a level of uniformity to that practice. To a certain degree, it does. But Parrish cautions that it is not enough to rely on the similarities across states when practicing in California. Trade secrets experience in Illinois or New Jersey will not provide the tools to litigate in California without significant additional preparation and research.

Parrish thus provides an important lesson for practitioners. Plaintiffs' counsel need to structure their California cases to avoid fatal California-specific defenses. And defense counsel, on the other hand, might be remiss in omitting these arguments. Otherwise, clients' cases are at risk, and the lawyers themselves may be exposed as well.

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[1] In addition, North Carolina has adopted a modified version of the UTSA and a version of the uniform statute is currently pending in the Massachusetts Legislature.

[2] Cal. Civ. Code § 3426.8.

[3] K.C. Multimedia Inc. v. Bank of Am. Tech. & Ops. Inc., 171 Cal. App. 4th 939, 956 (Cal. Ct. App. 2009).