

Trade Secrets Litigation and the Software Industry

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TRIALS | APPEALS

What We'll Cover

Exemplary settings

Trade secret status, and misappropriation, under California law

Plaintiff's case:

- Pre-suit investigation

- CAL. CODE CIV. P. §2019.210: Disclosure requirement

- Proving misappropriation

- Remedies

Experts

Defendant's case

Exemplary Settings

- Joint venture to develop software breaks down
- Software licensee terminates agreement, switches to competitor of licensor
- Software licensee accused of impermissibly building licensed software into licensee's other products
- Former employees leave to start a competing software company
- Plaintiff's contract software developer, and customer, cut out plaintiff, strike deal to use software plaintiff paid to have developed

Trade Secret Status and Misappropriation Under California Law

Trade Secrets:

- Information from which Plaintiff derives “independent economic value” from the fact that the information is not generally known to the public
- And for which Plaintiff took reasonable measures to maintain its secrecy

CAL. CIV. CODE §3426.1(d)

In the software setting...

What facts show that information is “not generally known”? [*Synopsis, Brocade*]

What measures are sufficient to maintain secrecy? [*Brocade, AtPac*]

What evidence shows “independent economic value” from the secrecy? [*TEA Sys.*]

Trade Secret Status and Misappropriation Under California Law

Synopsys, Inc. v. ATopTech, Inc., 2013 WL 5770542 (N.D. Cal. 2013):

- Plaintiff licensed Defendant to use Plaintiff's software for certain purposes.
- Plaintiff decided Defendant used the software outside the license, and allegedly downloaded proprietary content from P's password-protected website w/o consent.

- Defendant moved to dismiss Plaintiff's complaint under FED. R. CIV. P. 12(b)(6):
 - Asserts it neither identifies trade secrets, nor pleads facts showing misappropriation.
 - Merely points to everything Plaintiff created, claims all are trade secrets
 - Moreover, Plaintiff's alleged secrets were disclosed in its Copyright Office, Patent Office filings

- Synopsys responded:
 - Complaint specifically identified trade secrets as material claimed in redacted Copyright Office filings
 - Complaint pleaded specific acts alleged to amount to misappropriation

Trade Secret Status and Misappropriation Under California Law

Synopsys, Inc. v. ATopTech, Inc., 2013 WL 5770542 (N.D. Cal. 2013):

- 12(b)(6) motion granted. Complaint was impermissibly conclusory
- Stated that the alleged secrets “relate to [identified products]” and “include proprietary input and output formats, scripts, and technical product documentation, which generally are not publicly known and derive value from being secret”
- Didn’t like the complaint’s errant references to patents as constituting trade secrets
- “These are conclusions of law disguised as factual pleadings, and do not state claims under *Twombly* and *Iqbal*.”
- “It is impossible for the Court . . . to determine where trade secret protection begins and ends as to any of this material (e.g., non-redacted portions of public documents, open-source code, and so forth)”
- “Plaintiff’s complaint is too sweeping and vague for Defendant to be on notice of what trade secrets are at issue and . . . the boundary between those secrets and general knowledge....”

Trade Secret Status and Misappropriation Under California Law

Brocade Comm'ns Sys., Inc. v. A10 Networks, Inc., (N.D. Cal. 2013):

- Former-employee case
- Brocade proved its information was confidential:
 - Expert witness testified that in 48 years of experience in computer industry
 - As instructor, consultant, and editor of trade journals
 - He was unaware of Brocade's secrets until he worked on this case
- Brocade showed its measures to maintain secrecy were sufficient:
 - Source code and technical documents were marked confidential
 - Locks, building security, and passwords were used to prevent public disclosure
 - Source code was not shown to customers or others outside Brocade
 - Tracking system was used to identify who had access to source code

Trade Secret Status and Misappropriation Under California Law

AtPac, Inc. v. Aptitude Solutions, Inc., 787 F.Supp.2d 1108 (E.D. Cal. 2011):

- AtPac's measures to maintain secrecy of its software:
 - Employees were required to keep information confidential
 - Licensees, too, and also made to remove AtPac materials at license expiry
 - AtPac notified licensees of its IP and trade secret rights each time licensees used AtPac's software
 - AtPac restricted login accounts
 - AtPac administered all servers where its software and other secrets were kept
 - Access to source code and data schema was restricted to only those employees who needed it
 - Public search functionality was limited,
 - Source code was located behind firewalls,
 - Access to primary development server was limited,
 - Copyright Office procedures for filing only small part of code to be registered were used

Trade Secret Status and Misappropriation Under California Law

Yield Dynamics, Inc. v. TEA Sys. Corp., 66 Cal. Rptr. 3d 1 (6th Dist. 2007):

- Plaintiff failed to show the source code “derived independent economic value from being not generally known”:
 - P’s fact witness testified that the source code procedures were of “some help” to a programmer in creating new routines or a similar function, and saved time in programming
- Held:
 - Must show more than that information is useful or helpful to carry out an action
 - “The factfinder is entitled to expect evidence from which it can form some solid sense of *how* useful the information is...”
 - “E.g., *how much* time, money or labor it would save, or at least that these savings would be ‘more than trivial.’”
 - Here, what was required was evidence as to how long an experienced programmer with knowledge of the devices in question, would take to create these functions or carry out these actions

Trade Secret Status and Misappropriation Under California Law

Misappropriation:

- Acquisition of trade secret by one who knows/should-know it was acquired by improper means
- Disclosure or use, without express/implied consent, by one who
 - Acquired using improper means, or
 - At time of disclosure/use, knew/should-know it was
 - Derived from one who used improper means to acquire it or owed P duty to keep secret, or
 - Acquired under circumstances creating duty to keep secret or limit use, or
 - Knowingly retained the secret after learning—at a time before D materially changed position—it was a trade secret acquired via accident/mistake.

CAL. CIV. CODE §3426.1

Trade Secret Status and Misappropriation Under California Law

Silvaco Data Sys. v. Intel Corp., 109 Cal. Rptr. 3d 27 (6th Dist. 2010), *disapproved on other grounds by Kwikset*, 120 Cal. Rptr. 3d 741 (Cal. 2011):

- Defendant Intel bought software from third party that Silvaco previously had accused that third party of stealing its source code
- Silvaco sued Intel, alleged Intel's purchase of the software, knowing of Silvaco's allegations, amounted to trade secret misappropriation
- Intel never possessed or had access to the source code, only to executable, machine-readable, compiled code that the third party supplier provided.
- Holding: "One does not, by executing machine-readable software, 'use' the underlying source code; nor does one acquire the requisite knowledge of any trade secrets embodied in that code."

Plaintiff's Case: Pre-Suit Investigation

Often conducted under exigent circumstances after misappropriation discovered

Very helpful to know the law beforehand

May have time only to interview witnesses, learn essential facts, craft pleadings

Approach:

- Define the trade secrets at issue
 - Distinguish them from general knowledge in the industry
 - Distinguish them from any public disclosures made by Plaintiff (Patent Office filings, Copyright Office filings, trade show demonstrations, marketing mat'ls)
- Identify all measures taken to preserve secrecy; be imaginative, learn everything
- Explain, clearly and factually, why the secrets derive value from their secrecy
- As to misappropriation, identify specific acts by each defendant

Plaintiff's Case: Pre-Suit Investigation

Where information as to a defendant's misappropriation is incomplete at the time a filing must be made, know the jurisdiction's law as to the privilege to include allegations in pleadings without incurring tort liability

Document the investigation as it is made, or within a short time after filing

Will be useful if, at trial, defendant alleges bad-faith trade secret claim

Challenging to reconstruct months or years after the investigation

Be mindful that many courts dislike *ex parte* TROs, even where statute permits it

Be prepared if court insists that defendants receive notice and attend TRO hearing

To be ready for TI hearing, have prepared at the time of filing, or very soon after:

Discovery requests...Motion for expedited discovery...Protective Order

Protocol for forensic imaging of defendant's computers . . .

Expert witness retained and available once computers are turned over

Plaintiff's Case:

CAL. CODE CIV. P. §2019.210: Disclosure Requirement

California, alone, conditions P's right to discovery on a disclosure of P's asserted trade secrets

Genesis: *Diodes v. Franzen* (2nd Dist. 1968)

“Before a defendant is compelled to respond to a complaint based upon claimed misappropriation or misuse of a trade secret and to embark on discovery which may be both prolonged and expensive, the complainant should describe the subject matter of the trade secret with sufficient particularity 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.”

Plaintiff's Case:

CAL. CODE CIV. P. §2019.210: Disclosure Requirement

Diodes v. Franzen's holding was codified as part of CUTSA in 1984

Current home is at CAL. CODE CIV. P. §2019.210, requiring disclosure with “reasonable particularity” before P may take further discovery

Four purposes of § 2019.210:

1. Incentivizes P to thoroughly investigate claims, and define boundaries of asserted secrets
2. Burdensome enough to deter P's who file suit hoping to learn in discovery the secrets of D, their competitor
3. Assists trial court in ascertaining the proper scope of discovery, and if P's discovery requests are challenged, deciding whether they're permissible
4. Assists D by giving fixed target at which to aim

Plaintiff's Case:

CAL. CODE CIV. P. §2019.210: Disclosure Requirement

§2019.210's essentials:

1. After entry of protective order, P must serve on D a written designation of each asserted trade secret
 - a. Must provide “sufficient particularity to limit the permissible scope of discovery by distinguishing the trade secrets from matters of general knowledge in the trade, or of special knowledge of those persons skilled in the trade.” [Adv. Mod. Sputtering]
 - b. Not a pleading, but functions like one, b/c limits scope of discovery
2. Defendants often invoke § 2019.210 by moving for protective order staying discovery, moving for more definite statement, and moving to compel disclosure
3. When challenged, standard is reasonableness, and any doubts as to scope of discovery are to be resolved in favor of disclosure. [Adv. Mod. Sputtering]

Plaintiff's Case:

CAL. CODE CIV. P. §2019.210: Disclosure Requirement

§2019.210's essentials:

4. Where trade secrets at issue are low-tech, e.g., pudding formulae, a suitable disclosure may be 1-2 pages. [*Brescia v. Angelin*]
5. Catch-all language, surplusage, voluminous attachments, and an overall failure to enumerate the specific secrets at issue, may be deemed insufficient by the trial court. [*Perlan Therapeutics*]
6. Has been held to bar discovery as to non-trade-secret claims that shared the same factual premise as the trade secret claim.
7. Has not always been applied in federal courts—later decisions hold that it does apply. [*Gabriel Technologies* (S.D. Cal.), *Social Apps LLC* (N.D. Cal.)]
8. Defendants' challenge to a 2019.210 disclosure is not a merits challenge.
9. However, where P repeatedly fails to serve a sufficient disclosure, courts have suggested MSJs would be entertained from Ds. [*Art of Living Foundation*]

Plaintiff's Case: Proving Misappropriation

- Wrongful acquisition: That D acquired the trade secret, knowing/should-have-known that the acquisition was by improper means.
- Wrongful use or disclosure: That D used, or disclosed, the trade secret without P's authorization and
 - D acquired the secret through improper means, or
 - D knew or should have known, at the time of disclosure/use, that the secret was
 - Derived from one who (i) used improper means to acquire it or (ii) owed P a duty to keep it secret, or
 - Acquired under circumstances creating duty to keep secret or limit use
- Wrongful retention: That D retained the trade secret, after knowing, at a time before a material change in D's position, that it was a trade secret and acquired through accident/mistake

Plaintiff's Case: Proving Misappropriation

Unilogic, Inc. v. Burroughs Corp., 10 Cal. App. 4th 612 (6th Dist. 1992):

- Unilogic's predecessor was to develop PC prototypes that ran MS-DOS and a Burroughs proprietary operating system (BTOS)
- Burroughs provided cash, an employee, and BTOS in source code and object code
- Unilogic's predecessor could only use BTOS for the project, and return when done
- Ultimately, deliverables weren't achieved, Burroughs turned to another provider
- Litigation ensued.
- Burroughs' proof of misappropriation: post-termination, Unilogic had commingled BTOS with Unilogic software, and had shown third party prototypes containing the commingled software

Plaintiff's Case: Proving Misappropriation

Brocade Comm'ns Sys., Inc. v. A10 Networks, Inc., (N.D. Cal. 2013):

- Former-employee case
- Brocade showed that:
 - ex-employee had access to Brocade's code
 - ex-employee's new company (A10) produced similar or identical products with the same design as Brocade's
- A10 argued Brocade impermissibly shifted burden of proving misappropriation to A10
- Trial court disagrees
 - Brocade always had burden to prove misappropriation
 - Brocade's evidence was *prima facie* case of misappropriation
 - A10 could defend by showing independent derivation, if it produced evidence

Plaintiff's Case: Proving Misappropriation

Challenges:

- *Brocade* aside, departing employee (“bad leaver”) cases often are brought so soon after departure that no actual disclosure, or commercial use, has occurred
- These cases don’t involve wrongful acquisition, so disclosure/use must be shown
 - For TRO/PI, threatened use/disclosure suffices [CAL. CIV. CODE §3426.2(a)]
 - After the TRO/PI is secured, actual use/disclosure becomes important for trial
 - What is “use” of the trade secret?
 - *JustMed, Inc. v. Byce*, 600 F.3d 1118, 1130 (9th Cir. 2010) (software case decided under Idaho law, defining misappropriation like CUTSA)
 - “The term ‘use’ in the context of misappropriation of a trade secret generally contemplates some type of use that reduces the value of the trade secret to the trade secret owner.”
 - Citing 5th Circuit cases requiring “commercial” use

Plaintiff's Case: Remedies

Injunctive relief:

- “Actual or threatened misappropriation may be enjoined”: CAL. CIV. CODE §3426.2
- Injunction may condition use upon payment of reasonable royalty: *Id.*
- Mandatory injunction to compel affirmative acts to protect trade secret: *Id.*

TRO, PI:

- CAL. CODE CIV. P. § 525-534
- Prelim. Injunction may be granted anytime before judgment on verified complaint or affidavits showing sufficient grounds. [§ 527]
- PI always requires notice to opposing party
- TRO may issue ex parte where irrep. harm from waiting, plus attorney certification

Plaintiff's Case:

Remedies

Damages:

- Actual damages: CAL. CIV. CODE §3426.3(a)
- Plus unjust enrichment of defendant, provided no double recovery: [*Id.*]
- If actual damages/unjust enrichment can't be proved, reasonable royalty [§3426.3(b)]
- For willful and malicious misappropriation, exemplaries up to twice the award under §a or §b.

Attorney fees and costs:

- Bad faith cases, willful and malicious misappropriation cases [§3426.4]
- Expert witness fees recoverable under this provision [*Id.*]
- “Bad faith” requires (i) objective speciousness and (ii) subjective bad faith in bringing/maintaining the claim [*Gemini Aluminum; Rashedi v. McCue*]

Plaintiff's Case: Remedies

Unilogic, Inc. v. Burroughs Corp., 10 Cal. App. 4th 612 (6th Dist. 1992):

- Burroughs' trade secret theft claim: Unilogic retained BTOS post-termination
- No actual damages, because Unilogic prototypes containing BTOS were never sold
- Burroughs' misappropriation counterclaim was nonsuited by trial court
- On appeal, Burroughs argued for unjust enrichment damages or reasonable royalty
 - Ex-employee testified Burroughs paid \$1.3 million for creation of BTOS
 - Also testified value of paid-up license for BTOS object code was \$1.2 million, and for source code, \$100 k.
- Nonsuit affirmed:
 - Testimony didn't establish that Unilogic was enriched by those or any amounts
 - Nor did it establish what royalty was reasonable under these circumstances

Experts

Often very expensive, esp. if two sets of software code must be compared
P should budget for and raise with business when evaluating bringing suit
D, especially former employee, may be unable to secure expert

Continue to seek sources of guidance for use in deposing P's expert

D's counsel may have experience from prior depositions of forensic experts,
or colleagues who can lend outlines, suggestions

D's often challenge turnover of computers to P's forensic experts:

Courts often are inclined to permit discovery;

D's better option may be to secure protective order, discovery protocol
that alleviates privacy concerns

Defendant's Case

1. Distinctions from other commercial suits

Nuances/distinctions from run-of-the-mill suits:

- Very fast-moving, often involving TRO/PI; much to do, very compressed time frame
- Accused of theft of valuable property, D's credibility and honesty are under attack
- Many challenges exist in cases where D is individual sued by former employer
 - Nearly always retain counsel only after suit brought, PI hearing set
 - Seldom experienced with litigation or working with attorneys
 - Often reluctant to completely trust counsel, fully disclose vital facts
 - Potential for destruction of evidence before meeting with attorney
 - May not have found work after leaving; new employer may fire after suit filed
 - Initial retainer may be a challenge, and particularly subsequent payments
 - Dealing with suit often strains family life, particularly paying attorney fees, impediment to securing future work, and turning over home computer

Defendant's Case

2. Strategies

Approach:

- Work to gain client's trust, convey importance of excellent conduct during suit
 - Whatever has been alleged is only that, and more important, is done
 - What matters most now is achieving, and maintaining, good standing with court
 - No spoliation, or if it occurred before engagement, work to mitigate and explain
 - Avoid spurious counterclaims, such as
 - Claims based merely on filing of suit (in most jurisdictions)
 - Malicious prosecution as a counterclaim (in most jurisdictions)
 - IIMD, false imprisonment and battery during contentious exit interview
 - Utter candor between client and counsel
 - Straightforward conduct at depositions and on cross-exam at hearings
- Propose suitable fee arrangement; fee only for TRO/PI/depo has some drawbacks

Defendant's Case

2.Strategies

Strategies, continued:

- Explain that often, Plaintiffs lose interest in these suits after initial “wins” at TRO/PI
 - P has its “win,” business people turn to other issues, concerns, interests
 - The desire to “beat” D may ebb
 - Attention may shift to the cost in attorney fees to secure the TRO/PI and P’s desire to avoid any additional fees
 - P may see trial as far off and unlikely
 - This is when a smart counterattack by D makes the most sense, may have the greatest impact and may strike at a time when P wants to wrap up the case

Defendant's Case

2.Strategies

Strategies, continued:

- Smart, effective counterattacking:
 - Counterclaims that have a basis in facts of record, or that logically could be developed during discovery
 - Discovery requests that are well-connected to elements of counterclaims
 - Avoid asking for “apex” depositions of large corporations, or “all evidence” of how P treated others in cases that really aren't that similar
 - Put P's trade secrets at risk:
 - Investigate the alleged “measures taken to maintain secrecy”
 - Pin P down as to the distinctions between the alleged secrets and knowledge in the art
 - Develop testimony and other evidence blurring the alleged distinction

Defendant's Case

2.Strategies

Smart, effective counterattacking, continued:

- Attack P's pre-suit investigation, press for evidence as to P's knowledge of flaws in the claim or failure to diligently investigate other explanations
 - Ask about communications to third parties, e.g., the FBI, police, US Attorney
 - Seek discovery of notes taken by non-attorneys during witness interviews
 - Can argument be made for turnover of (some) communications w/ counsel?
- Defamation often is worth investigating
 - Not based on filing of complaint, but public statements made after filing
 - Particularly statements by P's managers to third parties outside company
 - Non-managerial employees are more likely to have made statements on Facebook and via email to friends, former co-workers, but those statements are more likely to be actionable against the employees, not the company

Defendant's Case

2.Strategies

Smart, effective counterattacking, continued:

- Where discovery shows D has not further used or disclosed the alleged secrets, ask P to drop suit (with agreed permanent injunction), and begin building case that continued maintenance of suit is bad faith
- Prepare term sheet of reasonable conditions under which D will settle case
 - Often a non-starter to ask P to pay D's attorney fees
 - The concern is ensuring D doesn't sign a hastily-considered settlement agreement that becomes a breach-of-contract claim in a second suit by P