

Trade Secret Update

IP Law Institute, PBI

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Scherer Design Group, LLC v. Ahead Engineering LLC, **2019 WL 937176 (3d Cir. Feb. 25, 2019)**

- Plaintiff SDG, engineering firm, and Schwartz, key employee, entered into discussions regarding potential ownership stake
 - Schwartz advised that if they could not reach agreement, he would start a competing firm
 - No non-compete
 - Company asked Schwartz to sign a non-compete
 - Schwartz declined
- Employee then led group of employees who
 - Left *en masse* to start two related engineering firms, competitors to SDG
 - While still at SDG, transmitted 77,000 SDG files to the new firms
 - CAD files and macros, automation tool to provide services to SDG's largest customer, construction plans, client documents, internal analysis tools for scheduling

***Scherer Design Group, LLC v. Ahead Engineering LLC*, 2019 WL 937176 (3d Cir. Feb. 25, 2019)**

- Company conducted forensic investigation
 - Accessed one employee's Facebook account
 - SDG: Employee left his account open
 - Defendants: SDG hacked in
 - Installed software to monitor that account without detection
 - Saw evidence of employees' plans to take company's IP
- But company had no policy retaining right to monitor use of company computers
- Company files suit in D.N.J., seeking TRO and preliminary injunction
- Employees argue that **unclean hands** bars injunctive relief

Scherer Design Group, LLC v. Ahead Engineering LLC, 2019 WL 937176 (3d Cir. Feb. 25, 2019)

- District Court disagrees and grants preliminary injunction
 - Held
 - Likelihood of success on breach of duty of loyalty
 - Irreparable harm absent injunction
 - Unclean hands not applicable
 - Misconduct not directly related to the activities plaintiff sought to enjoin
 - Injunction barring
 - solicitation of SDG's clients and
 - destruction of information taken
- Employees appeal

***Scherer Design Group, LLC v. Ahead Engineering LLC*, 2019 WL 937176 (3d Cir. Feb. 25, 2019)**

- Third Circuit affirms
- Majority opinion
 - Unclean hands requires:
 - Party seeking injunction committed unconscionable act; and
 - That act is related to the claim upon which equitable relief is sought
 - Unclean hands is not automatic bar to relief
 - Just a factor in determining whether to grant injunction

Scherer Design Group, LLC v. Ahead Engineering LLC, **2019 WL 937176 (3d Cir. Feb. 25, 2019)**

- Third Cir.: Trial court's decision not to invoke unclean hands was sound
 - Company did not dirty its hands to acquire the rights it asserted in the litigation
 - Company already had those rights (duty of loyalty)
 - » Distinguish from a patent holder who obtains patent rights based on fraudulent patent application
 - Surreptitious monitoring provided proof, but did not give rise to the claim
 - Company could prove breach of duty of loyalty without relying on the surreptitiously obtained Facebook messages
 - Facebook monitoring is not **related to** whether Defendants, at some earlier point, stole SDG's property
 - Alleged privacy violation and breach of duty of loyalty have separate remedies under the law

Scherer Design Group, LLC v. Ahead Engineering LLC, **2019 WL 937176 (3d Cir. Feb. 25, 2019)**

Judge Ambro dissents

- Employees had expectation of privacy
- Company's conduct was highly offensive
- Company could have obtained the information in discovery
- Relatedness is plausible
 - Motion for preliminary injunction rests on employees' taking of company documents
 - Both parties unlawfully acquired from the other information relevant to their competing businesses
 - So trial court could have concluded that Company's conduct affected the balance of the equities

***Scherer Design Group, LLC v. Ahead Engineering LLC*, 2019 WL 937176 (3d Cir. Feb. 25, 2019)**

Takeaways

- To be “unclean hands,” misconduct must be related to the rights asserted
 - Ideally,
 - Plaintiff dirtied its hands in acquiring the right
 - Misconduct pre-dated the wrong
 - But relatedness is subjective
- Decision applicable whenever equitable relief is sought, not just trade secret

Pittsburgh Logistics Systems, Inc. v. Beemac Trucking, LLC, 2019 WL 168477 (Pa. Super. Jan. 11, 2019)

- Plaintiff, PLS, is a third party logistics provider
 - Arranges freight shipments for customer with item to be shipped
- Defendant Beemac is a shipping company
- The parties had a contract
 - PLS may disclose confidential information such as names and addresses of shippers and other clients, volumes of traffic, and rate data
 - Non-compete
 - Beemac will not solicit or conduct transport for shippers or other clients of PLS, without the involvement of PLS,
 - During contract and for one year afterward
 - **No-hire** provision
 - Prohibits Beemac from hiring or soliciting for employment employees of PLS
 - During contract and for two years afterward

Pittsburgh Logistics Systems, Inc. v. Beemac Trucking, LLC, 2019 WL 168477 (Pa. Super. Jan. 11, 2019)

- During the contract, four employees of Beemac went to work for PLS
- PLS sued, seeking injunction to enforce non-compete and non-hire
- Trial court entered injunction as to non-compete only, finding:
 - Non-hire between contracting companies is question of first impression in Pennsylvania
 - Non-hire would violate public policy
 - Prevent employees from seeking employment without
 - Consideration,
 - Input, or even
 - Knowledge
- PLS appealed

***Pittsburgh Logistics Systems, Inc. v. Beemac Trucking, LLC*, 2019 WL 168477 (Pa. Super. Jan. 11, 2019)**

Pennsylvania Superior Court agreed, before and after rehearing *en banc*

- Unfair restraint on trade
- Void as a matter of public policy
 - Courts in other states differ, but
 - Such non-hire agreements essentially force a non-compete on employees without their consent, or even knowledge in some cases
- Exceeds necessary protection to secure PLS' business
 - Non-compete here is sufficient to protect PLS

Pittsburgh Logistics Systems, Inc. v. Beemac Trucking, LLC, 2019 WL 168477 (Pa. Super. Jan. 11, 2019)

- And PLS had “unclean hands”
 - Trial court in a separate action had found that PLS had unclean hands
 - Non-compete against employees had no geographic limitation, so overbroad
 - Overbreadth showed intent to oppress employees
 - So court refused to enforce non-competes
 - Appeals court:
 - It would be “incongruous to strike the employees’ restrictive covenant, finding PLS to have unclean hands, yet
 - allow PLS to achieve the same result via a contract between the two companies”

Pittsburgh Logistics Systems, Inc. v. Beemac Trucking, LLC, 2019 WL 168477 (Pa. Super. Jan. 11, 2019)

- But two judges, in **dissent**, would have upheld the non-hire
 - PA law generally favors arms-length contracts between sophisticated parties
 - Majority erroneously treats the no-hire like a restrictive covenant between an employer and employee
 - Not a back-door restrictive covenant
 - The employees can work anywhere except with Beemac
 - No-hire is fair
 - In exchange for access to PLS' specialized industry knowledge and contacts,
 - Beemac would not hire the employees and obviate the need for PLS' services

***Pittsburgh Logistics Systems, Inc. v. Beemac Trucking, LLC*, 2019 WL 168477 (Pa. Super. Jan. 11, 2019)**

- No PA decisions on no-hires, but federal precedent is persuasive
 - *GeoDecisions v. Data Transfer Solutions, LLC*, 2010 WL 5014514 (M.D.Pa. 2010)
 - Granted preliminary injunction based on no-hire

▪ Lessons

- Draft reasonably tailored non-competes
- Beware enforceability of
 - non-hire agreements
 - non-solicitation of employees

Wolfington Body Co. v. O'Neill and Grech Motors, Inc., **190 A.3d 754 (Pa. Super. 2018)**

- Wolfington is a bus sales and transportation company
- O'Neill was a salesperson at Wolfington
- Non-compete to protect confidential information
- Left to work for Grech Motors
- Wolfington sued
 - Sought preliminary injunction
 - To protect confidential information
 - Pricing information
 - Customer information
 - Marketing strategies

Wolfington Body Co. v. O’Neill and Grech Motors, Inc., **190 A.3d 754 (Pa. Super. 2018)**

- Trial court denies injunctive relief
 - No legitimate business interest
 - Information was common knowledge
 - Not secret
 - No competitive value
 - “Nothing unusual or new about the pricing of luxury commercial vehicles, the profit margins of the largest commercial vehicle companies, or their customers.”
 - Confidential Information defined too broadly
 - Would include any information the employee learned during his employment
 - Not reasonably tailored to protect Wolfington’s business interest
 - Geographic restraint overbroad
 - Every state where Wolfington has done business, not
 - The employee’s territory
 - Employee’s right to earn a living weighs more heavily
 - Refuses to blue pencil

Wolfington Body Co. v. O’Neill and Grech Motors, Inc., **190 A.3d 754 (Pa. Super. 2018)**

Appeals court agrees

- Customer lists, customer data and other information may be trade secrets, but
- Record supports finding that covenant is overbroad
- “Blue pencil” provision
 - Wolfington argues that trial court should have invoked it
 - Superior Court:
 - Wolfington waived the issue, but
 - Record supports trial court refusal to invoke

Lesson:

Draft non-competes to be narrowly tailored to protect legitimate business interest

Arconic, Inc. v. Novelis Inc., 2018 WL 4944373 (W.D.Pa. 2018)

- Parties are competing suppliers of aluminum to Ford Motor Company for pickup trucks
- Both companies have process for chemically pretreating aluminum sheets
- Ford opted to use Arconic's pretreatment process, but asked both companies to enter into license
 - so that both companies could supply the same pretreated aluminum to Ford
- Arconic and Novelis signed NDA and later a Technology Licensing Agreement
 - Arconic allowed Novelis access to the technology
 - Novelis retained rights to independently developed technology, including any improvements to Arconic's technology

Arconic, Inc. v. Novelis Inc., 2018 WL 4944373 (W.D.Pa. 2018)

- Novelis later filed patent applications which Arconic claimed misappropriated its trade secrets
- Arconic sued for trade secret misappropriation, among other things
- Novelis claimed that Arconic should be required to identify trade secrets prior to discovery
 - Issue in most trade secret cases
 - Court used Special Master, who agreed with Novelis
 - Some states have enacted procedures requiring identification of trade secrets before discovery commences
 - Plaintiff must identify trade secrets with “reasonable particularity”
 - Otherwise defendant cannot formulate a defense

Arconic, Inc. v. Novelis Inc., 2018 WL 4944373 (W.D.Pa. 2018)

- Special Master recommended that plaintiff be ordered to file its trade secrets under seal
 - Identify which elements are in the public domain and which are trade secrets
 - For any “combination” trade secret, explain what is it about such combination that makes it trade secret
- Court adopted recommendations
- Lesson: Defendants should argue for identification of trade secrets prior to discovery

Act III Management, LLC v. Panera Bread Co. et al **(Del. Chancery, March 8, 2019)**

- Panera Bread is chain of bakery-cafes
 - Over 2,000 in U.S. and Canada
- Act III Management is a company founded by Panera Bread's ex-CEO
 - Left in 2018
 - Finances brands that compete with Panera
 - Zoe's Kitchen
 - Tatte Bakery and Cafe
- Act III hired three key IT executives of Panera
 - Panera's principal software architect
 - Panera's director of enterprise architecture
 - Panera's director of delivery systems
- All had non-competes

Act III Management, LLC v. Panera Bread Co. et al **(Del. Chancery, March 8, 2019)**

- Panera fired the IT executives
- Panera and Act III then sued each other
 - Act III sued in Delaware Chancery
 - Claims Panera violated agreement allowing hire of employees with non-competes
 - Panera sued in Missouri, claiming
 - Act III recruited executives to get Panera's confidential information
 - Panera had invested millions in its technology
 - Missouri suit was transferred to DE due to forum selection clause
- DE Chancery judge grants TRO to Panera, temporarily preventing hire

Act III Management, LLC v. Panera Bread Co. et al **(Del. Chancery, March 8, 2019)**

- Court ruled
 - Plaintiffs have colorable claims
 - Act III has strong defenses, but
 - Colorability is a low standard, meaning nonfrivolous cause of action
 - Panera alleged that
 - three employees with access to confidential information
 - have gone to work at competitor
 - in violation of their non-competes
 - Imminent, irreparable harm
 - Breaches of non-competes and disclosure of confidential competitive information constitute irreparable harm
 - Stipulation in contract that breaches constitute irreparable harm
 - Strong, although non-binding, evidence of irreparable harm

Act III Management, LLC v. Panera Bread Co. et al **(Del. Chancery, March 8, 2019)**

- Balance of hardships favors Panera
 - Hardship to Panera of losing confidential competitive information outweighs harm to defendants from a brief delay in employment start date
 - True, the three executives have already begun work at Act III, BUT
 - Panera originally sued before the defendants started employment
 - We are post-employment only because of forum transfer
 - So status quo is “one where no alleged trade secrets are at risk of seeping out”
- Lesson:
 - Much better to sue *before* the thing you are trying to enjoin occurs, but
 - Even if sue afterwards, injunction may still be warranted

Optum Inc. et al v. Smith, U.S. District Court for the District of Massachusetts (Feb. 22, 2019)

- Amazon, Berkshire Hathaway and JPMorgan Chase have created health care startup
 - Nonprofit
 - “ABC”/Haven
 - Atul Gawande is CEO
 - Renowned surgeon, author, speaker
- Optum
 - \$100 billion business
 - A large pharmacy benefit manager and other businesses
- An Optum mid-level executive, David Smith, left Optum in January 2019 to work for ABC

***Optum Inc. et al v. Smith*, U.S. District Court for the District of Massachusetts (Feb. 22, 2019)**

- ABC's plans were unknown to the public
- But Optum was very concerned that Smith would use Optum's trade secrets for the benefit of ABC
 - Optum believed/feared that ABC would become a competitor
 - Amazon
 - Computer forensics for the day of Smith's first interview with ABC's COO show that Smith:
 - Printed confidential documents
 - including a memo about Optum's long-term goals and strategies
 - Made suspicious requests for information
- Smith had contract with Optum
 - No non-compete
 - Disputes to be arbitrated, but parties may seek injunctive relief first

***Optum Inc. et al v. Smith*, U.S. District Court for the District of Massachusetts (Feb. 22, 2019)**

- Optum filed trade secret misappropriation suit in federal court against Smith
 - Sought TRO to prevent Smith from working for Optum
- Trial court denied injunction
 - No showing that ABC posed an imminent threat
 - ABC COO testimony
 - Mission: Make health care
 - » Easier to understand
 - » Less expensive
 - » Produce better outcomes
 - ABC is focused on finding new ways to provide health care to employees of the 3 founding partners

***Optum Inc. et al v. Smith*, U.S. District Court for the District of Massachusetts (Feb. 22, 2019)**

- “Can we reinvent what insurance looks like in terms of benefit design?”
 - Not a competitor to Optum
 - Optum builds, operates and sells products; ABC purchases products.
 - No plan to compete with pharmacy benefit managers like CVS or Optum
 - Rather, will consider:
 - » “Could we contract with a PBM to get more transparency?”
 - » “Can we actually understand what costs are?”
- Held:
- No showing that ABC planned to compete
 - Unlikely that ABC will have *any* products or services to offer in 2019, much less products or services to compete with Optum

***Optum Inc. et al v. Smith*, U.S. District Court for the District of Massachusetts (Feb. 22, 2019)**

- ABC is in a fledgling, uncertain state
 - » Fewer than 30 employees
 - » Only now beginning to collect and analyze data from the three founding companies
- “Any prediction about ABC’s future now would be speculative”
- Public interest best served by Smith continuing to work for ABC
 - especially if ABC succeeds in providing better health care beyond A, B, and C
- Case now to arbitration

***Food Marketing Institute v. Argus Leader Media*, 889 F.3d 914 (8th Cir. 2018), cert granted, 139 S. Ct. 915 (U.S. 2019)**

- Supplemental Nutrition Assistance Program (SNAP)
 - f/k/a Food Stamp Program
 - USDA issues SNAP participants a card
 - Like a debit card
 - Use to buy food
 - Upon purchase, USDA receives a record of the transaction, called a SNAP redemption
- Plaintiff was Argus Leader Media
 - Owned by Gannett
 - Runs a newspaper in South Dakota
- Argus filed FOIA (Freedom of Information Act) request with USDA
 - Argus sought redemption totals that individual grocery retailers received under SNAP each year
 - For investigation of SNAP-related fraud

Food Marketing Institute v. Argus Leader Media, 889 F.3d 914 (8th Cir. 2018), cert granted

- USDA refused to provide the information, citing FOIA exemptions
 - Exemption 4:
 - trade secrets and
 - commercial or financial information that is obtained from a person and is privileged or **confidential**
- Issue is whether the information is “confidential”
- But most Circuits apply this exemption only if disclosure is “likely to cause substantial harm to the competitive position” of the source of the information
 - Courts differ on what such harm requires
 - Information potentially useful to a competitor
 - Defined competitive harm such as lost market share
- Trial court adopted the latter view
 - Found claim of such injury speculative here
 - So exemption does not apply

Food Marketing Institute v. Argus Leader Media, 889 F.3d 914 (8th Cir. 2018), cert granted

- USDA did not appeal, but
- Food Marketing Institute intervened and appealed
- 8th Circuit affirmed
 - USDA claims of competitive injury were speculative at best
 - Retailers already had access to
 - large quantities of data about their competitors and
 - existing models which explained consumer behavior
 - The contested data
 - was merely annual aggregations of SNAP redemption info
 - lacked the specificity needed to gain material insight into an individual store's
 - financial health
 - profit margins
 - inventory
 - marketing strategies
 - sales trends, or
 - market share.

Food Marketing Institute v. Argus Leader Media, 889 F.3d 914 (8th Cir. 2018), cert granted

- No meaningful evidence that retailers would be stigmatized and end their SNAP participation if the contested data were released
- Food Marketing Institute filed petition for *certiorari*
- U.S. Supreme Court granted cert
- Amici
 - Reporters Committee for Freedom of the Press
 - U.S. Chamber of Commerce
- Oral argument set for April 22, 2019

***Genentech, Inc. v. JHL Biotech, Inc. et al*, United States District Court for the Northern District of California (March 5, 2019)**

- Genentech makes biologics
 - Biologics are large-molecule, protein-based drugs
 - Produced by living cells and recombinant DNA technology
 - Genentech sells biologics to treat diseases such as cancer and cystic fibrosis
- October 2016: Genentech receives anonymous tip
 - Regarding Xanthe Lam, a principal scientist and employee at Genentech for 30 years
 - Lam was consulting for a competitor
- Genentech conducts internal investigation
- Genentech alerts FBI, which conducts parallel investigation

***Genentech, Inc. v. JHL Biotech, Inc. et al*, United States District Court for the Northern District of California (March 5, 2019)**

■ Investigation reveals

- JHL Biotech, a Taiwanese biotech startup, hired Xanthe Lam and husband Allen Lam to consult on biosimilar development
- Starting in 2013, Xanthe began secretly downloading Genentech documents
 - R&D technical reports
 - Stability studies
 - Degradation studies
 - Validation reports
 - Testing protocols
- 2014-2017: Xanthe enlists others

***Genentech, Inc. v. JHL Biotech, Inc. et al*, United States District Court for the Northern District of California (March 5, 2019)**

- September 2017: FBI executes search warrant of Lams' home
- October 29, 2018
 - Indictment against the Lams and two others is unsealed
 - Genentech files civil suit against JHL and the four individuals
 - Seeks injunction to prevent further use of trade secrets
- Court grants injunction

***Genentech, Inc. v. JHL Biotech, Inc. et al*, United States District Court for the Northern District of California (March 5, 2019)**

- Court rejects argument that Genentech failed to make reasonable efforts to maintain secrecy of trade secrets
 - JHL notes that Genentech allowed Xanthe to continue on as normal for eleven months after learning of her consulting work for competitor
 - But Genentech
 - Immediately launched investigation
 - Alerted FBI
 - Refrained from any action that might have alerted Xanthe to FBI investigation, at FBI's request
- Court rejects argument that certain JHL protocols differ materially from Genentech
 - JHL received hundreds of confidential Genentech documents filled with proprietary negative know-how
 - Would have saved JHL precious time and resources

***Genentech, Inc. v. JHL Biotech, Inc. et al*, United States District Court for the Northern District of California (March 5, 2019)**

- Court rejects argument that JHL was already incentivized to maintain secrecy
 - Risk of further dissemination of trade secrets remains
 - JHL in various partnerships that might require sharing of trade secrets
 - Use of negative know-how would be “virtually untraceable”
- Court orders injunctive relief as follows
 - Bond of \$50 million
 - Defendants shall not
 - use or disclose any of the 66 Genentech documents identified in Genentech’s Statement Regarding Trade Secrets
 - sell or market products using or developed using information in those 66 documents

***Genentech, Inc. v. JHL Biotech, Inc. et al*, United States District Court for the Northern District of California (March 5, 2019)**

- Within 21 days after posting of bond, Defendants shall
 - Return all copies of the documents
 - Prepare log of all communications
- Court thus allows JHL's work towards regulatory approvals to continue as long as it does not use the trade secrets
- Defendants seek stay of civil proceedings
 - Genentech agrees to stay generally as to individual indicted defendants
 - Court grants partial stay
 - Genentech may not seek discovery from any individual defendant
 - No stay as to JHL
 - May revisit in 6 months
 - Privilege invocations may unduly complicate discovery

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