

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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