



Protecting Confidential Information and Client Relationships

in the Financial Services Industry

Presented by Jeremy Cohen
and Kevin Mahoney

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Seyfarth Shaw LLP

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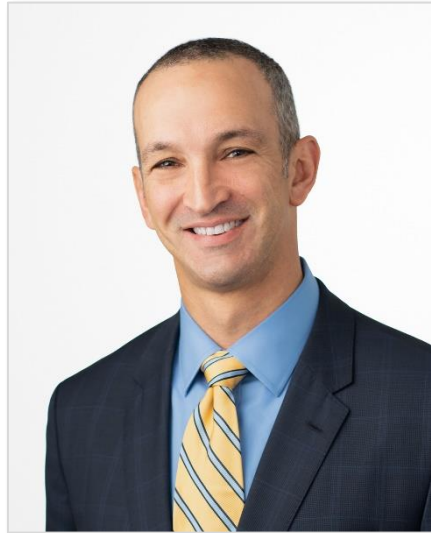
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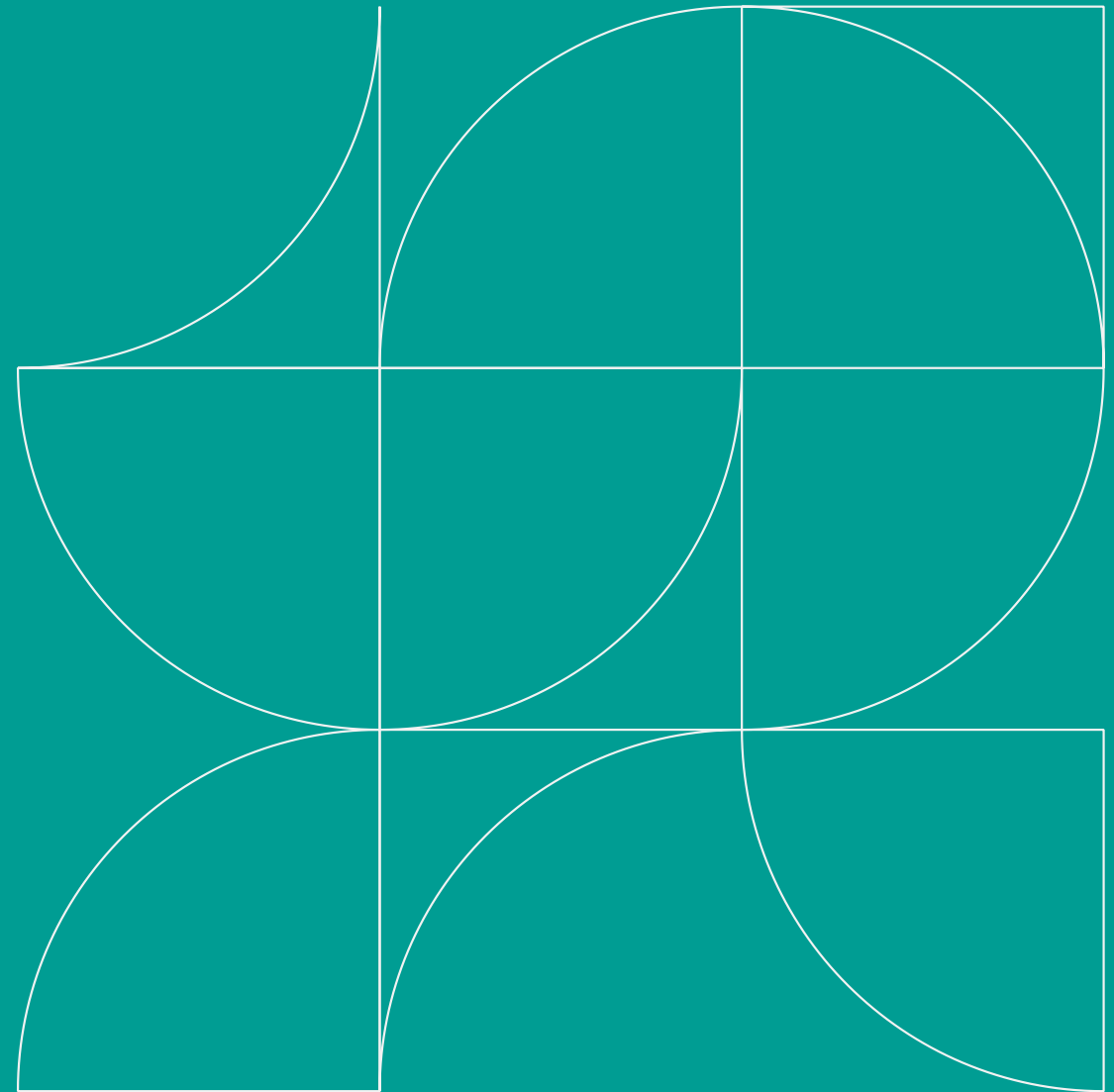


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Agenda

- 1 What is a trade secret?
- 2 Practical steps that financial services providers can implement to protect trade secrets and client relationships
- 3 What to do if a FINRA member takes your trade secrets or violates agreements
- 4 FINRA rules and the Protocol for Broker Recruiting: What you need to know and recent developments

What is a trade secret?





[A trade secret] is one of the most elusive and difficult concepts in the law to define.”

Learning Curve Toys Inc. v. PlayWood Toys, Inc., 2003 U.S App. LEXIS 16847 (Aug. 18, 2003)



Formal Definition

According to the UTSA, a trade secret is:

“information, including a formula, pattern, compilation, program, device, method, technique, or process, that: (i) derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use, and, (ii) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.”

In Simpler Terms

A trade secret is something that:

- **Is a secret**

- Not generally known in the industry, and gives a competitive edge;
- Cannot be reverse-engineered by a competitor except with significant investment of time, effort, and expense.

- **Is kept a secret**

- Owner takes *affirmative* measures to safeguard the secrecy that are...
- ...”Reasonable under the circumstances.”

Defend Trade Secrets Act (“DTSA”) of 2016

What It Does

Creates private right of action for misappropriation of trade secrets (18 U.S.C. § 1836(b))

What It Provides

Federal jurisdiction for claims of misappropriation

DTSA vs. UTSA

Fundamentally similar statutes which require similar allegations and proof

Misappropriation Under UTSA and DTSA

Under both the UTSA and DTSA, proving misappropriation requires:

1. The existence of a trade secret as defined under the statutes;
2. An unconsented disclosure or use of a trade secret by one who:
 - (i) used improper means to acquire the secret, or,
 - (ii) at the time of disclosure, knew or had reason to know that the trade secret was acquired through improper means, under circumstances giving rise to a duty to maintain the secrecy of the trade secret, or derived from or through a person who owed such a duty.

Potential Remedies for Misappropriation

- Injunctive Relief
- Monetary Relief
 - Actual Damages
 - Unjust Enrichment
 - Reasonable Royalty
- Relief for Willful and Malicious Misappropriation
 - Exemplary (Punitive) Damages
 - Attorneys' Fees
- In claims brought in bad faith, court can award attorneys' fees to defendant

Employee Protections Under DTSA

- Unlike the UTSA, the DTSA contains immunity and anti-retaliation provisions intended to protect individuals who **may need** to disclose trade secrets.
- DTSA provides immunity to individuals under ***any federal or state trade secret law*** for the disclosure of a trade secret that is made:
 - (i) in confidence to a federal, state, or local government official, either directly or indirectly, or to an attorney for the sole purpose of reporting or investigating a suspected violation of law, *or*
 - (ii) in a complaint or other document filed in a lawsuit or other proceeding, if such filing is made under seal.
- **Notice Required:** Any agreement entered into after May 11, 2016, that governs trade secrets (including employment and severance agreements) requires DTSA “immunity notice” language to preserve rights in the event of willful and malicious misappropriation

Examples of Financial Services Materials that May Be Trade Secrets

Internal Customer Lists

- High-trading or high-net-worth clients and their order histories
- Institutional fund clients, pension fund clients, and their portfolio allocations
- Angel / venture capital investors and their propensities

Internal Modeling Documents

- Cash-flow forecast models
- Options / futures pricing models
- Underwriting models
- Analytics compilations and modeling
- Trading algorithms

Internal Opportunities and Trends

- SWOT analyses
- Future private equity targets
- Emerging markets

What Information May **NOT** Be a Trade Secret?

- Publicly available, “scratch the surface” information, which can be found in...
 - Social media posts
 - Wall Street Journal
 - D&B Company Abstracts
 - Public guidance from regulatory agencies
 - Blogs, message boards, etc.
- Off-the-shelf software or programs
 - Unimproved credit-risk or insurance-risk programs
 - Excel spreadsheets populated with simple formulas or information

Compilations of Publicly-Available Information

“The fact that some or all of the components of the trade secret are well-known does not preclude protection for a secret combination, compilation, or integration of the individual elements. ... [T]he theoretical possibility of reconstructing the secret from published materials containing scattered references to portions of the information or of extracting it from public materials unlikely to come to the attention of the appropriator will not preclude relief against the wrongful conduct”

- *U.S. v. Nosal (C.A. 9th Cir.)*

Recent Illustrative Case Decisions

- *SRS Acquiom Inc. v. PNC Financial Services Group, Inc.*, 2020 WL 3256883 (D. Col. 2020)
 - Plaintiff sought injunction against former employee for misappropriation of trade secrets including customer contact list;
 - Court denied injunction where list only contained names and phone numbers of departed employee’s personal contacts without significant additional information, as information was readily available to the public, and had been prepared by employee prior to her tenure with plaintiff.
 - However, Court left the door open to proving damages for information beyond contact information, e.g. “insights and targeted contact information about who, exactly, at a particular potential customer may be the best contact.”
 - Found that plaintiffs failed to prove as much at injunction hearing.

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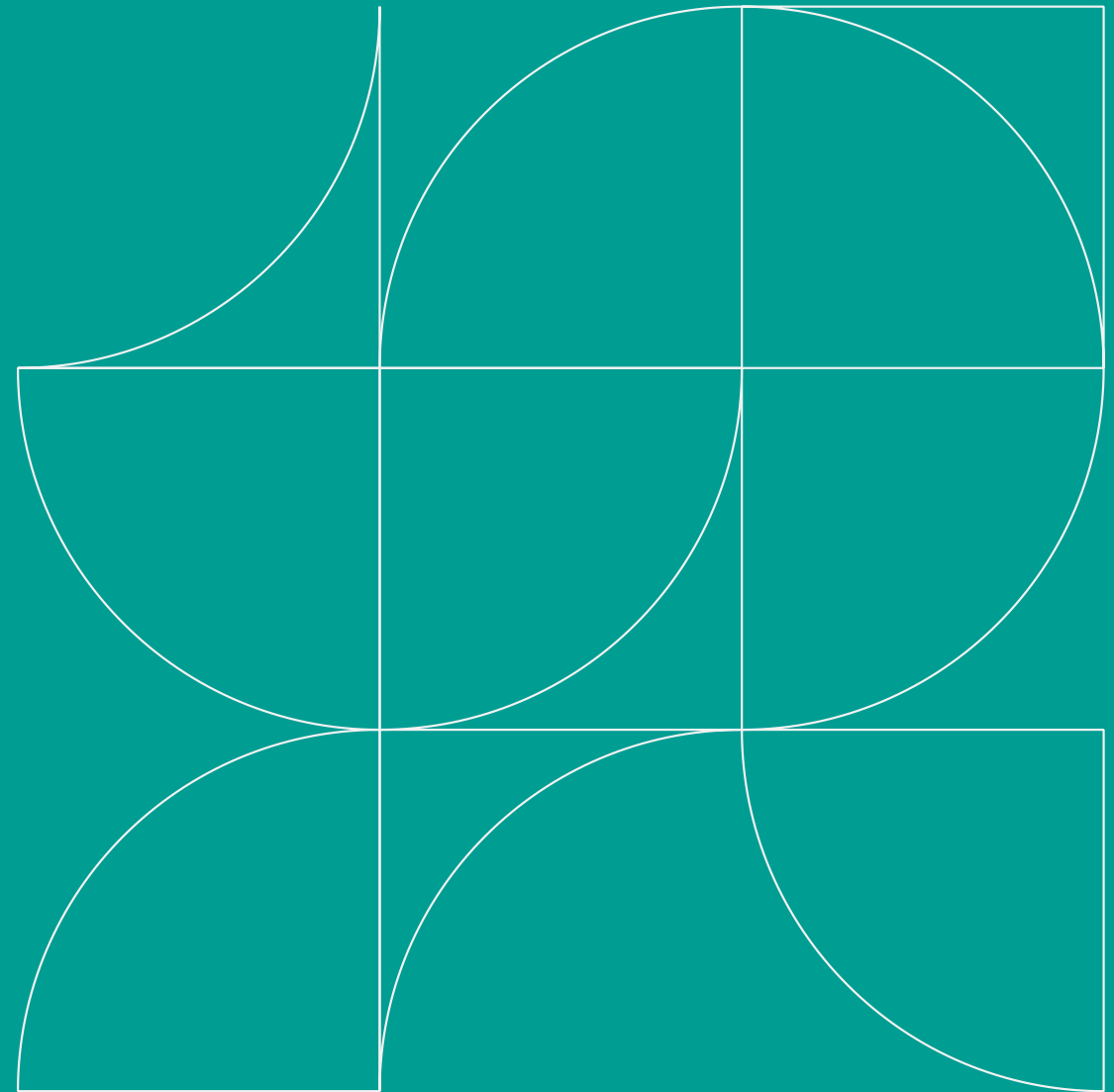
- *Elmagin Capital, LLC v. Chen, et al.*, 555 F. Supp. 3d 170 (E.D. Pa. 2021)
 - Use of algorithmic trading strategies and question of whether or not they qualified as a trade secret;
 - Court noted that a party is not required to provide computer code implementing a particular algorithm, but could express it in prose.
 - Question of fact for the jury as to whether trading strategies were in fact readily ascertainable to a “reasonably sophisticated trader” or were secret.



Other Recent Illustrative Case Decisions

- *Zabit v. Brandometry, LLC*, 540 F. Supp. 3d 412 (S.D.N.Y. 2021)
 - Plaintiff did not take reasonable measures to maintain secrecy of trading algorithm that it licensed to another company without a requirement that the licensee maintain confidentiality
 - Could still be a claim for theft, just not a DTSA claim
- *GeometWatch Corp. v. Hall*, 2017 WL 1136946 (D. Utah 2017)
 - Holding Plaintiff corporation’s business plans, corporate documents, and its “comprehensive financial model and business plan” merited trade secret protection
- *Smart & Assocs., LLC v. Indep. Liquor (NZ) Ltd.*, 2016 WL 7494471 (W.D. Ky. 2016)
 - Granting defendant beverage producer summary judgment on trade secrets claims because Plaintiff revealed **detailed financial information** about operations before signing of confidentiality agreement and did not take steps to sufficiently protect information
- *Pinnacle Agric. Distribution, Inc. v. Mayo Fertilizer, Inc.*, 2017 WL 889542 (M.D. Ga. 2017)
 - Holding plaintiff’s profit and loss statements, pivot tables, and vendor lists constituted trade secrets that defendants misappropriated

Practical steps to protect trade secrets and client relationships



Trade Secrets Must Be Kept Secret

- Public disclosure of a trade secret destroys the information's status as a trade secret. *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1002 (1984)
- **Between 2009 and 2018, 15% of trade secret cases were dismissed because the plaintiff did not take reasonable measures to protect its trade secrets.** And Defendants were successful in 54% of the cases that went to verdict between 2016 and 2018.
- Intent does not matter for disclosure – don't leave trade secret documents on the hotel printer.

What Level of Security Is Required?

- Absolute secrecy and heroic measures are not required – only measures that are “*reasonable under the circumstances.*”
- Prevention protocols are key
- However, if a trade secret is leaked and the company does not try to fix the leak and minimize damage, its value to the company may be severely compromised and lost forever.
- Courts will carefully scrutinize whether the company took appropriate steps to safeguard security

Best Practices for Protecting Your Information (ACE)

Audit

Create a culture of confidentiality

Enforce



Create a Culture of Confidentiality

- Ensure employees understand what the company considers confidential, and why it is important to maintain confidentiality
 - Tie it in with client service
 - And make sure to get it back
- Treat others how you would like to be treated!
- Provide training modules with examples of “dos” and “don’ts”
 - Identify industry standards
- Mark things confidential/proprietary
- Make security protocols easy to understand, familiar, and uniform

Measures to Protect Trade Secrecy Should Include:

- **Agreements with Employees**
 - Offer letters
 - NDAs, Return of Materials, Post-Employment Restrictive Covenants
- **Employee Policies and Handbooks – Written and Available**
 - Confidentiality, Privacy, BYOD
 - Include certifications of receipt/review
- **Confidentiality Agreements with Third Parties**
 - Clients, vendors, contractors, suppliers, JV partners
 - Due diligence parties – targets, acquirers, underwriters
- **Secure network and facility**
 - Password protection of hardware and software
 - Need-to-know distribution of materials
 - “Lock and Key”
 - Monitoring tools (real time and after-the-fact)
 - **ADJUST POLICIES FOR WORK-FROM-HOME CONSIDERATIONS**

Protection Against the Rogue or Sloppy Employee

1. Limit access to trade secrets on a need-to-know basis
2. Limit access of employee use of non-approved cloud solutions
3. Monitor access and downloading/printing of files
4. Conduct exit interviews (don't forget about onboarding!)
5. Collect and secure materials of terminated employees
6. Send reminders when appropriate (during and after employment)

What To Do in Case of Theft, Loss, or Breach

1. Secure information and assess damage (forensic imaging and review)
2. Send cease and desist letters, enforce agreements, pursue legal action to enforce rights
3. Determine whether client or individual notice is required (state and federal breach notification laws)
4. Notify insurers if appropriate
5. Re-evaluate company procedures, agreements, policies, and training; obtain participation of leadership, IT, and operations
- 6. Preserve evidence!**

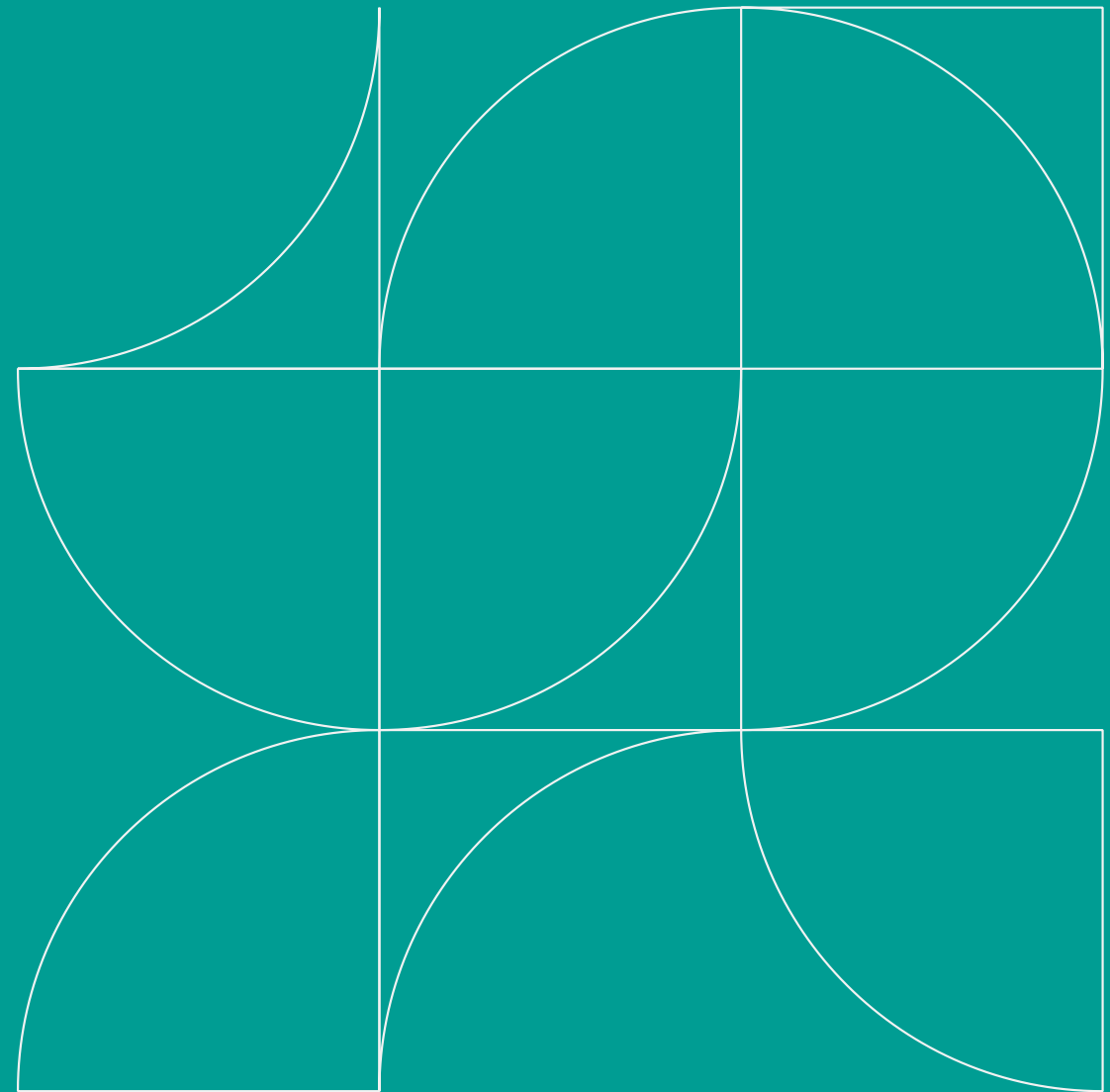
What Are Your Typical Legal Options?

- Breach of Contract or Other Civil Claims:
 - e.g., DTSA, UTSA, CFAA, Breach of Fiduciary Duty or the Duty of Loyalty, other state law misappropriation claims
 - Consider expedited discovery, injunctive relief, and, in very limited cases, an ex parte seizure order
 - Damages: Lost profits, salary/benefits, harm to goodwill, diminished value of trade secrets, reasonably royalties
 - Possible attorneys' fees (contract or statute)
- Criminal Referrals:
 - Criminal statutes governing misappropriation of trade secrets include CFAA, EEA
 - Call the FBI; work with outside counsel to help the FBI help you
 - Forfeiture and restitution are possible

Post-Employment Restrictive Covenants

- State level considerations on non-solicit and non-compete claims
 - Notice period, language advising consultation with attorney
 - Income thresholds
 - Limits on length of restrictions
 - Risk of including unenforceable restrictions in agreements
- Special Considerations
 - California, Colorado, Washington, Louisiana, and the out-of-state choice of law provision
 - Massachusetts and the “garden leave” requirement
 - Effect of termination without cause on restrictions

What about FINRA?



FINRA's Impact on Litigation

- Rules 13804 and 13209
 - File injunction action and FINRA simultaneously
 - If “Temporary” injunction granted, FINRA panel convenes within 15 days to decide injunctive relief
 - What is a “temporary injunction”?
 - All disputes go through FINRA after Court injunction hearing/ruling
 - *UBS Financial Services, Inc. v. Leubbehusen*, 22-CV-00341 (E.D. Mo. 2022)
 - Departing reps solicited customers
 - Stipulated Order: No solicitation of customers, but can return unsolicited phone calls
 - FINRA to decide merits
- Rules 11870 and 2140 – Cannot prevent account transfers
- Rule 2273 – Disclosure of certain information to solicited customers

Key Differences Between Court and FINRA

Court Litigation

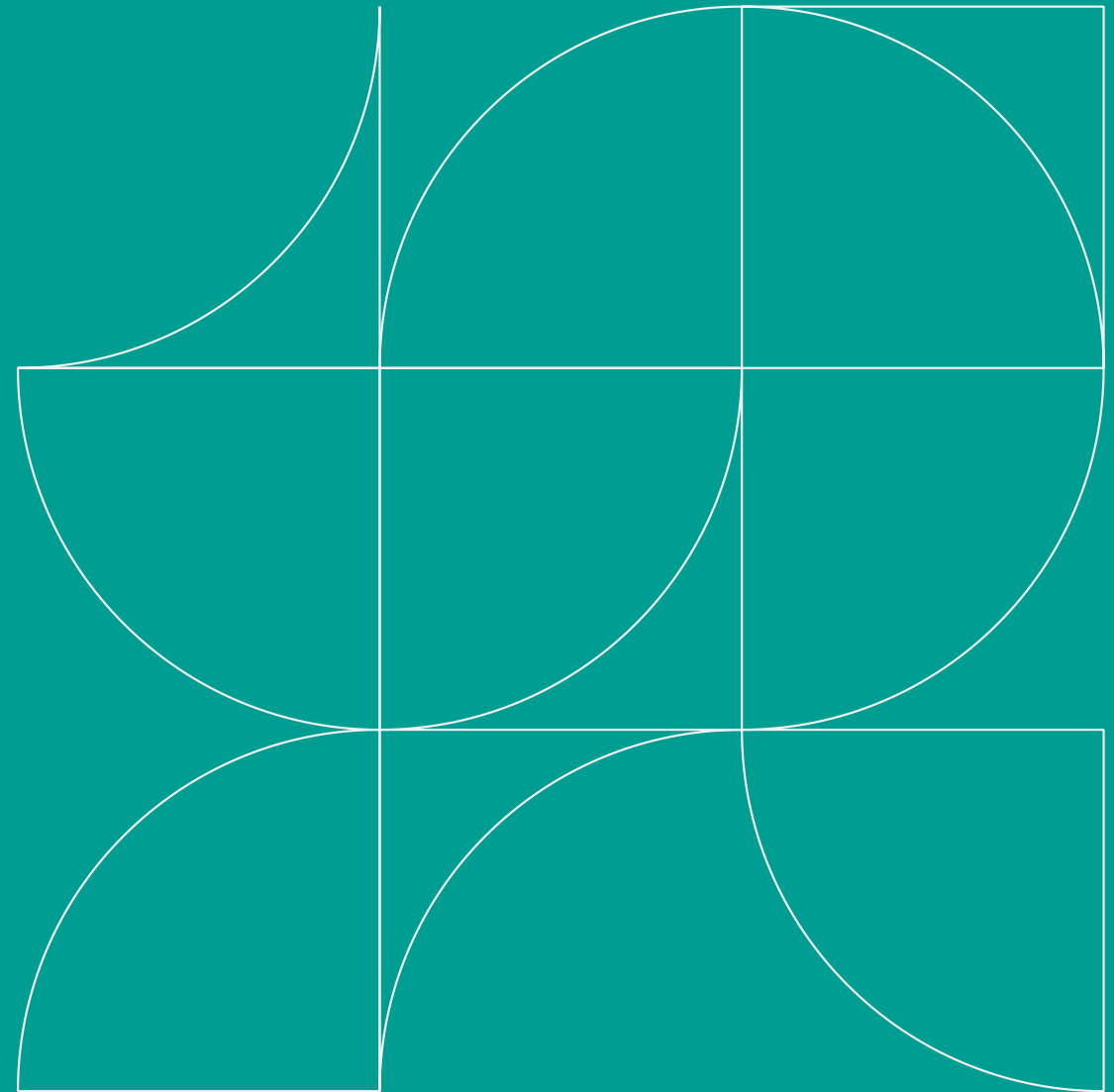
- More formal
- Full discovery
- Possibility of additional injunctive relief
- Rules of Evidence apply
- Experts
- Judge will decide injunctive relief
- Trier of fact will determine damages

vs.

FINRA Litigation

- Less formal
- Limited discovery
- No further injunctive relief
- Rules of Evidence do not apply
- Usually no experts (trailing twelves)
- Arbitration panel may or may not include lawyer
- Arbitrator justice

Protocol for Broker Recruiting



What Is It?

- Agreement executed in 2004 by CitiGroup Global Markets, Inc., Merrill Lynch, and UBS Financial Services to address broker movement
- Gained momentum during the financial crisis and currently has over 2,100 signatories
 - Momentum, however, may now be shifting away from Protocol (Morgan Stanley and UBS)
- Formerly administered by FINRA and SIFMA, now handled by outside forensics firm
- Allows for “reciprocal poaching”

What Does It Do?

- Allows broker to take the following account information to new employer:
 - client name
 - client address and telephone number
 - client email address
 - account title
- Allows broker to solicit clients he serviced at former firm
- Bars employer from seeking damages and injunctive relief
- Conflicts with confidentiality and restrictive covenant terms commonly found in broker employment agreements and firm policies

FINRA and Protocol Impact

- Litigation
 - Forum
 - Signatory plaintiff and defendant
 - Does not excuse bad acts
 - Does not excuse removal of information not covered by Protocol
 - Signatory plaintiff and non-signatory defendant
 - Non-signatory plaintiff and signatory defendant
- Company Agreements
 - Confidentiality obligations
 - Restrictive covenants
 - Team Agreements

FINRA and Protocol: Recent Case Study

- *Stephens v. Benjamin F. Edwards & Co, Inc.*, FINRA Case No. 17-02378
 - Corporate Raiding
 - Breach of Contract (Non-Solicitation)
 - Tortious Interference
 - Breach of Duty of Loyalty
 - Conspiracy
 - Misappropriation of Trade Secrets
 - Violation of Broker Protocol
- Damages
 - \$10,970,000 compensatory damages
 - \$5,000,000 punitive damages
 - \$2,205,373 attorneys' fees
 - \$88,875 hearing fees (\$5,625 to claimant)
- Dissent
- Confirmed by Arkansas court
 - Judgment satisfied in August 2022

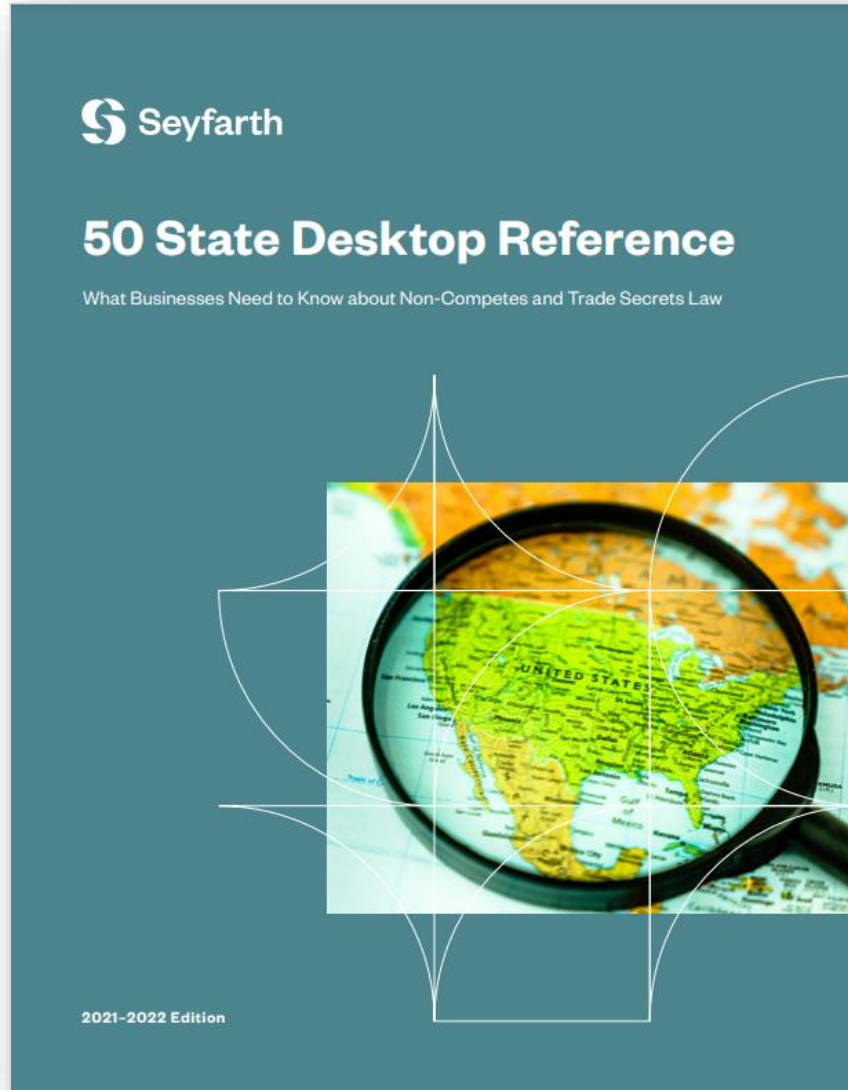
One Final Thing

Address trade secret protection **BEFORE** information is taken, not after a crisis situation arises!

“An ounce of prevention is worth a pound of cure.”

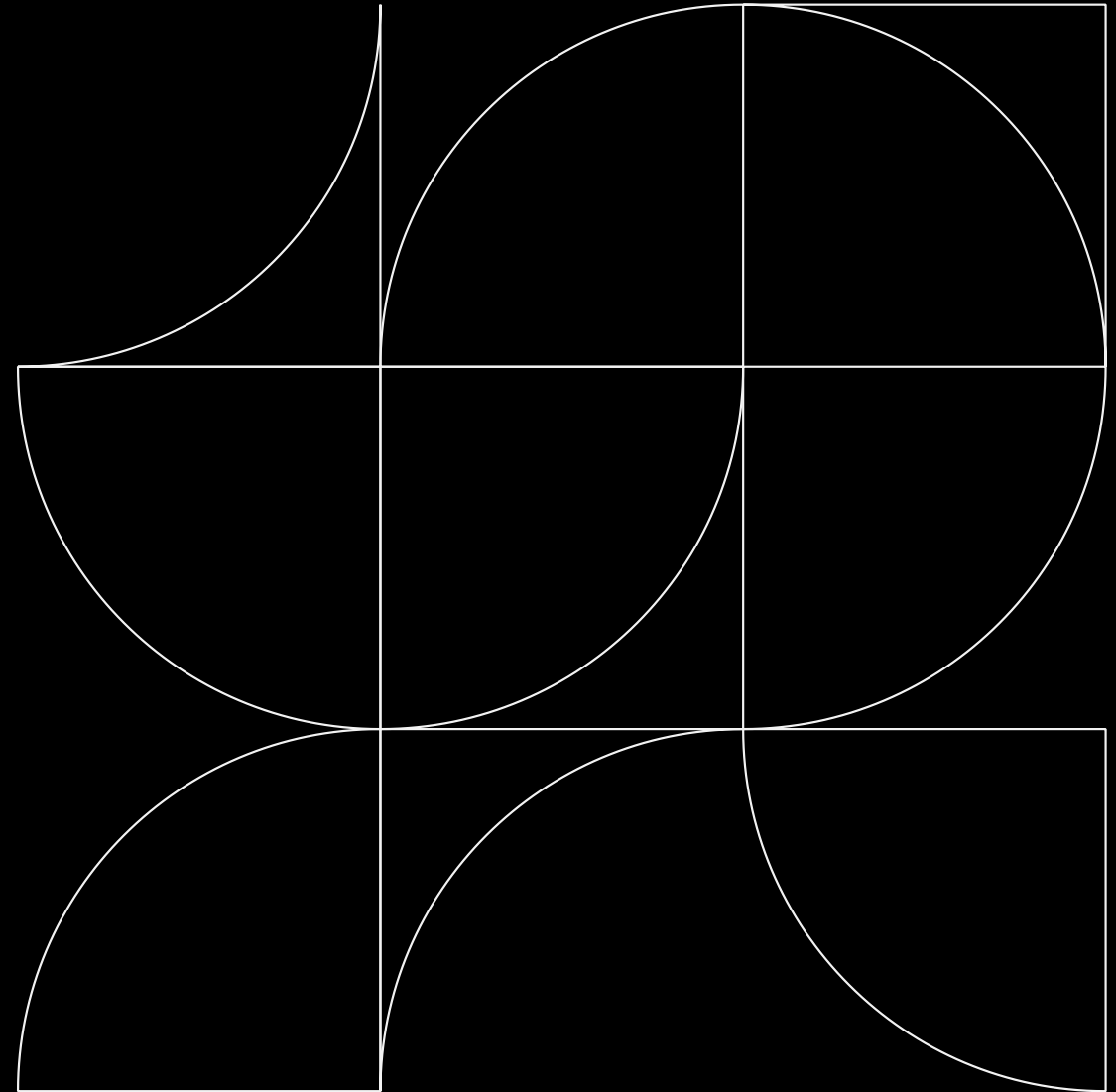
- Ben Franklin

Stay Up to Date on Trade Secrets & Non-Compete Issues



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Questions?



**thank
you**

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