SEYFARTH SHAW

Management Alert

Top 10 Developments/Headlines in Trade Secret, Computer Fraud, and Non-Compete Law in 2015

By Robert B. Milligan and Paul E. Freehling

Continuing our tradition of presenting annually our thoughts concerning the top 10 developments/headlines this past year in trade secret, computer fraud, and non-compete law, here—in no particular order—is our listing for 2015 and a few predictions for 2016. Please join us for our first webinar of the New Year on January 29, 2016 discussing these developments/headlines.

1) Enactment of federal trade secret legislation moves closer, while federal non-compete bill gains no traction. In last year's Top 10 listing, and in several blog posts from 2015, we described the ongoing effort of a large bipartisan group of U.S. Senators and Representatives to create a federal civil cause of action for trade secret misappropriation (according to govtrack.us, as of January 11, 2016 there were 23 cosponsors of such legislation in the Senate and 107 in the House). The proposed bill is entitled "The Defend Trade Secrets Act of 2015" ("DTSA"). On December 2, 2015, the Senate Judiciary Committee held a hearing on the DTSA and it received a positive reaction from the Committee. We expect that the DTSA will be voted on by Congress in the spring of 2016.

Many industry representatives who have written or spoken on the subject support the DTSA. They cite such reasons as: (a) it will provide uniform statutory provisions in contrast to the "Uniform Trade Secrets Act" ("UTSA")—adopted by every state except New York and Massachusetts—but which contains some significant state variations; (b) rather than litigate in state courts, some attorneys and companies prefer federal courts, particularly because of federal bench experience with patent, trademark, and copyright cases; (c) personal jurisdiction over defendants may be easier to obtain in a federal court than in a state court with respect to individuals or businesses charged with claims involving overseas trade secret misappropriation or computer fraud and discovery of parties and non-parties may be easier to conduct in federal court; and (d) the statute of limitations in the proposed DTSA is longer, and the maximum amount that can be awarded as punitive damages is higher than the amount available under the UTSA.

A number of academics oppose adoption of the DTSA. They suggest that the expense of litigating in federal court often exceeds the cost of handling a case in a state court. Some also take issue with, among other sections, the *ex parte* seizure provisions in the DTSA (although proponents cite those provisions as advantages). Opponents of the DTSA mention that the UTSA has had years of judicial interpretation that provides some measure of predictability. Opponents have also voiced concern with respect to some potentially ambiguous terms in the proposed DTSA.

We also reported on proposed federal legislation to ban enforcement of non-competes against low wage employees and to require employers to disclose in advance that employees must sign non-competes. The Senate bill is called "Mobility and

Opportunity for Vulnerable Employees" ("MOVE"). At present, MOVE has few sponsors and does not appear to be gaining any traction.

Please see our dedicated page for the latest updates on the proposed federal trade secret legislation. As discussed below, we expect regulators and employees to continue to challenge the necessity and breadth and scope of non-compete agreements in certain industries.

2) Watch for challenges to (a) confidentiality covenants interpreted as discouraging cooperation with government agency investigations or chilling Section 7 rights and (b) "do-not-hire" agreements. In 2015, federal government agencies such as the SEC took aim at confidentiality clauses seemingly intended to dissuade employees from whistleblowing with respect to alleged employer misconduct. Additionally, the NLRB continued its crusade of striking employer confidentiality agreements/policies that may chill employees from exercising their rights under the National Labor Relations Act. Accordingly, we expect that non-disclosure provisions that interfere with government investigations or chill Section 7 rights will continue to be scrutinized in 2016. Further, the government previously challenged agreements among competitors that prohibited them from hiring their competitors' employees. Plaintiffs' attorneys have attempted to capitalize on such efforts by bringing class actions for alleged unlawful "do-not-hire" arrangements between competitors and some cases have resulted in large settlements. We expect to see more such cases in 2016.

3) The Ninth Circuit's narrow interpretation of the Computer Fraud and Abuse Act ("CFAA") was supported by some courts in other circuits, but rejected by others, and other computer hacking issues continue to percolate. The CFAA states that one who "intentionally accesses a computer without authorization or exceeds authorized access" commits a crime. 18 U.S.C. § 1030. In 2012, in *U.S. v. Nosal*, the Ninth Circuit Court of Appeals (in a divided *en banc* decision) adopted the narrow interpretation that the only intended targets of the law were hackers who "break into" a computer and that the statute does not criminalize the unauthorized use of computerized data by misguided employees. 676 F.2d 854. The same court reiterated that view in *U.S. v. Christensen*, Nos. 08-50531, *et al.* (Aug. 28, 2015). The court added, however, that California Penal Code § 502, which prohibits unauthorized taking or using information on a computer without permission, does not require unauthorized access and, therefore, is markedly unlike 18 U.S.C. § 1030.

In decisions announced before 2015, the Fourth Circuit concurred with Nosal, but the First, Fifth, Seventh, and Eleventh disagreed. Judicial decisions in 2015 supported each position and, therefore, further muddied the waters.

In *U.S. v. Valle,* Nos. 14-2710-cr and 14-4396-cr (2d Cir., Dec. 3, 2015) (2-1 decision), the majority concluded that there is equal merit to the narrow statutory interpretation announced in *Nosal,* and the diametrically opposed, broader interpretation set forth by courts disagreeing with *Nosal.* Based solely on the doctrine of lenity, the Second Circuit adopted the narrow view.

Two judges in the Middle District of Florida reached opposite conclusions regarding Cf. Nosal (*Allied Portables v. Youmans*, 2015 WL 6813669 (June 15, 2015) (following *Nosal*), *with Enhanced Recovery Co. v. Frady*, No. 13-cv-1262-J-34JBT (Mar. 31, 2015) (rejecting *Nosal*)). A federal court in Utah adopted the broader interpretation in 2015. *Giles Construction, LLC v. Tooele Inventory Solution, Inc.*, No. 12-cv-37 (June 2, 2015). A judge in the Western District of Michigan followed *Nosal. Experian Marketing Solutions, Inc. v. Lehman*, No. 15-cv-476 (W.D. Mich., Sept. 25, 2015). A judge in the Eastern District of Michigan wrote a lengthy criticism of *Nosal,* and a prediction that the Sixth Circuit would not follow the Ninth, but the judge ultimately decided that the complaint before him stated a cause of action regardless of which statutory interpretation was intended. *American Furukawa, Inc. v. Hossain*, No. 14-cv-13633 (May 6, 2015). These widely disparate rulings will leave many employers without a clear path to follow.

Moreover, one Assistant U.S. Attorney told Congress in 2015 that the CFAA should be amended to clarify which of the two conflicting views Congress intended. We predict that, unless the statute is amended, the U.S. Supreme Court will have to resolve the circuit court split.

Additionally, we expect that the Ninth Circuit will issue another decision in the *U.S. v. Nosal* case this year to address whether password sharing to obtain access to a protected computer is actionable under the CFAA. Additionally, we expect

to see more Penal Code section 502 claims in California based upon the alleged misuse of company information "without permission."

4) Security breaches continue to plague owners of confidential data. Hackers, nation states, competitors, and disgruntled employees are among those responsible for the breach and dissemination of confidential data. Following the Ashley Madison incident and some other highly publicized incidents, we expect to see more data breaches and resulting litigation in 2016, particularly in those jurisdictions where courts have been willing to soften the standing requirements for maintaining such suits. To guard against this risk, it is essential that companies have comprehensive information security policies and solid data breach response plans in place.

Sometimes the breach benefits only a single individual or entity, such as when an employee transfers employers and provides proprietary information belonging to the former employer to the new employer. However, the more serious consequences occur when, without the owner's authorization, such data is published on-line for all the world to see. To make matters worse, social media privacy legislation and other privacy laws can often frustrate efforts to identify the thief and to abort the publication.

In connection with a recent New York Supreme Court—New York's trial court—injunction hearing, a party accidentally filed its trade secrets on the New York State Courts Electronic Filing system. The adversary insisted, over the vehement objection of the party that made the inadvertent filing, that this act constituted a posting on the Internet that rendered the information publicly available. The court has delayed making a definitive ruling. On the other coast, the Northern District of California recognized that the issue occurring in New York could arise in California. The court, proactively, promulgated guidelines on its website for the prompt and effective removal of erroneous e-filings.

5) Employers' attempts to enforce non-compete and non-solicitation covenants against lower level employees troubles courts and legislators. At one time, courts normally appeared sympathetic to the principle espoused by employers that parties' non-competition and non-solicitation covenants were contracts that should be enforced. In 2015, although some courts enforced restrictive covenants, a number of judges refused to grant preliminary injunctions sought by former employers against ex-employees. *See, e.g., Great Lakes Home Health Services Inc. v. Crissman*, No. 15-cv-11053 (E.D. Mich., Nov. 2, 2015); *Evans v. Generic Solutions Engineering*, No. 5D15-578 (Fla. App., Oct. 30, 2015); *Burleigh v. Center Point Contractors*, 2015 Ark. App. 615 (Oct. 28, 2015). Each of these courts concluded that the employers had not demonstrated the requisite extreme need for injunctive relief and protection. We expect courts to continue to make it difficult on employers to obtain injunctive relief in 2016, particularly where the employee is lower level and there is no clear evidence of imminent harm. We also saw some efforts (though not successful) in Michigan, Washington, Iowa, and Massachusetts to ban or otherwise limit non-competes.

6) Enforcement of restrictive covenants against franchisees gains traction. The NLRB signaled in 2015 its view that a franchisor's control over the business practices of franchisees may lead to treating the franchisor as a joint employer of the franchisees' employees. Additionally, some courts held in 2015 that restrictive covenants in a franchise agreement could be enforced by the franchisor against both the franchisees and persons who benefit from but are not signatories to the franchise agreement.

Some franchisors have sued to enforce covenants in contracts with franchisees. An Ohio federal judge in 2015 ordered an ex-franchisee that had signed a confidentiality agreement to return to the franchisor its operations manual, brochures, contracts, correspondence, client files, computer database, and other records relating to the franchise agreement. *H.H. Franchising Sys., Inc. v. Aronson*, No. 12-cv-708 (Jan. 28, 2015). Additionally, a Wisconsin judge held that an individual who was not a signatory to a franchise agreement that included a confidentiality clause, but who had benefitted from the franchise, was prohibited from using the franchisor's trade secrets. *Everett v. Paul Davis Restoration, Inc.,* No. 10-C-634 (E.D. Wis., Apr. 20, 2015). We expect to see more litigation involving franchisees and related parties in 2016.

7) Courts struggle with issues relating to the adequacy of consideration for restrictive covenants. The controversial *Fifield* decision by the Illinois Appellate Court several years ago continued to make waves in 2015. The court in *Fifield* held that a restrictive covenant executed by an at-will employee is unenforceable, for lack of adequate consideration, unless the

employment relationship lasts at least two years beyond the date of execution. *Fifield v. Premier Dealer Service,* 993 N.E.2d 938 (Il. App (1st) 2013). The Illinois Supreme Court has not yet opined on that holding. This past year, several Chicago federal trial judges, adjudicating cases in which they decided it was necessary to predict whether the Illinois Supreme Court would agree with *Fifield*, reached opposing conclusions. Moreover, in *McInnis v. OAG Motorcycle Ventures, Inc.*, 35 N.E.3d 1076 (Il. App. (1st) 2015), a panel of the Illinois Appellate Court split 2-1 on the question of whether *Fifield* should be followed.

Another wrinkle involving consideration arose in Pennsylvania, which adopted the so-called "Uniform Written Obligations Act" ("UWOA") (solely in force in Pennsylvania). Under the UWOA, if a written contract contains a commitment to which the parties "intend to be legally bound," then the parties may not question the adequacy of consideration for the agreement. On the other hand, the state has a long history of disfavoring restrictive covenants in employment agreements. This past year, the Pennsylvania Supreme Court ruled unenforceable for lack of consideration a covenant entered into after the commencement of employment, but for which no benefit or favorable change in employment status was given to the employee. *Socko v. Mid-Atlantic Systems of CPA, Inc.,* Case No. 3-40-2015 (Nov. 18, 2015). This ruling came down notwithstanding the UWOA, even though the agreement expressly quoted the "legally bound" language of that law. *See id.* This decision does not alter the doctrine that covenants signed by employees upon hire are supported by adequate consideration. We expect to see more challenges to the adequacy of consideration by employees in 2016.

8) New state legislation concerning restrictive covenants. State legislatures have enacted, and probably will continue to enact, new laws bearing on restrictive covenants.

1. **New Hawaii statute.** Passed in 2015, it provides that a non-compete or non-solicit clause in an employment contract for an employee of a technology business is void.

2. **New Connecticut, Montana, and Virginia statutes.** In 2015, these three states joined more than a dozen others by enacting laws that restrict employer access to personal social media accounts of employees and job applicants. We predict that these laws will adversely impact employers' efforts to uncover trade secret theft.

3. **New Mexico health care practitioner statute.** A law passed in 2015 provides that an employer of a health care practitioner may not enforce a non-compete covenant restricting the practitioner from providing post-termination clinical health care services.

4. **Alabama and Oregon statutes.** Alabama revised its non-compete statute (effective January 1, 2016). The revised statute will make it easier for employers to enforce non-competes against Alabama employees. Additionally, Oregon limited the duration of non-competes with employees to 18 months. The new law is also effective January 1, 2016.

9) Rulings regarding validity of forum selection provisions in restrictive covenant agreements. Some multi-state employers use one-size-fits-all covenants, and that practice—coupled with a litigant's forum shopping—sometimes leads to unexpected inconsistencies. California's policy, articulated in Business and Professions Code Section 16600 (which provides that employee non-compete clauses are typically void), has figured in a number of these cases and likely will continue to do so. California courts continue to dismiss or transfer such cases to other states in accordance with contracting parties' forum choice notwithstanding employees' arguments that the forum state might enforce covenants which seemingly are void in California. We did see some reluctance by courts in Delaware and New York to impose broad restrictive covenants on employees in 2015, particularly where the designated choice of law may unfairly impact the employee.

10) Proposed EU Directive to protect trade secrets makes progress; vote nears on U.S. involvement in Trans Pacific Partnership. The European Union and other foreign countries have varying rules with regard to the protection of trade secrets. In some instances, there are no rules regarding trade secret protection or the laws are not enforced. A U.S. company doing business abroad may encounter a wide variety of practices applicable to trade secrets. There has been an effort to harmonize trade secrets law abroad to provide minimum standards as exemplified by the EU Directive.

As we reported, the proposed EU Directive crossed yet one more procedural hurdle with a provisional agreement on the Directive reached by the European Council (represented by the Luxembourg presidency) and representatives of the European Parliament. Now that the provisional agreement has been reached, the Parliament and Council will conduct a legal-linguistic

review of the text. Once that process has been completed, the proposed Directive will then be submitted to the full Parliament for approval. Currently, the Parliament is expected to vote on the Directive around March 2016, but the precise date for a first reading has yet to be determined.

Additionally, as we reported, a proposed trade agreement, the Trans Pacific Partnership, was reached in October 2015 among a dozen Pacific Rim countries and the U.S. While the implementing legislation still needs to be passed by the signatory countries, the agreement will require signatory nations, such as Australia, Canada, Singapore, and Malaysia, to implement criminal procedures and penalties for the unauthorized misappropriation of trade secrets. The agreement signifies the Obama Administration's continued effort to enhance trade secret protections at home and abroad for the benefit of U.S. companies.

Robert B. Milligan is Co-Chair of the Trade Secrets, Computer Fraud & Non-Compete Practice Group in Seyfarth's Los Angeles office. Paul E. Freehling is senior counsel in the firm's Chicago office. If you have any questions, please contact your Seyfarth Shaw attorney, Robert B. Milligan at rmilligan@seyfarth.com/(310) 201-1579, Paul E. Freehling at pfreehling@seyfarth.com/(312) 460-5618.