The Defend Trade Secrets Act of 2016: Reconciling Inevitable Disclosure

by Kris J. Kostolansky and Frances Staadt

This article discusses the relationship between the Defend Trade Secrets Act and the inevitable disclosure doctrine, as well as the future of the doctrine under state law.

This article examines the Defend Trade Secrets Act of 2016 (DTSA or Act).[1] It analyzes the federal versus state approach to issuing injunctive relief based on the inevitable disclosure doctrine.

Defending Trade Secrets

The DTSA was signed into law by President Obama on May 11, 2016. The Act amends the Economic Espionage Act of 1996[2] to provide a federal civil remedy for the misappropriation of trade secrets. Before the DTSA's passage, victims of trade secret theft could bring civil actions only under state trade secret laws, which vary widely from state to state. Now, trade secret holders may seek civil redress in federal courts alongside copyright, patent, and trademark owners. The Act authorizes federal courts to issue an injunction "to prevent any actual or threatened misappropriation" of a trade secret.[3] Courts cannot, however, issue an injunction that prevents a person from entering into an employment relationship or that otherwise conflicts with an applicable state law prohibiting restraints on employee mobility.[4] An injunction may impose conditions on employment, but such conditions must be "based on evidence of threatened misappropriation and not merely on the information the person knows."[5] In addition to injunctive relief, the new Act offers both employers and employees significant protection, including an ex parte seizure remedy and immunity.[6]

The DTSA provisions authorizing injunctive relief have triggered discussion over a controversial trade secret topic: the inevitable disclosure doctrine. The inevitable disclosure doctrine made a name for itself in *PepsiCo, Inc. v. Redmond*, where the Seventh Circuit, in the midst of a "fierce beverage-industry competition," enjoined a former PepsiCo employee from joining Quaker's ranks.[7] The doctrine allows an employer to enjoin, either temporarily or permanently, a former employee from entering into an employment relationship with a competitor where the former employee possesses knowledge of a trade secret and reliance on that trade secret is inevitable.[8]

Following the *PepsiCo* decision, the doctrine became a divisive issue among state courts.[9] Some states, most notably California, rejected the doctrine in the interest of protecting employee mobility.[10] Even among the states that accepted the doctrine, there are differences in how courts address inevitable disclosure in the context of enjoining trade secret misappropriation.[11] These conflicting views are not surprising given the lack of uniformity among state trade secret laws. Appellate courts in several states, including Colorado, have yet to address the doctrine.

A review of the DTSA and the seminal *PepsiCo* case confirms that the inevitable disclosure doctrine will not provide a basis for injunctive relief under federal trade secret law. This comparison also gives rise to interesting questions about the future of the doctrine under state law.

The Origins of Inevitable Disclosure: *PepsiCo, Inc. v. Redmond*

In *PepsiCo*, the U.S. Court of Appeals for the Seventh Circuit affirmed an injunction preventing William Redmond, a former PepsiCo employee, from assuming a new position with Quaker.[12] PepsiCo and Quaker were beverage industry competitors, "especially in 'sports drinks' and 'new age drinks.'"[13] Quaker's sports drink, "Gatorade," dominated within this market niche.[14] In 1994, PepsiCo introduced its Gatorade rival, "All Sport." All Sport's sales lagged far behind Gatorade's.[15] In addition to dominating the sports drink arena, Quaker also led in new age drink sales.[16] Thus, "[b]oth

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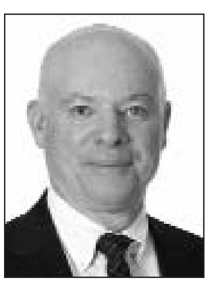

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companies [saw] 1995 as an important year for their products: PepsiCo [had] developed extensive plans to increase its market presence, while Quaker [was] trying to solidify its lead."[17]

Redmond held a relatively high-level position with PepsiCo, giving him access to confidential information and trade secrets.[18] After a series of covert negotiations with Quaker, Redmond resigned from PepsiCo on November 10, 1994 and accepted a vice president position with Quaker.[19] Within a week of Redmond's resignation, PepsiCo filed a diversity suit "seeking a temporary restraining order to enjoin Redmond from assuming his duties at Quaker and to prevent him from disclosing trade secrets or confidential information to his new employer."[20]

PepsiCo alleged that Redmond, as a senior employee of PepsiCo, had access to a number of trade secrets.[21] Specifically, Redmond was privy to PepsiCo's "Strategic Plan," "Annual Operating Plan," "attack plans" for specific markets, and innovations in its selling and delivery systems.[22] Based on Redmond's intimate knowledge of these plans and his new high-level position within Quaker, PepsiCo asserted that Redmond could not help but rely on PepsiCo's trade secrets when he assumed the Quaker position.[23] These secrets would "enable Quaker to achieve a substantial advantage by knowing exactly how [Pepsi-Cola North America (PCNA) would] price, distribute, and market its sports drinks and new age drinks and [be] able to respond strategically."[24] In response, Quaker and Redmond argued that they had not and did not intend to use any confidential information Redmond had gained during his employment with PepsiCo.[25]

In affirming the trial court's injunction precluding Redmond from assuming the position at Quaker, the Seventh Circuit concluded that Quaker and Redmond's argument fell "somewhat short of the mark," as "PepsiCo [had] not contended that Quaker [had] stolen the All Sport formula or its list of distributors."[26] The court emphasized that the "danger of misappropriation . . . is not that Quaker threatens to use PCNA'S secrets to create distribution systems or co-opt PCNA'S advertising and marketing ideas. Rather, PepsiCo believes that Quaker, unfairly armed with knowledge of PCNA's plans, will be able to anticipate its distribution, packaging, pricing, and marketing moves."[27] "In other words, PepsiCo finds itself in the position of a coach, one of whose players has left, playbook in hand, to join the opposing team before the big game."[28]

The Seventh Circuit therefore underscored an important distinction between evidence of an actual threat or intent to misappropriate a trade secret and evidence of inevitable reliance upon the trade secret.[29] According to *PepsiCo*, injunctive relief is available where there is threatened misappropriation. The existence of a threat or intent to misappropriate is a separate basis for obtaining injunctive relief.

The relevant inquiry regarding inevitable disclosure is whether a former employee possesses information that constitutes a trade secret and whether reliance on that information is inevitable. Thus, inevitable disclosure is a method of proving threatened misappropriation, even where there is no actual evidence of a threat or intent to misappropriate. In other words, it does not matter what the player plans to do with the playbook; the mere fact that she has it is dispositive.

The Seventh Circuit affirmed the district court's order enjoining Redmond from assuming his position with Quaker for six months and preventing Redmond from using or disclosing any of PepsiCo's trade secrets and confidential information.[30] Although the Seventh Circuit questioned the district court's conclusion that Redmond demonstrated untrustworthy behaviors, the court held that it was not an abuse of discretion.[31] The court concluded that injunctive relief preventing Redmond from assuming employment with Quaker was warranted given "the demonstrated inevitability that Redmond would rely on PCNA trade secrets in his new job at Quaker" and "the district court's reluctance to believe that Redmond would refrain from disclosing these secrets in his new position."[32] Thus, the inevitable disclosure doctrine was born.

Defend Trade Secrets Act Versus *PepsiCo*

The DTSA provides that a federal court may issue an injunction to prevent any actual or threatened misappropriation of a trade secret.[33] However, an injunction under the DTSA cannot prevent a person from entering into an employment relationship.[34] The order may impose only conditions on employment.[35] Conditions placed on employment must "be based on evidence of threatened misappropriation and not merely on the information the person knows."[36]

An analysis of the DTSA and the holding in *PepsiCo* leads to the conclusion that federal trade secret law expressly rejects inevitable disclosure as a basis for proving threatened misappropriation.

Federal Law Rejects the Inevitable Disclosure Doctrine as a Basis for Injunctive Relief

Federal law and *PepsiCo* both provide for injunctive relief where there is actual or threatened misappropriation.[37] But contrary to the holding in *PepsiCo*, federal law requires actual evidence of a threat or intent to use a trade secret to prove threatened misappropriation.[38] Under the DTSA, threatened misappropriation cannot be proven based merely on the information the person knows.[39] (Conversely, under *PepsiCo*, inevitable disclosure is established by evidence of the employee's knowledge of a trade secret, and does not require evidence of a threat or intent to use the trade secret.)

Therefore, the DTSA expressly rejects the doctrine as a basis for obtaining injunctive relief because mere knowledge of a trade secret is not enough to warrant the entry of injunctive relief.

It is also worth noting that the inevitable disclosure doctrine may not be used to obtain monetary damages under the DTSA. The Act provides that a federal court may award damages for "actual loss caused by the misappropriation of the trade secret" or for any "unjust enrichment caused by the misappropriation of the trade secret that is not addressed in computing damages for actual loss."[40] Because actual misappropriation is a prerequisite to obtaining damages (and inevitable disclosure does not require evidence of actual misappropriation), damages cannot be awarded under the Act based solely on inevitable disclosure.

Federal Injunctive Relief May Impose Only Conditions on Employment

Under the Act, an injunction cannot prevent a person from entering into an employment relationship.[41] An injunction may, however, impose conditions on the new employment to prevent actual or threatened misappropriation of a trade secret.[42] Thus, an employee could be enjoined from performing a particular job function to prevent actual or threatened misappropriation. Contrary to the holding in *PepsiCo*, the injunction may not be entered based "merely on the information the person knows."[43]

While the DTSA prohibits injunctions that prevent a person from entering into an employment relationship, this prohibition could be ordered in a DTSA case after employment has commenced. For instance, if an employee violates an order enjoining performance of a particular job function, the federal court could hold that employee in civil contempt. The court could remedy such contempt by barring the employee from continuing the new employment relationship.

Would PepsiCo *Be Decided the Same Way Today?*

PepsiCo was a diversity suit decided by the Seventh Circuit under Illinois state law. Would the Seventh Circuit have been as willing to assert the doctrine today? As federal courts continue to apply state trade secret law, the answer to that question will become clearer.

It can be said with certainty, however, that if *PepsiCo* were decided under federal law today, Redmond would not be sidelined for six months. In *PepsiCo*, the danger of misappropriation was "not that Quaker threaten[ed] to use PCNA's secrets to create distribution systems or co-opt PCNA's advertising and marketing ideas."[44] PepsiCo did not even accuse Quaker of stealing the All Sport formula or its list of distributors.[45] What mattered was the information that Redmond knew and the fact that much of that information constituted trade secrets owned by PepsiCo: Redmond was "unfairly armed with knowledge of PCNA's plans" and "able to anticipate its distribution, packaging, pricing, and marketing moves."[46]

Under the DTSA, Redmond would not be enjoined, even temporarily, from assuming his position with Quaker: *PepsiCo* turned on what Redmond knew and what he would likely rely upon, not actual or threatened misappropriation.[47] Under the DTSA, such evidence, standing alone, is insufficient to warrant an injunction.

However, that does not end the inquiry. PepsiCo could still seek relief under Illinois trade secret law. State trade secret laws are not preempted by the Act.[48] This means that plaintiff employers seeking to prevent employees from taking new positions based on trade secrets known by those employees may rely on the inevitable disclosure doctrine where it is recognized. But now that Congress has explicitly rejected inevitable disclosure under federal law, the doctrine's future among undecided state courts, such as Colorado, looks grim. The DTSA passed the U.S. Senate by a vote of 87 to 0. States that have not yet embraced the inevitable disclosure doctrine are not likely to buck the trend reflected by the DTSA. This is true even though the Committee Report on the DTSA states that it is not intended to "influence, or modify applicable State law governing when an injunction should issue in a trade secret misappropriation matter."[49] There is a difference between not modifying governing state law and expanding state law in the face of contrary federal pronouncements.

Conclusion

The DTSA has established a national standard for trade secret law. This standard excludes inevitable disclosure as a basis for establishing threatened misappropriation for the purposes of obtaining injunctive relief. The doctrine will remain available to trade secret holders in states that have adopted it. However, further expansion of the doctrine is unlikely.

Notes

1. Pub. L. No. 114-153, 130 Stat. 376.
2. Pub. L. No. 104-294, 110 Stat. 3489.
3. 18 USC § 1836(b)(3)(A)(i).
4. 18 USC § 1836(b)(3)(A)(i)(I)–(II).
5. 18 USC § 1836(b)(3)(A)(i)(I).
6. *See* 18 USC § 1836(b)(2)(A)(i) (providing an ex parte seizure remedy "in extraordinary circumstances" where the seizure of property is necessary to prevent propagation or dissemination of a trade secret). *See also* 18 USC § 1836(b)(3)(A) (granting immunity to whistleblowers and litigants in certain circumstances).
7. *PepsiCo, Inc. v. Redmond*, 54 F.3d 1262, 1263 (7th Cir. 1995). Prior to *PepsiCo*, several courts applied theories similar to the inevitable disclosure doctrine, but *PepsiCo* is responsible for the "contemporary popularity or notoriety of the doctrine." Rowe, "When Trade Secrets Become Shackles: Fairness and the Inevitable Disclosure Doctrine," 7 *Tul. J. Tech. & Intell. Prop.* 167, 172 (2005).
8. Kahnke et al., "Doctrine of Inevitable Disclosure," Faegre & Benson LLP 1 (Sept. 2008), www.faegrebd.com/webfiles/Inevitable%20Disclosure.pdf.
9. *Compare Whyte v. Schlage Lock Co.*, 125 Cal.Rptr.2d 277, 293 (Cal. Ct.App. 2002) (rejecting the inevitable disclosure doctrine under California law), *with DoubleClick, Inc. v. Henderson*, No. 11614/97, 1997 WL 731413 at *5 (N.Y.Sup.Ct. Nov. 7, 1997) ("Injunctive relief may issue where a former employee's new job function will inevitably lead her to rely on trade secrets belonging to a former employer.").
10. *See, e.g.*, *Whyte*, 125 Cal.Rptr.2d at 292–93 ("The decisions rejecting the inevitable disclosure doctrine correctly balance competing public policies of employee mobility and protection of trade secrets.").
11. *See, e.g.*, *PepsiCo*, 54 F.3d at 1270 (treating inevitable disclosure as a method of establishing threatened misappropriation); *Barilla Am. Inc. v. Wright*, No. 4-02-CV-90267, 2002 WL 31165069 at *9 (S.D. Iowa July 5, 2002) (holding that it would "simply enforce a stricter standard [of proof] on inevitable disclosure, and then treat it and the threatened disclosure doctrine as variations of the same standard"); *Merck & Co., Inc. v. Lyon*, 941 F.Supp. 1443, 1460 (M.D.N.C. 1996) (enjoining threatened misappropriation based on inevitable disclosure only where the injunction is limited to protecting specifically defined trade secrets; such trade secrets must be "clearly identified and of significant value"). *See also* Rowe, *supra* note 7 at 181–82 (pointing out that "courts and commentators appear confused about whether threatened disclosure and inevitable disclosure are the same theory or completely different theories").
12. *PepsiCo*, 54 F.3d at 1263.
13. *Id.* at 1264.
14. *Id.*
15. *Id.*
16. *Id.*
17. *Id.*
18. *Id.*
19. *Id.*
20. *Id.* at 1265.
21. *Id.*
22. *Id.* at 1265–66.
23. *Id.* at 1270.
24. *Id.*
25. *Id.*
26. *Id.*
27. *Id.*
28. *Id.*
29. *See id.*
30. *Id.* at 1272.
31. *Id.* at 1270–71.
32. *Id.* at 1271.
33. 18 USC § 1836(b)(3)(A)(i).
34. 18 USC § 1836(b)(3)(A)(i)(I).
35. *Id.*
36. *Id.*
37. 18 USC § 1836(b)(3)(A)(i); *PepsiCo*, 54 F.3d at 1267.
38. 18 USC § 1836(b)(3)(A)(i)(I).
39. *Id.*
40. 18 USC § 1836(b)(3)(B)(i)(I)–(II).
41. 18 USC § 1836(b)(3)(A)(i)(I).
42. *Id.*
43. *Id.*
44. *PepsiCo*, 54 F.3d at 1270.
45. *Id.*
46. *Id.*
47. This article recognizes that the district court's finding that Redmond was untrustworthy played a role in the *PepsiCo* decision. *Id.* at 1271. The Seventh Circuit, however, appeared much less willing to come to the same conclusion, offering several alternative explanations for the behavior the district court viewed as less than forthright. *Id.* Furthermore, untrustworthiness was not part of the Seventh Circuit's holding that "a plaintiff may prove a claim of trade secret misappropriation by demonstrating that defendant's new employment will inevitably lead him to rely on the plaintiff's trade secrets." *Id.* at 1269.
48. 18 USC § 1838.
49. HR Rep. No. 114-529 at 13 (2016). ■