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Trade Secret Litigation

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Tips on How to Allege and Establish Trade Secret Misappropriation at a Preliminary Injunction Hearing

Since its passage in 2016, the Defend Trade Secrets Act (DTSA) has become a valuable tool for employers seeking to stop former employees and competitors from misappropriating trade secrets. However, in requests for preliminary injunctive relief, companies often struggle with adequately alleging a likelihood of success on the merits of their claims under both DTSA and state trade secret laws. A recent case filed in the Northern District of Illinois, *Cortz, Inc. v. Doheny Enterprises, Inc.* [U.S. Dist. Ct., N. Dist. Ill. E.D., Case No. 17 C 2187, July 11, 2017], illustrates this struggle and offers valuable lessons when moving for a preliminary injunction on a trade secret misappropriation claim.

Plaintiff Cortz, Inc. sells swimming pool and spa products, and defendant Tim Murphy worked for Cortz as its Director of Purchasing. After Cortz terminated Murphy for his refusal to sign a retention bonus containing a two-year non-compete agreement, Doheny Enterprises, Inc., a direct competitor, hired him. Cortz then filed a complaint and sought a preliminary injunction against Murphy and Doheny alleging, among other things, violations of DTSA and the Illinois Trade Secrets Act (ITSA). The Court denied Cortz's request for a preliminary injunction because Cortz failed to present sufficient evidence it was likely to succeed on the merits of its claims. Specifically, the Court found Cortz's vendor pricing was not a trade secret and further concluded there was no evidence of misappropriation.

Lesson 1—Identify Your Trade Secrets with Particularity

Cortz alleged its "financial information" constituted a trade secret, citing the language of DTSA and ITSA which include in their definitions of trade secret "financial information" and "financial data," respectively. However, the court held the category of "financial information" was not a trade secret, citing the Seventh Circuit's instruction that it is not enough to point to broad areas of information and assert that they are trade secrets; instead, a plaintiff must show "concrete secrets." Thus, a plaintiff alleging trade secret misappropriation must be able to point to specific types of financial information in order to adequately state a claim. Broad descriptions or categories, without more detail, will not meet this threshold.

Cortz later narrowed "financial information" to vendor pricing, which the court accepted as a specifically narrow type of trade secret, but it ultimately failed to show that its vendor pricing actually constituted a trade secret.

Lesson 2—To Demonstrate That Confidential Information Is a Trade Secret, Offer Evidence of More Than Just the Measures Taken to Maintain Its Secrecy

To demonstrate that its vendor pricing is a trade secret, Cortz offered evidence of the measures it took to maintain its secrecy. For example, Cortz introduced evidence that: (1) vendors signed vendor agreements containing confidentiality clauses, (2) a vendor testified that Cortz keeps vendor prices confidential, and (3) Cortz entered into non-disclosure agreements with Doheny and Murphy when there were talks about a potential sale of Cortz to Doheny (which ultimately fell through).

Although Cortz showed it took measures to maintain the secrecy of its vendor pricing, the court found this was not enough. That is, the "efforts to maintain secrecy" prong is necessary but not sufficient to establishing a trade secret. Cortz did not present evidence regarding any other factors Illinois courts consider in deciding whether a trade secret exists, including:

1. The extent to which the information is known outside of the plaintiff's business;
2. The extent to which the information is known by employees and others involved in the plaintiff's business;
3. The extent of measures taken by the plaintiff to guard the secrecy of the information;
4. The value of the information to the plaintiff's business and to its competitors;
5. The amount of time, effort, and money expended by the plaintiff in developing the information; and
6. The ease or difficulty with which the information could be properly acquired or duplicated by others.

These elements go to the core question of whether or not information actually constitutes a protectable trade secret. At the most fundamental level, information must be commercially valuable and generally unknown outside plaintiff's operations. Merely alleging that information is treated as a secret is not enough.

Lesson 3—Evidence Introduced at a Preliminary Injunction Hearing Must Be Admissible, Credible, and Relevant

Even if Cortz's vendor pricing constituted a trade secret, the court found Cortz failed to present evidence of misappropriation. One of Cortz's witnesses testified a vendor told him Murphy asked the vendor about Cortz's costs and vendor pricing. However, according to the court, the testimony constituted inadmissible hearsay offered for its truth, and Cortz did not establish a hearsay exception. Further, the court weighed the testimony offered at the hearing based on the credibility of each side's witnesses, and concluded the defendants' witnesses were more credible than Cortz's.

In addition, according to testimony, Murphy sent certain documents to his personal email account because he could not access Cortz's server remotely. While evidence of an employee sending documents to a personal email account may sometimes constitute misappropriation in trade secret cases, the court found there was no evidence that Murphy physically took any documents from Cortz, let alone any trade secret documents. Moreover, the court found that any information Murphy remembered from his employment at Cortz would be stale and irrelevant. As a result, Cortz failed to present any admissible, credible, or relevant evidence to support its misappropriation argument.

While the standards for a preliminary injunction hearing are not as high as a trial on the merits and judges may apply more relaxed evidentiary standards, the federal rules of evidence still apply and deserve attention. It may be challenging to gather sufficient admissible evidence so early on in a case, but doing so is vital to successfully obtaining a preliminary injunction. Similar to non-compete cases requiring evidence of actual breach, trade secret cases require evidence of actual misappropriation or clear evidence of threatened misappropriation (more about this subsequently). Moving parties should use affidavits, vet witnesses and ensure they are consistent and will present credibly at a hearing. Rather than relying on generalized or speculative allegations, moving parties should focus on specific, relevant and recent information.

Lesson 4—Speculation of Misappropriation Is Not Enough, Especially under the Inevitable Disclosure Doctrine

Because Cortz's proffered evidence of misappropriation was neither admissible nor credible according to the court, Cortz was left with conjecture that Murphy might use Cortz's alleged trade secrets in his new job at Doheny. However, the court concluded Cortz's mere speculation or fear that Murphy would use Cortz's vendor pricing in his job at Doheny was insufficient to justify application of the inevitable disclosure doctrine. The court did not address threatened misappropriation outside of the inevitable disclosure analysis, though the two concepts are not necessarily the same (it does not appear Cortz put forward colorable evidence of threatened misappropriation).

In the absence of evidence of actual misappropriation, a plaintiff may request injunctive relief under a theory of threatened misappropriation. This may take the form of an explicit threat or other circumstances indicating the defendant's intent to use the plaintiff's secrets, even though actual use has not yet occurred. Both ITSA and DTSA provide injunctive relief for threatened misappropriation. [*See* 735 ILCS 1065/3(a); 18 U.S.C. § 1836(b)(3).] However, DTSA explicitly prohibits injunctions that prevent a person from entering into an employment relationship under such a theory. Moreover, any injunctive relief or conditions placed on employment must be based on evidence of threatened misappropriation, and not just on the fact that the employee has knowledge of his former employer's trade secrets.

In Illinois and certain other states, the inevitable disclosure doctrine is a related alternative to a theory of threatened misappropriation that permits the injunctive relief prohibited by DTSA. Under the inevitable disclosure doctrine, a former employee may be enjoined from working for a competitor if his former employer demonstrates that his new employment will inevitably lead him to rely on his former employer's trade secrets. [*See PepsiCo, Inc. v. Redmond*, 54 F.3d 1262 (7th Cir. 1995); *DoubleClick Inc. v. Henderson*, No. 116914/97, 1997 WL 731413 (N.Y. Sup. Ct. Nov. 7, 1997) (enjoining defendants from working with competitor under theory of inevitable disclosure); *Tate & Lyle Ingredients Americas LLC v. Craig*, 2017 IL App (4th) 160886-U (affirming preliminary injunction enjoining former employee from working for or continuing his employment with competitor).] The inevitable disclosure doctrine is disfavored in many states (and, in fact, has been outright rejected in some), so moving parties should rely on such a theory only in exceptional cases.

Just two months before *Cortz* was decided, the Northern District of Illinois addressed how a plaintiff can successfully allege a misappropriation claim under the inevitable disclosure doctrine. In *Molon Motor & Coil Corp. v. Nidec Motor Corp.*, No. 16 C 03545, 2017 WL 1954531 (N.D. Ill. May 11, 2017), the court focused on three factors that raise an inference that disclosure of a trade secret is inevitable: (1) the level of competition between the former employer and the new employer, (2) whether the employee's position with the new employer is comparable to his position with the former employer; and (3) the actions taken by the new employer to prevent the employee from using or disclosing its former employer's trade secrets.

Had Cortz framed its argument using these three factors, it may have been able to take advantage of the inevitable disclosure theory. Similarly, some of these factors may have helped it meet the less stringent threatened misappropriation theory. Cortz and Doheny appear to be direct competitors in the business of selling swimming pool and spa-related products. Murphy's position with Cortz as the Director of Purchasing was similar to his new consulting position with Doheny, where he analyzed sales trends to build and place orders with vendors, many of which were also Cortz's vendors. On the other hand, the third factor may have weighed against inevitable disclosure, as there was evidence that Doheny required Murphy to sign an agreement that he would not use third-party confidential information in connection with his employment with Doheny. In contrast, the *Molon Motor* court did not give the third factor much weight in deciding a motion to dismiss, concluding that it was unlikely for a complaint to contain allegations about what a competitor did to safeguard a plaintiff's secrets so early on in a case.

In the end, the court's decision in *Cortz, Inc. v. Doheny Enterprises, Inc.* provides some important "lessons learned" in seeking injunctive relief in trade secret misappropriation cases. First, it is vital to identify with specificity and establish with admissible evidence the baseline trade secrets at issue. Second, moving parties must put forward concrete evidence of misappropriation or at least threatened misappropriation. To this last point, it is important to keep in mind the differences between threatened misappropriation and inevitable disclosure, including the different theories that underlie these doctrines.

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