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Arbitrating the trade secret misappropriation case: benefits and challenges

By Claude M. Stern Esq.

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The trade secret misappropriation claim has become a popular and powerful weapon between industry players over the last two decades. It is asserted by employers against former employees and/or their new employers, between licensing partners, between competitors, and otherwise in state and federal courts and in arbitration under state law (the Uniform Trade Secrets Act in all states but New York) and federal law (the Defend Trade Secrets Act, 18 U.S.C. § 1836, et seq.).

Two primary factors contributing to the popularity of trade secret lawsuits are the perceived narrowed availability of patentable subject matter and increased employee mobility. But 2024 brings a third impactful development: the Federal Trade Commission's interest, mirrored by various state legislatures, in invalidating employee noncompetition agreements. Studies estimate that 20% of all U.S. salaried workers (including executives)—millions of workers—have noncompetes. Should employee noncompetes disappear or be materially narrowed, employee movement between competitors will materially increase, and so will trade secret cases.

Conventional wisdom dictates that parties arbitrate a trade secret case only because they are so compelled by a pre-dispute contract, and that absent such compulsion, the smart and most risk-free decision is to litigate the case in court, thereby obtaining maximum "optionality" as to who decides the case (judge or jury), the amount of discovery, the parties to the suit and the appealability of injunctive relief or judgment.

But maximum optionality comes at a price, especially in a trade secret case: a public forum exposing sensitive or embarrassing facts and potentially illegal conduct, greater fees and costs, massive discovery, supervision by an overwhelmed court, and trial and appeal delays.

For parties seeking efficient, less expensive, and meaningfully decided resolution of the trade secret case, arbitration—agreed to either pre- or post-dispute via a well-crafted arbitration provision—may be the preferred venue for both the trade secret holder and the alleged misappropriator.

So, what are the advantages and disadvantages of doing so?

The Neutral

The parties to an arbitration can select an arbitrator with a less crowded docket than any federal or state judge so that the neutral has more time to focus on the parties' case. And, they can select a neutral based on the neutral's knowledge of the relevant technical field and/or experience in trade cases, including unique procedures and damage theories associated with such disputes.

Are arbitrators less willing to grant sizeable awards to trade secret claim-

ants? Assorted studies comparing arbitral awards with jury verdicts find no material difference, with some suggesting arbitration yields larger awards on average. Similarly, anecdotal data suggest that arbitrators have no problem in the appropriate case awarding substantial damages, rivaling what any jury might do. *See, e.g., Seagate Technology, LLC v. Western Digital Corporation*, 854 N.W.2d 750 (Minn. 2014) (affirming arbitral award in trade secret case of more than $630 million).

Time to Trial

The average time in federal court from the filing of the complaint to trial was approximately 2 1/4 years between 2015 and 2020. As of September 2023, that duration has expanded to three years, an increase of 33%. This delay between filing and trial is bad for all parties, as it increases attorneys' and experts' fees and costs, bogs down the courts, and casts a cloud over the parties' respective proprietary technologies.

The limited published information about duration of private arbitration suggests that the duration between initiation and final award is somewhere between seven months and 1 1/2 years. And, every study on the subject shows that this translates into greater cost and time savings, even after considering arbitration's unique costs (filing fee, arbitrator fees).

Confidentiality

Because the public has no access to the proceedings, arbitrations are inherently confidential and can be and often are made entirely private (meaning no public comment by the parties) by agreement. This means all sensitive aspects of the case—the asserted trade secret, how it was developed, any difficulty identifying it, how the claimant maintained it (or failed to), how the accused obtained access to or used it (innocently or not), the asserted damages—are shielded from public scrutiny.

This is not so in a court-based trade secret case.

Public trade secret litigation risks inadvertent public disclosure of the asserted trade secret, the defendant's targeted technology, or internal business processes associated with protecting the trade secret or how it was leaked/stolen in depositions, in court filings, at hearings, with third-party witnesses and at trial.

Public trade secret litigation frequently discloses embarrassing, sometimes catastrophic, kinks in the trade secret holder's confidentiality protocols (helpful to industry competitors) and the accused's questionable (or even illegal) hiring or other industry practices.

Trade secret litigation requires the trade secret holder's early identification of the asserted trade secret, a procedure that is always hotly disputed and reveals the holder's uncertainty of what is its trade secret, and the accused's admission of what it does not consider a trade secret, information that can be useful to competitors or other departing employees.

Arbitration shields all this from public view.

Discovery

Discovery in trade secret cases—how the trade secret holder acquired the trade secret, how consistently they have treated it as secret, how they maintained or valued it, how the accused got access to it, how it was used by or disclosed to others, who participated in any alleged theft, how use of the trade secret affected the accused's business and expert opinions on these facts—can be the key to success for the accuser or the accused.

The extent of discovery in arbitration depends on the arbitration clause's provision related to discovery. If appropriate rules are incorporated, discovery can be as broad as in court litigation. If little discovery is permitted, either of the parties may be disadvantaged.

If, as is common, the arbitration clause permits discovery per the arbitral body's rules and the amount of discovery is, where the parties disagree, left to arbitrator discretion, the parties have no greater advantage or disadvantage than being before a judge with equal discretion. Importantly, one of the very few bases for vacating an arbitral award is the arbitrator's refusal to hear (or allow a party access to) material evidence. The arbitrator's exercise of reasonable discretion on allowable discovery renders the final award bulletproof.

Third-party discovery may be a challenge in arbitration, especially where the arbitration clause does not provide for it. In such cases, neither the arbitrator nor the parties can compel third parties to participate in the arbitral discovery phase (e.g., via deposition). But both the Federal Arbitration Act (FAA) and California Arbitration Act, as well as other state corollaries, give the arbitrator the power to order third-party documents or testimony at the arbitration hearing. So, third-party information is available in arbitration.

Consequently, in many arbitrations, including a trade secret case, the parties work with third parties to obtain documents and testimony before the hearing. So, any perceived disadvantage of third-party discovery may be more theoretical than real.

Injunctive Relief

Injunctive relief may be a provisional remedy of choice in the appropriate trade secret case, and this advantage is not lost through arbitration. The rules of many arbitral bodies authorize an arbitrator (often specially appointed) to issue pre-hearing emergency relief, which is equivalent to a temporary restraining order or preliminary injunction. Arbitration clauses may either incorporate these rules or allow or mandate such provisional relief to be provided by a court (which does not waive the right or duty to arbitrate).

For the arbitral temporary restraining order (TRO) or preliminary injunction (styled as an interim award) to be enforceable, the securing party must have it confirmed in court. This procedure is expeditious and not a substantive review of the award's merits. And because this award is not final, it is not reviewable for error (such as a court-ordered TRO or preliminary injunction).

In assessing the extent to which this lack of review is a disadvantage of arbitration, consider that, according to the data in a 2020 study by Munger, Tolles & Olson, TRO and preliminary injunction provisional relief in trade secret cases is sought and granted in only 6% to 9% of all trade secret cases. Also, according to the data in a 2010 trade secret study by O'Melveny & Myers, the likelihood of a party successfully appealing an erroneous trade secret provisional remedy is about 2% to 3%. Given other benefits of arbitrating the trade secret case, this low likelihood should not serve as a deterrent to arbitration.

Non-Signatory Joinder

Arbitration results from consent by the signatories to a contract containing an arbitration clause. What if a key target of the alleged trade secret theft is not a signatory? If an employee leaves Company A with its trade secret and joins Company B, which uses that secret, how does Company A seek redress against its former employee and Company B in one proceeding? In a court having personal jurisdiction over the employee and Company B, both can be named defendants in one action. But if Company A has a right to arbitrate against the employee only, Company A may face a two-front war—an arbitration against the employee and a lawsuit against Company B—and that is a disadvantage compared to a one-forum court case.

But procedures exist that can mitigate this challenge.

First, Company A or Company B may invoke any of several common law doctrines to compel non-signatories to arbitration, including the doctrines of assignment, agency, equitable estoppel, alter ego/veil piercing, "group of companies" and implied consent.

Second, if Company A files a single trade secret lawsuit against both the employee and Company B, the employee can seek to compel the case against them to arbitration and move to stay the case against Company B pending the outcome of the arbitration. Courts routinely stay cases against a non-signatory where the claim asserted against the non-signatory is the same as it is against the signatory. (This is uniformly true under the FAA (9 U.S.C. § 9) but may not be true under certain state arbitration statutes (e.g., California Code of Civil Procedure § 1281.2(c), (d).)

Considering this "stay" reality, Company B may offer to participate in the arbitration to assure that the employee's arbitration position is consistent with Company B's interests. This strategy is particularly compelling in those limited

circumstances where the arbitration award or findings are binding against the non-signatory under principles of *res judicata* or collateral estoppel.

Available Remedies

The scope of arbitrator remedies is determined by agreement and may or may not be limited to those awardable by a judge or jury. Where not so limited, trade secret parties in arbitration may seek more creative remedies, both defense-side and plaintiff-side, than the judge or jury may impose. Under *AMD v. Intel*, 9 Cal.4th 362 (1994) and similar decisions in other states, an arbitrator can fashion any award that is rationally related to the dispute, even if not authorized by law.

For a trade secret claimant, this may mean advancing unique damages or specific performance remedies that the law would not recognize (such as the re-upping of a terminated license in *AMD v. Intel*). Similarly, a successful trade secret defendant may be awarded attorneys' fees, even where the arbitration agreement contained no fee-shifting provision, merely because the claimant had made the mistake of praying for such discretionary fees in its arbitration demand. *See Spector v. Torenberg*, 852 F. Supp. 201 (S.D.N.Y. 1994).

Narrow Review of Final Award

The scope of a final arbitral (much less interim) award is extremely narrow. Parties to a trade secret case deciding post-dispute whether to arbitrate the case may or may not see the limited appeal right as a basis to avoid arbitration, even if a narrow appeal means a shorter case life, with substantial cost and time savings.

As Stout's Trends in Trade Secret Litigation Report 2020 shows, considering all court-litigated trade secret cases, there is only a 16% chance of a judgment being reversed on appeal. This statistic does not support a compelling argument for avoiding arbitration of a trade secret case.

Assuming an appropriately crafted arbitration provision, arbitrating the trade secret case provides distinct advantages to both plaintiffs and defendants wishing a more focused neutral, a more efficient and expeditious resolution process, a confidential forum, sufficient discovery to resolve all material questions of fact and a breadth of remedies.

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Claude M. Stern *serves as a mediator, arbitrator, special master/referee, and neutral evaluator at JAMS. He handles intellectual property, technology, product liability, gaming industry, artificial intelligence and international cases. He can be reached at cstern@jamsadr.com.*