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05 | 21 | 2010 Posted By

California Court Takes On Trade-Secret Preemption of Other Civil Claims

Recently, a California court of appeal took up an issue that is more often examined by federal courts than state courts: trade-secret preemption of related tort claims.

The California Uniform Trade Secret Act (CUTSA) governs trade-secret misappropriation claims in California and is codified in sections 3426 through 3426.11 of the California Civil Code. Section 3426.7(b) of the CUTSA provides, in pertinent part, that "This title does not affect (1) contractual remedies, whether or not based upon misappropriation of a trade secret, (2) other civil remedies that are not based upon misappropriation of a trade secret, or (3) criminal remedies. . ." Thus, the CUTSA expressly allows contractual and criminal remedies, whether or not they're based on misappropriation, yet preempts alternative tort remedies that are "based upon" trade-secret misappropriation. *Id.* 3426.7(b)(2).

Surprisingly, few California state courts have clarified which claims are "based upon misappropriation" under the CUTSA. Much of the jurisprudence in this area comes from federal courts.

For example, in *Callaway Golf Co. v. Dunlop Slazenger Group Americas, Inc.*, 318 F. Supp. 2d 216 (D. Del. 2004), the District of Delaware, interpreting California law, held that the CUTSA preempted conversion and unjust enrichment claims that were "based entirely on the same factual allegations that form the basis of its trade secrets claim." *Id.* at 219-20. The court also held that the CUTSA preempted a negligence claim because the plaintiff couldn't show that it was "supported by facts unrelated to the misappropriation of the trade secrets." *Id.* at 221.

The Northern District of California took up the issue in *Digital Envoy, Inc. v. Google, Inc.* 370 F. Supp. 2d 1025 (N.D. Cal. 2005). The Northern District similarly held that Digital Envoy's unfair competition claims (under statutory and common law) and unjust enrichment claim were preempted because they were "based on the identical nucleus of facts" as the misappropriation claim. *Id.* at 1034.

In *K.C. Multimedia, Inc. v. Bank of America Tech. & Ops., Inc.*, 171 Cal. App. 4th 939 (2009), the California Court of Appeals considered whether causes of action for breach of confidence, interference with contract, and unfair competition were likewise preempted by the CUTSA.

In that case, K.C. Multimedia sued a former employee and Bank of America for misappropriation of trade-secret technology used in banking software it had developed for the bank. *Id.* at 944. Ruling on a motion in limine, the lower court held that the three causes of action were "based on misappropriation of trade secrets" and were, therefore, preempted. *Id.* at 948. At the hearing, Bank of America argued that the "tort claims arise from the same operative facts; namely, misappropriation of trade secrets." *Id.* at 952. The court agreed, stating that "everything I've heard is that causes of action 2, 5 and 6 [for breach of confidence, interference, and unfair competition] are causes of action based on misappropriation of trade secrets. That is the gist of those causes of action." *Id.* at 953.

On appeal, K.C. Multimedia first challenged the ruling on procedural grounds, arguing that a motion in limine was not the proper procedure for the preemption ruling. *Id.* at 948. The court of Appeals rejected this attack, holding that K.C. Multimedia waived this objection by not raising it at the lower level, a

motion in limine could be used to test whether a complaint states a cause of action, and even if there was a procedural error, K.C. Multimedia wasn't prejudiced unless it was also correct on the substantive issue. *Id.* at 949, 951-52, and 953.

Next, the court considered K.C. Multimedia's substantive challenge to the preemption ruling, noting the differences between the CUTSA and the uniform act. The key difference was that the model act provides that it "displaces conflicting" law. *Id.* at 956. In states that have adopted the model act (Colorado, Minnesota, and Wisconsin), "courts will allow plaintiffs to maintain separate causes of action 'to the extent that causes of action have "more" to their factual allegations than the mere misuse or misappropriation of trade secrets.'" *Id.*

However, the California Legislature rejected that provision in favor of an entirely different one: CUTSA § 3426.7(b) ("This title does not affect. . . (2) other civil remedies that are not based upon misappropriation of a trade secret. . ."). "This provision would appear to be rendered meaningless if, in fact, claims which are based on trade secret misappropriation are not preempted by the state's statutory scheme." *K.C. Multimedia*, 171 Cal. App. 4th at 958 (quoting *Digital Envoy*). The court held that the CUTSA preempts "common law claims that are 'based on the same nucleus of facts as the misappropriation of trade secrets claim for relief,'" and that, unlike in model-act states, a plaintiff couldn't pursue other tort claims by simply alleging "something more" than trade-secret misappropriation. *Id.* (quoting *Digital Envoy*).

Turning to the facts before it, the court held that "the complaint as a whole rests on factual allegations of trade secret misappropriation." *Id.* at 959. "'A fair reading' of appellant's fifth amended complaint thus 'compels the conclusion that each and every cause of action hinges upon the factual allegation that [defendants] misappropriated [appellant's] trade secrets." *Id.* The court went on to hold that the "conduct *at the heart of*" the related tort claims and the "*gravamen* of the wrongful conduct asserted" in support thereof "rest[ed] squarely on [K.C. Multimedia's] factual allegations of trade secret misappropriation." *Id.* at 960-62 (emphasis added). Because these claims were factually based upon "the same nucleus of facts" as the trade-secret claim, they were therefore preempted by the CUTSA. *Id.*

The *K.C. Multimedia* court provides much-needed guidance on a topic of importance to trade-secret litigators. By dismissing causes of action that are superfluous to a trade-secret case, a defendant can limit the scope of discovery, the number of dispositive issues, and the overall cost of defending such a case.

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