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The Uniform Trade Secrets Act: Differences from the Common Law and from State to State

Recently, Texas adopted the Uniform Trade Secrets Act ("UTSA" or "the Act"), with some minor modifications, S.B. 953, 83rd Leg., Reg. Sess., § 4 (Tex. 2013), becoming the 47th State (plus Washington, D.C. and Puerto Rico) to do so. Massachusetts, North Carolina, and New York are the remaining holdouts, and a bill to adopt the Act is pending in the Massachusetts House of Representatives. The UTSA, which was promulgated in 1979, was significantly amended in 1985 and has been steadily adopted by the States since then. This article examines some of the Act's significant deviations from the common law, particularly the common law of New York, which is based in significant measure on the Restatement (Third) of Unfair Competition. Additionally, since States can (and often do) make changes to the Act when they enact it, this article discusses differences among certain major jurisdictions that have adopted some form of the UTSA, including California, Illinois, and Texas, as well as variations in interpretation of the UTSA among the courts of those States.

I. The UTSA's Departure from the Common Law

The first major difference between the Act and the common law lies in the definition of a "trade secret." New York case law defines a trade secret as any

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Quinn Emanuel Receives Top Rankings in *Chambers USA 2014*

The firm and its partners have once again received top rankings from *Chambers USA*. For 2014, the firm and its partners were recognized as market leaders in the areas of Intellectual Property, General Commercial Litigation, Securities Litigation, White-Collar Crime & Government Investigations Litigation, Media & Entertainment Litigation, Bankruptcy/Restructuring, International Arbitration, Appellate Law, and International Trade: Intellectual Property. Additionally, the firm made its debut on the list for Products Liability & Mass Torts. The firm's Products Liability group was also recognized earlier this year as *Chambers USA Product Liability Practice Group of the Year for 2014*. Q

Charles Verhoeven Named a Top IP Lawyer by the *Daily Journal*

San Francisco partner Charles Verhoeven was named a Top IP Lawyer by the *Daily Journal*. The annual list consists of leading intellectual property litigators and portfolio managers. Mr. Verhoeven is recognized in particular for his work on behalf of Google Inc. and Samsung Electronics Co. Ltd. against Apple Inc. and Microsoft Corp., and for his work on behalf of Motorola Mobility Inc. in *Microsoft Corp. v. International Trade Commission et al.* Q

Susan Estrich and Diane Doolittle Named Top Women Lawyers by the *Daily Journal*

Partners Susan Estrich and Diane Doolittle were recently named 2014 Top Women Lawyers by the *Daily Journal*. The feature recognizes the female attorneys in California whose work has made a significant impact on the legal field.

Ms. Estrich was recognized in particular for her work representing Samsung Electronics Co. Ltd., Mattel Inc., Marvell Technology Group Ltd., and Marvell Semiconductor Inc. Ms. Doolittle, Co-Chair of the firm's national trial practice group, was recognized for her work on behalf of Pfizer Inc. Q "formula, pattern, device or compilation of information which is used in one's business, and which gives [the employer] an opportunity to obtain an advantage over competitors who do not know or use it." *Ashland Mgt. v. Janien*, 82 N.Y.2d 395, 407 (1993). New York courts typically use a complicated, six-factor balancing test to determine if a "trade secret" exists, examining (1) the extent to which the information is known outside the business; (2) the extent to which those involved with the business know the information; (3) the extent to which measures are taken to protect the information's secrecy; (4) how valuable the information is; (5) the expense and/or difficulty involved in developing the information; and (6) the difficulty with which others could develop the information. *See, e.g.*, *Marietta Corp. v. Fairhurst*, 301 A.D.2d 734, 738 (3d Dep't 2003).

The UTSA shortens and simplifies the definition somewhat, stating that a "trade secret" is "information … that (i) derives independent economic value … from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use, and (ii) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy." UTSA § 1(4). The UTSA definition thus expressly narrows the definition of "trade secret" by making reasonable efforts to maintain secrecy and difficulty in independently ascertaining the information prerequisites to the existence of a "trade secret," as opposed to only factors in a balancing test. (In practice, however, under the common law, courts often treated both factors as requirements.) The UTSA definition, however, also broadens the definition of "trade secret" from the common law by eliminating the factor concerning the expense or difficulty involved in developing the information, meaning that even information discovered by accident or at minimal cost may constitute a "trade secret." This expansion is diluted somewhat by the requirement that third parties not be able to readily ascertain the information.

Another significant difference between New York common law and the UTSA is that in New York, a singular, discrete event will not qualify as a "trade secret"; rather, a trade secret "is a process or device for continuous use in the operation of the business." *Softel, Inc. v. Dragon Med. & Scientific Commc'ns, Inc.*, 118 F.3d 955, 968 (2d Cir. 1997). The UTSA, in contrast, contains no such continuous use requirement, and the commentary makes clear that it is a departure from the common law, broadening the definition of trade secret and the protections for the holders of such secrets. UTSA § 1**.**

Trade secret status can also be destroyed if one ceases to take reasonable precautionary measures. The UTSA states only that the measures must be "reasonable under the circumstances," and the commentary allows for controlled disclosure to employees and licensees. *Id.*. The common law has taken different approaches. In *Lamont v. Vaquillas Energy Lopeno Ltd.*, No. 04-12-00219-CV (Tex. App. – San Antonio, Dec. 11, 2013), a case involving conduct that occurred before the effective date of the UTSA in Texas, a Texas appellate court held that showing a document to prospective investors does *not* destroy a document's status as a trade secret. While the UTSA does not specifically address this issue, the provisions of the commentary approving limited disclosures to employees and licensees would seem to preclude prospective investors. Indeed, courts interpreting the UTSA's "reasonable measures" provision have emphasized that businesses only divulged information to their own employees in determining that such disclosure did not destroy the trade secret status, implying that divulging information outside of the business would destroy the protection. *See, e.g.*, *Food Servs. of Am., Inc. v. Carringon*, 2013 WL 4507593 (D. Ariz. 2013); *Sw. Whey, Inc. v. Nutrition 101, Inc.*, 117 F. Supp. 2d 770 (C.D. Ill 2000); *Alta Analytics, Inc. v. Muuss*, 75 F. Supp. 2d 773 (S.D. Ohio 1999); *Alagold Corp. v. Freeman*, 20 F. Supp. 2d 1305 (M.D. Ala. 1998); *Courtesy Temp. Serv., Inc. v. Camacho*, 222 Cal. App. 3d 1278 (Ct. App. 1990). Regardless of jurisdiction, it is prudent for companies to advise their employees that particular information constitutes a trade secret and that they should not disclose it widely, or to limit access to the trade secret in the first place.

Further supporting the notion that the UTSA made protection requirements more stringent, at least in Texas, is that, before the UTSA's passage, plaintiffs alleging trade secret misappropriation could sue under either the common law or the Texas Theft Liability Act (TTLA). The TTLA required only that the holder of a trade secret take *any* precaution to guard its secrecy, as opposed to the *reasonable* precautions requirement in the UTSA. Tex. Penal Code § 31.05(a)(4) (suit under the TTLA was by way of the Texas Penal Code). The UTSA has supplanted the TTLA as a remedy for trade secret misappropriation in Texas, and holders must now guard their secrets more carefully for them to be protectable.

Indeed, with respect to the efforts required to prevent disclosure of a trade secret, the UTSA standard is comparable to the relatively strict New York common law. Under New York law, if a trade secret is disclosed to an individual who is not under an obligation to protect the confidentiality of the information, then the trade secret loses its status as such. *See, e.g.*, *Big Vision Private Ltd. v. E.I. DuPont De Nemours & Co.*, 2014 WL 812820 (S.D.N.Y. 2014). Similarly, the UTSA stresses that disclosure may be made only to those individuals who are associated with a company and thus have a duty of loyalty not to disclose the information, or to those who have signed a confidentiality agreement. Confidentiality agreements satisfy both the UTSA and New York's standards for maintaining secrecy, as they are "reasonable precautions" that create an obligation by the third party to protect the information's confidentiality.

Consistent with its more restrictive standard for protection of information compared to the common law, the UTSA has established a so-called "royalty injunction" that provides an alternative to an injunction prohibiting a defendant's continued use of a trade secret. The royalty injunction provides that "[i]n exceptional circumstances, an injunction may condition future use upon payment of a reasonable royalty for no longer than the period of time for which use could have been prohibited." UTSA § 2(b) (1985). The provision thus provides courts with discretion to impose a royalty instead of a prohibitory injunction, typically in circumstances involving good-faith acquisition of trade secrets that others have misappropriated. *Id.* §2 at cmt.¶5 As discussed below, however, courts have differed in their interpretation of this provision.

Finally, the availability of attorneys' fees under UTSA presents an issue that should give all parties—both plaintiffs and defendants—pause. Under the common law, attorneys' fees were typically unavailable in the absence of specific contractual or statutory provisions. 2 Trade Secrets Law §§ 22:6, 41:3; *Mount Vernon City School Dist. v. Nova Cas. Co.*, 19 N.Y.3d 28 (2012); *Stilwell Dev. Inc. v. Chen*, 1989 WL 418783 (C.D.Cal. 1989); *Chernus Indus., Inc. v. Grounds & Assocs., Inc.*, 278 N.W.2d 81 (Minn. 1979). In contrast, the UTSA makes reasonable attorneys' fees available "if (i) a claim of misappropriation is made in bad faith, (ii) a motion to terminate an injunction is made or resisted in bad faith, or (iii) willful and malicious misappropriation exists." UTSA § 4 (1985). Thus, under the UTSA, attorneys' fees may be assessed against both the misappropriator acting wrongly and any party in litigation that does not prosecute an action in good faith. Courts have interpreted "bad faith" to include both "a subjective misconduct component and an objective speciousness component," *see, e.g.*, *VSL Corp. v. General Techs. Inc.*, 1998 WL 124208 (N.D. Cal. 1998) (applying California law), and therefore an award of attorneys' fees is not available if the motive behind the misappropriation is competition rather than malice, *Roton Barrier, Inc. v. Stanley Works*, 79 F.3d 1112 (Fed. Cir. 1996) (applying Illinois law).

II. The Lack of Uniformity Among the States That Have Adopted Some Form of the UTSA

A. Variations in States' Versions of the UTSA

In addition to the numerous differences between the common law and the UTSA, there are substantial differences among the States that have adopted the UTSA, including among California, Illinois, and Texas. These differences are both a product of timing—California, for example, passed its version of the Act in 1984 and therefore did not incorporate the substantial 1985 amendments—and a State's deliberate intent to deviate from particular provisions in the Act.

One significant difference between California's version of the Act and the 1985 UTSA is that the latter includes an exception regarding the availability of monetary damages: if awarding money damages would be inequitable because of a material and prejudicial change in position prior to learning of or having reason to learn of the misappropriation, the court will resort to injunctive relief rather than monetary relief. UTSA § 3(a) (1985). California law has no such protection for unwitting defendants. Cal. Civ. Code § 3426.3(a). Also, California law expressly provides that, under certain circumstances, a customer list for an employment agency is a trade secret. Cal. Bus. & Prof. Code § 16607. In contrast, under the common law doctrine of "casual memory," whether a customer list received trade secret protection was (and still is, in New York) a question of fact dependent on the specific circumstances of the case. *See, e.g.*, *Leo Silfen, Inc. v. Cream*, 29 N.Y.2d 387 (1972); *Riedman Corp. v. Gallager*, 48 A.D.3d 1188 (4th Dep't 2008).

Illinois's trade secrets act also differs from the UTSA in a few notable ways. First, unlike the UTSA or the common law, the Illinois Trade Secrets Act explicitly states that lists of "actual or potential customers" are entitled to trade secret protection, creating protections for employers whose employees leave and join a competitor. 765 Ill. Comp. Stat. 1065/2. The Illinois statute is also more friendly to trade secret holders in that the statutes of limitations for an action is five years as opposed to three under the UTSA. 765 Ill. Comp. Stat. 1065/7. Finally, the Illinois statute specifically mentions non-disclosure covenants, stating that "a contractual or other duty to maintain secrecy or limit use of a trade secret shall not be deemed to be void or unenforceable solely for lack of durational or geographical limitation on the duty." 765 Ill. Comp. Stat. 1065/8(1). The UTSA does not directly address non-disclosure covenants, while this provision in the Illinois statute ensures that broad non-disclosure agreements will not be presumed invalid under Illinois law.

Texas, the most recent State to enact the UTSA, also made a number of changes to the Act's uniform provisions. First, like Illinois, Texas expressly extended protection to customer lists. Tex. Civ. Prac. & Rem. § 134A.002(6). It also provided trade secret status to financial data. *Id.* Second, similar to California, Texas does not have the "equity" exception for monetary damages where a defendant unknowingly misappropriates a trade secret. UTSA § 3(a) (1985). Third, Texas appears to view protective orders more favorably in the context of trade secrets litigation than the UTSA, as it directs courts to adopt a presumption in favor of granting protective orders in such litigation. Tex. Civ. Prac. & Rem. § 134A.006.

B. Variations Among Courts in Interpreting the UTSA

Turning to judicial interpretation of the UTSA, the "royalty injunction" is by far the principal area of disagreement among courts—specifically, whether irreparable harm is required prior to issuance of such an injunction. While irreparable harm is generally a prerequisite to issuance of an injunction, no such requirement explicitly appears in the UTSA. A federal district court in Ohio has ruled that the UTSA's silence is irrelevant, as the default principles applicable to injunctive relief, including the existence of irreparable harm, apply to the statute. *See Allied Erecting & Dismantling Co. v. Genesis Equip. & Mfg., Inc.*, 2010 WL 3370286, *3 (N.D. Ohio Aug. 26, 2010). The court thus concluded that a royalty injunction would be inequitable for the same reason that a permanent, traditional injunction would have been inequitable—the plaintiff had not adequately shown irreparable harm. *Id.*

The Georgia Supreme Court took a different approach in *Electronic Data Systems Corp. v. Heinemann*, 493 S.E.2d 132 (1997). There, the trial court granted a royalty injunction after noting "the public's interest in competition, [the plaintiff's] delays in bringing the matter to a resolution, and the adequacy of a royalty to protect the parties' respective interests." *Id.* at 135. In affirming, the Georgia Supreme Court did not discuss irreparable harm either and, in fact, recognized that it was possible that "all commercial advantage of the misappropriation had evaporated." *Id.* Similarly, the Kansas Supreme Court, in reviewing a trial court's decision to grant a royalty injunction, did not discuss irreparable harm as a requirement for the injunction, but it did remand the case due to the trial court's inadequate explanation of the "exceptional circumstances" that prompted it to grant a royalty injunction. *Progressive Prods. v. Swartz*, 292 Kan. 947 (Kan. 2011).

While there appears to be a difference of opinion as to whether irreparable harm is a prerequisite to issuance of a royalty injunction, the magnitude of this difference is lessened considerably by "the principle that in misappropriation of trade secrets irreparable harm may be presumed," which an Ohio state court relied upon in distinguishing *Allied Erecting*. *See Columbus Steel Castings Co. v. King Tool Co.*, 2011-Ohio-6826 (App. 10th Dist. 2011).

Conclusion

The UTSA continues to spread nationwide, leaving few stragglers, but it is unlikely that New York, with its well-developed common law, will follow suit in the foreseeable future. While this variation among the States presents complications for companies that operate in multiple jurisdictions, two legal tools can provide some measure of uniformity even in jurisdictions that still follow the common law of trade secret misappropriation. First, confidentiality agreements offer protection against misuse of trade secrets and other sensitive information should interpretation or application of a specific trade secrets issue be difficult to predict. Second, regardless of variations in trade secrets law, the common law duty of loyalty will continue to protect employers in the common situation of an employee misappropriating trade secrets as they prepare to work for or start a competing business. Indeed, even if information does not rise to the level of a trade secret, employees violate their duty of loyalty—and risk monetary damages or injunctive relief—if they seek to use such information with the goal of competing. These tools thus offer companies substantial protections outside of the UTSA and its many variations. Q

NOTED WITH INTEREST

Enforceability of Settlement Terms in California Courts

California's public policy has long been to encourage settlement over litigation in the interests of efficiency and economy for the courts and for the parties involved. *See, e.g.*, *Kaufman v. Goldman*, 195 Cal. App. 4th 734, 745 (2011); *Osumi v. Sutton*, 151 Cal. App. 4th 1355, 1359 (2007); *Zhou v. Unisource Worldwide, Inc.*, 157 Cal. App. 4th 1471, 1475 (2007); *Brown v. Guarantee Ins. Co.*, 155 Cal. App. 2d 679, 696 (1957). This February, however, in *Purcell v. Schweitzer*, 224 Cal. App. 4th 969 (2014), the Fourth District Court of Appeal declined to enforce a liquidated damages provision in a settlement agreement on the basis that the damages were actually a penalty provision unrelated to actual damages arising from the breach of the settlement agreement. This decision raises the prospect that the terms of carefully negotiated and crafted settlement agreements will themselves be subject to litigation and potential invalidation by California courts.

The dispute in *Purcell* involved a settlement of a suit arising from Schweitzer's default on a $85,000 promissory note to Purcell. The settlement agreement stated that Schweitzer would pay Purcell $38,000 plus interest over 24 months, with a $20,000 initial payment followed by installment payments due on the first day of each month. The stipulation central to this case stated that if any payment was not made by the fifth day of the month, it would be considered a breach of the entire settlement agreement, and a judgment for the *original liability* of $85,000 could be entered against Schweitzer. The settlement agreement stated that this provision was "neither a penalty nor . . . a forfeiture," and explained that the $85,000 took into account, *inter alia*, limiting future attorney's fees, "elimination of uncertainties relating to collection of a Judgment in contrast to a full, voluntary payment and performance by Defendant," and "the public policy of judicial economy." The agreement further included a provision waiving Schweitzer's right to appeal or otherwise contest a default judgment.

After 18 months of timely payments, Schweitzer was six days late on a single payment. Accordingly, Purcell sought and obtained a default judgment for $58,829.35. Purcell also accepted Schweitzer's late payment and his subsequent monthly payments until the entire amount due under the settlement agreement was paid.

Schweitzer brought a motion to set aside the default judgment, arguing that the liquidated damages provision of the settlement agreement was an unenforceable penalty for breach. The trial court agreed. The Fourth District Court of Appeal affirmed, finding the stipulation allowing for default judgment "an unenforceable penalty" because, at nearly $60,000, it could have no reasonable relation to actual damages Purcell would suffer from a single late installment payment of about $750.

The court, relying on *Greentree Financial Group, Inc. v. Execute Sports, Inc.*, 163 Cal. App. 4th 495 (2008), held that the test for whether stipulated damages constitute an unenforceable penalty or an enforceable liquidated damages provision centers on whether the damages were a reasonable anticipation of harm caused by breach of the *settlement agreement*, not of the underlying loan contract. The facts of *Greentree* were similar; there, the underlying default was $45,000, and the settlement was for $20,000 in two installments with a judgment for the full $45,000 plus interest in the case of default. The key difference, however, was that the settlement agreement in *Greentree* did not include any provision attempting to clarify that the default judgment was not a penalty. Although the *Purcell* settlement agreement included such clarification, the court held that the language denying the stipulation was a "penalty" had no import because "public policy may not be circumvented by words used in a contract"—thereby foreclosing the possibility that a more carefully drafted provision might have been enforced.

The Fourth District Court of Appeal's analysis focused on California policy disallowing penalty provisions in contracts, ignoring the countervailing policy of encouraging settlement. *See e.g.*, *Kaufman*, 195 Cal. App. 4th at 745 (recognizing the "strong public policy favoring settling of disputes"). Though settlements are evaluated under the same legal standards as other contracts, there are several reasons why settlement agreements might deserve broader deference than contracts generally merit.

First, settlement agreements are usually entered into with the considered advice of attorneys on both sides, and are presumably highly negotiated; this diminishes concerns a court might otherwise have about, for example, contracts of adhesion or imbalances in information or bargaining power. The *Purcell* case is a particularly clear example of the foregoing, as the settlement agreement expressly sought to show that the agreed-upon amount was reasonably connected to the anticipated harm to Purcell by stating that neither party considered it a penalty and by explaining that the $85,000 amount took into account "the economics associated with proceeding further with this matter." It is likely that, in deciding to settle with a party who had already proven himself to be unreliable in making payments, Purcell relied on the inclusion of a strong incentive for Schweitzer to make his settlement payments.

Second, negotiations over settlement agreements occur in the shadow of an already extant dispute, with the increased knowledge that brings of damages and litigation costs, adding to both parties' negotiating capability.

Third, a primary attraction of settlement is often the ability to avoid litigation costs. The risk of being required to litigate over the terms of a settlement agreement could greatly diminish this benefit, thereby significantly working against California's policy to encourage settlement over litigation.

Though the facts make Schweitzer's case sympathetic—he was liable for an extra $58,000, despite being only six days late on one payment and having paid the entire liability by the time of the default judgment—it is easy to imagine a more borderline fact pattern where, in the absence of a substantial liquidated damages provision, a party would fail to make many or most of its payments on time. Additionally, the inability to enforce such damages provisions in settlement agreements may make parties in Purcell's position less likely to settle, thereby making it much harder for parties that have defaulted on a loan to obtain a settlement allowing for installment payments with a discount from the original liability. Q

Securities and Structured Finance Litigation Update

U.S. Supreme Court to Review Tolling of Securities Act Claims. In *Police & Fire Retirement System of the City of Detroit v. IndyMac MBS, Inc.* 721 F.3d 95 (2d Cir. 2013) ("*IndyMac*"), the Second Circuit addressed the reach of the Supreme Court's decision in *American Pipe & Construction Co. v. Utah* ("*American Pipe*"), 414 U.S. 538 (1974). *American Pipe* held that "the commencement of a class action suspends the applicable statute of limitations as to all asserted members of the class who would have been parties had the suit been permitted to continue as a class action." *Id.* at 554. The Second Circuit held in *IndyMac* that the tolling rule set forth in *American Pipe* does not apply to the three-year statute of repose in Section 13 of the Securities Act of 1933 (the "Securities Act"), 15 U.S.C. § 77m. *See IndyMac*, 721 F.3d at 101. In March 2014, the U.S. Supreme Court agreed to review the Second Circuit's *IndyMac* decision. How the Supreme Court resolves the applicability of so-called "*American Pipe* tolling" to Securities Act claims could have significant implications for investors, underwriters, and issuers of securities.

In *IndyMac*, the lead plaintiff and other potential class members alleged that the issuer and underwriters of certain residential mortgage-backed securities misrepresented the quality of the mortgages collateralizing the securities, in violation of Sections 11, 12, and 15 of the Securities Act. 721 F.3d at 101-03. Although the Securities Act generally provides that such claims are timely only if brought within three years of the issuance of the securities (with respect to Section 11 claims) or within three years of the sale of the securities (with respect to Section 12 claims), several potential plaintiffs sought to join the ongoing class action outside of the three-year statute of limitations set forth in Section 13, which is sometimes referred to as a "statute of repose." *Id.* at 103. In support of the timeliness of their claims, the potential *IndyMac* class action plaintiffs argue that the tolling principle announced in *American Pipe* also applies to Section 13's statute of repose. 721 F.3d at 103. The District Court (and, subsequently, the Second Circuit) ruled that it did not. *Id.* at 103, 109.

In *American Pipe*, the Supreme Court analyzed Federal Rule of Civil Procedure 23, which provides the procedures for class actions. The Supreme Court reasoned that a failure to permit a putative class action to toll the statute of limitations for all potential class members would encourage a multiplicity of suits (since each potential plaintiff might feel compelled to bring suit to ensure the timeliness of its claims), which is precisely what the class action mechanism was designed to avoid. The Supreme Court therefore held that filing a putative class action tolled the applicable statute of limitations for all potential class members until the court decided class certification or otherwise disposed of the case. *American Pipe*, 414 U.S. at 553-54.

In *IndyMac*, the Second Circuit initially considered whether *American Pipe* tolling was an "equitable," judicially created doctrine (which could not toll Section 13's statute of repose), or whether it was a form of "legal" tolling (and therefore could toll a statutory statute of repose). 721 F.3d at 107-08. The court did not answer this question, however, holding that even if the tolling principle in *American Pipe* were grounded in Rule 23 (and therefore constituted "legal," rather than "equitable," tolling), Rule 23 could not toll a statute of repose since the Rules Enabling Act, 28 U.S.C. § 2072(b), prohibits a federal rule from "abridge[ing], enlarge[ing] or modify[ing] any substantive right." 721 F.3d at 109. Because the Second Circuit held that Section 13 created a substantive right to be free from liability after a legislatively determined period, the court reasoned that Rule 23 could not abridge a defendant's right under a statute of repose to be free from liability from plaintiffs that had not brought suit within three years of the alleged violation. *Id.* Accordingly, the court dismissed the putative plaintiffs' claims as untimely. *Id.* at 112-13.

In their petition for a writ of certiorari, the *IndyMac* plaintiffs argued that *IndyMac* conflicted with a decision from the Tenth Circuit, which had ruled that *American Pipe* tolling *does* apply to Section 13's statute of repose. *See Joseph v. Wiles*, 223 F.3d 1155 (10th Cir. 2000). In *Joseph*, the Tenth Circuit held that "[i]f all class members were required to file claims in order to ensure the limitations period would be tolled, the point of Rule 23 would be defeated." *Id.* at 1167. One point raised in *Joseph*, and cited by the petitioners in *IndyMac*, is whether "*American Pipe* tolling" even constitutes tolling. *See Joseph*, 223 F.3d at 1168 ("Indeed, in a sense, application of the *American Pipe* tolling doctrine to cases such as this one does not involve 'tolling' at all. Rather, Mr. Joseph has effectively been a party to an action against these defendants since a class action covering him was requested but never denied."). Under this reading of *American Pipe*, that case did not actually turn on tolling, but instead relied on the representative nature of the class action vehicle, as the class members were effectively parties to the action once class action treatment was requested. Under this theory, the putative class action effectively asserted the *IndyMac* plaintiffs' claims, and therefore no resort to "tolling" is required for their claims to be timely under Section 13's statute of repose.

The petitioners in *IndyMac*, however, face a threshold obstacle that may prevent the Supreme Court from reaching the *American Pipe* tolling question at all. In their briefing to the Supreme Court opposing certiorari, the *IndyMac* respondents challenged the petitioners' ability to benefit from *American Pipe* tolling because the putative class representative in the underlying class action lacked standing to assert the petitioners' claims. *See* Brief in Opposition for Respondents, *IndyMac*, No. 13-640, at 9 (Jan. 24, 2014). The petitioners, in response, have pointed to their *own* standing to bring the class action claims as evidence that the Court should reach the question of whether *American Pipe* renders their claims timely. *See* Reply Brief for Petitioner, *IndyMac*, No. 13-640, at 10-11 (Feb. 12, 2014). To the extent the Supreme Court considers this standing issue dispositive, it may not reach the merits of the petitioners' timeliness claim, thus leaving this important issue undecided.

Whether, and how, the Supreme Court addresses the reach of *American Pipe* tolling of Securities Act class actions may have a significant impact on the fortunes of securities issuers, underwriters, and investors. The Court's decision is expected in late 2014 or the first half of 2015.

Bankruptcy and Restructuring Update

Intellectual Property Licenses in Bankruptcy—Uncertainties Remain Following the Eighth Circuit's En Banc Decision in Interstate Bakeries. The bankruptcy of a party to an intellectual property license presents serious challenges. Not only are there monetary issues—such as unpaid royalties—but also questions as to the continued exploitation of the intellectual property itself.

Lewis Brothers faced this problem when Hostess and its predecessor, Interstate Bakeries ("IBC"), filed for Chapter 11—twice in one decade. IBC had sold to Lewis Brothers one of its bakery divisions, including a perpetual, royalty-free exclusive license to exploit trademarks associated with the business. After IBC filed for bankruptcy in 2004, it asked the Bankruptcy Court to treat Lewis Brothers' license as an "executory contract," which IBC could assume or reject pursuant to Bankruptcy Code § 365 (11 U.S.C. § 365). Lewis Brothers objected, contending that the license was no longer "executory" because it was an integral part of the consummated sale of the business. Lewis Brothers feared that, if IBC were to reject the license, it would lose its ability to use brand names associated with its products. Although IBC ultimately assumed Lewis Brothers' license, IBC nonetheless obtained a ruling that the license was executory. Lewis Brothers appealed, because it remained concerned that the adjudication of the license as executory would place it at risk in the future.

Lewis Brothers' concerns were valid because IBC (which had changed its name to Hostess) filed a second Chapter 11 in 2012. Hostess sought to sell "free and clear" its remaining bread businesses to a third party, including the trademarks that had been licensed to Lewis Brothers. Lewis Brothers objected, contending (as it had in the first Chapter 11 case) that the license could not be rejected. Although a three-judge panel of the Eighth Circuit had affirmed the first Bankruptcy Court's finding that the license was executory, Lewis Brothers pursued *en banc* review. Meanwhile, in the second bankruptcy case, Lewis Brothers was able to obtain a reservation of rights, and thus the sale of Hostess' remaining business was subject to whatever rights Lewis Brothers had to the trademarks.

Lewis Brothers' rights were vindicated in *Lewis Bros. Bakeries, Inc. v. Interstate Brands Corp. (In re Interstate Bakeries Corp.*), 751 F.3d 955 (8th Cir. 2014), in which an 8 to 3 majority of the Eighth Circuit, sitting *en banc*, held that the trademark license was not executory. Applying what is known as the "Countryman definition," the court held that a contract is "executory" when "the obligation of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other." Under this definition, many intellectual property licenses would be considered to be "executory contracts," due to the licensee's duty to pay royalties, and the licensor's agreement to allow the licensee to continue to exploit the intellectual property. The Eighth Circuit, however, concluded that the Lewis Brothers' license was merely one component of the overall sale of IBC's business, which sale had been "substantially performed." Thus, if either party were to breach at this point, it would not excuse performance of the remaining obligations under the license (principally, IBC's duty to permit Lewis Brothers to exploit the trademarks). The Eighth Circuit's decision followed another recent holding that a trademark license acquired as part of a consummated sale of a business was not executory. *In re Exide Techs.*, 607 F.3d 957 (3rd Cir. 2010).

The *Interstate Bakeries* decision shows that at least some intellectual property licenses may not be affected by bankruptcy. The scope of the decision, however, is limited to those licenses that have been "substantially performed" by at least one party. Thus, many (if not most) licenses will still be treated as executory contracts. As a result, great uncertainty will remain because different rules apply depending upon (i) whether the bankrupt is the licensor or licensee, (ii) whether the license is exclusive or non-exclusive, and (iii) the type of intellectual property that is licensed.

When the Licensor Goes Bankrupt. The Bankruptcy Code provides some protection for licensees under executory intellectual property licenses, but the scope of that protection is limited. If the rejected license involves a debtor's patent or copyright, then the non-debtor licensee may elect either to (i) treat the license as terminated, in which case the non-debtor licensee will be relieved of all further obligations, but can no longer exploit the license, or (ii) continue to use the intellectual property generally pursuant to the license, including the payment of royalties to the debtor, but without the benefit of any ongoing affirmative performance by the debtor (such as continuing product support). 11 U.S.C. § 365(n). The law is unclear as to trademarks, however, which Congress excluded from the definition of "intellectual property." 11 U.S.C. § 101(35A). The majority view appears to be that a trustee or debtor may reject an executory trademark license, and thus deprive the licensee of any further rights. *See Exide*, 607 F.3d at 966 (Ambro, J., concurring). This is the fate that concerned Lewis Brothers, were its license held to be executory. However, a recent decision by the Seventh Circuit reaches a contrary result, holding that "rejection" of a trademark license is not tantamount to its termination, but is rather the equivalent of a breach under nonbankruptcy law. *Sunbeam Prods. v. Chi. Am. Mfg., LLC*, 686 F.3d 372 (7th Cir. 2012). As such, the licensee may elect to disregard the debtor's breach, and continue to use the trademark for the remainder of the license term.

Legislation has been introduced in the U.S. Senate (S. 1720) and House (H.R. 3309) to codify the result of *Sunbeam* by extending Bankruptcy Code Section 365(n) protections to trademark licensees. The legislation also would codify the result of *Jaffe v. Samsung Electronics Co.*, 737 F.3d 14 (4th Cir. 2013), which held that Section 365(n) protects the rights of patent licensees within the United States, even when patent licenses have been terminated in a foreign insolvency proceeding. We will be watching the progress of this legislation closely, but the window for passage in this congressional term is closing.

When the Licensee Goes Bankrupt. The bankruptcy of an intellectual property licensee also presents significant issues. The debtor licensee (or, if appointed, the bankruptcy trustee in its stead) generally must do one of three things with respect to the license: reject it, assign it to a third party, or assume it for the debtor's own use after the bankruptcy. If the license is rejected, then the debtor can no longer use the intellectual property. Any past-due royalties or other amounts owing will be claims in the bankruptcy case, payable—often at cents-on-the-dollar—pursuant to the terms of a plan (in Chapter 11) or by the trustee from the liquidation of the debtor's assets (in Chapter 7). Licenses, however, often have value, either in their own right, or as part of the debtor's overall business. When this is the case, the trustee or debtor may seek to assign the license, or to assume it. To do so, the trustee or debtor must "cure" any defaults under the license by paying the licensor in cash all past amounts owing under the license, and correcting any other outstanding breaches.

Debtors and trustees are limited in their ability to assign or assume intellectual property licenses over the licensor's objection. Although the Bankruptcy Code generally overrides contractual restrictions on the assignment of executory contracts, this is not true with respect to contracts that are considered "personal" in nature. *See* 11 U.S.C. § 365(c). Most courts have held that a debtor-licensee's rights under a *nonexclusive* intellectual property license are personal, and thus cannot be assigned over the objection of the licensor. One federal circuit has suggested that even *exclusive* licenses may be non-assignable, *see Gardner v. Nike, Inc.*, 279 F.3d 774 (9th Cir. 2002), but not all courts agree, *see In re Golden Books Family Entm't, Inc.*, 269 B.R. 300, 311 (Bankr. D. Del. 2001).

Because of rather confusing language in Section 365(c), the same prohibition on assignment (to third parties) of many intellectual property licenses may also prohibit their assumption by the debtor (for itself in its post-bankruptcy capacity), even if the bankruptcy results in no change to the debtor's ownership and management. *See, e.g.*, *Perlman v. Catapult Entm't, Inc. (In re Catapult Entm't, Inc.)*, 165 F.3d 747 (9th Cir. 1999). A minority of courts, however, allow a debtor to assume its intellectual property licenses, even if the licensor does not consent. *See, e.g.*, *In re Adelphia Commc'ns Corp.*, 359 B.R. 65, 72 (Bankr. S.D.N.Y. 2007). Two Justices of the U.S. Supreme Court have suggested that this conflict may be ripe for resolution. *See N.C.P. Mktg. Grp., Inc. v. BG Star Prods., Inc.*, 556 U.S. 1145 (2009).

As can be seen, the treatment of intellectual property licenses depends upon many factors, not the least of which is the jurisdiction in which the debtor's bankruptcy case is pending. Until either Congress or the Supreme Court acts to clarify the law, parties to intellectual property licenses will continue to face great uncertainty in bankruptcy.

Copyright Litigation Update

Courts Take More Expansive View of Copyright Fair Use. Due to increasing globalization and constant advances in technology, there exists today an unprecedented level of access to copyrightable material, which in turn has led to an ever-evolving copyright landscape. Today, for example, a television show broadcast in the United Kingdom might be watched online in the United States minutes later; an artist might sell her prints around the world through a virtual store; and a recorded audio sound bite from a company's stockholder meeting might go viral within milliseconds.

While the Copyright Act provides robust protection to authors to help prevent unauthorized copying of their works, Section 107 of the Copyright Act provides that "fair use" of a copyrighted work, such as copying "for purposes such as criticism, comment, news reporting, teaching … , scholarship, or research, is not an infringement." 17 U.S.C. § 107. In determining whether a use is fair, courts often focus on the first statutory factor: "the purpose and character of the use," *id.* § 107(1)—that is, whether the work is being used in a different manner or for a different purpose from the original, and thus is "transformative." Two recent cases demonstrate how the United States Court of Appeals for the Second Circuit is adopting an increasingly expansive view of the type of uses that are likely to be considered fair.

Last year, in *Cariou v. Prince*, 714 F.3d 694 (2d Cir. 2013), Prince, an "appropriation artist," incorporated photographer Cariou's copyrighted photographs into his own art by tearing the photographs out of a book, pinning them onto pieces of plywood, and altering them in various ways—from merely painting over facial features to largely obscuring the photos themselves. *Id*. at 699-700. In responding to Cariou's allegations of copyright infringement, Prince claimed that his uses of the photographs were protected as transformative fair uses. The Second Circuit largely agreed, ruling that most of Prince's uses were transformative, and thus fair, because he employed "an entirely different aesthetic from Cariou's photographs," and his "composition, presentation, scale, color palette, and media are fundamentally different and new compared to the photographs." *Id*. at 706.

In finding Prince's use transformative, the court clarified two important aspects of fair-use analysis. First, the court held that the "law imposes no requirement that a [secondary] work comment on the original or its author in order to be considered transformative," and that the universe of fair uses is not limited to the examples in the preamble of Section 107. *Id*. Second, the court ruled that whether a use is transformative is based not on the secondary user's subjective intent, but rather on how the work "may 'reasonably be perceived'" by the public—that is, an objective test. *Id*. at 707. Both of these clarifications serve to broaden the potential universe of acceptable fair use. A secondary use need not make any comment on the original, or even be created with a fair-use intent; rather, any alteration to the expressive content or message of a work, whether intended by the secondary author or not, may be transformative.

Earlier this year, the Second Circuit further expanded the universe of potential fair uses when it found a commercial, *non*-transformative use to be fair. In *Swatch Group Management Services Ltd. v. Bloomberg L.P.*, 742 F.3d 17 (2d Cir. 2014), *amended by* --- F.3d ---, 2014 WL 2219162 (2d Cir. May 30, 2014), privately-held media company Bloomberg obtained an unauthorized sound recording of a Swatch Group investor meeting and distributed it to its paying subscribers. Swatch Group alleged that Bloomberg's dissemination of the sound recording infringed its copyright, while Bloomberg claimed that the dissemination was protected as fair use. The court began by noting that Bloomberg's purpose "was to make important financial information about Swatch Group available to investors and analysts," and that "such public dissemination of financial information serves this public purpose in the nature of news reporting," one of the examples enumerated in Section 107 as consistent with fair use. *Id*. at *6. Further, the court found that "regardless of how transformative the use is," the first factor favored fair use for two reasons. *Id.* at *9. First, "copying the exact spoken performance of Swatch Group's executives was reasonably necessary to convey their full meaning," thereby serving "the interest of accuracy, not privacy." *Id.* (internal quotation marks omitted). Second, copying "to communicate factual information … in no way diminished Swatch Group's ability to communicate with analysts, and thus caused no harm to Swatch's copyright interests." *Id.* This ruling further clarifies the important role of fair use in copyright jurisprudence. Even where a secondary use may be commercial and nontransformative, and copies the original in its entirety, it may nonetheless be protected as fair use where an important public purpose is implicated.

Together, these cases suggest that the Second Circuit is moving toward broader acceptance of uses as fair, recognizing that strong copyright protections must give way to legitimate secondary uses that are in the public interest.

Patent and Antitrust Victory Against 3M

Quinn Emanuel recently obtained a significant antitrust and patent victory for TransWeb, LLC against 3M following a jury trial in New Jersey. The unanimous jury found that 3M illegally attempted to monopolize the markets for safety-related respirator products by suing for infringement of patents it knew were procured by fraud on the Patent Office. The jury also found 3M's asserted patents were invalid, not infringed and, in an advisory capacity, unenforceable due to inequitable conduct before the Patent Office. The Court subsequently awarded TransWeb more than $26 million in damages and attorneys' fees and concluded that 3M committed inequitable conduct before the Patent Office, which rendered its patents unenforceable.

TransWeb is a specialty manufacturer of filtration materials used in respirators and other filtration products. In 1996, TransWeb developed a process of plasma-fluorinating its filtration material and then charging it to make the material oil-resistant and meet new government respirator standards. This process helped the filter material stay light and breathable for longer, particularly in oily environments.

At this time, 3M had a different patented process for making oil-resistant filtration material, which used a chemical known as PFOS. However, due to environmental concerns, 3M was forced to abandon this process. In early 1997, 3M learned that TransWeb would be attending a filtration Expo in its hometown of Minneapolis and displaying its new T-Melt oil-resistant filtration material. 3M managers instructed certain employees to visit TransWeb's booth and obtain information and samples. Following the Expo, 3M also met with TransWeb to learn more about its products.

Around the same time, 3M inventors, including individuals who attended the Minneapolis Expo, began to rush the filing of a patent application for a manufacturing process nearly identical to TransWeb's. 3M analyzed samples of TransWeb's materials and respirators incorporating TransWeb's materials and realized they were made using the same process 3M sought to patent. Nevertheless, 3M proceeded with its patent application. Only after the Patent Office issued 3M a notice of allowability for the patent did 3M disclose the existence of TransWeb's materials. However, 3M fraudulently claimed TransWeb's products were confidential before 3M filed its patent application and therefore could not be prior art. 3M failed to disclose that TransWeb's products were publicly available more than a year before 3M filed its patent application. Based on 3M's misrepresentations, the Patent Office allowed 3M's patent to issue.

TransWeb is the only other manufacturer of plasma-fluorinated oil-resistant material in the world and supplies it to 3M's respirator competitors. 3M does not sell its plasma-fluorinated material to others, instead only using it internally. After twice unsuccessfully attempting to acquire TransWeb, 3M filed suit in Minnesota for patent infringement in May 2010, claiming TransWeb was infringing 3M's patented process. TransWeb obtained dismissal of the Minnesota action for lack of personal jurisdiction and filed a declaratory judgment action in its home state of New Jersey, where the case was tried to a jury.

Quinn Emanuel succeeded in obtaining a very rare jury verdict on a *Walker Process* antitrust claim and meeting the high standard for proving inequitable conduct before the Patent Office. As a result of this victory, partners Hal Barza and Michael Williams were recently named Litigators of the Week by the *American Lawyer*.

Quinn Emanuel Obtains Victory in Bet-the-Company Patent Litigation

The firm recently obtained a key victory for an innovator pharmaceutical company, Avanir Pharmaceuticals, Inc., in a "bet-the-company" Hatch-Waxman patent litigation against five generic competitors in the District of Delaware. The judgment holds that Avanir's Nuedexta® is entitled to patent protection until 2026. Nuedexta® is a combination of two drugs, dextromethorphan ("DM") and quinidine ("Q"), and is used for the treatment of pseudobulbar affect, or PBA—a devastating neurological disorder characterized by episodes of involuntary laughing and crying that are unrelated to the patient's mood.

The case began in July 2011, when Par Pharmaceutical, Inc. sent notice that it had filed an application with the Food and Drug Administration to market a generic version of Nuedexta® prior to the expiration of the patents that cover the product. Four other generics (Actavis, Wockhardt, Impax and Watson) quickly followed Par's lead. Avanir's patents claim the use of low-dose DM and Q combinations for the treatment of PBA—with DM as the therapeutic ingredient and Q acting to inhibit the body's metabolism of DM. The generics argued that Avanir's patents were invalid as obvious in view of earlier patents that broadly claimed the use of DM and Q, at much higher doses, for the treatment of PBA.

Quinn Emanuel quickly identified that the generics' obviousness theories were based entirely on hindsight—starting with Avanir's patents and working backwards to piece together the claimed inventions. Throughout discovery, the firm sought to expose the flaws in the generics' misplaced theory, including that persons skilled in the art at the time would not have ignored the prior art's teachings that much higher amounts of DM and Q were required to treat PBA. The firm obtained key admissions from the generics' experts that persons skilled in the art at the time of invention would not have had reason to lower the doses of DM and Q used in the prior art to treat PBA, and that even if they did, they would not have reasonably expected that the claimed lower dose combinations could effectively treat PBA.

After a six-day bench trial in front of Judge Leonard P. Stark, the Court ruled in Avanir's favor, holding the patents nonobvious. Judge Stark adopted many of Quinn Emanuel's nonobviousness arguments wholesale in his opinion, agreeing persons skilled in the art would have had no reason to diverge from the DM and Q dosages disclosed in the prior art for the treatment of PBA. Judge Stark also credited the evidence presented by Quinn Emanuel that persons skilled in the art at the time of invention would not have expected the use of the claimed amounts of DM and Q to be effective in treating PBA where "the dose of Q administered was reduced approximately 80-93%" from the prior-art dose.

Judge Stark's decision was critical to Avanir's future. Nuedexta® provides virtually all of Avanir's revenue, and many analysts predicted that Avanir would have had to shut its doors if it suffered defeat in this litigation. Instead, as a result of Quinn Emanuel's victory, Avanir's market value increased nearly 50% overnight, and Avanir retains patent protection on its flagship product for the next twelve-plus years.

Preliminary Injunction Victory for BlackBerry

The firm recently obtained a preliminary injunction on behalf of BlackBerry Limited to prevent defendant Typo Products LLC from selling iPhone cases that the court found were likely to infringe BlackBerry's utility and design patents. BlackBerry has been a global leader in the mobile communications industry for 30 years, and its innovative, cutting-edge technologies changed the face of telecommunications long before the iPhone was even conceived. Since the late 1990s, BlackBerry has released a series of game-changing handheld mobile devices with physical keyboards that originally enabled users to send and receive email and messages on the go and eventually evolved into some of the world's first smartphones. BlackBerry has put vast research, development and design efforts into its physical keyboards, which serve as iconic source identifiers of BlackBerry's products.

The founders of defendant Typo Products LLC were very familiar with BlackBerry's products because they were long-time BlackBerry users. One of them is TV celebrity Ryan Seacrest who has given interviews on his BlackBerry "addiction" over the years. Indeed, Typo recently began marketing and selling a case for an iPhone that incorporates a physical keyboard copying the distinctive keyboard design for BlackBerry's current flagship model, the Q10, in every material respect. The fact that Ryan Seacrest allegedly put $1 million into the company and was promoting it in interviews from *Late Night with Jimmy Fallon* to *TMZ* meant that Typo's keyboard case had a high profile.

BlackBerry came to Quinn Emanuel to bring a complaint against Typo alleging infringement of BlackBerry's patent and trade dress rights, which was filed on the eve of the Consumer Electronics Show where the Typo keyboard debuted. Quinn Emanuel then put together preliminary injunction papers and expert declarations that left no doubt BlackBerry was likely to succeed at trial. At a hearing before Judge Orrick in the Northern District of California, the firm presented a compelling case for infringement of one utility patent and one design patent. Quinn Emanuel argued that BlackBerry would suffer irreparable harm not only from consumer confusion generally but also from negative reactions to the Typo product that was not made according to BlackBerry's exacting standards.

One week later, the court issued an order granting a preliminary injunction finding likelihood of success on both patents, validity of both patents, and finding that BlackBerry was suffering irreparable harm on each of the grounds Quinn Emanuel asserted. The order repeats and adopts long passages taken from the motion papers and grants the requested injunction precluding Typo from making, using, selling, offering for sale, or promoting its sole product. Q

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