

REQUIRED READING

3.1A - Counsel's Obligation Not to Assert a Trade Secrets Claim that Lacks Actual Merit, Sedona Working Group 12 Ethics and Trade Secrets Drafting Team (Draft Commentary, September 2022)

Counsel's Obligation Not to Assert a Trade Secrets Claim that Lacks Actual Merit

[Proposed] Principle No. 2

Counsel in a trade secrets dispute should not assert a claim that counsel knows or reasonably should know would lack any reasonable factual or legal basis upon a trial or hearing of a fully developed record.

[Proposed] Principle No. 3

Counsel in a trade secrets dispute should not demand in settlement negotiations covenants in restraint of trade that counsel knows or reasonably should know materially exceed in scope the restraints on competition that a court might lawfully have awarded upon a trial or hearing of a fully developed record.

Summary

In any litigation, a basic ethical obligation of the trial lawyer is to act as a gatekeeper to the courts and to assess whether the claims or defenses of the client have a good faith legal and factual basis. An equally fundamental obligation of all counsel is not to assist the client in committing a crime or intentional tort. [Proposed] Principles 2 and 3 address these obligations for trial counsel representing a plaintiff in a trade secrets dispute. Because of the procedural posture in which trade secrets claims are often litigated and because of the legal and commercial issues that frame settlement negotiations in trade secrets disputes, compliance with these basic ethical precepts can be particularly fraught for the trade secrets plaintiff's counsel. This section describes the ethical risk factors inherent in trade secrets litigation, illustrates these risks with discussion of selected judicial decisions under the fee shifting provisions of the Uniform Trade Secrets Act and the Defend Trade Secrets Act, and suggests steps counsel may take to mitigate these risks.

[NOTE TO DRAFT: The rules of professional conduct that are relevant here should be well familiar to most readers and are the same rules addressed in multiple sections of the draft. We should avoid a repetitive discussion of the same rules in multiple sections.]

Discussion

The law of trade secrets at its core is about distinguishing when and when not to restrain competition in order to advance the strong public interest in innovation and developing commercially useful knowledge and technology.

The potential for bad faith trade secrets claims to be asserted for the purpose of impeding fair competition is well recognized. Expedited proceedings with limited time to probe the merits, compressed discovery and briefing schedules, and in some instances *ex parte* motions, all contribute to an erosion of many of the checks on bad faith litigation tactics. Trade secrets litigation provides a bad faith litigant broad opportunities to impose significant burden, disruption, and expense on an adversary and to threaten sweeping and potentially crippling temporary injunctive relief.

The substantial procedural leverage that a trade secrets plaintiff may exert against a defendant competitor invites bad faith settlement negotiation tactics. Settlements of trade secrets disputes routinely include as terms of the parties' settlement restrictive covenants in restraint of trade that are being entered into by litigation adversaries who are also competitors. A defendant competitor, faced with the burden of continued defense against a meritless claim, may accede to a plaintiff's demands for a settlement that imposes restraints on competition substantially broader than what the plaintiff might have been awarded by the court, even if the plaintiff has prevailed in full on all claims. An attorney who presses grossly excessive settlement demands with the leverage of bad faith trade secrets claims may be facilitating unlawful restraints on competition that, in some cases, could rise to the level of intentional torts or criminal offenses.

As is so often true in our profession, defining the boundary between zealous advocacy and ethical breach can be challenging. It is a highly fact specific inquiry that will vary from case to case and that must be guided by the judgment of counsel at the moment and without the benefit of hindsight.

In most cases, the attorney engaged in bad faith litigation or settlement tactics is not the caricature of the duplicitous melodrama villain who delights in wrongdoing. Instead, counsel may begin with good intentions but become swept up by a client's excessive zeal or misled by the client's own lack of candor. Serious ethical breaches often begin with minor lapses of judgment that snowball into major issues as counsel attempts to "fix" relatively minor problems with more material misconduct. An attorney who practices without regard for the ethical standards of our profession probably is not reading this paper anyway and is not our intended audience. Our starting point is the assumption that most attorneys are acting with good intentions, and our goal is to assist those well-intentioned attorneys from inadvertently falling into ethical lapses.

Why Trade Secrets Disputes Invite Bad Faith Claims and Settlement Demands

The starting point for both of the proposed principles is that trade secrets counsel has an ethical obligation to advocate for litigation outcomes that align with the actual merits of the dispute as known to the attorney. An attorney who exploits the opportunity to proceed to a preliminary injunction hearing without discovery and with shortened notice to defendant in order to advance a meritless case violates the standards of our profession, at least where the attorney knows or should know that on a full hearing on the merits the claim could not succeed. The same is true for an attorney who seeks to increase the burden or expense of expedited proceedings solely to coerce an adversary's consent to competitive restraints that exceed any plausible request for relief the party might win in court.

Although bad faith bullying tactics and extortionate settlement demands are hardly unique to trade secrets litigation, there are at least seven issues that amplify this issue for attorneys representing trade secrets claimants.

First, counsel for a trade secrets plaintiff may have very limited time to investigate and develop a factually complex claim. Trade secrets counsel often must rely heavily upon the client to develop the factual basis for the claim. Trade secrets may involve nuanced scientific or

technical matters far beyond the attorney's competence. Even when the trade secret is something as straightforward as a customer list or marketing plan, assessing the merits of a trade secrets claim may require a thorough understanding of the plaintiff's business and competitive position in the relevant market. Particularly in the context of a motion for temporary injunctive relief, there may be very limited time for counsel to explore beyond whatever information the client chooses to provide.

Second, the client may have strong motivations to be less than candid and forthright with their own counsel, either intentionally or unintentionally. From the client's perspective, trade secrets litigation only rarely is a straightforward commercial dispute. Most cases involve emotional and reputational issues and broader strategic objectives for staking out or protecting market share or re-positioning the broader relationship between competitors. A client may lack the objectivity to be a reliable source of information for counsel, even if the client is well-intentioned.

Third, for the same reasons, a client's business leadership may be less receptive to the professional advice and counsel of the attorney and may be more likely to exert pressure on the attorney to achieve through litigation objectives that bear little relationship to the actual merits of the suit.

Fourth, the front-loaded burden, disruption, and expense of the expedited proceedings associated with motions for temporary restraining orders and preliminary injunctions can create substantial settlement leverage for a plaintiff unrelated to the merits of the claim. The compressed proceedings offer defendants few procedural safeguards against abusive litigation tactics and often afford the plaintiff a significant tactical advantage.

Fifth, trade secrets disputes are often resolved by confidential settlement agreements between competitors that include prospective restraints on competition. Because trade secrets disputes are typically very fact intensive and are often settled at an early stage of litigation before development of a full factual record, it may be exceedingly difficult for a third party reviewing a settlement agreement in hindsight to distinguish between a settlement that fairly reflects the merits of the case and a settlement that is the product of bad faith. And because most settlement agreements will be subject to confidentiality, few settlement agreements will ever be subject to any third party review at all. Secret agreements in restraint of trade between competitors invite abuse.

Sixth, because most trade secrets disputes are resolved by settlement without a fully developed discovery and trial record, the risks of sanctions or liability for counsel and clients asserting a bad faith claim are often lower than in other litigation. If a case is likely to be resolved after only 60 or 90 days of litigation, counsel and clients may be emboldened by the likelihood that misconduct will never come to light. In litigation that ends quickly, an adversary who is a victim of bad faith tactics may have neither the incentive nor the opportunity to pursue a remedy for bad faith conduct, and the court likely will have no reason even to suspect that there has been a breach. It is thus not surprising that sanctions are awarded in trade secrets cases most often in multi-year disputes with protracted litigation, extensive discovery and the deep involvement of the court.

Seventh, the ethical issues for counsel are compounded because restraints on competition imposed by settlement agreements may implicate strong countervailing public interests and may have a substantial impact on the rights of third parties who have no notice, no knowledge, and no ability to challenge the agreed restraints. For example, a defendant employer in a trade secrets dispute brought by a competitor may agree not to solicit or to hire the plaintiff's employees for a period of time. As between the plaintiff and defendant, the no-poach agreement may be an attractive settlement deal term because a substantial part of the burden can be externalized to the employees whose economic opportunity is impeded. Those employees may never even know of the agreement but may suffer direct economic harm.

Practical Steps for Counsel to Mitigate the Ethical Risks

These ethical pitfalls for counsel can be mitigated by being mindful of the risks and taking steps where appropriate to address them. To be clear, there is no single checklist of best practices for plaintiff's counsel in a trade secrets dispute. Counsel must exercise good judgment in light of the specific circumstances of each case.

First, when a trade secrets plaintiff is a new client, counsel may conduct due diligence on the client as time allows. A search of prior litigation, inquiry about the other firms that regularly represent the client, and internet profiles of the professional and personal backgrounds of the client's principals and likely key witnesses may alert counsel to red flags.

Second, counsel may attempt to find within the client's organization subject matter experts who do not have a direct professional and personal stake in the outcome of the litigation. Where possible, counsel should consider interviewing multiple different persons on the same topics, and if time allows, retaining a consulting expert to assist in initial case assessment.

Third, counsel should discuss with the client at the outset of the engagement that the litigation may proceed to full discovery and a trial on the merits with the possibility of fee shifting. Where appropriate, counsel should use the risk of fee shifting to remind the client of the importance of a careful factual investigation.

Fourth, counsel should balance the client's need for expedited relief as a trade secrets plaintiff with the time necessary for reasonable factual investigation and legal analysis. Counsel's obligation as a gatekeeper for litigation requires reasonable time to assess the case even in expedited proceedings.

Fifth, counsel should not participate in or encourage hostile or intemperate language in client discussions regarding the litigation. The client's emotions already may be running high; calm, dispassionate communicates can diffuse the tensions and hostility that foster ethical abuses.

Sixth, when discussing litigation and settlement objectives with the client, counsel should expressly frame the objectives with reference to the legal and factual merits of the dispute and the relief that might be granted by the court. It is of course relevant and entirely appropriate to

consider with the client the burden and expense of litigation as a relevant factor in settlement discussions and to explore business resolutions to the parties' dispute, but counsel should be mindful that there is a slippery slope leading from these good faith discussions to pursuing a bad faith strategy of extortionate settlement demands divorced from the merits of the case.

Seventh, counsel should consider using methods of alternative dispute resolution to police settlement negotiations where there is a risk that the parties' discussions may devolve into demands for restraints on competition that bear no real relationship to the merits of the claims. Proceeding with settlement discussions before a judicial officer or skilled private mediator may temper these excesses.

Case Studies

[Subject to input from the Working Group, consider including two or three illustrative judicial decisions addressing requests for fee shifting against a plaintiff.]