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Disloyalty and the UTSA

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A venerable principle of the common law of employment is that all employees owe a duty of honesty and loyalty to their employers. So strong is this duty that employees who are placed in a position of trust and, on that account, receive confidential information from their employer, may not use that information in competition with the employer or to the employer's detriment — even after the employment relationship has ended. See, e.g., *North Atlantic Instruments v. Haber*, 188 F.3d 38, 47 (2d Cir. 1999). This duty of loyalty can be breached even if the information used does not "rise to the level of a trade secret." See, e.g., *Lamonte Burns v. Walters*, 770 A.2d 1158, 1166 (N.J. 2001).

Then comes along the Uniform Trade Secrets Act (UTSA), which has now been adopted, in some form or other, by 45 states. The UTSA has a broad pre-emption clause that, generally speaking, displaces prior common law relating to the misappropriation of trade secrets. Indeed, replacing the common law of the several states, with their individual variations, by a single multistate statute is precisely what a "uniform" law is supposed to do.

Cases with disloyalty, UTSA claims lack uniformity

What happens, however, when the UTSA intersects the prior common law of employment, as in the case of a former employee who is sued in a state that has adopted the UTSA for the disloyalty of using confidential information in competition with his former employer? The law should be that neither law displaces the other: The disloyalty claim survives even if the confidential information is not a trade secret and, if it is, a claim for the trade secret misappropriation may be asserted as well. Yet the cases applying the UTSA to claims of employee disloyalty involving an unauthorized use of confidential information often do not adopt that approach and are surprisingly less than uniform in this regard.

Some courts hold that confidential information not rising to the level of a trade secret is not regulated by the UTSA and, therefore, that there is no displacement of disloyalty claims based on the wrongful taking of such information. See, e.g., *Burbank Grease Services v. Sokolowki*, 717 N.W.2d 781, 792-93 (Wis. 2006). On this view, if the information at issue "does not meet the statutory definition of a 'trade secret,' " the UTSA is simply not implicated. The contrary and, perhaps, majority rule is "abolitionism": The UTSA "abolishe[s] common law remedies" contrary to its terms. See *Composite Marine Propellers Inc. v. Van Der Woulde*, 962 F.2d 1263, 1265 (7th Cir. 1992).

Because, under this view, the UTSA was intended to replace all tort claims for the unauthorized use of confidential information with a single statutory remedy, if information is not a trade secret as defined by the UTSA (and not otherwise protected by copyright, patent law or the like), it is "freely usable" by all. See *Confold Pacific Inc. v. Polaris Industries Inc.*, 433 F.3d 952, 959 (7th Cir. 2006). Read broadly, that would apply even to the faithless employee who absconded with it on his way out the door.

Consistent with this latter approach, some courts have held that employee disloyalty claims arising from the wrongful taking and use of the employer's confidential information are displaced by the UTSA, irrespective of whether the information meets the statute's definition of a "trade secret." See, e.g., *Thomas & Betts Corp. v. Panduit Corp.*, 108 F. Supp. 2d 968, 972-973 (N.D. Ill. 2000). Other courts, however, hold that disloyalty claims are not pre-empted by the UTSA — sometimes precisely because, at common law, disloyal use of confidential information is actionable whether or not the purloined information is protectable as a trade secret. See, e.g., *Coulter Corp. v. Leinert*, 869 F. Supp. 732, 735 (E.D. Mo. 1994).

The UTSA reporters themselves recognized that the uniform statute does "not apply to a duty imposed by law that is not dependent upon the existence of competitively significant information, like an agent's duty of loyalty to his or her principal." UTSA § 7, comment (1990). This could mean two things: either that the disloyalty claim survives, but *only if* it involves the unauthorized use of "competitively significant information," or that it remains viable *even*

if the disloyalty should take that form.

Under the former view, employee disloyalty claims survive for some things (like double-dealing or employee piracy) but not for the post-employment competitive use of the former employer's confidential information. The comment, however, would have been superfluous if the "duty of loyalty" under discussion did not involve misuse of confidential information, and this suggests that the UTSA reporters did not view "displacement" as extending quite that far.

It is generally accepted that if a claim "is not dependent" on (or requires facts other than) the unauthorized use of commercially valuable secret information, it is not displaced by the UTSA. See, e.g., *Bliss Clearing Niagara Inc. v. Midwest Brake Bond*, 270 F. Supp. 2d 943, 949-50 (W.D. Mich. 2003). But, as noted, some courts do not regard an employee disloyalty claim related to the misuse of confidential information as sufficiently distinct from trade secret misappropriation to avoid UTSA displacement; other cases suggest the opposite.

It is critical to recognize that an employee's duty of loyalty and the UTSA serve two distinct purposes. The UTSA is intended to protect against the "improper acquisition of a trade secret, whether or not the secret is used in direct competition with the rightful owner." *Smithfield Ham and Products Co. Inc. v. Portion Pac Inc.*, 905 F. Supp. 346, 350 (E.D. Va. 1995). Under the UTSA, trade secrets are assets whose value is diminished by disclosure, regardless of whether the person acquiring the asset uses it competitively.

Disloyalty claims involve 'biting hand that fed you'

In contrast, the duty of loyalty, which derives from the common law of agency, is breached whenever "the employee takes action inimical to the best interests of the employer." *Huong Que Inc. v. Luu*, 58 Cal. Rptr. 3d 527, 540 (Calif. 6th Ct. App. 2007). It is a breach of the confidence reposed in the employee that disloyalty claims seek to redress — whether by double-dealing while employed, inducing co-workers to leave, or taking the employer's business information for use by oneself or the benefit of another. What is critical for a disloyalty claim is not so much the taking of information, as it is using that information in competition with one's former employer. See Restatement (Second) of Agency §§ 395, 396. This "biting the hand that once fed you" aspect — that is to say, the perfidy — is at the heart of disloyalty claims; while a trade secret law is intended more to protect a kind of property from those who would use it without the "owner's" authorization.

There are commentators who argue, with some plausibility, that UTSA displacement of employee disloyalty claims is not significant as a practical matter because the definition of "trade secret" has now expanded to include business information (such as lists of customers and their preferences), which was not always so under the common law. It is also true that the UTSA definition of "misappropriation" includes the acquisition of information in violation of a breach of confidence by oneself or others. See UTSA § 1(2).

This means that the faithless employee's new employer can be held liable under both bodies of law, either as a misappropriation of trade secrets or as inducing a breach of the former employee's continuing fiduciary duties to the predecessor employer. Still, trying to get an injunction against the faithless employee who unquestionably stole confidential information is compounded by also having to show that the information was a trade secret, which includes showing that it is not generally available, and by having to make that showing even when the faithless employee actually acquired the information from the former employer and not from the public domain.

Disloyalty claims should be permitted in states that have adopted the UTSA not merely when the purloined information does not meet the statutory definition of a trade secret, but always. Regrettably, however, case law under the UTSA on this point is neither simple, clear nor settled.

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