

Where Trade Secret Preemption Meets Insurance Coverage

By Jay Bogan and Allen Garrett (March 27, 2019)

Virtually every state has adopted the Uniform Trade Secrets Act in one form or another.[1]

As enacted, the UTSA typically preempts “other laws of this State providing civil remedies for misappropriation of trade secrets.”[2] This preemption provision has generated a surprising split in decisions where a party asserts claims based on confidential information that does not rise to the level of protected trade secrets. And a preemption ruling can impact an insured’s efforts to secure insurance coverage for an action involving claims alleging misappropriation of confidential information that does not constitute a trade secret.

This article analyzes the continuing judicial divide over the application of UTSA preemption to non-trade secret information, including comparing two recent district court decisions that reached opposite conclusions. It also discusses the related question of the applicability of a “trade secret” exclusion to an insured’s demand for coverage of claims based on non-trade secret confidential information. These doctrines intersect, as a preemption ruling in an underlying case can impact an insured’s request for coverage under a policy containing a trade secret exclusion.

The UTSA Preemption Split

Courts continue to disagree as to the UTSA’s preemption of claims based on non-trade secret confidential information.

In *Brand Services LLC v. Irex Corp.*, [3] the U.S. Court of Appeals for the Fifth Circuit construed the preemption provision of the Louisiana Uniform Trade Secrets Act.

Brand Services, an industrial scaffolding company, alleged that a former employee misappropriated trade secrets and confidential business information when he went to work for a competing firm (Irex). The former employee allegedly transferred from his work computer digital files containing data about software that Brand Services used to bill customers and monitor employee productivity. The former employee then (according to Brand Services) used this information to help Irex create similar software. Brand Services instituted litigation against Irex, asserting claims under the LUTSA and for conversion of confidential business information.

The district court granted summary judgment in favor of Irex on the civilian law conversation claim. But the Fifth Circuit reversed the summary judgment grant in substantial part, “conclud[ing] that LUTSA preempts a civilian law claim for conversion of trade secrets, but does not preempt a civilian law conversion claim for confidential information that is not a trade secret.”[4]

The Fifth Circuit made an “Erie guess” on the issue, given that the Louisiana Supreme Court had never resolved the issue. Relying on Louisiana intermediate appellate decisions that “have twice held that LUTSA does not preempt where non-trade secret information was at issue,” the Fifth Circuit ruled that LUTSA preemption only extended to claims based on information that qualified as protected trade secrets.[5]

In reaching this decision, the Fifth Circuit noted that “courts interpreting their respective states’ versions of the Uniform Trade Secret Act (‘UTSA’) have not uniformly applied UTSA’s preemption provision; instead, courts have come to varying conclusions about the preemption provision’s intended scope.”[6]

The U.S. District Court for the District of Nevada recently came to a similar conclusion when construing



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Nevada's version of the UTSA in *Newmark Group Inc. v. Avison Young (Canada) Inc.*[7]

In *Newmark Group*, the plaintiffs brought a “noncontractual claim for misappropriation of confidential information that does not qualify as a trade secret.”[8] Noting that “[c]ourts in other jurisdictions are divided” on the question of whether the UTSA preempts claims regarding non-trade secret confidential information, the district court compared the Arizona Supreme Court’s decision in *Orca Communications Unlimited LLC v. Noder*[9] — which held such claims were not preempted — with the Hawaii Supreme Court’s opposite conclusion in *BlueEarth Biofuels LLC v. Hawaiian Electric Co.*[10]

The *Newmark Group* court then discussed *Irex* decision, quoting the Fifth Circuit’s similar observations about the split in authority on preemption of mere “confidential information” claims.[11] Finding no clear direction in the one decision of the Nevada Supreme Court addressing the issue, the district court allowed the plaintiff to “allege noncontractual claims for misappropriation of confidential information that does not constitute a trade secret.”[12]

The U.S. District Court for the Northern District of Illinois came to a different conclusion in a preliminary injunction ruling earlier this month in *Abrasic 90 Inc. v. Weldcote Metals Inc.*[13]

In *Abrasic*, a former employer claimed its former employee and his new employer had misappropriated trade secrets and other confidential business information. Finding the former employer had not shown a likelihood of success on the merits as to state law claims based on non-trade secret confidential information, the district court ruled those claims would be preempted under either Delaware’s or Illinois’ version of the UTSA.[14]

The UTSA includes a provision that it “shall be applied and construed to effectuate its general purpose to make uniform the law with respect to [trade secrets] among States enacting it.”[15] Courts, however, continue to reach divergent conclusions as to the preemptive effect of various states’ UTSA provisions as applied to claims based on confidential information that does not rise to the level of a trade secret. These forum-specific differences not only impact tort liability, but also the likelihood of securing insurance coverage when faced with claims for misappropriation of non-trade secret confidential information.

Trade Secret Exclusions

Many insurance policies exclude coverage for injuries “arising out of ... trade secret or other intellectual property rights.” Despite this seemingly broad language, such an exclusion may not bar coverage in a case in which trade secret and other claims are asserted. In *Crum & Foster Specialty Insurance Co. v. Willowood USA LLC*, [16] for example, a 2-1 panel of the U.S. Court of Appeals for the Ninth Circuit held that a claim alleging the theft of an advertising idea potentially triggered coverage under a comprehensive general liability policy, despite an exclusion of coverage for claims of “trade secret or other intellectual property rights.”

In *MedAssets Inc. v. Federal Insurance Co.*, [17] the policyholder sought coverage for an underlying action involving four claims by a medical device manufacturer against a competitor: “Count I-tortious interference in inducing the breach of a confidentiality agreement; Count II—tortious interference in inducing the breach of a contract; Count III-tortious interference with prospective contractual relations; and Count IV-misappropriation of trade secrets.”

The insurance carrier denied coverage, invoking an exclusion for claims “based upon, arising from, or in any consequence of any actual or alleged ... misappropriation of ideas or trade secrets.”[18] The district court held this exclusion insufficient to deny coverage, because the underlying action sought recovery for the mere theft of “confidential information” in addition to asserting claims for misappropriation of “trade secrets.”[19] “The first three counts of the [underlying] complaint do not rely on pricing information being a trade secret. Those counts rely upon the allegation that the pricing information is confidential. Only Count IV relies upon a trade secret allegation.”[20]

In *WoodSpring Hotels LLC v. National Union Fire Insurance Co. of Pittsburgh, Pa.*, [21] a directors and

officers liability policy excluded coverage “for any actual or alleged plagiarism, misappropriation, infringement or violation of copyright, patent, trademark, trade secret or any other intellectual property rights.” The insurer invoked this exclusion to deny coverage where the underlying litigation asserted multiple claims, including claims for trade secret misappropriation, arising out of the insured’s alleged theft of competitively-valuable information from its competitor.[22]

Acknowledging that “the gravamen of the [underlying] litigation is misappropriation of [the competitor’s] trade secrets,” the WoodSpring court nevertheless found coverage because not all of the claims depended on the stolen information qualifying for trade secret protection.[23] In particular, a claim alleging violations of the Consumer Fraud and Abuse Act “depends on unlawful access to [the competitor’s] computers and obtaining anything of value — i.e., [the insured’s employee] may have violated the CFAA by using a computer to take anything of value — not just trade secrets.”[24] Noting the CFAA count “does not even specifically use the term trade secrets or Trade Secrets,” the WoodSpring court granted summary judgment in favor of the policyholder on the issue of the carrier’s duty to defend.

In reaching its conclusion, the WoodSpring court compared two cases. In *Lemko Corp. v. Federal Insurance Co.*, [25] cited by the insurer, the district court rejected the argument that claims “for usurpation of corporate opportunity, tortious interference, and civil conspiracy” fell outside of a D&O exclusion for “trade secret” claims, because “each of those counts in the [underlying] complaint sets forth a theory of liability ‘based upon’ or ‘arising from’ the core factual allegations of misappropriation of proprietary trade secrets and confidential information.” The Lemko court also rejected a distinction between trade secrets and confidential information, because the underlying complaint defined the confidential information as trade secrets and because the exclusion reached not only misappropriation of trade secrets, but also “misappropriation of ideas.”[26]

In contrast to Lemko, the district court in *Hartford Fire Insurance Co. v. Vita Craft Corp.*, [27] cited by the insured, found coverage despite an exclusion for claims “‘arising out of’ any violation of intellectual property rights such as copyright, patent, trademark, trade name, trade secret, service mark or other designation of origin or authenticity.” The insured in Vita Craft pointed out that one claim in the underlying complaint, for common law unfair competition, alleged “that [the insured] spread false rumors about a [competitor], and that these allegations are not tied to intellectual property rights.”[28] The court agreed and found that the exclusion did not apply.

Thus, as with UTSA preemption of claims for misappropriation of non-trade secret confidential information, courts have reached different conclusions as to the applicability of “trade secret” exclusions where the underlying claims do not rest entirely on trade secrets. These two lines of cases can intersect, moreover, when courts in the underlying cases involving mere “confidential information” claims address UTSA preemption issues.

A finding that the UTSA preempts the underlying claims should provide heavy ammunition to an insurer invoking a “trade secret” exclusion in the pertinent insurance policies. In cases where a defendant seeks insurance coverage in the face of such an exclusion, filing a preemption-based motion to dismiss may have unfortunate insurance coverage consequences.

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[1] See <https://www.uniformlaws.org/committees/community-home?CommunityKey=3a2538fb-e030-4e2d-a9e2-90373dc05792> (listing of jurisdictions that have adopted the UTSA and noting pending legislation in New York to adopt the UTSA).

[2] See, e.g., *Abrasic 90 Inc. v. Weldcote Metals, Inc.*, No. 18 C 05376, 2019 WL 1044322, at *12 n.7 (N.D. Ill. Mar. 4, 2019) (quoting identical preemption language from Delaware and Illinois versions of UTSA).

[3] *Brand Services, L.L.C. v. Irex Corp.*, 909 F.3d 151 (5th Cir. 2018).

[4] *Id.* at 157.

[5] *Id.* at 159.

[6] *Id.* at 158 & n.4 (collecting cases from numerous jurisdictions evaluating the preemption issue).

[7] *Newmark Group, Inc. v. Avison Young (Canada) Inc.*, No. 2:15-cv-00531-RFB-GWF, 2019 WL 575476, at *7-*10 (D. Nev. Jan. 7, 2019).

[8] 2019 WL 575476, at *7.

[9] *Orca Communications Unlimited, LLC v. Noder*, 337 P.3d 545 (Ariz. 2014).

[10] *BlueEarth Biofuels, LLC v. Hawaiian Electric Co.*, 235 P.3d 310 (Hawaii 2010).

[11] *Id.* at *9.

[12] *Id.* at *10.

[13] 2019 WL 1044322, at *12-*13.

[14] *Id.* (citing *Spitz v. Proven Winners N. Am., LLC*, 759 F.3d 724, 733 (7th Cir. 2014), which applied Illinois law to find preemption of claims for misappropriation of non-trade secret confidential information, and several Delaware state court decisions reaching a similar conclusion under Delaware's version of the UTSA).

[15] *Irex*, 909 F.3d at 159 (citing La. Stat. Ann. § 51:1438).

[16] *Crum & Foster Specialty Insurance Co. v. Willowood USA, LLC*, 696 Fed. Appx. 276 (9th Cir. 2017).

[17] *MedAssets, Inc. v. Federal Ins. Co.*, 705 F. Supp. 2d 1368, 1370 (N.D. Ga. 2010).

[18] *Id.* at 1374.

[19] *Id.* at 1375-76.

[20] *Id.* at 1376.

[21] *WoodSpring Hotels LLC v. National Union Fire Insurance Co. of Pittsburgh, PA, C.A. No.: N17C-09-274 EMD CCLD*, 2018 WL 2085197, at *3 (Del. Super. Ct. May 2, 2018).

[22] 2018 WL 2085197, at *4.

[23] *Id.* at *12-*13.

[24] *Id.* at *13.

[25] *Lemko Corp. v. Federal Insurance Co.*, 70 F. Supp. 2d 905, 919 (N.D. Ill. 2014).

[26] *Id.* at 920.

[27] *Hartford Fire Insurance Co. v. Vita Craft Corp.*, 911 F. Supp. 2d 1164, 1180 (D. Kan. 2012).

[28] *Id.*