



California's Supreme Court Limits the Scope of a Trade Secrets Release and the Enforceability of a Covenant Not to Compete

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The California Supreme Court recently issued two opinions that concern important issues in the area of trade secret law: (1) the enforceability of broad release language that covers "known and unknown" claims; and (2) the ability of a court to enjoin sister state proceedings that seek to enforce a covenant not to compete that is unlawful in the issuing court's jurisdiction. Both decisions are narrow to the extent that they resolve only the limited issue presented, but at the same time leave open a number of issues that all business tort practitioners should be mindful.

In *Cadence Design Systems, Inc. v. Avant! Corporation*, 29 Cal. 4th 215; 57 P. 3rd 6470 (California Supreme Court, November 21, 2002), pursuant to a request for certification from the United States Court of Appeals for the Ninth Circuit, the California Supreme Court determined, that under the California Uniform Trade Secrets Act (UTSA), "a plaintiff's claim for misappropriation of a trade secret against a defendant arises only once, when the trade secret is initially misappropriated, and each subsequent use or disclosure of the secret augments the initial claim rather than arises as a separate claim." *Id.* at 25. The request for certification arose out of trade secret litigation initiated by Cadence against Avant! in 1995 in the United States District Court for the Northern District of California.

In June 1994, Cadence and Avant! entered into a confidential settlement agreement to resolve a dispute arising out of the alleged misappropriation of trade secrets by a Cadence vice president who had resigned and gone to work for Avant!.² The settlement agreement contained a broadly phrased mutual general release, which provided for "the release and discharge of any and all claims, [etc.], which the parties may have against each other at the time of the execution of this Agreement, known or unknown. ..." The Settlement Agreement also contained a waiver pursuant to California Civil Code Section 1542 which states:

These releases extend to claims which the parties do not know or suspect to exist in their favor, which if known by them would have materially affected their decision to enter into this release.

In the summer of 1995, a Cadence engineer discovered a "bug" in Avant!'s ArcCell software program that was similar to a bug he had inadvertently created several years earlier when writing source code for Cadence's DFII produce. In December of 1995, the local law-enforcement authorities executed a search of

Avant!'s headquarters. Among the items seized was a log that showed line-by-line copying of Cadence's source code in 1991 by a former Cadence employee and Avant! founder. Shortly thereafter, Cadence sued Avant! for theft of its trade secret source code and sought a preliminary order enjoining the sale of Avant!'s ArcCell and Aquarius products.

In anticipation of trial, both parties filed cross-motions for partial summary judgment concerning the effect of the settlement agreement and release. The District Court ruled that all of Cadence's trade secret claims for post-release misuse of its DFII trade secrets that were taken before the release were barred by the release. Upon its review, the Ninth Circuit certified the following question to the California Supreme Court:

Under the California Uniform Trade Secrets Act (UTSA) [citation omitted], when does a claim for trade secret infringement arise: only once, when the initial misappropriation occurs, or with each subsequent misuse of the trade secret?

Avant! argued that a cause of action for misappropriation of a trade secret by a particular plaintiff against a particular defendant arises only once, when the trade secret is initially misappropriated. Cadence asserted that under the UTSA, trade secrets are viewed as property, rather than only the protection of a confidential relationship. It thus argued that because trade secret misappropriation is the wrongful taking or use of protected property, each new use represents a new claim of misappropriation. After reviewing the common law as it existed prior to California's enactment of the UTSA in 1984, and relying principally upon the commissioner's comment on the construction of what is now California Civil Code Section 3426.6³, the Court ruled as follows:

From our examination of the above statutes, a distinction between a "misappropriation" and a "claim" emerges. A misappropriation within the meaning of the UTSA occurs not only at the time of the initial acquisition of the trade secret by wrongful means, but also with each misuse or wrongful disclosure of the secret. But a claim for misappropriation of a trade secret arises for a given plaintiff against a given defendant only once, at the time of the initial misappropriation, subject to the discovery rule provided in section 3426.6. Each new misuse or wrongful disclosure is viewed as augmenting a single claim of continuing misappropriation rather than as given rise to a separate claim.

Cadence Design Systems, Inc. v. Avant! Corporation, supra, at 16–18. In doing so, the Court also rejected Cadence’s argument that the term “claim” has different meanings in the context of litigation as opposed to the context of a general release.

Significantly, the Supreme Court specified that its ruling was “narrow” to the extent that it was limited to claims arising between a single plaintiff and a single defendant. In this regard, the Court noted that certain facts could give rise to a situation where a single plaintiff could have claims against different defendants that arise over time and involve different acts of misuse. The Court further provided guidance by suggesting that parties were free to frame the language of their release to reach into the future:

Parties to a release in a trade secret dispute remain free to fashion their release as broadly or narrowly as they chose. Moreover, under our interpretation of the UTSA, a trade secret infringer is by no means rewarded by its infringement with a license to use the infringed technology. Rather, a successful trade secret plaintiff is entitled to the full panoply of remedies, including injunctive relief against future misappropriation.

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The Court’s decision in *Cadence* thus teaches that a business tort practitioner must be careful to make sure that any settlement of a misappropriation claim between a single plaintiff and defendant includes language broad enough to prohibit future uses of the trade secret by the subject defendant. As the Court suggested, “a successful trade secret plaintiff is entitled to the full panoply of remedies, including injunctive relief against future misappropriation.”

In *Advanced Bionics Corporation, et al. v. Medtronic, Inc.*, ___ Cal. 3d __; 2002 Cal. LEXIS 8599, (December 19, 2002), a matter of first impression, the California Supreme Court, reversed the Court of Appeal’s affirmance of a temporary restraining order (TRO) that prohibited a Minnesota company from prosecuting its claim for equitable relief in a Minnesota state court. The Court’s ruling was based exclusively upon the principles of judicial restraint and comity:

We conclude ... that the Court of Appeal erred in upholding the TRO issued against the parties in the Minnesota proceedings. California courts have the same power as other courts to issue orders that assist in protecting their jurisdiction. However, enjoining proceedings in another state requires an exceptional

circumstance that outweighs the threat to judicial restraint and comity principles. As explained, the circumstances of this case do not provide sufficient justification to warrant our courts issuing injunctive orders against parties pursuing the Minnesota litigation.

We hold that the trial court improperly issued the TRO enjoining Medtronic from proceeding in the Minnesota action. We also conclude, however, that the Minnesota action does not divest California of jurisdiction, and Advanced Bionics remains free to litigate the California action unless and until Medtronic demonstrates to the Los Angeles County Superior Court that any Minnesota judgment is binding on the parties. As stated above, potentially conflicting judgments naturally result from parallel proceedings but do not provide a reason for issuing a TRO. ___ Cal. 3d at 22.

Medtronic Inc., a Minnesota corporation, manufactures implantable neurostimulation devices used to treat chronic pain. In 1995, Medtronic hired Mark Stultz in Minnesota as a senior products specialist responsible for spinal cord stimulator lead wires. Stultz was soon promoted to senior product manager in the “Neurostimulation—Pain Division,” where he was responsible for managing Medtronic’s neurostimulation products. In this capacity, Stultz had signed a “Medtronic Employee Agreement,” which contained the following covenant not to compete, providing that for two years after employment termination, Stultz would not:

directly or indirectly render services, including services in research, to any person or entity in connection with the design, development, manufacture, marketing or sale of a Competitive Product that is sold or intended for use or sale in any geographic area in which Medtronic actively markets a Medtronic product or intends to actively market a Medtronic product of the same general type of function.

The Employment Agreement defined a “Competitive Product” as:

of the same general type, perform similar functions, or is used for the same purposes as a Medtronic product on which the employee worked during the last two years of employment or about which he/she received or had knowledge of Confidential Information.

The Employee Agreement also included a choice of law provision that provided that the contract would be governed by the laws of the state in which the employee was last employed by Medtronic.

On June 7, 2000, Stultz resigned from Medtronic and went to California to work for Advanced Corporation (“Advanced Bionics”), a Delaware corporation. Advanced was a competitor of Medtronic that developed and manufactured implantable medical devices used to restore hearing in the profoundly deaf. It hired Stultz as a director of business development to market its spinal

cord stimulation device. On that same day, Stultz and Advanced Bionics sued Medtronic in the Los Angeles County Superior Court ("Superior Court") for declaratory relief, alleging that Medtronic's covenant not to compete and choice of law provision violated California's law and public policy and were void under California Business and Professions Code Section 16600.⁴ The next day, Stultz and Advanced Bionics notified Medtronic that they intended to apply for a temporary restraining order. The order sought to enjoin Medtronic from taking "any action, other than in this court, to enforce its non-competition agreement with Mr. Stultz or to otherwise restrain Mr. Stultz from working for Advanced Bionics." Medtronic immediately thereafter removed the action to federal court to avoid a hearing on the temporary restraining order.

The next day, Medtronic filed an action in Minnesota state court alleging claims for breach of contract against Stultz and tortious interference against Advanced Bionics. Medtronic also immediately obtained a TRO from the Minnesota court, enjoining Advanced Bionics from hiring Stultz in any competitive role. The order also barred both parties "from making any motion or taking any action or obtaining any order or direction from any court that [would] prevent or interfere in any way with [the Minnesota court's] determining whether it should determine all or any part of the claims alleged in [the Minnesota] lawsuit, including claims for temporary, preliminary or permanent relief." Shortly thereafter, the California federal court remanded the action based upon its finding that Medtronic had filed its removal notice without evidentiary support and "for the improper purpose of avoiding an unfavorable ruling upon a pending motion before a state court." One month later, Medtronic filed a motion in the Superior Court to dismiss or stay the California action on the ground that the matter should be decided in Minnesota. The Superior Court denied the motion, finding that, under a totality of the circumstances, staying or dismissing the California action would not serve the interests of substantial justice. Shortly thereafter, the Minnesota court issued a preliminary injunction that restricted Stultz's activities as an Advanced Bionics employee.

On August 8, 2000, Stultz and Advanced Bionics applied *ex parte* to the California court for a TRO and order to show cause regarding preliminary injunction to prohibit Medtronic from taking any further steps in the Minnesota action. The Superior Court granted the application, finding there was a "substantial chance" that Medtronic would "go to the Minnesota court [and] attempt to undercut the California court's jurisdiction." Under the TRO, Medtronic was "restrained and enjoined from taking any action whatsoever, other than in this Court to enforce [its covenant not to compete] against Stultz or to otherwise restrain Stultz from working for Advanced Bionics in California, including but not limited to making any appearance, filing any paper, participating in any proceeding, posting any bond or taking an other action in the second filed [Minnesota] lawsuit."

This TRO was the subject of Medtronic's appeal to the California Court of Appeal. The Second Appellate District upheld

the restraining order when it found:

(1) The trial court's TRO was necessary and proper to protect plaintiff's interest pending final disposition of the action, and thus was properly issued; (2) notwithstanding the choice of law provision in the Agreement, the case would be decided under California law; and (3) because California law will apply and the California action was filed first, California courts must decide the dispute.

Before the California Supreme Court, Medtronic argued that the Court of Appeal did not place sufficient emphasis on the principles of judicial restraint and comity, which should have prevented the issuance of a TRO in the underlying litigation. Stultz and Advanced Bionics, on the other hand, argued that, although California should pay deference to foreign state proceedings, California's strong public policy against noncompetition agreements under Section 16600 weighs against allowing an action to proceed in Minnesota and provides the exceptional circumstances that warrant the issuance of the TRO. The Court rejected this lat-

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ter argument for a variety of reasons. Relying upon decisions in Texas, New York, and Illinois, the Court observed that "even if a sister state applies different substantive law than the forum state, that fact alone does not justify the issuance of a TRO enjoining proceedings in the sister state." With regard to the Section [16600] argument, the Court stated:

We agree that California has a strong interest in protecting its employees from non-competition agreements under Section 16600. But even assuming a California court might reasonably conclude that the contractual provision at issue here is void in this state, this policy interest does not, under these facts, justify issuance of a TRO against the parties in the Minnesota court proceedings. A parallel action in a different state presents sovereignty concerns that compel California courts to use judicial restraint when determining whether they may properly issue a TRO against parties pursuing an action in a foreign jurisdiction.

* * *

The comity principle also supports our conclusion. ... The comity principle requires that we exercise our power to enjoin parties in a foreign court sparingly, in line with the policy of judicial restraint discussed above.