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MBA COMPLEX COMMERCIAL LITIGATION SECTION NEWSLETTER SUMMER 2015

BUSINESS LITIGATION

'LIGHTLAB' AND FIRST MOVER ADVANTAGE

BY PHILIP SAUNDERS JR., PH.D.

First mover advantage (FMA) is the market advantage that a firm gains for being first with a product. In *LightLab Imaging, Inc. v. Axsun Technologies, Inc. & Another*, SJC-11374, July 28, 2014, the Supreme Judicial Court affirmed a decision to deny lost profits claimed, in part, based upon the plaintiff's assertion of FMA. The trial court had not rejected the FMA concept *per se*, but found no evidence of loss and the methodology deficient "particularly as to quantification."

Since *LightLab*, FMA has been argued by a pharmaceutical development company seeking a preliminary injunction in *Theravectys SA v. Immune Design Corp.*, C.A. No. 9950-VCN, Court of Chancery of Delaware, Mar. 9, 2015. The court, in finding failure to establish irreparable harm, observed that the "first-mover advantage argument ... fails to establish a non-speculative harm." It will be interesting to see whether the argument will be resuscitated at trial and, if so, with what result.

Other unsuccessful appearances of FMA include a trade secrets case in which the plaintiff argued potential loss of FMA in a failed attempt to obtain an injunction. See *Aetna, Inc. v. Bradley M. Fluegel et al*, CV0740333455, Sup. Ct., Conn., July 7, 2008. Also, in a case that did not go to trial, in which the author was an expert for the defense, the plaintiff's expert described the advantage of being the first mover but was unable to point to any specific lost profits. The case settled with no money changing hands.

More promising for the first mover concept was a favorable mention at the U.S. Supreme

Court: "[F]irms that innovate often capture long-term benefits from doing so, thanks to various first mover advantages, including lock-ins, branding, and networking effects." See *Bernard L. Bilskey et al v. David J. Kappos*, 130 S.Ct. 3218, June 28, 2010. The same Court of Chancery of Delaware that rejected first mover advantage in *Theravectys* subsequently accepted the theory as the basis for the choice of a growth rate above the rate of inflation, a small part of a much larger company valuation analysis. See *Leilani Zutrau v. John C. Jansing et al*, C.A. No. 7457-VCP, Court of Chancery of Delaware, July 31, 2014.

There is an extensive literature on FMA. The prevailing view is that being the first mover confers an advantage. Some studies have focused not on FMA *per se* but on explaining market share. Eleven such studies have found market share and order of entry to be correlated: the earlier a product was in the market, the larger its market share was likely to be.

However, there is general agreement in the literature that the magnitude and durability of the advantage may vary substantially depending upon a variety of factors, some of which are discussed below.

The extent of FMA is different in different product categories. The advantage generally dissipates over time. The size and durability of FMA is affected by advertising (the first mover's and the competition's); pricing; and relative quality, or at least customer perception of relative quality, of later entering products. Sometimes being first mover is more important than being better; followers with superi-

Philip Saunders Jr., Ph.D., is principal of Philip Saunders Associates. He is an economist specializing in valuation of privately held companies and valuation of damages in litigation.



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or products don't always succeed in overtaking the first mover.

FMA can be enhanced by having a technology not readily replicated by a competitor, for legal or other reasons; control of scarce resources, which the first mover may own, collect or create (e.g., raw material, IP, location, key employees, key suppliers, customer first impressions, know-how); customer switching costs (i.e., monetary or simply intangible costs of changing habits or organizational practices or of learning new methods); and network effects, which can create a kind of switching cost in situations where customers seek a common standard or the ability to interact with other users.

Market factors are important as well. New product categories seem to attract more followers than old categories. For a brand extension, being first mover can count for more than for a new brand. Rapid market expansion can be a blessing, if the first mover has the resources to keep up, but a curse, if the first mover does not and a follower does. If a technology is dis-

BANKRUPTCY COURT: SUCCESSOR IGNITION SWITCH DEFECT CLAIMS ARE BARRED AGAINST 'NEW GM'

BY JONATHAN M. HORNE

At the depths of the 2008 financial crisis, General Motors ("Old GM") filed the fourth largest bankruptcy in United States history, seeking approval to sell substantially all of its assets to a newly formed entity ("New GM") "free and clear" of its legacy liabilities. At the time, Old GM was bleeding cash and surviving only thanks to emergency loans from the federal government, earning it the dubious nickname "Government Motors." That sale — totaling approximately \$82 billion — was approved within 40 days of the bankruptcy filing and allowed New GM to emerge from bankruptcy a more financially stable company.

Fast forward to March 2014, when New GM first announced to the public the presence of defects in ignition switches installed in model years prior to the bankruptcy sale. Dozens of accident deaths have reportedly been linked to the defect, which has resulted in one of the largest automobile recalls in history. Significantly, at the time of the bankruptcy sale, dozens of GM employees, including engineers, senior managers and attorneys, knew enough information about the ignition defect to trigger Old GM's obligations under the National Traffic and Motor Vehicle Safety Act to conduct a recall of the affected vehicles. Upon this revelation, vehicle owners immediately filed complaints against New GM. In response, New GM agreed to compensate victims who suffered physical injury or death as a result of the defect, but otherwise argued that the "free and clear" provision of the Bankruptcy Court's sale order insulated it from successor liability on claims for various forms of economic loss. The U.S. Bankruptcy Court for the Southern District of New York — the same court that approved the bankruptcy sale — recently entered an order enforcing that sale order and concluding that ignition switch defect claims were barred by the bankruptcy sale order.¹

THE BANKRUPTCY SALE

The increasingly favored means of accomplishing a bankruptcy "reorganization" is to sell substantially all of the bankruptcy debtor's assets free and clear of all liens, claims and encumbrances under Bankruptcy Code § 363. These so called "363 Sales" amount to an effective short sale of the going concern business, with the Bankruptcy Court sale order insulating the purchaser from claims of pre-bankruptcy creditors. Generally, the purchaser of a debtor's assets is not liable for claims asserted

Jonathan M. Horne is a senior associate at Jager Smith PC in Boston. He represents debtors, trustees, committees and creditors in connection with all aspects of commercial insolvency and reorganizations, and parties in various areas of commercial litigation, including construction law disputes and corporate Directors & Officers (D&O) fiduciary claims.



against the debtor unless the purchaser expressly agrees to assume such liabilities. However, in the case of future claims against a purchaser — such as where a product sold prior to the bankruptcy sale injures someone after the sale — the issue becomes much thornier when these future claimants lacked sufficient notice and constitutional due process that are bedrock principles on which bankruptcy sales are built.

By any standard, the GM bankruptcy and 363 Sale were remarkable. The company employed over 200,000 people and did business with approximately 11,500 vendors as part of its supply chain that employed approximately 500,000 more people. These factors alone made it a complex deal, made only more complicated by the United States and Canadian governments' involvement, and a 40-day closing deadline. In total, 850 parties in interest objected to the sale in one form or another, although the majority of objections were to specific provisions of the proposed order — including the "free and clear" provision — and not to the sale as a whole. Ultimately, the court overruled objections to the free and clear provisions and concluded that New GM should be protected from successor liability claims.

THE IGNITION SWITCH CLAIMANTS

While the ignition switch defect resulted in many accidents causing injury and death, New GM had agreed to satisfy claims for death, personal injury, and property damage in accidents occurring after the 363 Sale involving vehicles manufactured by New GM and Old GM alike. Furthermore, the Sale Order did not insulate New GM from its obligations to conduct recalls and fix defects in accordance with federal and state law, even for defects in vehicles manufactured by Old GM.

FIRST CIRCUIT EXPANDS ACTUAL FRAUD EXCEPTION TO BANKRUPTCY DISCHARGE, DEEPENS CIRCUIT SPLIT

BY JUSTIN KESSELMAN, LAW CLERK, HON. ROBERT J. CORDY, SUPREME JUDICIAL COURT

Section 523(a)(2)(A) of the Bankruptcy Code excepts from discharge "any debt for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition." For several years, a line of bankruptcy court decisions in Massachusetts, Rhode Island and other jurisdictions has construed *Field v. Mans*, 516 U.S. 59 (1995) as incorporating the common law elements of fraudulent misrepresentation into the definition of "actual fraud." In *Sauer Southeast v. Lawson (In re Lawson)*, 791 F.3d 214 (1st Cir. 2015), however, the First Circuit disagreed that *Field* limited actual fraud to fraudulent misrepresentation, holding specifically that proof of a misrepresentation is not required where the fraud consists of a debtor's knowing receipt of a fraudulent transfer intended to hinder the transferor's creditors.

The "new standard" articulated in *In re Lawson* arose from a factual paradigm that smacked of bankruptcy abuse. The story begins where it should have ended: a creditor obtaining a state-court judgment for fraud against the debtor's father. Shortly after the entry of judgment, however, the father transferred \$100,150 into a shell corporation formed by his daughter, who transferred \$80,000 from the corporation into her personal accounts. The creditor then pursued a successful fraudulent transfer action against the daughter, who again pivoted by filing a petition under Chapter 13 of the Bankruptcy Code. Undeterred, the creditor filed an adversary complaint against the daughter alleging that the money she received amounted to a nondischargeable debt procured by actual fraud. Relying on *Field* and its progeny, the bankruptcy court dismissed the complaint for failure to allege a misrepresentation.

The First Circuit reversed. The court

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ZHANG INDICTMENT REMINDS DOMESTIC COMPANIES OF CHINA'S THREAT TO TRADE SECRETS, LACK OF RELIEF ABROAD

BY HANNAH T. JOSEPH

Between 2006 and 2009, two Chinese nationals allegedly stole trade secrets from their U.S. employers for the benefit of Tianjin, a Chinese government-controlled university. The U.S. Department of Justice (DOJ) subsequently issued a 32-count indictment against the two men and four other named defendants, alleging violation of the Economic Espionage Act. The indictment, describing the complex scheme by which the defendants allegedly stole technology and sought to misrepresent it as their own through patent applications, reminds the domestic private sector of the real threat that China poses to trade secrets in the United States. According to a 2015 report issued by the U.S. Trade Representative, remedies under Chinese law continue to be “difficult to obtain, given that civil, administrative, and criminal enforcement against misappropriation of trade secrets remains severely constrained.” Domestic businesses are thus left to seek relief in U.S. state and federal courts, where effective extraterritorial enforcement remains uncertain.

THE INDICTMENT OF HAO ZHANG

On May 16, 2015, Chinese national Hao Zhang was arrested pursuant to a 32-count superseding indictment alleging economic espionage and theft of trade secrets in violation of the Economic Espionage Act (18 U.S.C. §§ 1831-1839). The indictment accuses Zhang, a former employee of Woburn-based Skyworks Solutions, Inc. (“Skyworks”), of colluding with

five other individuals to steal trade secrets for the benefit of entities controlled by the People's Republic of China (PRC).¹

As set forth in the indictment, Zhang met co-defendant Wei Pang while studying electrical engineering at the University of Southern California. After obtaining his Ph.D. in 2006, Zhang went to work at Skyworks in Woburn, Massachusetts. Pang, who also obtained his Ph.D. in 2006, accepted employment with Avago Technologies (Avago) in Fort Collins, Colorado. Skyworks and Avago were both in the business of developing film bulk acoustic resonator (“FBAR”) technology, which is used to filter incoming and outgoing signals for wireless devices and has substantial use in wireless consumer and military applications.

Starting in 2006, Zhang, Pang and the other named defendants designed an elaborate scheme to effectively “mov[e] Avago to China.” The goal was to “lift” Avago's and Skyworks' technologies and establish a competitive FBAR fabrication facility in the PRC. By cutting research and development costs and leveraging the stolen technologies as their own, the individual defendants planned to sell to large cell phone manufacturers such as Nokia, Motorola, Samsung, and LG. According to the DOJ, the individual defendants “stole recipes, source code, specifications, presentations, design layouts and other documents marked as confidential and proprietary from the victim companies

Hannah T. Joseph is a litigation associate at Beck Reed Riden LLP, where she specializes in business litigation and employment law. Ms. Joseph graduated from Boston College Law School in 2013, and in 2012 was awarded the Asian American Lawyers Association of Massachusetts (AALAM) Scholarship for Excellence.



...”² In his own words, “[Pang’s] work [was] to make every possible effort to find out about the *process’s* every possible detail and *copy* directly to China.” (Translated, emphasis in original.)

In 2008, the individual defendants partnered with PRC-controlled Tianjin University (TJU), which agreed to provide them with “funding, equipment, and space” for their work. Then, at TJU’s direction, the individuals formed a shell corporation in the Cayman Islands in order to create the appearance that the stolen trade secrets had a valid source. According to the indictment, TJU controlled the laundering arrangement. In further efforts to create the illusion of legitimacy, Zhang and Pang used Avago’s and Skyworks’ trade secrets to apply for a series of patents in the United States and PRC in 2009. By filing patent applications, the individual defendants aimed to demonstrate to potential investors and suppliers that they owned the stolen intellectual property. The patent applications also bolstered the credentials of Zhang and Pang, who later obtained full professorships at TJU. In their applications, Zhang and Pang falsely listed themselves as sole inventors of the relevant technologies.

Avago first became aware of Pang’s misappropriation in 2011, when it recognized its own trade secrets in Zhang’s U.S. patent applications. The theft was later confirmed when an Avago employee observed Avago’s technology in a lab run by Zhang and Pang in the PRC.

THE STATE OF PLAY IN CHINA

The indictment and arrest of Hao Zhang serves to remind domestic companies of the very real threat that China poses to trade secrets in the U.S. and abroad. As reported in the United States Trade Representative (USTR) 2015 Special 301 Report³:

IS YOUR COMPANY (OR CLIENT) DOING ENOUGH TO PROTECT ITS VALUABLE TRADE SECRETS?

BY PAUL CRONIN, NUTTER McCLENNAN & FISH LLP AND NEHAL KHORRAMINEJAD, THE UNIVERSITY OF MICHIGAN LAW SCHOOL

Most businesses possess valuable and confidential information. If you operate or advise such a company, you should be asking this question: Is the business doing enough to protect its most valuable information as a trade secret?

Under Massachusetts law, a trade secret is defined as “any formula, pattern, device or compilation of information which is used in one’s business, and which gives him an opportunity to obtain an advantage over competitors who do not know or use it.”¹ Courts in Massachusetts evaluate the following six factors to determine if information qualifies as a

trade secret:

- (1) The extent to which the information is known outside of the business;
- (2) The extent to which it is known by employees and others involved in the business;
- (3) The extent of measures taken by the employer to guard the secrecy of the information;
- (4) The value of the information to the employer and to his competitors;

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SUPREME JUDICIAL COURT: The Supreme Judicial Court recently made available the 2015 edition of the *Massachusetts Guide to Evidence*. The 2015 edition of the guide incorporates additional appellate decisions through January 2015 as well as several new sections. Among the new additions are Section 1113 on Opening Statements and Closing Arguments and Section 1114 on Restitution. The guide may be downloaded for free at <http://www.mass.gov/courts/case-legal-res/guidelines/mass-guide-to-evidence/>.

In separate news, the SJC's Standing Advisory Committee on the Rules of Professional Conduct is inviting comments on a proposed amendment to Rule 5.5 of the

Rules of Professional Conduct. The proposed amendment would permit lawyers from foreign countries who are in good standing in their home countries to act as in house counsel to an employer in Massachusetts.

APPEALS COURT: On July 22, 2015, Justice Scott L. Kafker was sworn in as the sixth Chief Justice of the Massachusetts Appeals Court. Justice Kafker first joined the Appeals Court as an Associate Justice in 2001. Following law school at the University of Chicago and two judicial clerkships, Justice Kafker worked at Foley, Hoag & Eliot and then as deputy chief legal counsel to Governor Weld and as chief legal counsel for MassPort. In addition to his service on the Appeals Court,

Chief Justice Kafker teaches state constitutional law at Boston College Law School.

SUPERIOR COURT: The Superior Court list of judges and sessions participating in the *Voir Dire* Pilot Project for the remainder of 2015 is available at <http://www.mass.gov/courts/court-info/trial-court/sc/sc-voir-dire-participating-sessions-gen.html>. The list is subject to modification if judicial assignments change.

U.S. DISTRICT COURT: For the first time in years, in January 2015 the District of Massachusetts bench reached full strength with the swearing in of Judge Burroughs. With Judge Woodlock taking senior status in June 2015, there is now an opening for the appointment of an additional District Judge. ■

'LIGHTLAB' CONTINUED FROM P. 1

ruptive (e.g., the PC), rather than incremental (e.g., new kinds of main frames), it is harder to predict what will become of the FMA.

In short, whether the first mover can establish and maintain market leadership seems to be highly case specific, depending upon a variety of factors which may or may not be relevant to a particular industry, market, or company.

There are definitional issues that would need to be addressed in any successful claim based on FMA.

Is the first mover, the inventor or holder of the patent, the first to develop a prototype, the first to market, or the first to develop a significant market share? Obviously, the further along the plaintiff is the stronger the case.

What is the market? A new pharmaceutical effectively treating a disease, with no previous effective treatment, defines the market and is the first mover. If the pharmaceutical treats a disease that has existing remedies, the new product may be the first mover in only a market segment.

What is the time horizon? Plaintiffs like to assume their products will triumph in perpetuity. However, courts are reluctant to award damages based upon projections into a distant future, particularly, as in *LightLab*, when the projections go beyond some identifiable date certain (e.g., expiration of a lease, contract, or patent). It may be enough to demonstrate that, but for the breach or tort, the plaintiff would likely have enjoyed a few years of profitability.

What is the basis for damages? The common claim, as in *Lightlab*, is for lost profits. However, a common end for successful startups is to be bought out, as happened to LightLab, which never made money but sold for \$92.8 million. The grounds for damages may need to be reframed from lost profits to something else, say, loss of capital or destruction of value. Doing so would raise legal and economic issues beyond the scope of this brief paper, but to deny the possibility would be to deny a remedy for loss of potential with real economic value.

Netscape can be an example, with 20-20 hindsight, of how these definitional issues might have been addressed had Netscape been

in litigation. Netscape did not develop and was not the first to market a browser, but it was arguably the first to develop and dominate a significant browser market (first mover definition). The market was fairly clearly defined: a means of finding stuff on the internet (market definition). The company existed independently for only five years (time horizon). Cumulatively, profits were negative, but AOL purchased Netscape in a deal valued at the time at about \$4.2 billion (basis for damages).

The brief history of the FMA concept in litigation makes it clear that merely asserting FMA as the basis for a lost profits claim accomplishes little. However, the extensive work that has been done on FMA outside the courts makes it clear that the advantage is real. FMA may best be thought of not as a sole basis for a damage claim but as a useful framework within which to perform a traditional lost profits analysis. FMA could be a lens through which to examine the facts of a case to assess the magnitude of a FMA and help quantify the damages. With a proper analysis of the relevant factors, FMA may yet play a meaningful role in the courtroom. ■

HOW TO SUBMIT ARTICLES

To inquire about submitting an article to the *ComCom Quarterly*, please contact Jim Harrington (jharrington@robinskaplan.com) or Derek Domian (ddomian@goulstonstorr.com).

ZHANG INDICTMENT CONTINUED FROM P. 2

The theft of trade secrets [in China] remains a particular concern. Such theft occurs inside and outside of China for the competitive advantage of Chinese state-owned and private companies. Conditions are unlikely to improve as long as those committing such theft, and those benefiting, continue to operate with relative impunity, often taking advantage of the theft in order to compete unfairly or to enter into business relationships that disadvantage their victims.

Furthermore, although China has implemented several progressive legislative and judicial initiatives since 2013, U.S. rights owners are unlikely to obtain relief in China:

Under Chinese law . . . available remedies are difficult to obtain, given that civil, administrative, and criminal enforcement against misappropriation of trade secrets remains severely constrained. Enforcement obstacles include deficiencies in China's [Anti-Unfair Competition Law], constraints on gathering evidence for use in litigation, difficulties in meeting the criteria for establishing that information constitutes a trade secret, and criminal penalties that are not clearly deterrent.

While China has committed to taking “concrete actions to address enforcement, enhance public awareness, and require strict legal compliance with respect to trade secrets,” U.S. businesses may be (as a practical matter) confined to pursuing justice in the U.S. until the foreign legal landscape improves.

ENFORCEMENT IN THE U.S. AND CHOICE-OF-LAW ISSUES

Even where a plaintiff opts to bring a civil suit in the U.S., it may still need to grapple with Chinese law. This was the case in *Enargy Power Co. v. Xiaolong Wang*, 2013 WL 6234625 (D. Mass. Dec. 3, 2013), in which plaintiffs failed to establish a likelihood of success on their claim for trade secret misappropriation in part because they neglected to apply Chinese law.

Enargy involved alleged acts perpetrated against a Chinese company (“Enargy”) by its former employee (“Wang”), who resided in Massachusetts. During the employment relationship, which lasted from 2008 to 2011, the parties jointly developed several trade secrets to be used in specialized aircraft power converters. At some point, the relationship began to deteriorate and, in 2011, Wang left the company. Before his departure, Wang allegedly contacted his assistant at Enargy in China, and instructed the assistant to password protect files containing the trade secrets, transmit the files to him and destroy the original files from

Enargy’s server. Based on this conduct, Enargy and others sued Wang for trade secret misappropriation and violation of the Computer Fraud and Abuse Act (CFAA).

The U.S. District Court for the District of Massachusetts granted plaintiffs preliminary injunctive relief based on their CFAA claim, holding that Wang had exceeded his authorized access to Enargy’s computer systems. In so doing, the court noted that the CFAA could apply to computers located outside of the United States and conduct occurring outside of the United States.

With regard to the misappropriation claim however, the court engaged in a choice-of-law analysis and found that Chinese law applied because China had the most significant relationship to the parties. The court held that the plaintiffs had not demonstrated a likelihood of success on their claim under Chinese law.⁴

THE UPSHOT

The indictment of Hao Zhang demonstrates, and the USTR 2015 Special 301 Report confirms, that China continues to pose a very real threat to trade secrets in the U.S. and abroad. Considering that China has frequented the USTR’s “Priority Watch List” since at least 1989, this is not necessarily news. Given China’s recent efforts to address trade secret misappropriation, however, it will be worthwhile to follow its movement in this area. For now, it appears that enforcement is best pursued in the United States.

When bringing a civil suit in the United States that involves foreign entities, practitioners should be vigilant in applying the appropriate substantive and procedural laws. See *Enargy Power Co.*, 2013 WL 6234625; see also *Hadley Pollett, LLC v. Yun Zhu*, 2009 WL 5909268 (Mass. Super. Dec. 10, 2009) (direct service on a Chinese corporation at its Chinese address was contrary to the Convention on Service Abroad of Judicial and Extrajudicial Documents in Civil and Commercial Matters). Legislative developments in the United States may help with the bigger problem; there have been increasing Congressional efforts to strengthen and to create a private right of action under the Economic Espionage Act. This would create a federal civil remedy for trade secret misappropriation and confer extra-territorial jurisdiction. Stay tuned. ■

1. The indictment, now unsealed, is available at <http://www.justice.gov/file/439936/download>.
2. A press release by the DOJ is available at <http://www.justice.gov/opa/pr/chinese-professors-among-six-defendants-charged-economic-espionage-and-theft-trade-secrets>.
3. The USTR 2015 Special 301 Report is available at <https://ustr.gov/sites/default/files/2015-Special-301-Report-FINAL.pdf>.
4. The court also found that the plaintiffs had failed to meet their burden under Massachusetts law.

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TRADE SECRETS CONTINUED FROM P. 3

- (5) The amount of effort or money expended by the employer in developing the information; and
- (6) The ease or difficulty with which the information could be properly acquired or duplicated by others.²

This article focuses on factor (3), the measures businesses take to protect the secrecy of their valuable information, and to what extent those measures are sufficient to maintain trade secret status.

There are no statutes or regulations in Massachusetts that specify steps necessary to protect information that is allegedly a trade secret. Instead, the evaluation is based entirely on common law.

The effective implementation of confidentiality agreements with employees and third parties is important evidence that the company has taken reasonable steps in protecting its trade secrets. In her 2014 decision in *Boston Scientific Corp. v. Lee*, U.S. District Judge Denise Casper acknowledged that a plaintiff asserting trade secret protections must show that it took reasonable security precautions, and observed that “[o]rdinarily . . . confidentiality agreements suffice to constitute reasonable protective measures.”³

But confidentiality agreements alone do not automatically satisfy the requirements of secrecy; instead the agreements are merely

evidence along with evidence of other protective measures tending to prove a company’s diligence in protecting its trade secrets. Adoption of an appropriate trade secret policy is further evidence of a company’s diligence in maintaining the secrecy of its information.

As recognized in Massachusetts state and federal case law, successful trade secret policies include:

- Taking measures to contain the trade secret within the company and to limit external exposure.
- Restricting employee access, only exposing the trade secret on a need-to-know basis within the company.
- Limiting public access to company information through steps such as password protection on computers, prohibiting unescorted visits to the office, and hiring security guards.
- Labeling the information as confidential in order to put anyone with exposure on notice.
- Requiring employees and customers to sign an agreement preventing them from exposing trade secrets to third parties.

It is imperative that a business seeking to protect its secrets take affirmative and well-planned steps to both establish an effective trade secret policy and maintain the confidentiality strictures that support trade secret

status. Trade secret status is imperiled when a business:

- Fails to expressly inform employees about the confidentiality of trade secrets and their confidentiality obligations.
- Informally instructs employees to limit outside exposure, with no set policy or system in place.
- Openly shares the information among employees.
- Acquiesces in employee violations of trade secret policies including the use of unsecure email and storage of trade secrets on unsecure devices.

Businesses should be proactive in their approach to trade secrets. Secrecy, and the appropriate measures to maintain secrecy, should never be an afterthought. For an individual business client, success requires vigilance in establishing and following strict trade secret policies, and diligence in implementing and enforcing the appropriate confidentiality measures necessary to maintain the secrecy of the company’s valuable information. ■

1. *J.T. Healy & Son, Inc. v. James A. Murphy & Son, Inc.*, 260 N.E. 2d 723, 729 (Mass. 1970).

2. *Jet Spray Cooler, Inc. v. Crampton*, 282 N.E. 2d 921, 925 (Mass. 1972).

3. Civil Action No. 13-13156-DJC, 2014 WL 1946687, at *7 (D. Mass. May 14, 2014).

FRAUD EXCEPTION CONTINUED FROM P. 2

acknowledged that *Field* defined actual fraud in reference to the elements of fraudulent misrepresentation set forth in the Restatement (Second) of Torts § 537. Yet, the court reasoned that this merely reflected the fact that *Field* was a misrepresentation case; the substance of the Supreme Court’s holding, rather, was that actual fraud must be construed in harmony with the concept of fraud distilled by the Restatement. The Restatement recognizes several species of fraud, including “fraudulent interference with [property rights],” which does not require proof of a misrepresentation. See Restatement (Second) of Torts, § 871 (“One who intentionally deprives another of his legally protected property interest or causes injury

to the interest is subject to liability to the other if his conduct is generally culpable and not justifiable under the circumstances.”). The First Circuit concluded that this concept embraced the knowing receipt of a fraudulent transfer intended to deprive a creditor of its interest in the transferred property. A contrary reading, the court opined, would sanction the “two-step routine” of a fraudulent transfer followed by the filing of a bankruptcy petition, converting the Bankruptcy Code into an “engine for fraud” and subverting the Bankruptcy Code’s purpose of providing a fresh start to only the “honest but unfortunate debtor.”

The First Circuit’s holding is significant on several fronts. First, it bolsters the creditor’s arsenal by providing at least one new tool for preserving and recovering debts previously deemed dischargeable under bankruptcy

court decisions. Second, it opens the door to argument on additional forms of actual fraud. Although the court did not elaborate on which other forms of “deceit, artifice, trick, or design . . . used to circumvent and cheat another” might come within the ambit of actual fraud, it provided a strong clue by directing the reader to the word “Fraud” in the index to the Restatement. Third, the decision deepens the Circuit split on this issue, joining the position long held by the Seventh Circuit and rejecting the position taken recently by the Fifth Circuit. Compare *McClellan v. Cantrell*, 217 F.3d 890 (7th Cir. 2000), with *Husky Electronics, Inc. v. Ritz (In re Ritz)*, 787 F.3d 312 (5th Cir. 2015). Given that the Supreme Court’s *Field* decision is largely responsible for creating this fault line, the Supreme Court’s intervention to close it seems likely. ■

BANKRUPTCY COURT CONTINUED FROM P. 2

Thus, the claims put at issue by the 363 Sale were limited to mostly unliquidated claims alleging an amalgam of economic loss damages estimated in the aggregate between \$7 and \$10 billion. These economic loss damages allegedly flowed from such things as the reduction in the resale value of affected cars; other economic loss, such as missing work when getting the ignition switch replaced; and inconvenience. Other classes of claimants included victims suing with respect to accidents occurring before the bankruptcy sale, and owners of non-defective GM vehicles claiming that the defect and recall caused damage to the GM brand and thus resulting economic loss to them.

THE COURT'S ANALYSIS

The Bankruptcy Court focused on whether the bankruptcy sale process afforded the various ignition switch claimants procedural due process, and if not, whether the court could or should do anything about it at this stage.

Generally, notice must be provided in bankruptcy cases that is reasonably calculated, under all the circumstances, to apprise people of the pendency of any proceeding that may result in their being deprived of any property, and to afford them an opportunity to present their objections. However, where the identities of creditors are known, actual notice must be given. Thus, while the court concluded that

notice by publication was sufficient to all vehicle owners generally, it was not sufficient to owners whose cars had ignition switch defects, because at that time Old GM had a known recall obligation and knew the names and addresses of those owning the affected vehicles. As a result, ignition switch defect claimants had not received sufficient notice of the 363 Sale.

However, even where a claimant has not received sufficient notice, due process is not violated unless the lack of notice results in actual prejudice to the aggrieved party. Thus, the court concluded that while the claimants were prejudiced with respect to the bar date for filing claims against Old GM, only economic loss claimants were prejudiced with respect to the 363 Sale because at the time of the sale, the court considered and rejected most of the same arguments the ignition switch claimants now advanced. In one respect, however, the court held that economic loss claimants were prejudiced by their lack of notice; noting that no one had argued — as they were now — that the proposed bankruptcy sale order was overbroad in that it should not have excluded claims involving Old GM vehicles and parts, so long as the claims were based solely on New GM conduct and not successor liability.

Given that certain claimants' procedural due process rights had been violated, the court concluded that they deserved a remedy tailored to the prejudice they suffered, to the extent the law permits. However, the fact that purchasers of bankruptcy assets like New GM

acquire property rights too, and that taking away purchasers' contractually bargained-for rights strikes at the heart of the bankruptcy system, was also a critical factor in the court's analysis. In light of these concerns, the court settled on a "remedy" of sorts by clarifying that under its previous sale order New GM would have liability for ignition switch defect claims only to the extent that it had engaged in its own independently wrongful conduct, and not because it assumed any Old GM liabilities. Ultimately, the court affirmed that New GM would not suffer successor liability for Old GM liabilities, and thus cautioned trial courts analyzing claims that are supposedly against New GM to be extraordinarily careful to ensure that they are not in substance successor liability claims "dressed up to look like something else."

CONCLUSION

While the GM bankruptcy and sale were certainly unique in scope and circumstance, the court's ruling that ignition switch claimants cannot assert successor liability claims against New GM based on Old GM conduct reaffirms that sales "free and clear" of prepetition claims mean what they say, and that buyers can generally rely on the protections provided by bankruptcy sale orders even where substantial unknown liabilities are subsequently revealed. ■

1. *In re Motors Liquidation Co.*, 529 B.R. 510 (Bankr. S.D.N.Y. 2015).