

WHAT IS THE SCOPE AND EFFECT OF THE COPYRIGHT ACT'S PREEMPTION OF A STATE LAW CLAIM FOR THEFT OR MISAPPROPRIATION OF TRADE SECRETS? WHAT EVIDENCE IS INSUFFICIENT TO AVOID SUMMARY JUDGMENT IN FAVOR OF THE DEFENDANT?

By Rebecca Todd*

Spear Mktg. v. BancorpSouth Bank, 791 F.3d 586 (5th Cir. 2015).

BACKGROUND

In 2015, the United States Court of Appeals for the Fifth Circuit (“Fifth Circuit”) held that the preemption provision of the federal Copyright Act¹ preempted state law claims based on ideas fixed in tangible media, including the plaintiff’s technical trade secrets.² Spear Marketing, Inc. (“SMI”) created cash management software called VaultWorks, which it licensed to BancorpSouth Bank (“Bancorp”) from 2002 to 2012.³ VaultWorks was developed by SMI to optimize the amount of cash a banking institution needs on hand at its branch and ATM locations.⁴ However, SMI’s customers did not have access to the VaultWorks software itself.⁵ Instead, SMI customers logged on to internet user interface screens to manually enter data and receive cash management reports.⁶

In 2012, Bancorp did not renew its agreement with SMI, choosing to license new cash management software developed by ARGO Data Resource Corporation (“ARGO”).⁷ Similar to SMI, ARGO develops software for the banking industry and developed its own cash management system, Cash Inventory Optimization (“CIO”).⁸ However, unlike VaultWorks, CIO is installed directly on the bank’s computers and integrated with the rest of the bank’s operating system.⁹ CIO essentially eliminates the need for the bank’s personnel to manually input cash data.¹⁰ SMI claimed that ARGO created CIO by using SMI’s trade secrets from its own cash management software.¹¹

PROCEDURAL HISTORY

SMI filed its case in Texas state court, alleging theft and misappropriation of trade secrets,

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¹ 17 U.S.C. § 301(a) (2014).

² Spear Mktg. v. BancorpSouth Bank, 791 F.3d 586, 597 (5th Cir. 2015).

³ *Id.* at 589, 591.

⁴ *Id.* at 589–90.

⁵ *Id.* at 590.

⁶ *Id.*

⁷ *Id.* at 591.

⁸ Spear Mktg., 791 F.3d at 590.

⁹ *Id.*

¹⁰ *Id.*

¹¹ *Id.* at 591.

conversion, fraud, and breach of contract, among other causes of action.¹² The case was removed to federal court on the basis of copyright preemption because SMI's primary claims centered on ARGO copying the Vaultworks software.¹³ SMI subsequently amended its state court petition, removing its conversion claim and references to copying and distribution.¹⁴ SMI then argued that removal had been improper because none of its claims should be preempted.¹⁵ The district court denied SMI's motion, holding that the conversion and theft claims were completely preempted.¹⁶ The court did not consider whether the rest of SMI's claims were preempted, but chose to exercise supplemental jurisdiction over them pursuant to 28 U.S.C. § 1367 (2014).¹⁷ The district court granted full summary judgment in the defendants' favor, holding that SMI had no proof that its trade secrets were used.¹⁸ SMI appealed, challenging federal jurisdiction, and the Fifth Circuit affirmed.¹⁹

The district court considered SMI's motion to remand by evaluating the Original Petition for grounds for removal.²⁰ SMI alleged that the district court should have considered SMI's amended complaint where SMI dropped its conversion claim and deleted language regarding copying.²¹ Defendants countered that the removal was measured according to the time-of-filing rule.²² The Fifth Circuit concluded that the district court was correct to consider the Original Petition when deciding SMI's motion to remand.²³ SMI's motion sought remand under 28 U.S.C. § 1447(c) and argued that removal had been improper; therefore, the relevant record was the Original Petition not the one that was changed to exclude copyright language.²⁴

The Fifth Circuit then looked to whether the Original Petition provided a basis for federal jurisdiction and determined that theft of an idea fixed in a tangible medium falls within the subject matter preempted by federal copyright law.²⁵ A two-part test was used when determining if the Copyright Act preempts a state law claim: (1) whether the claim falls within the subject matter of copyright law, and (2) whether the rights protected by the asserted claim are equivalent to the exclusive rights of federal copyright.²⁶ A claim must satisfy both prongs of this test to be preempted.²⁷

¹² *Id.*

¹³ *Spear Mktg.*, 791 F.3d at 591.

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ *Id.* at 591, 600.

¹⁹ *Spear Mktg.*, 791 F.3d at 598.

²⁰ *Id.* at 591.

²¹ *Id.*

²² *Id.* at 592 (quoting *Louisiana v. Am. Nat. Prop. & Cas. Co.*, 746 F.3d 633, 636 (5th Cir. 2014)) ("Jurisdictional facts are determined at the time of removal and consequently post-removal events do not effect that properly established jurisdiction.").

²³ *Id.* at 593.

²⁴ *Id.*

²⁵ *Id.* at 597.

²⁶ *Id.* at 594.

²⁷ *Id.*

2016] SCOPE AND EFFECT OF COPYRIGHT ACT'S PREEMPTION OF STATE LAW 223

As to the first prong, the Fifth Circuit had previously held that the exclusivity of the federal copyright law, 17 U.S.C. § 301(a), completely preempts the substantive field but had not answered, until now, whether § 301(a) preemption extends to all works fixed in tangible media, including those excluded from copyright protection, such as ideas.²⁸ The parties disputed whether § 301(a) preemption extends to all works satisfying the requirements of § 102(a), even those that contain noncopyrightable material as defined in § 102(b).²⁹ SMI asserted that it carefully defined its trade secrets to only include ideas and concepts, thus excluding them from the subject matter of copyright.³⁰ Bancorp and ARGO argued that the preemption analysis should focus not on the copyrightability of the expression itself, but on the type of work—software.³¹ The Fifth Circuit determined that technical trade secrets found within VaultWorks fell within the subject matter of copyright.³² SMI based its case on the fact that ARGO stole its trade secrets by: (1) enticing SMI to perform a demo of its software to ARGO, as part of an acquisition pitch, and (2) receiving screenshots of VaultWorks from BCS during the implementation of CIO.³³ It was clear that these ideas appeared in a tangible medium—computer software.³⁴ Since the tangible medium falls within the subject matter of copyright as defined in § 102(a), so do the specific trade secrets contained within it.³⁵

Because most times, parties concede the subject-matter element, many of the court's decisions rest on the second (“equivalency”) element of the preemption test.³⁶ According to the second part of the test, the court examines SMI's causes of action to determine whether the causes of action protect rights equivalent to any of the exclusive rights of a federal copyright.³⁷ The district court held that SMI's conversion and theft claims were completely preempted, and the Fifth Circuit agreed.³⁸ SMI's conversion claim, to the extent it alleges conversion of intangible “confidential information” and “certain trade secrets,” was preempted.³⁹ In addition, copying, communicating, and transmitting are equivalent acts to reproducing and distributing. Thus, SMI's theft claim was also found to be validly preempted.⁴⁰ The court concluded this part of its analysis by affirming the district court's refusal to remand the case to the state court, holding the district court had jurisdiction under the Copyright Act's preemption provision.⁴¹

²⁸ *Id.* at 595.

²⁹ *Id.* at 594; 17 U.S.C. § 102 (2015).

³⁰ *Spear Mktg.*, 791 F.3d at 594.

³¹ *Id.*

³² *Id.* at 597.

³³ *Id.*

³⁴ *Id.*

³⁵ *Spear Mktg.*, 791 F.3d at 597.

³⁶ *Id.* at 595.

³⁷ *Id.* at 597.

³⁸ *Id.*

³⁹ *Id.* at 598.

⁴⁰ *Spear Mktg.*, 791 F.3d at 598.

⁴¹ *Id.*

SUMMARY JUDGMENT

a. Misappropriation of Trade Secrets

In order to establish trade secret misappropriation in Texas, the plaintiff must establish: (1) a trade secret existed; (2) the trade secret was acquired through a breach of a confidential relationship or discovered by improper means; and (3) use of the trade secret without authorization by the plaintiff.⁴² In their motion for summary judgment, defendants challenged the first and third elements of the test.⁴³ Defendants argued that the trade secrets were not substantially secret and that they did not “use” SMI’s purported trade secrets in developing their software.⁴⁴ The Court found that SMI failed to point to any genuine dispute regarding its misappropriation claim.⁴⁵

First, SMI argued that it produced sufficient evidence to prove that Bancorp shared SMI’s trade secrets with ARGO in order to help ARGO finalize the development of their software program.⁴⁶ Ultimately, the Court found that SMI produced evidence relevant to the second element of its misappropriation claim, but not to the third.⁴⁷ SMI produced nothing to prove that ARGO copied any design elements of VaultWorks, let alone that ARGO used SMI’s purported trade secrets in any manner.⁴⁸ There was no evidence of similarity between SMI’s software and the competing product.⁴⁹

Second, SMI contends, “that on multiple occasions, ARGO requested access to SMI’s trade secrets so that it could test and validate its own product but instead, Bancorp sent ARGO the trade secrets.”⁵⁰ But SMI’s record citations indicated that ARGO requested cash flow data from Bancorp so that it could adjust CIO to handle different cash flow situations. SMI cannot claim Bancorp’s branch cash flow data as its own trade secret.⁵¹ Moreover, SMI relied on *Cudd Pressure Control Inc. v. Roles*, which held that “an alleged misappropriator’s use of a trade secret ‘to validate’ its own product was enough to raise a genuine issue of material fact as to trade secret use.”⁵² In *Cudd*, a former employee showed Cudd Pressure Control’s confidential financial data to potential investors to secure financing for his own newly formed competing venture, in essence proving that such a business model was viable.⁵³ The Fifth Circuit found that this type of validation or “proof” was qualitatively different from the validation that allegedly occurred here—the use of Bancorp’s own records, as displayed in a

⁴² *Id.* at 600.

⁴³ *Id.*

⁴⁴ *Id.*

⁴⁵ *Id.*

⁴⁶ *Spear Mktg.*, 791 F.3d at 600.

⁴⁷ *Id.*

⁴⁸ *Id.* at 601.

⁴⁹ *Id.* at 601–02.

⁵⁰ *Id.*

⁵¹ *Id.*

⁵² *Cudd Pressure Control Inc. v. Roles*, 328 F. App’x 961 (5th Cir. 2009) (unpublished).

⁵³ *Id.* at 966.

2016] SCOPE AND EFFECT OF COPYRIGHT ACT'S PREEMPTION OF STATE LAW 225

printout from VaultWorks, to test CIO's predictions with Bancorp's historical data.⁵⁴ SMI's reliance on *Cudd* was misplaced.⁵⁵

Finally, SMI argued a theory of trade secret use, based on timing.⁵⁶ According to SMI, "a jury could reasonably infer that [Defendants] used SMI's trade secrets" because ARGO, after years of unsuccessful attempts to license CIO to Bancorp, started making progress with Bancorp at about the same time that SMI attempted to sell VaultWorks to ARGO, and in the process, revealed trade secrets to ARGO.⁵⁷ However, SMI failed to identify how defendants allegedly used SMI's trade secrets, and cited no legal authority.⁵⁸ The mere fact that VaultWorks and CIO occupied the same market would not permit an inference of copying.⁵⁹ The Fifth Circuit affirmed the district court's dismissal of SMI's claims of misappropriation of trade secrets.⁶⁰

REMAINING CLAIMS

Additionally, the district court dismissed all of SMI's remaining claims.⁶¹ SMI waived merits consideration of its remaining eight claims by failing to identify any error in the district court's reasoning or submit any new authority in support of its position.⁶² The Fifth Circuit agreed with the district court.⁶³

HOLDINGS

In summary, SMI failed to provide sufficient evidence that its case should not be heard in federal court. The Fifth Circuit found that that the district court properly considered only the original petition in deciding a software developer's motion to remand its state law claims. Further, the original petition provided a basis for federal jurisdiction where the state law claims were based on ideas in tangible media and such claims fell within the subject matter of copyright for purposes of 17 U.S.C. § 301(a). The district court's dismissal of the misappropriation of trade secrets claim was affirmed where there was no evidence of the similarity between SMI's software and the competing product.

⁵⁴ *Spear Mktg.*, 791 F.3d at 601.

⁵⁵ *Id.*

⁵⁶ *Id.*

⁵⁷ *Id.*

⁵⁸ *Id.*

⁵⁹ *Id.* at 602.

⁶⁰ *Id.*

⁶¹ *Spear Mktg.*, 791 F.3d at 602.

⁶² *Id.* at 603.

⁶³ *Id.*