

A Brief History of Trade Secret Law, Part 1

by Ernie Linek

Everyone has heard of trade secrets. Employees are often asked to sign an agreement regarding their protection, whereas employers often worry that employees will move to a competitor and take the company's trade secrets with them. The Internet appears to contain information on every company now in business (and many no longer in business). Much of the public corporate information now available on the Internet would have been viewed as trade secret information just a few years ago.

What is a trade secret today? Are trade secrets still important? Are there any left to protect? If yes, how can those secrets be protected in today's information age? Part one of this article discusses legal definitions of trade secrets in the United States and their implications for protection. Part two will discuss federal enforcement provisions and specific methods companies can use to protect their trade secrets.

WHAT IS A TRADE SECRET?

A trade secret is information that can be used in the operation of a business or other enterprise that is both sufficiently valuable and sufficiently secret to give the owner an actual or potential competitive advantage. Two or more businesses could each possess the same trade secret (or variations of the same secret) because each of them

developed it independently and kept it secret.

An exact definition of a trade secret is not possible because each secret is specific to a particular business operation. Some of the factors typically considered in determining whether business information qualifies as a trade secret are

- the extent to which the information is known outside of the business
- the extent to which it is known by employees and others involved in the business
- the extent of measures taken by the business to guard its secrecy
- the value of the information to the business and its competitors
- the amount of effort or money expended in developing it
- the ease or difficulty with which it could be properly acquired or duplicated by others.

See the Restatement of Torts box for one famous legal definition of trade secrets.

Unlike the federal patent laws (1) and trademark laws (2), trade secret protection was traditionally provided by various laws of the individual states, and litigation involving trade secrets was usually handled in the state court systems. Some states protected trade secrets under the common law; some enacted statutes specifically directed to their protection. Thus trade-secret law developed unevenly around the United States, which was a problem because of its



The secret formula for Coca-Cola is one of the oldest and most famous trade secrets in the world. THE COCA-COLA COMPANY (WWW2.COCA-COLA.COM)

commercial importance to interstate business. Trade secret litigation often occurred in states with large commercial centers, but it rarely occurred in less populous and more agricultural jurisdictions. Even in states where there had been significant litigation, the parameters of trade secret protection and the appropriate remedies for misappropriation were uncertain. Adding to the confusion was the 1978 release of the Second Restatement of Torts, which eliminated the Section 757

RESTATEMENT OF TORTS

The following definition of trade secrets was made in Section 757 of the 1939 Restatement of Torts.

A trade secret may consist of 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. It may be a formula for a chemical compound, a process of manufacturing, treating, or preserving materials, a pattern for a machine or other device, or a list of customers.

It differs from other secret information in a business in that it is not simply information as to single or ephemeral events in the conduct of the business, as, for example, the amount or other terms of a secret bid for a contract or the salary of certain employees, or the security investments made or contemplated, or the date fixed for the announcement of a new policy or for bringing out a new model or the like.

A trade secret is a process or device for continuous use in the operation of the business. Generally it relates to the production of goods, as, for example, a machine or formula for the production of an article. It may, however, relate to the sale of goods or to other operations in the business, such as a code for determining discounts, rebates, or other

concessions in a price list or catalogue, or a list of specialized customers, or a method of bookkeeping or other office management.

The subject matter of a trade secret must be secret. Matters of public knowledge or of general knowledge in an industry cannot be appropriated by one as his secret. Matters which are completely disclosed by the goods which one markets cannot be his secret.

Substantially, a trade secret is known only in the particular business in which it is used. It is not requisite that only the proprietor of the business knows it. He may, without losing his protection, communicate it to employees involved in its use. He may likewise communicate it to others pledged to secrecy.

Others may also know of it independently, as, for example, when they have discovered the process or formula by independent invention and are keeping it secret. Nevertheless, a substantial element of secrecy must exist, so that, except by the use of improper means, there would be difficulty in acquiring the information.

REFERENCE

Restatement of Torts, Section 757, Comment b, 1939.

definition of trade secrets quoted above that had served as a legal guide for trade secret protection since 1939.

A STANDARD DEFINITION?

Thus starting in the 1980s, many states adopted a new trade-secret law called the Uniform Trade Secrets Act (UTSA) (3). Some states that adopted the UTSA modified certain provisions of the original model, so a local attorney should always be consulted to determine which sections and/or definitions have been adopted by your state (4).

The UTSA defines a protectable trade secret as follows:

"Trade secret" means information, including a formula, pattern, compilation, program, device, method, technique, or process, that

(i) derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use, and

(ii) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.

The UTSA definition goes beyond the 1939 Restatement of Torts definition, which required that a trade secret be continuously used in one's business. The broader definition in the UTSA extends protection to a trade-secret owner who has not yet had an opportunity or acquired the means to put a secret to use. The definition also includes information that has commercial value from a negative viewpoint, such as the results of

lengthy and expensive research proving that a certain process will not work, which could be of great value to a competitor.

The UTSA codified the basic principles of common law trade-secret protection, preserving its essential distinction from the patent laws. Under both the UTSA and common law principles, for example, more than one person can be entitled to trade-secret protection of the same information, and analysis, in the hope of "reverse engineering" a lawfully obtained product to discover a trade secret, is permissible.

Misappropriation or Proper Discovery? For liability to exist under the UTSA, a trade secret must exist, and either a person's acquisition of that secret, disclosure of it to others, or use of it must be improper. For example, the mere copying of an unpatented item is not a violation of the UTSA.

Misappropriation, as defined by the UTSA means

(I) acquisition of a trade secret of another by a person who knows or has reason to know that the trade secret was acquired by improper means; or

(II) disclosure or use of a trade secret of another without express or implied consent by a person who

(A) used improper means to acquire knowledge of the trade secret; or

(B) at the time of disclosure or use, knew or had reason to know that his knowledge of the trade secret was

(i) derived from or through a person who had utilized improper means to acquire it;

(ii) acquired under circumstances giving rise to a duty to maintain its secrecy or limit its use; or

(iii) derived from or through a person who owed a duty to the person seeking relief to maintain its secrecy or limit its use; or

(C) before a material change of his/her position, knew or had reason to know that it was a trade secret and that knowledge of it had been acquired by accident or mistake. (4)

One of the broadly stated policies behind the UTSA is maintenance of standards for commercial ethics. In connection with that policy, the UTSA identified several proper means for determining the trade secrets of another, including

- Discovery by independent invention
- Discovery by reverse engineering: that is, by starting with the known product and working backward to find the method by which it was developed. (The acquisition of the known product must, of course, also be by a fair and honest means, such as purchase of the item on the open market, for reverse engineering to be lawful.)
- Discovery under a license from the owner of the trade secret
 - Observation of the item in public use or on public display
 - Obtaining it from published literature.

Improper means of discovery could include otherwise lawful conduct that is improper under the circumstances: e.g., an airplane overflight used as aerial reconnaissance to determine a competitor's plant layout during construction. Because a trade secret can be destroyed through public knowledge, the unauthorized disclosure of a trade secret is also a misappropriation.

Under the UTSA, "not being generally known to and not being readily ascertainable by proper means by other persons" does not require that information be generally known to the public for trade secret rights to be lost. For example, a method of casting metal may be unknown to the general public but readily known within the foundry industry, in which case it could not be considered a trade secret.

Information is readily ascertainable if it is available in trade journals, reference books, or

published materials. Often, a product lends itself to being readily copied as soon as it is available on the market. On the other hand, if reverse engineering is lengthy and expensive, a person who fairly discovers the trade secret through reverse engineering can the information obtained as a trade secret.

Reasonable efforts to maintain secrecy have been held to include advising employees of the existence of a trade secret, limiting access to a trade secret, and controlling plant access. On the other hand, public disclosure of information through display, trade journal publications, advertising, or other carelessness can preclude protection. The efforts required to maintain secrecy are those "reasonable under the circumstances." The courts do not require that extreme or unduly expensive measures be taken to protect trade secrets from flagrant industrial espionage. It follows that reasonable use of a trade secret, including controlled disclosure to employees and licensees, is consistent with the requirement of relative secrecy.

ENFORCEMENT OPTIONS

The UTSA not only provided definitions of *trade secret* and *trade secret misappropriation*. It also set forth a single statute of limitations for the various property, quasicontract, and violation of fiduciary relationship theories of noncontract liability used in common law. The statute of limitations is generally three years from either discovery of a misappropriation or a time when, by the exercise of reasonable diligence, the misappropriation should have been discovered. The UTSA permits courts to grant injunctions against actual or threatened misappropriation of trade secrets. Injunctions are frequently sought restraining future use and disclosure of misappropriated trade secrets, typically by employers against former employees.

The general rule of the UTSA regarding such relief is that an

injunction should last as long as is necessary, but no longer, to eliminate the commercial advantage or "lead time" a misappropriator has over good faith competitors. An injunction should thus terminate when a former trade secret becomes either generally known to good faith competitors or generally knowable to them because of the lawful availability of products that can be reverse engineered to reveal a trade secret.

In addition to injunctive relief, the UTSA permits the recovery of damages based on the actual loss caused by trade secret misappropriation. Like injunctive relief, a monetary recovery for trade secret misappropriation is appropriate only for the time the information is entitled to protection as a trade secret plus the additional period, if any, in which a misappropriator retains an advantage over good-faith competitors because of misappropriation. Although a claim for actual damages and net profits can be combined with a claim for injunctive relief, if both claims are granted, the injunctive relief will ordinarily preclude a monetary award for the time the injunction is effective.

The UTSA also allows the court to award reasonable attorney fees to a prevailing party in specified circumstances as a deterrent to specious claims of misappropriation, specious efforts by a misappropriator to terminate injunctive relief, and willful and malicious misappropriation.

The UTSA is not a comprehensive body of law because it does not deal with criminal remedies for trade secret misappropriation. It applies to duties imposed by law to protect competitively significant secret information. The UTSA does not apply to duties voluntarily assumed through an express or implied-in-fact contract. The enforceability of covenants not to disclose trade secrets and covenants not to compete, which are also generally intended to protect trade secrets,

are governed by other law, often contract law, as enforced by state and/or federal courts.

Although the UTSA was a valuable update of the laws designed to protect trade secrets, clearly more was needed, particularly on a federal level, because states did not uniformly adopt it. So in 1996, Congress passed the Economic Espionage Act (EEA) in recognition of the increasing importance of the value of intellectual property in general, and trade secrets in particular, to the economic well-being and security of the United States and to close the federal enforcement gap. Part two of this article will discuss the changes created by the EEA and steps companies can take to protect their trade secrets.

REFERENCES

1 United States Patent and Trademark Office. *US Code*, Section 1 et seq., Title 35, 1999, www4.law.cornell.edu/uscode/35.

2 Application for Registration; Verification. *US Code*, Section 1051 et seq., Title 15, 2002, www4.law.cornell.edu/uscode/15/1051.html.

3 Economic Espionage. *US Code*, Section 1831 et seq., Title 18, 1996, www4.law.cornell.edu/uscode/18/1831.html.

4 States that have enacted statutes based in whole or in part on the UTSA are: AK, AL, AR, AZ, CA, CO, CT, DE, FL, GA, HI, ID, IL, IN, IO, KS, KT, LO, MD, ME, MI, MN, MS, MT, ND, NE, NH, NM, NV, NC, OH, OK, OR, RI, SC, SD, TN, UT, VT, VA, WA, WV, WI. The District of Columbia has also enacted a UTSA statute. MA has its own statute. Six other states (MO, NJ, NY, PA, TX, and WY) protect trade secrets under their common law. 🌐

Ernie Linek is senior partner at *Banner & Witcoff, Ltd.*, 28 State Street, 28th Floor, Boston, MA 02109-1775, ELinek@bannerwitcoff.com.