



## DELIVERING STRATEGIC SOLUTIONS ACCA'S 2000 ANNUAL MEETING

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### TRADE SECRETS

#### A. Introduction

The importance of the trade secret in technological advancement and economic development has not been sufficiently appreciated. Today trade secrets are gaining greater reverence as a tool for protection of innovation. As was stated by Mark Halligan in his talk on trade secrets in John Marshall Law School's 44<sup>th</sup> Annual Conference on Developments in IP Law on February 25, 2000, "Trade secrets are the IP of the new millennium and can no longer be treated as a stepchild."

Halligan also pointed out that trade secrets are no longer merely a matter of employer/employee disputes, the definition of trade secrets and trade secret misappropriation is a broad one and no secrecy agreement is needed. It was only Minnesota and New York anyway where a contract had to be in the picture and that has changed in those states, too.

And James Pooley proclaimed recently "Forget patents, trademarks and copyrights...trade secrets could be your company's most important and valuable assets." ("The value of trade secrets", *Managing Intellectual Property*, October 1999.) Indeed, in many companies trade secrets are their "crown jewels".

And the stakes are getting higher. Damage awards from trade secret misappropriation have been in the hundreds of millions and in a recent trial in Orlando, in which two businessmen were seeking \$1.4 billion in damages from Walt Disney Co., accusing the company of stealing trade secrets for the sports complex at Walt Disney World, the jury awarded them \$240 million.

Trade secrets are the orphan in the IP family or the black sheep in the IP barnyard, with no government bureaucrats involved in their creation and few lawyer groups focused on them. They have been maligned as flying in the face of the patent system, the essence of which is disclosure of inventions to the public. Keeping inventions secret is, therefore, supposed to be reprehensible. One noted IP professor went even so far as to say "Trade secrets are the cesspool of the patent system."

Nothing could be further from the truth. Patents are but the tips of icebergs in an ocean of trade secrets. Over 90% of all new technology is the stuff of trade secrets and over 80% of all license and technology transfer agreements involve proprietary know-how, i.e. trade secrets, or constitute hybrid agreements relating to trade secrets and patents. (Karl Jorda, *Les Nouvelles*, June 1986.) As a practical matter, patent licenses, which do not also include associated know-how, are often not enough for licensees to use the patented technology commercially. (Homer Blair, "Understanding patents...and Their Role in Technology Transfer and

Licensing", FPLC Publication, 2<sup>nd</sup> ed., 1989.) Bob Sherwood calls trade secrets the "workhorse of technology transfer." (Intellectual Property & Economic Development, Westview Press, 1990.) The role they play in innovation is largely unobserved.

Trade secrets are the first-line defense: they come before patents, go with patents and follow patents.

It is interesting, as Henry Perritt states, that "patent law was developed as a way of protecting trade secrets without requiring them to be kept secret and thereby discouraging wider use of useful information." (Trade Secrets – A Practitioners' Guide, PLI, 1994.) That makes patents a supplement to trade secrets rather than the other way around, as is commonly assumed.

## B. Trade Secret Protection Basics

### 1. History of Trade Secrets

- "Trade Secret law is the oldest form of intellectual property protection," according to Perritt. (Cave people?!)
- Back in Roman times, the law afforded relief against a person who induced another's employee (slave) to divulge secrets relating to the master's commercial affairs.
- Trade secrecy was practiced extensively in the European guilds in the Middle Ages and beyond.
- Modern law evolved in England in early 19th century – in response to the growing accumulation of technology and know-how and the increased mobility of employees.
- Recognized in U.S. by middle of 19th century, *Peabody v. Norfolk* (1868) held that a secret manufacturing process is property, protectable against misappropriation; secrecy obligation for an employee outlasts term of employment; a trade secret can be disclosed confidentially to others who need to practice it and a recipient can be enjoined from using a misappropriated trade secret.
- By the end of the 19th century the principal features of contemporary law were well established and in 1939 the Restatement of Torts attempted to "codify" it.

### 2. Definitions of a Trade Secret

#### a. 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. (Restatement of Torts, § 757, Comment b (1939))

#### b. (Uniform Trade Secrets Act) UTSA

A trade secret is any information, including a formula, pattern, compilation, 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. (Uniform Trade Secrets Act § 1(4), 14 U.L.A. 372, 1985 & Supp. 1989) (Adopted in over 40 states.)

### c. Restatement of Unfair Competition

A trade secret is any information that can be used in the operation of a business or other enterprise and that is sufficiently valuable and secret to afford an actual or potential economic advantage over others. (Restatement (third) of Unfair Competition, § 39, 1995)

### d. GATT-TRIPS

Natural and legal persons shall have the possibility of preventing information lawfully within their control from being disclosed to, acquired by, or used by others without their consent in a manner contrary to honest commercial practices so long as such information:

(a) is secret in the sense that it is not, as a body or in the precise configuration and assembly of its components, generally known among or readily accessible to persons within the circles that normally deal with the kind of information in questions;

(b) has commercial value because it is secret; and

(c) has been subject to reasonable steps under the circumstances, by the person lawfully in control of the information, to keep it secret. (TRIPS Agreement, Part II, Sect. 7: Protection of Undisclosed Information, Art. 39, Par. 2, 1994)

### e. Definition of Know-how (Knowledge and Skill)

Know-how is knowledge and experience of a technical, commercial, administrative, financial or other nature, which is practically applicable in the operation of an enterprise or the practice of a profession. (AIPPI Resolution – Mexico Congress – 1973.)

It can be noted from these definitions that know-how and trade secrets are not synonymous. Trade secrets can cover both patentable inventions as well as unpatentable know-how and know-how is not protected unless it is securely maintained in secrecy.

## 3. Scope and Characteristics of Trade Secrets

- No registration requirement.
  - No subject matter or term limitation.
  - No tangibility requirement.
  - No strict novelty requirement.
  - Subject matter must not be generally known or available.

- But secrecy is the most important criterion – a *sine qua non*. There are no exceptions.
- Affirmative measures must be taken to safeguard a trade secret.
  - Sufficient economic value or competitive advantage is also a requisite.
  - Proper criterion is not "actual use" but "of value to company", i.e. negative results can also give a competitive advantage.

The Restatement of Torts adopted and the courts relied on the following criteria for determining whether a trade secret exists:

- (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 to guard the secrecy of the information;
- (4) the value of the information to the business and to competitors;
- (5) the amount of effort or money expended in developing the information;
  - (6) the ease or difficulty with which the information could be properly acquired or duplicated by others.

## 1. Management of Trade Secrets

In line with the requirement that affirmative measures must be in place to safeguard trade secrets, checklists have been developed. An illustrative checklist goes as follows:

- Memorialize the trade secret policy in writing.
- Inform employees of trade secrets.
  - Have employees sign employment agreements with confidentiality obligations.
- Restrict public accessibility to sensitive areas.
- Restrict access to trade secrets (on need-to-know basis).
- Lock gates and cabinets.
- Label trade secret documents as such.
- Screen speeches and publications by employees in advance.
- Conduct exit interviews with departing employees.
  - Use contracts with confidentiality obligations in dealing with third

parties.

The necessary affirmative measures do not require a fortress with walls and moats; efforts that are reasonable under the circumstances will do.

## 1. Misappropriation of Trade Secrets

As stated in the Introduction, the definition of trade secret misappropriation is a broad one.

In UTSA "misappropriation" 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
      - A. before a material change of his [or 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.

Unif. Trade Secrets Act § 1 (2), 14 U.L.A. 372 (1985) (Supp. 1989).

In a nutshell, misappropriation is:

- Acquisition by improper means.
- Acquisition by accident or mistake.
  - Use or disclosure of a trade secret, which is acquired improperly or in violation of a duty to maintain confidentiality.

"Improper means" includes "theft, bribery, misrepresentation, breach or inducement of a breach of a duty to maintain secrecy, or espionage through electronic or other means."

Independent discovery, reverse engineering, or discovery from observing what has been allowed to enter the public domain, do not support a claim for misappropriation.

## 6. Trade Secret Litigation

As trade secret law is state law, litigation is in state courts, except in diversity cases (parties are residents of different states; over \$50,000 is at stake) and cases also involving a federal issue, e.g. patent infringement.

After questions of jurisdiction and venue are dealt with, this is what happens in a typical trade secret misappropriation case:

- Pleadings (Complaint, Answer, Counterclaims) are filed and served on other party.
- Discovery (via interrogatories, requests for documents and admissions, depositions of witnesses) takes place.
- Pretrial motions are filed, such as, in particular, a motion for summary judgment.
- A trial is held before a judge or jury, where the plaintiff has the burden of proof and must establish the basic elements of a trade secret and its misappropriation. In defense, defendant attempts to deny the charges and/or use affirmative defenses, e.g. unclean hands.
- To protect the trade secrets from disclosure, the court will issue protective orders and hold trial sessions in camera (in the judge's chamber).
- Appeals can follow the trial; the dispute can be settled or arbitrated or mediated.

Remedies for misappropriation include one or more of the following:

- Injunctions – specially important in trade secret cases.
  - Interlocutory injunctions (temporary restraining orders and preliminary injunctions) and permanent injunctions. As to the length of time that an injunction should last, many courts will issue a "reverse engineering injunction" which lasts for the estimated time it would take a hypothetical competitor to take a public disclosure and work backward to discover the trade secret.
  - Damages – compensatory damages, defendant's profits, royalties, punitive damages, attorney's fees.
  - Searches and Seizures – where they are the only way to obtain evidence of misappropriation.

Although trade secret misappropriation cases are, as a general rule, civil cases brought in state courts; several states make trade secret misappropriation a crime via explicit criminalization (e.g. Pennsylvania) or via larceny and theft of "property" (e.g. Massachusetts, Minnesota, New Jersey, Ohio, Texas).

## 7. Economic Espionage Act

More importantly, as of 1996 we have the Economic Espionage Act (EEA).

The EEA is the first federal criminal statute to impose serious penalties for the misappropriation of trade secrets. The EEA does not preempt existing state or federal trade secret law; however, as a criminal statute, the EEA does not afford a private right of action. Under current Justice Department policy, only the Attorney General, the Deputy Attorney General or the Assistant Attorney General for the Criminal Division can authorize prosecution under the EEA.

The EEA generally prohibits the intentional misappropriation of trade secrets to benefit anyone other than the owner.

The penalty under the EEA is half a million dollars and/or 15 years imprisonment for individuals and for organizations it is \$5 million but if the trade secret misappropriation benefited foreign entities, it is \$10 million.

### C. The Trade Secret/Patent Interface – Compatibility

Patents and trade secrets are not mutually exclusive but actually highly complementary and mutually reinforcing; in fact, they dovetail. In this context, it should be kept in mind that our Supreme Court has recognized trade secrets as perfectly viable alternatives to patents (*Kewanee Oil v. Bicron* (1974) "the extension of trade secret protection to clearly patentable inventions does not conflict with the patent policy of disclosure") and further strengthened the bases for trade secret reliance in subsequent decisions (*Aronson v. Quick Point Pencil* (1979) and *Bonito Boats v. Thunder Craft Boats* (1989)). Interestingly, in his concurring opinion in the *Kewanee Oil* decision, Justice Marshall was "persuaded" that "Congress, in enacting the patent laws, intended merely to offer inventors a limited monopoly (sic) in exchange for disclosure of their inventions (rather than) to exert pressure on inventors to enter into this exchange by withdrawing any alternative possibility of legal protection for their inventions.". Thus, it is clear that patents and trade secrets cannot only coexist, but are in harmony rather than in conflict with each other.

In the past – and even today – if trade secret maintenance was contemplated at all, e.g. for manufacturing process technology, which can be secreted unlike gadgets or machinery, which upon sale can be reverse-engineered, the question always was phrased in the alternative. E.g. titles of articles discussing the matter read "Trade Secret vs. Patent Protection", "To patent or not to patent?" "Trade Secret or Patent?" etc.

I submit that it is not necessary, and in fact shortsighted, to choose one over the other. To me the question is not so much whether to patent or to padlock but rather what to patent and what to keep a trade secret and whether it is best to patent as well as to padlock, i.e. integrate patents and trade secrets for optimal protection of innovation.

In his 1991 treatise on "Intellectual Property Law: Commercial, Creative and Industrial Property", Professor Jay Dratler of the University discussed in great detail the emergence of intellectual property as a single field of law ("knit(ing) this patchwork of separate legal (IP) regimes into a single, coherent fabric") and focused on the overlap between the separate fields of IP and on exploiting this overlap to achieve multiple and synergistic IP protection. But Bob Sherwood (*supra*) had already observed in 1990 "the interplay of several forms of intellectual property protection" with respect to the new technologies of computer software and biotechnology.

Subsequently, other writers picked up this theme and there can be no doubt now that exploiting the overlap to develop fall-back positions via multiple protection is the best strategy.

It is true that patents and trade secrets are at polar extremes on the issue of disclosure. Information that is disclosed in a patent is no longer a trade secret. Yet, the highest degree of overlap, and the best opportunities

for exploiting this overlap, exists with trade secrets and patents. This is due to the fact that patents and trade secrets are indeed complementary, especially for and under the following reasons and circumstances:

Firstly, in the critical R&D stage and before any applications are filed and also before patents issue, trade secret law particularly "dovetails" with patent law (see *Bonito Boats*).

Secondly, provided that an invention has been enabled and the best mode described in the patent application, as is requisite, all associated know-how not disclosed can and should be treated and retained as a trade secret. That the "written description" and "best mode" requirements apply only to the claimed invention and only at the time of filing should be kept in mind in this context.

Thirdly, all the mountains of R&D data, including data pertaining to better modes, usually developed after filing, whether or not inventive, can and should also be maintained as trade secrets, to the extent the data are not disclosed in separate applications.

Fourthly and especially with respect to complex technologies consisting of many patentable inventions and volumes of associated know-how, complementary patenting and secreting is tantamount to having the best of both worlds. In this regard GE's industrial diamond process technology, which is partially patented and partially under trade secret protection, comes to mind as an excellent illustration of the synergistic integration of patents and trade secrets to secure robust protection.

Was GE's policy to rely on trade secrets in this manner, or, for that matter, Coca-Cola's decision to keep their formula secret rather than patent it, which could have been done, damnable? I think not.

#### D. The Trade Secret/Patent Interface – Respective Rights Issue

The discussion that patents and trade secrets, far from being mutually exclusive, actually dovetail, as trade secrets are perfectly equal and viable alternatives to patents, obviously left unanswered the question of the respective rights of a first inventor who elects to hold and use patentable subject matter as a trade secret (trade secret owner) and the second independent inventor who seeks and obtains a patent thereon (patentee). This is the highly controversial issue of whether the first inventor has the so-called "prior user right" to continue to practice the invention in question in the face of the second inventor's patent thereon. In hearings in the U.S. Patent & Trademark Office last year about IP bills pending in Congress, the threat was made by a noted patent attorney that, inasmuch as prior user rights would be "unconstitutional, because they undermine the notion of 'exclusive rights' inherent in the patent grant," he is "prepared to sue to test it". In my view, he won't get a chance to follow up on his threat and, even if he did, wouldn't get to first base. Such a proposition is simply not tenable. This goes also for the common, baldly-stated misconception that the trade secret owner infringes the second-inventor's patent and hence can be enjoined.

First of all, the modifier "exclusive" doesn't mean "exclusive, exclusive". No right is ever totally exclusive and anent patents, there are several areas where something akin or tantamount to a prior user right already exists. Angelo Notaro lists a veritable litany of statutorily- or decisionally-created "co-uses", "forced sharing of inventions", "estoppels", "implied licenses", "intervening rights", "judicial recognition of prior user rights", etc. as, for example, shoprights, temporary uses of inventions on vessels or aircrafts, intervening rights in reissue and reexamination cases, co-uses in supplier/customer, manufacturer/distributor, contractor/contractee relationships, public interest situations where injunctive relief is denied, certain uses by government or uses under the Clean Air and Atomic Energy acts, compulsory licenses as a remedy for antitrust violations, etc. (Notaro, *Patents and Secret Prior User Rights...*, 81 *patent and trademark review*, 1983.) We also have an experimental use exception and the patent right is a negative right and a patentee may be blocked by a dominant patent.

And as regards the respective rights, I contend that the trade secret owner has a *de facto* prior user right to



continue the practice of his trade secret. I do so on the basis of 1) much thoughtful literature, going back to at least 1944 (all referenced in my 1979 *JPOS* article), which postulates such a right, and 2) the fact that it has never happened that a trade secret owner was enjoined by a "Johnny-come-lately" patentee.

Such a right, which is very prevalent outside the U.S. and has existed in some countries for over 100 years, has also been posited in the literature as a kind of "*in personam* right", "shopright," "intervening right," "right of co-use," "right of personal possession" and "personal easement on the invention."

In his classic treatise on Trade Secrets (Sec. 180), Ellis concluded:

"To give a patent to a subsequent inventor without barring him from suing the first inventor and secret user of the invention, would be to offer, as a reward to anyone who could discover the invention by independent research, the economic scalp of the first inventor and secret user."

A similar sentiment resides in the cogent maxim: "A Constitutional award to one inventor does not mandate a Constitutional penalty to another." (Bennett, *The Trade Secret Owner Versus the Patentee...*, *JPOS*, 1975.)

In the literature, referred to above, it is also emphasized that an *in personam* right or a prior user right:

- is a first inventor's common law right,
- is required by principles of equity and due process and
  - not granting it, amounts to taking property without compensation.

The contrary position, espoused by patent advocates, holds that when the choice is made to forego a patent and to rely instead on trade secret protection, the trade secret owner assumes the risk of being enjoined by the patentee. Also clearly an untenable position! How can there be such an assumed risk when the Supreme Court recognized trade secrets as viable and compatible alternatives to patents (*Kewanee Oil*, 1974; *Bonito Boats*, 1989) and when "no court has ever decided a case in which the issue was even raised." (Bennett).

The *Gore v. Garlock* (CAFC, 1983) decision has mistakenly been interpreted as putting an end to this debate by resolving the perceived conflict in favor of the patentee. Far from it! This case, which was limited by subsequent cases to an interpretation of Sec. 102(b), not Sec. 102(g), did hold that trade secrets of a third party are not prior art, but such a holding is an entirely different proposition from a holding that the trade secret owner is an infringer of a later inventor's patent and can be enjoined as such.

Maintaining secrecy is a *sine qua non* in trade secret law and is not to be equated with "concealment" in patent law, which means in a Sec. 102(g) context only too long a delay in filing a patent application in relation to another applicant, i.e. in a situation where both resort to the patent system. This is to be clearly distinguished from a situation where one party relies on the trade secret system and is outside the patent system altogether.

Thus, it is abundantly clear that the patentee does not have superior rights vis-à-vis the trade secret owner and the reason the later patentee leaves the trade secret owner alone, is the former's concern that putting the patent on the block is risky, knowing he/she was not the first to invent and the patent may be invalid for a number of Sec. 102 and/or Sec. 102/103 grounds due to the activities of the trade secret owner, illustrating at least the level of ordinary skill in the art at the time the later invention is made. Consequently, an accommodation between the two serves them best because patent coverage continues and other competition is shut out.

In light of the above argumentation, my advice, when such a respective rights issue came up in my corporate

practice, was to ignore the patents of the "Johnny-come-lately" inventor. It never boomeranged on me; after all, we do (or did in light of what follows?) have a *de facto* prior user right system.

But, you might say, a prior user rights provision, styled "First to Invent Defense," was enacted into law last year and this mooted the issue. Unfortunately, this "first-to-invent-defense" provision bears little resemblance to a true prior user right provision, as exists abroad and as was initially introduced as part of the proposed patent reform legislation. The present version is not just narrowed but totally gutted; it has so many exceptions and limitations that it is not just meaningless but dangerous.

Meaningless, because "serious and effective preparation" for commercial use is excluded, and it is this development stage which is crucial; the prior invention concerning which the defense is asserted is now required to have been reduced to practice more than one year before the patentee's filing date, and it is precisely within a year that inventions often are conceived independently by more than one inventor due to outside stimuli; and the defense, which was to apply only to manufacturing processes anyway, rather than across the board, as it should, was further constricted to cover only methods of doing business, newly patentable in the wake to last years' CAFC decision in the *State Street Bank* case.

The present, completely eviscerated version, is also dangerous, because before we could rely on the existence of a *de facto* prior user right, which might not be possible after the enactment of an unduly narrow provision.

What is needed is a true prior user rights provision that would cover commercial use of an invention or effective and serious preparations for such use, prior to the filing date of the later patent, such rights being of limited alienability (personal rights – transferable only with the entire enterprise), limited territoriality (the territory of the patent), limited scope (continuation of existing prior use) and limited recognition of prior acts (good-faith use without derivation or theft).

As a final credo, it is submitted that such a strong prior user right, which is absolutely essential in a first-to-file system, is equally important in our first-to-invent system, as a better alternative to our archaic, costly and inadequate interference practice and as a better way for protection of trade secrets in view of their transcending importance.

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