# Invoking Trade Secret Protection


Excerpt from *Entrepreneurs' Guide to Patents, Trademarks, Copyrights Licensing and Trade Secrets*
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Patent and copyright applications are matters of public record that your competitors can peruse on the internet, to see exactly what you have done and how. Trade secret law provides a mechanism to keep valuable knowledge from your competitors when other areas of intellectual property law require public disclosure of the very information you're trying to protect.

*The original formula for Coca-Cola was concocted by a pharmacist named John Pemberton in 1886, using mysterious equipment and ingredients in his own backyard. He dubbed the formula 7X, and kept it locked up in a bank security vault in Atlanta. Had Mr. Pemberton, instead, opted to patent 7X, that patent have expired more than 100 years ago, and the formula would have been marketed by competitors once it entered the public domain. Instead, Mr. Pemberton's 7X remains subject to trade secret protection and is the exclusive property of the Coca-Cola Company to this day.*

***In This Chapter You Find Out:***

- The advantages of trade secret protection over patent and copyright
- How to identify information that should be afforded trade secret status
- How you can inadvertently lose a trade secret
- How to protect and defend trade secrets from misappropriation

Krispy Kreme donuts are made out in the open for the public to see, but their precise recipe is a closely guarded trade secret. The Kellogg Company, at one time, stopped tours of its facilities because it feared corporate spies posing as tourists would gain access to valuable breakfast cereal formulas. Nearly every business has a customer list that warrants consideration of trade secret protection.

## Why Do We Have Trade Secret Protection?

Information requires investment of money, technology and skilled human capital to research and produce. It can be the most valuable asset your business owns, but it can quickly become worthless if disclosed to your competitors. Trade secret law recognizes that proprietary information is a unique form of intellectual property. As with other forms of intellectual property, it's in the interest of society to promote the research and development that leads to advancements.

Trademark and copyright require public exposure and publication, which is exactly the opposite of what you want for intellectual property you're trying to keep confidential. Patents also require disclosure of information sufficient to replicate your invention in an application document that is freely available on the Patent and Trademark Office Web site require you to prove that the knowledge you're seeking to protect is a novel technological advancement.

## Special Laws Protecting Trade Secrets

Both federal and state governments favor the development of commercial and industrial knowledge that place businesses within their borders at a competitive advantage. Both federal and state statutes provide the necessary cloak of secrecy to foster this research and development.

### *State Statutes: Uniform Trade Secrets Act and Restatement of Torts*

Most states have their own statutes covering trade secrets, but many, if not all, have co-opted the basic concepts and language from a three of well known sources: common law and, the Uniform Trade Secrets Act and the Restatement of Torts.

*Common law* is law developed by courts rather than Congressmen. It consists of legal rules and precedents established by court decisions, rather than statutes. Often statutes are developed to codify prior common law decisions as laws which are more concise and easier for the public to access. Most state and federal trade secret statutes laws are based on common law principles.

Some state statutes are based on the *Uniform Trade Secrets Act*, which is a "model" act created by a collaboration of judges, lawyers and scholars in various states. About half of the states have adopted the Uniform Trade Secrets Act in some form, which is based largely on common law principals.

In addition to the Uniform Trade Secrets Act, the *Restatement of Torts* is a guide used by most states. It summarizes common law principles pertaining to trade secret protection, and has also been adopted by most states that have codified some form of the Uniform Trade Secrets Act.

The Uniform Trade Secrets Act was created in 1979, and significantly amended in 1985. In the states where it's been adopted, it's deemed to preempt any previously established common law (except that which is included in the Restatement of Torts, if it's been adopted).

### *Federal Law: Economic Espionage Act of 1996*

In 1996 President Clinton signed the Economic Espionage Act into law. The Act makes it a federal crime to steal a trade secret, or to receive or possess trade secret information if you know that it's been stolen. As you might imagine, a major target of the act is high tech theft of information over the Internet.

The Act provides criminal penalties, with jail terms up to 10 years and fines of up to $500,000 for individuals. Corporations or organizations can be fined up to $5 million.

Stricter penalties apply if a trade secret benefits a foreign entity. Maximum prison terms shoot up to 15 years, and fines for individuals $500,000. Corporations can be fined up to $10 million for stealing secrets for foreign entities.

The act also provides mechanisms to all the U.S. government to seize property obtained as a result of trade secret theft, and to dismantle entities and networks facilitating the theft of trade secrets.

## What is a Trade Secret?

Because something is secret, doesn't necessarily mean it is valuable. Trade secrets must possess both confidentiality and have value. Whether the particular information has value is a matter is highly specific to and industry context.

### *Definition of a Trade Secret: The Uniform Trade Secrets Act*

The Uniform Trade Secrets Act primarily promotes uniformity primarily by providing a standard definition as to what constitutes a trade secret.

This definition is so central to the statutory scheme of the majority of states, that it warrants some scrutiny. The Act Provides:

> A trade secret is 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 and use, and
> >
> > (ii) the subject of efforts that are reasonable under the circumstances to maintain its secrecy

From this definition, it’s apparent that there elements information must possess in order to be characterized as a trade secret. Although trade secret protection may differ slightly from state to state, you can assume that a trade secret in any jurisdiction must be all of the following:

- **Non-ascertainable**: The Information must not be generally known or ascertainable to the members of the general public through legitimate means. Information disclosed in marketing materials and presentations, customer seminars, trade journals and other non-confidential marketing materials is considered readily ascertainable.

- **Valuable-** to be classified as a trade secret, information must have actual economic value. Value can be proven by showing that revenue is derived as a result of using the information.

- **Maintained with discretion-** The owner of a trade secret must use reasonable efforts to maintain its secrecy or the the information loses its status as a trade secret.

## *Some Examples of Trade Secrets*

A good test for determining something is a trade secret is to ask yourself whether your business would be damaged if your competitors got hold of it.

Examples of information you might want to protect as trade secrets include:

- Formulas and procedure used for creating and delivering your product or service
- Marketing strategies
- Customer lists and valuable knowledge obtained about the needs of your clients
- Research pertaining to new product formulations
- Research pertaining to rejected or abandoned product formulations
- Specialized training materials developed to train employees in methods specific to your company
- Designs and specifications for your manufacturing facility and equipment
- Specialized modifications made to commercial software products

# Comparing Patent and Trade Secret Protections

Occasionally and inventor or entrepreneur will opt for trade secret protection, rather than going to the trouble and expense of applying for a patent. The two protections are sometimes are mutually exclusive, since the patent process requires public disclosure in the patent application, while trade secret protections requires that confidentiality be maintained. This means that an entrepreneur can "lay down their money" on one, but not both of these types of protection.

## *Advantages of Trade Secret Over Patent Protection*

Trade secret protection is much cheaper and faster to obtain than patent protection. Patents can require upwards of $10,000 and eighteen months to prosecute, with no guarantee that the patent will ultimately be granted. Other potentially more important advantages of trade secret protection over the long term include:

- **Perpetual protection** - Utility patents expire after 20 years. Trade secret protection, like the Coca-Cola formula, can be maintained in perpetuity.

- **Broader Protection** - Patents must be narrowly drawn and cannot cover elements of your business know-how unless they are proven to be novel and non-obvious. Thus, patent protection may not cover many aspects of your business process. Trade secret can be used to protect processes and information in its entirety.

- **Timely and Automatic Protection** - Trade secret protection is automatic if your information falls within the statutory definition . You aren't' at the mercy of the patent office to grant your application, and do not need to wait out the average 18 month waiting process

- **No proof of novelty required** - You are not required to prove that your information constitutes novel technological advancement, as is the case with patented inventions.

## *Limitations of Trade Secret Protection*

Trade secrets protection can be tenuous in many areas. The following considerations might induce you to apply for a patent:

- **Reverse Engineering** - Any one is free to discover your trade secret by legitimate means. This is called reverse engineering, and is strictly prohibited by the patent process which gives you a virtual monopoly to make, sell and use the technology claimed. Reverse engineering is the reason trade secret protection is not useful for most computer software which can be reverse engineered using computers called *decompilers*.

- **Loss of Protection-** Trade secret protection is immediately lost if you fail to maintain confidentiality or the information becomes known through any legitimate means whatsoever.

- **Someone else can patent your trade secret** -The fact that you have decided to protect your innovation or process as trade secret, and have acted properly to do so, does not prevent someone else from developing the technology by legitimate means and patenting it.

## Protecting Your Trade Secrets

Trade secret protection can literally be lost overnight if your competitor gets the information through legitimate means. This can occur if the competitor somehow independently develops the information, or if you are sloppy or ineffectual when it comes to taking reasonable precautions to maintain its confidentiality.

### *The Clean Room Doctrine*

To demonstrate that a company develop information "proper means" a company must demonstrate that it developed it independently. This can include deliberate reverse engineering.

Under the *clean room doctrine*, a figurative clean room exists when a company demonstrates that its own engineers and analysts have developed the information independently, using publicly available technology. Companies who are actively engaged in reverse engineering of trade secrets usually maintain careful documentation to show how the information was developed and that only publicly available resources were consulted. obtained the information through other legitimate means.

### *Your Duty to Maintain Confidentiality: Who Has Access?*

Trade secrets that have been maintained for decades can be lost overnight by a single breach in confidentiality. The law is surprisingly unsympathetic even when the secrets are discovered by unethical or unscrupulous means. A stray file, a misdirected e-mail or a disgruntled employee can be the kiss of death for a trade secret.

Once you've determined information has value as trade secret, you need to be careful about who has access to it. You also need to document policies and procedures calculated to keep it confidential. Failure to exercise such controls can lead to a finding by a court that that you haven't really kept the information secret at all.

What do your employees need to know to do their jobs? Can their duties be defined so no employee is fully aware of all of the elements of the secret? What do your suppliers know? When employees transfer from one department to another, will they learn enough about making the product in each department to replicate it? What do your suppliers need to know?

Coca-Cola has several suppliers provide parts of their formula, but final mixing is done under direct secure company control. Kellogg stopped tours of its facility after suspicions that industrial spies were posing as tourists. Many companies immediately cut off the access to a facilities an computer systems by terminated employees.

### *Employee Confidentiality Agreements*

The biggest threat to company confidentiality can come from within your own ranks. Your employees may have knowledge of your company's manufacturing processes, proprietary formulas, trade secrets and customer outlets. Employees are likely to be an integral part of your marketing and development strategy.

> **Business Tip:** Customer lists and specifications can be viewed as a form of trade secrets.

It's good preventative medicine to have employees routinely enter into confidentiality or non-disclosure agreements. These agreements put the employee on notice that they are under an obligation to keep mum about the details of your daily operations, particularly where competitors are concerned. Without a formal agreement, and the discussion that accompanies it, an employee would assume that anything he or she learns on the job is theirs to claim on a resume regardless of how sensitive or integral that information may be to your business.

Unfortunately, in the absence of an express written agreement, a disgruntled employee who blabs to your competitors may have the stronger legal position in court. By the time you get to court, your trade secrets may have long since lost their secrecy. For example, everyone on your customer list may already have been contacted.

To avoid this scenario, the confidentiality agreement into which you enter with your employees should establish the following:

- **The scope of the confidentiality** – the agreement should specifically define what information is to be kept confidential and is considered proprietary by the employer.

- **Ownership of innovations or creative work developed in the workplace** – The agreement should make clear the that the employer is the owner of innovations and creative work product, related to employment, developed during the course of employment.

- **The existence of "valuable consideration" –** In order for any contract to binding, *both* parties must receive something of value. The legal term for this is called *consideration.* If the agreement is signed at the beginning of the employment relationship, the employment opportunity may serve as legal consideration to the employee. If the agreement is entered into later, bonuses and raises may serve as consideration. The consideration given to the employee should be specifically identified in the agreement.

### *Third Party Confidentiality Agreements*

Suppliers, consultants and even investment bankers can all pose a hidden threat to your trade secrets, depending on how much they need to know to assist your business and do their jobs. Confidentiality agreements for third parties have become relatively common place. Generally, if your supplier wants your account, it will have no problem signing such an agreement. Investment bankers and financial professionals consider them routine. A sample third party Non-Disclosure Agreement is included in Appendix C.

## Litigating to Protect Your Trade Secrets

Trade secret litigation can proceed under two theories. The first is the breach of a contractual obligation to maintain confidentiality. The second is an established cause of action of misappropriation by improper means.

To prevail on a contract theory, you must have an enforceable agreement that the material was to be kept confidential. Agreements can be oral, but a written agreement puts you in a stronger position.

The Uniform Trade Secrets Act defines misappropriation as the acquiring of information by unauthorized means by someone who knew or should have known they had a duty to maintain it. A common defense is that the information was not "secret." To prevail on a theory of misappropriation, you have the burden of proving that you took reasonable measures to secure the information and maintain its confidentiality.

**Lawyer's Note:** The Uniform Trade Secrets Act has a three year statute of limitations, but states that have not adopted the Act may have different limitations periods.