

UNITED STATES TRADE SECRET LAW

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I. Introduction

Trade secrets law is concerned with the protection of technological and commercial information not generally known in the trade against unauthorized commercial use by others. The policy basis for trade secret protection is the desire to encourage research and development by providing protection to the originator of business information, and also to maintain proper standards of business ethics. *See Kewanee Oil Company v. Bicron Corp.*, 416 U.S. 470 (1990). The trade secret owner is not granted exclusivity to the information, but rather is only protected against improper acquisition and/or use of the information. As a result, others are free to discover a trade secret by any fair means.

II. Legal Basis

Until relatively recently, trade secret protection had been based on common law principles; namely, trade secrets had been protected under contract, quasi-contract, and property theories. Protection of trade secrets under contract theories includes instances in which there existed an express contract concerning non-disclosure or use of a trade secret, or there existed a confidential relationship, giving rise to a duty not to disclose or use the trade secret – such as an employer-employee relationship. The quasi-contract basis of trade secret protection includes avoidance of unjust enrichment from trade secret misappropriation. Finally, under the property theory, a trade secret is viewed as a property right - a property right subject to protective restrictions on its use and disclosure.

Perhaps the most widely used common law definition of a trade secret was set forth in the Restatement of Torts, § 757, comment b (1939):

[A trade secret is] [a]ny 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.

More recently, the Restatement of Unfair Competition, § 39 (2002), defines a trade secret with a slight difference.

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.

Washington State is also one of the few states that recognize the theft of trade secrets as a crime. *See, generally*, RCW § 9A.56.010. There are no reported cases of criminal trade secret theft in Washington.

The Restatement also lists six factors to be considered in determining the existence of a trade secret:

1. the extent to which the information is known outside the business;
2. the extent to which it is known by employees and other involved in his business;
3. the extent of measure taken by him to guard the secrecy of the information;
4. the value of the information to him and to his competitors;
5. the amount of efforts or money expended by him in developing the information; and
6. the ease or difficulty with which the information could be properly acquired or duplicated by others.

These factors are “[t]he most-cited listing of the objective criteria for determining the existence of a trade secret.” *M. Jager*, Trade Secrets Law § 5.05 (1995). Note that this definition is still widely used in spite of the decision of the authors of the Restatement (Second) of Torts (1979) to omit any discussion of trade secrets.

In recent years, trade secret law has become largely statutory. The Uniform Trade Secret Act (UTSA) has now been adopted (sometimes with modifications) in 42 states and the District of Columbia. *M. Jager, supra*, at § 3.05 (2001). Washington adopted the UTSA as of January 1, 1982. RCW 19.108 *et seq.* Nonetheless, and despite the UTSA’s widespread adoption, the *Restatement* definition retains vitality and is often referred to by the courts during the course of their deliberations in applying the UTSA.

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The Oregon State Trade Secrets Act was adopted in 1987 and is also based on the UTSA. *See, generally*, OR. Rev. Stat. §§646.46 *et seq.* (1998).

In slight contrast the Idaho State Trade Secrets Act is based on the 1985 revised version of the USTA. *See, generally*, Idaho Code §48-801 *et seq.* (2002).

The UTSA defines a trade secret as 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.

III. Elements of a Trade Secret

Under both the old Restatement of Torts and the current statutory definition, to establish the existence of a trade secret one must show that the information or item alleged to be a trade secret is: (1) of an appropriate subject matter to be protected as a trade secret; (2) not a matter of common knowledge in the trade and not readily ascertainable by proper means; (3) of value; and (4) the object of reasonable precautions taken under the circumstances to maintain secrecy.

IV. Protectable Subject Matter

Under the common law and the Washington statutory definition, almost any knowledge or information used in conjunction with one's business may be held as a trade secret. Specific examples include:

1. Formulas for chemicals, drugs, cosmetics, foods, etcetera.
2. Industrial Processes. *E.I. du Pont de Nemours & Company, Inc. v. Christopher*, 431 F.2d 1012 (5th Cir. 1970).
3. Know-how, *i.e.*, technical information relating to the practical application of patented or unpatented inventions.
4. Blueprints, such as for a building or machinery.
5. Computer software, to the extent it cannot be reverse engineered.
6. Sources of supply, pricing information, identity of vendors or suppliers, and customer lists.

In addition and contrary to common belief, trade secrets are not limited to technical items, know-how and related matters, but include a wide variety of business information (*i.e.*, employee benefit information and financial statements and projections). Under the Washington statute, a trade secret can include information that has commercial value from a negative standpoint (*e.g.*, knowledge that a particular process cannot be used to produce a certain product).

V. Not Generally Known or Readily Ascertainable

Trade secret protection is available only for information not generally known (*i.e.*, secret information), and is not available for information, which is common knowledge. In addition to not being generally known, a trade secret must not be readily ascertainable

by proper means. The comments to the UTSA indicate that information is “readily ascertainable” if it is available in trade journals, reference books or other published materials.

Note, that secrecy is not lost if the possessor of the information disclosed it to another in confidence or under an express or implied obligation not to disclose it. Thus, information can be disclosed, for example, to prospective purchasers of the trade secret, or to employees involved in a manufacturing process, which utilizes the trade secret, without destroying the trade secret. These types of disclosures comport with commercial reality.

In Washington, trade secrets must be “novel” and not ascertainable from other sources. *Spokane Research & Dev. Found. v. City of Spokane*, 983 P.2d 682 (Wash. App. 1999) (citing *Confederated Tribes of Chehalis Res. v. Johnson*, 135 Wn.2d 734, 749, 958 P.2d 260 (1998) (*en banc*); See also, *Buffets, Inc. v. Klinke*, 73 F.3d 965, 969 (9th Cir. 1996) (recipes denied trade secret protection under USTA because they lacked requisite novelty and economic value).

Another interesting twist in Washington trade secret law is that even memorizing information, such as customer lists, can be considered trade secret misappropriation. *Ed Nowogroski Ins., Inc. v. Rucker*, 88 Wn. App. 350, 356, 944 P.2d 1093, 1096 (1997) (memorized information included insurance agency’s confidential customer lists and other unspecified confidential customer information).

VI. Independent Economic Value

To be protectable, the trade secret information must provide a competitive advantage over others who are unaware of the secret information. Earlier decisions required that for a trade secret to have value, the information must be regularly used in the proponent’s business. This requirement, which could post a problem during research and development, has been rejected by the UTSA.

VII. Reasonable Efforts to Maintain Secrecy

The requirement that the possessor of a trade secret must make reasonable efforts to maintain secrecy is based on the rationale that if the possessor does not treat the information as a trade secret, then the law also should not. The degree of secrecy required is that which is reasonable under the circumstances and may include:

1. establishing / enforcing clear policies about confidential business information;
2. identifying technological and technical information deemed to be secret;
3. advising / training employees and others of the existence of trade secrets;

4. use of nondisclosure and confidentiality agreements with employees and others;
5. limiting access to trade secrets on a “need-to-know-basis”;
6. controlling access to company files and facility locations;
7. central control of blueprints and engineering drawings;
8. use of security systems and guards;
9. providing locked storage for sensitive information such as laboratory notebooks;
10. implementation of document protection and retention policies; and
11. use of computer passwords and firewalls throughout organization.

VIII. Trade Secret Misappropriation

Under the common law, liability for trade secret misappropriation required acquisition by another by improper conduct or unfair means together with the use or disclosure by such person to the trade secret owner’s detriment. Under the UTSA, the definition of misappropriation is much broader; it can include simple acquisition of a trade secret by a person who knows or has reason to know that the trade secret was acquired by improper means no subsequent or impending use of the trade secret is required.

The UTSA specifies that “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. Again, one of the broadly stated policies behind trade secret law is the maintenance of standards of commercial ethics. Thus, improper means could include otherwise lawful conduct which is improper under the circumstances; *e.g.*, an airplane over-flight used as aerial reconnaissance to determine the competitor’s plant layout during construction of the plant. *E.I. du Pont de Nemours & Co., Inc. v. Christopher*, 431 F.2d 1012 (CA5, 1970).

IX. Relief Available

A. Injunctive Relief

Once it has been established that a trade secret has been misappropriated, injunctions to enjoin further use of a trade secret generally have been issued by the courts. This remedy is expressly provided under the UTSA. Under the common law, there were several different views concerning the duration of prohibitory injunction. Under one doctrine, the defendant could be permanently enjoined from using the

misappropriated trade secret, even if it later became public knowledge. *Allen-Qualia Co. v. Shellmar Products Co.*, 87 F.2d 104 (7th Cir. 1936). This view was based on the theory that the defendant by her own inequitable conduct had permanently deprived herself of the right to employ the trade secret. Under a second doctrine, the injunction is terminated once the information becomes available to the public. *Conmar Products Corp. v. Universal Slide Fastener Co.*, 172 F.2d 150 (2d Cir. 1949). And under a third doctrine, the duration of the injunction is limited to the period of time it would have taken the defendant either by reverse engineering or by independent development to develop its product or process without the use of the trade secret. *K-2 Ski Company v. Head Ski Co., Inc.*, 506 F.2d 471 (9th Cir. 1974).

UTSA adopts the *K-2* rule; injunctive relief terminates once a trade secret ceases to exist – however, the injunction may be continued for an additional length of time to eliminate any commercial advantage derived from the misappropriation. As such, the maximum duration of an injunction is the period of time it would have taken the defendant to lawfully discover the trade secret either through independent development or reverse engineering.

X. Damages and Attorney’s Fees

The UTSA provides that in addition to or in lieu of injunctive relief, damages of the actual loss caused by the misappropriation may be awarded. In addition to damages, the complainant may recover the unjust enrichment resulting from the misappropriation, provided that such amount is not taken into account in computing the actual loss. If willful or malicious misappropriation is found, the court can award exemplary damages in an amount not to exceed twice actual damages, together with recovery for unjust enrichment. In such circumstance, the court may also award attorney’s fees. The comments to the UTSA indicate that the patent laws of the United States are followed in determining whether attorney’s fees should be provided.

XI. Statute of Limitations

The UTSA specifies that an action for misappropriation must be brought within three years after the misappropriation is discovered or reasonably should have been discovered.

XII. Economic Espionage Act of 1996

The Economic Espionage Act of 1996 (the “EEA”, now codified in 18 U.S.C. §§1831-1839) has created an important change in the law relating to the protection of trade secrets; namely, it provides for trade secret protection at the federal level. Specifically, the EEA was enacted as a federal criminal statute and, as such, it is enforced by the U.S. Department of Justice and its U.S. Attorneys’ offices located in each federal district across the country. The EEA does not provide for a private civil right of action. Accordingly, a victim of trade secret theft seeking redress must persuade the federal prosecutor in its judicial district that their particular case is worthy of prosecution.

The EEA contains two operative sections describing the conduct that is prohibited by the law. Section 1831 applies to actors engaged in foreign economic espionage, and requires that the theft of trade secrets benefit a foreign government, instrumentality or agent. Section 1832 is a general criminal trade secrets statute; applicable to anyone engaged in the common misappropriation of trade secrets. Both sections punish one who knowingly: (1) steals or misappropriates trade secrets, (2) receives misappropriated trade secrets, or (3) participates in a conspiracy to misappropriate trade secrets. 18 U.S.C. §§ 1831(a) and 1832(a). The territorial scope of the EEA is essentially limitless: it criminalizes not only acts conducted within the United States, but also foreign acts, provided the actor is a United States resident, 18 U.S.C. § 1837(1), or any “act in furtherance of the offense was committed in the United States.” 18 U.S.C. § 1837(2).

Individuals who violate section 1832 (domestic misappropriation of trade secrets) face penalties of up to ten (10) years in prison and unspecified fines. 18 U.S.C. § 1832(a). (Under federal law, the general maximum fine for felonies is \$250,000.) Corporations or other organizations that violate section 1832 may be fined up to \$5 million. The penalties for engaging in foreign economic espionage in violation of section 1831 (foreign economic espionage) are even greater: the maximum organizational fine is increased to \$10 million and the maximum prison term is raised to fifteen (15) years.

XIII. Inevitable Trade Secret Misappropriation

A. Inevitable Disclosure Is Not The Law In Washington

The only Washington case to mention inevitable disclosure is an unpublished Washington Court of Appeals case, *Solutec Corp. v. Agnew*, 88 Wash. App. 1067, 1997 WL 794496 (Wash. App. 1997) (noting the lack of Washington law on inevitable disclosure) (unpublished).¹ *Solutec* has no precedential value; therefore, it is for this Court to decide whether inevitable disclosure should be considered law in Washington for purposes of this case. *See Wash. Rev. Code Ann. 2.06.040*.

Additionally, inevitable disclosure was not essential to the *Solutec* case. The main issue in that case was whether certain edible wax formulas were trade secrets, because the defendants had *actually threatened* to use the formulas, asserting that they were not trade secrets. *See Solutec* 1997 WL 794496 at *1, 4 (trial court made a specific finding that defendants had threatened to misappropriate plaintiff's trade secrets). The *Solutec* decision also does not discuss the inevitable disclosure doctrine directly, it simply cites favorably to *PepsiCo* in a short two-paragraph discussion. *See id.* at *8.

¹ Washington law is quite clear in stating that unpublished opinions have no precedential value. *See Wash. Rev. Code Ann. § 2.06.040* ("All decisions of the court having precedential value shall be published as opinions of the court. Each panel shall determine whether a decision of the court has sufficient precedential value to be published as an opinion of the court. Decisions determined not to have precedential value shall not be published.").

B. Inevitable Disclosure Improperly Restricts The Freedom Of Individuals To Pursue Their Careers By Changing Jobs

Inevitable disclosure operates as a constraint on freedom of employment by allowing employers to enjoin former employees from working for competitors *without* a covenant not to compete. See *PSC Inc. v. Reiss*, 111 F. Supp.2d 252, 256 (W.D.N.Y. 2000) ("in cases that do not involve the actual theft of trade secrets, the court is essentially asked to bind the employee to an implied-in-fact restrictive covenant based on a finding of inevitable disclosure").

Such a constraint on freedom of employment is contrary to Washington's trade secrets and employment laws. In what is easily the most comprehensive case addressing Washington trade secrets law, the Washington Supreme Court, sitting *en banc* in a case subsequent to the unpublished *Solutec* decision, stated that "[a]s a general rule, an employee who has not signed an agreement not to compete is free, upon leaving employment, to engage in competitive employment." *Ed Nowogroski Ins. Inc. v. Rucker*, 137 Wash.2d 427, 437 (Wash. 1999). The court went on to say that former employees remain under a duty not to disclose their former employer's trade secrets and that when those trade secrets are improperly used, then that competitive activity can be enjoined or damages can be awarded. *Id.* at 437-8. Nothing in that opinion indicates that employees can be enjoined from working in their chosen profession under the Washington UTSA absent a showing of actual or threatened misappropriation. While the Washington Supreme Court did not address inevitable disclosure directly,² inevitable disclosure is contrary to the Court's broad proclamation in favor of employee mobility. Indeed, courts that have rejected the inevitable disclosure doctrine have consistently emphasized the constraints it places upon freedom of employment in the absence of a non-compete agreement as a main reason for rejecting the doctrine. See *e.g.*, *Bayer Corp. v. Roche Molecular Sys., Inc.*, 72 F. Supp.2d 1120 (N.D. Cal. 1999) (stating that applying inevitable disclosure when there is no showing of actual or threatened use or disclosure "creates a de facto covenant not to compete"); *EarthWeb, Inc. v. Schlack*, 71 F. Supp.2d 299, 311 (S.D.N.Y. 1999) ("[c]learly, a written agreement that contains a non-compete clause is the best way of promoting predictability during the employment relationship and afterwards"); and *PSC*, 111 F. Supp.2d at 256-7.

C. Inevitable Disclosure Gives Too Much Power To Employers

In addition to creating de facto covenants not to compete, inevitable disclosure gives employers a powerful tool by which they can improperly threaten and cover employees into staying with the company. See *EarthWeb*, 72 F. Supp.2d at 310-11 (describing how inevitable disclosure can be a "powerful weapon" in the hands of an employer and how the threat of litigation can have a "chilling effect" on employees' legal right to switch jobs).

In contrast, a non-compete agreement is negotiated in advance, mutually agreed upon, and provides specific guidance regarding prohibited actions. See *EarthWeb*, 71 F.

² There was no dispute in *Nowogroski* regarding misappropriation, the issue was whether the information in question was a trade secret or not.

Supp.2d at 310-11 (describing the numerous problems with applying the inevitable disclosure doctrine, which the court described as "fraught with hazards," including the lack of a "frame of reference because there is no express non-compete to test for reasonableness").

With the inevitable disclosure, however, employers can get all of the benefits of a non-compete agreement (including the threat of it, which is perhaps the most important of all) without having to give up or negotiate anything. See *EarthWeb*, 71 F. Supp.2d at 310-11 (stating that the "chilling effect" caused by the "risk of litigation" posed by inevitable disclosure and other "constraints should be the product of open negotiation"). Inevitable disclosure is simply not consistent with Washington law, which supports the rights of employees to freely move between jobs.

D. Adoption Of Inevitable Disclosure Is Contrary To Washington's Public Interest

Separate and apart from inherent fairness to employees, there is a strong argument that freedom of employee movement helps promote a state or region's economy, especially in the field of technology, and that restrictions on employee movement can impede growth. For example, Professor Ronald Gilson has argued that one of the main reasons for the boom in Silicon Valley, compared to Massachusetts Route 128,³ was due to California's refusal to enforce non-compete agreements, allowing much more employee mobility and consequently, a greater sharing of knowledge. Ronald J. Gilson, *The Legal Infrastructure of High Technology Industrial Districts: Silicon Valley, Route 128, and Covenants Not to Compete*, 74 N.Y.U.L. Rev. 575 (1999); see also AnnaLee Saxenian, *Regional Advantage: Culture and Competition in Silicon Valley and Route 128* (1994). Indeed, Gilson specifically argued against the adoption of inevitable disclosure, arguing that it could end California's economic advantage over other regions. See Gilson, 74 N.Y.U.L. Rev. at 622-27.

While adoption of inevitable disclosure might have a more dramatic effect on California, due to its general refusal to enforce covenants not to compete, a stronger argument could be made for applying it in California for just that reason. In contrast, Washington enforces reasonable non-compete agreements. See *Knight, Vale and Gregory v. McDaniel*, 680 P.2d 448, 451-52 (Wash. App. 1984) (citing *Sheppard v. Blackstone Lumber Co., Inc.*, 540 P.2d 1373 (Wash. 1975)). If employers want to restrict valuable employees from working for competitors in Washington, then they can negotiate a non-compete agreement with that employee. Similarly, employers have remedies under traditional trade secrets laws for former employees that actually disclose or threaten to disclose trade secrets. Inevitable disclosure simply gives employers a weapon that, as professor Gilson demonstrates, inevitable disclosure is contrary to the interests of the public at large.

³ In 1968, technology employment in Route 128 was triple that of Silicon Valley. Over the next few decades, Silicon Valley surged past Route 128. See *Gilson*, 74 N.Y.U.L. Rev. at 586-87.

In September 2002, a California appellate court ruled that the theory of “inevitable disclosure” is not recognized in California. The decision, *Whyte v. Schlage Lock Co.*, 101 Cal. App.4th 1443 (Cal App. 2002), is important for trade secrets law, even though several federal courts have already rejected the “inevitable disclosure” theory. The *Whyte* court made clear that the “inevitable disclosure” theory conflicts with California’s strong policy in favor of every employee’s right to take the job of his or her choice. It also rejected the idea that the phrase “threatened misappropriation” in California’s Uniform Trade Secrets Act is a proxy for “inevitable disclosure” lawsuits. The critical portions of California’s Uniform Trade Secret laws are exactly the same as Washington’s statutes.

On January 2, 2002 a New York appellate court ruled that the doctrine of inevitable trade secret misappropriation is greatly disfavored and presumably not the law of New York. (*Marietta v. Fabhurst*, 2002, WL 31898398 (N.Y.A.D. Dept. 3 2002).

XIV. Comparison With Patent Law

PATENT v. TRADE SECRET

	<u>PATENT</u>	<u>TRADE SECRET</u>
SUBJECT MATTER	specific and limited by statute (machines, articles of manufacture, processes, and compositions of matter)	applies to broad range of intellectual property and business information
REQUIREMENTS	must be useful must be novel must not be obvious	must be potentially useful must not be generally known need not be novel or obvious
DEFINITION	defined strictly by language of the “claims”	often difficult to define with equal precision, but can be as broad as the “equities” of a particular case require
DISCLOSURE	required	any disclosure must be limited and controlled
PROTECTION	defined by narrow but specific statute monopoly granted	varies depending upon circumstances and court; based on many theories protection only against “unfair” users; none against those who independently discover or reverse-engineer
DURATION	20 years from filing	potentially unlimited

	<u>PATENT</u>	<u>TRADE SECRET</u>
EXPENSE	procuring policing infringement	protecting from unauthorized disclosure or use
RISK	invalidity	independent discovery or inadvertent disclosure difficult to prove theft
MARKETABILITY	licensing easier	licensing more difficult, and requires policing of licensee security measures