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The Law of Trade Secrets

Bryan M. Carson J.D., M.I.L.S.
Western Kentucky University Libraries, bryan.carson@wku.edu

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Legally Speaking — “A Wink is as good as a Nod:”
The Law of Trade Secrets

by Bryan M. Carson, J.D., M.I.L.S. (Coordinator of Reference and Instructional Services, Librarian for Philosophy, Religion, & Russian/Eastern European Studies, Western Kentucky University Libraries, 1 Big Red Way, Bowling Green, Kentucky 42101; Phone: 270-745-5007; Fax: 270-745-2275) <bryan.carson@wku.edu>

This article is about the law of trade secrets. Although less familiar than copyrights, patents, and trademarks, trade secrets are a type of intellectual property. As such, they can be protected in a court of law.

According to the definition used by the Uniform Trade Secret Act:

"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 important points to remember are that the information must have some economic value that comes from being kept a secret, and the person providing the information must make reasonable efforts to maintain the secret. The secret "provides the owner of the information with a competitive advantage in the marketplace, and is treated in a way that can reasonably be expected to prevent the public or competitors from learning about it, absent improper acquisition or theft."

Some examples of trade secrets include the secret formula of Coca-Cola, the secret ingredient in Skyline Chili, "a formula for a sports drink, survey methods used by professional pollsters, recipes, a new invention for which a patent application has not yet been filed, marketing strategies, manufacturing techniques and computer algorithms." Other types of trade secrets include a database of customer names and addresses, a new pharmaceutical drug, and even how much profit a private company makes. (Publicly traded companies are required by law to disclose profit information to the Securities and Exchange Commission.) In effect, a trade secret can be anything, as long as it contains independent economic value.

Since a trade secret is potentially unlimited in time, this form of protection is often used to maintain intellectual property rights in a product when the producer is worried about patent rights expiring. When a patent application is filed, the applicant must only disclose complete details of their invention, but must also provide the Patent and Trademark Office with a working model. Patent protection is complete and total—but only for a limited time. Once the patent has expired, the invention becomes available for anyone to copy without payment of royalties.

Trade secrets, on the other hand, do not involve any kind of filing. Rather, the owners take steps to keep the information confidential. As a result, misappropriation of a trade secret grounds for a lawsuit.

Trade secret law is generally a matter of state law, although there are some Federal statutes that apply as well. Many states have adopted the Uniform Trade Secrets Act (or parts thereof), which offers a pretty good overview of the field. In addition, the Economic Espionage Act of 1996 also provides for criminal penalties in the event of misappropriation of trade secrets.

The Case of the "Ancient Chinese Secret?"

Let's analyze how information becomes a trade secret. Remember the 1972 ad for Calgon laundry detergent? A customer asks the manager of a laundry how he gets the shirts so clean. The manager replies [paraphrased] "Ancient family secret!" The manager's wife reveals that the "ancient secret" is actually Calgon detergent. She calls across the room to her husband, "We need more Calgon!" The customer then says to the manager [paraphrase] "Ancient Secret, huh?" Does this information qualify as a trade secret?

The brand of detergent that a laundry uses may indeed be something that you would not want your competitors to know. However, in order to determine whether this is in fact a trade secret or simply a regular secret, we need to do the two-part test given above. We need to be able to show that there is independent economic value to the information, and that the person with the secret has taken reasonable steps to maintain secrecy.

In this case, the brand that a laundry uses may very well have independent economic value. After all, if the competitors know what detergent is being used, they may be able to also use the same product and lure customers away. So this information satisfies the first part of the requirements for being a trade secret.

However, there are two parts to the trade secret test. The individual's must also make reasonable efforts to keep the information confidential. In the Calgon ad, the wife shouts across the room, "We need more Calgon!" This doesn't sound like a reasonable effort to keep the information secret. As a result, the Calgon ad fails the second part of the test and is not a trade secret.

Reasonable Efforts to Maintain Secrecy

So what would be a reasonable effort to maintain secrecy? According to Findlaw:

A trade secret owner can prevent the following groups of people from copying, using and benefiting from its trade secrets or disclosing them to others without permission:

• people who are automatically bound by a duty of confidentiality not to disclose or use trade secret information, including any employee who routinely comes into contact with the employer's trade secrets as part of the employee's job
• people who acquire a trade secret through improper means such as theft, industrial espionage or bribery
• people who knowingly obtain trade secrets from people who have no right to disclose them
• people who learn about a trade secret by accident or mistake, but had reason to know that the information was a protected trade secret, and
• people who sign nondisclosure agreements (also known as "confidentiality agreements") promising not to disclose trade secrets without authorization from the owner.

In order to make sure that trade secret status is maintained, you should stamp documents "Confidential," lock secrets away, and only give information to those who "need to know." (In continued on page 75

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effect, this is what James Bond is doing when he says, "I can tell you, but I'll have to kill you!"
However, the best way to protect your secrets is to have everyone who works with the secret material sign a non-disclosure agreement agreeing not to give out the information. Non-disclosure provisions are routinely included in employment contracts and business agreements. Many highly compensated employees also have a covenant not to compete in their contracts, specifying that they can’t use trade secrets if they go to work for a competitor. I firmly recommend that anyone who is in possession of trade secret information make use of appropriate non-disclosure and non-competition agreements.

Legal and Equitable Remedies
In the event that a trade secret is disclosed, the law calls for a multitude of remedies. These include getting an injunction to prevent further disclosure, asking for financial damages, and other types of legal and equitable remedies. In some circumstances, courts have prevented former employees from taking new jobs because of the “inevitable disclosure” of confidential knowledge; however, this is very unusual.

The idea of the “inevitable disclosure” doctrine is that the former employee learned secrets of a type that they could not help but rely upon in their new job. The most famous example of this situation is the case of PepsiCo v. Redmond. In this case, William Redmond Jr. was a high-level employee at PepsiCo. As part of his employment, he was acquainted with numerous trade secrets, including strategic marketing plans for the “All-Sports” drink which PepsiCo produced. This product was in direct competition with Gatorade, which was produced by the Quaker Oats Company.

On November 8, 1994, Redmond was offered a job with Quaker Oats as chief operating officer for the Gatorade/Snapple division. PepsiCo asked the court to block Redmond’s employment on the grounds that his knowledge of the All-Sports strategic marketing plan would constitute an inevitable disclosure of trade secrets. (Because of “diversity jurisdiction,” i.e., the parties were from two different states, the case wound up in Federal court.) The court looked at the idea behind the inevitable disclosure doctrine, which is that “an employee with knowledge of a former employer’s trade secrets would ‘inevitably’ disclose the same to the new employer since the nature of the new job would lead to such disclosures, given that the new and old employers were competitors.”

The court explored the delicate balance between trade secret protection and freedom of choice. According to the 7th Circuit:

The question of threatened or inevitable misappropriation in this case lies at the heart of a basic tension in trade secret law. Trade secret law serves to protect “standards of commercial morality” and “encourage invention and innovation” while maintaining “the public interest in having free and open competition in the manufacture and sale of patented goods.” Yet that same law should not prevent workers from pursuing their livelihoods when they leave their current positions. It has been said that federal age discrimination law does not guarantee tenure for older employees. Similarly, trade secret law does not provide a reserve clause for solicitors employ-
ers... This tension is particularly exacerbated when a plaintiff sues to prevent not the actual misappropriation of trade secrets but the mere threat that it will occur. [Emphasis in the original; citations omitted] The court found in favor of PepsiCo, ruling that:

[When we couple the demonstrated inevitability that Redmond would rely on PCNA trade secrets in his new job at Quaker with the district court's reluctance to believe that Redmond would refrain from disclosing these secrets in his new position (or that Quaker would ensure Redmond did not disclose them), we conclude that the district court correctly decided that PepsiCo demonstrated a likelihood of success on its statutory claim of trade secret misappropriation... we also agree with... the likelihood of Redmond's breach of his confidentiality agreement should he begin working at Quaker...]

This type of non-competition action is very unusual, and generally only applies to executives and managerial employees that are very high in the organizational chart who have been offered jobs at a similar level by a competitor. Most state courts have refused to adopt the inevitable disclosure doctrine for fear that it would chill economic freedom of action. For example, California rejected the doctrine in the case of Whyte v. Schlage Lock Co.11 The court in Whyte stated that:

"The chief ill in the covenant not to compete imposed by the inevitable disclosure doctrine is its after-the-fact nature: the covenant is imposed after the employment contract is made and therefore alters the employment relationship without the employee's consent. The doctrine of inevitable disclosure thus rewrites the employment agreement and "such retroactive alterations... upset the balance which courts have attempted to achieve in construing non-compete agreements..." Schlage and Whyte did not agree upon a covenant not to compete. We decline to impose one, however restricted in scope, by adopting the inevitable disclosure doctrine. Last there be any doubt about our holding, our rejection of the inevitable disclosure doctrine is complete. [Emphasis added] If a covenant not to compete (which would include, for example, a nonsolicitation clause) is part of the employment agreement, the inevitable disclosure doctrine cannot be invoked to supplement the covenant, alter its meaning, or make an otherwise unenforceable covenant enforceable...

Once again, the best way to avoid problems would have been with non-disclosure and non-competition agreements in the employment contracts. As the court in the Whyte case so eloquently stated, if the employer wanted to avoid competition this should have been in the employment contract.

Another potential penalty for violating trade secrets is found in the Economic Espionage Act (EEA) of 1996. This statute provides for criminal penalties in the event of misappropriation of trade secrets.12 According to Findlaw, "The EEA punishes intentional stealing, copying or receiving of trade secrets 'related to or included in a product that is produced for or placed in interstate commerce.'"13 Violation of the EEA is a pretty big deal, involving both large fines and lengthy prison sentences. If the individual is performing a theft on behalf of a U.S.-based company, he or she may be fined up to $500,000 and receive a prison sentence of up to 10 years. Corporations that are found guilty of industrial espionage may be fined up to $5 million. Performing an act of industrial espionage on behalf of a foreign government or a foreign agent may cause the fines to double and the jail time to increase to 15 years. Section 1831 and 1834 of the EEA also allow both the company and the proceeds to be confiscated by the government and sold.14 The EEA was an unprecedented change in the trade secret law. For the first time, criminal penalties were possible for trade secret violations. The EEA has been subject to both praise and criticism from different parties, but either way you should be careful of the provisions of this criminal statute.

Conclusion

Trade secret law is a type of intellectual property that involves keeping information confidential. Because trade secrets are potentially unlimited in duration, many companies use this type of protection rather than patent, trademark, or copyright. Unlike these other forms of intellectual property, the owner never files, and the "secret" has the potential of staying protected for an unlimited period of time.

In order to obtain the status of trade secret, the information must have some economic value that comes from being kept a secret, and the person providing the information must make reasonable efforts to maintain the secret. Reasonable efforts can include keeping the information under lock and key, only providing information to those who "need to know," and provisions in employment and licensing contracts relating to secrecy. Owners who take these kinds of steps are eligible for both legal remedies (monetary damages) and equitable remedies (injunctions) from the courts. In addition, some types of industrial espionage may be subject to criminal penalties under the Economic Espionage Act (EEA) of 1996.

The law of trade secrets is an important part of intellectual property. For example, without these provisions, the recipe for Coca-Cola would be out in the open and the company would go out of business. Other types of information also have great economic impact, including financial information and chemical formulas. This is why it is important to have trade secret protection, since information often does have economic value, and when it comes to keeping confidences, a wink really is as good as a nod.