Cislo & Thomas LLP®

presents

The Manager's Guide to Intellectual Property

SECOND EDITION

JEFFREY G. SHELDON, ESQ.

Second Edition: July 2018
Printed in the United States of America
ISBN: 978-1-64254-561-6

CHAPTER 3

Trade Secrets

Introduction

Trade secret protection is an alternative to patent protection for inventions that can be maintained secret. It is also useful for other valuable business knowledge such as customer lists, business plans, and ongoing research and development.

Requirements for Trade Secret Protection

For information to qualify for trade secret protection it must meet three requirements: eligible subject matter, economic value, and secrecy.

Eligible Subject Matter

Eligible subject matter that can be protected under trade secret law is very broad. Typical of the law in many states, California defines the subject matter as "Information, including a formula, pattern, compilation, program, device, method, technique, or process." There is very little that goes on in a business that does not meet this definition.

Examples of eligible trade secrets that the law protects include the following:

- methods of manufacture
- software programs

- financial data such as profit margins, cost of goods
- customer lists
- customer data such as the identity of buyers, pricing, ordering profiles
- suppliers and source of raw materials
- product formulations
- products under development
- business plans

Economic Value

The subject matter for which protection is desired needs to have economic value stemming from its not being generally known. The economic value can be actual or potential. An example of potential economic value is research and development results that have not yet made their way into a product. The economic value must result from the information not being generally known to the public or to other persons who can obtain economic value from its disclosure or use.

> ***Example****:* Imagine a company in the business of manufacturing hatbands. If there are only five hat manufacturers in the United States, the customer list of hat manufacturers is likely to be considered a trade secret.

Secrecy

By definition, the information must be "secret." Absolute secrecy is not required, but efforts to maintain secrecy that are reasonable under the circumstances must be continually applied.

> ***Example***: Flying a plane over a chemical plant and taking pictures of the plant to learn a chemical process that is a trade secret is illegal misappropriation of the trade secret. It is not reasonable to require the owner of the chemical plant to build a roof over it.

If it is ever necessary to prove that certain information is a trade secret, it is necessary to show what efforts were made to maintain secrecy. Examples of what the courts look for include the following:

- warning employees about the need to keep information secret in the policy manual
- labeling documents as "confidential"
- providing access to trade secrets on a need-to-know basis
- including a trade secret protection clause in employee contracts
- conducting exit interviews with departing employees, warning them of trade secret obligations, and confirming in writing
- limiting facility access
- not publicizing research and development
- carefully analyzing if an invention should be patented or protected by trade secret
- using nondisclosure agreements
- shredding documents containing trade secrets
- establishing employee information program where employees are warned of secrecy requirement

- including trade secret protection clauses in agreements with outside consultants

Example: An employer importing shoes had no employment agreements or policy manual, allowed access to its facilities to multiple visitors, had no exit interviews, and its suppliers were determinable from custom documents. An attempt to keep an ex-employee from disclosing those suppliers was unsuccessful because there were insufficient efforts made to maintain secrecy.

Example: A secret process was used to manufacture a product. The manufacture of the product was sent off shore to China. The Chinese manufacturer failed to keep the process secret. Trade secret protection was lost.

Trade Secret Protection vs. Patent Protection

Trade secret protection can be an alternative to patent protection. It is not available for such things as products that can be reverse engineered once they are on the market. But if trade secret protection is feasible, it should be considered. There are tradeoffs, of course. See the advantages and disadvantages of trade secret protection as compared to patent protection below:

Advantages of Trade Secret Protection

Duration: In theory, trade secret protection can last forever, as long as the trade secret is kept secret. Patents have a limited life.

Initial cost: Trade secret protection initially is free. Contrarily, obtaining a patent has initial costs for preparation of a patent application. In addition, there are ongoing maintenance fees to keep a patent in force. However, there usually is a cost in keeping information secret. For example, if a formulation is a trade secret, it might be necessary for the raw materials to be received and relabeled off site, and then sent to the manufacturing plant.

Ease of Protecting Formulas, Methods, and Software: Product formulations, methods of manufacture, and computer software that cannot be readily discerned from products available on the open market can be kept from the eyes of competitors by protecting them as trade secrets. Such formulations, methods, and/or software may also be protectable by patents, but patent law requires that the totality of such inventions be disclosed within the patent. It may be difficult to determine if a competitor infringes on a patent covering such formulations, methods, and/or software, because the subject matter of the patent cannot be readily discerned from products available on the open market. Enforcement of such patents may be problematic.

Disadvantages of Trade Secret Protection

Easy Loss of Protection: It is easy to lose trade secret protection. A careless or dishonest employee can disclose the trade secrets to the world. A competitor can independently develop the same trade secret and disclose it to the public. Secrecy may be lost in a court proceeding to enforce the trade secret. The government may require disclosure or inadvertently disclose the secrets to a competitor.

No Protection Against Independent Development: Patents protect against an infringer, even if innocent. For example, if a competitor independently develops an infringing product, there still is liability. In contrast, trade secret protection only protects against those that misappropriate the trade secret. If a competitor develops the same product without misappropriating a trade secret, then there is no liability.

Avoiding a Trade Secret Infringement Claim

Most businesses do not set out to steal the trade secrets of a competitor. However, even the most ethical of businesses may be subject to a trade secret misappropriation claim if its employees are not continually respectful of the trade secrets of others. A common problem scenario, for example, arises when a new employee uses trade secrets of a prior employer. The following actions minimize this risk:

- a provision in the applicable policy manuals prohibiting use of trade secrets of others

- a provision in employment agreements where employees agree not to use trade secrets of others
- entrance interview on the first day of employment warning against use of trade secrets of others

Covenants Not to Compete

Some companies try to tie up their employees with covenants not to compete if they are fired or quit as a way to keep trade secrets from being used. Generally, these covenants are disfavored by courts because judges do not like to keep people from earning a living. In some states they are illegal. For example, covenants not to compete with regard to an employee are illegal in California with limited exceptions such as when an owner of a business sells the business. Even where such covenants are permissible, they need to be reasonable with regard to time, scope, and geography.

The Inherent Disclosure Doctrine

Sometimes an employer takes the position that when a key employee goes to work for a competitor, inherently that employee will use the employer's trade secrets. This is the inherent disclosure doctrine. On that basis, the employer tries to keep the ex-employee from working at all for a competitor. Some courts accept that doctrine. However, many do not. For example, California requires evidence that the ex-employee actually used or disclosed a trade secret and will not take action against an ex-employee based on the mere possibility of such disclosure or use.