

INTELLECTUAL PROPERTY LAW PRIMER
TRADE SECRETS

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□ Sources of Trade Secret Law

- Common Law
 - Well-developed principles and body of law
- Uniform Trade Secrets Act (“UTSA”)
 - Enacted by approximately 45 states including Pennsylvania (in 2003).

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□ Elements of Common Law Trade Secret Claim

- that the information constitutes a trade secret;
- that it was of value to the owner and important in the conduct of his business;
- that by reason of discovery or ownership, the plaintiff had the right to the use and enjoyment of the secret; and
- that the secret was communicated to the defendant while in a position of trust and confidence under such circumstances as to make it inequitable and unjust for him to disclose it to others, and to make use of it himself, to the prejudice of his employer.

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□ Definition of Trade Secret

- Common Law
 - Pennsylvania has adopted the definition of a trade secret set forth in the *Restatement of Torts* § 757, comment b (1939), which provides:
- A trade secret may consist of any formula, pattern, device or compilation of information which is used in one's business, and which gives [one] 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.

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- PUTSA
 - The PUTSA defines a trade secret to be "information, including a formula, drawing, pattern, compilation including a customer list, program, device, method, technique or process that:
 - Derives independent economic value, actual or potential, from not being generally known to, and being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use, and
 - Is the subject of efforts that are reasonable under the circumstances to maintain its secrecy."

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□ Establishing Existence of Trade Secret

- the extent to which the information is known outside of the owner's business;
- the extent to which it is known by employees and others involved in the owner's business;
- the extent of measures taken by the owner to guard the secrecy of the information;
- the value of the information to the owner and to his competitors;
- the amount of effort or money expended by the owner in developing the information; and
- the ease or difficulty with which the information could be properly acquired or duplicated by others.

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■ **Basic Principles**

- Whether information constitutes a trade secret is a question of fact for the fact finder.
- Where the material facts are uncontroverted, a court may enter summary judgment in a trade secrets case.
- The two most essential indicia of a trade secret are substantial secrecy and competitive value to the owner.
- Any formula, pattern, device, or compilation of information may be a trade secret if it is used in business and gives the business an advantage over competitors who do not know or use it.

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- Formulas for chemical compounds, processes for manufacturing goods, and patterns for machines or devices are all examples of protectable trade secrets.
- Cost, pricing, profit margin data, and overhead calculations have been held to qualify as trade secrets.
- The fact that individual pieces of the information may be available to the general public does not defeat a trade secret claim if the value of the information stems from its compilation or collection in a single place or in a particular form which is of value.
- Customer lists have been found to be trade secrets. However, a customer list will not be a trade secret if the list could be easily generated from a trade journal, telephone listing, or general knowledge.
 - Note that "customer lists" were included in the definition of a trade secret in the version of the UTSA as adopted in Pennsylvania.
- Pennsylvania courts have held that business plans are protectable as trade secrets.

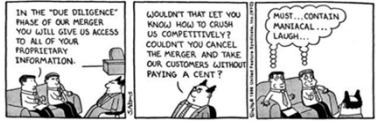
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Litigation Tip

- Courts have consistently held that a plaintiff has the duty to specify its trade secrets with reasonable particularity. A plaintiff cannot satisfy this duty by simply referring the defendants to a large quantity of documents. The touchstone is that the disclosure must be sufficiently specific to enable a defendant to avoid speculation as to what the trade secret is and to be able to conduct discovery and prepare a defense.
- Courts have ruled that where a trade secrets plaintiff fails to specify its trade secrets with reasonable particularity after being ordered by the trial court to do so, the plaintiff's complaint should be dismissed pursuant to a summary judgment motion.


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- Maintenance of Secrecy and Independent Discovery
 - It is not necessary that the secrecy of a trade secret be absolute, but the owner of the secret must take reasonable precautions to prevent the secret from being disclosed to unauthorized third parties.
- Best practices of maintaining a trade secret include:
 - Restricting access to proprietary information;
 - Marking proprietary information with "confidential" legends;
 - Requiring the execution of nondisclosure agreements in commercial relationships where confidential information may be disclosed.




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- Shredding and destroying all discarded proprietary information;
- Utilizing employment agreements which require that employees maintain the secrecy of sensitive or proprietary information;
- Restricting access to the employer's facility;
- Keeping higher level proprietary information in an area where access is tightly limited and monitored;
- Investigating all possible misappropriations of confidential information; and
- Keeping tight controls over access to computers and password.



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- It is well-recognized that secrecy is the single most important factor in the law of trade secrets. It is equally well-recognized, however, that the holder need not take every conceivable measure to ensure secrecy, but must take reasonable precautions.



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■ A claim for trade secret misappropriation will fail if the defendant is able to establish that it acquired the alleged trade secret through proper means.

- A worker's aptitude, skill, dexterity, manual and mental ability, and subjective knowledge gained in the course of employment are not trade secrets.

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- Information known to an employee prior to his employment with a particular employer is necessarily known outside the employer's business and thus cannot be classified as a trade secret.
- Matters which are fully disclosed by a marketed product and which are susceptible to "reverse engineering" – *i.e.*, starting with the known product and working backward to divine the process which aided in its manufacture – cannot be protected as trade secrets.
- The burden is on the defendant to demonstrate that it properly developed the information which is alleged to be a trade secret through independent knowledge, inspection and/or reverse engineering.

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- The ease or difficulty with which information could be properly acquired or duplicated by others is a factor in weighing its status as a trade secret. Information which can be duplicated only by an expensive and time-consuming method of reverse engineering could be secret, and the ability to duplicate it would not constitute a defense.
- A trade secret must be novel but only to the extent necessary to show that it is not a matter of public knowledge.

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□ Existence of a Confidential Relationship

- Liability for misappropriation of trade secrets attaches both to one who gains access to trade secrets through improper means and one whose disclosure of the information constitutes a breach of confidence.
- An employee's duty not to use or disclose her employer's trade secrets may arise from a restrictive covenant or may be implied from a confidential employment relationship.

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- Espionage, fraudulent misrepresentations to induce disclosure, use of physical force, breaking into an office or computer system to steal a trade secret, and breaches of fiduciary duties are examples of improper means of discovering trade secrets.

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□ Misappropriation Under PUTSA

- acquisition of a trade secret of another by a person who knows or who has reason to know that the trade secret was acquired by improper means; or
- disclosure or use of a trade secret of another without express or implied consent by a person who:

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- used improper means to acquire knowledge of a trade secret;
- at the time of the disclosure or use, knew or had reason to know that his knowledge of a trade secret was
 - derived from or through a person who had utilized improper means to acquire it;
 - acquired under circumstances giving rise to a duty to maintain its secrecy or limit its use; or
 - derived from or through a person who owed a duty to the person seeking relief to maintain its secrecy or limit its use; or
- before a material change of his 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.

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- PUTSA Definition of "Improper Means"
 - The PUTSA defines improper means as acts including, but not limited to, theft, bribery, misrepresentation, breach or inducement of a breach of a duty to maintain secrecy or espionage through electronic or other means.
 - Courts applying Pennsylvania law have long recognized that misappropriation and misuse of trade secrets can rarely be proved by convincing direct evidence.
 - Because of the difficulty of proving misappropriation, plaintiffs in such matters may establish use or disclosure through inference, by showing that the defendant had access to plaintiff's trade secret, and that there are substantial similarities between defendant's product and plaintiff's secret information.

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- Actual or Threatened Use of a Trade Secret
 - The plaintiff usually must prove that the defendant used the trade secret in an action brought under common law.
 - The concept of "use" has been expanded under the PUTSA. The plaintiff has a claim for relief based solely upon defendant's improper acquisition of the trade secret and need not wait until there is an actual use in order to bring a misappropriation claim.
 - Getting a "head start" through the improper explanation of another's trade secrets has been held to be a "use" under the UTSA.

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□ Establishing "Use" Through Inevitable Disclosure

- The owner of trade secrets will often seek to enjoin a person (usually an ex-employee) to whom the secrets have been disclosed from taking employment (usually with a competitor) where the disclosure and/or use of the secrets disclosed would be "inevitable."
- The Third Circuit recently has held that, under Pennsylvania law, a court has discretion to enjoin a defendant from beginning new employment if the facts of the case support a "substantial threat of a trade secret misappropriation" or a "sufficient likelihood" of "defendant [disclosing a trade secret] in the future."

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□ Preemption Under the UTSA

- Information that is merely "confidential," but not necessarily a "trade secret," may be the subject of a tort claim.
- Pennsylvania courts have acknowledged that claims based merely on "confidential" information, as opposed to "trade secret" information are not preempted.

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□ Detriment to the Plaintiff

- The plaintiff bears the burden of proving that it suffered or will suffer damages as the result of the defendant's wrongful misappropriation.

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□ Defenses

- Independent Development
 - The owner of a trade secret, unlike the owner of a patent, does not have a monopoly over the process or formula. If others in the field discover and use the same method through their own independent efforts, there is no violation of the law.
 - However, the fact that a defendant *could* have independently developed the information is not a defense if the defendant wrongfully used the plaintiff's trade secret.
- Lawful acquisition by purchase, abandonment by owner or reverse engineering

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■ Statute of Limitations

- Prior to the enactment of the PUTSA, the statute of limitations applicable to a trade secret misappropriation claim under Pennsylvania law was two years.
- Pursuant to the PUTSA, the statute of limitations does not begin to run until an aggrieved person discovers or reasonably should have discovered the existence of the misappropriation. The person aggrieved then has three years to vindicate its rights as a result of the misappropriation.

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□ Remedies and Damages

- Injunctive Relief – Courts may issue two types of injunctions to protect a trade secret, a “production injunction” or a “use injunction.”
 - A production injunction completely bars the defendant from manufacturing the type of product in which the trade secret is utilized.
 - A use injunction only prohibits a defendant from using a misappropriated trade secret in the manufacture of a product, but it does not otherwise interfere with the defendant's business.
 - The trial court has wide discretion in determining the proper scope of an injunction and may issue an injunction broad enough to ensure the protection of the trade secret.

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□ The PUTSA authorizes a court to impose a "reasonable royalty" along with the grant of an injunction. Section 5303(b) provides that in "exceptional circumstances" a court when granting an injunction may condition "future use upon payment of a reasonable royalty for no longer than the period of time for which use could have been prohibited." The exceptional circumstances which are included in the statute include "a material and prejudicial change of position prior to acquiring knowledge or reason to know of misappropriation that renders a prohibitive injunction inequitable."

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■ **Compensatory Damages**

□ **Common Law**

- The appropriate measure of damages is not limited to the amount that the plaintiff lost, but rather may include the benefits, profits, or advantage gained by the defendant in the use of the trade secret.
- Damages accrue from the time that the defendant began using the trade secret.

□ **Pursuant to the PUTSA**

- Damages under the PUTSA are greatly expanded. Consistent with existing Pennsylvania law, the PUTSA endorses the calculation of the damages suffered by the plaintiff predicated upon its actual loss or defendant's unjust enrichment or benefit as a result of the misappropriation. The PUTSA adds a measure of damages not previously contemplated by Pennsylvania law by permitted the use of a "reasonable royalty" measure of calculating damages "in lieu of damages measured by any other methods."

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- The damages suffered by a plaintiff may include lost profit damages stemming the from loss of sales or customers.
- An award of unjust enrichment damages may be measured by the profit that defendant made through use of the misappropriated trade secret information or the saved development costs and increased productivity that the defendant was able to gain because of the wrongful conduct.

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- Exemplary Damages
- The PUTSA permits a court (rather than a jury) to award exemplary damages if willful or malicious misappropriation exists. However, such award may not exceed twice the award of monetary damages.

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- The PUTSA as adopted by Pennsylvania also provides for an award of reasonable attorneys fees, expenses, and costs to the prevailing party under the following circumstances:
 - If a claim of misappropriation is made in bad faith;
 - If a motion to terminate an injunction is made or resisted in bad faith; or
 - If willful and malicious misappropriation exists.

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- Criminalization of Trade Secret Misappropriation
 - U.S. Economic Espionage Act of 1996
 - Whoever, intending or knowing that the offense will benefit any foreign government, foreign instrumentality, or foreign agent, knowingly
 - 1) steals or without authorization appropriates, takes, carries away, or conceals, or by fraud, artifice, or deception obtains a trade secret;
 - 2) without authorization copies, duplicates, sketches, draws, photographs, downloads, uploads, alters, destroys, photocopies, replicates, transmits, delivers, sends, mails, communicates, or conveys a trade secret;
 - 3) receives, buys, or possesses a trade secret, knowing the same to have been stolen or appropriated, obtained, or converted without authorization;
 - 4) attempts to commit any offense described in any of paragraphs (1) through (3); or

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5) conspires with one or more other persons to commit any offense described in any paragraphs (1) through (3), and one or more of such persons do any act to effect the object of the conspiracy shall be liable for the recited penalties.

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