The Trade Secret Quagmire--A Proposed Federal Solution

Minn. L. Rev. Editorial Board

Follow this and additional works at: https://scholarship.law.umn.edu/mlr

Part of the Law Commons

Recommended Citation
https://scholarship.law.umn.edu/mlr/2857

This Article is brought to you for free and open access by the University of Minnesota Law School. It has been accepted for inclusion in Minnesota Law Review collection by an authorized administrator of the Scholarship Repository. For more information, please contact lenxx009@umn.edu.
Notes

The Trade Secret Quagmire—A Proposed Federal Solution

I. INTRODUCTION

For almost a century American courts have prohibited the improper acquisition and use of trade secrets in an effort to enforce meaningful standards of business morality. However, in their attempt to formulate a code of business ethics, the courts have failed to recognize the needs of a changing society. The law which developed in the context of the small, self-contained community is outmoded when applied to the modern integrated national economy. Although the focus on commercial conduct is laudable, the effect of existing trade secret law on the national interests has been more detrimental than beneficial. Because of its inordinate complexity, the law of trade secrets is unpredictable even within a particular jurisdiction. As a result, trade secret owners are over-protected, often at the expense of their employees, and always to the ultimate detriment of society. In the absence of legislative guidance, the courts have been unable to formulate satisfactory criteria for balancing the parties' rights. Moreover, the interests of the general public have been virtually ignored. This Note will explore the major defects in the present law, analyze the interests involved, and suggest a fundamental revision of trade secret protection.

II. THE PRESENT LAW

Trade secret law has used a variety of legal theories: Property rights; express or implied contract; tort; agency; breach of confidence or trust; and equitable considerations of unfair compe-

1. E.g., Abalene Exterminating Co. v. Oser, 125 N.J. Eq. 829, 5 A.2d 733 (Ch. 1939).
3. E.g., Smith v. Dravo Corp., 203 F.2d 369, 376 (7th Cir. 1953).
6. E.g., E. I. duPont de Nemours Powder Co. v. Masland, 244 U.S. 100 (1917).
tion. However, regardless of the label used, liability requires both a subject matter capable of protection and improper appropriation by another.

Anything which bestows an economic advantage on its holder and which is not readily ascertainable by willing exploiters may be capable of protection. This includes "any formula, pattern, device or compilation of information which is used in one's business..." The ideas expressed in a shaving cream formula, a hydraulic garbage compressor, a collapsible fishing pole, the structural design of a tape recorder, a secret pricing list, and customer lists have all been considered trade secrets. However, these business intangibles are not protectible per se. Unlike the holder of a patent who has a monopoly, a trade secret owner is only protected against those who acquire or use his secret under circumstances found to be contrary to fair commercial morality. Since liability requires improper conduct, any protection afforded the secret is merely incidental. Thus, an independent discoverer may use the idea freely.

8. This proposition accurately reflects the general theory of trade secret protection. Since the purpose of this Note is an analysis of the major problems in trade secret law, exceptions and technicalities have not been enumerated. For a more detailed treatment, see 2 Callmann, Unfair Competition and Trade-Marks ch. 14 (2d ed. 1950); Ellis, Trade Secrets (1953); Turner, Trade Secrets (1962).
10. Restatement, Torts § 757, comment (b) (1939).
15. Simmons Hardware Co. v. Waibel, 1 S.D. 488, 47 N.W. 814 (1891).
16. Abalene Exterminating Co. v. Oser, 125 N.J. Eq. 329, 5 A.2d 738 (Ch. 1939). For a discussion of this special area of trade secret law, see 2 Callmann, op. cit. supra note 8, § 55(c)(2) (1950, Supp. 1965); Ellis, op. cit. supra note 8, ch. 7.
17. In Tower Mfg. Co. v. Monsanto Chem. Works, 20 F.2d 386, 387 (S.D.N.Y. 1927), the court said: "The outstanding difference is that a patentee has a monopoly as against all the world, while the owner of a secret process has no right, except against those who have contracted, expressly or by implication, not to disclose the secret, or who have obtained it by unfair means."
TRADE SECRETS

In determining whether a claimant has a protectible interest the courts consider such factors as whether the secret is known outside of his business, the steps taken to retain the secret nature of the information, the value of the information to both himself and his competitors, the investment in developing the information, and the difficulty in acquisition and duplication by others.¹⁹ These factors, however, are too indefinite and are not uniformly applied. Some courts have held that publication of the idea in a trade journal²⁰ or knowledge of it in another country²¹ destroys the requisite secrecy. Others have ignored the fact that the idea was disclosed in an expired patent²² or well known outside the local market,²³ and have focused on whether or not the idea was a secret as far as the appropriator was concerned.²⁴ This is an undisguised technique for finding liability when the court is particularly displeased with the appropriator's conduct.²⁵ There are similar problems with the criteria of investment in development²⁶ and difficulty of duplication.²⁷ Consequently, any standard is meaningful only in the context of a multitude of variant factors and affords little basis for predicting whether the disputed matter will be protected.²⁸

Given subject matter capable of protection, the other determinant of liability is the nature of the defendant's conduct. This is considered in light of the relationship, express or implied, between the trade secret owner and the person to whom the secret has been divulged.²⁹ The manner in which the trade secret is disclosed is crucial since the owner's rights will be protected only when he makes a disclosure under circumstances indicating that he intends to keep the information confidential.³⁰ Commercial exploitation

¹⁹. ReSTATEMENT, TORTS § 757, comment (b) (1939).
²⁴. See Smith v. Dravo Corp., 203 F.2d 369 (7th Cir. 1953).
²⁸. See Turner, op. cit. supra note 8, at 8.
²⁹. An actual personal disclosure to an employee is not necessary. CAllMANN, op. cit. supra note 8, at 819. See generally Turner, op. cit. supra note 8, at 287–96.
³⁰. Callmann, op. cit. supra note 8, at 803.
usually requires disclosure to employees or to parties who wish to purchase, license, manufacture, or market the secret or some product embodying the secret. Disclosure in these contexts raises a confidential relationship between the parties. Failure of the disclosee to honor this relationship is the conduct which trade secret law attempts to regulate.\textsuperscript{31} Thus an employee cannot work for a competitor\textsuperscript{32} or go into business for himself\textsuperscript{33} and thereby disclose or use the trade secrets of his former employer. The holder is also protected if he is induced to disclose his secret on the pretext that the disclosee intends to represent the product\textsuperscript{34} or enter into a licensing agreement.\textsuperscript{35}

Unprotected disclosure occurs through voluntary publication of the secret in technical or trade journals, patent file, advertising material, or any other disclosure which is inconsistent with an intention to maintain secrecy.\textsuperscript{36} The product itself may disclose the secret. Thus one is entirely free to purchase a competitor's product on the market, analyze or "reverse engineer"\textsuperscript{37} it to determine its contents or construction, and enter into direct competition with an identical product.\textsuperscript{38}

If the ultimate user of an appropriated trade secret is a third party, his rights and liabilities turn generally on when he dis-

\textsuperscript{31} See E. I. duPont de Nemours Powder Co. v. Masland, 244 U.S. 100 (1917). "[T]he starting point for the present matter is not property or due process of law, but that the defendant stood in confidential relations with the plaintiffs . . . . These have given place to hostility, and the first thing to be made sure of is that the defendant shall not fraudulently abuse the trust reposed in him." \textit{Id.} at 102.


\textsuperscript{34} See Franke v. Wiltschek, 115 F. Supp. 25 (S.D.N.Y. 1953).


\textsuperscript{36} See Klein, \textit{The Technical Trade Secret Quadrangle: A Survey}, 55 Nw. U.L. Rev. 437, 441 (1960); Stedman, \textit{supra} note 9, at 6-8.


covered that the secret was wrongfully taken. If he knew or should have known of the confidential relationship, he is held in pari delicto with the disclosee.\textsuperscript{39} If he acquires the secret in good faith and without knowledge of the appropriation, there is no liability until he has notice of the wrongful taking.\textsuperscript{40} In addition, he may not be liable for use, even after he has notice if he has so changed his position that any liability would be “inequitable.”\textsuperscript{41}

A variety of remedies is available to the injured plaintiff. At law he can get damages for deceit,\textsuperscript{42} compensatory damages for breach of contract,\textsuperscript{43} either express or implied, punitive damages,\textsuperscript{44} and costs. In equity, the common remedy is either a temporary\textsuperscript{45} or permanent\textsuperscript{46} injunction. The injunction may restrain use or disclosure of the trade secret,\textsuperscript{47} or compel surrender of the embodiments of the trade secret\textsuperscript{48} or a sublicense on patents procured to perfect a patent on the appropriated trade secret.\textsuperscript{49} Other equitable remedies include: Specific performance of a contract not to compete\textsuperscript{50} or to reveal trade secrets;\textsuperscript{51} an express or constructive trust leading to an accounting;\textsuperscript{52} award of a reasonable royalty for use;\textsuperscript{53} reconveyance of the trade secret;\textsuperscript{54} rescission of the em-

\textsuperscript{39} See Servo Corp. of America v. General Elec. Co., 337 F.2d 716, 725 (4th Cir. 1964).
\textsuperscript{40} See Vulcan Detinning Co. v. American Can Co., 75 N.J. Eq. 542, 73 Atl. 603 (Ct. Err. & App. 1909).
\textsuperscript{41} Restatement, Torts § 756(b), comment (e) (1939).
\textsuperscript{42} Oppenheim, Unfair Trade Practices 522 (1950).
\textsuperscript{44} McDonald's Corp. v. Moore, 243 F. Supp. 255 (S.D. Ala. 1965).
\textsuperscript{46} A. O. Smith Corp. v. Petroleum Iron Works Co., 73 F.2d 531 (1934), modified, 74 F.2d 934 (6th Cir. 1935).
\textsuperscript{48} Ernst Slide Fastener Co. v. Stamberg, 120 N.Y.S.2d 311 (Sup. Ct. 1933); see Callmann, op. cit. supra note 8, § 59.3; Oppenheim, op. cit. supra note 42, at 522.
\textsuperscript{52} Englehard Indus., Inc. v. Research Instrument Corp., 324 F.2d 347 (9th Cir. 1963) (dictum).
\textsuperscript{53} Kamin v. Kuhnauf, 232 Ore. 139, 374 P.2d 912 (1962).
ployment contract if still in force; and excusing an obligation to pay the employee's compensation for services rendered. In addition, the appropriator may be subject to criminal sanctions.

While the foregoing represents a general survey of trade secret law, it should be noted that each state has been free to fashion its own rules. Also, the federal courts have developed their own body of trade secret law to some extent. The federal law developed prior to *Erie R.R. v. Tompkins* is currently applied when a trade secret issue arises as a related claim to patent infringement. This law has also influenced post-*Erie* state law. Although federal courts do defer to state law in diversity actions, they often assume that state law is the same as federal law and discuss the problem in terms of equitable federal doctrines.

### III. EVALUATION

Trade secret law has not successfully regulated business conduct. Its fundamental weakness is its inherent uncertainty. The standard of conduct, developed on a case by case basis, only reflects each court's philosophy of commercial morality. Despite a century of development in this country, trade secret law cannot tell an employee how much of his knowledge and skill is his own and how much is a restricted trade secret of his employer. Conversely, the employer hires a potential lawsuit with each new technically skilled employee. Legal advice becomes either vague or

56. See, e.g., N.J. STAT. ANN. §§ 2A:119-5.1-.5 (1965); N.Y. REVISED PEN.
    CODE § 155.30(3); PENN. STAT. ANN. tit. 18, § 4699.2 (1965). See also 7 Boston College Indus.
    trial & Commercial L. Rev. 324 (1966). It has been suggested that although criminal sanctions may be desirable for acts of intentional
    espionage, they are a constant threat to the "innocent" appropriator. Certainty of definition is equally as difficult as in civil cases. See Arnold,
57. 304 U.S. 64 (1938).
58. E.g., Carter Prods. v. Colgate-Palmolive Co., 130 F. Supp. 557 (D.
    Md. 1955).
59. See Note, 66 Harv. L. Rev. 1094, 1105 (1953); cf. Note, 60 Harv. L.
    Rev. 1315, 1317 (1947).
60. "But the tendency of the law ... has been in the direction of enforcing increasingly higher standards of fairness and commercial morality in trade. The tendency still persists." RESTATEMENT, TORTS ch. 35, at 540 (1938). See also Winston Research Corp. v. Minnesota Mining & Mfg. Co., 350 F.2d 134, 138 (9th Cir. 1965).
or unreliable as the courts mix varying definitions of trade secret law with their own notions of equitable conduct. In one case, an employee had worked for the plaintiff eight years, devoting half his time to analyzing and improving upon competitors' products. The employer later sought to enjoin the employee from using his knowledge, claiming it was a trade secret of the employer. The court, in denying relief, found this knowledge belonged to the employee. However, another court, on identical facts, held an implied confidential relationship had been created and protected the discoveries as trade secrets of the employer.

A second criticism of trade secret law is its use of injunctions. Some courts, following the rule of Shellmar Prods. Co. v. Allen-Qually Co., grant broad permanent injunctions. They stress the inequitable conduct of the defendant as the determining factor. It is irrelevant that the secret became known during trial, after trial, or that the information could have been obtained from a legitimate source. Once information is disclosed in secret, it always retains a confidential status on the theory that a person cannot discover the same thing twice. A permanent injunction prevents the defendant from using what is in fact public knowledge. Also, an injunction may give the owner a virtual monopoly because no one else may be willing to risk an entry into the plaintiff's market.


66. See, e.g., Smith v. Dravo Corp., 203 F.2d 369 (7th Cir. 1953).


69. See Smith v. Dravo Corp., 203 F.2d 369, 375 (7th Cir. 1953), where the court stated that the Pennsylvania test was how the defendant learned the secret, not whether he could have obtained it from a legitimate source.


71. "[A]nyone except appellant could have infringed it if he desired to do so .... [but] by its inequitable conduct appellant has precluded itself from enjoying the right of the general public to the patent disclosure ...." Shellmar Prods. Co. v. Allen-Qually Co., 87 F.2d 104, 108 (7th Cir.), cert. denied, 301 U.S. 695 (1936).

72. In Hyde Corp. v. Huffines, 153 Tex. 506, 314 S.W.2d 763 (1958), the enjoined defendant was producing the product before the judgment. But see
Other courts will not grant an injunction if the information is not secret at the time of trial.\textsuperscript{73} The confidential relationship rests on the secret nature of the disclosure; if there is no secret, there can be no confidence — and no protection. This approach, known as the Conmar rule (\textit{Conmar Prods. Corp. v. Universal Slide Fastener Co.}\textsuperscript{74}), has three variations. Under the first variation the court will grant an injunction which will be dissolved when the secret becomes public through unprotected disclosure.\textsuperscript{75} The second variation allows an injunction for the remainder of the estimated time it would have taken a competitor to reverse engineer and market his own product.\textsuperscript{76} This puts the owner in the same position he would have been had the secret never been appropriated. Under this rationale, when a product is marketed it is assured the same period of protection from the defendant as it would have from analysis and use by any other competitor. The third variation of the Conmar rule sanctions an injunction running from the time of judgment for the entire estimated period of time it would take to reverse engineer and market the product.\textsuperscript{77} This results in protecting the owner from the appropriator even though the product has in fact been reverse engineered by another competitor.\textsuperscript{78}

Injunctions create further difficulties under either the Shellmar or the Conmar rules. The Federal Rules of Civil Procedure, substantially duplicated in many states,\textsuperscript{79} provide that an injunction "shall describe in reasonable detail, and not by reference to the complaint or other document, the act or acts sought to be restrained. . . ."\textsuperscript{80} Yet trade secret injunctions are usually drawn in

\textsuperscript{73} Wissman v. Boucher, 150 Tex. 326, 240 S.W.2d 278 (1951), where the same court denied an injunction in a similar situation on grounds that it would be essentially the same as an agreement not to compete, and thus unenforceable as being in restraint of trade.


\textsuperscript{75} 172 F.2d 150 (2d Cir. 1949).

\textsuperscript{76} Space Aero Prods. Co. v. R. E. Darling Co., 288 Md. 93, 125, 198 A.2d 74, 91 (1963), cert. denied, 382 U.S. 848 (1966). Of course the enjoined party cannot increase the publicity of the secret by his own disclosures.

\textsuperscript{77} Winston Research Corp. v. Minnesota Mining & Mfg. Co., 380 F.2d 134 (9th Cir. 1965). This time period includes everything necessary to actually market the product.

\textsuperscript{78} Schulenburg v. Signatrol, Inc., 38 Ill. 2d 879, 212 N.E.2d 865 (1965).

\textsuperscript{79} \textit{Id.} at 212 N.E.2d at 869–70.

\textsuperscript{80} \textit{Id.} at 212 N.E.2d at 869–70.

\textsuperscript{79} See, e.g., \textit{Texas R. Civ. P.} 63; \textit{Kentucky Civ. Rule} 65.02.

\textsuperscript{80} \textit{Fed. R. Civ. P.} 65(d).
such vague terms that the enjoined party has no way of knowing their scope. An injunction against using “any device like the plaintiff’s device” is injunction by way of example. It not only protects the secret features of plaintiff’s device, but the incorporated public ideas as well. Similarly, an injunction against “using in any way the confidential information obtained by defendants from an examination of plaintiff’s [product]” is injunction by reference. Since the “confidential information” is never defined, the injunction is certain to protect more than the plaintiff’s trade secret.

The typical justification for the use of broad language in such injunctions is based upon a fear of disclosing the plaintiff’s secrets. It also has been asserted by way of justification that the defendant knows what he has done wrong and can act accordingly. Other cases have suggested that trade secret definition may be too difficult for the courts who find it “impracticable if not impossible” to enumerate all the secrets that the defendant learned from the plaintiff. The uncertainty stemming from the issuance of vague injunctions has resulted in grants of broader protection than is legally justifiable. Without specific guidance, the defendant may be forced to forego utilization of legitimate information which might possibly be related to the protected secret. The defendant cannot be certain that activity which he considers to be legitimate will be so viewed by the court which has previously issued an injunction to protect the plaintiff’s secret.

The major criticism of trade secret law stems from the courts’ primary concern with the interests of the immediate parties and their failure to evaluate objectively the societal impact of the

82. In Hyde Corp. v. Huffines, 158 Tex. 566, 314 S.W.2d 763 (1958), the defendant was restrained by perpetual injunction from “manufacturing or selling any device made substantially in accordance with any feature of a garbage compressor described in [plaintiff’s] original ‘application for a patent’ . . . .” Id. at 569, 314 S.W.2d at 765.
84. See, e.g., Pomeroy Ink Co. v. Pomeroy, 77 N.J. Eq. 293, 78 Atl. 698 (Ch. 1910).
85. See Ungar Elec. Tool, Inc. v. Sid Ungar Co., 192 Cal. App. 2d 398, 13 Cal. Rptr. 268 (Dist. Ct. App. 1961): “Appellants complaint that the injunction here is too broad is ill-founded when it is considered that the matters treated by the injunction are matters within the peculiar knowledge of the appellants . . . .” Id. at 404, 13 Cal. Rptr. at 272.
law. Trade secret law is law for the entrepreneur. On one side is the trade secret owner. In order to capitalize on the time, money, and effort invested the owner must disclose his secret. He expects that disclosure to be protected. On the other side is the potential appropriator who desires the freest access to commercially advantageous innovations. Trade secret law is ostensibly designed to balance these conflicting interests. However, this balancing process has often neglected other public interests.

The most serious injuries occur where the dispute involves an employee of a trade secret owner.88 If the secret is clearly that of the employer, the courts have little difficulty in protecting it. The problem arises in distinguishing the job skills of the technically skilled employee from the protectible trade secrets of his employer.89 In making this distinction the court is forced to consider equally undesirable alternatives: Either the employee is restrained from using his best skills; or the employer finds his trade secret in the hands of a competitor. Resort to the policies favoring either party fails to suggest reasons why either side should have the benefit of any presumptions. The result is an ad hoc determination of many cases. The uncertainty regarding the employee's job skills, coupled with the threat of vague injunctive relief, reduces the employee's mobility and bargaining power.90 Employers are unwilling to hire an employee whose skills may be the trade secret91 of a former employer. Specialization has made the problem more acute. Public policy would seem to favor


We are not here concerned with any claim of patent infringement nor are we concerned with the rights of the public generally. . . [Defendant's] conduct was grossly improper and gave rise to the plaintiff's cause of action, based on long-settled equitable principles and supported by the marked changes in the attitude of the law towards the need for commercial morality.

Id. at 474–75, 114 A.2d at 442.


91. In order to avoid trade secret actions, DuPont has a policy of placing new employees in departments unrelated to the employees' specialization with former employers. Fortune, July 1964, p. 242.
technological advance through specialization of the labor force. Now, however, the skilled employee who wishes to change jobs or to become self-employed runs the risk of disclosing secret information of his former employer. As specialization increases, it becomes more difficult to classify the employee's skills accurately. The employer may then use the uncertainty of the law to restrict the employee. Not only is the individual employee affected, but also society is deprived of the optimum technically skilled labor force. Furthermore, preventing the employee from starting his own business or joining his employer's competitors reduces competition.

Under the present approach to trade secret protection, the interests of society suffer on a broader scale as well. The only public policy the courts expressly consider is the enforcement of some standard of commercial morality. Yet, the courts have failed to consider the losses resulting from the secrecy which the present law encourages. To qualify for protection, the owner is required to keep his secrets not only from the public and his competitors, but also from his own employees, parcelling out information on a need-to-know basis. The resulting aura of loyalty and secrecy lowers employee incentive, inhibits the free interchange of basic research, duplicates effort, and creates a demand for industrial espionage. From an economic standpoint, reverse engineering, duplication of research, and costly security systems are all wasteful diversions of resources. Society must ultimately absorb these losses in higher costs and in a slower rate of technological advance.

The last fundamental criticism of trade secret law is that it frustrates the federal patent policy. The Constitution gives Congress power to promote the useful arts and sciences by granting limited protection. Congress has emphasized the interests of the public by enacting the patent laws. Rewarding the inventor is


96. U.S. CONST. art. 1, § 8.
only a secondary consideration. The grantee's ideas must advance useful knowledge and there must be disclosure so that the protected ideas may be freely used by the public at the expiration of seventeen years. Thus, patent law is protected disclosure which confers immediate benefits on the innovator and the ultimate benefits on society.

Trade secret law, however, is protected secrecy. The only true beneficiary is the trade secret owner, who is in fact over protected. The incongruity of approach is highlighted in actions for patent infringement which include an alternative claim for trade secret violation. If the patent is invalidated, the owner may still get equivalent relief under trade secret law. All information contained in an invalidated patent enters the public domain, and is usable by anyone except the adjudged trade secret appropriator.

Another conflict with patent policy exists when an idea embodied in an expired patent is protected as a trade secret. The grant of a monopoly entitles the public to unrestricted use upon termination of the period of protection. Nevertheless, the defendant cannot use this public "secret" if he learned of it in a confidential relationship rather than from the public records. Furthermore, a system of protected secrecy allows the owners of patentable innovations to avoid the impact of public disclosure. Thus there is an incentive to rely on secrecy and escape the disclosure condition of patent protection, particularly where the product is incapable of reverse engineering. This diminishes the


99. "The district courts shall have original jurisdiction of any civil action asserting a claim of unfair competition when joined with a substantial and related claim under the copyright, patent or trade-mark laws." 28 U.S.C. § 1338(b) (1964).

100. See, e.g., A. O. Smith Corp. v. Petroleum Iron Works Co., 73 F.2d 531 (6th Cir. 1934).


102. E.g., Franke v. Wiltschek, 209 F.2d 493 (2d Cir. 1953).

103. Franke v. Wiltschek, 209 F.2d 493 (2d Cir. 1953). But see Luccous v. J. C. Kinley Co., 376 S.W.2d 336 (Tex. 1964), where the patentee unsuccessfully sought protection for his own expired patent under trade secret law.

104. Over one-half of all issued patents in litigation are invalidated. S. REP. No. 1464, 84th Cong., 2d Sess. 4 (1956).
effectiveness of the patent laws because the innovator can avoid the choice between disclosure and loss of protection. If the secrecy can be maintained, protection could exist for longer than seventeen years. The public may be deprived of the benefit indefinitely. Because of the unpredictability of trade secret law, the owner, by use of either threats of litigation or enforcement of a broad, vague injunction, is afforded greater protection for his idea than is the patentee who must meet a high standard of innovation and who must litigate within the scope of his patent claims.\textsuperscript{105} The recent case of Sears, Roebuck & Co. \textit{v. Stiffel Co.},\textsuperscript{106} suggests that the United States Supreme Court is becoming more sensitive to encroachments on the federal patent policy. In \textit{Stiffel} the plaintiff's design and mechanical patents were invalidated; nevertheless, the lower court protected the plaintiff's product against use by the defendant under a state unfair competition law prohibiting copying. The Supreme Court reversed, holding that the state law conflicted with the federal patent system. In the companion case, \textit{Compeco Corp. \textit{v. Day-Brite Lighting Co.}},\textsuperscript{107} the Court indicated that the copier's motives were irrelevant.\textsuperscript{108} While these decisions have not been construed to apply to trade secret law in general,\textsuperscript{109} the language and rationale used by the Court suggest that it will reject a result under trade secret law which frustrates patent policy.

\textbf{IV. THE NEED FOR REFORM}

While there has been increasing criticism of trade secret law,\textsuperscript{110} few constructive proposals have been advanced. One simplistic suggestion has been to amend the Lanham Trademark Act\textsuperscript{111} to give exclusive common law jurisdiction to the federal courts.

\begin{itemize}
  \item \textsuperscript{105} See Arnold, \textit{supra} note 81, at 256.
  \item \textsuperscript{106} 376 U.S. 225 (1964).
  \item \textsuperscript{107} 376 U.S. 234 (1964).
  \item \textsuperscript{108} Id. at 238.
  \item \textsuperscript{109} See, e.g., Servo Corp. of America \textit{v. General Elec. Co.}, 337 F.2d 716, 724–25 (4th Cir. 1964); Schumberg \textit{v. Signatrol, Inc.}, 33 Ill. 2d 379, 212 N.E.2d 865, 868 (1965). \textit{But cf.} Winston Research Corp. \textit{v. Minnesota Mining \& Mfg. Co.}, 350 F.2d 134 (9th Cir. 1965), where the court relied on \textit{Stiffel} to reject the contention that trade secrets are protectible per se.
\end{itemize}
federal courts could then develop a consistent body of law, and
the problems of drafting comprehensive legislation would be
avoided. Although this approach may produce uniformity, it does
not insure certainty. Since this proposal would incorporate in toto
the present rationale of protected secrecy, an employee still will
not be able to evaluate the legal consequences of his job skills.
Any party to whom business information has been disclosed will
still be unable to assess his potential liabilities. Worst of all, the
courts probably would continue to ignore the public interest.

A statutory system of protected disclosure analogous to patent
law has also been suggested. Although many feel that all-inclusive
legislation would be virtually impossible,112 one commentator has
suggested possible criteria.113 This plan would allow some statu-
tory protection for registered information which does not meet
patent standards. Such a statute would permit independent dis-
covery. Wrongful appropriators would be penalized by exacting a
royalty or other compensation. Injunctions would not be allowed.
Finally, protection would not extend to unregistered information.
Contract rights would not be recognized beyond the fixed period
of protection. The problems of constitutionality, scope, and ad-
ministration of such a statutory scheme should be evaluated in
terms of "the present confusion, ambiguity, frequently inequitable
results and, most of all, the undesirable side effects to which our
present law of trade secrets contributes, in terms of the strong
pressures to be secretive rather than to make data public ...."

An analysis of trade secret law seems to support reorganization
along the lines of protected disclosure, a change which can only be
accomplished by statute. Federal rather than state legislation is
necessary to insure uniformity and to avoid possible federal pre-
emption problems. The constitutionality of federal legislation
could be based on the commerce clause,115 patent clause,116 and
treaty power.117 While the complexity of the commercial system
makes detailed legislation impossible, a statute drafted in terms
of general limitations could resolve the majority of the critical
problems and yet leave room for constructive judicial develop-
ment in accordance with the uniform policy expressed in the
statute. This integration of legislative and judicial direction could

---

112. See Arnold, supra note 81, at 270.
114. Id. at 34; see Note, 38 N.Y.U.L. Rev. 324, 347-49 (1963).
116. Ibid.
encourage the free use of information and dissemination of valuable ideas, while retaining enough protection to assure commercial exploitation.

The following statutory proposal attempts to reconcile all interests involved by raising standards of protectibility, limiting the period of protection, and restricting available remedies. Its desired effect is to benefit society by encouraging disclosure, and to assist parties directly involved with trade secrets by improving the certainty of the law.

V. AN ACT REGULATING TRADE SECRETS

SECTION 1. DEFINITION

A trade secret under this act is any device, invention, process or idea which is not generally known by members of any trade willing to use it and which gives its holder a competitive advantage.

Comment: This definition does not modify the present law except for the qualification that secrecy must extend to any trade willing to use it. Even though information may be new or secret in one trade, it will not be protected if it is freely used in another trade. The word "generally" allows a court to deny protection when the information is available from a legitimate source, and yet grant relief when the information is not legitimately available.

SECTION 2. PROTECTION AFFORDED SECRETS UNDER THIS ACT

(a) Trade secrets which are discoverable through reverse engineering.

Subdivision 1. A trade secret which can be reverse engineered when it is marketed shall not be appropriated and used before expiration of its secrecy. For purposes of this subsection, secrecy expires upon publication by the owner or an independent discoverer, or upon termination of the period of time it would have taken to reverse engineer and market the owner's trade secret, or five years, which ever occurs first.
Subdivision 2. A third party may not use an appropriated secret after receiving reasonable notice of the appropriation unless he has innocently changed his position so as to make any action inequitable.

Subdivision 3. Violation of this subsection gives the injured party a right of action for treble damages against the appropriator or, if actual damage cannot be proven, reasonable punitive damages may be awarded.

Comment: Under this subsection the holder will not get the broad protection presently available because the right to protection expires at the end of the statutory period. Unless five years have elapsed, or the secret has been published by an independent discoverer, the court must determine that both the appropriation and the use occurred before a distinterested third party would have been able to achieve the same results. It follows that the owner can claim no injury after the time in which an independent party could have embodied the secret in his own product. A party who has reason to believe that he may be using the secret of another will have an opportunity to analyze his position and to sacrifice an early market entry for the assurance that his ultimate production will not be in breach of trust. This subsection does not change the present law regarding the liability of third parties.

Because damages often will be speculative, especially if suit is brought before the expiration of the secrecy period, punitive damages are likely to be the rule. The court will award punitive damages based on the nature of the appropriator's conduct. 218

118. In awarding punitive damages under this section, the courts should be primarily concerned with adequately compensating the plaintiff. Punishing the defendant should only be incidental. See Lucas v. Michigan C.R.R., 98 Mich. 1, 56 N.W. 1039 (1893); Ten Hopen v. Walker, 96 Mich. 236, 55 N.W. 657 (1893). In effect, this will allow the courts to use a more liberal standard as in analogous cases where compensation for a plaintiff's injuries can not be accurately estimated. See McChesney v. Wilson, 132 Mich. 252, 93 N.W. 627 (1899); Bixby v. Dunlap, 96 N.H. 459 (1879). Also, the court should consider all the relevant facts in making its determination. See Gaither v. Meacham, 214 Ala. 343, 108 So. 2 (1926).

Damages need not exceed a reasonable royalty, but this is not mentioned as a limitation.

Injunctions will not be available even if an intentional theft is involved since the resulting competition will benefit society and possibly may even benefit the originator. The entry into the market of additional producers may increase the sales of all producers because of the additional advertising and communication to the public.\(^{119}\) This may also cause earlier acceptance of the product by the public.

\(\text{(b) Industrial, mechanical and chemical processes which are not disclosed by the holder before registration, or by the product which they produce; and, trade secrets which cannot be reverse engineered.}\)

Subdivision 1. If registered either as a patent which is later held invalid, or as a trade secret by the discoverer, subject matter under this subsection shall not be infringed for a period of five years from the date of application for registration. Application for registration shall be made within one year of discovery or development, or within one year of the effective date of this statute.

Subdivision 2. A violation of this subsection for which an injunction for the remaining period of protection is inadequate shall give rise to an alternate claim for treble damages. In any infringement action the court may award punitive damages appropriate to the existing facts.

Subdivision 3. Use of subject matter registered in accordance with this subsection shall not constitute infringement under

119. See Stigler, *The Economics of Information*, 69 J. Pol. Econ. 213, 220–24 (1961); Telser, *Advertising and Competition*, 72 J. Pol. Econ. 537, 550 (1964). The traditional view of advertising is that in fact it reduces competition because a copious advertiser can corner the market for his product. This idea has been criticized on the ground that competition is actually increased. See Advertising Age, Oct. 11, 1965, p. 3, col. 4; Telser, *supra*, at 541–51. It can also be argued that any increase in competition at an early stage will inhibit monopolistic tendencies.
Comment: Subsection (b) makes a significant change in the existing law. Innovations which cannot be reverse engineered are granted an exclusive statutory monopoly in exchange for disclosure. To obtain protection the holder must register the secret and permit public use after the period of protection. Information may be kept secret through internal control. But the trade secret owner will be encouraged to disclose either through a public registration system established pursuant to this act, or through the patent office. Failure to register a secret which could not be reverse engineered would preclude relief for its loss, whether through independent discovery or theft. This subsection affords enough protection for even the smallest company to maintain a substantial investment in developing products and processes.\textsuperscript{120} At the same time, the high standard of innovation required should avoid the dangers of granting monopolies to low class innovations.\textsuperscript{121} The threat of commercial extortion by individuals hoarding unique ideas will be eliminated.

This subsection also modifies patent law. Patented innovations which are invalidated qualify for protection under this subsection if they cannot be reverse engineered. Since patent application involves substantial risks for the inventor, there has been an incentive to withhold secrets which do not disclose themselves and to rely instead on trade secret law for protection. Under this act,

\textsuperscript{120} The five year period of protection is used arbitrarily for purposes of illustration. What the proper term of protection should be is a determination for the legislature.

\textsuperscript{121} The potential dangers of granting monopolies to low class innovations is a standard consideration in patent law.

It was never the object of those laws to grant a monopoly for every trifling device, every shadow of a shade of an idea, which would naturally and spontaneously occur to any skilled mechanic or operator in the ordinary progress of manufactures. Such an indiscriminate creation of exclusive privileges tends rather to obstruct than to stimulate invention. It creates a class of speculative schemers who make it their business to watch the advancing wave of improvement, and gather its foam in the form of patented monopolies, which enable them to lay a heavy tax upon the industry of the country, without contributing anything to the real advancement of the acts.

there will be no protection without disclosure. This subsection will encourage the innovator to apply for a patent and thus disclose his invention by granting an adequate period of protection for commercial exploitation despite the invalidation of the patent.

Injunctive relief is allowed under this subsection. The five year limitation eliminates the possibility of perpetual monopoly by injunction. Since the claimant must now litigate within the scope of his registration or patent claim, the problem of the vague injunction should be greatly reduced.

Subdivision 3 limits infringement to persons or products in competition with each other. This will allow independent discovery and use if it will not injure the registered party. Although large companies will find this subdivision advantageous, the principal beneficiaries will be the small companies which need to invest in research free from the threat of discovery and registration by other firms.

(c) **Customer Lists.**

Where the holder of a customer list has manifested an intent to keep it secret, such customer list shall not be appropriated and used if it contains information which is of a personal nature or is being held confidentially between customer and dealer. Names of customers are not protected. An injunction or treble damages may be awarded for a violation of this section along with reasonable punitive damages.

*Comment:* This subsection affords injunctive relief for customer lists while limiting the protection to information of a high classification. For the sake of competition, customer names are explicitly excluded from protection. Because of the difficult nature of the problems which deal with countless types of business firms, the courts must exercise wide discretion in resolving the facts while keeping the intent and purpose of the statute in mind.

(d) **Undeveloped ideas and know-how.**

Subdivision 1. An undeveloped idea is one which is not substantially ready to be utilized if it is to be used in a product or
process; or, if the idea is of such a nature that it can be readily marketed after discovery, it must be so used or it shall be unprotected.

Subdivision 2. Undeveloped ideas and knowhow not covered under subsections (a) or (b) may be protected against appropriation and use for a period not exceeding a reasonable time for their development or exploitation. A reasonable time may extend to the limit of protection under another appropriate section of this act. The court may provide any remedy that circumstances demand and which is in keeping with the purpose of this act.

Comment: Undeveloped ideas and know-how which do not fall within an explicit part of this act are given limited protection. But this protection should not exceed any other protection which would be allowed if the idea were substantially developed. This subsection serves as an all inclusive provision for the many problems which are difficult to cover with specific legislation.

(e) Restrictive covenants, licensing agreements, and other express and implied contracts regulating the disclosure and use of trade secrets.

Subdivision 1. No agreement or part of an agreement between an employer and employee regulating the disclosure of trade secrets under this act shall be effective either after termination of employment or the expiration of any other period of protection under this act for that class of secret, whichever occurs later.

Subdivision 2. Licensing or royalty agreements forbidding disclosure or use of a secret shall be unenforceable after the period of protection for that secret has expired under this act.

Comment: This subsection insures that the secret will not get longer protection through private agreement than under the act. It establishes a definite position from which the parties can bar-
gain. No implied relationships should be inferred from any disclosure preceding the agreement. Under subdivision 1 of this subsection, the employer may be able to extend protection for his secrets by the payment of postemployment “salary for services rendered” in order to delay the termination of employment. While this device has some support from the bar, it should be held to a high standard of reasonableness to prevent the impairment of employees' earning power and mobility.

(f) Attorney's Fees.
In addition to any other relief granted, the court may award reasonable attorney's fees to a party injured through a violation of this act.

Comment: This subsection has two purposes. It eliminates reluctance to sue because of the cost of litigation. It also deters willful violation because the injured party will be more willing to sue and the possibility that an unsuccessful defense may be very costly. The taxing of fees is not mandatory, and its allowance should be based on the nature of the violator's conduct.

(g) Pre-Emption by act.
Except as provided in this act, no protection shall be afforded trade secrets under any other theory of law or equity.

Comment: This subsection, together with section 4, establishes that this act completely pre-empts all prior law governing trade secrets.

SECTION 3. OTHER ACTS OF UNFAIR COMPETITION RELATING TO TRADE SECRETS

(a) Any party who uses another's trade secret or that which was previously a trade secret shall

---

122. A postemployment agreement not to compete might provide for the annual payment for three years of 25% of the employee's last annual salary in exchange for "consultation services." From the employer's standpoint, such payments represent much cheaper protection for his trade secrets than does costly litigation. On the employee's side, this "bonus" will compensate him when he is forced to take lower pay in order to get a job that will not require his restricted skill.

123. See Arnold, supra note 81, at 269-70; Blake, Employee Agreements Not To Compete, 73 HARV. L. REV. 625, 638 (1960).
be enjoined from passing off his subsequent product as containing any part of that secret. (b) Any other utilization of the goodwill of a previously held trade secret in order to promote the use or sale of a subsequent competitive product shall be enjoined by court order.

Comment: Section 3 is aimed at restricting the intentional use of advertising or other sales promotion to pass off a subsequent product as containing the equivalent components of formula of previously held trade secrets. For example, if the formula for Coca-Cola were divulged, it would be impermissible to advertise a product as containing the same formula. It would also be a wrongful act to announce that the same formula were being used but that it had been improved.

Section 4. Jurisdiction

The federal courts shall have exclusive jurisdiction over all cases arising under this act.