

Trade Secret Basics FAQ

What every business owner should know about trade secret law.

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What is a trade secret?

In most states, a trade secret may consist of any formula, pattern, physical device, idea, process or compilation of information that both:

- 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 potential trade secrets are:

- 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.

Unlike other forms of intellectual property such as patents, copyrights and trademarks, trade secrecy is basically a do-it-yourself form of protection. You don't register with the government to secure your trade secret; you simply keep the information confidential. Trade secret protection lasts for as long as the secret is kept confidential. Once a trade secret is made available to the public, trade secret protection ends.

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What types of information can trade secrets protect?

Trade secrets often protect valuable technical information that cannot be sheltered under other forms of intellectual property law, such as the formula for Coca-Cola. Trade secrets may also:

- protect ideas that offer a business a competitive advantage, thereby enabling a company or individual to get a head start on the competition -- for example, an idea for a new type of product or a new website
- keep competitors from learning that a product or service is under development and from discovering its functional or technical attributes -- for example, how a new software program works
- protect valuable business information such as marketing plans, cost and price information and customer lists -- for example, a company's plans to launch a new product line
- protect "negative know-how" -- that is, information you've learned during the course of research and development on what not to do or what does not work optimally -- for example, research revealing that a new type of drug is ineffective, or
- protect any other information that has some value and is not generally known by your competitors -- for example, a list of customers ranked by how profitable their business is.

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What rights does the owner of a trade secret have?

A trade secret owner can prevent the following groups of people from copying, using, or 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. This may be the best way for a trade secret owner to establish a duty of confidentiality.

There is one group of people that cannot be stopped from using information protected under trade secret law. These are people who discover the secret independently, that is, without using illegal means or violating agreements or state laws. For example, it is not a violation of trade secret law to analyze (or "reverse engineer") any lawfully obtained product and determine its trade secret.

EXAMPLE

XCEL glue is comprised of a trade secret protected formula. Phil, a chemist, analyzes the contents of XCEL glue, determines its composition and recreates the formula. Phil can legally use this information to make and sell his own glue.

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How can a business protect its trade secrets?

Simply calling information a trade secret will not make it so. A business must affirmatively behave in a way that proves its desire to keep the information secret. Some companies go to extreme lengths.

Example: The formula for Coca-Cola (perhaps the world's most famous trade secret) is kept locked in a bank vault that can be opened only by a resolution of the Coca-Cola Company's board of directors. Only two Coca-Cola employees ever know the formula at the same time; their identities are never disclosed to the public and they are not allowed to fly on the same airplane.

Fortunately, extraordinary trade secrecy protection measures are seldom necessary. Although you should take reasonable precautions to protect any information you regard as a trade secret, you don't have to turn your office into an armed camp to do so. Sensible precautions include marking documents containing trade secrets "Confidential," locking trade secret materials away after business hours, maintaining computer security and only providing access to secret information to people with a reasonable need to know.

But the very best way to protect trade secrets is through use of nondisclosure agreements. Courts have repeatedly reiterated that the use of nondisclosure agreements is the most important way to maintain the secrecy of confidential information.

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How can a business enforce its rights if someone steals or improperly discloses confidential information?

Every state has a law prohibiting theft or disclosure of trade secrets. Most of these laws are derived from the Uniform Trade Secrets Act (UTSA), a model law drafted by legal

scholars. A listing of states that have adopted some version of the UTSA is provided at the end of this FAQ.

A trade secret owner can enforce rights against someone who steals confidential information by asking a court to issue an order (an injunction) preventing further disclosure or use of the secrets. A trade secret owner can also collect damages for any economic injury suffered as a result of the trade secret's improper acquisition and use. Here are some examples of incidents that can lead to trade secret lawsuits:

- Sarah, a former employee of C-com, discloses C-com trade secrets to her new employer.
- Mary hacks her way into the network for a computer company and downloads the specs for a new silicon chip. She sells the information to a third party -- a rival computer company.
- Sheldon is a software programmer who works as an independent contractor for Diskco. Sheldon signed a nondisclosure agreement with Diskco, but later discloses Diskco secrets to a rival.

To prevail in a trade secret infringement suit, a trade secret owner must show (1) that the information alleged to be confidential provides a competitive advantage and (2) the information really is maintained in secrecy. In addition, the trade secret owner must show that the information was either improperly acquired by the defendant (if the defendant is accused of making commercial use of the secret) or improperly disclosed by the defendant (if the defendant is accused of leaking the information).

The "Inevitable Disclosure" Doctrine

In some cases, a company may prevent a former employee from working for a competitor if the company can demonstrate that employment with the competitor will inevitably lead to disclosure of trade secrets. In a 1995 case, PepsiCo successfully argued that a former executive could not work as Chief Executive Officer of Gatorade/Snapple because the executive could not help but rely on PepsiCo's trade secrets as he plotted Gatorade and Snapple's new course, giving the competitor an unfair advantage over PepsiCo.

Some states have rejected the inevitable disclosure doctrine because it challenges an employee's basic freedom to switch employers. In one case, a court refused to apply the doctrine unless there was additional showing of bad faith, underhanded dealing, or employment by a competitor lacking comparable technology.

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Is stealing trade secrets a crime?

Intentional theft of trade secrets can constitute a crime under both federal and state laws. The most significant federal law dealing with trade secret theft is the Economic Espionage Act of 1996 (EEA) (18 U.S.C., Sections 1831 to 1839). The EEA gives the U.S. Attorney General sweeping powers to prosecute any person or company involved in trade secret misappropriation and punishes intentional stealing, copying or receiving of trade secrets. Penalties for violations are severe: Individuals may be fined up to \$500,000 and corporations up to \$5 million. A violator may also be sent to prison for up to ten years. All property used and proceeds derived from the theft can be seized and sold by the government.

The EEA applies not only to thefts that occur within the United States, but also to thefts outside the U.S. if the thief is a U.S. citizen or corporation, or if any act in furtherance of the offense occurred in the U.S. If the theft is performed on behalf of a foreign government or agent, the corporate fines can double and jail time may increase to 15 years.

Several states have also enacted laws making trade secret infringement a crime. For example, in California it is a crime to acquire, disclose or use trade secrets without authorization. Violators may be fined up to \$5,000, sentenced to up to one year in jail, or both. (Cal. Penal Code Section 499c.)

STATES THAT HAVE ADOPTED SOME VERSION OF THE UNIFORM TRADE SECRETS ACT

State	Statute
Alabama*	Ala. Code. §§ 8-27-1 et seq.
Alaska	Alaska Stat. §§ 45.50.910 et seq.
Arkansas	Ark. Stat. Ann. §§ 4-75-601 et seq.
California	Cal. Civ. Code §§ 3426 et seq.
Colorado	Col. Rev. Stat §§ 7-74-101
Connecticut	Conn. Genl. Stat. §§ 35-50 et seq.
Delaware	Del. Code Ann. Title 6 §§ 2001 et seq.
District of Columbia	D.C. Code Ann. §§ 36-401 et seq.
Florida	Fla. Stat Ann. §§ 688.001 et seq.
Hawaii	Haw. Rev. Stat. §§ 482B-1 et seq.
Idaho	Idaho Code §§ 48-801 et seq.
Illinois	Ill. Ann. Stat. ch. 140 §§ 351-59
Indiana	Ind. Code. Ann. §§ 24-3-1

Kansas	Kan. Stat. Ann. §§ 60-3320 et seq.
Louisiana	La. Rev. Stat. Ann. §§ 51:1431 et seq.
Maine	M.R.S.A. Title 10 §§ 1541 et seq.
Maryland	Md. Com. L. Code §§ 11-1201 et seq.
Minnesota	Minn. Stat Ann. §§ 325C.01 et seq.
Montana	Mont. Code Ann. §§ 30-14-401 et seq.
Nebraska	Neb. Rev. Stat. §§ 87-501 et seq.
Nevada	Nev. Rev. Stat. §§ 600A.010 et seq.
New Mexico	N.M. Stat. Ann. §§ 57-3A-1 et seq.
North Carolina*	N.C. Gen. Stat. §§ 66-152 et seq.
North Dakota	N.D. Cent. Code §§ 47-25.1-01 et seq.
Oklahoma	Okl. Genl. Laws §§ 6-41-1
Oregon	Or. Rev. Stat. §§ 646.461 et seq.
Rhode Island	R.I. Gen. Laws §§ 6-41-1 et seq.
South Dakota	S.D. Cod. Laws §§ 37-29-1 et seq.
Utah	Utah Code Ann. §§ 13-24-1 et seq.
Virginia	Va. Code. Ann. §§ 59.1-336 et seq.
Washington	Wash. Rev. Code. Ann. §§ 19.108.010 et seq.
West Virginia	W. VA. Code. §§ 47-22-1 et seq.
Wisconsin	Wis. Stat. Ann. § 134.90

* Although they have adopted portions of the UTSA, Alabama and North Carolina are considered to have taken "major departures" from the UTSA because Alabama narrows trade secret protection while North Carolina broadens it.

More Information About Trade Secrets

For a more detailed explanation of trade secrets and nondisclosure agreements, as well as the full text of the Uniform Trade Secrets Act, see www.ndasforfree.com.

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