

Trade Secrets

University of Houston
Digital Transactions
Week #4
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In General

- Basis in common law or state statute
 - No federal preemption
- Grounded in policy of business ethics
 - Look at magic industry as an example
- Pro: Rights can be perpetual
 - So long as secrecy is maintained
- Con: Rights are non-exclusive
 - Can't prevent independent discovery

In General

- Sometime preferable over patents
 - Cheap to get, unlike patents
 - Especially helpful when lifetime of innovation is short (like software)
 - Most useful when patent infringement is hard to detect

Beware

- Trade Secret laws have vague standards
 - “not being generally known”
 - “not readily ascertainable”
 - “efforts reasonable under the circumstances to maintain secrecy”
- What constitutes misappropriation?
 - *Rivendell* (D.Ct.) details of software program
 - *Rivendell* (10th Cir.) knowledge of *system*

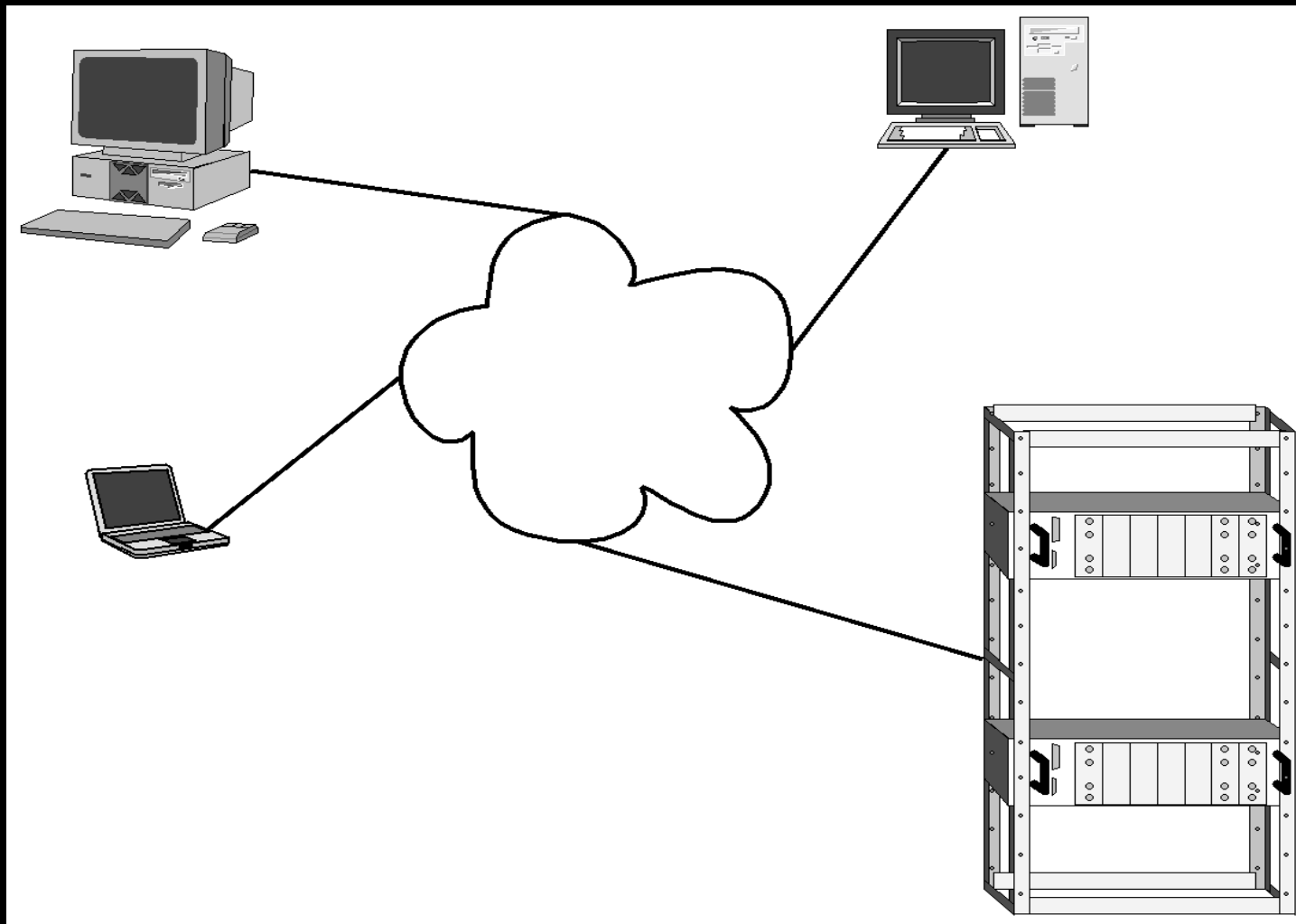
Misappropriation

- Burden on plaintiff to show:
 - There was a trade secret
 - Secrecy was maintained
 - Defendant had access to trade secret
 - Defendant either:
 - Stole the information making up the trade secret;
or
 - Breached a confidential relationship (e.g., NDA)
after it obtained the information

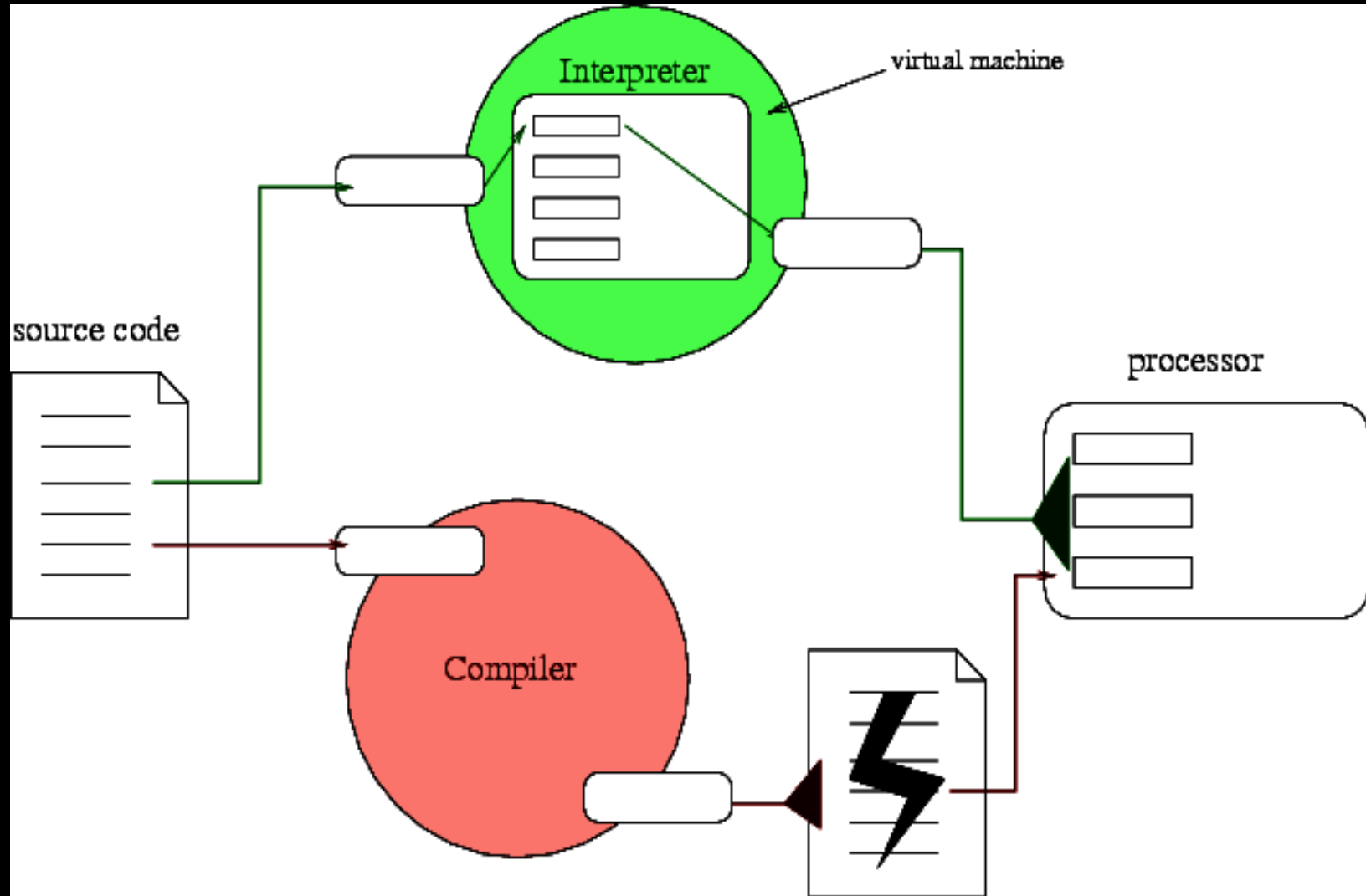
Trade Secrets for Software

- Can be tricky
 - Great if client uses ASP model
 - Disaster if client distributes scripted code
 - Okay if client distributes binary code
 - *Trandes Corp. v. Guy F. Atkinson Co.*, 996 F.2d 655 (4th Cir. 1993); *Q-Co Indus. v Hoffman*, 625 F. Supp. 608, 617 (S.D.N.Y. 1985).
 - NDA may be necessary, especially if source code is disclosed
 - *Data General Corp. v. Digital Computer Controls*

ASP Model



Scripts/Binary Dichotomy



Agreements

- Trade Secrets typically involve three types of agreements
 - Non-Disclosure Agreement (“NDA”)
 - Assignment of Rights in the Trade Secret
 - Often in the Employment Agreement
 - Non-Competition Agreement
 - Usually in the Employment Agreement

Non-Disclosure Agreement

- Pros:
 - Provides Notice to Recipient
 - Evidence that Discloser had technology at the time of the agreement
 - Might be enforceable
 - Depends on residuals clause
 - What about reverse engineering?
- Cons:
 - Usually doesn't change Recipient's behavior

Assignments

- Usually what the employer pays for
- But...
 - Part of job description?
 - May be limited by state “garage inventor” statutes
 - What about post-employment issues?
 - Policing ex-employees?
 - Deny them employment opportunities?

Non-Competition Clauses

- Goal is to avoid litigation
- But, there are vague standards
 - “reasonable time and scope”
- State laws differ
 - California is very lax, New York almost so
 - Other states use “blue pencil” standard
 - Courts can modify overly restrictive clause

Non-Competition Clauses

- Factors to consider:
 - Rule of Reasonableness
 - Independent (Contract) Consideration
 - Duration
 - 1-2 years okay. Longer may be suspect.
 - Distance (if applicable)
 - Blue Pencil Rule
 - Potential Liability for New Employer

Texas Non-Compete Agree.

- Non-compete agreements in Texas must be:
 - 1) ancillary to or part of an otherwise enforceable agreement at the time the agreement is made; and
 - 2) reasonably limited as to time, geographical area and scope so that they do not impose a greater restraint than is necessary to protect the goodwill or other business interest of the employer.
- See, *Light v. Central Cellular Co.*, 883 S.W.2d 642, 647 (Tex. 1994).

Texas Non-Compete Agree.

- The only consideration that an employer may give to support a non-compete agreement is the confidential information the employee needs to do his or her job. See, *Strickland v. Medtronic, Inc.*, 97 S.W.3d 835, 838 (Tex. App. 2003).
- In other words, employment itself -- even if under the terms of a contract of employment for a period of time -- is not sufficient consideration.

Texas Non-Compete Agree.

- The employer must provide the confidential information at the moment the employee signs the non-compete agreement. *Trilogy Software, Inc. v. Callidus Software, Inc.*, 143 S.W.3d 452, 461-62 (Tex. App. 2004)
- This is the “timeliness requirement”
 - At-will employee must receive confidential information at the time of signing the non-competition agreement
 - Strictly enforced in Texas

Civil Enforcement

- Much to prove on plaintiff's part
- Emotional, plus costly
- Outcome is tough to estimate
- Threats can have ancillary effects
 - Countersuits
 - Hiring of new employees
- Inevitable Disclosure Doctrine

Criminal Enforcement

- State Laws
- Economic Espionage Act
- Problems
 - Getting a prosecutor to take up the case
 - Standards vary between tech and business
 - Useful against miscreants, but may impede movement of people and thus dampen cross-fertilization