

INTELLECTUAL HISTORY OF TRADE SECRET LAW

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INTRODUCTION

The protection of trade secrets is a well-established concept¹, functionally related to the impact of innovation in the evolution of the economy. Starting from the 19th century, the industrial revolution urged law makers to shape the notion of trade secrets as a specific asset deserving legal protection. Over the decades and until the emergence of the new economy, the different sensitivity of legislators determined a heterogeneous and patchy evolutionary path mirroring the local economic context. Not surprisingly, the rise of the global information society has given a new boost to the role of trade secrets and has generated the demand for a uniform standard of protection across national boundaries. The critical question for trade secret law always has been and continues to be: Why give legal protection to secret information? As will be discussed later, this question had a relatively clear answer in the late nineteenth century, but the answer lost its power to persuade with the ascendancy of legal realism in the 1920s and 1930s. We have yet to find a satisfactory substitute.²

THE EMERGENCE OF A GENERAL THEORY OF TRADE SECRET LAW

Trade secret law as it is known today began to develop with the rise of industrial capitalism in the early nineteenth century.³ It was not until mid-century, however, that a general theory began

¹ Prof. A. Watson, University of Georgia Law School "*Trade Secrets and Roman Law: the Myth Exploded*" (1996). *Scholarly Works*. P. 476.

² See John C. Stedman, *Trade Secrets*, 23 OHIO ST. L.J. 4, 26-27 (1962) (noting that the many legal theories used to protect trade secrets lack a coherent policy rationale).

³ It appears that secrets might have received some protection in Roman law, although the matter is open to some dispute. See A. Arthur Schiller, *Trade Secrets and the Roman Law: The Actio Servi Corrupti*, 30 COLUM. L. REV. 837 (1930). In any event, this early form of protection is very different from the trade secret law we know today.

to take shape. Prior to 1860, courts simply dealt with specific legal issues in the course of deciding suits involving express agreements not to use or disclose secret information. These issues included whether courts of equity had jurisdiction to grant injunctive relief (they did),⁴ and whether agreements not to use or disclose were void as unlawful restraints on trade (they were not).⁵ All these issues were decided on the basis of established legal principles, though they were decided with some difficulty due to the intangible nature of the new subject matter. No court tried to expound a general theory, but by the middle of the nineteenth century, there were enough suggestions in the opinions for a general theory to emerge.

The Massachusetts Supreme Judicial Court seized the opportunity to generalize in an 1868 opinion, *Peabody v. Norfolk*,⁶ which is credited with crystallizing the law of trade secrets in the United States.⁷ The plaintiff, Francis Peabody, invented a new process and machinery for making gunny cloth from jute butts. He built a factory and employed Norfolk as a machinist under a written contract that obligated Norfolk not to use or disclose the secret process. Sometime later, Norfolk left Peabody's employment and joined with James Cook and others to

⁴ The earliest published cases, decided in England, expressed doubts about the existence of equity jurisdiction, but assumed that plaintiffs could seek a remedy at law for breach of contract. *See Newbery v. James*, 2 Mer. 446, 35 Eng. Rep. 1011, 1012-13 (Ch. 1817) (framing the issue in terms of the availability of specific performance and denying the decree because enforcement would disclose the secret); *Williams v. Williams*, 3 Mer. 157, 36 Eng. Rep. 61, 62 (Ch. 1317) (framing the issue in terms of specific performance and expressing doubts about jurisdiction). It did not take long, however, for English courts to resolve the issue in favor of jurisdiction, although they never quite agreed on the rationale. *See Morison v. Moat*, 9 Hare 241, 68 Eng. Rep. 492 (Ch. 1851) (observing that jurisdiction is well settled, but courts disagree on whether it is founded on breach of contract, breach of trust, or property).

⁵ *See Vickery v. Welch*, 36 Mass. 523, 527 (1837) (holding agreement not to use or disclose enforceable in connection with sale of a business); *Jarvis v. Peck*, 10 Paige Ch. 118, 125 (N.Y. Ch. 1843) (agreement not to use or disclose enforceable in connection with sale of a partnership interest). These early cases involved the sale or transfer of a business interest where secret information, such as a manufacturing process, was the most valuable asset. Because it was impossible for the transferor to erase the information from his mind, the only way to effect a transfer of the secret was for the transferor to agree not to use or disclose it after the transfer. The problem with enforcing these agreements, however, was that they seemed to impose a restraint on trade by impeding the seller's ability to compete. Nevertheless, courts upheld the agreements and even implied promises not to use or disclose when it was clear that the parties intended a transfer. *See Vickery*, 36 Mass. at 527 ("The public are not prejudiced by the transfer [because] if it were worth anything, the defendant would use the art and keep it secret, and it is of no consequence to the public whether the secret art be used by the plaintiff or by the defendant."); (finding "the object of the parties

was not to restrain trade, but to insure to the purchasers of an interest in the secret the full benefit of their purchase"). At the same time, however, the rule only applied when the information was actually secret. *See Taylor v. Blanchard*, 95 Mass. 370, 374 (1866); *see also* MICHAEL J. TREBILCOCK, *TIM COMMON LAW OF RESTRAINT OF TRADE: A LEGAL AND ECONOMIC ANALYSIS* 11-12, 35 (1986) (noting how courts historically have found it easier to justify restraints attached to the sale of business than to justify restraints attached to employment).

⁶ 98 Mass. 452 (1868).

⁷ *See* MELVIN F. JAGER, *TRADE SECRET LAW* § 3.03, at 3-47 (1996)

build a competing factory using Peabody's machinery and process. Peabody sued in equity for an injunction against the new factory.

Cook demurred to the bill and raised every conceivable issue in defense. Defenses included that the agreement was in restraint of trade, that the information could not be kept secret in a large factory, that enforcing the agreement was inconsistent with the patent laws, that Cook had no privity of contract with Peabody, and that secret information was not property capable of passing by will or inheritance.⁸ Given the precedent, *Peabody* was in fact a hard case. Since the plaintiff sought enforcement of a contract against a former employee, the restraint-of-trade defense could not be disposed of in the usual way, by arguing that the contract was necessary to perfect a sale or transfer of the secret. Moreover, Cook learned the secret from Norfolk and so was not in privity of contract with Peabody. In a masterful opinion, Justice Gray rejected each of Cook's arguments. In the process, he pulled the many strands of trade secret precedent together into a compelling synthesis. Justice Gray began with a statement of policy: "It is the policy of the law, for the advantage of the public, to encourage and protect invention and commercial enterprise."⁹ Instead of arguing directly from this policy, however, he shifted immediately to a statement of general principle and focused on it for the rest of the opinion: "If a man establishes a business and makes it valuable by his skill and attention, the good will of that business is recognized by the law as property."¹⁰

Gray clearly intended this principle to unify all branches of what is today known as "intellectual property law." Moreover, the principle had clear implications for trade secret law: If [a person] invents or discovers, and keeps secret, a process of manufacture, whether a proper subject for a patent or not, he has not indeed an exclusive right to it as against the public, or against those who in good faith acquire knowledge of it; but he has a property in it, which a court of chancery will protect against one who in violation of contract and breach of confidence undertakes to apply it to his own use, or to disclose it to third persons.¹¹

⁸ 98 Mass. at 455-57. Given the precedent, *Peabody* was in fact a hard case. Since the plaintiff sought enforcement of a contract against a former employee, the restraint-of-trade defense could not be disposed of in the usual way, by arguing that the contract was necessary to perfect a sale or transfer of the secret. Moreover, Cook learned the secret from Norfolk and so was not in privity of contract with Peabody.

⁹ 98 Mass. at 457.

¹⁰ *Ibid.*

¹¹ *Ibid.*, at 458.

However, the *Peabody* court's principle justified a decision to overrule Cook's demurrer only because the concept of "property" was understood to have certain legal consequences. For example, classifying secret information as "property" meant that a contract to convey that information could not be an unlawful restraint on trade.¹² Moreover, classifying the information as property meant that the court could restrain Cook even though he was not in privity with Peabody. Equity courts had always exercised jurisdiction to grant injunctive relief when necessary to provide an adequate and complete remedy for a property rights violation. But *Peabody* left an important question hanging: if secret information is property, why does the owner not have "an exclusive right to it as against the public" like other property owners? Today we would be inclined to answer this question by referring to trade secret policies. For example, one might argue that an *in rem* right would generate excessive costs, or that it would provide more protection than necessary to safeguard privacy. Late nineteenth century courts and commentators did not rely on functional arguments of this sort but instead reasoned formalistically from an ideal conception of "property" linked to the concept of exclusive control. Of course, few nineteenth century courts were as ambitious as *Peabody*. Most just applied the rules, occasionally nodding in the direction of a deeper theory. But some opinions offer more, and the secondary literature is also suggestive. The explanation in the text reconstructs a theory of trade secret law from these sources and from what we know about the dominant mode of legal reasoning and prevailing ideas about property during the late nineteenth century.

At common law, property rights depended on possession. Possession was a prerequisite to ownership, and ownership was necessary for common law rights.¹³ Moreover, possession required clear acts manifesting an intent to bring the thing under exclusive control and to appropriate it to individual use.¹⁴ A person obtained exclusive property rights by exercising actual control over things in the world.

¹² see HARRY D. NIMS, *THE LAW OF UNFAIR COMPETITION AND TRADEMARKS* § 144, at 298 (2d ed. 1917) ("[T]here is no difference between contracts as to trade secrets and contracts as to any other personal property, so far as restraint of trade is concerned.").

¹³ See *Ghen v. Rich*, 8 Fed. 159, 161 (D. Mass. 1881) (the right of property in a whale attaches with first possession, achieved by shooting the whale with a distinctively marked harpoon); *Pierson v. Post*, 3 Ca. R. 175, 177-78 (N.Y. Sup. Ct. 1805) (property in a fox depends on possession, which requires acts to bring the fox under control).

¹⁴ See Carol M. Rose, *Possession as the Origin of Property*, 52 U. Cm. L REV. 73, 76 (1985).

Since the legal protection of secret information not covered by statutory patent or copyright was a matter for the common law, common law principles applied. Thus, for secret information to be "property," as the court in *Peabody* held, the owner must possess it. The difficult question was how someone could "possess" an intangible thing, like information, which was not subject to physical control. Moreover, there were other difficulties as well. Because information is capable of infinite replication, everyone can enjoy it without anyone having any less of it. And once someone learns information, there is no way to erase that knowledge and therefore no means of excluding the person in fact. For these reasons, exclusivity must have seemed oddly inappropriate.

It followed from these special features that the only way someone could possess information to the exclusion of others was to keep it secret.¹⁵ Ideas were like wild animals *ferae naturae*, common property free for all to enjoy until captured.¹⁶ An idea could be captured by "discovering" it and then excluding others through secrecy. Secrecy required constant vigilance, however, since ideas, like wild animals, had a tendency to escape. Once gone, they returned to the commons as public property.

Accordingly, secrecy was the *sine qua non* of possession and thus of common law property rights in information. To late nineteenth century courts and commentators, this meant that common law and Statutory rights were mutually complementary. The common law protected information so long as it remained secret. Once published, however, the information became "public property" and all common law rights ended. The public, which then owned the information, decided through legislation what exclusive rights, if any, to give to individuals. Thus, rights in published information were statutory, conferred by the Patent and Copyright Acts.¹⁷

¹⁵ *Haskins v. Ryan*, 71 N.J. Eq. 575, 580 (1906).

¹⁶ The analogy to wild animals was made explicit in *Werckmeister v. American Lithographic Co.*, 134 Fed. 321 (2d Cir. 1904), a celebrated common law copyright case: [Conceptions] are as free as the birds of the air or the wild beasts of the forest, but they belong to him who first reduces them to captivity.... To pursue the foregoing analogies, the common-law protection continues only so long as the captives or creations are kept in confinement or controlled.

¹⁷ Robert G. Bone, *A New Look at Trade Secret Law: Doctrine in Search of Justification*, 86 Cal. L. Rev. 241 (1998). Available at: <http://scholarship.law.berkeley.edu/californialawreview/vol86/iss2/1>. Last visited, 6/22/2018 8:37:58 PM.

These statutory rights were treated as subordinate to common law property rights. Many late nineteenth century jurists believed the common law to be a repository of fundamental and universal principles of right. As an application of common law principle, therefore, trade secret law had a strong claim to authority; indeed, a legal system that did not protect secret information would be incomplete. Statutes, on the other hand, were just expressions of historically and culturally contingent social policy. Therefore, the Copyright and Patent Acts had no special claim to authority. Their authority depended entirely on the policy choices of particular legislatures at particular times.¹⁸

This simple, property-based theory had powerful implications. It justified the court's decision in *Peabody* to anchor legal protection for secret information in property rather than contract or trust. Indeed, the link to common law property elevated trade secret law over patent and statutory copyright—the reverse of the status those fields enjoy today. Moreover, the property-based theory reached beyond the law of trade secret to explain other, seemingly unrelated fields, such as common law copyright and privacy rights.¹⁹

Most importantly, the theory offered a rationale for trade secret rules. As we have seen, secrecy was a necessary requirement for exclusion. But secrecy was not sufficient. Even if the plaintiff alone knew the information, courts still required the plaintiff to take affirmative steps to protect the secret in order to demonstrate his intent to exclude others. Thus, in addition to requiring secrecy in fact, many courts also required reasonable precautions against disclosure, or at least hesitated to find secrecy where the plaintiff failed to take such precautions. In addition, the property-based theory answered the question left hanging in *Peabody*—why trade secret law did not recognize property rights against the world. The answer followed logically from the scope of the property right. Exclusive rights against the world simply did not fit the kind of factual exclusivity that defined the common law property right in secret information. The only way a person could violate a trade secret owner's exclusivity was by invading his secrecy. Thus, trade secret liability depended entirely on whether the defendant used unfair means to acquire the information.

¹⁸ Robert G. Bone, *Mapping the Boundaries of a Dispute: Conceptions of Ideal Lawsuit Structure from the Field Code to the Federal Rules*, 89 COLUM. L. REV. 1, 9-26 (1989).

¹⁹ *Werckmeister v. American Lithographic Co.*, 134 Fed. 321, 324 (2d Cir. 1904) (noting that "the common law protection continues only so long as the captives or creations are kept in confinement or controlled," and the federal Copyright Act "permits them to go free and releases the restraint").

As a result, independent discovery and reverse engineering were perfectly lawful because they did not cross the boundaries of the owner's secrecy and violate his factual exclusivity. A marketed product "communicated" its contents to the public, so anyone was free to infer those contents from the publicly available product, just as he was free to discover the information from any other publicly available source.²⁰

Furthermore, a trade secret owner could communicate secret information and still preserve its secrecy if the recipient promised to hold the information in confidence. This was, after all, the customary way to share secrets, and the confidentiality agreement was evidence of the owner's continuing intent to exercise exclusive control.

This property-based theory also explained why strangers were liable for obtaining secret information through criminal wrongdoing, such as theft and fraud. Independently wrongful conduct of this sort improperly invaded the owner's zone of secrecy. It is important to recognize, however, that the criminal wrong was not the basis for the cause of action. The cause of action vindicated an infringement of property rights, and the wrong was simply the manner in which the defendant violated those rights. This explains why trade secret liability attached to third parties who induced a breach of confidence, even though they were not in privity with the trade secret owner, and also why those third parties were not liable if they were bona fide purchasers without notice of any wrong. These rules follow logically from the fact that liability was based on violation of a property right rather than breach of contract or confidence. The breach was merely *the way* the property right was violated.²¹

This relatively simple theory had a serious drawback, however. It was incapable of identifying all the impermissible modes of acquisition, use, or disclosure. Breach of an express confidentiality duty was easy, but what about talking with customers or surreptitiously following the plaintiff and observing the raw materials he purchased? Nothing in the ideas of possession, control, or secrecy gave a clear answer in cases like these. The real question was

²⁰ Robert G. Bone, *A New Look at Trade Secret Law: Doctrine in Search of Justification*, 86 Cal. L. Rev. 241 (1998). Available at: <http://scholarship.law.berkeley.edu/californialawreview/vol186/iss2/1>. last visited, 6/22/2018 8:37:58 PM.

²¹ See *Board of Trade v. Christie Grain & Stock Co.*, 198 U.S. 236, 252 (1904) (noting that the contracts between the plaintiff and telegraph companies were not the basis of the cause of action, but instead simply showed that plaintiff's communications were all confidential and thus did not destroy the trade secret claim).

whether the plaintiff, in order to keep his information secret, was obliged to guard against the particular means used by the defendant, or whether he could reasonably expect the defendant and others to avoid such means as improper invasions of secrecy. Since this question had to be answered before determining whether the information was secret and whether the plaintiff exercised sufficient control to establish possession, the ideas of secrecy, control, and possession could not supply an answer. The normative standard had to be found outside of these property notions, and the logical place to find it was in whatever norm-contractual obligation, confidentiality, or the like-the defendant violated by acquiring, using, or disclosing the information.

Perhaps because of this, some courts and commentators glossed over the property theory and focused instead on the wrongfulness of the defendant's conduct as the true basis of liability, despite the strength of the common law property theory. In addition, the notion that trade secret rights were not good against the world did not sit well with many nineteenth century jurists, nor was it easy for many of them to conceive of property rights in an intangible thing like information.²²

THE COLLAPSE OF THE GENERAL THEORY

The general theory that supported common law property rights in secret information began to lose its grip, first with the rise of sociological jurisprudence, and then with the advent of legal realism in the early twentieth century. A new positivism and commitment to instrumental reasoning replaced the natural law formalism of the late nineteenth century. This change undermined the logic of the common law property theory-in particular, its claim that exclusivity through secrecy implied property and that property implied legal rights which protect the owner's exclusivity.²³

²² Christopher Columbus Langdell, *Patent Rights and Copy Rights*, 12 HARV. L. REV. 553 (1898);

²³ Kenneth Vandeveld, *The New Property of the Nineteenth Century: The Development of the Modern Concept of Property*, 29 BUFF. L. REV. 325 (1980).

In a passage frequently quoted by the new positivists, Justice Holmes framed the central question for trade secret law in terms that rejected the late nineteenth century conception of property:

*The word "property" as applied to trade-marks and trade secrets is an unanalyzed expression of certain secondary consequences of the primary fact that the law makes some rudimentary requirements of good faith. Whether the plaintiffs have any valuable secret or not, the defendant knows the facts, whatever they are, through a special confidence that he accepted. The property may be denied, but the confidence cannot be. Therefore, the 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.*²⁴ On this view, property was not a logical entailment of fundamental truths about possession and ownership. Instead, property rights were created by positive law and were designed to serve whatever goals the community wished to pursue.

This new view of property created a problem for trade secret doctrine. During the nineteenth and early twentieth century', the formalistic conception of property made it possible to justify trade secret law as distinct from contract and ordinary tort law. With its property foundation stripped away, however, trade secret law lost its justifying theory and its source of normative independence from other fields of law. Courts and commentators had been trying to fill the gap ever since which was later filled by TRIPS leaving no room for theoretical justification.

WHERE WE ARE-ARGUMENTS FROM EFFICIENCY

Above narrated brief history shows, late nineteenth century judges did not justify trade secret law on policy grounds. Instead, they invoked a natural-rights-based formalism that is no longer accepted today. This raises doubt as to whether there actually is a convincing policy argument for trade secret law and prompts to examine the conventional justifications with some care. At the same time, it is significant that trade secret law has endured for more than a century. This

²⁴ Robert G. Bone, *A New Look at Trade Secret Law: Doctrine in Search of Justification*, 86 Cal. L. Rev. 241 (1998). Available at: <http://scholarship.law.berkeley.edu/californialawreview/vol86/iss2/1>. last visited, 6/22/2018 8:37:58 PM.

suggests that the doctrine has some practical value. But one would have to take the extreme and highly problematic view that the common law evolutionary process always produces good rules in order to defend trade secret law on this ground alone.

The fact that trade secret law endures is a reason to take all possible policy justifications seriously, but it does not relieve trade secret proponents of their burden of persuasion. There may be arguments from rights and fairness to establish justification.

CONCLUSION

Trade secret law although treated as a branch of intellectual property, with its relational focus, fits poorly with other intellectual property theories, such as copyright, patent, and trademark, that grant property rights against the world. Moreover, trade secret's liability rules include many puzzling features that resist policy justification. But it could easily be justified on the theories of rights and fairness and with the advent of TRIPS it needs no other justification as it is a key intellectual property with others in this techno-complicated world. This has been clear with inclusion of individual legislations enacted regarding the protection of trade secrets by most of the member countries in the compliance of TRIPS.