



January 1985

The Uniform Trade Secrets Act: California Civil Code 3426

James H. Pooley

Follow this and additional works at: <http://digitalcommons.law.scu.edu/chtlj>



Recommended Citation

James H. Pooley, *The Uniform Trade Secrets Act: California Civil Code 3426*, 1 SANTA CLARA HIGH TECH. L.J. 193 (1985).
Available at: <http://digitalcommons.law.scu.edu/chtlj/vol1/iss2/3>

This Article is brought to you for free and open access by the Journals at Santa Clara Law Digital Commons. It has been accepted for inclusion in Santa Clara High Technology Law Journal by an authorized administrator of Santa Clara Law Digital Commons. For more information, please contact sculawlibrarian@gmail.com.

THE UNIFORM TRADE SECRETS ACT: CALIFORNIA CIVIL CODE § 3426

James H. Pooley*

I. INTRODUCTION

Trade secret litigation is close to becoming one of the high technology industry's fastest growing markets. Fifteen years ago, this type of lawsuit was uncommon and was directed at fairly extreme acts of disloyalty and theft. Today, highly qualified technical employees can scarcely consider changing jobs without risking expensive, career-threatening litigation. This is due to the industry's increasing reliance on slight and short-lived technical innovations to give a company its competitive edge and on a growing awareness that the courts are available to protect highly valuable intellectual assets. Moreover, since the extraordinarily expensive trade secret lawsuit can easily be used to squash an incipient competitor, the law preventing unfair competition has excellent potential as one of the monopolist's most effective weapons.¹

Whatever the cause and effect, trade secret litigation is a major issue for technology-related business. At the same time, trade secret law differs from state to state and is decided on a case by case basis. The modern common law of trade secrets has drawn its principles chiefly from the First Restatement of Torts, which defined the subject matter and remedies in a general fashion. However, the courts have relied on a potpourri of theories, including trade secrets as property, breach of trust or confidence, and breach of contract.

The bench and bar have taken note of the problems in the interpretation and enforcement of trade secret rights. In the 1960's there was considerable concern that state law governing trade secrets was preempted by the federal patent system, which was based on the principle of public disclosure of inventions. Although never articulating that direct holding, the United States Supreme Court through its decisions in *Sears, Roebuck v. Stiffel Co.*, *Compto*

Copyright © 1985 James H. Pooley. All Rights Reserved.

* James Pooley is an attorney with the law firm of Mosher, Pooley & Sullivan in Palo Alto, California.

1. See, Pooley, *The Trade Secret Lawsuit As An Anticompetitive Tool*, 1 *COMPUTER L. RPTR.* 894 (1983).

Corp. v. Day Brite Lighting, Inc. and *Lear, Inc. v. Adkins*² created speculation that this result was inevitable. The later cases *Aronson v. Quick Pint Pencil Co.* and *Kewanee Oil Co. v. Bicron Corp.*³ have quieted the fears of pre-emption, but in the process attention has been drawn to the patchwork nature of the available caselaw on trade secret protection.

The call for statutory reform arose in this context. With the rapid advances in technology throughout the country, the uneven development of decisional law from state to state was seen as a major problem. In addition, the leading cases presented a confusing array of standards and theories on what information should be protected and what conduct should be proscribed. Finally, the bedrock source of principles disappeared, as the drafters of the Second Restatement of Torts concluded that the law of unfair competition had come into a life of its own and dropped the seminal language that had been incorporated into scores of published opinions. The time had come to fill the void with a unified approach to trade secret litigation.

The substantial work of producing a uniform state law on the subject was undertaken by the National Conference of Commissioners on Uniform State Laws, which in 1979 approved, and recommended for adoption by the states, the Uniform Trade Secrets Act. The proposed statute was approved by the American Bar Association the following year.⁴ Since then it has been adopted in some form by at least twelve states.⁵ This essay focuses on the California

2. *Sears, Roebuck v. Stiffel Co.*, 376 U.S. 225 (1964); *Compco Corp. v. Day Brite Lighting, Inc.*, 376 U.S. 234, *reh'g denied*, 377 U.S. 913 (1964); *Lear, Inc. v. Adkins*, 395 U.S. 653 (1969).

3. *Aronson v. Quick Point Pencil Co.*, 99 S. Ct. 1096 (1979); *Kewanee Oil Co. v. Bicron Corp.*, 416 U.S. 470 (1974).

4. In 1981, however, the Patent, Trademark and Copyright Section of the American Bar Association issued resolutions opposing the Act as drafted and proposing specific amendments. Apparently in response to this criticism, the Commissioners, at their December 1984 meeting, issued amendments to the Uniform Act. See Appendix A, *infra*. These amendments for the most part do not change the substance of the Act, or have already been incorporated into the California statute (drafts of the ABA proposals were available during the 1984 legislative drafting process).

5. See ARK. STAT. ANN. § 70-1001 to 1007 (West Supp. 1983); 1983 CONN. ACT 344; DEL. CODE ANN. Tit. 6, § 2001-09 (West Supp. 1982); IDAHO CODE § 48-801 to 807 (West Supp. 1984); IND. CODE ANN. § 24-2-3-1 to 24-3-2-3-8 (Burns Supp. 1984); KAN. STAT. ANN. § 60-3320 to 3330 (Vernon Supp. 1983); LA. REV. STAT. ANN. § 51:1431-39 (West Supp. 1984); MINN. STAT. ANN. § 325C.01-08 (West 1984); N.C. GEN. STAT. § 66-152 to 157 (Michie Supp. 1983); N.D. CENT. CODE § 47.25.1-01 to 08 (Smith Supp. 1983); WASH. REV. CODE ANN. § 19.108.010 to .940 (West Supp. 1984).

statute, enacted in 1984 and effective as of January 1, 1985.⁶

II. STRUCTURE OF THE CALIFORNIA STATUTE

The California statute is similar in structure and language to the Uniform Act.⁷ The legislation defines the act of misappropriation of a trade secret, describes various remedies available, and outlines special procedures to be followed in litigation of trade secret disputes. It provides for a three-year statute of limitations, and specifies its limited preemptive effect with respect to other statutes. With the exception of one section (peculiar to California) relating to discovery and therefore placed as section 2036.2 of the Code of Civil Procedure, the entire statute is set forth as section 3426 of the Civil Code.

It is clear that the California legislature intended to secure the benefits of uniformity with other state statutes. Section 3426.8 provides that the legislation "shall be applied and construed to effectuate its general purpose to make uniform the law with respect to the subject of this title among states enacting it."⁸ Moreover, the official comments which were promulgated along with the Uniform Act have been incorporated verbatim as part of the California law, with one exception relating to a specific amendment which required additional comment.⁹

A. "Trade Secret"

The statute defines "trade secret" as any:

[i]nformation, including a formula, pattern, compilation, pro-

6. A synopsis of the legislative history of the California statute is found in Appendix A, *infra*.

7. Differences between the Uniform Act and the California statute will be highlighted and discussed *infra*.

8. However, a cautionary note is appropriate here. The Uniform Trade Secrets Act, like the Restatement, gives general guidelines. In interpreting those guidelines, it is possible that the courts of other states will not accept California's strong policies which tip the balance of rights in favor of open competition. See, e.g., *Hollingsworth Solderless Terminal Co. v. Turley*, 622 F.2d 1324 (9th Cir. 1980); *Frame v. Merrill Lynch*, 20 Cal. App. 3d 668, 97 Cal. Rptr. 811 (1971).

9. The California statute was amended in the Senate Committee on Judiciary to remove the requirement that a plaintiff prove that the claimed trade secret is not "readily ascertainable." This was proposed by the State Bar, on the ground that the definition as originally stated was ambiguous and unfairly required the plaintiff to prove a negative.

New language (drafted primarily by the author of this essay) was added to the official comments, to shift the burden, making it clear that a defendant could show by way of defense that given information was "readily ascertainable." The official comments as amended were adopted by the Senate Committee on Judiciary as reflective of legislative intent. See *infra* notes 17 & 18 and text accompanying.

gram, device, method, technique, or process, that: (1) Derives independent economic value, actual or potential, from not being generally known to the public or to other persons who can obtain economic value from its disclosure or use; and (2) Is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.¹⁰

The first distinction between the statutory definition and the Restatement is the inclusion of information which has "potential" value. Under a literal reading of the Restatement, a claimed trade secret could qualify only when the holder could show that it was actually used in its business: "A trade secret may consist of any formula pattern, device or compilation of information which is used in one's business and which gives him an opportunity to obtain an advantage over competitors who do not know or use it."¹¹

The official comments to the Act explain that the statutory definition reaches beyond the Restatement in order to extend "protection to a plaintiff who has not yet had an opportunity or acquired the means to put a trade secret to use."¹² It does not appear that the Commissioners meant to abrogate the recognized distinction applied to concepts or abstractions, which have been held not to qualify.¹³ Under prior California law, "ideas," of potential value in a speculative sense, can be the basis of a claim only where there exists an express or implied obligation to hold the idea in confidence.¹⁴

The statutory imprimatur on "potentially useful" inventions, however, does seem to put an end to the argument that an employee's inventions produced on behalf of an employer are entitled to lesser protection than the employer's existing trade secrets which

10. CAL. CIV. CODE § 3426.1(d) (West 1985).

11. The "used in one's business" standard, however, has not been given a literal interpretation by the California courts. *See, e.g.,* *Sinclar v. Aquarius Electronics, Inc.*, 42 Cal. App. 3d 216, 222, 116 Cal.Rptr. 654 (1974) where the court stated:

[t]he portable device converting brain waves to audible form was, to say the least, a mechanical improvement on the previous stationary equipment used in laboratories. In addition, the device was put to mass commercial production in appellant's business. Under these circumstances, appellant's claim that the inventor did not utilize the device in his own business is entirely immaterial and has no bearing on the issues at hand.

12. UNIF. TRADE SECRETS ACT, 14 U.L.A. 541, 543 (1980).

13. *Richter v. Westab, Inc.*, 529 F.2d 896, 900 (6th Cir. 1976)(a fashion coordinating concept whereby notebook covers would be coordinated with clothing fashions was not a trade secret under Ohio law).

14. *Densy v. Wilder*, 46 Cal. 2d 715, 299 P.2d 257 (1956); *Davies v. Krasna*, 14 Cal. 3d 502, 535 P.2d 1161 (1975); and *Monolith Portland Midwest Co. v. Kaiser Aluminium & Chem. Corp.*, 267 F.Supp. 726, 730 (S.D. Cal. 1967), *modified*, 407 F.2d 288 (9th Cir. 1969).

are disclosed to an employee.¹⁵

The Uniform Act settles the issue of “negative information” by giving it trade secret status. There is some authority for the proposition that employees are free to use their knowledge “of what not to do” in their future employment.¹⁶ However, the comments to the Uniform Act make it clear that the definition of trade secret includes such negative information as “the results of lengthy and expensive research which proves that a certain process will not work.” This represents a significant clarification of the law. The general skill acquired by an employee is and should be transportable to future employment. However, the problem of distinguishing between that learned skill and the trade secret knowledge of specific techniques found not to work is a difficult one and will have to be addressed and solved in the courts.

A second important feature of the definition of “trade secret” in the California statute arises from a modification to the language originally proposed in the Uniform Act. The original version of the first subsection of Civil Code Section 3426.2(d), taken from Section 1(4)(i) of the Uniform Act,¹⁷ required that the value of the information be derived “from not being generally known to, *and not being readily ascertainable by proper means by*, another person who can obtain economic value from its disclosure or use.”¹⁸ The California legislature altered the Uniform Act to read: “from not being generally known *to the public or to other persons* who can obtain economic value from its disclosure or use.” The requirement that

15. The argument was based on language in *Wexler v. Greenberg*, 399 Pa. 569, 160 A.2d 430 (1960), which was cited with approval in *Futurecraft v. Clary Corp.* 205 Cal. App. 2d 279, 283, 23 Cal. Rptr. 198 (1962):

The court concluded that Greenberg was privileged to disclose and use the formulas which he had developed — they being a part of the technical knowledge and skill that he had acquired by virtue of his employment (p.437). Therefore, even though the formulas were plaintiff's trade secrets, Greenberg was privileged to use them.

It is understandable, even before enactment of the Uniform Trade Secrets Act, that the courts did not rush to embrace this approach. Reading the language of the Uniform Act together with California Labor Code Sections 2860 and 2870 would seem to bury this argument for good. The result makes sense, since there is no logical justification for extending ownership rights to an employee when the employer paid for the creative work.

A more difficult question of relative rights is presented when the employee later seeks to use “skills” which he developed in conjunction with, or indeed which contributed to, the invention created for the employer.

16. *Winston Research Corp. v. Minnesota Mining & Mfg. Co.*, 350 F.2d 134, 144 (9th Cir. 1965) (employees privileged to use knowledge of shortcomings in former employer's machine in order to build improved version for subsequent employer).

17. UNIF. TRADE SECRET ACT, 14 U.L.A. 541, 542 (1980).

18. CAL. CIV. CODE § 3426.2(d) (West 1985).

the plaintiff prove that the information is not "readily ascertainable" has been omitted from the statute. This amendment was proposed by the Patent, Trademark and Copyright Section of the State Bar apparently as a reaction to a recent appellate court decision in Indiana.¹⁹

To be a workable standard, "readily ascertainable" must be viewed in the same way as "improper means." It is a deliberately vague formulation which is to be applied in a factual context. If the effort required to recreate data is very substantial, then it is not *readily* ascertainable; if the effort is relatively small, then the data will be considered available for use by those who know it, regardless of the source.²⁰

The uniform comments make it clear that information cannot be considered a trade secret if it can quickly (i.e., "readily") be reverse engineered.²¹ On the other hand, the Uniform Act specifically recognizes that a trade secret exists in the "headstart" which accrues to the trade secret holder who markets a product that requires a more substantial reverse engineering effort.²²

In the legislative hearings during 1984, the State Bar continued to press for this amendment, and a compromise was eventually reached, permitting the amendment while inserting new language into the official comments making it clear that the "readily ascertainable" standard remains available as a matter of affirmative defense.²³ Thus, the issue is simply one of burden of proof; under the

19. *Steenhoven v. College Life Insur. Co. of Amer.*, 460 N.E.2d 973 (Ct. App. Ind. 1984) holds that a list of insurance policy holders and related information could not qualify as a trade secret because the data could have been properly acquired from the policyholders themselves. Examining the opinion, however, one finds no new standard expressed. The result appears odd, but is either wrong or stems from special facts not apparent from the face of the opinion. Certainly, when dealing with a "compilation" such as a customer list, it must be recognized that value exists from the effort of compiling the data. To determine the issue on the fact that effort is capable of duplication, without critical analysis of the amount of effort involved, simply begs the question.

20. Thus, in the customer list context, the "list of names" claimed as a trade secret will be "readily ascertainable" if it consists in the simple identification of all potential customers who are listed elsewhere in trade publications and catalogs. It will not be "readily ascertainable" if it is a subset identified by characteristics of profitability, revenue generation and the like, information developed by an employer over time in the conduct of its business. This comports both with common sense and with long-established case law. *See, e.g., Nalley's Inc. v. Corone Processed Foods Inc.*, 240 Cal. App. 2d 948, 50 Cal. Rptr. 173 (1966).

21. The Commissioners cite *Wesley-Jessen, Inc. v. Reynolds*, 182 U.S.P.Q. 135, 144-145 (N.D. Ill. 1974) for the proposition that a camera sold on the open market cannot preserve its trade secrets when it can be reverse engineered in "several days."

22. CAL. CIV. CODE § 3426.2(a) (West 1985). *See infra*, note 53 and accompanying text.

23. *See Appendix A, infra.*

California version of the Uniform Act, the defendant must carry that burden. Therefore, while on the surface it may appear that a major change has taken place, a reading of the statutory language together with the official comments demonstrates that the change will have little effect.

The overall objective of trade secret law is to enforce reasonable standards of commercial morality, and the statutory language serves as a guideline which must be interpreted in this context. Therefore, when the trade secret information can be gathered, like pieces of a puzzle, from data in the public domain, but the successful collection of that data by the defendant occurred only with benefit of how the finished puzzle would appear, a court is justified in rejecting the "readily ascertainable" defense.²⁴ The defense should generally apply where the "reverse engineering" or "independent discovery" effort is in fact minimal, so as to support the inference that the defendant could easily have accomplished it had he in good faith thought it was required. Therefore it is only necessary to show that the product could have been easily reversed engineered not that it was reversed engineered.

A third, and more significant, change in the definition of a "trade secret" is the requirement that plaintiffs prove they have expended reasonable efforts to maintain the secrecy of the information sought to be protected. The standard of reasonableness is consistent with current case law, which imposes on a trade secret holder the obligation to use measures that are appropriate to the technology which it claims as a secret.²⁵ Absolute secrecy is not required.²⁶ The significance of the statutory requirement is that a plaintiff cannot prove a trade secret simply by showing a vague intent or pronouncement that it be treated that way. Rather, the statute, as did the common law, requires the showing of some affirmative acts taken by the plaintiff in advance of the litigation which can be viewed as strong circumstantial evidence of such an intent. The official comments explain what should be expected:

[R]easonable efforts to maintain secrecy have been held to include advising employees of the existence of a trade secret, limit-

24. *Rohm & Haas Co. v. Adco Chem. Co.*, 689 F.2d 424 (3rd Cir. 1982). There was extensive testimony indicating that defendants had tried and failed to duplicate plaintiffs method of producing latex paint. Only after defendants obtained the process itself by hiring the developer could they produce a competing product. Therefore, defendant's litigation-inspired collection of public literature which arguably revealed the process was held insufficient to avoid the misappropriation claim.

25. *K-2 Ski Co. v. Head Ski Co., Inc.*, 506 F.2d 471 (9th Cir. 1974).

26. *Id.* at 473.

ing access to a trade secret on 'need to know basis' and controlling plant access. On the other hand, public disclosure of information through display, trade journal publications, advertising, or other carelessness can preclude protection.²⁷

Many companies operating within the technology industries are relatively young, and have neglected to prepare a comprehensive program for the protection of proprietary data. This statutory development provides an opportunity for counsel to remind such clients that inaction can lead to disaster, and that a comprehensive trade secret protection plan should be developed and implemented.²⁸

B. *Misappropriation*

The statute defines misappropriation by reference to six specific types of conduct. The first three begin with acquisition of a trade secret by "improper means." As described below, "improper means" is broadly defined and encompasses conduct which, in the opinion of the court, falls below an acceptable level of commercial morality.²⁹

The first class of prohibited conduct is acquisition of a trade secret with knowledge or reason to know that it was acquired by improper means.³⁰ Under the common law, possession of another's trade secret is insufficient to establish liability for damages without a showing of *use* or further unauthorized disclosure. Since the Act provides an injunctive remedy for *threatened* use (including an order to return trade secret materials) it is appropriate to define misappropriation as including mere unauthorized possession. However, a reasonable interpretation of the statute would require that the plaintiff demonstrate use or further disclosure of the trade secret by the defendant in order to recover money damages.

The other five categories of "misappropriation" expressly require disclosure or use. The second type applies to disclosure or use of a trade secret by one who used improper means to acquire it.³¹ This is an extension of liability to the person described in the first category who has gone on to use the trade secret he improperly acquired.

27. CAL. CIV. CODE § 3426.1(d)(2) (West 1985), *see* official comments.

28. Rohm & Haas Co. v. Adco Chem. Co., 689 F.2d 424 (3rd Cir. 1982).

29. E.I. du Pont de Nemours & Co. Inc. v. Christopher, 431 F.2d 1012, 1015, *cert. denied*, 400 U.S. 1024 (1970).

30. CAL. CIV. CODE § 3426.1(b)(1) (West 1985).

31. CAL. CIV. CODE § 3426.1(b)(2)(A) (West 1985).

The third category goes beyond the person who engaged in the improper acquisition, and applies to disclosure or use by one who knew or should have known that the secret was acquired by improper means.³² Liability is imposed under this subsection without regard to the actor's participation in acquisition of the trade secret, but attaches only in the event that it can be proved that the defendant used or disclosed the trade secret after he had actual or constructive knowledge that the information was improperly obtained.

The remaining three categories of misappropriation assume that the information was acquired properly, but that disclosure or use has occurred in contravention of some express or implied agreement to hold the information as confidential.³³ This is to be distinguished from circumstances which create a confidential relationship, without regard to an express or implied undertaking, to hold a particular matter in confidence.³⁴

The fourth category of "misappropriation" applies to disclosure or use of a trade secret by one who acquired it under an express or implied duty to keep it confidential.³⁵ Fifth, the definition applies to disclosure or use where one knew or should have known that the information was subject to an obligation of confidentiality.³⁶ This subsection would apply to an employer who hires away an extremely knowledgeable technical employee and "looks the other way" while the employee effectively recreates his former employer's trade secrets.³⁷ The breadth of this subsection is defined by the phrase "reason to know", which should extend to any situation in which the circumstances would indicate to the second employer that the confidential information of the former employer was being put at risk of use or disclosure.

The sixth type of misappropriation arises from accidental disclosure. Here, liability for disclosure or use is imposed only if (1) the defendant knew or should have known that the information was acquired by accident or mistake, and (2) the knowledge is acquired before a material change of position by the defendant.³⁸ In the Commissioners' most recent amendment to the Uniform Act, this

32. CAL. CIV. CODE § 3426.1(b)(2)(B)(i) (West 1985).

33. *Winston Research Corp. v. Minnesota Mining & Mfg. Co.*, 350 F.2d 134, 140 (9th Cir. 1965).

34. *Davies v. Krasna*, 14 Cal.3d 502 at 510, 536 P.2d 1161 (1975).

35. CAL. CIV. CODE § 3426.1(b)(2)(B)(ii) (West 1985).

36. CIV. CAL. CODE § 3426.1(b)(2)(B)(iii) (West 1985).

37. *Rohm & Haas Co. v. Adco Chemical Co.*, 689 F.2d 424 (3rd Cir. 1982). *See supra* note 24.

38. CAL. CIV. CODE § 3426.1(b)(2)(C) (West 1985).

subsection is deleted as "redundant," since the issue of a good faith "misappropriation" is covered in other portions of the Act.³⁹

C. *Improper Means*

According to the Restatement, "improper means" is a term incapable of precise definition, but which refers to action "below the generally accepted standards of commercial morality and reasonable conduct."⁴⁰ The breadth of this standard is illustrated by *E.I. duPont deNemours & Co. v. Christopher*,⁴¹ where the defendant attempted to justify his aerial surveillance of a chemical plant under construction by claiming that it was in plain view. The court explained:

In taking this position we realize that industrial espionage of the sort here perpetrated has become a popular sport in some segments of our industrial community. However, our devotion to freewheeling industrial competition must not force us into accepting the law of the jungle as the standard of morality expected in our commercial relations.⁴²

One commentator has suggested — accurately — that the application of this standard in any given case depends upon the particular moral values of the trier of fact: "A means is 'improper' because a court decides just that."⁴³ In practical terms, the law requires that business competitors avoid more than clear dishonesty, fraud and bad faith; they are also well advised that this standard may prevent potential misappropriations from circumventing the statute by a mere technicality. In effect, attempt to get something for nothing will most likely fail as being unacceptable conduct.

The California statute, unlike the Uniform Act, adds a specific exemption of reverse engineering from the definition of "improper means."⁴⁴ This amendment was unnecessary, since the official comments expressly state that reverse engineering is a "proper means" of discovering a trade secret. However, in the case of a major reverse engineering effort, it must be demonstrated that the effort was undertaken, not merely that it could have been.

39. See Appendix A, *infra*.

40. RESTATEMENT OF TORTS, § 757, comment f, (1939).

41. 431 F.2d 1012 (5th Cir. 1970), *cert. denied*, 400 U.S. 1024 (1971).

42. *Id.* at 1016.

43. 120 U. PA. L. REV. 378, 388 (1971).

44. CAL. CIV. CODE § 3426.1(a) (West 1985).

III. PROCEDURAL CHANGES

A. *Specification of Claimed Secrets*

Trade secret litigation is very expensive and disruptive, especially for the start-up technology company which must struggle to achieve credibility with customers, employees and sources of financing. As a result, trade secret lawsuits are very effective in the hands of unscrupulous plaintiffs who would pursue a claim not to achieve protection of a legitimate trade secret, but simply to harrass and possibly destroy a new competitor. Recognizing this problem, the Patent, Trademark and Copyright Section of the California State Bar reported its view on a potential amendment to the Uniform Trade Secrets Act at the 1983 Conference of Delegates:

[T]here should be a measure of protection against the institution of an action to pursue extensive discovery without revelation of the trade secret or secrets, and there should be codification of the principle that general allegations of designs, processes, techniques and know-how are inadequate (*Diodes, Inc. v. Franzen, et al.*, 260 Cal. App. 2d 244, 252 [1968]).⁴⁵

As a result, a new provision was enacted as Section 2036.2 of the Code of Civil Procedure:

In any action alleging the misappropriation of a trade secret under the Uniform Trade Secrets Act . . ., before commencing discovery relating to the trade secret . . ., the party alleging the misappropriation shall identify the trade secret with reasonable particularity subject to any orders which may be appropriate under Section 3426.5 of the Civil Code [for the protection of confidentiality of alleged trade secrets].

In practice, this legislation can be expected to achieve a salutary result. Potential plaintiffs who are put to the task of identifying exactly what it is they claim to have been stolen will have to pause and consider carefully their motives for bringing the action in the first place. In addition, the provision will help to narrow the scope (and therefore the cost) of discovery in trade secret litigation, since the parties will be able to conduct discovery only in relation to the specific matters alleged to have been misappropriated. Indeed, it is entirely possible that a defendant, when confronted with the required list, may express a willingness to stipulate to injunctive relief as to some or all of the described secrets thereby further narrowing the scope of the controversy or eliminating it altogether.

45. Report of Patent, Trademark and Copyright Section to the California State Bar Conference of Delegates (August 1983).

B. *Protection of Trade Secrets in the Litigation Process*

One potential difficulty inherent in litigating a trade secret dispute in the courts is the possibility that a party's trade secrets will be further compromised by disclosure to the other party or the public. Under the common law, the courts have recognized their inherent power to avoid such a result by the imposition of protective orders designed to limit access to the court files and to limit disclosure and use of information secured by the parties in discovery.⁴⁶ The Uniform Trade Secrets Act codifies these cases, and specifically authorizes a court to take whatever action is appropriate to protection of the secrets being litigated, including protective orders in discovery, closed hearings, and even sealing the entire records of the action.⁴⁷ An interesting aspect of the statute is that it directs the court to protect information which is claimed to be a trade secret without respect to whether it in fact qualifies as such: "In an action under this title, a court *shall* preserve the secrecy of an alleged trade secret by reasonable means."⁴⁸ Therefore, a reasonable argument could be made that a court is without discretion to deny reasonable protection to any matter which either party claims to be a trade secret, before an actual trial is held to determine the validity of the secrecy claimed.

C. *Statute of Limitations*

California previously applied a two year limitations period to trade secret claims.⁴⁹ Under the Uniform Act, the period is extended to three years after the misappropriation is discovered or with reasonable diligence should have been discovered.⁵⁰ A continuing misappropriation is treated as a single claim for limitations purposes.⁵¹

D. *Effective Date*

The statute is effective for all acts of misappropriation occurring on and after January 1, 1985. If a "continuing misappropriation

46. *Richards of Rockford, Inc. v. Pacific Gas & Elec. Co.*, 71 F.R.D. 388 (N.D. Cal. 1976) (declining discovery); *People v. Serrata*, 62 Cal. App. 3d 9, 133 Cal. Rptr. 144, 146-148 (1976) (quashing of blanket subpoena); *Lee Pharmaceuticals v. Den-Mat, Inc.* 197 U.S.P.Q. 62 (C.D. Cal. 1976) (control over scope of discovery by court).

47. CAL. CIV. CODE § 3426.5 (West 1985).

48. *Id.*

49. *Monolith Portland Midwest Co. v. Daiser Aluminum & Chem. Co.*, 267 F. Supp. 726, 730, *modified*, 407 F.2d 288 (9th Cir. 1969).

50. CAL. CIV. CODE § 3426.6 (West 1985).

51. CAL. CIV. CODE § 3426.6 (West 1985).

tion" began before that date and went on into 1985, the Act would not apply to the earlier conduct. It would apply to the later conduct, so long as it would have been considered misappropriation under the common law.⁵²

IV. INJUNCTIONS

A. *Time Period*

The California statute, which tracks the Uniform Act on this subject, requires that an injunction be terminated when a trade secret ceases to exist as such, but permits the court to extend the injunction for an additional period "in order to eliminate commercial advantage that otherwise would be derived from the misappropriation."⁵³ The Act thereby rejects the concept of permanent injunctions, but permits the court to protect a plaintiff's "headstart" or "lead time" by prohibiting use by a misappropriator even when the trade secret has entered the public domain, if the defendant had gained an advantage over the general public through having had earlier access to the material.⁵⁴ For example, a defendant may claim that it should not be penalized for having misappropriated what the plaintiff claims as a trade secret, because the information can be reproduced from public data and is therefore "readily ascertainable."⁵⁵ The court may reject that assertion, finding instead that the defendant, had it not misappropriated the technology, would have required a particular, substantial period of time to collect the data or reverse engineer the technology. This time period becomes the plaintiff's "lead time" which the defendant has misappropriated, and is tacked onto the injunction period that otherwise would be imposed.

B. *Royalty As Alternative to Injunctive Relief*

Even in a clear case of misappropriation, an injunction against future use may nevertheless be denied for a number of reasons. Among these are an overriding public interest, such as a government requirement of availability of certain equipment. In addition, as noted above, a trade secret may have been disclosed to a defendant without its knowledge, and before learning of the true status of the information the defendant may have spent substantial sums in

52. CAL. CIV. CODE § 3426.10 (West 1985). See Appendix A, *infra*, Amendment 5.

53. CAL. CIV. CODE § 3426.2(a) (West 1985).

54. See *supra*, note 19.

55. See *supra* note 17 and accompanying text.

commercial exploitation, or may have so irretrievably incorporated the data into its products that future use could not be prohibited without causing enormous loss. Under such circumstances, the statute permits the court to "condition future use upon payment of a reasonable royalty for no longer than the period of time the use could have been prohibited."⁵⁶

C. *Affirmative Acts*

In many trade secret actions, a major part of the plaintiff's complaint is the actual carrying away or retention of documents or goods which the plaintiff claims as its property. Seeking return of such materials, a plaintiff could run up against the traditional judicial antipathy toward mandatory injunctions, and might be left with the cumbersome alternative of a parallel proceeding in replevin. The Uniform Act lays to rest such concerns, and expressly provides that "affirmative acts to protect a trade secret may be compelled by court order."⁵⁷ Moreover, the statute appears to authorize the court to impound products or work in process which infringe the plaintiff's trade secret rights.

V. DAMAGES

A. *Generally*

The statute follows the common law rules concerning measure of damages in a trade secret action. A plaintiff may recover damages for its own loss as a result of the misappropriation, and may also recover the resulting gain to the defendant (unjust enrichment), to the extent that the second element does not duplicate the first.⁵⁸

B. *Royalty*

As noted above, when an injunction might otherwise be appropriate, but a court determines that circumstances are such that an injunction cannot be entered, a royalty may be imposed. The Act also provides for imposition of involuntary royalties by the court if the plaintiff cannot prove either element of damage specified by the statute. In the event that such a royalty is imposed, it may not continue beyond the time when an injunction against use could have

56. CAL. CIV. CODE § 3426.2(b) (West 1985). See Official Comments to this subsection. In their 1984 amendments to the Uniform Act, the Commissioners further defined the royalty alternative as available under "exceptional circumstances". See Appendix A, *infra*.

57. CAL. CIV. CODE § 3426.2(c) (West 1985).

58. CAL. CIV. CODE § 3426.3(a) (West 1985).

been imposed.⁵⁹ Whenever a "reasonable" royalty is to be determined by the court, it is incumbent upon the defendant to demonstrate the extent to which the plaintiff's trade secret may account only for a portion of the revenues or profits realized by the defendant's sales. In the absence of such proof, the court would be justified in imposing a royalty which related to the defendant's entire income from such sales.

C. *Punitive Damages*

Under the common law, punitive damages for trade secret misappropriation were available under the same standards as applicable to other torts. They could be determined by a jury and were limited only by vague standards of reasonable relation to the actual damages or wealth of the defendant. Under the Uniform Act, punitive damages are left to the discretion of the court, and the maximum amount awardable is double the compensatory damages proved.⁶⁰ To recover punitive damages the plaintiff must prove "willful and malicious misappropriation." While the California statute was before the legislature for consideration, a tentative amendment was enacted, changing this standard to "willful or malicious," at the urging of the State Bar. In the final version, however, the Uniform Act language was restored.⁶¹

D. *Attorneys' Fees*

A major change from the common law is effected by the Uniform Act, by allowing attorneys' fees in any of the following situations: (1) where a claim of misappropriation is made in bad faith; (2) where a motion to terminate an injunction is made or resisted in bad faith; or (3) where willful and malicious misappropriation exists.⁶² The official comments indicate that the new remedy is included "as a deterrent to specious claims" by a plaintiff or defendant. Moreover, the Commissioners point out that where "willful and malicious misappropriation" exists, the court should

59. CAL. CIV. CODE § 3426.3(b) (West 1985).

60. CAL. CIV. CODE § 3426.3(c) (West 1985).

61. The change was proposed by the Patent, Trademark and Copyright Section of the State Bar, on the ground that the standard was too high. The American Electronics Association, testifying before the Senate Committee on Judiciary, pointed out that the term "willful" has been interpreted to include voluntary action without an intent to achieve the result caused, and that the phrase "willful and malicious" has been employed successfully in other legislation, such as the Federal Bankruptcy Act.

62. CAL. CIV. CODE § 3426.4 (West 1985).

take into consideration whether punitive damages may be awarded, in deciding whether to grant an additional award for attorneys' fees.

Although the Act is not explicit on this point, there appears to be no reason why an application cannot be made to the court under this section for an award of attorneys' fees in conjunction with an application for preliminary injunction. Although the court in such a proceeding does not make final findings of fact, another statute indicates that the legislature intends that such a remedy be available in pretrial proceedings.⁶³ In many cases, a plaintiff will be justified in filing an action based only upon a reasonable suspicion that the defendant has misappropriated its trade secrets. However, by the time of the preliminary injunction, a plaintiff will typically have had the opportunity to conduct sufficient discovery so that it can be held to a higher standard of proof. If at that point the plaintiff continues to assert its request for injunctive relief based on supposition and tenuous circumstantial evidence, the trial court may be justified in awarding attorneys' fees to the defendant.

Both plaintiff's and defendant's counsel must be attentive to the impact of an award of attorneys' fees. From the plaintiff's perspective, this calls for a continuing assessment of the merits of the claims, and a pursuit of remedies which are related to the realistically anticipated harm. For defendants, this means cooperating in return of materials belonging to the plaintiff at the earliest opportunity, inviting the plaintiff to discuss resolution of legitimate concerns without continued litigation, and the continued reappraisal of defenses to assure that they are supported by the facts.

VI. RELATIONSHIP TO OTHER STATUTES AND REMEDIES

A. *General Provisions*

The first two subsections of Civil Code Section 3426.7 describe the effect of the Uniform Act on other State laws and remedies:

- (a) Except as otherwise expressly provided, this title does not supersede any statute relating to misappropriation of a trade secret, or any statute otherwise regulating trade secrets.
- (b) This title does not affect (1) contractual remedies, whether or not based upon misappropriation of a trade secret, (2) other civil remedies that are not based upon misappropriation of a trade secret, or (3) criminal remedies whether or not based upon misappropriation of a trade secret.

63. CAL. CIV. PROC. CODE § 128.5 (West 1985).

The language of subsection (a) was changed from that appearing in the Uniform Act, which reads:

This Act displaces conflicting tort, restitutionary, and other law of this State pertaining to civil liability for misappropriation of a trade secret.

It is not clear from the available legislative history why this change was made. It appeared in the first version of the California statute, introduced as Assembly Bill 3738 in the 1981-82 legislature. From an examination of the rest of the statute, as well as the official comments, however, the substituted language does not appear to open the door to litigation of trade secret claims outside the procedures established by the Act. The legislature was motivated to consider the Act by a perception that undue uncertainty existed in the law concerning trade secret remedies.⁶⁴ Moreover, Civil Code Section 3426.8 requires that the Act "be applied and construed to effectuate its general purpose to make uniform the law with respect to the subject of this title among states enacting it."

Therefore, the somewhat different language used in the California version of the statute should be interpreted to indicate that non-statutory theories for trade secret relief do not remain available, at least not where the result would be an evasion of the procedural protections and definitions provided by the Act. To conclude otherwise would be to ignore the statute's major objective of achieving a unitary approach to resolution of these problems.

It is true that the Act, both in its initial form and as enacted in California, exempts contractual remedies from its scope.⁶⁵ But this should not mean that private parties are free to contract away the procedural protections of the statute. For instance, the Act should still apply in a case where an employer is seeking trade secret relief based on a non-disclosure agreement and frames its pleading to rely solely on breach of that contract. In the same vein, the Act should not be construed to abrogate the common law rule that private parties cannot agree by contract that something is a trade secret when in fact it is not. Not only is this conclusion supported by a common sense review of the statute and its legislative history, but is also compelled by California's strong policy in favor of a freely competi-

64. Staff analysis on Assembly Bill 501 prepared for the Assembly Committee on Judiciary, dated April 25, 1983, page 2 [hereinafter cited as Staff Analysis].

65. The original version of the California statute used the phrase "rights and remedies". This was amended in Committee to limit the exemption to contractual remedies.

tive marketplace.⁶⁶

B. *State Agency Disclosures*

California's version of the Uniform Act includes a unique provision which exempts application of the statute to disclosure of a record by a state or local agency pursuant to the Public Records Act. As to such disclosures, the law to be applied is that which was in effect before the operative date of the new statute.⁶⁷ This provision was inserted apparently at the request of California Rural Legal Assistance, which had expressed concern about possible impact on availability of pesticide data.⁶⁸ Curiously, the issue seems to have been separately addressed in the same session of the legislature by the enactment of Government Code Section 6254; therefore, this anomaly in the Act was probably unnecessary.⁶⁹

VII. CONCLUSION

The Uniform Trade Secrets Act does not provide easy answers to all the difficult issues inherent in disputes over proprietary data. Its contribution is in updating and clarifying a number of important concepts, and in broadening the scope of available precedent to include court decisions from other states. Moreover, California's version of the statute provides a well-balanced mechanism for controlling potential abuses of litigation while still preserving and expanding effective remedies for misappropriation.

66. *Hollingsworth Solderless Terminal Co. v. Turley* 622 F.2d 1324, 1338 (9th Cir. 1980).

67. CAL. CIV. CODE § 3426.7(c) (West 1985).

68. Staff Analysis, *supra* note 64. The author noted the concern of CRLA that the Uniform Act "might be construed to limit public access to pesticide testing data under the Public Records Act."

69. Government Code § 6254.1 provides that pesticide information shall be open to public inspection under the same standards as are set forth in the Federal Insecticide, Fungicide and Rodenticide Act.

VIII. APPENDIX A

AMENDMENTS TO
UNIFORM TRADE SECRETS ACT
December 17, 1984

AMENDMENT 1

Section 1 of the Act is amended to read:

SECTION 1. [Definitions]

As used in this Act, unless the context requires otherwise:

(1) "Improper means" includes theft, bribery, misrepresentation, breach or inducement of a breach of a duty to maintain secrecy, or espionage through electronic or other means;

(2) "Misappropriation" means:

(i) acquisition of a trade secret of another by a person who knows or has reason to know that the trade secret was acquired by improper means; or

(ii) disclosure or use of a trade secret of another without express or implied consent by a person who

(A) used improper means to acquire knowledge of the trade secret; or

(B) at the time of disclosure or use, knew or had reason to know that his knowledge of the trade secret was

(I) derived from or through a person who had utilized improper means to acquire it;

(II) acquired under circumstances giving rise to a duty to maintain its secrecy or limit its use; or

(III) derived from or through a person who owed a duty to the person seeking relief to maintain its secrecy or limit its use; or

~~(C) 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.~~

(IV) acquired by accident or mistake.

(3) "Person" means a natural person, corporation, business trust, estate, trust, partnership, association, joint venture, government, governmental subdivision or agency, or any other legal commercial entity.

(4) "Trade secret" means information, including a

formula, pattern, compilation, program, device, method, technique, or process, that:

- (i) derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use, and
- (ii) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.

Comment on Amendment

This proposed amendment derives from the proposed amendments to Sections 2(b) and 3(a) that deal with a material change of position by a good faith acquirer. In view of these proposed amendments, which respond to concerns expressed by the American Bar Association Patent Section, it is redundant to continue to deal with this issue in the definition of misappropriation.

AMENDMENT 2

Section 2 of the Act is amended to read:

SECTION 2. [Injunctive Relief]

(a) Actual or threatened misappropriation may be enjoined. Upon application to the court, an injunction shall be terminated when the trade secret has ceased to exist, but the injunction may be continued for an additional reasonable period of time in order to eliminate commercial advantage that otherwise would be derived from the misappropriation.

~~(b) If the court determines that it would be unreasonable to prohibit future use~~ *In exceptional circumstances*, 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. *Exceptional circumstances include, but are not limited to, a material and prejudicial change of position prior to acquiring knowledge or reason to know of misappropriation that renders a prohibitive injunction inequitable.*

(c) In appropriate circumstances, affirmative acts to protect a trade secret may be compelled by court order.

Comment on Amendment

This proposed amendment adopts the American Bar Association Patent Section's proffered "exceptional circumstances" stan-

dard for a royalty order injunction. A definition of “exceptional circumstances” makes clear that a material and prejudicial change of position by a good faith acquirer can constitute an exceptional circumstance.

AMENDMENT 3

Section 3 of the Act is amended to read:

SECTION 3. [Damages]

(a) ~~In addition to or in lieu of injunctive relief~~ *Except to the extent that a material and prejudicial change of position prior to acquiring knowledge or reason to know of misappropriation renders a monetary recovery inequitable, a complainant may is entitled to recover damages for — the actual loss caused by misappropriation. A complainant also may recover for* *Damages can include both the actual loss caused by misappropriation and the unjust enrichment caused by misappropriation that is not taken into account in computing damages for actual loss. If a complainant is unable to prove a greater amount of damages by other methods of measurement, the damages caused by misappropriation can be measured exclusively by imposition of liability for a reasonable royalty for a misappropriator's unauthorized disclosure or use of a trade secret.*

Comment on Amendment

This proposed amendment responds to the American Bar Association Patent Section's concern that measurement of damages by a reasonable royalty unintentionally is precluded. The amendment clarifies both the continued availability of the remedy and the circumstances under which it is available.

AMENDMENT 4

Section 7 of the Act is amended to read:

SECTION 7. [Effect on Other Law]

(a) ~~This~~ *Except as provided in subsection (b), this Act displaces conflicting tort, restitutionary, and other law of this State pertaining to providing civil liability remedies for misappropriation of a trade secret.*

(b) This Act does not affect:

(1) ~~contractual or other civil liability or relief that is~~ *remedies, whether or not based upon misappropriation of a trade secret;*
or

(2) ~~criminal liability for~~ *other civil remedies that are not based upon misappropriation of a trade secret; or*

(3) *criminal remedies, whether or not based upon misappropriation of a trade secret.*

Comment on Amendment

This proposed amendment responds to the American Bar Association Patent Section's concern that the Act is unclear as to whether contractual remedies are precluded with respect to conduct that is both a breach of contract and statutory trade secret misappropriation. Section 7 is clarified to preempt only certain other legal rights providing remedies for misappropriation. Contractual remedies expressly are excluded from preemption.

AMENDMENT 5

Section 11 of the Act is amended to read:

SECTION 11. [Time of Taking Effect]

This Act takes effect on _____, and does not apply to misappropriation occurring prior to the effective date. *With respect to a continuing misappropriation that began prior to the effective date, the Act also does not apply to misappropriation that occurs after the effective date.*

Comment on Amendment

This proposed amendment responds to the American Bar Association Patent Section's concern that the applicability of the Act to a continuing misappropriation that began prior to its effective date is unclear. The proposed amendment excludes all coverage of a continuing course of misappropriation that began prior to the Act's effective date.

IX. APPENDIX B

SYNOPSIS OF LEGISLATIVE HISTORY OF THE CALIFORNIA UNIFORM TRADE SECRETS ACT

The first bill was introduced substantially in the form of the Uniform Act as Assembly Bill 3738 (Harris) in the 1981-82 legislature on March 25, 1982.

AB 3738 was amended on May 12, 1982, to strike the statutory definition of "trade secret" and add provisions allowing disclosure of trade secrets by court order or through government agencies in

order to avoid injustice. This amendment resulted from concerns raised by California Rural Legal Assistance regarding availability to farm workers of pesticide formulas. The bill died in committee.

The legislation was re-introduced in the next session of the legislature on February 7, 1983, as AB 501 (Harris). The format was the same as the original version of former AB 3738.

On April 21, 1983, the bill was amended in the following respects:

(1) In Section 3426.2(a), the word "reasonable" was stricken as a qualifier to the phrase "period of time" as relating to continuing an injunction for the "headstart" period.

(2) Section 3426.3(a) was amended by striking the phrase "in addition to or in lieu of injunctive relief" which had introduced the section on damages.

(3) Section 3426.3(b) was added as a new section, as a result of suggested amendments by the patent, trademark and copyright section of the America Bar Association and the Patent Law Association, to the effect that a reasonable royalty could be imposed by the court, not to exceed the permissible injunction period, in the event that damages were not provable.

(4) Section 3426.8 was inserted, to the effect that the statute did not affect any "contractual rights or remedies" [note that this provision was changed in the final version: see Section 3426.7, which refers only to "contractual remedies"].

(5) Section 3426.11 was inserted, as a result of a suggestion by the patent, trademark and copyright section of the American Bar Association, providing that the Act would apply to that portion of a "continuing misappropriation" which occurred after the effective date of the statute.

(6) Code of Civil Procedures Section 2036.2 was added, at the suggestion of the State Bar, to the effect that a trade secret plaintiff before discovery begins, must identify its trade secrets "with particularity" [note that this provision was changed in the final version of the statute by the insertion of the qualifier "reasonable"].

(7) Added a new Government Code Section 6266, to the effect that no damage claim could be made against a government employee for disclosure of a public record, unless the disclosure was made in bad faith.

On May 3, 1983, the bill was amended to drop the proposed new Government Code Section 6266, and to add Civil Code Section 3426.7 [providing for application of pre-existing law to government disclosures].

On July 6, 1984, the following changes were made:

(1) Section 3426.3(c) was amended to change "willful and malicious" to "willful or malicious", and to change "twice" to "three times the amount of" [both of these amendments were later reversed].

(2) Section 3426.4 was amended to change "willful and malicious" to "willful or malicious" [this amendment was later reversed].

(3) Section 3426.11 was amended to change the effective date of the statute to January 1, 1985.

(4) Code of Civil Procedure Section 2036.2 was amended to insert the word "reasonable" as a qualifier to "particularity".

On August 15, 1984, the following amendments were made in approving the final version of the statute:

(1) Section 3426.1(a) was amended to add to the definition of "improper means": "reverse engineering or independent derivation alone shall not be considered improper means."

(2) Section 3426.1(d)(1) amended the definition of "trade secret" by removing "and not being readily ascertainable by proper means by" and inserting "the public." At the same time, at the request of the American Electronics Association, the official comments to this section of the statute were amended to include the following paragraph:

The phrase 'and not being readily ascertainable by proper means by' was included in this section as originally proposed by the National Conference of Commissioners on Uniform State Laws. It was removed from the section in favor of the phrase 'the public or to.' This change was made because the original language was viewed as ambiguous in the definition of a trade secret. However, the assertion that a matter is readily ascertainable by proper means remains available as a defense to a claim of misappropriation.

(3) Sections 3426.3(c) and 3426.4 were amended to restore the "willful and malicious" standard and to restore the punitive damage measure as double the actual damage.

(4) Section 3426.7(b) was amended, using language suggested by the Patent, Trademark and Copyright Section of the ABA, to strike "this title does not affect any contractual rights or remedies," and to substitute the language found in the final version of the statute.