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Trade secrets: Who owns what is in your head?

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One of the most perplexing questions in trade-secret law relates to proof of "ownership" of the trade secret. The holder of a trade secret must prove the ownership status for each alleged trade secret. Understanding trade secret ownership issues including the allocation of ownership between employers and employees is critical in trade secrets litigation.

The existence of a trade secret precedes ownership of a trade secret. If a piece of information is generally known in the trade, or if it is readily ascertainable by proper means, then ownership becomes irrelevant because anyone can disclose or use this piece of information. The world owns it.

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There is no definition of "owner" in the Uniform Trade Secrets Act (UTSA). For years, the "ownership" issue was ignored. The trade secret plaintiff did not plead ownership. The alleged misappropriator did not plead lack of ownership. Many trade secret misappropriation lawsuits would have had different outcomes had ownership been a prima facie element of plaintiff's cause of action for trade secret misappropriation.

Things have changed now. The "ownership" element of proof is now front and center. The Defend Trade Secrets Act (DTSA) defines the requirement of ownership in the first sentence of the private civil cause of action in Section 1836 of the DTSA: "An *owner* of a trade secret that is misappropriated may bring a civil action if the trade secret is related to a product or service used in, or intended for use in, interstate or foreign commerce." (Emphasis added).

The DTSA has merged with the Economic Espionage Act of 1996 (EEA), and Section 1839 of the EEA defines "owner," with respect to a trade secret, as "the person or entity in whom or in which rightful legal or equitable title to, or license in, the trade secret is reposed."

For example, assume that Company A develops a secret engineering technique for manufacturing lawn mowers. A few years later, several employees leave Company A to start Company B and the former employees used the same secret technique to manufacture lawn mowers in direct head-to-head competition with Company A. These same former employees then leave Company B to start Company C and continue to use the secret engineering technique to manufacture lawn mowers.

Company B sues Company C and the former employees for trade secret misappropriation of the secret engineering technique.

Based on this hypothetical, who is the owner of the trade secret?

If Company C moves to dismiss the lawsuit or seeks summary judgment dismissing the lawsuit — should the motion be granted? The trade secret was developed by Company A, not Company B. Does Company B have standing to sue Company C? Are the former employees liable for trade secret misappropriation?

The law of agency has established special rules for the allocation of ownership between employers and employees. Without an assignment of the trade secret from the employee to the employer, the employee owns the secret he conceives or invents during the employment.

There is only one narrow exception to this common-law rule, and it is called the hired-to-invent doctrine. If an employee is hired to solve a specific problem and the employee solves the problem — the employer owns the solution. The reasoning for the hired-to-invent rule is that the employee agreed up-front to the consideration and terms of the hired-to-invent agreement and cannot later claim ownership of the intellectual property emanating from the hired-to-invent agreement.

If an employee is hired to do work in a particular area in which he or she is an expert, the courts will not infer employer ownership and instead ownership will vest with the employee.

Trade secret ownership is a critical, fact-intensive analysis. There is no "work for hire" doctrine in trade-secret law. The employer does not own everything the employee conceives or invents during the course and scope of employment. Absent application of the work-for-hire doctrine, the employee owns the trade secret unless there is a contractual assignment of the trade secret from the employee to the employer.

Another factual consideration in the ownership analysis involves the general knowledge, skills, and experience of the employee. The employer cannot usurp ownership of an employee's skills, knowledge, training, and experience which belong to the employee. If an employee is hired to do work in a particular area in which he or she is an expert, the courts will not infer employer ownership and instead ownership will vest with the employee.

The final piece of the trade secrets ownership analysis is the "shop rights" doctrine. If the trade secret is owned by the employee, the employee has the unfettered right to use or disclose the trade secret to others. But the employee cannot sue the employer for trade secret misappropriation. The law protects the employer with a "shop right" — an irrevocable, nonexclusive, royalty-free license to use the trade secret because the trade secret was developed by the employee using the employer's time, personnel, facilities, and equipment.

Illustrations can be found in these three scenarios in Section 42 of the Restatement Third of Unfair Competition:

(1) A, a manufacturer of household chemicals, employs B, a chemist, to develop new products. In the course of the employment, B develops a formula for a new floor cleaner that is a significant improvement over existing products. After leaving the employment with A, B is induced by C, a competitor of A, to disclose the secret formula. Because B was hired by A specifically to develop new products, the formula is owned by A; B and C are subject to liability to A.

(2) The facts being otherwise as stated in Illustration 1, B is hired by A to analyze the formulas of the products sold by A's competitors. After leaving the employment with A, B is hired to perform a similar task for C, a competitor of A. In analyzing the formulas for C, B relies on the general skill and training acquired during the former employment. B and C are not subject to liability to A.

(3) A is a toy maker. B, who is hired by A as a toy designer, invents a new manufacturing process valuable in A's business. B terminates the employment with A and begins work for C, a competing toy maker, and assists in implementing the new manufacturing process at C's factory. Because the new process was not the product of B's assigned duties while employed by A, in the absence of an agreement to the contrary the rights in the process are owned by B; B and C are not subject to liability to A.

The first illustration is an example of the hired-to-invent doctrine.

The second illustration is an example of the employee's right to use his general skills and training without liability for trade secret misappropriation.

The third illustration is an example of the employee's ownership of trade secrets that were not the product of the employee's assigned duties with the employer's "shop right" to use the trade secrets.

R. Mark Halligan is a regular contributing columnist on trade secrets law for Reuters Legal News and Westlaw Today.

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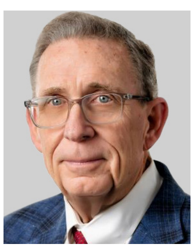

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