

PROTECTION OF TRADE
SECRETS

Report of the Torts & General Law Reform
Committee of New Zealand

Presented to the Minister of Justice in
December 1973

R E P O R T

ON

PROTECTION OF TRADE SECRETS

Introduction

The Committee was asked by the Law Revision Commission to report on the adequacy of the existing law relating to the protection of trade secrets. To the extent that the problems associated with trade secrets come within the wider context of the rules of law relating to unfair competition, some reference will be made to this wider area.

There is no commonly recognised definition of a "trade secret" and by corollary there is (apart from the patent system) no coherent body of law which can be readily classified as "the law of trade secrets". The rules of criminal law, contract, property law and equity have served to protect in some instances the invasion of another's right in a process, idea or machine which the law in these various areas has regarded as having been improperly appropriated by another person.

The nature of the problems with which the law is required to deal may best be gauged if the type of fact situation in which these problems arise is first stated. Here a useful starting point is para. 757 of the American Restatement of Torts, comment 5(b), which describes a trade secret in these terms:

"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. It may be a formula for a chemical compound, a process of manufacturing, treating or preserving materials, a pattern for a machine or other device, or a list of customers."

The types of situation in which the protection of the law may be required can be classified as follows, although it should be recognised that novel methods of industrial espionage preclude any classification from being described as exhaustive.

1. Where the trade secret is known to an employee - or former employee - of the plaintiff who discloses it to a competitor or seeks to utilise it himself.
2. Where an employee of the plaintiff is persuaded or used by a competitor to gain access to the trade secret either by way of personal knowledge or by means of photographs or some other form of recording. This type of activity is colloquially referred to as an "inside job".
3. Where an employee on his own initiative gains access to the trade secret and releases this information, usually for personal reward, to a competitor.
4. Where by means of photography, electronic eaves-dropping or some other form of detection a competitor is able to acquire information as to the trade secret. This type of activity is colloquially referred to as an "outside job".
5. Where by a process of reverse engineering (i.e. by working back from a completed product and determining its composition by analysis) a competitor is able to discover the plaintiff's process or formula.

6. Where a competitor who is granted by contract the right to use the trade secret, makes use of it for some purpose which is outside the terms of the contract, or discloses the trade secret to other persons.
7. Where in the course of negotiations for the sale or development of the trade secret it is disclosed to the other party to the negotiations. This party later uses this knowledge to his own advantage.

The patent system

Any discussion of existing law must begin with the patent system which provides a means for protection of trade secrets for a limited term in return for public disclosure. Under the Patents Act 1953 application may be made for the issue of a patent to protect any invention. Full specifications of the invention must be filed with the Commissioner of Patents and are open to public examination in accordance with s.20 of the Act. The term of a patent is sixteen years from the date of the patent, but the term may be extended for a further period of five, and in exceptional cases, ten years, where the patentee establishes that he has not been adequately remunerated by the patent. Proceedings for infringement may be brought during the currency of the patent and an injunction may be ordered by the Court, and except in certain cases stated in s.68, an account of profits or damages may also be awarded.

The purpose of patents was stated by the Departmental Committee appointed by the President of the Board of Trade in Great Britain in April 1944 (known as the Swan Committee). The recommendations of this committee

strongly influenced the Report in New Zealand in 1950 of the Commission to Inquire into and Report upon the Law of Patents, Designs and Trade Marks. The Swan Committee in its report stated that the theory upon which the patent system is based is that the opportunity to acquire exclusive rights in an invention stimulates technical progress in four main ways:

1. It encourages research and invention;
2. It induces an inventor to disclose his discoveries instead of keeping them as a trade secret;
3. It offers a reward for the expense of developing inventions to the stage at which they are commercially practicable.
4. It provides an inducement to invest capital in new lines of production which might not appear profitable if many competing producers embarked on them simultaneously.

In considering the reform of the law relating to the protection of trade secrets due weight must be given to this social interest which forms the basis of the patent system.

Outside the area of patent law there are no specific provisions dealing with the protection of trade secrets, but the general principles of the criminal law, the law of contract, tort and equity do affect the question.

Criminal sanctions

There are no criminal provisions which deal directly with trade secrets, so that any protection for the possessor of trade secrets must arise out of the following sections of

the Crimes Act 1961 : s.220 (theft), s.238 (extortion by certain threats), s.246 (obtaining by false pretences) and s.258 (receiving property dishonestly obtained). S.217 defines things which are capable of being stolen as follows:

"Every inanimate thing whatsoever, and every thing growing out of the earth, which is the property of any person, and either is or may be made movable, is capable of being stolen as soon as it becomes movable, although it is made movable in order to steal it".

It is clear that documents are capable of being stolen within the terms of s.217, particularly when this is read in conjunction with s.231. However, there are techniques available which do not require the physical "taking" or "moving" of the document or the intent that would be required for theft to take place as defined by s.220(1) and (5). Photographing of documents and other techniques coming under the fourth category described earlier would not constitute theft. The provisions of the Crimes Act would accordingly require amendment if that Act is to deal with the situation where valuable information is taken or recorded without the consent of the person holding it. There are problems here in defining the nature of the information deserving the protection of the criminal law and the interest which should be protected. "Ownership" of information is a difficult concept and protection would have to be accorded on some basis which would protect the person who is lawfully holding or using the information.

The application of the criminal law, though important as a deterrent to dishonest commercial practice, does not provide for the compensation of the injured parties, and reform in this area of the law would not in itself be

adequate unless the civil remedies for the recovery of compensation are judged to be satisfactory.

Contract

Some United Kingdom cases have indicated that the courts are ready to read a "no divulging" provision into a contract of employment, if it is not a stated term. In 38 Halsbury's Laws of England (3rd ed), 33 it is stated:

"A contract not to divulge a trade secret may be reasonable though unlimited as to space or time, and a restraint imposed in order to give effect to such a contract would apparently be treated in the same way, but in no case has an absolutely unlimited restriction been under consideration."

And in volume 25, p.462:

"A servant is under an obligation not to disclose confidential information obtained by him in the course of and as a result of his employment."

The authority given is Bents Brewery Co. v. Hogan [1945] 2 All E.R. 570 where Lynskey J. at p.576 said:

"In my view it is quite clear that an employee is under an obligation to his employers not to disclose confidential information obtained by him in the course of and as a result of his employment. Different Judges, in various cases, have given different grounds for the existence of this obligation. Sometimes it has been said that the obligation was the result of an implied term in the contract of service: sometimes that it was an obligation arising out of the employee's position or status as such, and sometimes that the obligation arises because of the trust or confidence which an employee owes of necessity to his employer.

Whatever the true ground may be, in my view the obligation exists upon an employee not to disclose such confidential information. In my opinion, such an obligation arises from an implied term in the contract of service, but for the purpose of this case it does not matter so long as it is clear that the obligation exists"

In this case an injunction was granted against the defendant (a trade union organiser) prohibiting him from asking members of the union certain questions relating to employers' profits.

Consequently an employer can rely on an implied term of the contract of employment or an express term prohibiting disclosure for an indefinite period. It is arguable that the latter type is void as against public policy if it is to enure for longer than a relevant patent period.

The Courts have similarly been willing to imply a term prohibiting disclosure into a contract relating to the right to use the trade secret: Saltman Engineering Co. Ltd. v. Campbell Engineering Co. Ltd. (1948) 65 R.P.C. 203 C.A.; Torrington Mfg Co. Ltd. v. Smith & Sons Ltd. [1966] R.P.C. 285. In the latter case information was handed over under express contract with the contractual implication that it was only to be used for certain purposes. At p.301 the Court stated:

"Where information provided is to be considered as confidential its use and disclosure is in my view to be limited to the purpose for which the information is given."

Contractual protection is therefore available in cases coming within categories (1), (2), (3) and (6) listed above where an existing employee or other contracting party acts in breach of an express or implied term in the contract prohibiting disclosure.

Equity

The Courts have in several recent cases developed the equitable principles relating to the duties of persons in a confidential relationship, in order to provide a remedy where a party acts in breach of confidence in order to secure a profit or advantage for himself.

It is now well established that the Court's intervention to restrain an action in breach of confidence is based not on contract or property but on the equitable principle that he who has received information in confidence shall not take unfair advantage of it:

Saltman Engineering Co. Ltd. v. Campbell Engineering Co. Ltd. (supra) 414, Cranleigh Precision Engineering Co. Ltd. v. Bryant [1964] 3 All E.R. 289, 295, Seager v. Copydex Ltd [1967] 2 All E.R. 415, 417.

This was a principle which received early recognition in the United States where in 1917 the Supreme Court stated:

"the word property as applied to trade secrets is an unanalysed 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 defence 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, but that the defendant stood in confidential relations with the plaintiffs".

(E.I. Du Pont de Nemours Powder Co. v. Masland (1917) 244 U.S. 100, 102,)

In order to provide grounds for the Court's intervention it must be established that the information is of a confidential nature and is being used by the defendant without the consent express or implied of the plaintiff. The Courts do not appear to have regarded it as essential that the defendant be in confidential relationship with the plaintiff when he acquires the information. In Saltman Engineering Co. Ltd. v. Campbell Engineering Co. Ltd. (supra) Greene M.R. at 417 stated:

"If a defendant is proved to have used confidential information, directly or indirectly obtained from the plaintiff, without the consent express or implied of the plaintiff, he will be guilty of an infringement of the plaintiff's rights."

Lord Denning was prepared to apply the rule to the person who acquired the information innocently and only later learned of its confidential character. In Fraser v. Evans [1968] 3 W.L.R. 1172, 1178 he says:

"No person is permitted to divulge to the world information which he has received in confidence, unless he has just cause or excuse for doing so. Even if he comes by it innocently, nevertheless once he gets to know that it was originally given in confidence, he can be restrained from breaking that confidence."

This principle of equity has proved to be a flexible instrument which the Courts have been willing to apply to a variety of fact situations. It has been used to grant protection to the plaintiff in cases under category (1) listed earlier where a former employee misuses his knowledge of a trade secret learned in his former employment: Cranleigh Precision Engineering Ltd. v. Bryant (supra). A case coming under category (7) is Seager v. Copydex (supra) where the Court of Appeal granted damages to the plaintiff relating to the use of an invention which had been confidentially disclosed to the defendants in the course of negotiations for the right to market the invention. The negotiations were unsuccessful and no contract was concluded between the parties, but the defendants were held to have acted albeit innocently in breach of confidence in using the idea of the invention in their own product. Conversely, in Baker v. Gibbons [1972] 2 All E.R. 759, relief was refused where a former director of the plaintiff company had solicited certain of the company's agents to

leave their employment and join him in a rival business. The Court said there was no general rule that, where a director had learned the name and address of a particular employee of the company, that information was to be regarded as confidential. Unless the defendant is using a written list of names acquired during his employment, evidence of the confidentiality of each particular name and address will be required.

The broad statement of principle in Fraser v. Evans and the Saltman Engineering case referred to earlier would cover the type of situation coming within categories (2), (3) and (4), although there are no cases which directly raise this type of fact situation. For example, where an employee photographs secret information and sells this to a competitor, it is submitted that an injunction will lie to restrain the competitor's use of the information. If it was obtained by the competitor dishonestly, with the knowledge that the employee had improperly obtained it, the case would come within Greene M.R.'s dicta in the Saltman Engineering case as confidential information "indirectly obtained without the consent express or implied of the plaintiff." If the competitor acted innocently in purchasing the information, the case would come within the scope of Lord Denning's dicta in Fraser v. Evans to the effect that where "he comes by it innocently, nevertheless once he gets to know that it was originally given in confidence, he can be restrained from breaking that confidence".

Added flexibility is given to the application of this principle by the Court's willingness to invoke public policy in order to deny protection. In Fraser v. Evans (supra) at p.1179 Lord Denning states:

"There are some things which may be required to be disclosed in the public interest, in which event no confidence can be prayed in aid to keep them secret".

This principle was applied by Lord Denning in Hubbard v. Vosper [1972] 1 All E.R. 1023 in refusing an injunction to restrain the publication of material which "it was in the public interest should be made known". In this case Megaw L.J. would have reached the same result by invoking the equitable doctrine that the party who seeks equitable relief from the Court must come with clean hands. The Court was also prepared to treat the public interest as a ground for refusing an injunction in an earlier decision, Initial Services v. Putterill [1968] 1 Q.B. 396.

There appears to be only one reported New Zealand decision on the breach of confidence action. This is Conveyor Co. of Australia Pty. Ltd. v. Cameron Bros. Engineering Co. Ltd. [1973], 2 N.Z.L.R. 38 where the Court held that the defendants committed a breach of confidence by continuing to make and sell products very similar in design to the plaintiff's after the expiry of a contract pursuant to which they were put in possession of the necessary design information. The Court said that it is enough to provide a plaintiff with a cause of action if the offending article is "evolved" from the plaintiff's designs so long as the particular defendant has made use of confidential information.

Tort

Given that "it is now settled that interference with economic relations, which are merely in prospect and not yet cemented by contract, is not actionable at the suit of of the person disappointed" (Fleming The Law of Torts 4th ed. 612 citing Allen v. Flood [1898] A.C. 1) it is clear that the only real protection afforded by tort relates to an action for inducement of breach of contract. This raises questions of contract canvassed above. According to Salmond on Torts 15th ed. 653:

"Liability will attach only if the intervener knows of the existence of the contract and, with intent to procure its breach, (i) definitely and unequivocally persuades, induces or procures one of the contracting parties to break it, or (ii) if he does some act, wrongful in itself, which prevents a contracting party from performing his bargain."

This remedy in tort is relevant to those cases falling within category (2) listed earlier.

One commentator has recently suggested that tortious liability for breach of confidence might be founded on an analogy with conversion and detinue with the remedy lying in damages. (P.M. North, 12 J.S.P.T.L. 149).

The need for reform

Preliminary comments were sought from the New Zealand Manufacturers Federation and a leading firm of patent attorneys about the desirability of a change in the law to afford greater protection to trade secrets. Neither was aware of any instances in which it was established that industrial espionage had taken place in New Zealand although in the view of the patent attorneys the possibility of such practices having taken place was suggested by the circumstances of some cases. The type of situation brought to the attention of the Manufacturers Federation by its members concerned the misuse of confidential information by employees of firms.

A working paper was later circulated to these and other interested groups including the N.Z. Law Society and the Associated Chambers of Commerce. As a result, the Associated Chambers of Commerce sought comments from their members and made helpful material available to the Committee. They expressed the view that criminal sanctions would be beneficial in this field. However, there does not appear to be any

widespread complaint as to the operation of the present law or a demand for changes to be made.

The Younger Committee Report

In July 1972 a United Kingdom Committee on Privacy sitting under the chairmanship of the Right Hon. Kenneth Younger presented its report to Parliament. This comprehensive document deals among other things with industrial espionage and the disclosure of confidential information and information unlawfully obtained. The Committee makes the following recommendations on these matters:

- (1) The law relating to breach of confidence should be referred to the Law Commission with a view to its clarification and statement in legislative form.
- (2) It should be a civil wrong, actionable at the suit of any person who has suffered damage thereby, to disclose or otherwise use information which the discloser knows, or in all the circumstances ought to have known, was obtained by illegal means.
- (3) There should be a new criminal offence and a new tort for the unlawful use of technical surveillance devices.

The second recommendation appears to stem from the Committee's uncertainty as to whether the action for breach of confidence would extend as far as this. Nevertheless existing law seems wide enough to cover at least the situation where the defendant actually knew that the information had been obtained by illegal means.

The desirability of reform

It has already been stated that any proposal for reform in this area must give due weight to the social policy underlying the patent system. This system seeks to balance the interest which society has in the disclosure of scientific and technological research with the need to encourage research by granting protection to the person developing a trade secret for a sufficient length of time to enable him to develop the process commercially and recoup the cost of research. It would therefore be undesirable to introduce a form of legal protection outside the patent system which would provide means for the protection of a trade secret without requiring disclosure, or which would grant protection for a period longer than that provided by the patent system. This leaves only two general areas in which protection may properly be granted outside the patent system.

- (i) A process or idea in the course of development which has not been perfected to the stage at which application can be made for a patent.
- (ii) Information of a type which cannot be protected under the present patent law, e.g. some technical know-how, computer programmes and general commercial information such as lists of customers. The patent system is concerned with the protection of "inventions" as defined in s.2 of the Act. The scheme of the legislation limits such patentable inventions to a type of machine, process or method which is capable of precise specification.

A further important policy factor which must be considered when determining whether greater protection of a trade secret is desirable is the interest which both society and the individual have in utilising and developing

special skills in the labour force. The principles developed by the Courts with respect to restraint of trade have sought to ensure that an employer is not able unreasonably to restrain an employee from exercising his skills elsewhere in the community.

Overseas provisions

There are no specific provisions dealing with the misappropriation of trade secrets in either the United Kingdom or Australia. Under certain circumstances, however, as in New Zealand, such action could constitute an offence against the criminal law.

The situation under the Canadian Criminal Code is much the same. However, s.7 of An Act Relating to Trade Marks and Unfair Competition (1-2 Elizabeth II, chapter 49) states:

"No person shall

- (e) do any other act or adopt any other business practice contrary to honest industrial or commercial usage in Canada".

Civil remedies are available in the Courts if this requirement is breached.

Many of the countries which have enacted legislation relating to trade secrets have limited themselves to criminal provisions which have some of the aspects of a tort. In many cases (for example the Austrian legislation) prosecution can take place only at the request of the injured party. Provision is sometimes made (as it is in the West German legislation) for the fine imposed to be paid to the injured party either in whole or in part. The weakness inherent in much of the legislation is that

it deals only with disclosure by employees and former employees and consequently does not cover the "outside job".

Some American States have enacted criminal provisions. Thus in New Jersey a person commits an offence, if, with intent to deprive or withhold from the owner thereof the control of a trade secret, or with intent to appropriate a trade secret to his own use or to the use of another, he

- (a) steals or embezzles an article representing a trade secret, or
- (b) without authority makes or causes to be made a copy of an article representing a trade secret.

The term "trade secret" means the whole or any portion or phase of any scientific or technical information, design, process, procedure, formula or improvement which is secret and of value. (N.J. Stat. Ann. S.2A : 119-5. 1-5.4 (1965)). The law of Wisconsin goes further and protects secret "scientific, technical, laboratory, experimental, development or manufacturing information, equipment, tooling, machinery, design, process, procedure, formula or improvement, or any business information used or for use in the conduct of a business" Wis. Stat. S.943.205(2)(a) (1965).

The only comprehensive legislative attempt to provide a civil remedy for misuse of trade secrets is contained in a bill introduced into the United States Congress in 1967 to provide for the amendment of section 43(a)(4) of the Unfair Competition Act. The proposed amendment, which does not appear to have yet attained statutory form provides as follows:

"(a) Any person who shall engage in any act, trade practice, or course of conduct, in commerce, which (4) results or is likely to result in the wrongful disclosure or misappropriation of a trade secret or other research or development or commercial information maintained in confidence by another shall be liable in a civil action for unfair competition".

The provisions of the draft section are discussed in a note in 30 Ohio State Law Journal 157 (1969). Another useful article on the need for legislation in this area appears in 120 University of Pennsylvania Law Review 378 (1971).

Conclusions

1. Our survey of the law on this matter and of such other materials as were available to us has led to the conclusion that there is no need for major change in the existing law. In our view, the existing actions available at common law and equity provide a satisfactory remedy in those cases outside the patent system where protection is desirable. The Courts have shown a willingness to develop the equitable principles relating to breach of confidence in order to cover new types of situation. At the same time the rules developed by the Courts have proved sufficiently flexible to take account of other interests, namely the interests of employees and society in the mobility of labour and utilization of special skills, and the public interest in receiving disclosure.

The statutory protection accorded by the United States Federal legislation does not, in our view, do more than put the common law rules into statutory form. We can see little advantage in a

statutory restatement of the existing rules and consider that such a provision may well retard the development of the law and discourage the Courts from their flexible approach which has been characteristic of the application of the equitable principles in this area.

2. The chief weakness in the present law is the lack of any provisions in the Crimes Act 1961 adequate to deal with the types of practice coming within categories (1) - (4). The Younger Committee thought that the creation of a new offence of theft of information "bristles with difficulties". It cannot be denied that the formulation of such an offence would be far from simple. The information covered would have to be defined with a degree of precision appropriate to the framing of a fairly serious criminal offence, as would the circumstances constituting theft or misappropriation. Care would have to be taken that the protection conferred was not so wide as to cut across the patent system and encourage inventors to keep their inventions secret. Regard would also have to be paid to the principle of freedom of communication in an open society. We have not undertaken a detailed study of the form a new offence of misappropriation of secret information might take since we regard this as a task more appropriately within the sphere of the Criminal Law Reform Committee. However, we take the view that the creation of such an offence could well represent a desirable strengthening of the law, assuming that difficulties of the kind we have touched upon can be satisfactorily overcome.

3. We are of the view that the patent system provides the proper forum for protection in those cases where the trade secret is capable of being put into patentable form and no question of breach of confidence is involved. It would be undesirable to create separate statutory protection which derogates from the principle of disclosure underlying the patent system. Cases coming within category (5) should in our view be entitled to no more than the protection accorded to the patent.

4. We have received no information to suggest that the misappropriation of confidential information by means of technical surveillance devices is a problem in this country. It seems reasonable to assume that any legislation that might be framed in due course to control the use of these devices would be of a general nature and would thus deal with any future problem that may arise in the particular area of trade secrets.



(I.L. McKay)
Chairman
for the Committee

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