

## **Working Guidelines**

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### **Question 247**

#### **Trade secrets: overlap with restraint of trade, aspects of enforcement**

##### **Introduction**

- 1) This Working Question concerns certain aspects of the protection afforded to trade secrets, both in substantive legal terms as well as through the procedures involved in actions for violations of trade secrets. In particular, this Working Question addresses the following four aspects: (i) overlap between trade secret protection and prohibitions on restraints of trade, (ii) ensuring confidentiality during Court proceedings concerning trade secret violations, (iii) valuation of loss suffered by owner of trade secrets / quantum of damages and (iv) proving actual or imminent trade secret violations, especially where no discovery is available.
- 2) Recognizing that protection for trade secrets is implemented in different ways, this Working Question covers both criminal and civil laws relevant to trade secrets. However, where the protection conferred by criminal and civil laws for trade secrets is identical, it is not necessary to discuss the same issues twice in response to this Working Question.
- 3) In some countries a trade secret may be classified as a proprietary right or intangible property. Where relevant to the issues in this Working Question, it would be helpful if it could be mentioned and the relevance explained.

##### **Aspect (i) - Overlap with restraint of trade**

- 4) Can trade secret protection form a *de facto* restraint of trade, when workers move to new employment with knowledge, but without a legal entitlement to use that knowledge in new employment? When employees move to new employment they inevitably carry knowledge from their previous employment, including trade secrets of

which they were personally aware. It could be years before an employee naturally forgets such information, especially if the information is valuable. Further, once an employee has changed employment, misuse of such information is difficult to control especially if evidence of misuse is not visible.

- 5) In some jurisdictions, contractual limitations or restrictions on a person's ability to find employment elsewhere or set up their competing enterprise can be unlawful. A rationale for this is that otherwise employees become locked into employment in one enterprise, inhibiting the development of a competitive economy, and giving an employer a significant negotiating advantage in the relationship between the two. However, an employee cannot expunge the information they know when moving employment, and if the risk of disclosure or misuse is sufficiently high such that the Courts will grant an injunction to prevent such misuse, the enforcement of trade secret laws can have the result of preventing the movement of employees. In these circumstances the purpose of laws prohibiting restraints of trade may be frustrated if, in fact, the movement of an employee can be made practically impossible under trade secret laws.
- 6) Variations in the level of protection for trade secrets may occur in certain jurisdictions, based at least on the importance of the information in question, and the position of the person who possesses the information in question. Some jurisdictions distinguish between trade secrets, confidential information and general knowledge or know-how irrespective of where they might be employed, and accord a higher level of protection for information that is more important. Senior personnel at companies may have more onerous obligations than other employees as to keeping certain information secret and the use (if any) that may be made of it. This may be due to such factors as their role in the organization, their particular obligations to their employer or the nature of the information to which they are privy. For example, company directors may be subject to fiduciary or statutory duties which prevent the disclosure or use of information even though a corresponding contractual restriction might ordinarily be void.

#### Aspect (ii) - Ensuring confidentiality during Court proceedings

- 7) It is a fundamental principle of many judicial systems that proceedings must be public and relevant documents must be available to the public, unless there is an overriding interest requiring confidentiality.
- 8) Where the application of this principle to trade secret cases requires that information about trade secrets enters the public domain during the course of an enforcement action, the secrecy of the trade secret is lost.

#### Aspect (iii) – Valuation of loss

- 9) It is an inherent feature of trade secrets that they have value because they are secret, or at least not well known. Accordingly, frequently the main relief sought for actual or imminent violations is an injunction to prevent the disclosure of the trade secret to others, which could then enable misuse of the trade secret. It is difficult to estimate, based on losses suffered by the trade secret owner, what damages would be appropriate in these circumstances, because if the injunction is granted promptly and is effective it follows that the owner of the trade secret should suffer no loss.

Damages may still of course be appropriate if calculated on another basis, e.g. unjust enrichment of or unlawful profits made by the person misappropriating the trade secret.

- 10) A trade secret can also be misused without there being disclosure to others. For example, it is possible to conceive of the secret misuse of a trade secret to improve the market success of a competing product, with a consequent loss of market share for the owner of the trade secret. In these circumstances, it is easier to see the relevance of damages based on the loss of the trade secret owner, in addition to an injunction preventing misuse.
- 11) Further, it would be of interest to understand whether damages for trade secret violations can also be awarded in respect of the concept of "moral prejudice" (or like concept), and if so, how such damage might be calculated. The proposed EU Trade Secrets Directive<sup>1</sup> refers to moral prejudice in the context of compensation for an injured holder of a trade secret, without explaining what constitutes the concept "moral prejudice".

#### Aspect (iv) – Proving infringement

- 12) Where a trade secret violation has occurred or is suspected, in legal systems where the trade secret violation is a civil matter, it is usually for the trade secret owner to formulate a claim and pursue that claim in Court so as to prevent the violation from taking place and/or claim damages.
- 13) This process can be assisted if pre-action discovery is available to plaintiffs. Similarly, if Courts can order the search of premises for the seizure of evidence, or to prevent evidence from being destroyed, the plaintiff may be able to obtain sufficient factual evidence to launch proceedings.
- 14) Without such tools being available to plaintiffs, launching proceedings may not be possible at all, frustrating the purpose of laws to protect trade secrets.
- 15) With greater mobility of employees in the global marketplace, another question is whether plaintiffs will be able to obtain evidence from the relevant location. For example, an ex-employee of a company based in one country can easily move to a competitor based in another country, taking secret information with them. If the original contract of employment mandated exclusive jurisdiction for breach of contract to the Courts of a specific country, without the ability to seek evidence in some way from the Courts of the country to which the ex-employee has moved, the plaintiff's ability to commence proceedings may be limited.

#### **Previous work of AIPPI**

- 16) AIPPI has previously studied aspects of trade secrets.
  - a. In the Resolutions relating to Q53A – "Know-how" (1970, Madrid; 1972, Mexico, 1974, Melbourne), AIPPI set down some general principles regarding the protection of trade secrets. AIPPI defined the concept "know-how" and

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<sup>1</sup> Proposal for a Directive of the European Parliament and of the Council on the protection of undisclosed know-how and business information (trade secrets) against their unlawful acquisitions use and disclosure, COM (2013) 813 final.

stated that know-how is protected against misuse and wrongful disclosure, depending on whether the know-how is secret or not. AIPPI also proposed a section regarding know-how for incorporation in the Paris Convention.

- b. In the Resolutions relating to Q115 – "Effective protection against unfair competition under Article 10bis Paris Convention of 1883" (1994, Copenhagen; 1995, Montreal), AIPPI examined the nature of trade secrets, being information that is kept secret, and recommended that certain trade secret violations, for example unlawful disclosure of a trade secret, and industrial and commercial espionage, should amount to unfair competition. AIPPI also addressed the question of good faith acquisition of trade secrets.
- c. In the Resolution on Q138A – "Confidentiality, disclosure and publication of data in information networks" (1997, Vienna), AIPPI discussed the issue of confidential information in digital networks, and resolved that certain methods of storing information in such networks were incompatible with maintaining confidentiality. AIPPI recommended that steps to protect confidentiality are taken where needed.
- d. In the Resolution on Q215 – "Protection of trade secrets through IPR and unfair competition" (2010, Paris), AIPPI resolved that Article 39.2 of TRIPS should be implemented so as to protect trade secrets, and mandated the availability of injunctive relief for threatened or actual violations of trade secrets. AIPPI also resolved that:
  - i. seizures of evidence should be available to preserve evidence, but did not go on to specify that seizures should also be available to obtain evidence of actual or threatened trade secret violations; and
  - ii. every country should adopt provisions to provide effective and substantial means of protecting confidentiality of alleged trade secrets of any party during proceedings and of proven trade secrets after proceedings. However, AIPPI did not regulate, in more detail, how such confidential treatment should operate.
- e. In a workshop entitled "Trade secrets" (2013, Helsinki), it was noted that in many areas of the world the laws regulating the protection of trade secrets are still being developed. The presentations from that workshop are available on the AIPPI website.

## Discussion

17) Article 39 of TRIPS states that:

- (1) *In the course of ensuring effective protection against unfair competition as provided in Article 10bis of the Paris Convention, Members shall protect undisclosed information in accordance with paragraph 2 [...].*
- (2) *Natural and legal persons shall have the possibility of preventing information lawfully within their control from being disclosed to, acquired by, or used by*

*others without their consent in a manner contrary to honest commercial practices so long as such information:*

- (a) is secret in the sense that it is not, as a body or in the precise configuration and assembly of its components, generally known among or readily accessible to persons within the circles that normally deal with the kind of information in question;*
- (b) has commercial value because it is secret; and*
- (c) has been subject to reasonable steps under the circumstances, by the person lawfully in control of the information, to keep it secret.*

18) Whilst some national laws in Europe provide for protection for trade secrets, there is currently no common European law on trade secrets, although an EU Trade Secrets Directive has been proposed (see footnote 1). In relation to the four aspects of this Working Question, the proposed Directive provides as follows:

- a. **Overlap between trade secret protection and restraints of trade.** Article 6(1)(b) provides that measures against trade secret violations should be applied in a manner that “*avoids the creation of barriers to legitimate trade in the internal market.*”
- b. **Confidentiality.** Article 8 makes provision for confidential treatment. Article 8(1) provides that any person who becomes aware of a trade secret through participation in legal proceedings cannot use or disclose the information they have become aware of; and Article 8(2) provides that on application by any party, access to trade secrets may be restricted in legal proceedings.
- c. **Valuation of loss.** Article 13(1) specifies the damage as “*damages commensurate to the actual prejudice suffered.*” This is further defined in Article 13(2) as:

*When setting the damages, the competent judicial authorities shall take into account all appropriate factors, such as the negative economic consequences, including lost profits, which the injured party has suffered, any unfair profits made by the infringer and, in appropriate cases, elements other than economic factors, such as the moral prejudice caused to the trade secret holder by the unlawful acquisition, use or disclosure of the trade secret.*

*However, the competent judicial authorities may also, in appropriate cases, set the damages as a lump sum on the basis of elements such as, at a minimum, the amount of royalties or fees which would have been due if the infringer had requested authorisation to use the trade secret in question.*

- d. **Obtaining evidence to prove infringement.** Article 9 provides that interim measures for seizing suspected infringing goods may be granted. Seizures of other evidence are not discussed, but these are in part allowed by the Enforcement Directive (2004/48/EC), Articles 6(1) and 7(1).

- 19) In the United States (**US**), the proposed Trade Secrets Protection Act 2014 would introduce a new civil federal level of protection for trade secrets, which has included a proposal for a new *ex parte* seizure provision.
- 20) Proposals for development of the laws relating to trade secrets have also been discussed in China.
- 21) The effectiveness of measures in any new laws developed in the US, European Union, China or elsewhere would be enhanced if similar or uniform protection were to be available for trade secrets. In countries where trade secret laws are not being actively reformed, harmonization could be achieved through the clarification/modification of contract law or equitable principles.

Aspect (i) - Overlap with restraint of trade

- 22) Doctrines prohibiting restraint of trade are, in many jurisdictions, an element of contract law. For example, there is a body of English case law on when contractual restrictions amount to unenforceable restraints of trade.
- 23) It is therefore relevant to understand the extent to which national laws allow a defendant accused of a trade secret violation to argue that the enforcement of the trade secret amounts to a restraint of trade and should be disallowed for that reason.
- 24) In the United Kingdom (**UK**), *Generics v Yeda* [2012] EWCA Civ 726 provides an example of how the protection of trade secrets may effectively operate as a restraint of trade. The claimant's in-house patent attorney had previously worked for the defendant, where she was responsible for the conduct of EPO opposition proceedings. On appeal, the test applied was whether there was a real risk, not a merely fanciful or theoretical one, that the confidential information would be disclosed. The Court of Appeal was mindful of the potential impact that such an injunction might have on the ability of legal professionals (particularly those working at a relatively junior level) to move roles in order to progress their careers, an outcome that was viewed as undesirable.
- 25) This is consistent with the decision in *Faccenda Chicken v Fowler* [1985] Ch 117, which remains the leading UK case on the extent to which companies can restrain their ex-employees in order to protect trade secrets. *Faccenda Chicken* describes the protection afforded to different types of information, and whether such protection should outlast the relationship of employment as follows:
  - a. Information which, because of its trivial nature or easy accessibility from public sources, cannot be regarded as confidential, is not protected at all.
  - b. Information which the employee had to treat as confidential but which, once learned, necessarily remained in their mind and became part of their own skill and knowledge, are protected during the period of employment but not subsequently.
  - c. Specific trade secrets which are so confidential they cannot lawfully be used for anyone's benefit but the employer are protected both during and post employment.

- 26) One purpose of this Working Question is to explore the tension between categories b. and c. above in national laws.

Aspect (ii) - Ensuring confidentiality during Court proceedings

- 27) It is relevant to understand national procedures for the protection of trade secrets in legal proceedings, in particular, the availability of protection while seeking preliminary relief, when filing a claim and for other documents involved in a case, and during oral hearings and in judgments.

Aspect (iii) – Valuation of loss

- 28) When there is no imminent public disclosure of a trade secret, in addition to providing the ability for Courts to injunct any continued non-public misuse of the trade secret, national laws may provide for damages for the misuse that has occurred so far.
- 29) Given that frequently a trade secret is used by its proprietor in a commercial sense, such damage may be quantified by reference to lost sales of the proprietor.
- 30) However, where quantification by lost sales is not possible, it would be relevant to understand the basis on which national laws quantify the damage suffered. If such damage is described as moral damage or damages or fines designed to impede further infringement, again a question arises as to what level of damages or fines is sufficient to achieve that objective.

Aspect (iv) – Proving infringement

- 31) It is important to understand what evidence and/or submissions are needed for a claim of trade secret violation to be validly filed, and whether a claim can be filed merely on the basis that there is a suspected violation, or does the claimant need to have knowledge of an actual violation?
- 32) It would be helpful to understand what mechanisms exist for obtaining information about actual or suspected trade secret violations, both before an action has been filed and after an action has been filed.
- 33) Under Article 10 of the proposed EU Trade Secrets Directive, before granting the interim measures laid down in Article 9, judicial authorities have the authority to require the applicant to provide evidence to show that the trade secret exists, that the applicant is the legitimate trade secret holder, that the trade secret has been acquired unlawfully or is being unlawfully used or disclosed, or that an unlawful acquisition, use or disclosure is imminent. Without some method of gathering this information, e.g. through a pre-action seizure, it is possible to imagine that it will be challenging for a claimant to show that trade secrets are being misused if such misuses are in secret.

***You are invited to submit a Report addressing the questions below. Please refer to the 'Protocol for the preparation of Reports'.***

## Questions

### I. Current law and practice

#### Aspect (i) - Overlap with restraint of trade

- 1) Is trade secret protection viewed as a form of restraint of trade and, if so, under what circumstances and under which legal regimes (e.g. competition law)?
- 2) How does your law distinguish between general skills or knowledge acquired during the course of employment, confidential information, and trade secrets? What protection is extended to each?
- 3) Are employees under a duty of confidence whether or not such a duty is set out in their contract of employment? If yes:
  - a. are express confidentiality clauses to protect classes of information broader than would anyway be protected by the employee's duty of confidence permitted; and
  - b. how long after the end of employment does an ex-employee's duty of confidence in relation to trade secrets last in the absence of any express confidentiality clause?
- 4) If not constrained by an enforceable non-compete agreement, may workers use knowledge acquired in the course of earlier employment in their new employment? If yes, is there any distinction between the types of knowledge they can use?
- 5) Are certain employees subject to a higher obligation of confidentiality / non-use? If so, which employees, and what is the rationale for any distinction between employees?

#### Aspect (ii) - Ensuring confidentiality during Court proceedings

- 6) What measures or provisions are available to preserve the secrecy of trade secrets during Court proceedings? For example, do trade secret proprietors have access to the following mechanisms to preserve the secrecy of a trade secret during proceedings (subject to the Court's discretion to allow/disallow such access):
  - a. restricted access to the hearing and / or evidence;
  - b. disclosure of evidence only to the legal representatives of the opponent, but not to the opponent themselves;
  - c. non-confidential versions of documents being provided to all except authorised individuals;
  - d. only non-confidential parts of any judgment / decision publicly available?
- 7) If such (or similar) measures are available, do they apply by default, or must the trade secret holder submit sufficient evidence to convince the Court that the information merits protection?



- 8) Whether or not such measures are available, does the Court restrict the defendant's or claimant's use – after the proceedings have terminated - of the information they gain during the proceedings?

Aspect (iii) – Valuation of loss

- 9) Are damages available as a remedy for trade secret violation? If so:
- a. how (if at all) is that value diluted by publication?
  - b. how are those damages quantified? Specifically, is allowance made for loss of profits; unjust enrichment; and /or what the trade secret holder would or might have charged as a reasonable royalty fee or licence?
  - c. can damages be awarded for moral prejudice suffered by the trade secret holder? If so, how is moral prejudice defined, and how are such damages quantified?

Aspect (iv) – Proving infringement

- 10) What elements must be proved to establish violation of a trade secret?
- 11) What additional elements must be proved (if any) for a trade secret violation in comparison to a breach of confidence, to the extent those are different types of violations?
- 12) Can constructive knowledge of a trade secret by an ex-employee or a new employer be imputed, e.g. if the subject-matter of that ex-employee's work was closely linked to the trade secret? If so, in what circumstances?
- 13) Does your jurisdiction provide for discovery? If yes, does it provide for discovery at the pre-action stage; and / or against third parties?
- 14) Does the burden of proof switch to the defendant if the applicant is able to demonstrate, to a certain level of probability, that there has been a violation? If yes, what is this threshold?
- 15) Does your law provide for any other methods for securing evidence, such as seizures or ex parte measures? If so, what requirements must be fulfilled in order for the measure to be ordered and what safeguards are in place to prevent abuse?
- 16) Where seizure is available, for what purposes can it be used? To secure evidence, to prevent items entering into circulation or for other reasons?

**II. Policy considerations and proposals for improvements of the current law**

Aspect (i) - Overlap with restraint of trade

- 17) Should limits be placed on the protection of trade secrets to avoid unlawful restraints on trade? If so, what limits? If not, why?

- 18) Should different obligations of confidence / non-use apply to different employees? Why/why not?

Aspect (ii) - Ensuring confidentiality during Court proceedings

- 19) Should a defendant, who is sued unsuccessfully for a trade secret violation, and who learns of the trade secret during the course of the litigation, be required to not use the trade secret after the proceedings? Why/why not?
- 20) Should such obligations of confidentiality attach to information that the defendant developed independently prior to the trade secret proceedings, or develops independently after the trade secret proceedings? Why/why not?

Aspect (iii) – Valuation of loss

- 21) Should damages as a remedy be available by default, or only where injunctive relief is (a) not possible, (b) adequate, or (c) not necessary? If by default, why?

Aspect (iv) – Proving infringement

- 22) Should constructive knowledge of a trade secret by an ex-employee be imputed to their new employer? If yes, in what circumstances? If no, why not?
- 23) Should pre-action evidence preservation orders and seizure orders be available? If so, should the hearings to decide whether or not to grant them be able to take place ex parte? Why/why not?
- 24) What if the claimant learns of new trade secrets (of the defendant) during the course of a seizure?

**III. Proposals for harmonisation**

- 25) Is harmonisation in this area desirable?

*If yes, please respond to the following questions without regard to your national or regional laws.*

*Even if no, please address the following questions to the extent you consider your national or regional laws could be improved.*

Aspect (i) – Overlap with restraint of trade

- 26) Please propose principles for the circumstances in which trade secret enforcement actions should fail, because such actions would be de facto restraints of trade.
- 27) What relief should courts give when a trade secret violation has occurred or is about to occur, but an enforcement action is barred as a restraint of trade?
- 28) Should employees subject to a stricter obligation of confidentiality be released from that duty in certain circumstances? If so, in what circumstances?

Aspect (ii) – Ensuring confidentiality during Court proceedings

- 29) What protection for trade secrets should be available during Court proceedings, and what conditions should be satisfied for that protection to be given?
- 30) If an enforcement action fails (e.g. because the defendant had independently developed the secret information and did not misappropriate it), what type(s) of confidentiality or non-use obligation, if any, should continue or cease to apply?

Aspect (iii) – Valuation of loss

- 31) Please propose the principles for quantifying damages for trade secret violations.
- 32) Should courts award moral damages? If so, how should they be quantified?

Aspect (iv) – Proving infringement

- 33) What measures to secure or preserve evidence should be available?
- 34) What restrictions should apply to the use of seized evidence by the claimant?

***Please comment on any additional issues concerning trade secrets you consider relevant to this Working Question.***