

# TRADE SECRETS

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## the other IP right

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What kind of intellectual property (IP) is most often relied on by business to protect competitive advantage? Most people would answer with one of the best known areas of IP: patents, copyright, trademarks or designs. But they would be wrong. The most common form of protection used by business is secrecy.

Why then do trade secrets receive less attention than the other areas of IP? There are several reasons. First, secrecy does not involve a government registration process; it is implemented as a matter of practice by each business. Second, although the general principles of trade secret law – also referred to as the law of undisclosed, or confidential, information – are established in similar ways in most countries, there are few common rules or regulations about enforcement. Third, secrecy disputes are usually secret, so they do not become part of the public debate.

Recently, however, trade secrets have shot to the top of the news, with stories of “cyber-espionage” attacks on companies throughout the world, with spies using fake email messages to get inside corporate networks and trawl for useful information. But trade secret law is also getting a fresh look for more positive reasons, as a framework that can enable collaborative innovation, often involving actors located in many different countries. Whatever the catalyst, governments and industry are clearly interested. Within the last year, major initiatives on secrecy have been launched by the European Commission as well as the US government.

### JUST WHAT IS A TRADE SECRET?

Most simply, a trade secret is information that you do not want the competition to know about. The law generally protects not just secret formulas and designs, but even simple facts, such as the features that might be introduced in the next iPhone, or which country a business intends to go into next.

Secrecy has been a part of trade for thousands of years. For example, secrecy allowed a region of China to profit for centuries from clever harvesting of the silkworm's thread, and it gave a family from Armenia a 400-year lead in producing the best orchestral cymbals.

Trade secrecy is a legal regime that protects relationships of trust. Before the industrial age, innovative craftsmen would keep their “tricks of the trade” closely held through small, family-owned shops. However, as industry moved from the cottage to the factory, there was need for a legal system that would enforce an employee's promise of confidence about a secret process or piece of machinery.

It is important to keep in mind that secrecy is a legitimate tool for businesses of all sizes. Enforcing business secrets has nothing to do with lack of transparency in government. Although it may seem paradoxical, trade secret laws can enable and encourage technology transfer, because they provide a commercially reasonable way to disseminate information. Although some aspects of secrecy laws, such as data exclusivity for drug companies (Art. 39.3 of the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS Agreement)), can be controversial, there is general agreement that confidential disclosure is beneficial in a modern economy. Indeed, keeping secrets – often information about customers and their needs and

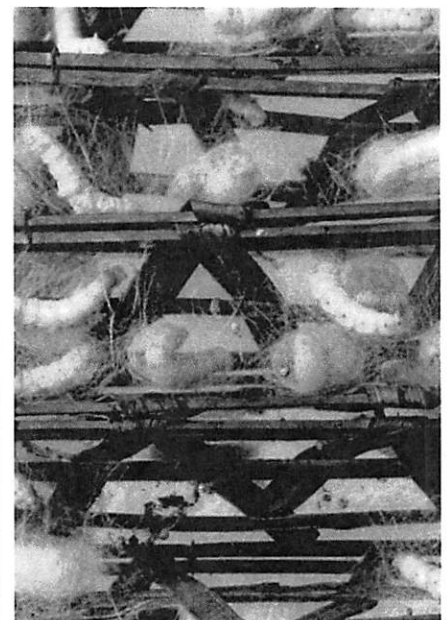


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preferences – is the main way that small and medium-sized enterprises (SMEs) protect their business advantage.

It is easier to understand this point if you imagine what it would be like if no one could count on the law to enforce obligations of confidence. Businesses would hire fewer people, since each new employee would expand the risk of information loss. The cost of enforcing physical security – locks, fences, etc. – would increase. Perhaps most important, many licensing transactions and research collaborations would never happen, because there would be nothing to ensure that partners would not run off with the new technology and unfairly compete against its creator. The general approach would be to hoard information, slowing the progress of innovation.

#### **WHY USE SECRECY?**

Why do businesses turn most often to secrecy to maintain their advantage? First, it is cheaper than other forms of IP that require registration with a government agency, often with the expense of hiring lawyers or other professionals. In contrast, to establish your trade secret right, all you need to do is be careful with it, spending only what is necessary to keep it from becoming generally known. Usually keeping facilities secure and getting nondisclosure agreements from employees and vendors is enough.

In addition, much more information can be protected through secrecy than is possible with patents, which can only be granted for truly novel technical innovations. Secrecy covers any information that gives you an advantage, even if someone else is already using it; the only limitation is that it not be generally known.

That point reveals the downside of secrecy: there is no guaranteed exclusivity. If someone else discovers your secret without stealing it from you, there's nothing you can do about it, although for most businesses this is not a significant drawback.

#### **LEGAL PROTECTION**

Trade secret law, like other forms of IP, is governed by national legal systems. However, international standards for protecting secrets (called “undisclosed information”) were established as part of the TRIPS Agreement in 1995. Article 39 of the agreement provides that member states shall protect “undisclosed information” against unauthorized use “in a manner contrary to honest commercial practices” (this includes breach of contract, breach of confidence and unfair competition). The information must not be generally known or readily accessible, must have

value because it is secret, and must be the subject of “reasonable steps” to keep it secret. This general formula for trade secret laws has been adopted by well over 100 of the 159 members of the World Trade Organization.

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Articles 42 to 49 of the TRIPS Agreement cover enforcement, requiring that civil judicial proceedings be available to enforce all IP rights and that “confidential information” be protected from disclosure. Nevertheless, because national judicial systems, including the methods for granting access to evidence, vary greatly, enforcement of trade secret rights around the world is generally viewed as uneven.

#### **CYBER ESPIONAGE**

The practical challenges of protecting secrets are more difficult to overcome than the legal ones, however. Paradoxically, the great explosion of innovation that has brought so many benefits to the world has also made it easier for thieves to steal valuable business information. For example, through a process known as “spear-phishing”, commercial spies send an email using personal information gleaned from Facebook or other social media, leaving the recipient unaware that the message is a hoax. Once the embedded link is clicked, the thief's malicious software, known as “malware”, invades the recipient's computer and through it the employer's network. Staying in the computer system for months or sometimes years, this silent invader searches for important confidential files and passwords, and sends all of it back to the hackers who use or sell the information.

Tracing the source of cyber-espionage is notoriously difficult, given the ubiquity and anonymity of the Internet. Estimating



Keeping secrets is the main way that SMEs protect their business advantage.

damage to businesses is likewise challenging, in part because many enterprises do not know that their systems have been compromised, and also because those who do are often reluctant to report it. Nevertheless, studies show that the problem is growing, and governments around the world are looking for ways to address it.

For businesses, the issue is not just about protecting their own valuable information, but about avoiding being infected by secrets belonging to others. In a global market characterized by easy movement of employees and complex webs of connections among companies' suppliers and customers, it takes special vigilance to avoid contamination by unwanted information. Greater competition also means that businesses have to work continuously on finding ways to exploit their secrets, either through direct commercialization, collaborations or licensing. In the meantime, the sheer volume of potentially valuable data creates its own challenges of inventory and valuation.

For businesses that rely on patent protection, secrecy is a critical part of the innovation process. Because most national patent laws require "absolute novelty", this means that until the day a patent application is filed, the invention must be completely protected from any public disclosure. Where the technology requires refinement through experimentation outside the laboratory, this can be extremely difficult. That is why discussions regarding international patent law harmonization often include the idea of a "grace period" of up to one year before filing, during which time disclosures by an inventor will not disqualify a later patent application.

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#### ADVANTAGES FOR SMES

It is in comparing patents and secrecy that one can most easily see the importance of trade secrets for SMEs. Patents have been key to the success of many businesses, particularly as they reach into global markets where a period of exclusivity is needed to recoup the cost and risk of innovation. That sort of advantage is greatly amplified when using the Patent Cooperation Treaty (PCT), the international patent filing system administered by WIPO, which gives applicants up to 30 months to refine their plans and find partners and sources of funding. However, patents are not the only tool for protecting technological advantage. Secrecy can do this too, through licensing and various forms of collaboration.

Indeed, it is in the rapidly-expanding realm of international "open innovation" that trade secret laws may be turned to greatest advantage, particularly for smaller firms and individual inventors from developing and least developed countries. These actors often can leverage their special creativity and local knowledge most effectively by collaborating with large, well-established multinational corporations that are looking for fresh ideas. That kind of partnering – the building of "trusted networks" of SMEs and other innovators – is enabled by national trade secret laws that protect the integrity of shared information.

Emerging from a long period of relative obscurity, the subject of trade secrets is currently getting a lot of attention. There is good reason to be concerned about commercial espionage, because like other forms of piracy it disrupts markets and slows progress. But another reason to focus on secrecy is for what it can do to support and amplify the creative work of individuals and SMEs throughout the world, by making it possible to connect with other firms to deliver innovative solutions to the public. ♦