

UNIFORM TRADE SECRETS ACT

House Bill 5312 as passed by the House Second Analysis (6-10-98)

Sponsor: Rep. Andrew Richner
Committee: Commerce

THE APPARENT PROBLEM:

According to the Michigan Law Review Commission, a valid patent provides a legal monopoly for 17 years in exchange for public disclosure of an invention. If, however, courts ultimately decide that the Patent Office improperly issued a patent, an invention will have been disclosed to competitors with no corresponding benefit. In view of the substantial number of patents that are invalidated by the courts, many businesses now elect to protect commercially valuable information through reliance upon the state law of trade secret protection.

Since 1974, a decision from case law has established that neither the patent clause of the U. S. Constitution nor the federal patent law preempt state trade secret protection for patentable or unpatentable information. A subsequent decision reaffirmed that federal patent law is not a barrier to a contract in which someone agrees to pay a continuing royalty in exchange for the disclosure of trade secrets concerning a product.

However, the National Conference of Commissioners on Uniform State Laws observes that notwithstanding the commercial importance of state trade secret laws to interstate business, this law has not developed satisfactorily in the courts: development is uneven; and, there is undue uncertainty concerning the parameters of trade secret protection and the remedies for misappropriation of a trade secret.

The majority of states have adopted a uniform trade secrets act, although Michigan has not. Some argue that clear, uniform trade secret protection is urgently needed, and they urge adoption of a uniform statute.

THE CONTENT OF THE BILL:

House Bill 5312 would repeal Public Act 329 of 1968, an act that prohibits stealing, embezzling, or copying trade secrets. It would replace this law with a new act, the Uniform Trade Secrets Act, to protect business, governmental, and other legal entities' trade secrets. Under current law, a 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; and a trade secret is considered to be secret when the owner thereof takes measures to prevent it from becoming available to persons other than those selected by the owner to have access thereto for limited purposes." A person who misappropriates a trade secret is guilty of a misdemeanor, punishable by a fine of up to \$1,000, imprisonment for up to one year, or both. The act specifies that it is no defense that the person charged claims to have intended to return or returned the stolen, embezzled, or copied article.

Under House Bill 5312, trade secrets would be defined to mean information including "a formula, pattern, compilation, program, device, method, technique, or process." Under the bill, the information would be protected when the information had independent economic value not readily ascertainable by others, and reasonable efforts had been made to maintain that information's secrecy.

Under the bill, a person (an individual, corporation, partnership, association, governmental entity, or other legal entity) would be prohibited from "misappropriating" a trade secret of another. This would include acquiring a trade secret from a person who knew, or had reason to know, that the trade secret was acquired by improper means; or, disclosing or using a trade secret without express or implied consent by a person who used improper means to acquire knowledge of the trade secret, or who, at the time of the disclosure, knew or had reason to know that his or her knowledge of the secret was derived from a person who had acquired it by improper means.

The bill would allow a person to bring legal action for an injunction and damages against a person who misappropriated a trade secret. Such an injunction would continue for a reasonable period of time to

eliminate any commercial advantage to the person who misappropriated the trade secret. If there had been a material and prejudicial change of position by the person who acquired the trade secret before that person knew of the misappropriation that would make such an injunction inequitable, the court could allow continued use of the trade secret but require payment of a reasonable royalty for a reasonable period of time to eliminate any commercial advantage.

A person could recover damages for the misappropriation of his or her trade secret. Damages would include both the actual loss caused by the misappropriation, and any unjust enrichment received by the person who misappropriated the secret. In addition, the court could order a reasonable royalty to be paid, in lieu of damages. Additionally, upon a finding that a claim of misappropriation was made in bad faith, that a motion to terminate an injunction was made or resisted in bad faith, or that there was willful and malicious misappropriation, the court could award reasonable attorney fees and costs to the prevailing party.

In an action under the bill, the court would be required to preserve the secrecy of an alleged trade secret by reasonable means, which could include granting protective orders in connection with discovery proceedings, holding in-camera (private) hearings, sealing the records of the action, and ordering people involved in the litigation not to disclose an alleged trade secret without prior court approval.

An action for misappropriation under the bill would have to be brought within three years from the date the person knew or should have known of the misappropriation. For purposes of this provision, a continuing misappropriation would constitute a single claim.

The bill also specifies that it would displace conflicting tort, restitutionary, and other law providing civil remedies for misappropriation of a trade secret. However, the bill would not affect contractual remedies, other civil remedies, or criminal remedies that are not based upon misappropriation of a trade secret. The bill would take effect October 1, 1998.

BACKGROUND INFORMATION:

Beginning in 1968, three sections of the American Bar Association (the Patent Law Section; the Corporation, Banking and Business Law Section; and the Antitrust

Law Section) recognized a need to reconcile what was perceived to be a fundamental policy conflict between

state statutes, that generally protect trade secrets (that is to say, keep them secret), and federal patent policy, which is generally designed to encourage public disclosure of innovations (and provide a legal monopoly for 17 years). In 1978 and following a lengthy and substantive review, the American Bar Association proposed a fifth draft of its proposed Uniform Trade Secrets Act to the National Conference of Commissioners on Uniform State Laws. Subsequently, in 1985, the National Conference of Commissioners on Uniform State Laws recommended a uniform statute to all of the state legislatures.

This bill is one of several recommended to the Michigan legislature by the Michigan Law Revision Commission, in order to update and to recodify bodies of law, including for example, the Uniform Commercial Code.

The National Conference of Commissioners on Uniform State Laws was created in 1892. The conference identifies outmoded statutes, substantiates its recommendations to eliminate those statutes with scholarly research, and then drafts uniform up-dated statutes. The updated "tentative" statutes are drafted over several years, allowing for ample review, argument, and revision. Revisions of the drafts are facilitated through a network of linkages constituted by scholars and practitioners who serve as members of the law sections of the federal and local bar associations, as well as those who serve as volunteer commissioners in state-level review commissions. These contexts provide an opportunity for stakeholders to study unacceptable statutes in light of emerging legal doctrines. The conference proposes the new statutes, first to the law sections, and then to the entirety of the American Bar Association for review by scholars, teachers of law, and legal practitioners. Once endorsed by the American Bar Association, the uniform statutes are disseminated to a network of state-level Uniform Law Commissions (for example the Michigan Law Revision Commission), whose members review the proposals once again, and then in some instances recommend their introduction as bills in the state legislatures.

According to the conference, since its organization, the conference has drafted more than 200 uniform laws on many subjects and in various fields of law, setting patterns for uniformity across the nation. Uniform acts include the Uniform Probate Code, the Uniform Child Custody Jurisdiction Act, the Uniform Partnership Act, the Uniform Anatomical Gift Act and the Uniform Limited Partnership Act. Beginning in 1940, the conference made a significant decision to attack major commercial problems with comprehensive legal

solutions--a decision that set in motion the project to produce the Uniform Commercial Code. The code took ten years to complete and another 14 years before it was enacted across the country. It remains the signature product of the conference. Today the conference is recognized primarily for its work in commercial law, family law, probate and estates, law of business organizations, health law, and conflicts in law. It rarely drafts law that is regulatory in character.

The Michigan Law Revision Commission has issued more than 30 annual reports, although the commission was created by statute in 1986 (MCL 4.1401). Each year the commission issues a report to describe the topics of its study reports, and to recommend statutes. Some statutes are enacted into law. Under its enabling statute, section 401 of Public Act 268 of 1986, the commission's membership is: four legislators to be bicameral and bipartisan, the director of the Legislative Service Bureau (or designee), and four members appointed by the Legislative Council. The Legislative Council designates the chair. The commission's reports are available at its Web Site, <http://www.dcl.edu>.

FISCAL IMPLICATIONS:

Fiscal information is not available.

ARGUMENTS:

For:

Forty-two states have already enacted this uniform statute; Michigan should join them. State trade secrets law provides an alternative to federal patent law for the protection of inventions, formulas, patterns and the like, that businesses wish to keep confidential in order to preserve a competitive advantage. Patent law provides a legal monopoly for 17 years in exchange for public disclosure of an invention. However, many inventors choose not to protect their inventions under patent law because (1) they do not want to risk the denial of a patent after public exposure of their invention and loss of confidentiality, or (2) they want to maintain the monopoly for a longer period than 17 years. Instead, confidentiality can better be maintained through a modern state trade secrets law.

For:

The bill would codify the basic principles of common law trade secret protection. Information must be qualified as a secret before it is protected under trade secret law. An owner's trade secret is only protected from misappropriation by another party; appropriation

by separate invention or "reverse engineering" is not prohibited. If a court finds that a trade secret has been misappropriated, it can issue an injunction forbidding the use of the misappropriated secret, assess damages for misappropriation, or both.

POSITIONS:

The National Conference of Commissioners on Uniform State Laws proposed the enactment of the bill.

The Michigan Bankers Association supports the bill. (6-10-98)

Analyst: J. Hunault

■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.