

# Trade Secrets and Employee Loyalty

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## Introduction

In today's competitive business environment, employees can "make or break" an enterprise when it comes to intellectual property (IP) protection. While there are several legal and technical mechanisms that can be put in place for protecting IP assets of enterprises, employee loyalty remains one of the biggest challenges faced by enterprises in protecting their IP. This article discusses the need for enterprises to build strong employee loyalty as a key element in their strategy for protecting trade secrets. The article draws attention to the principle ways that could be followed to obtain trust and commitment from employees, thus discouraging them from unauthorized disclosing the trade secrets of an enterprise.

The adage "information is power" is very relevant to the whole concept of strategic use of trade secrets. When used strategically, trade secrets often provide a significant competitive advantage in the market place. Further, trade secrets can be central to the creation of a market niche which competitors may find it difficult to penetrate. Competitive advantage is often acquired by simply keeping strategic information confidential or secret as outsiders are prohibited by law (in most countries) to use or copy secret or confidential information without the consent of the owner of that information. The law of trade secrecy discourages espionage/unlawful access to such information by punishing those found guilty of accessing information by improper means.

Trade secrets are but one tool amongst a collection of different intellectual property tools and when used appropriately complement and strengthen the other tools. Enterprises that successfully protect their trade secrets strengthen other IP assets that they have; for example, when Coca-Cola protects its secret formula as a trade secret, by doing so it also strengthens its trademark.

Since the market is changing so rapidly, and the fact that trade secrets can be independently discovered by others, enterprises are advised not to rely only on their existing trade secrets but to make continuous efforts to develop new trade secrets in order to remain competitive. In addition, this will be helpful in case of unwanted disclosure because the enterprises would be able to rely on a newer and better product or plan.<sup>[1]</sup>

## Identifying Trade Secrets

There are three basic requirements for any information to be considered a trade secret and thus be legally protected:

1. The information must be secret or shared in a context of confidentiality;
2. The information must have commercial value by virtue of being secret;
3. The owner of the information should have made reasonable efforts under the relevant circumstances to keep the information secret.

A trade secret may be any type of information such as formulae, devices, patterns, financial information, business plans, client lists, unannounced products and so on that an enterprise considers to be valuable and offers it an advantage over its competitors.

## Pros and Cons of Trade Secret Protection

When deciding whether to rely on trade secret protection, an enterprise must consider the advantages and disadvantages of doing so in comparison with other IP tools<sup>[2]</sup>.

On the advantage side, a trade secret:

- Involves no registration costs
- Is not limited in time
- Is immediately effective
- Does not require disclosure or registration with the government

On the other hand, the disadvantages include:

- If the secret is embodied in a product, others may be able to discover the underlying secret and use it legally by "reverse engineering" it
- Protection is not granted if the secret is publicly disclosed
- Protection is only effective against improper acquisition and use or disclosure of the confidential information
- Protection is weaker than the protection granted to patents
- If the secret is embodied in a product, others may be able to discover the underlying secret and use it legally by "reverse engineering" it – see below
- A trade secret does not protect against those who independently come up with the same confidential idea. As a consequence, a trade secret that is also patentable may be patented by another if independently developed by that other. This is in contrast to patents that protect the owner of the patent even against those who happen to independently develop the same invention

The law does not punish fair discovery, which includes discovery by legal means like:

- Independent creation; trade secrets do not provide exclusivity, so anyone can discover your trade secret independently and use it or patent it.
- Reverse engineering; this is a common practice employed to find out the mechanism or the ingredients of a product, when a competitor studies a product to duplicate it or even make a better product.

## Protecting Trade Secrets

Given today's progress in communication technologies and the speed at which information can be duplicated and moved, maintaining a trade secret is an everyday challenge. To meet this challenge an enterprise must consider the following:<sup>[3]</sup>

- Identify all valuable trade secrets and develop and put in place a trade secret protection policy and program;
- Educate employees about the importance of trade secrets and communicate to them the policy and the program;
- Carefully decide and review periodically as to which employees "need to know or use" the information and restrict access to trade secrets on a "need to know" or "need to use" basis;
- Apply physical and technological restrictions to access trade secrets;
- Limit and monitor public access to buildings that house trade secrets;
- Mark "secret" or "confidential" all documents containing trade secrets so as to avoid accidental or inadvertent disclosure;
- Sign confidentiality agreements with all relevant employees and also with outsiders who in one way or another may get access to an enterprise's trade secrets.

## Employees are the Biggest Threat

New and improved products and processes which cannot be copied provide the much needed competitive advantage, to an enterprise. Continuously finding ideas that are creative or inventive is a perpetual challenge. Some enterprises are even willing to unscrupulously steal competitors' employees with the objective of accessing their creative and inventive abilities, as well as their knowledge of the secrets of success of the competitor. Most disclosures or use of confidential information are done by current employees and especially by former enterprise<sup>[4]</sup>.

When working in an enterprise there is always a "psychological contract" between the employer and the employee. Different from a formal legal contract, it is a set of expectations that both employees and employers have concerning each other's contributions to the enterprise and the incentives they will receive for their contribution<sup>[5]</sup>. These expectations are mostly learned and understood while working in the company. As employees gradually come to understand a company's culture, it becomes clear to them as to what is acceptable or not, what are their duties and what they owe to the company and what the company owes them.

An employee automatically owes confidentiality to the employer. However, in an environment where employee mobility is high, "psychological contracts" are no longer reliable; it implies that giving formal legal contracts a greater importance becomes important. Such contracts or clauses in contracts enhance legal protection of trade secrets and provide an enterprise security in case of litigation. There are several types of contractual clauses in employment agreements that an enterprise can enter with its employees to protect its confidential information.

- First and foremost are the mutual non-disclosure clauses, where both parties agree not to disclose any confidential information covered by the contract. Such clauses should be included in all types of contracts, be it regular employees, interns, temporary staff, shareholders, customers or any one else likely to come into contact with the enterprise's trade secrets.
- Another clause that is also popular is the non-compete clause that prevents employees from pursuing a similar profession or position with the employers' competitors or even pursuing personal business using the enterprise's information. A non-competition provision should include a duty not to moonlight, not to compete with the employer, not to organize a competing company, and a duty not to solicit fellow employees to leave the company to undertake competitive employment. In some countries, however, such clauses are prohibited altogether; while in most others, the restrictions have to be reasonable in terms of duration and geography.

## Confidentiality Contracts not Infallible

Keeping the confidentiality of a trade secret is an endless challenge as the fear of disclosure is always present. Generally employees are a main threat because there is no guarantee that the "non-disclosure agreement" and "non-compete agreement" will be sufficient to prevent the use or unauthorized disclosure of secret information by departing employees. In any case, a non-compete clause is not an absolute guarantee, as it is often bound by restrictions on its duration as well as a geographic limitation.

There have been major changes in the business world and the workforce in the last couple of decades. In the past, once hired an employee believed it was a life time job and managers expected their unstinted loyalty to the enterprise. Similarly, workers used to be devoted to their employer. This image of employment loyalty has gradually changed with the advent of "globalization" when employees began to face restructuring, company relocations, and downsizing<sup>[6]</sup>. Employers 'broke the rules', mutual obligations are reconsidered, life time employment and devotion is no longer expected, job-hopping is considered to be a normal phenomenon, and people are constantly striving for higher salaries or better working conditions. Loyalty and trust have become more difficult to obtain and give in the work place.

Statistics from research conducted in 2000 in the American workplace by Fortune Personnel Consultants have shown that the size of an enterprise has an influence on the state of employees' loyalty to their employer. The results indicate that almost 80 percent of people working in SMEs feel loyal to their companies, whereas under 50 percent of people working in large enterprises feel loyal to their organization<sup>[7]</sup>.

Trade secret law tries to balance competing policy options. On the one hand, there is interest in promoting innovation and creativity and protecting companies that invest in innovative and creative activities. On the other hand, there is interest in promoting healthy competition and the freedom of employment. The complexities of these differing and often conflicting policy interests are demonstrated in the 'inevitable disclosure doctrine and the spring board doctrine' in common law countries.

The 'inevitable disclosure doctrine' has developed around the issue of employees seeking new employment in a similar business. The underlying principle is that employees who have had access to confidential information will inevitably disclose the information to a future employer if working in the same field. Even if the employee has good intentions the doctrine presumes that it is inevitable that the information, skills and knowledge absorbed while working in one employment will automatically or instinctively come out when working in the next employment if it is in the same field. The policy considerations referred above come into play here. On the one hand, society needs to protect the confidential information of its enterprises but it also cannot restrict the freedom of employment of its members.

The judicial decisions in this area have revolved around the particular facts and circumstances of individual cases<sup>[8]</sup>. In general, an order preventing an employee from taking on a new employment has been made if it was found that the former employee was likely to bring into the new job information which was neither generally known nor readily ascertainable by competitors in the industry. Specific confidential information must be separated from the ordinary skills and knowledge that the employee had developed while in his former employment. He/she cannot be prevented from using the latter information. The PepsiCo Inc. vs. Redmond case is an example where the doctrine was applied to prevent an employee from working with a competitor. PepsiCo asked for an injunction against former employee of Redmond to prevent him from working for Quaker Oats Co., which was a direct competitor of PepsiCo Inc. at that time. PepsiCo won the case on the ground that due to the position offered by Quaker, Redmond would have inevitably disclosed PepsiCo's trade secrets and confidential information. The court also prevented Redmond forever from disclosing PepsiCo trade secret<sup>[9]</sup>.

The 'springboard doctrine' is applied to constrain an employee who by virtue of his/her employment has been able to access the employers' confidential information and intend to use the said information for his own benefit and thus gaining an unfair advantage vis à vis the former employer. An example is the ROGER BULLIVANT vs. ELLIS case where the managing director resigned from his company to join a competing business and took with him technical and commercial documents, trade secrets and customers' information from his former employer. There is no doubt in this case that the ex-employee would have gained an unfair advantage by using this information and thus was prohibited from using this information. A springboard injunction can also be applied even if relevant information is already in the public domain, in order to prevent a former employee who during his employment has acquired a particular production/manufacturing skill/knowledge from using the said skill/knowledge in the production of a competing product. This is due to the fact that such knowledge would give the former employee an unfair head start, over others who have access to the publicized information<sup>[10]</sup>. However, issuing an injunction is not easy because the issue of confidentiality is complex, as it is difficult to clearly identify and separate the knowledge that an employee already has at the time of beginning an employment and the one that he acquires during his subsequent employment.

The changes in the working environment and consequently in employee loyalty that have occurred during the last few decades have increased the chances of breach of a psychological contract. It is, therefore, time to pay greater attention to building employee loyalty as a tool for protecting trade secrets. It can only be to the advantage of the employer to regain commitment because it increases performance and, more importantly, it discourages mobility and reduces the percentage of turnover, and thus minimizes the risk of divulging trade secrets.

## Promoting Employee Loyalty

Companies like Southwest Airlines, Toyota and Cisco, which are building profits by taking care of workers, have come to understand that employees' commitment must be well integrated in its human resource policies and overall business strategies. Employee loyalty is as important as customer loyalty since enterprises entrust clients to employees and it is important to combine, integrate and interpret information about employees to have a clear understanding of the need and expectations of employees. The relationship between employer and employee should be based on mutual respect and understanding, treating employees fairly and equally, no matter what their position may be.

Communication is an important step in promoting employee commitment. Managements' expectations might not be similar to those of the employees, so mutual expectations should be crystal clear to make sure all parties understand what is expected from them. When managers gain respect and confidence from their team commitment is reinforced. So offering leadership development programs to managers can perfect their skills in leadership and help them in specific areas<sup>[11]</sup>.

Internal communication can be useful and listening to employees is important in making them feel relevant to the organization and the organization may elicit useful input from them for improving management and for solving internal problems. Installing programs like internal forums where employees can express themselves freely and give suggestions could create a positive environment. Listening to employees can also alert a company to weak links and pools of dissatisfaction which would enable management to take timely remedial measures. In a lower "power distance culture", superiors treat subordinates with respect and do not pull rank, subordinates are entrusted with important assignments, blame is either shared or very often accepted by the superior due to it being their responsibility to manage and managers may often socialise with subordinates. Lower power distance

culture and a more collective, democratic or decentralized environment in the workplace are very helpful in developing employee loyalty, as they ease communication between managers and employees and increase mutual respect. When interacting with employees the employers should show care and concern for their conditions. In addition, a collective and low power distance workplace gives a familial environment that creates a sense of belonging. Developing ownership in an organization encourages loyalty. When creating a commitment strategy the objective is to make every employee understand his/her role in the company and how it contributes to the overall success of the business, as this would enhance the sense of belonging, improved self image and identity and greater loyalty to the company.

Appropriate rewards and benefits are also important for employees. Financially, the salaries must be fair according to employees' contribution. A way of aligning the business' interest with those of the employee is introducing profit-sharing plans that consist in creating plans in which employees receive bonuses according to the company's profits. Both employees and employer basically work for a common goal for mutual profit. Procter & Gamble, for example, gives lucrative profit-sharing plans to employees and many of its employees are holders of hundreds of thousands of dollars in company stocks<sup>[12]</sup>. This gives a great sense of ownership and an interesting financial advantage for the employees.

Nonfinancial reward should also be provided to employees for their contributions. For example, recognition, paid time off, employee of the month programs, access to training programs, and so on. SAS Institute, which is the largest private software company in the world, has a 4 percent employee turnover. Factors that can be said to contribute to the relatively low turnover are provisions of benefits like site day care for mothers, recreational activities, full indemnity health insurance plans as well as 35 hour business weeks<sup>[13]</sup>.

## Monitoring Employee Activities

While promoting employee loyalty is important, employers should not lose focus on the importance of protecting trade secrets. Employers should continually monitor employees' work to protect trade secrets. In doing this, employers should act with limitations; they must respect employees' privacy. Too much monitoring can be a threat for employee loyalty, as employee may feel untrustworthy.

## Exit Interview

In case of employee termination, it is essential to conduct an exit interview where the employer would remind an exiting employee about their post employment obligations to maintain the confidentiality of the trade secrets that they have had access to in the course of their employment, and the consequences of a breach of these post employment obligations. Such exit interviews are also beneficial to an employer, as they will acquire information on the future plans of the former employee, such as where the employee plans to work. This information will help employers understand better the potential threats to their trade secrets and identify the competitors.

## Conclusion

When making the decision to keep certain information secret enterprises must build a strong protection system around such information. In addition, enterprises should establish strong psychological loyalty with its employees to stand a better chance of seeing its non- disclosure and non- compete agreements being effective and thus safeguarding its trade secrets. Enterprises are thus advised to include measures to improve psychological loyalty as part and parcel of its IP strategy and overall business strategy.

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\*The views expressed in this article are those of the author and do not necessarily represent those of WIPO. Comments, suggestions or any other feedback concerning this article may be sent to [talhiya.sheikh@wipo.int](mailto:talhiya.sheikh@wipo.int) or [talhiyas@hotmail.com](mailto:talhiyas@hotmail.com). Many thanks to Guriqbal Singh Jaiya, Tamara Nanayakkara and Lien Verbauwheide for their most valuable guidance and comments.

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