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The Artificial Distinction Between Trade Secrets and 'Confidential Information'

JAMES POOLEY

JULY 28, 2022, 12:15 PM



“Many companies insist on ‘confidential’ as a separate category of data, distinct from secrets.... But for most organizations, there is a real benefit to treating ‘secret,’ ‘proprietary,’ ‘company private,’ ‘confidential,’ and other similar terms as synonyms.”

“What’s in a name?”– William Shakespeare

One of the most frustrating questions I get from clients asks “what is the difference between ‘confidential’ and ‘trade secret’?”

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let's identify the source of this nomenclature problem: it's an outfit you've probably never heard of called the American Law Institute.

The ALI is a volunteer organization of law professors who read, discuss and then “restate” the law in a form that courts can usefully refer to and consider authoritative.

As with standards in other areas affecting the public (the internet protocol, railroad tracks, fire hydrant connections, food

additives), it makes sense to try to harmonize the law so that we're all reading from the same sheet of paper. But if it's going to be a national standard, you've got to get it right. When it came to trade secret law, the ALI failed us terribly. To understand this story, we're going to have to put on our history hats.



The year was 1939, and with everything else that was going on in the world at the time (Germany invading Poland, Russia invading Finland, and the release of both *Gone with the Wind* and *The Wizard of Oz*), maybe the professors were distracted. And in their defense, it should be pointed out that trade secrets were just one small part of the “Torts” (that is, wrongs done by one person to another) section of their work, which included eight other equally weighty sections like Contracts, Judgments and Trusts. So, they were very busy.

Trade Secrets Viewed As ‘Property’

Nevertheless, they should have been aware that over 100 years before, trade secret law had been introduced into the United States, adopted from the English common law that imposed judicial oversight on commercial behavior. This first case, *Vickery v. Welch* in 1837, involved the sale of a chocolate factory, and the Massachusetts Supreme Court held that the seller's promise to keep confidential the secret recipe was enforceable, even though it could be called a “restraint of trade.” *Vickery v. Welch*, 36 Mass. 523 (1837).

In 1868, the same court addressed the need to share secrets with factory workers. *Peabody v. Norfolk* dealt with an employee who left with secrets for manufacturing gunny cloth. *Peabody v. Norfolk*, 98 Mass. 452 (1868). Approving an injunction, the opinion set out many of the principles

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extended to customer information in the 1913 case of *Empire Steam Laundry v. Lozier*, where the California Supreme Court held that a wagon driver's knowledge of the location and preferences of his employer's customers was a protectable trade secret. *Empire Steam Laundry v. Lozier*, 195 Cal. 95, 130 P. 1180 (1913).

Up to this point, no one questioned whether the theory of the law was more about the information as property, or more about the confidential relationship, or whether that even mattered. In fact, it seemed as though both ideas fit neatly together, since the property could be protected by enforcing the confidence.

But by the 1930s, a sense of disquiet had arisen within the legal academy, as some professors, used to the idea that all "property" had to be exclusive in order to deserve the name, focused on the fact that trade secrets were non-exclusive; in fact, more than one company in an industry could possess and protect the same secret formula. This couldn't be justified, they thought, and the law had to be quietly "adjusted" in the direction of limiting the scope of the trade secret interest.

They found justification in *DuPont v. Masland*, a three-paragraph 1917 opinion of the U.S. Supreme Court, authored by Justice Holmes. *DuPont v Masland*, 244 U.S. 100 (1917). The decision approved of a trial court's order that claimed secrets could be revealed to the defendant's lawyer but not to a third-party expert. In explaining his reasoning, Holmes said, "The property may be denied, but the confidence cannot be." Yanked from its narrow factual context, this dictum became the central reference point for those who sought to re-cast trade secret law more narrowly than the courts had been applying it.

Restatement of Torts Chokes but Doesn't Kill Trade Secret Law

The Restatement of Torts was issued by ALI in 1939, and it declared that "trade secrets" were strictly limited to "a process or device for continuous use in the operation of the business," judged according to a non-exhaustive list of six abstract factors. Explicitly excluded was "information as to single or ephemeral events in the conduct of the business" such as secret bids, unannounced policies or products, financial information, "plans for expansion or retrenchment," and presumably the entire record of a company's experimental research leading to a protectable process or product. That kind of information, even if "confidential," was protected only against deliberate espionage. Even information coming within the cramped definition of a trade secret would be unprotected against "innocent" possession by a third party who had changed its

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Without apparent consideration of the contrary view expressed long before in *Peabody v. Norfolk*, the drafters of the Restatement flatly rejected the property rationale of trade secret law and deliberately distanced it from other forms of intellectual property by declaring that “protection is not based on a policy of rewarding or otherwise encouraging the development of secret processes or devices. The protection is merely against breach of faith and reprehensible means of learning another’s secret.”

The most consequential of these pronouncements was the shunting off into a separate category all “confidential” information that was not “in continuous use” in the business. This orphaned class, as we can appreciate from the perspective of the 21st century information age, contains some of a company’s most valuable data assets, including all of the records of experimentation leading to the launch of a successful product. The authors of the Restatement simply waved it away by observing that they weren’t dealing with it, unless there had been deliberate espionage. This maltreatment of “merely confidential” information naturally and understandably led courts to find other theories to justify its protection. This is how we came to use the law of “misappropriation” or “unfair competition” to try to protect information that doesn’t “rise to the level” of a trade secret.

The Supreme Court Rides to the Rescue

If only everyone had waited until 1974. That happened to be my first full year of practice as a lawyer, and it was when the U.S. Supreme Court decided *Kewanee v. Bicron*, confirming that the state “common law” on trade secrets was consistent with, and not preempted by, federal patent law. *Kewanee v. Bicron*, 416 U.S. 470 (1974). The idea that it should be preempted had been promoted by a group of commentators – suspiciously thick with law professors – who saw supporting secrecy as antithetical to the patent law’s goal of public disclosure of innovations. No, said the Supreme Court, trade secret law in fact enhances innovation by ensuring continued control over secret processes, and it avoids hoarding and enables dissemination through licensing; in any event, it’s been around a long time (remember that chocolate recipe?), and Congress has not raised an objection. It is in fact a form of intellectual property.

Kewanee v. Bicron ushered in the modern era of trade secret law. We got the Uniform Trade Secrets Act beginning in 1979, the Economic Espionage Act in 1996, and the Defend Trade Secrets Act in 2016. All of these frameworks – along with the new (third) Restatement from ALI in 1995 – embraced an extremely broad definition of what could be a trade secret. Virtually any information that gives business some sort of advantage can qualify, as long as it’s not generally

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product (making possible all those dramatic unveilings by Steve Jobs), as well as the “negative” secrets accumulated during a long and expensive process of experimental research and development.

So, as a practical matter, the phrase “not rising to the level of a trade secret” should have as much meaning as “it’s your nickel” (sorry, millennials, that’s from the time of coin-operated phones and it means “I’m ready to listen to you”). And realizing that “trade secret” now encompasses this vast sea of important business information that used to be treated separately, we can stop making the distinction, right?

It’s Hard to Let Go

Unfortunately, habits die hard, and there’s a lot of inertia built into the old nomenclature. Many companies insist on “confidential” as a separate category of data, distinct from secrets. And in fairness, businesses handle some personal information about individuals that has to be protected even though it doesn’t belong to the company. But for most organizations, there is a real benefit to treating “secret,” “proprietary,” “company private,” “confidential,” and other similar terms as just synonyms describing information for which the business wants to control access.

That doesn’t mean that you shouldn’t use “confidential information” as a broadly defined term in your contracts. It also doesn’t eliminate classification systems that distinguish among various kinds of information according to their sensitivity by using some of these terms like “private” or “restricted” or “top secret” to signal different levels of required care. But try to avoid suggesting to the workforce that there is a meaningful difference between the company’s “confidential information” and its “trade secrets,” because that might be interpreted to say that the former is not entitled to the same legal status as the latter.

Shakespeare’s question, posed by Juliet, was meant to be rhetorical – whatever name you pick (e.g., Capulet, Montague) doesn’t affect the essential quality of a person. You can’t say the same for valuable business data, because we have a lot of people dealing with it, and we don’t want them to be confused or to misunderstand. Modern trade secret law gives business very wide discretion about how to maintain control over its information assets. We should be careful not to surrender any of that discretion through misuse of terminology.

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James Pooley is one of the world's foremost experts in trade secret law and management. His first volume, "Trade Secrets," updated semi-annually, is the leading lawyer's desk reference on the [\[...see more\]](#)

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Jim Pooley

August 2, 2022 01:09 pm

Yes, the duration of the secrecy obligation is very important and often overlooked. The recipient doesn't want to be perpetually burdened. But the information's value may have genuinely open-ended life. Unfortunately, just labeling something as "CI" and other information as "trade secrets" begs the central question, and the only way to resolve it is to identify specifically what falls into the temporary category and what should be longer-lasting or even permanent. Specificity in the NDA helps avoid misunderstanding.



Gene

August 2, 2022 12:19 pm

I've seen NDAs that explicitly do not require CI to be marked as such. It may include information perceived by persons traveling within the premises of the Discloser. The information so disclosed may include trade secrets. CI must be kept confidential by the Recipient for five years; trade secrets for as long as the information remains secret. Totally ridiculous. So yes, there is an absolute need to distinguish CI from trade secrets, lest all NDAs impose a perpetual obligation.



Jim Pooley

July 31, 2022 11:22 am

Professor Sandeen disagrees with my suggestion that, in dealing with employees, businesses should feel comfortable treating "confidential information" the same as "trade secrets." She emphasizes the legal definition of a trade secret which includes the requirements of value and reasonable efforts. But that misses the ultimate point of my article, which is that in communicating with the workforce to avoid

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The main reason I wrote this piece was to explain how the courts were doing just fine developing the common law of trade secrets until a group of professors came along to “restate” it in a way that satisfied their narrow conception of property rights. I wanted to shine a light on how much trouble that caused us. And it still does today. Professor Sandeen closes her comment by insisting that the “property status of confidential information not meeting the definition of a trade secret is weak to non-existent.” But the U.S. Supreme Court seems to disagree: “Confidential business information has long been recognized as property.” *Carpenter v. United States*, 484 U.S. 19, 26 (1987), citing *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1001-1004 (1984).

That said, I wasn't trying to argue that all confidential information should automatically qualify as a trade secret. The other two legal requirements are of course important to establish if you need to enforce your rights. But if you try to communicate with your employees about the issue in legal terminology, or by making distinctions between “confidential information” and “trade secrets,” you will lose their attention. As we all know, it's employee carelessness that leads to most information loss. Let's try to keep it simple for them.



Sharon Sandeen

July 29, 2022 09:42 am

I disagree. The former, “confidential information,” is often distinct from trade secrets and I think it is a mistake to equate the two, in business practice and litigation. Trade secrets are confidential information that meet 2 other requirements. Thus, not all confidential information is a trade secret.

But, I agree from a business planning perspective that employees can and should be contractually obligated to protect both types of confidential information: that meeting the definition of a trade secret and that which does not. But I have come to the conclusion that there are risks to using language of trade secrecy in confidentiality agreements, at least in the description of information to be protected, particularly if the agreement is reciprocal. A critical risk is it will be deemed an admission of the status of the information when such is a legal conclusion. Thus, confidentiality agreements need to be worded carefully.

Without a confidentiality agreement that applies to all forms of confidential information, there is no way for companies to state a successful claim if the information does not meet the definition of a trade secret. With such an agreement, there would be two possible claims: breach of contract and trade secret misappropriation. (But I know Jim knows this).

Finally, the asserted property status of confidential information not meeting the

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