Trade Secrets and Intellectual Property When Dealing with Vendors and Suppliers

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The four main varieties of intellectual property ("IP") are patents, copyrights, trademarks and trade secrets. Patents protect rights in inventions that are new and useful processes, machines, manufactures, or compositions of matter, or any new and useful improvements thereof. 35 U.S.C. § 101. Copyrights protect originals works of authorship capable of being fixed in tangible media, such as, among other things, literary works, pictorial works, audiovisual works, and architectural designs. 17 U.S.C. § 102.

Trademarks can be, among other things, words, phrases, symbols, devices or logos, or combinations thereof, that identify a company as the source of a product or service. 15 U.S.C. § 1127. Trade secrets are, among other things, processes, skills, methods or know how not generally known to the public that give their owner an advantage in practicing the owner's trade or profession. Uniform Trade Secrets Act § 1.4.

Patent rights arise first in the inventor, but an employer can under certain circumstances compel an employee-inventor to assign the employee's patent rights to the inventor. *Standard Parts Co. v. Peck*, 264 U.S. 52 (1924). The copyright in works created by an employee resides in the employer as a work for hire, absent a contrary written agreement. 17 U.S.C. § 101. Enforceable trademark rights arise with use of the mark in connection with the sale of a product or service in commerce. *Trade-mark Cases,* 100 U.S. 82 (1879). Trade secret ownership will vary with the facts of the particular situation, but in practice are typically owned by the company or person who developed them, as long as they are protected from unnecessary disclosure.

All varieties of IP may be licensed non-exclusively either expressly by way of a writing or orally, as well as by implication. The better practice, for the sake of clarity and protection of rights, is to memorialize all licenses in writing. Actual conveyance of ownership of copyrights patents and trademarks must be by way of a writing. 17 U.S.C. § 204; 35 U.S.C. § 261; 15 U.S.C. § 1060. Because of their unregistered and intangible nature, conveyance of trade secrets should always be accomplished by way of a writing. *See, e.g., Chemetall GMBH v. ZR Energy, Inc.*, 320 F.3d 714 (7th Cir. 2003)

Depending on the nature of the relationship, either the vendor or the customer, or both, may have a hand in the creation of protectable IP. Further, even if neither the vendor nor the customer creates IP during the relationship, one or both may be licensing or otherwise providing access to IP during the relationship.

When dealing with an independent contractor vendor or supplier, a customer must take care to obtain either an express conveyance of the IP rights in the vendor's work product or a license sufficient to address the customer's business needs. Whether a conveyance of ownership rights is more appropriate or reasonable to expect than a license typically depends on factors such as much the customer is paying for the work product and whether the work product is specific to the customer rather than generic to all of the vendor's customers or licensees.

Restrictive Covenants and Nondisclosure Agreements

Restrictive covenants and nondisclosure agreements are commonly used and effective tools to protect the confidential nature of trade secrets and other proprietary data. Restrictive covenants are provisions that prevent a person or an entity from engaging in an activity, soliciting a set of clients, or competing for a stated period of time.

The three key dimensions of restrictive covenants are the time, geography and field of endeavor affected by the covenant. A customer should take care in drafting such provisions, because courts are reluctant to enforce overly broad restrictive covenants because their application threatens to deprive the affected workers of the ability to make a living. *See, e.g., PharMethod v. Caserta*, 382 Fed. Appx. 214 (3d Cir. 2010). There are also potential antitrust issues when actual or potential competitors agree not to compete for certain business or for certain customer. *See, e.g., Nichols v. Spencer International Press, Inc.*, 371 F.2d 332 (7th Cir. 1967).

Courts will require a party seeking to enforce a restrictive covenant that the covenant's scope is "reasonable" in relation to the competitive harm sought to be avoided, balanced against the interest of the employee in making a living, in light of the interests of the public. *PharMethod*, *supra*. Some courts have a practice of "blue-lining" an overly broad covenant to enforce its restrictions in a more narrow way. *See The 7's Enter., Inc. v. Del Rosario*, 111 Haw. 484 (2006). Others refuse to do so and invalidate the entire provision. *See Kalani v. Gluska*, 64 Cal. App. 4th 402 (1998).

In light of this uncertainty and unevenness in the handling of restrictive provisions, the better practice is to have a legitimate and rational basis, in light of the commercial and competitive realities facing the customer, behind the contours of any restrictive covenant. In addition, as with other important aspects of the contract, the customer should objectively define the classes of customers, business, or fields of endeavor that are off-limits for the vendor to pursue. Ambiguity with respect to these items often incentivizes opportunistic behavior on the vendor's part and jeopardizes the customer's ability to prevail in any resulting litigation.

Non-disclosure agreements are either free-standing agreements, or sets of provisions within agreements, whereby one or both parties agree to keep certain categories of information confidential and/or to limit use or disclosure of information to certain permissible purposes outlined in the agreement.

As with restrictive covenants, to be most effective, non-disclosure agreements should be as specific as possible. Ideally, they should name the specific items of intellectual property or proprietary information sought to be protected. This will reduce the possibility of a factual dispute over whether a particular item is within the agreement's intended scope.

Preliminary or temporary injunctive relief is often the most effective, and in some cases, the only effective remedy with respect to threatened unfair competition and improper disclosure of confidential information. Courts are sometimes reluctant to grant this type of relief because the parties have often not had the opportunity to have full discovery and the opportunity for a full trial on the merits. For this reason, courts require a heightened showing as a prerequisite to obtaining this kind of relief. Typically, to obtain injunctive relief, a movant must demonstrate (1) a likelihood of success on the merits of the claim; (2) the imminent threat of irreparable harm that cannot be addressed by monetary damages; (3) that the defendant will not suffer more harm from the grant of the injunction than the movant would suffer if an injunction did not issue; and (4) that the grant of an injunction would serve the public interest. *New York Pathological & X-Ray Laboratories, Inc. v. Immigration and Naturalization*, 523 F.2d 79 (2d Cir. 1975).

In light of this required showing, customers should move quickly in the event of a threatened or actual breach of a restrictive covenant or non-disclosure agreement. Otherwise, the court may not be convinced that the customer is at risk of imminent harm, or that the harm is such that the parties cannot wait until the ultimate resolution of the lawsuit. Together with clear drafting and thoughtful and reasonable construction of the scope of a restrictive covenant or non-disclosure agreement, quick action to enforce these provisions will maximize the customer’s probability of obtaining meaningful relief.