

3. Incentive Mechanisms for Incremental and Minor Innovations under Unfair Competition Law and Trade Secrets Law in Sri Lanka

'He who has no hope that he shall reap will not take the trouble to sow'.
Jeremy Bentham³⁶⁴

In the preceding Chapter, I have attempted to explore the possibility of protecting minor and incremental innovations under the existing IP paradigms; namely, patent and designs. The remit of this Chapter is, therefore, to consider whether and to what extent unfair competition and trade secret regimes can be used to protect innovative achievements of enterprises, especially those of SMEs in the Sri Lankan context. Generally speaking, while the rules against unfair competition supplements in some cases IP protection, trade secrets protection is an alternative to other IP rights such as patents. As a caveat, however, it should be borne in mind that unfair competition law does not grant exclusive rights as in the case of patent or design, rather it prohibits and provides remedies against specific acts of misappropriation. Perhaps more importantly, even though the trade secret regime would come under the umbrella of unfair competition law, for the purposes of this Chapter, it is treated separately given its increasing importance in incentivising innovation in the current business environment in Sri Lanka.

3.1. Unfair Competition Law

As Lord Justice Peterson has stated 'what is worth copying is worth of protecting'³⁶⁵ and the underpinning idea of unfair competition law is to prevent someone reaping where he has not sown. In the realm of IP law, the protection against unfair competition falls outside the hard-core IP themes and is considered to be the 'fallback protection', especially when

364 J Bowring, *The Works of Jeremy Bentham* (vol 3 -part 1, William Tait 1839) 71.

365 *University of London Press Ltd v. University Tutorial Press Ltd* (1916) 2 Ch. 601, 610.

there is no other specific IP right available. Arguably, one can of course make a strong case for developing a misappropriation-based unfair competition regime as a third IP paradigm for the protection of products that fall through the crack between patent and copyright.³⁶⁶ Indeed, from an innovation perspective, mostly though not necessarily, an unfair competition law regime ensures fair play in the market and reduces the risk of an economic injury to a business, thereby creating incentives to invest in innovation. Significantly, the rational basis for protection against unfair competition can be traced as to protect competitors by ensuring trade values to be observed in the market on one hand, and to safeguard the interests of consumers, as well as public at large, on the other.

3.1.1. Introduction

The concept of unfair competition, *concurrence déloyale*, emerged in France around 1850.³⁶⁷ According to scholars, “it is not known who originated the use of this widely-adopted legal concept. It is known, however, who provided the impetus for creating a law of competition: the businessmen, the honorable merchants who under the new free competitive system saw no other means of protecting themselves from unlawful competition. In order to satisfy their needs, the French courts, working from the Code Napoléon, developed a law against unfair competition”.³⁶⁸ Over the years, unfair competition law has developed to remedy the *lacunae* between rights and it provides an alternative approach to avoiding situations deserving of protection falling into the ‘gap’ which lies between the specifically defined IP right and public domain, in particular, in guarding the interests at stake when new ideas are developed.³⁶⁹ Conversely, one might still argue that the habit of relying on unfair competition regimes to protect innovations carries many drawbacks.

366 See DS Karjala, ‘Misappropriation as a Third Intellectual Property Paradigm’ (1994) 94 *Columbia Law Review* 2594, 2604-2605.

367 G Schrieker, ‘Unfair Competition and Consumer Protection in Western Europe’ (1970) 1 *International Review of Intellectual Property and Competition Law* 415, 415.

368 *Ibid.*

369 C Colston and K Middleton, *Modern Intellectual Property* (2nd edn, Cavendish Publishing 2005) 37-38.

Viewed from an economic perspective, a free market economy implies competition. Competition is the ‘great regulative force’ which establishes control over economic activities.³⁷⁰ The freedom to engage in business and to compete for the patronage of prospective customers is the fundamental premise of the free enterprise system. Competition in the marketing of goods and services creates an incentive to offer quality products at reasonable prices and foster general welfare by promoting the efficient allocation of economic resources.³⁷¹ Most notably, competition encourages innovation in two ways. First, it pressures companies to introduce new or improved products or services that win them additional customers, or to keep up with the innovations introduced by their competitors.³⁷² Second, competition creates pressure to reduce costs or improve the quality of existing products.³⁷³ The law of course favours the doctrine of free competition; but where there is competition; there is also the likelihood of unfair competition. In today’s global market, safeguarding free but fair competition in the market has become even more important.³⁷⁴

Unfair competition law is one of the most important areas of law in the face of increasing globalization and free market economy, even as it remains an elusive area of law. A recent study by the World Intellectual Property Organisation (WIPO) has revealed that the many different national legal systems which offer protection against unfair competition throughout the world have many common elements, but also employs the diversity of norms in use throughout the world.³⁷⁵ It is certainly true that terms such as ‘honest practices’, ‘good customs’, ‘good faith’ and ‘professional correctness’ escape clear-cut universal definitions. Very broadly, an act of unfair competition may be defined as ‘any act that a competitor or

370 A Terry, ‘Unfair Competition and the Misappropriation of a Competitor’s Trade Values’ (1988) 51 *Modern Law Review* 296.

371 JC Ginsburg, J Litman, ML Kevlin, *Trademark and Unfair Competition Law: Cases and Materials* (4th edn, Foundation Press 2007) 1.

372 Economic Commission for Europe-The Committee on Economic Cooperation and Integration, ‘Good Practices and Policy Recommendations: Intellectual Property and Competition Policy as Drivers of Innovation’ (Economic and Social Council of the United Nations, Geneva, 26 September 2012, document prepared by the Secretariat) 2-3.

373 *Ibid* 2.

374 A Kamperman-Sanders, *Unfair Competition Law: The Protection of Intellectual Property and Industrial Creativity* (Clarendon Press Oxford 1997) 1.

375 *Ibid* 56.

another market participant undertakes with the intention of directly exploiting another person's industrial or commercial achievement for his own business purposes without substantially departing from the original achievement'.³⁷⁶

3.1.2. The International Dimension

As commentators have pointed out, it is quite difficult to determine what is meant by the term 'unfair competition'. The very term 'unfair competition' is paradoxical, and therefore it is very difficult to define.³⁷⁷ There is certainly no international consensus on the meaning of the term, and neither is there anything like an international unfair competition convention. As a result, there is no real starting point for an understanding of unfair competition either in Europe, the US or any other part of the world. One possible starting point is the Paris Convention.³⁷⁸ The original Convention of 1883 (Paris Convention) did not carry any specific provision concerning the repression of unfair competition and the Article 10bis which postulated the principle of unfair competition was newly inserted by the Revision Conference of Brussels in 1900.³⁷⁹ Then the Revision Conference in Washington in 1911 went further by introducing an obligation for all States adhering to this revision to provide effective protection against unfair competition.³⁸⁰ Most importantly, the definition and examples of acts of unfair competition were introduced at the Hague Conference in 1925 and the Lisbon Conference in 1958.³⁸¹ Article 10bis of the Paris Convention contains the law against unfair competition in a nutshell, or rather part of such a law, since that article contains no provisions concerning the legal

376 UNCTAD-ICTSD, *Resource Book on TRIPS and Development* (Cambridge University Press 2005) 521.

377 G Dworkin, 'Unfair Competition: Is the Common Law Developing a New Tort?' (1978/9) 1 European Intellectual Property Law Review 241.

378 Paris Convention for the Protection of Industrial Property of March 20, 1883 as last revised in 1978.

379 GHC Bodenhausen, *Guide to the Application of the Paris Convention for the Protection of Industrial Property* (BIRPI 1968) 142.

380 *Ibid.*

381 *Ibid* 142-143.

consequences of violation of the principles of unfair competition.³⁸² Most notably, the repression of unfair competition, according to Article 1(2) of the Paris Convention, is treated as a part of the protection of industrial property. As a result, the landscape of international unfair competition law has considerably changed in the last few decades.

Unfair competition is defined in the second paragraph of Article 10bis as ‘any act of competition contrary to honest practices in industrial or commercial matters’.³⁸³ In other words, any act of competition will have to be considered unfair if it is contrary to *honest practices in industrial or commercial matters*.³⁸⁴ As argued by scholars, this criterion is not limited to honest practices existing in the country where protection against unfair competition is sought.³⁸⁵ Of course, the term ‘honest’ is a flexible one, and arguably, courts should adopt a purposive interpretation in order to achieve the underlying objectives of the provision. Moreover, three types of behaviour are explicitly prohibited in Article 10bis (3), creating the risk of confusion, discrediting or denigrating competitors through false allegations, and making misleading indications or allegations about one’s own goods. However, this list of examples is not enumerative, so other dishonest competitive acts can also be covered by the general clause.³⁸⁶ For example, the act of unfair free riding on the back of other competitors’ achievements (case of unfair coat-tail riding), misappropriation or violation of others’ trade secrets, comparative advertising, touting such as offering bonuses and many other acts, although not expressly mentioned, would arguably come into this catalogue. The general clause (the second paragraph of Article 10bis) can be considered the heart of every law on unfair competition. Most significantly, such a general clause seems necessary in order to accommodate ever-changing market practices. Moreover,

382 G Schricker, ‘Twenty-Five Years of Protection against Unfair Competition’ (1995) 26/4 International Review of Intellectual Property and Competition Law 782, 782.

383 See also F Henning-Bodewig, and Gerhard Schricker ‘New Initiatives for the Harmonization of Unfair Competition Law in Europe’ (2002) 24/5 European Intellectual Property Law Review 271, 272.

384 GHC Bodenhausen, Guide to the Application of the Paris Convention for the Protection of Industrial Property (BIRPI 1968) 144.

385 Ibid.

386 F Henning-Bodewig, ‘International Protection Against Unfair Competition – Article 10bis Paris Convention, TRIPS and WIPO Model Provisions’ (1999) 30/2 International Review of Intellectual Property and Competition Law 166, 173.

it may also be assessed as a ‘gate of entry’ for consumer protection in the Paris Convention.³⁸⁷ Most national courts, however, have tended to construe this wide provision *ejusdem generis* with specified activities, and not as the catch-all provision that a literal reading of the article might suggest.³⁸⁸

Furthermore, the TRIPS Agreement refers to Article 10bis of the Paris Convention within the framework of the protection of geographical indications³⁸⁹ and undisclosed information.³⁹⁰ In particular, unfair competition law as such is not mentioned in Part II of the TRIPS Agreement and there is nothing in the language of TRIPS that would lead one to conclude that unfair competition law should be put on an equal footing with patent, trademark, copyright and design law.³⁹¹ Cornish argues that the TRIPS Agreement itself contains no substantial provisions on unfair competition, save for Article 39, when it is mentioned in relation to undisclosed information. The TRIPS Agreement therefore ‘reinforces’ the Paris Convention’s Article 10bis only by making the existence of that article binding on WTO states.³⁹² Arguably, Article 10bis should be viewed as the minimum threshold of protection against unfair competition. Compared with other disciplines of industrial property law, in particular, patent and trademark laws, the law of unfair competition is far less strongly developed in many countries of the world. In international law as well, the rules against unfair competition were recognized as part of the protection of industrial property relatively recently.³⁹³

387 G Dworkin, ‘Unfair Competition: Is the Common Law Developing a New Tort?’ (1978/9) 1 European Intellectual Property Law Review 241, 242-243.

388 Ibid.

389 Articles 22-24 of the TRIPS Agreement.

390 Article 39 of the TRIPS Agreement.

391 F Henning-Bodewig, ‘International Protection Against Unfair Competition – Article 10bis Paris Convention, TRIPS and WIPO Model Provisions’ (1999) 30/2 International Review of Intellectual Property and Competition Law 166, 178-179.

392 WR Cornish, ‘Genevan Bootstraps’ (1997) 7 European Intellectual Property Law Review 336.

393 G Schriker, ‘Twenty-Five Years of Protection against Unfair Competition’ (1995) 26/4 International Review of Intellectual Property and Competition Law 782, 782.

3.1.3. Current Legal Regime against Unfair Competition in Sri Lanka

Sri Lanka's IP Act of 2003 contains specific provisions on the protection against unfair competition. At first glance, the statutory scheme in section 160 first deals with the general clause followed by a list of non-exhaustive specific acts. Pursuant to section 160(1) of the Act, the term 'unfair competition' is defined as 'any act or practice carried out or engaged in, in the course of industrial or commercial activities, that is contrary to honest practices'. This broad definition is comparable with the basic principle postulated in Article 10bis (2) of the Paris Convention and it has reinforced the general clause. The basic elements of unfair competition under Sri Lankan law are: (1) any act or practice; (2) contrary to honest practices; (3) carried out or engaged in, in the course of industrial or commercial activities. According to commentators, the law refers to both 'act and practices' and the word 'practices' is used in addition to 'act' in order to avoid a strict interpretation of the word 'act' which can also include 'omissions'.³⁹⁴ In view of the WIPO Model Provisions, 'failure to correct or supplement information concerning a product test published in a consumer magazine, thereby giving a wrong impression of the quality of the product offered on the market, or failure to give sufficient information concerning the correct operation of a product or concerning possible side-effects of a product' can also be considered an act of unfair competition.³⁹⁵ Moreover, the phrase 'industrial and commercial activities' should be broadly construed so as to include not only the activities of enterprises providing goods and services, but also activities of professionals such as medical or legal practitioners.³⁹⁶ The meaning of 'contrary to honest practices' will be dealt with in the next section in the light of judicial pronouncements on the subject by Sri Lankan courts. Moreover, Section 160 embraces a wide spectrum of specific acts with much-detailed examples of instances of unfair competition. This includes acts of causing confusion or being likely to cause confusion with respect to competitors' goods or ser-

394 DM Karunaratna, *Elements of the Law of Intellectual Property in Sri Lanka* (Sarasavi Publishers 2010) 324.

395 WIPO, *Model Provisions on Protection against Unfair Competition: Articles and Notes* (WIPO 1996) 9.

396 Ibid. DM Karunaratna, *Elements of the Law of Intellectual Property in Sri Lanka* (Sarasavi Publishers 2010) 324.

vices,³⁹⁷ causing damage to goodwill or reputation including acts of dilution,³⁹⁸ acts that are misleading such as advertisements, any false or unjustifiable allegations, discrediting or denigration of competitors, etc.³⁹⁹ Most notably, the wordings of the provision indicate that the above acts are examples and not exhaustive. At first sight, it appears that Sri Lankan law has given wide and comprehensive protection for unfair competition in compliance with its international obligations.

3.1.4. Development of the Case-Law

Apart from the statutory provisions, the ramification of the case-law is of vital importance to understand unfair competition law in practice. Thus, an examination of evolving case-law of the superior courts in defining the boundaries of unfair competition law in Sri Lanka is warranted. The statutory law more often than not is far from perfect and the concepts that we read in IP law acquire better clarity when understood in the context of the application of the law by the courts to a set of facts in a real life dispute.⁴⁰⁰ Recent judicial decisions have perceptively recognized the importance of purposive interpretation of provisions relating to unfair competition. In particular, the decision of the Supreme Court in *Sumeet Research and Holdings Ltd. v. Elite Radio & Engineering Co. Ltd.*,⁴⁰¹ deserves a special notice in this regard. Most notably, the decision of Justice Mark Fernando in this case is a step in the right direction. In this case, for the first time, the Sri Lankan judiciary enthusiastically came out with an authoritative interpretation of the meaning of unfair competition embodied in Section 142 of the Code of Intellectual Property Act, No.52 of 1979,⁴⁰² (Section 160 of present Act). Arguably, the case also illustrates the court's willingness to expand the scope of protection in order to achieve the desired objectives

397 See Section 160(2); this sub-section in particular deals confusion caused by look-alike products and appearance of a product (get-up/trade dress).

398 See Section 160(3); significantly, anti-dilution protection has been introduced via this provision. Dilution can lessen the distinctive character of a trademark by blurring or tarnishment.

399 See Section 160(4) and (5).

400 Z Thomas, 'Intellectual Property Case Law Development' (2009) 14 Journal of Intellectual Property Rights 153.

401 (1997) 2 Sri LR 393.

402 Code of Intellectual Property Act No. 52 of 1979.

of the law. This case, of course, could have important and far-reaching implications in relation to unfair competition as applied in Sri Lanka. In expounding the phrase ‘contrary to honest practices in industrial or commercial matters’, Justice Fernando, in the *Sumeet Research & Holdings* case, gave a broad definition to include higher standards of conduct, norms of business ethics that do not merely restate existing legal obligations and the determination of such standards of conduct is a matter for the trial judge.⁴⁰³ Commendably, the *Post-Sumeet Research and Holdings* case law development suggests that Sri Lankan law is moving towards a broad and flexible concept of unfair competition. Perhaps more encouragingly, in *Viocom International Inc v The Maharaja Organization Ltd*, another landmark judgment of the Sri Lankan Supreme Court, recently recognized that unfair competition law safeguards not only the interests of the traders and service providers but also of the consumers.⁴⁰⁴

Perhaps more significantly, in *James Finlay and Company Ltd. v. Stassen Exports Ltd*,⁴⁰⁵ Justice CV Wigneswaran highlighted the importance of Sri Lankan law moving from the narrow passing off principle to a broader understanding of unfair competition law. As his Lordship rightly pointed out, there is no need for us to conclude that English law principles were introduced to Sri Lanka through the Code of Intellectual Property Act. The Act itself is based on the model of the United International Bureaus for the Protection of Intellectual Property (BIRPI). The Act must be interpreted as is, and any attempt to read into its provisions the principles and traditions peculiar to English law might do harm to the Act.⁴⁰⁶ Though this statement refers to the earlier Code, the importance of this judicial pronouncement is great. It is hoped that future decisions would follow the same path with this consistent pattern. There is absolutely no need to go back to the narrow scope of the passing off tort. One of the most significant changes that has occurred in the unfair competition law landscape in Sri Lanka in recent years is the move from the traditional English Common Law approach to a broader international concept of unfair competition. This trend has been amply demonstrated by the developments of the statutory regime and its approval by the judiciary in subsequent decisions. This positive development is more in line with the continental European

403 (1997) vol 2 Sri LR 393, 402.

404 As per Justice R Fernando (2006) vol 1 Sri LR 140, 150.

405 (2001) 3 Sri LR 336.

406 *Ibid.*

approach to unfair competition, which has found its way to set international norms through the Paris Convention and the TRIPS Agreement. Besides, the international unfair competition law anchored in Article 10bis has further been developed by WIPO Model Provisions on protection against unfair competition that has gone beyond these two key international instruments.⁴⁰⁷ In fact, the WIPO Model provisions are an extremely useful tool for countries wishing to adopt or improve their legislation on unfair competition. This progressive development no doubt, is useful for the Sri Lankan context in terms of interpretation of provisions set out in section 160 of the Act.

3.1.5. How Effective is Unfair Competition Law to Protect Sub-patentable Innovation?

Broadly speaking, an unfair competition regime provides protection for technical and non-technical achievements of business entities in Sri Lanka. Interestingly, as evidenced from relatively high numbers of reported and unreported cases, the protection against unfair competition has been popularly used by industrial and commercial sectors in the country, especially the competitors in the tea industry. The evidence gathered from interviews with large, medium and small enterprises suggests that there is a serious issue in relation to imitation and copying of new products in Sri Lankan markets. The survey evidence from judges, legal academics and lawyers in Sri Lanka has further confirmed that the unfair competition regime is one of the most used mechanisms in both trial and appellate courts. Little is known, however, about the effectiveness of the unfair competition regime as an instrument in protecting small incremental improvement from the exploitation of existing technologies by the SME sector. At first sight, unfair competition regime should be able to accord a reasonable protection for innovation that falls through the safety net of patent and design regimes. In reality, as earlier observed, unfair competition law has become a platform to introduce protection for all sorts of

⁴⁰⁷ WIPO, *Model Provisions on Protection Against Unfair Competition* (WIPO 1996). This model law is a type of guidelines and no binding effect under Public International Law.

achievements which IP laws cannot properly accommodate.⁴⁰⁸ But then again the question would arise as to whether such protection is appropriate and desirable from IP law policy perspectives. There lies a danger that the over-stretching of the unfair competition regime to accommodate sub-patentable innovation would undermine the delicate balance between the other IP regime on the one hand, and unfair competition on the other. Similarly, it might also be argued that the unfair competition law would have an adverse impact on the freedom of imitation. Cornish makes trenchant criticism of too carefree an adoption of wide-ranging unfair competition emphasizing the potential danger of such as a remedy.⁴⁰⁹ Perhaps more importantly, unfair competition rules supplement in some cases the protection of industrial property rights, such as patents and trademarks. Unlike the latter, however, the protection against unfair competition does not entail the granting of exclusive rights, thus a granting of license is not possible.⁴¹⁰ Another possible downside of relying on unfair competition to protect subpatentable innovations is that such protection relates to the conduct of an imitator, rather than what is imitated. Therefore, it is submitted that an unfair competition regime cannot be viewed as an effective protection mechanism as such.

3.1.6. Passing-off Action

In Sri Lanka, the passing off action is quite often pursued in infringement actions as the second or alternative course of action in a context where unfair competition is available. Arguably, this is an undesirable practice from a legal policy perspective. Since Sri Lankan law has been heavily influenced by English Common Law, the legal profession is inclined to use English legal principles. As a fact, English law remains skeptical about the

408 C Heath, *Intellectual Property Law in Asia* (vol 5, Kluwer Law 2003) Max Planck Series on Asian IP Law 155.

409 C Colsten and K Middleton, *Modern intellectual Property law* (2nd edn, Cavendish Publishing 2005) 39 (Cornish argues that such a remedy can all too easily become a weapon by which first entrants on the market can engage in legalistic bullying of those who would subsequently seek to compete with them).

410 UNCTAD-ICTSD, *Resource Book on TRIPS and Development* (Cambridge University Press 2005) 551.

value of a law of unfair competition.⁴¹¹ It traditionally refused to deal with concepts such as fairness or good faith in business, leaving the marketplace to determine its own morality without the force of legal sanction.⁴¹² The tort of passing off is a judge-made law that evolved through judicial precedent. The essence of the passing off action, as enunciated in the House of Lords decision of *Reddaway v Banham* by Lord Halsbury, is that ‘nobody has any right to represent his goods as the goods of somebody else’.⁴¹³ The tort of passing off is concerned with misappropriation by misrepresentation. It offers protection of goodwill against misrepresentations that would mislead the public as to the origin or quality of goods and services. In recent years, the passing off action has mostly been used in the context of trademark actions. As has been authoritatively established in *Reckitt & Colman v Bolden*, the case which has become a ‘traveling jurisprudence’ in many Common Law countries, the essential ingredients of passing off have now been reduced to three elements.⁴¹⁴ To establish the right of action, one must prove the ‘so-called classic trinity’: goodwill or reputation, misappropriation and damage. Goodwill has been defined as the ‘attractive force which brings in customers’.⁴¹⁵ Moreover, in a passing off action, the defendant must represent his goods or services to be those of the claimant,⁴¹⁶ and the claimant should have suffered damages due to the defendant’s conduct.

411 A Roberson and A Horton, ‘Does the United Kingdom or the European Community Need an Unfair Competition Law?’ (1995) 12 European Intellectual Property Law Review 568.

412 *Ibid* 569.

413 *Reddaway v Banham* (1896) AC 199, 204. See also WR Cornish and D Llewellyn, *Intellectual Property: Patents, Copyrights & Trade Marks and Allied Rights* (6th edn, Sweet & Maxwell 2007) 627.

414 As per Lord Oliver in *Reckitt & Colman v Bolden (Jif Lemon case)* (1990) RPC341. Previously in *Erven Warnink* case (1979) AC 731, another leading case Lord Diplock has set out a five factor test to establish a passing off claim, namely: (1) misrepresentation; (2) made by a trader in the course of trade; (3) to prospective customers of his or ultimate consumers of goods or services supplied by him; (4) which is calculated to injure the business or goodwill of another trader; (5) and which causes actual damage to the business or goodwill of the trader bringing the action.

415 RM Hilty and F Henning-Bodewig, *Law of Unfair Competition: Towards a New Paradigm in Europe?* (Springer 2007) 190.

416 P Torremans, *Holyoak and Torremans Intellectual Property Law* (4th edn, OUP 2005) 446-467.

In this context, it is important to understand the meaning of the words ‘misrepresentation’ and ‘misappropriation’ along with their conceptual underpinnings. The phrase ‘misrepresentation’ means saying something which is wrong or not true, while ‘misappropriation’ is taking away someone else’s trade values. In many continental European jurisdictions, protection is available against misappropriation of trade values as such. In contrast, English law only provides for misappropriation carried out by misrepresentation, that is, by saying something which is wrong. As a result English law provides for a limited scope of protection, despite the attempt by the House of Lords’ to liberalize the range of actionable misappropriation in the *Advocaat* case, a leading case on the issue.⁴¹⁷ Undoubtedly, the English law approach is much narrower in comparison to other continental European jurisdictions with regard to misappropriation of trade values. This difference is amply highlighted in the Privy Council decision of *Cadbury-Schweppes v. Pub Squash*.⁴¹⁸ In *Pub Squash* case, there was no misrepresentation whatsoever and no confusion caused between the drinks of the respective parties, which means that there is nothing wrong in that respect. The *Pub Squash* decision of the Privy Council is a clear case of misappropriation, because the defendant company had tried to take away the goodwill that the plaintiff company had built up with significant financial investment.

Unfortunately, the attempt to persuade the Privy Council to develop a concept similar to that which exists in continental Europe with regard to the right to restrain unfair competition by protecting trade values in the *Pub Squash* case was not welcomed by the Law Lords. The reluctance on the part of judiciary to expand the scope of passing off was demonstrated by the decision of Lord Scarman.⁴¹⁹ In hindsight, it very much depends on judicial creativity and the willingness of judges to stretch the boundaries of law. Perhaps Lord Denning said it best when he wrote that the develop-

417 As per Lord Diplock in *Even Warnink Besloten Vennootschap v. J. Townend & Sons (Hull) Ltd. and Other Respondents* (1979) AC 731. Most notably, this decision of House of Lord shows a high point in a gradual extension of passing off.

418 The decision of Privy Council (1981) RPC 429, in this Australian case, the plaintiff intensively promoted a lemon squash using various slogans and themes. The defendant launched his own squash and employed similar marketing and advertising themes. The Privy Council concluded that unfair competition is based upon misappropriation and there is no cause of action for misappropriation as such.

419 *Cadbury-Schweppes v. Pub Squash* (1981) RPC 429.

ment of law depends on ‘bold spirits and timorous souls’.⁴²⁰ According to Andrew Terry, ‘reaping without sowing’ will continue to haunt the intellectual property jurisdiction until one of Lord Denning’s ‘bold spirits’ pushes back the perceived limits of judicial doctrine and formalities in the judiciary’s sphere of influence, or the legislature intervenes.⁴²¹ The current status of English law relating to unfair competition is without critics. For instance, Gerald Dworkin states that unless it can be protected by one of the recognized IP or other ‘property rights’ reaping without sowing may escape liability.⁴²²

Nevertheless, Cornish argues that the fundamental British skepticism towards the expansion of unfair competition law is due to excessive protection. In England, consumers are protected by both criminal law and public authorities, with the result that there is no need for competitors’ actions to protect the consumer.⁴²³ There is no doubt that English law’s argumentation is based on the premise that too much protection would restrict free competition. The rationale of this argument would be that the world needs to keep a strict rein on the spread of unfair competition liability, for it can all too easily become a weapon by which first entrants on the successful market can engage in legislative bullying of those who would subsequently seek to compete with them.⁴²⁴ This English law approach with regard to passing off action has been followed by many Commonwealth jurisdictions including India, Pakistan, Sri Lanka and even Malaysia.

420 See the dissenting judgment of Lord Denning in *Candler v. Crane, Christmas and Co* [1951] 2 KB 164, 178 (the occasional victories of the ‘bold spirits’ over the ‘timorous souls’).

421 A Terry, ‘Unfair Competition and the Misappropriation of a Competitor’s Trade Values’ (1988) 51 Modern Law Review 296, 322.

422 G Dworkin, ‘Unfair Competition: Is the Common Law Developing a New Tort?’ (1978/9) 1 European Intellectual Property Law Review 241, 246.

423 RM Hilty and F Henning-Bodewig, *Law of Unfair Competition: Towards a New Paradigm in Europe?* (Springer 2007) 263.

424 WR Cornish, ‘Genevan Bootstraps’ (1997) 7 European Intellectual Property Law Review 336, 337.

3.1.7. Current Status of Passing-off Action in Sri Lanka

As the Sri Lankan legal framework is based on Common Law legal principles, their influence cannot easily be disregarded. Before the introduction of the Code of IP Act of 1979, the protection against acts of unfair competition was provided by the general concept of passing-off. Thus, one can reasonably argue that the passing of action is well established in the domestic legal system. Then a question that arises today is whether or not the action for passing off has, in view of the provisions relating to unfair competition embodied in the Act (formerly the Code of 1979), ceased to exist in the Sri Lankan legal system.⁴²⁵ There are two lines of argument on this point. It was pointed out by several members of the Sri Lankan judiciary (during our interviews with them) that there is absolutely no need to look for passing off action as it only protects just one form of unfair competition, namely, the protection of reputation or goodwill which is covered by the broad scope of an unfair competition regime. Thus, judges should not allow passing off action to be claimed and maintained in an action for infringement. Nevertheless, Karunaratna, one of the leading scholars in the field of IP in Sri Lanka, counter-argues this point and maintains that this question is yet to receive the attention of an authoritative court.

‘It is arguable that the statutory provisions on unfair competition cover the acts of passing off and consequently, the law of passing off has become irrelevant and redundant. On the contrary, it may also be arguable that the action for passing off is a remedy available in Common Law and it continues its presence in the law of Sri Lanka despite the statutory provisions relating to unfair competition. The Code of Intellectual Property Act or the IP Act of 2003 has not expressly abolished the action for passing off. Consequently, it appears that both the Common Law remedy and as well as the statutory remedy co-exist’.⁴²⁶

Even an analysis of earlier case-law would suggest a similar kind of conclusion that the passing off action remains unaffected, though the IP Act has not specifically provided for it.⁴²⁷ In light of the above, it seems logi-

425 DM Karunaratna, *Law of Trademarks and Service Marks in Sri Lanka* (Sarvodaya Vishva Lekha Publishers 1997) 145.

426 DM Karunaratna, *Elements of the Law of Intellectual Property in Sri Lanka* (Sarasavi Publishers 2010) 344.

427 Case law such as *Kapadia v. Mohamad* (1918) 22 NLR 314 and *Liver Brothers v. R. M. Renganathan Pillai* (1937) 39 NLR 332 provide argument for the above proposition.

cal to argue that the passing off action has been recognized by implication. Although the current IP Act has not explicitly preserved the passing-off action as a separate cause of action, the ramifications of case law supports the retention of the same. This argument can be buttressed by recourse to Justice Shaw's decision in *Kapadiya v Mohamed*, where the court held that even though passing-off actions are not specifically reserved in our trade mark Ordinance, such an action can be maintained under Sri Lankan law.⁴²⁸ Furthermore, our survey evidence suggests that there is a tendency of Sri Lankan legal practitioners to file actions based on passing off action. One possible explanation would be that they are more familiar with English Law principles than the IP Act. Yet another reason for this would be that the legal community is less familiar with the modern concept of unfair competition. This development is neither encouraging nor desirable as the concept of unfair competition attracts broader protection than the action for passing off. There is an uncertainty, however, as to the correct legal position. Understandably, the opinions are divided and some judges and academics consider that passing off action is still available in spite of the comprehensive protection scheme provided in IP Act. The question then arises, should there still be any role for the passing-off action in Sri Lanka? The answer is probably no. This answer follows logically from the provisions of the current IP Act which has a broader scope of protection though both unfair competition law and passing-off closely overlap. In short, the protection afforded by unfair competition law inevitably diminishes the role of passing-off action.⁴²⁹ Since there has been so far no decision on this issue under the new Act, one has to wait until Sri Lankan the Supreme Court is confronted with this issue in the future. But for the sake of argument, one can still highlight the importance of passing-off action as a gap-filler of trademark law as used in England.

3.1.8. Conclusion

In essence, unfair competition law regulates the behaviour of the competitors in the market and ensures that competition is fairly and properly carried on. The great strength of unfair competition is that it can extend pro-

428 *Kapadiya v. Mohamed* (1918) 20 NLR 314.

429 P Torremans, *Holyoak and Torremans Intellectual Property Law* (4th edn, OUP 2005) 446.

tection for subject matters that other IP rights cannot reach and tackles the problem of free riding and promotes innovation without creating unnecessary barriers for free competition. As noted before, however, the biggest weakness of unfair competition is that the concept is vague, difficult to define and imprecise. As commentators have pointed out, if the courts stretch the arm of protection too far to catch the areas previously unprotected, it would reach an undesirable destination by limiting the vigorous competition on which a market economy is based on. Paradoxically, unfair competition law would create a negative impact on free competition in the market. What is needed is a law to promote responsible business conduct without undermining the delicate balance between unfair competition on one hand, and other branches of IP law on the other. Viewed from a policy perspective, if the unfair competition regime is broadly interpreted to offer protection for incremental innovation, there would also be an allegation that it is creating protection through the back door. Moreover, protection against unfair competition does not entail exclusive rights such as to grant a license in the case of a utility model or petty patent systems.

In the Sri Lankan context, it is especially disappointing that despite the fact that the current IP Act provides broad protection for unfair competition the passing off action is still invoked in many cases of unfair competition probably due to the lack of awareness on the part of legal practitioners and the familiarity of Common Law principles practiced among the legal community for centuries. The case law development in recent years is rather encouraging and Sri Lankan law can be further developed by recourse to international jurisprudence, in particular, learning from the continental European experiences.⁴³⁰ Furthermore, in defining the boundaries of unfair competition law, it is essential that a balance is struck between, on one hand, the interests of competitors, and, on the other, the interests of consumers and the general public as a whole. Moreover, Sri Lankan courts should closely follow international developments and legislative patterns in order to meet new situations and circumstances. Only this type of approach will allow the future of unfair competition law of Sri Lanka to support one of the fundamental goals of a free market economy: fair competition in the market. Last but not the least, minor and incremental innovations may indirectly be protected under the existing unfair competition

430 For example, Germany-Act Against Unfair Competition 2004 (as last amended 1 October 2013) available at WIPO Official website: <<http://www.wipo.int/wipolex/en/details.jsp?id=14027>> (accessed 12 March 2013).

regime in Sri Lanka, but such protection may not be real or an ideal protection that would incentivise such innovations.

3.2. Trade Secrets Protection

'He who has received information in confidence shall not take unfair advantage of it'.

Lord Denning⁴³¹

3.2.1. Background and the Emergence of Trade Secret Law

As succinctly illustrated by Lord Denning, the legal concept of breach of confidence in Common Law jurisdictions emanated from the Chancery Courts in the nineteenth century.⁴³² Trade secrets law is a relative late-comer to the IP pantheon,⁴³³ and in many ways, trade secrets law is the 'Cinderella' of the IP law field, the forgotten step-daughter who toils in the shadow of her more privileged siblings: patent, copyright and trademark law.⁴³⁴ Even though trade secret law in its modern form in Anglo-American jurisprudence is a Common Law creation, there were forms of trade secret protection in Europe dating perhaps as far back as Roman times.⁴³⁵ In the world of IP, the legal protection of trade secrets (often referred to as undisclosed information) is considered to be 'soft intellectual property' which lies on the periphery of hardcore IP such as patent and copyright.⁴³⁶ According to Posner, IP rights tend to be limited in time, but there are forms of IP or quasi-IP that do not have durational limitation.⁴³⁷ One of the prominent exemptions to durational limitation of IP is trade se-

431 *Seager v. Copydex Ltd* (1967) 1 WLR 923, 931.

432 Ibid.

433 MA Lemley, 'The Surprising Virtues of Treating Trade Secrets as IP Rights' (2008) 61/2 Stanford Law Review 311, 315.

434 PK Yu (ed), *Intellectual Property and Information Wealth: Patents and Trade Secrets* (Praeger 2007) 399.

435 MA Lemley, 'The Surprising Virtues of Treating Trade Secrets as IP Rights' (2008) 61/2 Stanford Law Review 311, 325.

436 See also, Justice Raynor Asher, 'Breach of Confidence' (2009) March, IP Forum 3, 4.

437 RA Posner, 'Do We Have Too Many Intellectual Property Rights?' (2005) 9 Intellectual Property Review 173, 174-175.

crets protection. Posner further argues that trade secrets are IP in only a special sense because the main trade secret law only allows its owner to enforce tort law and contract law against efforts to appropriate some secret process or methods that he has. As long as copiers and imitators avoid violating tort law or contract law they can make use of other firms' secrets after disclosing them through legal means such as reverse engineering.⁴³⁸ Nevertheless, today, trade secrets are among the most valuable assets that enterprises own and the ability of companies to compete in any market depends on their ability to acquire and maintain a competitive advantage.⁴³⁹ Companies carefully guard essential and sensitive information that has an impact on a company's strength to compete. Protecting this sensitive information as a trade secret is one legal mechanism that companies generally use to this end.⁴⁴⁰ From a historical perspective, trade secrets laws developed as a substitute for the physical and contractual restrictions those companies would otherwise impose in an effort to prevent a competitor from acquiring their information.⁴⁴¹ Therefore, it appears that trade secret protection is a key aspect of creating a favourable investment climate for businesses in any country. Moreover, some commentators argue that trade secrets law is a useful supplement to patent law because it allows inventors to internalize more of the social benefit of their inventions.⁴⁴²

3.2.2. What is a Trade Secret?

Defining the term 'trade secret' is not an easy task, but, very broadly, a trade secret may include 'any information that can be used in the operation of a business or other enterprise and that is sufficiently valuable and secret to afford an actual or potential economic advantage over others'.⁴⁴³ Obviously, trade secrets are proprietary information that would include cus-

438 Ibid 175.

439 BH Malkawi, 'A Critical Look at Trade Secrets Protection in Jordan' (2012) 1 Intellectual Property Quarterly 123, 123.

440 Ibid.

441 MA Lemley, 'The Surprising Virtues of Treating Trade Secrets as IP Rights' (2008) 61/2 Stanford Law Review 311, 336.

442 D Friedman, W Landes and R Posner, 'Some Economics of Trade Secret Law' (1991) 5/1 Journal of Economic Perspectives 61, 64.

443 The American Law Institute, Restatement of the Law (Third) of Unfair Competition (1994) Section 39.

tomer lists, formulas, practices, manufacturing processes, designs and even business plans etc. Even though the TRIPS Agreement, by virtue of Article 2(1) has recognised ‘undisclosed information’ or trade secret as one of the categories of IP rights, it does not give a specific definition as to what undisclosed information means. Nevertheless, pursuant to Article 39(2), the TRIPS Agreement specifies what conditions that such information needs to meet in order to be protected as trade secrets. It is obvious from the wording of the article that such information should be secret, possess a commercial value and be subject to reasonable steps, under the circumstances, to be kept secret.⁴⁴⁴ From an innovation perspective, by creating a right to protect information, trade secrets (from European terminology, secret know-how) act as an incentive for investment in technological development.⁴⁴⁵ Moreover, trade secrets law provides the means to exclude third parties from misusing valuable knowledge and thus increases the competitive advantage and the expected returns of innovation. And it also provides a basis for technology transfer.⁴⁴⁶ Significantly, the theoretical underpinning of the protection for trade secrets may be traced primarily to two main theories. The first counts in its utilitarian justification, according to which the protection against the theft of proprietary information encourages investment in such information.⁴⁴⁷ The second is a duty-based theory which emphasizes the maintenance of commercial morality and thus the aim of trade secret law is to punish and prevent illicit behavior, and even to uphold reasonable standards of commercial behavior.⁴⁴⁸ Arguably, the trade secret regime provides an additional incentive to innovate beyond what may be possible under other IP rights, especially patents.

444 See also UNCTAD-ICTSD, *Resource Book on TRIPS and Development* (Cambridge University Press 2005) 521.

445 H Lovells-International LLP, Report on Trade Secrets for the European Commission (2012) 5.

446 *Ibid.*

447 MA Lemley, ‘The Surprising Virtues of Treating Trade Secrets as IP Rights’ (2008) 61/2 Stanford Law Review 311, 320.

448 *Ibid.*

3.2.3. Current Protection of Trade Secrets in the IP Act

Like in some other jurisdictions, even under Sri Lankan IP law, trade secrets are referred to as confidential information. The key provisions of the Sri Lankan trade secret law are found in the section for unfair competition. In other words, trade secret provisions are incorporated into the section dealing with the unfair competition. Presumably, the reason for not addressing trade secrets in a separate provision may be due to the legislature's thinking that trade secrets should be treated as a part or subset of unfair competition. Nevertheless, more encouragingly, by virtue of Section 160(6) of the IP Act of 2003, in the history of IP law has attempted to grant statutory protection for undisclosed information for the first time. Pursuant to Section 160(6)(a) any act or practice, in the course of industrial or commercial activities, that results in the disclosure, acquisition or use by others, of undisclosed information without the consent of the person lawfully in control of that information and in a manner contrary to honest commercial practices shall constitute an act of unfair competition. At a glance, this provision covers a large array of instances of disclosure, acquisition or use of trade secrets. More significantly, even though the Act does not define what undisclosed information means, it sets out what conditions that information needs to fulfill in order to qualify for protection as undisclosed information. Accordingly, information shall be considered 'undisclosed information' if: (i) it is not, generally known among, or readily accessible to, persons within the circles that normally deal with the kind of information in question; (ii) it has actual or potential commercial value because it is secret; and (iii) it has been subject to reasonable steps under the circumstances by the rightful holder to keep it secret.⁴⁴⁹ In fact, this provision corresponds to Article 39 of the TRIPS Agreement. Moreover, the wording of the provision reveals that such information shall include technical information, as well as business information. Arguably, it needs to be interpreted broadly and not as limitative.⁴⁵⁰

By following the approach of footnote 10 of the TRIPS Agreement, Section 160(6)(b) of the Act provides certain examples of disclosure, acquisition and use of undisclosed information 'contrary to honest commercial practices' including, industrial espionage, breach of contract, induce-

449 See Section 160 (6)(c) of the IP Act of Sri Lanka No 36, 2003.

450 See Section 160 (6)(e).

ment to breach of contract, and includes the acquisition of undisclosed information by third parties who knew, or were grossly negligent in failing to know, that such practices were involved in the acquisition of such information.⁴⁵¹ It is also evident that the IP Act has imposed legal obligations, by virtue of Section 160(6)(d), upon public authorities regarding the information coming to their possession. In particular, this provision provides protection for secret test data or other data that is submitted for approval from relevant regulatory authorities. Moreover, not only civil remedies, even criminal sanctions may be invoked against a person who willfully or without lawful authority discloses any undisclosed information.⁴⁵² As another important matter, Section 160(9) has expressly provided that, unlike in the case of unfair competition, provisions relating to undisclosed information in the Act exist in addition to the Common Law rights. It means that the Common Law action for breach of confidence remains unaffected by the provisions in the IP Act. Last but certainly not the least, the protection of undisclosed information under the provisions of the IP Act has been relied upon, before the Commercial High Court of Sri Lanka, at least, in several cases so far.⁴⁵³

3.2.4. Common Law Action for Breach of Confidence

The breach of confidence action is rooted in the law of equity and developed through principles and rules laid down by Chancery and Common Law courts. Sri Lanka being a Commonwealth country has long followed Common Law jurisprudence. Before the introduction of the New IP Act 2003, the breach of confidence action was the principle means of protecting trade secrets in Sri Lanka. As noted above, the current IP Act has specifically stated that the Common Law rights are unaffected by the pro-

451 TRIPS Agreement's footnote 10: 'For the purpose of this provision, 'a manner contrary to honest commercial practices' shall mean at least practices such as breach of contract, breach of confidence and inducement to breach, and includes the acquisition of undisclosed information by third parties who knew, or were grossly negligent in failing to know, that such practices were involved in the acquisition.'

452 See Section 160 (8), if convicted, such a person may be liable to a fine or to imprisonment or for both.

453 See *Mackwoods Ltd v. Manoj Wickramatunga & Another* (CHC/Case No: 37/2003(3)).

visions of section 160(6) relating to undisclosed information. Thus, it is obvious that the protection of trade secrets can be sought under principles of Common Law and equity as followed by Sri Lankan courts. One of the major advantages of the breach of confidence action is that, irrespective of the existence of contractual obligations, courts can grant remedies for breach of confidence by relying on the broad equitable doctrine that 'he who has received information in confidence shall not take undue advantage of it'.⁴⁵⁴ In cases of misuse of trade secrets, as they are more familiar with the Common Law rights, Sri Lankan legal practitioners are often inclined to file such cases based on the breach of confidence claim in the District Court (the first instance court on civil matters) instead of going to commercial high court on the basis of the provisions of IP Act. Bringing the action in the Commercial High Court, which is the specialized court for IP matters, would however have the advantage of getting the case heard by judges who are better aware of IP issues.

As enunciated by Megarry J in *Coco v. AN Clark (Engineers) Ltd*, a landmark case in Common Law jurisprudence, the main elements of breach of confidence action are: (1) information should have the necessary quality of confidence; (2) it should be imparted in confidence; and (3) the person who received the information must have misused it.⁴⁵⁵ Today, these elements of a breach of confidence action have become the general requirements and are followed in Common Law jurisdictions, including Sri Lanka. Moreover, as a result of further judicial developments of law in this area, the 'springboard' doctrine has emerged to prevent a person who is in breach of a confidentiality obligation from obtaining an unfair advantage, even when information is in the public domain. According to this doctrine, a person who has obtained information in confidence is not allowed to use it as a springboard for activities detrimental to the person who made the communication.⁴⁵⁶ Consequently, a person who has used the information in breach of confidence may still be under an obligation not to compete with the owner of the trade secret for a certain period of time even after the information ceases to be confidential. In a breach of confidence action, Common Law remedies of injunctions and damages are generally granted by the courts and a number of superior

454 As per Lord Denning in *Seager v. Copydex Ltd* (1967) 2 All ER 415.

455 (1969) RPC 41.

456 As per Roxburgh J in *Terrapin Ltd v. Builder's Supply Co. (Hayes) Ltd* (1967) RPC 375.

court decisions⁴⁵⁷ in recent years suggest that the beach of confidence action is fairly used by the Sri Lankan industrial sectors in protecting their valuable trade secrets. Nevertheless, the reliance on the Common Law action has its own downside because the judicial decisions in this area depend very much on the particular facts and circumstances of each case and the court has to decide on a case by case basis whether the information is qualified for protection or not. Of course, this task involves judicial anthropology, an endeavor at which the judges may not be particularly skilled and the judge, after all, is on the outside, looking in.⁴⁵⁸ Arguably, this would create clouds of uncertainty for the business sector that primarily rely on such protection. Nevertheless, it might still be argued whether there is a need for a separate trade secrets provisions in the IP Act when the Common Law principle would suffice.

3.2.5. Other Legal Regimes: Contract and Labour Law

The area of trade secrets law has a fascinating interface with other branches of law. Thus, courts, lawyers, scholars, and treatise writers argue over whether trade secrets are a creature of contract, tort, property, labour, or even criminal law. In that sense, trade secrets law is simply a compilation of bits and pieces of other laws.⁴⁵⁹ From a labour law perspective, the Common Law master and servant relationship imposes a duty of loyalty and fidelity upon all employees. As judicial pronouncements have further illuminated, such a fiduciary obligation is implied by the contract of employment.⁴⁶⁰ Most significantly, in many cases, business firms in Sri Lanka rely on contractual liability to prevent unauthorized disclosure of secret information and to stop employees walking out with trade secrets and join-

⁴⁵⁷ *Coats Thread Lanka (Pvt) Ltd v. Samarasundara* 2011 BLR 37, *Hently Garments Ltd v. JSA Fernando* (1980) 2 Sri LR 145. *Finlay Rentokil Ltd v. Vivekananda* (1995) 2 Sri LR 346. *Caldera v. John Keels Holdings Ltd* (1986) 1 CALR 575.

⁴⁵⁸ SL Carter, 'Custom Adjudication, and Petrushevsky's Watch: Some Notes from the Intellectual Property Front' (1992) 72 Virginia Law Review 129.

⁴⁵⁹ MA Lemley, 'The Surprising Virtues of Treating Trade Secrets as IP Rights' (2008) 61/2 Stanford Law Review 311, 312.

⁴⁶⁰ See *Robb v. Green* (1895) 2 QB 315.

ing other competitors.⁴⁶¹ These contractual arrangements can generally take the form of either non-disclosure or non-compete covenants. As many other Common Law courts, Sri Lanka, has been very reluctant to enforce such contracts in restraint of trade, especially post-contractual obligations involving ex-employees, citing public policy reasons. Critics point out that these covenants impose draconian limits on the mobility of employees in the ever-changing employment market. Thus, it might still be argued that an ex-employee is free to use the skill and knowledge acquired during employment in exercising his or her profession.

An analysis of the latest case-law of the Sri Lankan Supreme Court shows that the courts engage in a two-step inquiry into post-employment obligations. Whenever the employer tries to enforce such restrictive clauses, courts first examine whether the contract is so restrictive of the employee's liberty, and if so, the agreement is considered to be *prima facie* void.⁴⁶² Then it is up to the employer to show that the covenant can be justified as being reasonable in the light of the interests of both parties and the public.⁴⁶³ Sri Lankan courts have adopted the test of reasonability in ascertaining the validity of any covenant of restraint of trade.⁴⁶⁴ In analyzing reasonableness, the court needs to investigate whether the post-employment restrictions are justifiable in terms of scope, geography and time to protect the legitimate interests of the employer in view of employee's freedom of employment. Arguably, courts have to achieve a reasonable balance between economic incentives for employers on the one hand and the employee's interests in maintaining his employment option on the other. Nevertheless, the law in this area is neither clear nor well-settled and the outcome of the case depends on the particular facts and circumstances of each individual case. Sri Lankan court decisions are highly influenced by Common Law case-law developments in this area of law. Viewed from a different perspective, the legal regimes under the trade secrets law and

461 WADJ Sumanadasa, 'The Intersection of Contract Law with IP Law in the Protection of Undisclosed Information: A Sri Lankan Perspective' ((2012) Annual Research Symposium of the University of Colombo, Sri Lanka 160-162.

462 *Finlay Renckottill (Ceylon) Limited v. Vivekanthan* (1995) 2 Sri LR 345.

463 As per Ranasinghe J in *Hentley Garments v. GSA Fernando* (1980) 2 Sri LR 145.

464 See JAN de Silva CJ in *Coats Thread Lanka (Pvt) Ltd v. Samarasundara* (2011) BLR 37.

restraint of trade agreements are not mutually exclusive, but overlapping.⁴⁶⁵ On the other hand, trade secrets law goes beyond contract law and reaches where contract law alone cannot.⁴⁶⁶ However, the most serious concern with contract law is that its protection is limited to privity of contract. It means that, whenever an outsider or third party is involved in the act of misappropriation of trade secrets, contract law has no satisfactory remedy.

3.2.6. Empirical Evidence

The survey evidence gathered from large and SME sectors suggests that the use of trade secrets protection in the Sri Lankan industry is quite encouraging.⁴⁶⁷ The information obtained through telephone interviews with the Sri Lankan SME sector has confirmed that many firms (more than 60 percent) use at least informal means of secrecy to protect their products and processes. Most of them utilize access restrictions to control valuable information getting into the hands of their competitors. Nevertheless, firms in the SME sector hardly use legal advice in protecting their trade secrets. Almost none of the respondent firms had any in-house lawyers or counsels to provide necessary assistance to deal with trade secrets issues. Most notably, at least several SMEs in the TK-based product sector (i.e. herbal beauty-care products and its herbal medicine industry) have employed legal officers to deal with undisclosed information and issues relating to employment contracts with employees. Thus, it is evident that the TK-based industrial sectors especially use trade secret protection as an ap-

465 WADJ Sumanadasa, 'The Intersection of Contract Law with IP Law in the Protection of Undisclosed Information: A Sri Lankan Perspective' ((2012) Annual Research Symposium of the University of Colombo, Sri Lanka 160-162.

466 MA Lemley, 'The Surprising Virtues of Treating Trade Secrets as IP Rights' (2008) 61/2 Stanford Law Review 311, 331-332.

467 Information gathered through conducting face to face interviews and detailed telephone interviews with the owners, managers, and legal officers of large, small and medium sized enterprises consisting of 5 large and 25 SMEs in Sri Lanka. These respondent-firms were selected from a list of SMEs in Sri Lanka, whose contact details were obtained from the government Ministry of Productivity Promotion and 5 other large companies were selected representing different industrial and commercial sectors in Sri Lanka. These interviews were carried out in 2011 and 2012.

propriate means of protecting their innovative products and processes. Moreover, a large part of TK-based enterprises belong to so-called ‘family businesses’ and it is observed that such firms keep their traditional recipes and formulas within family boundaries. As a general matter, expenses and costs involved in securing patent or other IP rights have encouraged SMEs to use secrecy in their innovative activities. It is notable, when asked about the reasons for not using the patent system to protect innovation, not only the SMEs sector but also large firms answered that they have serious concerns about the disclosure requirement and they did not want their competitors to see their valuable information. Significantly, there is both logical and evidentiary reason to believe that, even though trade secrets protection may not be very effective to protect innovative achievements of firms, many enterprises use such protection mainly due to the lack of awareness of other IP regimes, procedural impediments (difficulties) in acquiring IP rights and various costs involved in maintaining and enforcing IP rights. As commentators have rightly pointed out, SMEs often use trade secrets protection by default, i.e. as a way of avoiding the expenditure and administrative procedures involved in patent protection, without taking adequate measures that need to be in place in order to ensure that confidential information is considered a legally protectable trade secret.⁴⁶⁸

3.2.7. Why is Trade Secrets Protection so Attractive?

Probably, due to the strategic importance of trade secrets protection, many firms rely heavily on such protection, irrespective of being big or small. According to scholars, keeping an innovation as a trade secret offers its owners some significant advantages over other forms of IP rights.⁴⁶⁹ It is cheaper and quicker to obtain, since it does not require government approval, and it extends the protection to types of business and process information that are unlikely to be patentable.⁴⁷⁰ Interestingly, there is a growing number of innovators who do not wish to apply for patent protection due to the disclosure requirement and they fear that, if the relevant infor-

468 WIPO, *Intellectual Property Rights and Innovation in Small and Medium-Sized Enterprises* (WIPO 2004) 9.

469 MA Lemley, ‘The Surprising Virtues of Treating Trade Secrets as IP Rights’ (2008) 61/2 Stanford Law Review 311, 313.

470 Ibid.

mation is disclosed, their products would easily be copied by competitors. Moreover, unlike other IP rights, a trade secret can be protected for an indefinite period of time as long as it remains secret. Globally, the food and beverages industries have a keen interest in keeping their proprietary information secret for example Coca Cola's secret formula. Most significantly, trade secrets laws protect types of information that do not qualify for protection under the patent regime and this may be one of the reasons why it is more attractive for many SMEs. As noted in the previous Chapter, the innovations made by SMEs are often characterized by minor adaptation of existing products and emanate from the informal sector making them rely on secrecy. It is obvious that any kind of invention that confers a competitive advantage on its owner may be protected under a trade secrets regime. In that sense, trade secrets protection gives firms additional incentives for innovation.⁴⁷¹

As argued by scholars, "another reason for choosing the trade secret route is that it gives the developer of new and valuable information, a right to restrict others from using it, and therefore the prospect of deriving profits from the information".⁴⁷² This may be true of business as well as technical secrets, since some protection for business ideas helps ensure a first-mover advantage for those who take risks on untested business models.⁴⁷³ Perhaps more interestingly, one of the great strengths of trade secrets protection is protecting technical information of 'easy to invent/design around' products for which trade secrets protection is far more satisfactory than patents. Furthermore, trade secrets protection can coexist with contractual obligations in order to extend protection beyond the privity of contract. As noted above, trade secrets protection can be a valuable alternative which can supplement and/or complement other IP rights. As survey evidence suggests, from a practical perspective, immediate protection compared to patent or trademark rights which usually require several years of waiting for registration (at least four years waiting in the case of patents), is more effective and appropriate for fast-moving consumer goods industries that need quick protection. When compared to other IP rights, of course with the exception of trademark cases, trade secret litigations are a relatively frequent phenomenon in the Sri Lankan context. This

471 See *Kewanee Oil Co. v. Bicron Corp* (1974) 416 US 470, 481-485.

472 MA Lemley, 'The Surprising Virtues of Treating Trade Secrets as IP Rights' (2008) 61/2 Stanford Law Review 311, 330.

473 Ibid.

3. Incentive Mechanisms for Incremental and Minor Innovations

is no surprise given that costs involved in acquiring; maintaining and enforcing patent rights makes such a protection mechanism unattractive for many SMEs. Sri Lankan case-law also shows that many cases have been filed based on breach of confidence premised on contractual obligation.

3.2.8. Difficulties and Challenges for SMEs

Even though trade secrets protection provides incentives for innovators by protecting valuable investment in technological progress, there may also be considerable disadvantages and risks associated with such a protection mechanism. One of the major concerns in this regard relates to the enforcement aspect of trade secrets protection in Sri Lanka. As in many other jurisdictions, there is always a risk that court proceedings might lead to possible further disclosure of a trade secret.⁴⁷⁴ Arguably, there should be clear legal provisions against such public disclosure of trade secrets during and after litigations. The current IP Act of Sri Lanka does not contain any legal provision specifically designed to address this issue. Nor is there any case-law dealing with such a situation. Survey evidence obtained from legal practitioners in Sri Lanka confirmed that, in many cases that involve misappropriation of trade secrets, the plaintiff has to describe his trade secret in the pleadings supported by other relevant documents, and also in the event of leading evidence in open court, such court proceedings would further jeopardize the interests of the trade secret owner. One possible solution to this problem is to allow ‘in camera’ hearing (hearing that excludes the public from court proceedings) and to make confidential schedules to pleadings in trade secret cases.⁴⁷⁵ It is clear that Section 160 of the IP Act does not provide for any kind of such protection.

Moreover, Article 106(1) of the Constitution of Sri Lanka provides that all sittings of every court shall be held in public, and all persons shall be entitled freely to attend such sittings. There are exceptions to this constitutional rule in cases such as proceedings relating to family relations, sexual offences and issues relating to national security, but arguably such excep-

⁴⁷⁴ Hogan Lovells International LLP, *Report on Trade Secrets for the European Commission* (2012) 44. In the Sri Lankan context, the decision of the Commercial High Court in *Link Natural Products Ltd v Tropical Herbs Ltd* (CHC Case No: 25/2001/03 decided on 1 February 2013) illustrates this point.

⁴⁷⁵ *Ibid.*

tions would probably not include the protection of trade secrets.⁴⁷⁶ The correct legal position under Sri Lankan law is far from clear, but as pointed out by an eminent member of the judiciary and a legal academic in Sri Lanka, the Court can hold proceedings in camera under exceptional circumstances, though the general rule is that the court proceedings must be open to the public. Section 839 of the Civil Procedure Code will provide discretion to the Judge if holding the proceedings in public would defeat the ends of justice; then the Judge can decide to hold it in camera. Pursuant to Section 839 of the Civil Procedure Code, the court has the power to make an order to conduct the proceedings in camera or in an appropriate manner that is necessary for the ends of justice by making use of its inherent powers.⁴⁷⁷ However, it is purely a matter that is left to the discretion of Court. Therefore it depends on the circumstances of each application and one cannot draw a line to identify the area covered under that Section of the Civil Procedure Code.⁴⁷⁸ On the most general level, any relief under judicial discretion depends on the skills of the trial lawyer and most importantly the lawyer needs to invite the judiciary to use its inherent discretionary powers to prevent further disclosure of trade secrets. Arguably, due to limited awareness of the lawyers, in many cases the above provision would hardly be used. In view of the above, it can reasonably be argued that the trade secrets regime may not be of any real assistance in practice for SMEs in Sri Lanka as long as it does not provide effective procedural tools to prevent further disclosure of trade secrets in the course of litigation. Understandably, this may be one of the reasons for many firms to avoid going to courts in case of trade secrets violations and, in fact, there could be very little to gain by recourse to legal means of protection. Moreover, not only court proceedings, but also the handling of the case by lawyers (when a case involves technical information lawyers need to consult experts) and a judgment of the court can be a possible source of further disclosure of a trade secret.

476 See Article 106 (2) of the Constitution of Sri Lanka of 1978 as amended.

477 According to Section 839 of the Civil Procedure Code Ordinance No. 2 of 1889 as amended Section 839, nothing in this Ordinance shall be deemed to limit or otherwise affect the inherent power of the court to make such orders as may be necessary for the ends of justice or to prevent abuse of the process of the court.

478 Personal communication with a senior members of Sri Lankan judiciary (email received on 11Februray 2013and a senior legal academic in IP law (email received on 15 February 2013).

Among other concerns, gathering information of misuse would also be a serious issue in the enforcement of trade secrets law by industrial sectors, especially for SMEs. Most notably, in order to be protected, the information should be kept secret. The secrecy requirement, therefore, serves as a gatekeeper function and once the control of access to information is lost there is no protection available.⁴⁷⁹ Moreover, when a third party receives a trade secret in good faith, there is no possible remedy. Trade secrets protection has several other downsides. In general, detection of trade secret theft is likely to be very difficult. Unlike tangible property, information can be stolen without depriving the owner of anything observable and without leaving any physical trace of the deed whatsoever.⁴⁸⁰ Moreover, the simple fact that a competitor eventually acquired the information is not in itself a sign of stealing; a competitor may properly acquire such information through independent discovery or reverse engineering.⁴⁸¹ Furthermore, the potentially high direct and indirect enforcement costs involved in trade secret law-suits discourage many firms from bringing trade secret suits. One reason for the high costs is the large number of complex factual issues in a trade secret case. For example, plaintiffs must prove that they took reasonable precautions to protect the secret and that the defendant acquired the information from the plaintiff and did so unlawfully.⁴⁸² Given the likelihood of concurrent innovation in the technology field, it can often be very difficult to show that the defendant obtained the information improperly. This difficulty is only compounded when a secret is susceptible to lawful reverse engineering.⁴⁸³ For this reason, the likelihood of success in a trade secret lawsuit is relatively low. Significantly, as scholars pointed out, the uncertain scope and the vague concept of ‘commercial morality’ of trade secret law create incentives for frivolous litigation designed to harass competitors rather than to obtain relief for trade secret misappropriation.⁴⁸⁴ This problem is also aggravated when a company

479 MA Lemley, ‘The Surprising Virtues of Treating Trade Secrets as IP Rights’ (2008) 61/2 Stanford Law Review 311, 313.

480 RG Bone, ‘A New Look at Trade Secret Law: Doctrine in Search of Justification’ (1998) 86 /2 California Law Review 241, 278.

481 Ibid.

482 Ibid.

483 BH Malkawi, ‘A Critical Look at Trade Secrets Protection in Jordan’ (2012) 2 Intellectual Property Quarterly 123, 127.

484 RG Bone, ‘A New Look at Trade Secret Law: Doctrine in Search of Justification’ (1998) 86 /2 California Law Review 241, 278.

sues ex-employees who leave to start a competing firm in order to hinder their ability to raise capital during the start-up phase. Frivolous suits of this sort not only add to litigation costs, they also chill competition.⁴⁸⁵

A survey of the cases reported in Sri Lanka shows that the majority of trade secrets cases involve disloyal employees who use or disclose their employers' secrets in violation of a duty of confidence stemming from the employment contract. Not many cases have come to courts over improperly acquiring trade secret by theft. But the possibility of espionage or stealing cannot be ruled out as a potential risk, given the increasing use of modern technology in the industry. There has been a number of incidents of computer hacking and other forms of corporate espionage in recent years. In an era of information technology, this may be cause for concern in view of the fact that documents and data can be downloaded, stored and transmitted electronically. As lucidly illustrated by Robert G Bone:

‘Ideas were like wild animals ferae naturae, common property free for all to enjoy until captured. An idea could be captured by "discovering" it and then excluding others through secrecy. Secrecy required constant vigilance, however, since ideas, like wild animals, had a tendency to escape. Once gone, they returned to the commons as public property’.⁴⁸⁶

According to critics, trade secrets law is in a muddle today. Thus, from a policy perspective, Sri Lankan courts should also need to be very cautious when defining the boundaries of the scope of trade secrets protection because such protection may encroach upon things that are in the public domain which would ultimately defeat the purpose of the law. As has been argued by commentators, an over-generous protection could undermine the objectives of IP regimes, such as copyright and patent law, and have harmful effects on competition.⁴⁸⁷

485 Ibid.

486 Ibid 255.

487 See H Carty, ‘An Analysis of the Modern Action for Breach of Commercial Confidence: When a Protection is Merited’ (2008) 4 Intellectual Property Quarterly 416, 433. See also Lord Hoffmann’s statement in *Douglas v Hello!* (2007) UKHL 21, 292. Lord Hoffmann argued that unorthodox forms of IP should not be created by a manipulation of the action for breach of confidence. Furthermore, in the same case, Lord Walker warned that ‘uncontrolled growth of the law of confidence... tends to bring incoherence into the law of IP’.

3.2.9. Conclusion

Today, the protection of trade secrets or undisclosed information has a profound impact on the innovation climate of a country. A trade secrets regime primarily deals with the protection of commercially valuable information that is maintained secret. Article 39 of the TRIPS has laid the foundation for international harmonization of such protection. In the Sri Lankan context, apart from the protection under the IP Act, different layers of protection are available such as the Common Law action for breach of confidence and protection under the law of contract. What may be striking is that the statutory protection of undisclosed information is a part of the section that deals with unfair competition law. There may be a need in the future for specific and comprehensive legislation dealing with trade secret protection in order to create a better legal environment. Perhaps more interestingly, trade secrets are more prevalent than ever before among Sri Lankan business enterprises, especially within TK-based firms. There are several reasons for this trend including the disclosure requirement under patent law and the costs involved in acquiring, maintaining and enforcing other IP rights. There are both logical and evidentiary reasons to conclude that a large number of enterprises in Sri Lanka use or have used informal means of secrecy in their businesses. Even though trade secrets protection may, in some cases, supplement or even complement other IP rights, there are practical concerns regarding the enforcement of trade secret rights. In particular, legal proceedings in trade secrets may lead to possible further disclosure. Obviously, there seems to have been no satisfactory answer on this issue at least in the Sri Lankan context.

All in all however, both unfair competition law and trade secret law have an inherent flexibility to extend the protective arm to a number of corners that patent and other IP rights cannot reach. However, herein lies a danger that flexibility may be replaced by incoherence. As noted above, there is always a policy argument that trying to create protection from the back door is undesirable. Viewed from policy perspectives, neither unfair competition law nor trade secrets protection provides a precise form of protection with adequate legal certainty. In that sense, it might still be argued that both regimes would not provide sufficient alternatives to a second-tier protection regime. Conversely, by providing a reasonable protection for simple and obvious innovations that fall through patent and design regimes and by preventing misappropriation of undisclosed information,

the trade secrets regime may provide some protection for minor and incremental innovations in the industrial geography of Sri Lanka.