Legal Opinion Letter

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COURT REJECTS STATE LAW COMPELLING INGREDIENT DISCLOSURE

by
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In *Philip Morris, Inc. v. Reilly*, 312 F.3d 24 (2002), the United States Court of Appeals for the First Circuit held a Massachusetts law requiring tobacco manufacturers to disclose their products' ingredients invalid because it created an unconstitutional taking of the companies' trade secret ingredient lists. In an en banc decision, the First Circuit reversed an earlier panel decision and held that MASS.GEN.LAW Ch. 94 § 307B improperly required the ingredient lists to be disclosed to the state and subjected to possible, if not likely, public disclosure, thereby destroying their trade secret value without compensation.

The Disclosure Act, ostensibly enacted primarily for the purpose of protecting the public health, required "any manufacturer of cigarettes, snuff, or chewing tobacco sold in the Commonwealth" to disclose, for each particular brand, "the identity of any added constituent other than tobacco, water or reconstituted tobacco sheet made wholly from tobacco, to be listed in descending order according to weight, measure or numerical count." One additional significant goal was to help consumers make more informed choices about the tobacco products they choose to consume. The Act contained no provision to maintain the confidentiality of the information; to the contrary, the Act specified that any information provided by the companies shall be disclosed as a public record if: (a) there was a reasonable scientific basis for concluding that the availability of the information could reduce the risks to public health and (b) the attorney general did not believe that such a disclosure would be an unconstitutional taking.

In the previous panel decision, since withdrawn, the court invoked the three part test for regulatory takings outlined in *Penn Central Trans. Co. v. City of New York*, 438 U.S. 104 (1978) and used in *Ruckelshaus v. Monsanto*, 467 U.S. 986 (1984) (a trade secret takings case). To evaluate whether a regulatory taking has occurred courts must analyze: (1) the economic impact of the regulation; (2) the character of the government action; and (3) the interference of the action with reasonable investment-based expectations. Focusing on the third part of the test, which *Monsanto* calls so overwhelming as to be dispositive, 467 U.S. at 1005, the panel reasoned that a manufacturer, aware of the conditions under which data is submitted (public disclosure of information in exchange for the right to market product in

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Massachusetts), could not claim a reasonable investment-based expectation in the data's secrecy and that the Act, therefore, did not create a regulatory taking.

The new en banc decision also focused, in part, on the third part of the test but came to the opposite conclusion. The court reasoned that because Massachusetts protects trade secrets, *see e.g. Jet Spray Cooler, Inc. v. Crampton*, 385 N.E.2d 1349 (1979), and because the tobacco companies had invested significant amounts of money developing their ingredient lists and expected them to remain secret prior to the Act, the Act interfered with the companies' reasonable investment-based expectation. The majority opinion declared that the required disclosure of trade secret information in exchange for the right to market the product is an "unconstitutional condition" and noted that "Massachusetts cannot condition the right to sell tobacco on the forfeiture of any constitutional protections the appellees have to their trade secrets." The court also found the economic impact "potentially tremendous" as the Disclosure Act "essentially destroys the tobacco companies' trade secrets." In this case the court found the character of the government action particularly wanting. It commented "Frankly, for a state to be able to completely destroy valuable trade secrets, it should be required to show more than a *possible* beneficial effect" and that such a "tremendous individual loss is simply not justified by such a speculative public gain." As a result the court declared the Disclosure Act invalid as requiring an unconstitutional taking.

A concurring opinion to the en banc decision, written by Judge Selya, (who dissented with similar reasoning from the original decision) explained that the Act so vitiated the property right in question that the situation was more akin to a physical taking than a regulatory one and argued that a *per se* takings rule might be more appropriate to alleged takings of trade secrets. Interestingly, the majority did not completely close the door on this possibility, but declined to adopt a *per se* rule in this case, characterizing *per se* rules as "simply shortcuts" and saying that it was reluctant to adopt any rule which would preclude future courts from undertaking a full *Penn Central* takings analysis.

The First Circuit's decision can be called a victory for trade secret owners, though it certainly did not preclude all future threats to trade secrets. On one hand the court was unwilling, in the name of public health, to allow the state to destroy trade secrets covering a list of ingredients for what is widely acknowledged to be a product with serious health effects (effects which almost each opinion written during the history of this case has acknowledged). Should other businesses be faced with forced disclosure of trade secrets it will be easier for them to challenge the regulation based on the Takings Clause under a *Penn Central* analysis. They may even, based on an appropriate factual scenario and using the logic of the concurring opinion and the majority's *dicta*, convince the courts that a wholesale taking of trade secrets should be subject to a *per se* takings analysis and sidestep the *Penn Central* regulatory takings analysis.

On the other hand there may be future situations where owners of even less politically charged trade secrets may be forced into disclosure if the state can show a significantly stronger nexus between disclosure and some public benefit. State legislatures may learn from this case and craft statutes more finely tuned to that nexus. Additionally, there may be no taking if the trade secret is developed after (with actual or constructive knowledge of) the enactment of the Disclosure Act. The First Circuit, using favorable language, cited a piece of Texas legislation which was similar to the Massachusetts Disclosure Act in that it required tobacco companies to turn over ingredient lists but it guaranteed the secrecy for the disclosed trade secrets thereby avoiding a taking. For the sake of public health the Massachusetts legislature may again require tobacco companies to turn over their ingredient lists but this time may add a provision that the trade secret status of the ingredient lists will be preserved. It is such statutes which protect both the public interest and private property rights that will be of the most benefit to all.

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