

Strategic Implications of Trade Secrets

Trade secrets are the Rodney Dangerfield of intangible asset management: they don't receive the respect they deserve. Trade secrets are valuable both as an alternative to patents and as a compliment to patents.

What are Trade Secrets?

Trade secrets are proprietary information, knowledge, formulas, methods, designs or processes. What differentiates trade secrets from know-how is that trade-secrets must present a commercial advantage; are not commercially known or readily ascertainable; and, are the subject of efforts to keep such knowledge secret.

Advantages of Trade Secrets

Trade secrets enjoy several benefits over patents. Their use is not contingent on examiner approval and there is no requirement to disclose the underlying unique knowledge or process. On the contrary, doing so invalidates the trade secret. Since trade secrets must be maintained confidentially, it is more difficult for competitors to design around trade secrets than to design around patents which are published to the public.

Unlike patents, trade secrets can endure indefinitely and be licensed forever. The licensee can be obligated to continue paying royalties for the trade secrets license even if the information (subject to the trade secret license) has entered the public domain.

Another benefit of companies becoming more trade secret savvy is that they often uncover more proprietary assets. For instance, failed research efforts are typically dismissed as an extraneous byproduct of a research initiative. However, failed research can yield a company a competitive advantage since it demarks what did not work and this knowledge could be valuable to competitors. Guarding such information as a trade secret enhances a company's portfolio of intangible assets and ultimately its enterprise value.

Trade secrets yield value in terms of an inventor requesting a potential licensee to sign a Non-Disclosure Agreement. According to Ron Laurie, CEO of Inflexion Point Strategy, "An inventor wants to position his invention as a trade secret, because if the potential licensee violated the NDA, you can bring two causes of action. One cause of action is a breach of contract and the other is the misappropriation of a trade secret. If a court deems that a misappropriation of a trade secret occurred, the plaintiff could receive punitive damages. If the invention is simply managed as know-how, you are limited to one cause of action; that being breach of contract."

Disadvantages Associated with Trade Secrets

Concerns about relying on trade secrets to protect proprietary information revolve around independent discovery, applicable law and expense.

A trade secret does not protect against independent discovery as does a patent. If competitors arrive at the same discovery as a trade secret covers, they are unrestricted in trying to capitalize on such knowledge. Sanford Warren, Partner at Akin Gump in Dallas, points out that the ability to reverse engineer a patent is even more lethal than many realize. Mr. Warren notes that a competitor can reverse engineer a patent, improve upon such disclosures, and file for patent protection of the enhanced invention. All of which may effectively make the previous patent irrelevant. (However, practicing the subject matter of an enhancement or improvement patent may (and often does) infringe the underlying, basic patent.)

There is a heightened risk that a company could compromise its own trade secrets when such trade secrets are used in intra-company settings. This is because the safeguards required to maintain trade secret status are not usually enforced in intra-company dealings.

Eric Kirsch, Partner at Cooper & Dunham in New York City, makes important points about the legal recourse a company has at its disposal when its trade secrets are violated. According to Mr. Kirsch, "trade secret actions may or may not be resolved in Federal Court. If diversity of citizenship does not exist, these cases are litigated in State Courts. This is disadvantageous because, oftentimes, State Courts are not as streamlined as their Federal counterparts and their judges are not as familiar with intellectual property matters as are Federal Judges."

It is not always evident which bodies of law govern trade secret disputes. If a licensee of trade secrets uses the trade secret beyond what is agreed to in the license, trade secret law may not necessarily apply to the dispute. Instead, contract or tort law may govern the situation. There is also the unresolved question of whether trade secret misappropriation is a property right violation or a tort. A case currently pending in California state courts, *Jasmine v. Marvel Semiconductor*, involves "standing" to bring an action for trade secret misappropriation. In that case, the party alleging the theft of trade secrets sold the relevant technology before the suit was filed. The question presented is whether trade secret misappropriation violates a property right (as does patent infringement) or whether it is a tort. If it is the latter, then the claim survives sale of the alleged trade secret. If it is the former, current ownership is a prerequisite to bringing suit.

While there are no search, filing, prosecution or maintenance fees associated with trade secrets, Mr. Warren warns that the total costs of maintaining trade secrets can actually exceed the costs of securing patent protection. Companies that wish to protect their trade secrets must undertake practices such as

requiring employees to sign employment agreements with confidentiality obligations; screen the speeches and publications of employees; detail security measures governing trade secrets in their employee handbooks; mark relevant documents as “confidential” and require the logging in to access labs and sensitive information on computers. Companies covetous of trade secrets should conduct employee exit interviews as trade secrets are particularly difficult to enforce when employees leave their companies. Brian Boyer, Partner at Syndicated Law in Redwood City, CA, suggests that it may even be necessary to hire someone to look after all of these security measures.

Another onerous, but overlooked cost is that of operational inefficiencies that result from maintaining trade secrets. Companies often grant access to proprietary information on a “need to know basis” and silo off parts of formulas or processes among privileged employees. This often results in the need to have more employees—and a more convoluted process—to reduce to practice the proprietary knowledge than would be case if there were no trade secrets.

Trade Secrets vs. Patents

The following are among the criteria that inventors can use to determine when trade secrets are more or less appropriate than patents.

- If the invention is easy to reverse engineer, it is better to get a patent. Someone will be able to discern the invention anyway and securing a patent enables the patentee to assert against infringers. If the invention is difficult to reverse engineer, it is better to maintain the proprietary knowledge as a trade secret.
- An invention that provides a significant commercial advantage should probably be patented.
- If a competitor’s exclusivity would be disadvantageous, you should patent.
- If a claim is easily avoided, its value is considerably reduced. Patents that would have weak or narrow claims are easy to design around, and thus should be kept as trade secrets.
- If competitors can reasonably easily ascertain the nature of the product, patent protection would be favored.
- If the disclosure to competitors would help them, you should go the trade secret route.
- If others are working in the field, they could arrive at the same development and patent it first. One might be excluded from using the product if patent protection is not sought.
- If the company is unwilling or unable to sue over its patents, its patent is basically worthless. The opportunity for trade-secret protection would be lost through publication. In these situations, trade secrets are the better route to take.

- If a company's culture does not lend itself to keeping trade secrets, a patent is more appropriate. Some companies believe that the free flow of information leads to innovation and that an open culture is more important than maintaining trade secrets.
- If detecting infringement would be extremely difficult, the ultimate value of a patent would be reduced.
- If the inventor wishes to monetize the invention through licensing, it is better to patent. Companies that cite earlier patents essentially identify themselves as potential licensees. Licensing and sublicensing of trade secrets is inherently more difficult to negotiate, enforce and audit due to the secretive nature of trade secrets.

Using Trade Secrets in Tandem with Patents

Mr. Boyer provides valuable insight about the sequencing of trade secrets and patents when he explains that, "It is better to patent first and then trade secret the improvements. However, if you begin a business venture by providing a service based on a trade secret and later decide to turn your service into a product—protected with a patent—you can lose your right to patent." Perhaps if Coca-Cola decided to sell cola making machines for home use, it could encounter challenges in being granted a patent because of proceeding commercial sales of a similar manifestation of the invention.

To the extent known to them, patentees must disclose the prior art, references and best modes of practices for their arts when filing for patent protection. However, after patent applications are filed improvements are typically made to inventions. Since these improvements are not required to be disclosed on patent applications, they can be kept as trade secrets. Inventors should protect their improvements as trade secrets so that a trade secret agreement can accompany a patent license agreement.

About the Author: David Wanetick is a Managing Director at Incremental Advantage, a valuation and consulting firm based in Princeton, NJ. He teaches Valuation of Emerging Technologies and Negotiating Licensing Agreements at The Business Development Academy. He may be reached at dwanetick@incrementaladvantage.com.