CHAPTER 5

TRADE SECRET LICENSING: ARE YOU ADEQUATELY PROTECTING YOUR MOST PRIZED ASSETS? THE NEED FOR A TRADE SECRET AUDIT IN AN AIA WORLD

Justin Krieger and Nicki Kennedy

§ 5.01 INTRODUCTION

The corporate value of intangible assets is often greater than that of tangible assets and thus the protection of intellectual property is a primary business concern. While intellectual property may be protected through trademarks, copyrights, patents, and trade secrets, this chapter focuses on reevaluating corporate trade secrets, and in particular, determining whether that information would be better protected by filing one or more patent applications. Historically, the "forfeiture doctrine" has precluded inventors and companies from filing patent applications for processes that have been commercialized for more than one year. The America Invents Act (AIA),[1] however, appears to have effectively eliminated the forfeiture doctrine rendering the current need for a trade secret audit particularly important. Technology companies are thus now presented with a unique opportunity to reevaluate how best to protect their most prized trade secret assets.

§ 5.02 TRADE SECRET VS. PATENT

Many businesses have a history of protecting their confidential information as trade secrets over disclosing information through patents. Depending largely on the nature of the information, this strategy may have more than adequately protected this sensitive information. To understand the strengths and weaknesses of protecting confidential information as a trade secret, a basic understanding of some of the similarities and differences of trade secret and patent protection is necessary. A common misconception regarding trade secrets lies in the basic definition of a trade secret. Some of the most famous examples of trade secrets relate largely to food and go to the heart of the product. For example, the recipes for Coca-Cola®, Thomas'® English Muffins, and KFC's® fried chicken have been maintained as trade secrets for decades. These trade secrets have great value and go to the heart of the product involved. Not all trade secrets, however, rise to that level.

A trade secret, as defined by the Uniform Trade Secrets Act (UTSA), is information, including without limitation, a formula, pattern, compilation, program, device, method, technique or process, that: (a) derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by the public or any other persons who can obtain commercial or economic value from its disclosure or use; and (b) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.[2] Most U.S. states have adopted some version of the UTSA and the definition of a trade secret in the UTSA is generally accepted, although additional

[1] LEAHY-SMITH AMERICA INVENTS ACT, Pub. L. No. 112-29, 125 Stat. 284 (2011) (codified at 35 U.S.C.); *see also* 35 U.S.C. § 102 (2011) and Pre-AIA 35 U.S.C. § 102.

[2] UNIF. TRADE SECRETS ACT (amended 1985), 14 U.L.A. § 1(4) (2005).

sources of trade secret law exist in the United States.[3] The definition of trade secret outside of the United States varies by country, but Article 39 of the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) outlines general standards for trade secret protection that are similar to those provided by the UTSA.[4]

In the chemical engineering context, a trade secret may include, for example, a combination of equipment or reaction conditions, *e.g.*, reactor temperature, material, size, or pressure, that results in improved product formation, either in terms of conversion, selectivity or product quality. In a food application, a trade secret may include the specific source of a specific ingredient, or concentrations or ratios of ingredients themselves, so long as that information cannot be reverse engineered. In the electrical and software fields, trade secrets may include, for example, source code, proprietary algorithms, business methods, and system architecture.

An important feature of trade secret protection lies in the requirement that reasonable steps must be taken to keep the information secret, especially because the "reasonable steps" are typically analyzed by a court after the fact during litigation. Examples of "reasonable steps" include: limiting the number of people who have access to the information to those having a "need to know," having a written trade secret policy, implementing password protection for documents and firewalls to internally and externally limit access to the information, marking confidential information as such, as well as employing non-disclosure agreements, and conducting exit interviews for departing personnel. Of course, in order to take reasonable steps to keep confidential information secret, that information should be adequately documented, for internal purposes, as a confidential trade secret.

Trade secrets are defended through both civil and criminal causes of action with trade secret misappropriation being the most common cause of action. In contrast to trade secret protection, patent protection provides the affirmative ability to prevent others from making, using, selling, offering for sale, or importing the claimed invention for the life of the patent, in exchange for disclosing the invention to the public.[5] Value can thus be extracted from patents through licensing efforts and/or patent infringement litigation. Once filed, a patent application is examined and, if patentable, will issue as a patent. Patentable subject matter includes any useful process, machines, manufactured articles, or composition of matter.[6] The duration for utility patents in the United States begins on the issue

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[3] *See* Restatement (First) of Torts, § 757 cmt. b (1939); Restatement of Unfair Competition § 39 (1995); and Economic ESPIONAGE ACT, 18 U.S.C. § 1839 (1996).

[4] TRIPS: Agreement on Trade-Related Aspects of Intellectual Property Rights, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1C, THE LEGAL TEXTS: THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS 320 (1999), 1869 U.N.T.S. 299, 33 I.L.M. 1197 (1994).

[5] 35 U.S.C. § 271.

[6] 35 U.S.C. § 101.

date and expires 20 years from the date on which the application was filed in the United States.[7] Common defenses to patent infringement include allegations of invalidity of the patent and now, under the AIA, the prior user rights defense, which allows a corporation accused of patent infringement to avoid liability if it can demonstrate that it continuously practiced the invention more than one year before the earliest priority date of the patent.[8]

Put simply, patent protection is limited in duration and requires public disclosure, but allows the patent owner to affirmatively prevent others from practicing the patented subject matter. A trade secret, as its name implies, is not publicly disclosed and requires no formal registration process, but is not limited in duration and can be used to prevent misappropriation, for example, by a disgruntled employee. A trade secret, however, cannot be used to prevent others from independently developing or discovering the information.

§ 5.03 CHANGES PRESENTED BY THE AIA

In assessing an invention's patentability, a patent claim is compared to the "prior art," which is largely defined by the scope of 35 U.S.C. § 102. Under Pre-AIA § 102(b), a person is entitled to a patent unless, among other reasons, the invention was "in public use or on sale" in the United States "more than one year prior to the date of application for patent."[9] The predecessor to this provision had been interpreted in *Metallizing Engineering Co. v. Kenyon Bearing & Auto Parts Co.*,[10] as creating a personal bar to patentability for secret processes that are not in the public domain in the event a product made by that process was commercialized in the United States more than one year before the filing of a patent application. By extension, for pre-AIA patent applications filed before March 16, 2013, the private or secret commercial use of an invention for more than one year has been held to forfeit an inventor's right to patent the invention under 35 U.S.C. § 102(b).[11] The reason for the so-called forfeiture doctrine was that it was against the public's interest to effectively extend an inventor's patent term and delay the public's benefit of the inventive process.

For decades, *Metallizing Engineering* and its progeny was the law of the land, creating a dilemma for inventors and companies who were faced with the following decision: (i) continue to use the inventive process as a trade secret at the risk of the process being later independently developed and patented by another, or (ii) attempt to patent the process within one year of its first commercial use and limit its commercial value to the term of any resulting patent. Historically,

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[7] 35 U.S.C. § 154.

[8] 35 U.S.C. § 273.

[9] Pre-AIA 35 U.S.C. § 102(b).

[10] 153 F.2d 516, 520 (2d Cir. 1946).

[11] *See* Pfaff v. Wells Elecs., 525 U.S. 55, 68 (1998) (quoting *Metallizing Eng'g*, 153 F.2d at 520).

those electing to keep their inventions as trade secrets could not change their mind and seek patent protection for these processes once they had been commercialized for more than one year. The AIA, however, appears to have given those who originally opted for trade secret protection a fresh opportunity to reconsider that IP strategy.

The AIA fundamentally changed the standard for defining patentable subject matter by changing the United States from a "first to invent" country to a "first to file" country. With this change came significant revisions to the US patent act, and in particular, 35 U.S.C. § 102. Section 102(a), as amended by the AIA, recites:

> A person shall be entitled to a patent unless—
> 1. the claimed invention was patented, described in a printed publication, or in public use, on sale, ***or otherwise available to the public*** before the effective filing date of the claimed invention . . . . [12]

Although to date there has been minimal judicial review of the new statutory language of § 102, the legislative history, commentators and legal scholars have given significant attention to the new language in § 102.[13] In particular, although the meaning of the language "or otherwise available to the public" was initially hotly debated, the general consensus today is that prior art under the AIA is expressly limited to art that is available to the public and, hence, in the public domain. As a result, the secret commercial use of a secret process likely would not constitute prior art under current § 102(a)—either personally to the individual commercially using that process or to others.[14]

In fact, the current position of the U.S. Patent & Trademark Office (USPTO) is that the AIA has effectively overturned the *Metallizing Engineering* decision since "the Office views the 'or otherwise available to the public' residual clause of the AIA's 35 U.S.C. 102(a)(1) as indicating that secret sale or use activity does not qualify as prior art."[15] Moreover, in responding to public comments on proposed post-AIA examination guidelines, the USPTO stated:

> With respect to comments that *Metallizing Engineering* and other forfeiture doctrines should be preserved because they serve important public policies, the Office notes that the choice of which public policies to pursue through the definition of prior art is made by Congress, not by the Office. Also, some of

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[12] 35 U.S.C. § 102(a)(1).

[13] *See* 157 Cong. Rec. No. 132, Sept. 8, 2011 at S5431; No. 35, Mar. 9, 2011 at S1496-S1497; No. 90, June 22, 2011 at H4429; Maier, *IP Today*, "The Big Secret of the America Invents Act," Dec. 2011.

[14] A secret prior art process that can be reverse engineered from the public sale of a commercial product made by that process would likely constitute prior art under both pre-AIA § 102 and current § 102(a)(1).

[15] *See* Fed. Reg. Vol. 78, No. 31 at 11,060 (Feb. 14, 2013).

> the purposes ascribed to these doctrines in case law appear to be ill-suited to or inconsistent with the AIA. The problem of delayed filing of applications is unique to pre-AIA 35 U.S.C. 102, under which an applicant can rely on a secret invention date in order to establish a priority date.[16]

Notwithstanding the foregoing, the legal community will breathe a collective sigh of relief once the federal courts have formally addressed this issue.

§ 5.04 GLOBAL INTELLECTUAL PROPERTY AUDIT

In light of the current view that the commercialization of a secret process likely would not constitute prior art under § 102(a)(1), IP savvy companies would be wise to conduct a comprehensive internal trade secret audit to reconsider whether internally documented trade secrets would be better protected going forward as patents. The comprehensive trade secret audit should include, at a minimum, the following steps: (i) education of appropriate personnel; (ii) identification of the corporation's trade secrets, (iii) determination of value, (iv) evaluation of how best to protect the information going forward through an IP action plan, and (v) execution of the plan.

[A] Education

At the outset, an appropriate team should be assembled to conduct the audit. Since highly confidential business information will be discussed in the audit, it is critical that those involved are highly trustworthy and that all individuals involved have executed appropriate non-disclosure documents prior to seeing any confidential information. Key internal personnel, including trustworthy representatives from business, legal, and technology groups, should be involved in the discussions. The importance of having a diverse team of individuals having significant knowledge of the corporation's businesses and technology cannot be understated since oftentimes the importance of confidential information cannot be ascertained without this base level corporate knowledge.

Before beginning the audit process, the concept of intellectual property and, in particular, the differences between trade secret and patent protection should be discussed so that those involved understand the meaning of these terms and the goal of the audit. Additionally, the steps of the overall trade secret audit process should also be discussed so that everyone involved understands the purpose of the audit and the goal of the process. Ideally, the audit step would be led by IP counsel, either internal or external, in order to ensure that the basic concepts are clearly conveyed and understood by all involved in the process.

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[16] *Id.* at 11,062.

[B] Identification

As discussed above, a trade secret exists because of a conscious decision to keep that information secret. Accordingly, once the team has been assembled and brought up to speed on the overall process, the next step is to review information previously designated as confidential. Ideally, such information is organized in a centralized database that is password protected and access restricted. It is quite common, however, for corporations to not adequately document their confidential information. Oftentimes, such non-documentation is with the best of intentions ("Why would I actually want to document our most confidential information?!"). As discussed above, however, identifying information as a trade secret is an important step to protecting that information as a trade secret.

Regardless whether confidential information has or has not been adequately documented, the identification step may additionally include a comprehensive brain storming session in order to find and identify as much undocumented confidential information as possible. Such brain storming sessions may be expanded to include additional individuals involved in developing and/or operating the technology at issue, since these individuals will frequently have key insight into additional confidential information that may not otherwise have been documented.

During the review of previously designated trade secrets, measures that have been taken to keep the information secret also should be discussed and documented. Such discussions may include assessing whether the information has been disclosed to any third parties and if so, what measures were taken to ensure continued confidentiality.

Between audits, companies may want to track newly developed confidential information and inventions through a formalized internal disclosure process, which may include providing invention disclosure forms for employees to complete and submit to the legal department as appropriate. Such forms serve as a valuable tool for documenting new concepts and inventions, key personnel involved, and experiments or other work that led to the invention. Such documents can also be used as a blue print for subsequent patent drafting, if desired, or serve as a starting point for documenting trade secrets. Establishing a corporate culture that educates its employees on the importance of intellectual property and encourages the internal disclosure of corporate IP is critical to establishing a successful long term IP strategy for the corporation.

[C] Valuation

Once a company's trade secrets have been identified, they should be valued relative to each other in order to ensure that time in the audit is properly allocated between the trade secrets based on their value. The valuation of trade secrets is not an exact science and typically involves weighing numerous factors. Some of these factors include:

1. The criticality of the information to existing commercial processes (of the corporation or its competitors)
2. The existence and availability of known alternatives to the process
3. The ability of motivated third parties to ascertain, *e.g.*, reverse engineer, the information
4. The value of the product manufactured using the information
5. The risk that the information has been or will be compromised in the future
6. Whether appropriate steps have been taken historically to protect the information
7. The costs associated with developing the information
8. Past and future licensing value

After considering these factors, the trade secrets may be ranked in order from most valuable to least valuable.

Although there are no absolutes, lower value trade secrets are generally better kept as trade secrets in view of the costs and uncertainties associated with preparing and prosecuting a patent application. The converse is not necessarily true, however, as higher value assets may or may not be more protectable as a patent; in some circumstances, for example, a high value trade secret may be high value in part because it is extremely difficult to reverse engineer. Such information may be better protected as a trade secret than a patent.

[D] Determination

After assessing the value of the identified corporate trade secrets, the next step is to determine how best to protect that information going forward. Not all trade secrets constitute patentable subject matter. For example, although they may constitute extremely valuable trade secrets, customer lists and pure business methods are not patent eligible. In addition, although certain production processes may be patent eligible, they may not be sufficiently inventive based on the prior art to warrant patent protection. As such, it may be beneficial to begin this step by taking an initial pass through the identified trade secrets and culling out those trade secrets that either do not constitute patentable subject matter or are non-inventive.

Once these non-patentable trade secrets have been set aside, each of the remaining trade secrets should be reviewed, from highest value to lowest value, to determine how they can be best protected going forward. Like the valuation step, this analysis typically involves weighing numerous factors and making a final judgment call. Many factors should be considered in this analysis, several of which are listed below.

FACTORS TO BE CONSIDERED IN DETERMINING WHETHER TO PROTECT INFORMATION AS A TRADE SECRET OR PATENT

Factor	*Favors*
Information has a very short lifetime? (<5 Years)	Trade Secret
Information has a substantial lifetime (*e.g.*, 10-20 years)	Patent
Information has a lifetime well beyond 20 years	Trade Secret
Information can be reverse engineered from the product	Patent
Information is likely to be independently discovered or developed in near future	Patent
Company has high turnover rate	Patent
The commercial field is very IP litigious	Patent
There are many commercially viable alternatives to the information	Trade Secret
Information is in a crowded field with significant prior art	Trade Secret
Information is unlikely to be patentable	Trade Secret

Once all of these factors have been considered, a final decision should be assigned to each of the identified trade secrets in an IP Action Plan.

It should be borne in mind that seeking patent protection does not necessarily mean that the process will necessarily be patented. In a worst case scenario, an applicant deciding to change course and disclose a long held trade secret in a patent application may later learn a year or two later that the prior art renders the process unpatentable—thereby losing both trade secret and patent protection for the process. To mitigate this risk, it is recommended that any entity contemplating patent protection for a particularly valuable trade secret process conduct a comprehensive patentability search prior to filing the patent application. If the prior art uncovered in the search results is sufficiently close to the trade secret process, it may be determined that the most prudent strategy is *not* to file a patent application, instead keeping that information as a trade secret. If little relevant art is uncovered in the patentability search, that may favor proceeding to seek patent protection.

[E] Execution

Once a determination has been made for each of the identified trade secrets, corporate budgets and priorities will likely dictate the speed and quantity of patent application filings. In-house or outside patent counsel can assist in recommending filing strategies, including consolidating ideas into fewer filings, identifying countries with strong patent protection, and reducing drafting and prosecution costs.

As discussed above, to be protected as a trade secret, reasonable steps must be taken to protect that information. Thus, for those trade secrets designated for continued trade secret protection, it is important to take reasonable steps to keep the information secret.

Reviewing existing license agreements is also important. To the extent that licenses are due to be updated or renewed, it may be necessary to evaluate whether a change in terms is warranted based on any new patent filings. Because monetization of intellectual property is an important business objective, the audit process may also include evaluating whether existing patents are still valuable to the business and whether further efforts should be made to derive additional value from new patent filings, potentially through new licensing overtures.

§ 5.05 CONCLUSION

A unique opportunity has been presented by the AIA to reevaluate corporate trade secrets, allowing businesses to rethink decisions made long ago on how best to protect this important information. Now more than ever, IP savvy corporations need to reevaluate their trade secret portfolios and conduct a comprehensive IP audit to protect their most prized intellectual property assets.