

Trade Secrets v. Patents: The New Calculus

By R. Mark Halligan

There are four types of intellectual property rights: patents, copyrights, trademarks, and trade secrets.

Only two of these intellectual property rights protect information: patents and trade secrets. Patents protect information by dedicating the information to the public in return for a limited monopoly. Trade secrets protect information with independent competitive value derived from the secrecy of the information.

The birth of every patent starts out as a trade secret. At the time of conception, the idea or information can only be protected by keeping it secret. However, a subsequent decision needs to be made to determine whether or not to convert the trade secret asset into a patent asset. The traditional approach is based on the NUN factors: novelty, usefulness, and non-obviousness. If the trade secret asset meets the patentability requirements, then the decision tree often dictates that the owner seek patent protection because a patent will provide greater protection.

The owner of a patent is entitled for a limited time to exclude any person or entity from making, using, selling, or offering to sell the patented invention.¹ In contrast, the life cycle of a trade secret depends upon secrecy.² Disclosure of the trade secret to the public vitiates the trade secret. Moreover, trade secret protection extends only to confidential relationships and does not prevent independent development by a competitor.

The traditional patent-versus-trade-secret calculus also takes into consideration the ease or difficulty in detecting patent infringement by a competitor and the ease or difficulty that a competitor will encounter “reverse engineering” the trade secret. In both circumstances, the greater the degree of difficulty in detection or reverse engineering, the greater the scale tips in favor of trade secret protection.

For example, the famous Coca Cola® formula has been kept as a trade secret asset for over 100 years because competitors cannot reverse engineer the exact Coca Cola® formula. If the owner had patented the famous formula, then intellectual property protection would have been lost forever upon the expiration of the patent.

Similar considerations exist in the licensing world too. Trade secrets, unlike patents, can be licensed forever. The right to obtain royalties for a patent ends upon the expiration of a patent.³ In contrast, the “trade secret” licensee can be obligated to continue paying royalties for the trade secret license even if the information has entered the public domain. This fundamental principle was enunciated in the famous *Listerine* case.⁴

The traditional calculus for patent versus trade secret protection has now undergone a major transformation. Recent decisions in patent law have weakened patent protection. In contrast, trade secrets have flourished with broad protection and with a wide range of available remedies.

Under federal law, patent protection can extend to any new and useful process, machine, manufacture, or composition

of matter, or any new and useful improvement thereof.⁵

However, patent-eligible subject matter is under attack.

Everyone is familiar with the Federal Circuit decision in *In re Bilski*.⁶ In that case, the court affirmed the rejection of patent claims involving a method of hedging risks and it announced a new machine-or-transformation test for patent-eligible subject matter, rejecting the previous and broad “useful, concrete and tangible result” test announced in the *State Street* decision.⁷ *Bilski v. Kappos* is now before the U.S. Supreme Court, but the pundits expect new restrictions on patent-eligible subject matter for “business methods” when the Supreme Court renders its decision.

Contrast patent-eligible subject matter to trade secrets. There are no subject matter constraints imposed on trade secret protection so long as the information provides a competitive advantage derived from the secrecy of the information.⁸ Both technical and nontechnical information can be protected. The gamut of trade secret protection extends from formulas, processes, research and development, quality control, processes, and methods to financial and strategic information including pricing and customer information.⁹

For example, a proprietary method for hedging risks such as the one at issue in *In re Bilski* can be protectable as a trade secret if the business method is kept secret. However, by pursuing patent protection unsuccessfully, the inventor has lost both patent protection and trade secret protection because the business method is now in the public domain. This is the “Catch-22” with any patent application disclosed to the public during the USPTO patent prosecution proceedings in the United States. The moment the patent application is published, any trade secret rights in the patent application are vitiated. Then if the patent does not issue, the inventor has lost all proprietary protection. In hindsight, the inventor would have been better off keeping the commercially valuable information secret if patent protection is uncertain.

The modern scope of trade secret protection in the United States extends to 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.¹⁰ Negative know-how (what doesn’t work) can be protected as a trade secret. Further, the fact that some or all of the components of the trade secret

R. Mark Halligan, a Nixon Peabody partner based in Chicago, is an accomplished trial lawyer who focuses his practice on IP litigation and complex commercial litigation. Mr. Halligan has also developed an extensive practice as an intellectual property litigator focused on protection and enforcement of trade secrets. He is a frequent lecturer on intellectual property issues and serves on the Adjunct Faculty of John Marshall Law School in Chicago, where he teaches trade secrets law. He can be reached at rmhalligan@nixonpeabody.com.

are well known does not preclude trade secret protection for a secret combination, compilation, or integration of the individual elements.¹¹

Today, patents are harder to get and harder to defend. The recent decision by the U.S. Supreme Court in *KSR v. Teleflex* is illustrative of this trend in the law.¹² In *KSR*, the Supreme Court changed the test for nonobviousness. Previously, a combination of references required some teaching, suggestion, or motivation that would lead one of ordinary skill in the art to combine the references. In *KSR*, the Supreme Court liberalized the test and patent examiners are no longer constrained by the TSM test. The so-called obvious to try test has now been sanctioned by the Supreme Court. If the alleged invention was “obvious to try” based upon a finite number of identified, predictable solutions, then the alleged invention fails on obviousness grounds.

The NUN factors are *not* applicable to trade secret protection. Novelty is not required for trade secret protection. Usefulness is not required for trade secret protection; in fact, negative know-how (what doesn’t work) is protectable as a trade secret. Obviousness does not come into play because the invention is treated as a trade secret. Instead, the trade secret analysis is constrained only by the difficulty to reverse engineer the trade secret. If the information is not readily ascertainable and cannot be easily reverse engineered, then the invention can be protected as a trade secret if potential or actual economic advantage is derived from the secrecy of the information.

The patent infringement analysis also needs to be considered. To establish literal infringement, the accused product must include each and every element of a single claim in order to literally infringe that claim. If the accused product does not literally infringe a patent claim, then the infringement analysis must rest on the doctrine of equivalents, which is a common law doctrine for finding patent infringement even if the literal claims of the patent are not infringed.

However, the U.S. Supreme Court in *Warner-Jenkinson Co. v. Hilton Davis Chemical Co.*¹³ circumscribed the doctrine of equivalents. The Supreme Court observed that “[t]here can be no denying that the doctrine of equivalents, when applied broadly, conflicts with the definitional and public-notice functions of the statutory claiming requirement.”¹⁴ Since *Warner-Jenkinson*, there have been numerous limitations placed on the doctrine of equivalents, including prosecution history estoppel, the all-elements rule, dedication to the public, and the “vitiation of a claim” limitation.

In contrast, the scope of trade secret misappropriation is not so limited. Proof of misappropriation can be based on circumstantial evidence.¹⁵ Access plus substantial similarity is sufficient to establish trade secret misappropriation. A finding of trade secret misappropriation does not require a showing that all the elements have been copied. Instead, a finding of trade secret misappropriation can rest on substantial similarity or substantial derivation of the products or processes at issue.¹⁶

In trade secret law, the analysis often turns upon proof of independent development or independent reverse engineering by the defendants. If the defendants cannot establish a “clean room” or other evidence to establish the independent development of the alleged infringing product, then the defendant faces liability for trade secret misappropriation. Attempts to make slight

modifications or to change the products after exposure to the trade secrets will be to no avail. Even substantial variances in the defendant’s product can fall within the ambit of trade secret misappropriation once there has been “exposure” to the trade secret.

Available remedies for patent infringement and trade secret misappropriation are another important consideration. There are numerous limitations on patent damages. The plaintiff must show actual damages; there can be no recovery for unjust enrichment.¹⁷ The patented product must be properly marked as patented or there must be proof that the infringer had actual notice and continued to infringe in order to recover past damages.¹⁸ There is no remedy available for patent infringement that occurs prior to the issuance of the patent.

Patent damages are designed to compensate patentees for their losses, not to punish accused infringers or to require them to disgorge their profits. Proof of lost profits is often not available to the patent holder because the required proof of the absence of noninfringing substitutes cannot be met. So the patent owner must turn to a “reasonable royalty” analysis and application of the entire market value (EMV) rule, which permits recovery based on the value of the entire apparatus if the patented feature is “the basis” for customer demand. However, courts are now restricting use of the EMV rule where there is a lack of evidence to show that the patented feature is the sole or predominant driver of customer demand for the product.

In contrast, damages for trade secret misappropriation can include both the actual loss caused by the misappropriation and the unjust enrichment caused by misappropriation that is not taken into account in computing actual losses.¹⁹ The right to recover “unjust enrichment” damages, which is not an available remedy in a patent infringement case, opens up a wide vista of ways to prove up damages and to seek “disgorgement of the ill-gotten gains” from the infringer, known as a “misappropriator” in trade secrets law.

In addition, the right to recover reasonable royalty damages is also recognized in trade secrets law as an available remedy in the event that neither damages nor unjust enrichment caused by the misappropriation can be proved by a preponderance of the evidence.²⁰ In trade secret cases, unlike patent cases, the “reasonable royalty” damages measure is rarely used because the “unjust enrichment” analysis almost always leads to greater damage verdicts. For example, the jury returned an award of \$192.5 million in a recent trade secrets case based on an “unjust enrichment” analysis.²¹

One also must consider the likelihood of recovery of increased damages in a patent infringement suit versus the recovery of increased damages in a trade secret misappropriation action. In the patent world, the Federal Circuit redefined willful infringement in the *In re Seagate* decision.²² Sitting *en banc*, the Federal Circuit ruled that for a trial court to award increased damages, the patentee must show by clear and convincing evidence that the infringer acted despite an objectively high likelihood that its actions constituted infringement of a valid patent. The Federal Circuit jettisoned the “duty of due care” standard. As a result, the bar is much higher now for a patentee to establish the right to recover increased damages for willful and deliberate infringement in a patent suit.

Contrast the patent rule to the recovery of increased damages

in a trade secret misappropriation case. If “willful and malicious misappropriation” exists, under the Uniform Trade Secrets Act, the trial court may award exemplary damages in an amount not exceeding twice the amount of compensatory damages.²³ This calculation, in effect, results in an award of treble damages. A finding of “willful and malicious” misappropriation takes into account both objective and subjective factors based on the totality of the evidence and most juries that find trade secret misappropriation also find that such misappropriation was “willful and malicious.” In addition, the court may award attorney’s fees to the trade secret owner if willful and malicious misappropriation exists.²⁴

Of course, no discussion of potential remedies would be complete without a discussion of the right to obtain injunctive relief. Permanent injunctions are sought in patent infringement suits and trade secret misappropriation suits as an equitable remedy to stop the infringement. However, the Supreme Court in the now famous *eBay* decision overturned the practice of granting automatic injunctions upon a finding of patent infringement.²⁵ The patentee must now also satisfy the four-factor test for injunctions: (1) the patent holder has suffered irreparable injury; (2) remedies available at law, such as monetary damages, are inadequate to compensate for the patent infringement; (3) considering the balancing of hardships, a remedy in equity is warranted; and (4) the public interest would not be disserved by a permanent injunction. In short, the *eBay* decision eradicates the certainty that permanent injunctive relief will be granted upon a finding of patent infringement.

In contrast, injunctive relief is the primary remedy in a trade secret lawsuit because “a trade secret once lost, is lost forever.” An injunction to prevent trade secret misappropriation can be issued to prevent both the “actual” or “threatened” misappropriation of trade secrets.²⁶ Further, the inevitable disclosure doctrine provides the trade secret owner with the right to seek injunctive relief based upon the “inevitable disclosure” of trade secrets against head-to-head competitors even before there is any proof of actual misappropriation.²⁷

For all the foregoing reasons, it is now time for the intellectual property bar to revisit the decision whether to protect commercially valuable information as a trade secret asset or a patent asset. In recent years, decisions by the U.S. Supreme

Court and other developments in the law have circumscribed the once broad protection afforded to patent holders as well as remedies available to patent holders. Upon consideration of all the issues discussed in this article, the protection of such assets as trade secrets may provide a better choice for your clients in today’s environment. ■

Endnotes

1. 35 U.S.C. § 271.
2. *Kewanee Oil Co. v. Bicron Corp.*, 416 U.S. 470 (1974).
3. *Brulotte v. Thys Co.*, 379 U.S. 29 (1964).
4. *Warner-Lambert v. John F. Reynolds, Inc.*, 178 F. Supp. 655 (S.D.N.Y. 1959), *aff’d*, 280 F.2d 197 (2d Cir. 1960).
5. 35 U.S.C. § 101.
6. 545 F.3d 943, 88 U.S.P.Q.2d (BNA) 138 (Fed. Cir. 2008).
7. *State Street Bank & Trust Co. v. Signature Fin. Group, Inc.*, 149 F.3d 1368 (Fed. Cir. 1998).
8. *NCMIC Fin. Corp. v. Artino*, 638 F. Supp. 2d 1042 (S.D. Iowa 2009).
9. *See* Uniform Trade Secrets Act (enacted in 46 states).
10. RESTATEMENT (THIRD) UNFAIR COMPETITION § 39 (1995).
11. *Rivendell Forest Prods. v. Georgia-Pacific Corp.*, 28 F.3d 1042 (10th Cir. 1994).
12. *KSR Int’l Co. v. Teleflex, Inc.*, 127 S. Ct. 1727 (2007).
13. 520 U.S. 17 (1997).
14. *Id.*
15. *Greenberg v. Croydon Plastics Co.*, 378 F. Supp. 806, 814 (E.D. Pa. 1974).
16. *Mangren Research & Dev. Corp. v. Nat’l Chem. Co.*, 87 F.3d 937 (7th Cir. 1996).
17. 35 U.S.C. § 284.
18. *Id.* § 287(a).
19. Uniform Trade Secrets Act § 3(a).
20. *Id.*
21. *Mannsfeld v. Ineos Phenol GbmH & Co.* (Ala. Cir. Ct. 2008).
22. *In re Seagate Tech., LLC*, 497 F.3d 1360 (Fed. Cir. 2007).
23. Uniform Trade Secrets Act § 3(b) (modified in some states).
24. *Id.*
25. *eBay, Inc. v. MercExchange, LLC*, 547 U.S. 388 (2006).
26. Uniform Trade Secrets Act § 2.
27. *PepsiCo, Inc. v. Redmond*, 54 F.3d 1262 (7th Cir. 1995).