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IP Considerations in Corporate Transactions Series – Part 1: Trade Secrets

A company's patents, copyrights, trademarks, trade secrets, trade dress, and goodwill are typically among its most valuable assets. Due diligence regarding intellectual property rights is essential to an accurate evaluation of your position whether it be in a merger, acquisition, divestiture, or joint venture. Moreover, if as a lender, you are collateralizing IP, that carries its own set of issues. And some forms of organization of IP assets can make them harder to enforce and, hence, reduce their value. Finally, taxes and bankruptcy can present opportunities but also traps for the uninformed.

Defining Trade Secrets

A trade secret is defined under the federal Defend Trade Secrets Act (DTSA) or the Uniform Trade Secrets Act (UTSA)[1] as "information which derives independent economic value from being not generally known or readily ascertainable through proper means."[2] Unlike patents, trade secrets can be abstract ideas so long as they provide value to those that own them and are not generally known. For example, an algorithm created by its owner but never written down or fixed in a tangible medium can be a trade secret.

A trade secret also need not be novel over the prior art in a field, so long as the secret is not generally known in the prior art. Trade secrets can take nearly any form. They can include customer and pricing information, sales and marketing strategies, logistics for delivery routes, research and development, or any type of know-how, so long as it gives the owner a competitive advantage. One indicator of a trade secret is whether its disclosure would allow a competitor to take market-share or customers away without making a similar investment of time and resources into the

information used to compete with the trade secret owner.[3]

The Dirty Secret of Trade Secrets

There is a dirty secret to trade secrets that can present challenges in transactions: many businesses when asked will say that any non-public information they use in their business is trade secret. Not true. Information an employer is required to collect and maintain or report by law may be confidential, but it is not typically a trade secret because it does not give the business an advantage over competitors in the market. Some information that was trade secret has been disclosed publicly and is no longer secret. This includes technology disclosed in a patent but not claimed as an invention. The nature of a trade secret means that it cannot be used in a meaningful way in a transaction unless the trade secret has been defined, shown to have been kept secret and that its secrecy continues to be protected, and creates some sort of competitive advantage for the owner (even if the full value is not yet realized, as with early stage R&D).

Protecting Trade Secrets

The evaluation of the viability of a trade secret as an element of a transaction requires due diligence and efficacy of the protective measures and investigation of the utility of the trade secret.

Both the DTSA and the USTA require that the trade secret owner has used "reasonable measures" to keep the information secret. There is not a bright-line test for whether the methods employed to maintain secrecy are "reasonable." Instead, reasonableness is a function of the nature and economic value of the trade secrets relative to the costs of employing various security measures and the likelihood of misappropriation.[4] Reasonable measures can include, but are not limited to, restricted access, such as password protections and compartmentalization of information on a need-to-know basis, surveillance systems, and non-disclosure or confidentiality agreements.

Defining Trade Secrets – Value from Secrecy

Once the trade secret has been defined and security measures found adequate, the big issue is whether the secret gives its owner an advantage over its competitors by not being generally known. For example, an algorithm that can interpret data sets more efficiently and with greater accuracy than methods known in the industry has utility. But is it generally known? Your client likely has good information on the trade secret's utility or advantages, but you may need to do a sort of "prior art" search to see if the technology is unknown or if a customer list in the area has value (a customer list culled from 10,000 customers in a market is generally unknown, but a customer list culled out of five customers – not so much!)

Trade secrets, like other forms of property can be valued, and there are valuation experts in related areas who can value them.

Trade Secrets as Collateral or Security

Using a trade secret as collateral or security is tricky because public filings cannot reveal the trade secret without destroying it. Filing a lien in the county property records doesn't work for trade secrets the way it works for real property. Creative ways of securing trade secrets require exploration – something our team is able to do.

This blog was drafted by Holly Barnes and DJ Healey, attorneys in the Spencer Fane Houston office. For more information, visit spencerfane.com.

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[1] 1 The UTSA has been enacted by all states with the exception of New York and North Carolina.

[2] *CAE Integrated, L.L.C. v. Moov Techs., Inc.*, 44 F.4th 257, 262 (5th Cir. 2022).

[3] *Cisco Sys., Inc. v. Chung*, 462 F.Supp.3d 1024, 1047 (N.D. Cal. 2020).

[4] See, e.g., *WWMAP, LLC v. Birth Your Way Midwifery*, 711 F.Supp.3d 1313, 1321-22 (N.D. Fla. 2024).

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