Unique Trade Secret License Agreement Features

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While there has been significant growth in worldwide patent applications filed and patents granted, much intellectual property continues to be protected as a trade secret. Fortunately, much like other forms of intellectual property, trade secrets can be licensed to generate revenue. There are some unique features in a trade secret license when compared to other forms of intellectual property licenses that need to be considered when drafting and negotiating such licenses.

Actual Protection

Given the secret nature of a trade secret it must actually be kept confidential to retain its inherent value (although nothing prevents a third party from independently developing the trade secret). This is a unique feature of a trade secret license. In other forms of intellectual property (IP) licenses the details of the IP are publicly known. The licensor will take steps and implement safeguards and measures to maintain the confidentiality of the trade secret. In cases where a trade secret has extreme value the licensor may implement a full scale trade secret program, including a wide range of measures from sign-in procedures for visitors, escorted access for visitors, confidentiality training for employees, clean room procedures and, of course, cybersecurity controls.

Licensors that appreciate the types of measures required to protect a trade secret will appreciate that the terms of a trade secret license must similarly obligate the licensee to take such measures. This may go beyond usual confidentiality covenants that require a licensee to (a) keep the trade secret confidential, (b) only disclose the trade secret to its employees and contractors who have a need to know (and then only to contractors who are contractually bound to keep the trade secret confidential) and (c) employ reasonable physical, technical and administrative safeguards to protect the trade secret.

In addition to these obligations, a licensor may want to conduct some due diligence to determine how a licensee protects its own trade secrets before entering into the license, and then contractually obligate the licensee to shore up any deficiencies identified during such due diligence.

A licensor may further want to spell out some of the best practices for protecting trade secrets in a license. This may include requiring adherence to cyber security industry

standards, or at least particular cyber security controls if the trade secret is particularly susceptible to a security breach.

Still further, a licensor may want to include an early warning provision to obligate the licensee to provide notice as soon as possible if an unintended disclosure appears likely or may have occurred. This can allow the parties to act quickly to try to preserve the trade secret. Dealing with a number of false positives in such circumstances is better than dealing with an actual unauthorized disclosure after it is too late.

A licensee may also be interested in obliging the licensor to implement similar protection measures (rather than just dealing with the consequences of the licensor failing to take these steps), particularly if the trade secret disclosure would enable the licensee's competitors, or if the licensor does not seem to be sophisticated enough to appreciate the steps required to maintain a trade secret.

Disclosure Consequences

The corollary of the need to protect a trade secret's confidentiality in a trade secret license is the need to address the consequences of disclosure or independent development. Despite the parties' best intentions and efforts to protect a trade secret there can be accidental or negligent disclosure or a third party may independently develop or discover the trade secret without any breach of the trade secret license agreement.

Before addressing the consequences of a potential disclosure, the parties should be obliged to be certain that there has actually been an unintended disclosure, and to take immediate steps to try to mitigate a potential disclosure. This may sometimes involve a forensic analysis, conversations with ex-employees or threats to third party actors, but in some cases, through such measures, the parties may realize the trade secret is still confidential or can be maintained as such.

If a trade secret truly has been publicly disclosed then a trade secret license should have provisions addressing (among other things) the implications on the royalties, payment terms, damages and other remedies. The various outcomes of a disclosure often depend on the circumstances of the disclosure. The disclosure may have been caused by the licensor, by the licensee or by a third party acting through malfeasance (hackers, corporate espionage, etc.). The disclosure may have been wilful, negligent or a pure accident. Conversely, a third party may have independently developed or discovered the trade secret. How can each of these circumstances be properly reflected in a trade secret license?

The effect on the royalty or payment terms depends on the parties' understanding of the value of the trade secret and what rights the license conveys. In some cases the value of the license is the licensors' initial disclosure of the trade secret to the licensee, rather than the ongoing right to make or use the trade secret or sell products that incorporate the trade secret (after all, it is not a patent license). The licensee derives value from learning the trade secret to incorporate it into the licensee's processes or manufacturing methods – there may be no other inherent value. In other cases, where the license is a hybrid license or where improvements to the trade secret are shared with the licensee over time there can be additional value.

When the parties subscribe to the view that the royalty payments or other compensation are tied to the value of the initial disclosure then the terms may be unaffected by a disclosure of the trade secret by the licensee or by a third party, or as a result of independent development. That is, in these cases the licensee's obligation to pay royalties will not stop on the disclosure of the trade secret.

Conversely, if the parties agree that there is a secondary value in the trade secret for the licensee then the licensor's disclosure may result in the royalties being adjusted to reflect the loss of a benefit. Ideally the parties will contemplate the amount of this adjustment or formula as part of the license agreement rather than trying to agree on the mechanism when the parties find themselves in the difficult situation that exists when the trade secret has been disclosed.

If there is a bundle of trade secrets in the license then the agreement may set out remedial measures to be taken to protect the remaining trade secrets or future trade secrets (such as improvements) that are shared.

A trade secret license should address the remedies arising from trade secret disclosure. For example, while royalty payments may continue after public disclosure of the trade secret by either party, a licensor may not be satisfied with such an outcome. If it is a hybrid exclusive license and a more lucrative licensing opportunity with another licensee is available then the licensor may prefer to terminate the agreement altogether.

In some cases parties may want to spell out a measure of pre-calculated liquidated damages if the licensee caused the public disclosure. This can be a helpful discussion for the parties during negotiations of the license agreement as it can expose each party's expectations of the value of the trade secret. Such a discussion can help with royalty calculations, help each party understand the relative investment they should make in trade secret protection measures (as there can be a significant institutional cost associated with trying to keep a secret) and it can also help the licensee appreciate the implications of incorporating the trade secret into their commercial process.

To be sure that a remedy for a claim for damages is available the parties will want to draft the limitation of liability provisions carefully. For example, while indirect and consequential damages are often excluded in a variety of commercial agreements, that may not be appropriate for a trade secret license given the types of losses that can result from a breach of the agreement.

A word of caution for licensors — if the license is just for a trade secret (i.e. it is not a hybrid license) then it may be an unlawful restraint of trade to restrict the licensee from using the trade secret once it is publicly disclosed or publicly available. This is one very good reason to pro-actively address disclosure scenarios in the license agreement, as once the secret is disclosed some remedies are no longer available.

There are some unique considerations for drafting trade secret licenses given the sometimes precarious or fragile nature of trade secrets due to their secret nature, particularly when compared to other forms of intellectual property. While trade secret licenses are a useful tool for licensors to extract value from IP, and while they can help licensees get a jump on their competitors, both parties must be aware of how to appropriately handle these unique elements to successfully commercialize this form of intellectual property asset.

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