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Fiduciary Duties of Directors When Managing Intellectual Property

By Irah H. Donner*

ABSTRACT

The law covering corporate director duties pertaining to management of intellectual property assets is evolving, making it important for directors to remain up-to-date on any and all changes in management procedures and best practices. Generally, courts treat intellectual property assets like any other corporate asset, which means directors must approach intellectual property with the same due care as they would any other asset.

For example, directors must be informed of the value of their intellectual property and always remember their duty of loyalty to their shareholders. Similarly, courts require directors to implement necessary internal controls to protect their corporation’s intellectual property assets. Finally, directors must refrain from misappropriating intellectual property.

Recent cases include DuPont v. Medtronic Vascular, where the Superior Court of Delaware acknowledged that corporate officers and directors may have an affirmative duty to monetize their corporation’s intellectual property, including the use of litigation if necessary.1 Furthermore, the Securities and Exchange Commission recently filed a complaint against CytoGenix Corporation, its president, Lex Cowsert, and a board member, Christopher Plummer, claiming the defendants lied to investors by issuing false press releases associated with an influenza vaccine’s development when the corporation had already lost all of its patents in a prior lawsuit.2

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I. FIDUCIARY DUTIES OF DIRECTORS

¶1 Under Delaware corporate law, directors of a corporation are required to perform their duties to the corporation with due care, loyalty, and in good faith. Due care requires that the directors make informed decisions, which therefore requires directors to be sufficiently knowledgeable in the subject matter for which such decisions must be made.\(^3\) The duty of loyalty requires that directors take actions in the best interest of the corporation. The directors must go about their actions in good faith. If such actions are taken in bad faith, directors’ decisions could face scrutiny and potential liability.

¶2 In the current corporate climate, because intellectual property assets tend to comprise a high percentage of a company’s value (especially for technology companies), the management of these assets could very well fall within the ambit of directors’ fiduciary duties.

¶3 If a director or a board of directors fails to adequately manage a corporation’s intellectual property assets, they could be deemed to have breached their fiduciary duty to the corporation. Under the business judgment rule, courts will defer to a board’s decision as long as the directors fulfilled their duties to the corporation and their decision was made with a rational basis. If a director fails to act in good faith or acts on an uninformed basis, he or she could face scrutiny. In addition, directors could face scrutiny for wasting valuable corporate assets. A court may find directors breached their duty by not properly managing the corporation’s assets, amounting to waste. However, as this article discusses further, the threshold for improper management to be considered wasting a corporate asset is significant.

¶4 Directors also face additional duties under the Sarbanes-Oxley Act. Intellectual property may need to be accounted for under the Sarbanes-Oxley disclosure rules, and the mismanagement of corporate assets by directors could lead, in exceptional cases, to charges of securities fraud and 10(b) and 10b-5 violations.

II. BREACH OF FIDUCIARY DUTIES AND THE BUSINESS JUDGMENT RULE

¶5 Generally, because courts believe boards, with the knowledge and tools they have at their disposal, are better equipped to run their companies than the courts themselves, they will defer to the judgment of directors in business decisions.\(^4\) However, if the board makes a decision in bad faith, on an uninformed basis, or if there is no rational business basis for its decision-making, courts may be unwilling to defer to the board’s judgment.\(^5\)

¶6 In the intellectual property context, this raises questions as to the extent to which a board needs to manage such assets, and whether it may defer to the expertise of intellectual property counsel. Directors have different duties depending on whether they are actively

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\(^3\) Lyman Johnson, The Modest Business Judgment Rule, 55 BUS. LAW. 625, 630 (2000). Similar rules may apply in respect to limited liability companies. See, e.g., Auriga Capital Corp. v. Gatz Props., LLC, 40 A.3d 839, 850–51 (Del. Ch. 2012), aff’d, 59 A.3d 1206 (Del. 2012). In some situations, an LLC operating agreement may restrict or eliminate a manager’s fiduciary duty of loyalty. See Zimmerman v. Crothall, 62 A.3d 676, 701–04 (Del. Ch. 2013). This restriction of fiduciary duty will likely not affect a manager’s covenant of good faith and fair dealing. See, e.g., 6 Del. C. § 18–1101(c) (prohibiting parties to an LLC operating agreement from contracting out of the implied covenant of good faith and fair dealing).

\(^4\) Johnson, supra note 3, at 626–27.

\(^5\) Id.
engaging in buying and selling assets or overseeing the management of the corporation’s assets.

A. Board Action – Miron

¶7 When a board is determining whether to buy or sell material assets, it will not meet its fiduciary duties unless it is well-informed on the matter. To stay well-informed, directors must perform due diligence with respect to the relevant assets. Although, a board of directors may want to consult with an expert, the board should make its own decision as to whether or not to buy or sell material assets. A plaintiff shareholder may be able to overcome the business judgment rule by showing that the process of arriving at a decision was done in bad faith or on an uninformed basis.

¶8 For example, a shareholder class action lawsuit was filed by ContentGuard Holdings (“ContentGuard”) against ContentGuard directors and its majority shareholders, Microsoft Corporation (“Microsoft”), Xerox Corporation (“Xerox”), and Time Warner, Inc. (“Time Warner”). See Stockholders Derivative and Class Action Complaint, Miron v. Microsoft Corp., No. 1149, 2005 WL 5769566 (Del. Ch. Mar. 4, 2005). The majority shareholders (some of whom had members on the ContentGuard board of directors) tried to obtain extremely broad and valuable intellectual property licenses from ContentGuard at nominal value. See id. ¶ 4. The employee shareholders of ContentGuard alleged that the majority shareholders and the director defendants breached their fiduciary duties owed to the employee shareholders.

¶9 The complaint alleged that the defendants breached their duties of loyalty and good faith and fair dealing by causing ContentGuard to license its valuable technology in exchange for only nominal consideration, and that the defendants prevented ContentGuard from growing its revenues, earnings and cash flow, thereby acting in bad faith. See id. ¶ 55. Although this case was settled, it highlights the importance of directors being informed on the value of their intellectual property assets and in this case, the value of their technology licenses. When deciding whether to license or sell material assets, directors have a duty of loyalty and care to their shareholders.

¶10 In another class action lawsuit, Tibotec-Virco CVA v. Rompaey, shareholders of Tibotec-Virco CVA (“Tibotec”) brought an action against Rompaey, a director of TherapyEdge, Inc. (“TherapyEdge”), a corporation of which Tibotec was a minority shareholder. See Verified Complaint at 2, Tibotec-Virco CVA v. Rompaey, No. 673-N, 2004 WL 2364795 (Del. Ch. Sept. 1, 2004). TherapyEdge owned very valuable intellectual property, including a method and system that helped provide treatment programs for HIV patients. See id. The complaint alleged that Rompaey breached his fiduciary duty to the shareholders by failing to exercise due care in managing these material assets.

¶11 The shareholders complained that because Rompaey approved the sale of TherapyEdge assets for inadequate consideration with grossly unfair terms, he breached

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7 See id. ¶ 4.
8 See id.
9 See id. ¶ 55.
11 Id.
12 Id.
his duty of care. The shareholders also alleged Rompaey failed to take reasonable steps to maximize shareholder value when selling TherapyEdge’s assets, and that Rompaey breached his duty of loyalty and good faith by not acting in the corporation’s best interest. They also alleged that Rompaey failed to maximize shareholder value when he sold the assets for less than fair consideration, which was detrimental to TherapyEdge, its shareholders, and, its creditors. This case was eventually settled, but it too shows the importance of directors fulfilling their fiduciary duties to their companies in the intellectual property context.

These cases exemplify the types of claims that shareholders might bring against a board for breaching its fiduciary duty in the intellectual property context. When a corporation fails to receive adequate consideration for its material intellectual property assets, shareholders might claim the directors breached their fiduciary duty to the corporation and to the shareholders. These cases also demonstrate that directors should perform adequate due diligence on the value of their material assets before taking any action in their sale or disposition. Furthermore, in the intellectual property context, board members must stay well-informed in the acquisition and sale of material intellectual property assets. It should be noted, however, that in Delaware, the Delaware Code protects directors from personal liability for breaches of the duty of care, but not for breaches of the duties of loyalty or good faith.

B. Board Inaction – In Re Caremark/Cement Lock

Not only may boards face scrutiny for actions they take that may breach of their fiduciary duties, but they also may face liability for their inaction. Though a board must make major decisions regarding a corporation’s material assets, the board also may be responsible for the daily management of those assets. In the landmark case In re Caremark, the Delaware Chancery Court provided guidance on what a board’s duties are in the ongoing maintenance of corporate assets. In that case, the court acknowledged that the business judgment rule generally applies to board actions; however, a board cannot turn a blind eye to the day-to-day management of the corporation and be shielded from liability because they took no action.

Caremark involved a health care service corporation that was making illegal payments to doctors who, in return for a kickback from Caremark, would recommend that their patients use Caremark products. The directors were accused of breaching their fiduciary duties to the corporation for failing to detect illegal payments that were being made by the corporation. However, the court found that this failed oversight did not amount to a breach of their duties. Instead, the court said that, to lose the protection of the

13 Id.
14 Id. ¶ 72, 74.
15 Id. ¶ 81.
16 DEL. CODE ANN. tit. 8, § 102(b)(7) (West 2015).
18 See id.
19 Id. at 961–62.
20 Id.
business judgment rule, a board must have a “sustained or systematic failure . . . to exercise oversight . . . .” 21

Caremark leaves open the question of how much oversight is needed by the board. The only guidance provided by the court was “the level of detail that is appropriate . . . is a question of business judgment.” 22

In Pereira v. Cogan, a chapter 7 trustee brought an action against a corporate debtor’s directors for self-dealing and breach of fiduciary duty. 23 Some of the directors had not voted on certain corporate expenditures and tried to shield themselves from liability by arguing they had not taken any action at all. 24 The Southern District of New York ruled that directors, by abstaining from voting on challenged corporate expenditures, could not insulate themselves from liability. 25 Their decision not to vote thereby lost the protection of the business judgment rule, and the directors had to prove that their decision not to vote was based on sound business judgment. 26

In another Southern District of New York case, In re Oxford Health Plans, Inc., shareholders brought an action against the directors of the health care plan provider for “failing to have in place sufficient financial controls and procedures to monitor the planned conversion to a new computer system . . . .” 27 The court found that demand futility was properly pled because the shareholders alleged specific facts to show the directors breached their duties to the corporation by failing to oversee certain procedures. 28

Recently, in Zomolosky v. Kullman, shareholders brought an action against the directors of DuPont Co., an agricultural products corporation, for demand futility because the board of directors allegedly failed to prevent willful infringement of a competitor’s patent. 29 In this case, the shareholders claimed that the board of directors supported unlawful acts of patent infringement, which resulted in a billion-dollar judgment against DuPont Co. 30 However, the court ruled that the claim was not properly established because there was no evidence to show that the directors knew that DuPont Co. was infringing. 31

It is likely that this standard of care and diligence would also apply to the management of intellectual property assets. However, what is unclear is just how much oversight is necessary. Because of the highly sophisticated and technical nature of intellectual property, boards might consider deferring or delegating the management of those assets to the corporation’s lawyers, including patent and intellectual property counsel. A director can delegate this power only when it does not abdicate the director’s authority. Abdication occurs when the board delegates duties that “[lie] at the heart of the management of the corporation.” 32 This determination is fact specific and may differ from

21 Id. at 971.
22 Id. at 970.
24 Id.
25 Id.
26 Id.
28 Id. at 116.
30 Id.
31 Id.
corporation to corporation, given the relative importance of their intellectual property assets.

¶20 For example, in *Cement-Lock v. Gas Technology Institute*, members of Cement-Lock Group, LLC (“CLG”) brought a derivative action on behalf of CLG against certain board members, claiming they failed to institute the necessary internal controls.33

¶21 CLG asserted some of its board members were losing the company revenue through entering into fraudulent contracts to lease out CLG’s patented decontamination technology.34 The District Court in Illinois, applying Delaware law, made clear that the defendants were “liable not only if they were aware of the [fraud] but also if they should have been aware of it.”35 The Court ruled the plaintiffs submitted enough evidence to withstand defendants’ summary judgment motion.36

¶22 Similarly, in a class action lawsuit against RSA Security, Inc. (“RSA”), shareholders argued that the directors breached their fiduciary duty of care by not filing for European patent protection, thereby allowing other companies to use RSA’s technology abroad.37 Even though this case was settled, the threat of large class actions and settlements is important for directors to consider in the management of their material intellectual property assets.

¶23 Finally, in an ongoing suit, DuPont shareholders brought a derivative claim against the corporation’s board for breach of fiduciary duty, asking the court to direct DuPont to improve its corporate governance.38 The complaint stems from a $1 billion jury verdict in 2009 against DuPont for patent infringement.39 In 2002, DuPont crafted a licensing agreement for herbicide-resistant seeds, which was found to incorporate a rival’s patent.40 The complaint alleges that DuPont’s board knew it could not rely on the licensing agreement to manufacture its herbicide-resistant seeds, because the corporation’s rigid internal controls would have alerted the board that the alleged infringement posed a serious danger.41

¶24 In a recently filed suit, shareholders asserted claims against Marvell Technology Group’s directors and officers for failing to stop Marvell’s production of products found to willfully infringe a competitor’s product, for failing to settle the lawsuit, and for failing to inform shareholders before trial that Marvell was likely infringing a competitor’s patents.42 The claims arise from a jury verdict, and subsequent district court judgment, that found that Marvell willfully infringed two claims of two patents.43 The court awarded $1.17

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33 523 F. Supp. 2d 827, 842 (N.D. Ill. 2007).
34 Id.
35 Id.
36 Id. at 864.
39 See id.
40 See id. at 2–3.
43 See id.
billion in damages. The complaint alleges that the award granted in the case “has impaired or may impair [Marvell’s] ability to pay future dividends to its shareholders.”

Mismanagement of the intellectual property of a corporation is a potential source of liability for directors. Directors must therefore ensure that they are fully informed about their corporation’s material assets before they sell or dispose of them. However, the board must also ensure that there is an effective system in place that allows it to monitor the ongoing activities of the corporation.

C. Failure to Take Shareholder Vote – Van Gorkom/Apple Computer, Inc.

Failing to implement effective monitoring systems is one potential grounds for a claim of intellectual property mismanagement, but there are other ways in which a claim of mismanagement against directors can arise. For instance, the court in Smith v. Van Gorkom formulated that:

[i]n the specific context of a proposed merger of domestic corporations, a director has a duty under 8 Del.C. § 251(b), along with his fellow directors, to act in an informed and deliberate manner in determining whether to approve an agreement of merger before submitting the proposal to the stockholders. Certainly in the merger context, a director may not abdicate that duty by leaving to the shareholders alone the decision to approve or disapprove the agreement.

Hence, directors must make an informed, deliberate decision on merger proposals, and may also be obligated to submit the proposal for a shareholder vote.

For instance, consider the case of Apple Computer, Inc. v. Exponential Technology, Inc. Apple was Exponential’s largest shareholder when Exponential auctioned off forty-five patents without prior shareholder approval. Apple claimed that shareholder approval of the patent sale was required under title 8, section 271 of the Delaware Code. The court found that Apple pled facts that sufficiently alleged Exponential’s failure to comply with its statutory obligations by neglecting a shareholder vote. If true, the court said, this failure would constitute gross negligence.

III. WASTE – IN RE WALT DISNEY/ANALYTICA OF BRANFORD, INC.

Directors have the general responsibility of managing the assets of their corporation. For example, section 122(4) of the Delaware General Corporation Law states that directors

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45 See Complaint at 2, Sutardja, Nos.: 14-cv-01581.
47 488 A.2d 858, 873 (Del. 1985).
49 Id.
50 Id.
51 Id.
52 Id.
have the power to “sell, convey, lease, exchange, transfer or otherwise dispose of, or mortgage or pledge, all or any of its property and assets, or any interest therein.” 53 Under the doctrine of waste, directors can be liable for breaching their fiduciary duty when they sell material assets for an inadequate price even if the business judgment rule applies. The threshold to prove a violation under a waste claim is high. In order to be liable for waste, the price that the seller receives must be “so inadequate in value that no person of ordinary, sound business judgment would deem it worth what the corporation has paid.” 54

This strong language shows that waste claims are difficult to prove even outside of the intellectual property context. Waste claims are generally made when a board decides to sell or transfer assets for inadequate consideration. 55 Therefore, these claims generally only apply to board action, not inaction.

Consider the Delaware Supreme Court’s decision in In re Walt Disney, where the shareholders tried to make a waste claim when the directors paid exorbitant amounts to its president. 56 The Disney board of directors endorsed the Disney Chief Executive Officer’s decision to hire a new president. 57 Fourteen months later, the new president was terminated without cause and his severance package amounted to $130 million. 58 The court found that even this substantial payment did not result in waste, because there was no proof the payment was an irrational business decision. 59 The CEO contract did materially affect the value of the corporation, but the transaction was not irrational enough to constitute waste. 60

The In re Walt Disney standard now applies to a number of scenarios, including those involving intellectual property. For instance, consider Analytica of Branford, Inc. v. Fenn. 61 Analytica of Branford (“AOB”) was co-founded by John Fenn in order to market a patent which Fenn developed. 62 AOB eventually sued Fenn, claiming he engaged in misrepresentations; Fenn counterclaimed, alleging AOB committed corporate waste by entering into a contract with Yale University that provided AOB no benefit. 63 Quoting In re Walt Disney the court noted, “[t]o recover on a claim of corporate waste, the plaintiffs must prove that the exchange was so one-sided that no business person of ordinary, sound judgment could conclude that the corporation has received adequate consideration.” 64 The Court concluded that because Yale was actually the rightful owner of the patent, “Fenn

53 Delaware General Corporation Law, Del. Code Ann. tit. 8, § 112 (West 2015). Because directors have the duty to manage the corporation’s assets, this means that directors have the duty to manage their intellectual property assets as well.
55 See, e.g., In re Citigroup Inc. S’holder Derivative Litig., 964 A.2d 106, 137–38 (Del. Ch. 2009) (allowing a waste claim to go forward on the basis of the plaintiffs’ allegations that the board approved the payment of a “multi-million dollar compensation package to a departing CEO whose failures as CEO were allegedly responsible, in part, for billions of dollars of losses at [the company],” in exchange for which the company obtained from the CEO non-compete, non-disparagement, non-solicitation, and release agreements of allegedly limited value).
56 In re Walt Disney Company Deriv. Lit., 906 A.2d 27 (Del. 2006)
57 Id.
58 Id.
59 Id. at 75.
60 Id.
62 Id.
63 Id. at *2
64 Id. (citation omitted).
[had not] presented any evidence that the . . . license agreement was ‘one sided’ and thus of little benefit to [AOB].”65

Similarly, in Swingless Golf Club Corporation v. Taylor, Swingless Golf Club Corporation (“SGCC”) sued Roy Taylor over the use and transfer of four patents relating to the creation of the swingless golf club.66 SGCC allegedly owned the patents involved in the club’s production, and Taylor was the former CEO of SGCC, as well as the inventor and former owner of the patents.67 Taylor counterclaimed, arguing that SGCC committed corporate waste by misusing investor funds because SGCC failed to develop the product for many years and never made any attempts to sell the product.68 The Northern District of California held that because SGCC neither developed nor attempted to sell the swingless golf club, Taylor’s counterclaim was sufficiently plausible to survive a motion to dismiss.69

Precedent on waste makes it clear that courts have afforded directors a great amount of protection against these claims. Just like under the business judgment rule, courts tend to defer to the board’s expertise when analyzing any claims against them. Despite this deference, shareholders still pursue these claims. For example, in the Microsoft and ContentGuard complaint, the plaintiffs alleged that the director defendants seized valuable corporate opportunities and prevented ContentGuard from growing by selling their valuable assets for a nominal value.70 Furthermore, in a more recent case, the Superior Court of Delaware acknowledged that there may be an affirmative duty on corporate officers and directors to monetize their corporation’s intellectual property.71 This right includes the ability to “vigorously defend [the corporation’s] intellectual property, through litigation if necessary. [Furthermore,] there is nothing nefarious about a corporation generating profits through its legal department.”72

IV. SARBAKES-OXLEY

The Sarbanes-Oxley Act of 2002 (“Sarbanes-Oxley Act”) imposes certain disclosure obligations on public companies.73 These obligations require that corporations have effective systems in place to monitor and manage their disclosure.74

Section 302 of the Sarbanes-Oxley Act requires that the Chief Executive Officer and Chief Financial Officer of a corporation personally certify the effectiveness of disclosure controls and procedure.74 Section 404 of the Sarbanes-Oxley Act requires that issuers include in their annual reports the scope and adequacy of their internal control system and their procedures for financial reporting.75 This obligates companies to establish and

65 Id. at *2–3.
67 Id. at 1064.
68 See id. at 1065.
69 See id.
72 Id.
74 Id. § 302.
75 Id. § 404.
maintain adequate internal control structures and assess their systems’ effectiveness at the end of the year. Finally, Section 409 of the Sarbanes-Oxley Act requires that issuers make real-time disclosures to the public of any material changes to their financial condition or operations, suggesting that directors must be aware of any material changes to corporate assets in a timely manner.77

Although the directors of public companies should be aware of these disclosure laws, the Sarbanes-Oxley Act neither explicitly lists intellectual property as something that directors must account for in their disclosure nor imposes any unique requirements for intellectual property issues. However, because of the importance of intellectual property to many companies, directors should not overlook their intellectual property when accounting for their corporation’s assets. In the current industrial climate, if a corporation experiences a material loss from an intellectual property risk and has not accurately disclosed such loss in a timely manner due to inadequate controls, a corporation could face significant exposure.

V. SECURITIES VIOLATIONS – IN RE AOL, INC./IN RE HP SECURITIES LITIGATION

Directors also may face liability for violations of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder.78 Violations under this section of the Act occur when a person schemes to defraud others by making material misstatements or material omissions in the sale or purchase of securities.79 In recent years, shareholders have brought claims against directors for their failure to release material information about intellectual property assets they are buying or selling.80

In In re AOL, Inc. Repurchase Offer, shareholders alleged that the AOL, Inc. (“AOL”) management deceived AOL shareholders by entering into a common stock repurchase program at artificially deflated prices while concealing material information about their assets’ true value.81 AOL’s management planned on monetizing a patent portfolio, which would have caused a huge increase in value over what AOL’s books allegedly indicated.82 Shareholders alleged that they were tricked into selling their stock shares prematurely to AOL at an artificially depressed price, while AOL secretly planned to sell the stock for a large profit after the patent portfolio sale was complete.83 Because shareholders claimed the management concealed the true value and liquidity of their patent portfolio from the shareholders, management faced potential Section 10(b) and 10b-5

76 See id.
77 See id. § 409 (“Each issuer reporting under section 13(a) or 15(d) shall disclose to the public on a rapid and current basis such additional information concerning material changes in the financial condition or operations of the issuer, in plain English, which may include trend and qualitative information and graphic presentations, as the Commission determines, by rule, is necessary or useful for the protection of investors and in the public interest”).
79 See id.
81 966 F. Supp. 2d 307 (S.D.N.Y. 2013)
82 Id.
83 Id.
liability for their allegedly intentional scheme to defraud shareholders of the real value of their intellectual property. 84

¶39

In another ongoing case, Hewlett-Packard (“HP”) bought Autonomy, a corporation that allegedly had very serious accounting misrepresentations on its financial statements regarding its intellectual property assets. 85 About a year after the purchase, HP claimed an almost $9 billion loss. 86 The shareholders of HP brought Section 10(b) and 10b-5 claims against the directors and management of HP. 87 They alleged that the defendants prepared and approved the false statements of Autonomy’s asset valuation, which contained material misrepresentations and failed to disclose material facts necessary in order to make the statements truthful. 88 The shareholders alleged that because of this material misrepresentation, they paid artificially inflated prices for HP stock. 89 Similarly, the Securities and Exchange Commission recently filed a complaint against Christopher Plummer (a member of the board of CytoGenix Corporation) and Lex Cowsert, (CytoGenix Corporation’s president) individually, and against CytoGenix Corporation, claiming the defendants lied to investors by issuing false press releases associated with an influenza vaccine’s development when the corporation had already lost all of its patents in a prior lawsuit. 90

¶40

These complaints make it clear that the directors and managers of corporations need to have a good understanding of the corporation’s assets and manage them in a prudent manner. This applies to intellectual property assets as well. If directors intentionally fail to inform themselves of the value of their assets, they could face 10(b) or 10b-5 liability. For example, if intellectual property assets are sold for significantly less than the alleged fair value, then directors may face liability if they failed to obtain prior to the sale any valuation of those assets.

VI. TRADE SECRETS – COMPONENTS FOR RESEARCH, INC. V. ISOLATION PRODUCTS, INC.

¶41

Boards should be aware that different duties arise with respect to disclosure of trade secrets and disclosure of patents. Some assets are not innovative enough to be granted a patent and may gain protection through trade secret classification. Directors should take these differences into account when deciding to apply for a patent or keeping an asset as a trade secret.

84 Id. Unrelated to the shareholders’ allegations regarding management deception, AOL’s motion to dismiss was granted on the basis that the shareholders failed to plead facts sufficient to raise plaintiff’s theory (that AOL’s auction of the patent portfolio was a sham) above mere speculation. See id. at 313.
86 Id.
87 See id.
88 Id.
89 See id. HP’s motion to dismiss was granted for claims arising out of statements made in a context that did not require discussing the overall valuation of Autonomy assets and made prior to HP knowing of specific allegations of Autonomy’s accounting fraud. Id. However, HP’s motion to dismiss was denied for claims arising out of statements made about possible explanations for Autonomy’s weakness that did not mention the possibility of accounting fraud, which were made after HP knew of specific allegations of such accounting fraud. See In re HP Sec. Litig., No. 3:12-CV-05980, 2015 WL 4477936 (N.D. Cal. July 20, 2015).
¶42 Trade secrets have advantages over patents. They are not limited in time, whereas most patents have a twenty-year limit.\(^91\) There are no registration costs for trade secrets, although keeping trade secrets private can be costly as well.\(^92\) Finally, trade secrets are effective immediately and no disclosure to a government agency is required.\(^93\)

¶43 However, trade secrets have some disadvantages. Outside parties may be able to disassemble the asset and recreate it so they can use the asset on their own.\(^94\) Patents allow for the exclusive use of an asset, but trade secrets do not.\(^95\) Furthermore, if the secret becomes public, all people can use it. Protection of a trade secret is not as strong as the protection afforded to a patent. Finally, an outside party may patent a trade secret by developing the information in their own way.\(^96\)

¶44 These differences should be kept in mind when directors are determining whether to apply for a patent or to keep the asset as a trade secret. Directors need to understand their intellectual property asset and whether it will benefit the corporation more as patented technology or as a trade secret. If directors are careless about applying for patents and lose valuable intellectual property, they might face liability under the doctrines previously discussed.

¶45 Similarly, directors’ duties pertaining to trade secrets are often analogous to those covering other forms of intellectual property. For instance, in *Components for Research, Inc. v. Isolation Products, Inc.*, plaintiffs sought to enjoin defendant corporation from misappropriating plaintiff’s trade secrets.\(^97\) When defendant Joseph Bianco was terminated as Components’ sales manager, yet remained one of plaintiff’s directors, he began forming Isolation Products as Components’ competitor partly by taking Components’ drawings and customer lists.\(^98\) Components notified Bianco that his corporation’s manufacturing trade secrets were disclosed to him in confidence and demanded that they cease manufacturing.\(^99\) The court found the evidence fully sustained the conclusion that the defendants violated their fiduciary duty to Components, explaining that “even in the absence of an express agreement against revelation of trade secrets, a director is under a fiduciary duty not to use or reveal them to the detriment of the corporation of which he is a director.”\(^100\)

¶46 On the other hand, the court in *AccuImage Diagnostics Corp., v. TeraRecon, Inc.* found that the plaintiffs failed to allege a director misappropriated trade secrets.\(^101\) In that case, defendant Taylor was AccuImage’s Chief Executive Officer and executed a “Confidentiality, Trade Secrets, and Assignment of inventions” provision.\(^102\) Taylor


\(^{92}\) *Id.*

\(^{93}\) *Id.*

\(^{94}\) *Id.*

\(^{95}\) *Id.*

\(^{96}\) *Id.*


\(^{98}\) *Id.*

\(^{99}\) See *id.*

\(^{100}\) *Id.* at 831.


\(^{102}\) *Id.* at 945.
eventually resigned from this position and immediately began working for TeraRecon. Plaintiffs claimed that after Taylor resigned, Boyd, an AccuImage board member and a major TeraRecon shareholder, allowed Taylor to keep his AccuImage laptop, which contained “highly confidential and sensitive proprietary trade secret information.” Two months later, TeraRecon demonstrated a new product that substantially resembled AccuImage’s technology. AccuImage claimed Boyd misappropriated trade secrets by conspiring with Taylor to steal proprietary information. The court concluded, “[e]ven if Boyd knew of TeraRecon’s misappropriation of AccuImage’s trade secrets and intentionally allowed Taylor to take his AccuImage laptop with him to his new employment, Boyd still never acquired, possessed, disclosed or used AccuImage’s trade secrets without express or implied consent.”

Overall, directors must familiarize themselves with the differences between trade secrets and other forms of intellectual property, as well as their respective duties pertaining to each.

CONCLUSION

As intellectual property assets become more significant to more corporations, directors will need to be aware of the intellectual property assets of their corporation in order to meet their fiduciary, and in some cases, legal duties. Currently, this area of the law is largely undeveloped. Directors will lessen the risk of litigation by staying well-informed on the status of their corporation’s intellectual property and recommended practices when managing such intellectual property.

To do this, directors should ensure that their corporation has an effective monitoring system in place that allows them to fulfill their fiduciary duties. For example, some have suggested that companies:

- Familiarize CEOs and CFOs with the corporation’s IP portfolios so they can make accurate and informed decisions;
- Keep board members and other directors informed to effectively oversee such decisions;
- Involve IP counsel in overall IP management; and
- Implement an effective IP Asset Management Plan.

Of course, the nature of such procedures and/or systems will differ, depending on the corporation and the intellectual assets it holds. Because of the uncertainty of the law, directors should consider consulting intellectual property counsel regularly regarding their duties.

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103 Id.
104 Id.
105 Id.
106 Id.
107 Id. at 951.