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# **CALCULATING AND PROVING DAMAGES**

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## CHAPTER 9

### Trade Secret Damages\*

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§ 9.01     **Introduction**

The law of trade secrets protects information that provides independent economic value because others do not generally know that information. The holder of a trade secret seeks to capitalize on the business advantage that derives from ownership of the trade secret and prevent use of the trade secret by competitors. Moreover, the trade secret owner must make reasonable efforts to maintain the secrecy of the trade secrets or risk loss of the trade secret protection. If a trade secret can be established, any improper disclosure or use of the trade secret by others can be actionable. If the trade secret owner succeeds in its action, it can prevent use of the trade secret through a court-ordered injunction, or it may be entitled to money damages.

Trade secret protection differs dramatically from patent protection. Unlike patented ideas, which must be published for all to see and use (subject to licensing and royalty requirements), a trade secret must be kept confidential from the business community that would benefit from its use.<sup>1</sup> In addition, a trade secret need not meet the more exacting requirements for granting a patent. A trade secret is neither reviewed nor approved by governmental authorities, nor must it overtly meet other tests such as obviousness and advancing the prior art. Indeed, competitors may independently develop similar trade secrets that each can protect from use by the other. Trade secrets can also include known business or technical techniques that are applied in a new and unknown way.<sup>2</sup> However, a trade secret cannot be maintained for information that is readily ascertainable by others.<sup>3</sup>

Trade secret protection will expire when the protected information or technique becomes publicly known to persons who are able to obtain economic value from it,<sup>4</sup> or when the trade secret holder

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<sup>1</sup> Uniform Trade Secrets Act ("UTSA") § 1(4) (as amended 1985).

<sup>2</sup> *Fourth Circuit: Head Ski Co. v. Kam Ski Co.*, 158 F. Supp. 919, 922 (D. Md. 1958) (a metal bonding technique for airplane parts was successfully employed to manufacture laminated metal skis).

**State Courts:**

*Arkansas: Saforo & Associates v. Porocel Co.*, 337 Ark. 553, 557-562, 991 S.W.2d 117, 120-122 (1999) (the plaintiff combined components that were individually known but resulted in a competitive advantage, and therefore together qualified as a trade secret).

<sup>3</sup> UTSA § 1(4).

<sup>4</sup> *Id.*

does not adequately protect the secrecy of the trade secret.<sup>5</sup> Finally, a trade secret infringement claim cannot be maintained against a third party who independently develops or obtains the trade secret either through a separate engineering process, public domain sources, or other proper means.<sup>6</sup>

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<sup>5</sup> *Id.*

<sup>6</sup> UTSA § 1, Comment; *Restatement of Torts* § 757, Comment (f) (1939).

## § 9.02 Definition of Trade Secret

### [1]—Uniform Trade Secrets Act

The modern law of trade secrets derives from the Uniform Trade Secrets Act (“UTSA”),<sup>1</sup> as adopted by the states. The UTSA has been adopted, either in full or in part, by forty-seven states, the District of Columbia, and the U.S. Virgin Islands.<sup>2</sup>

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<sup>1</sup> Uniform Trade Secrets Act (“UTSA”), drafted by the National Conference of Commissioners on Uniform State Laws and approved by the American Bar Association on August 9, 1979, with four clarifying amendments approved in 1985. See [http://www.uniformlaws.org/shared/docs/trade%20secrets/utsa\\_final\\_85.pdf](http://www.uniformlaws.org/shared/docs/trade%20secrets/utsa_final_85.pdf) (last visited February 9, 2015) (text of the Act with Comments).

<sup>2</sup> Jurisdictions that have adopted UTSA or a variation thereof include the following:

*Alabama:* 8 Ala. Code §§ 27-1 *et seq.*  
*Alaska:* Alaska Stat. §§ 45.50.910 *et seq.*  
*Arizona:* Ariz. Rev. Stat. Ann. §§ 44-401 *et seq.*  
*Arkansas:* Ark. Code Ann. §§ 4-75-601 *et seq.*  
*California:* Cal. Civ. Code §§ 3426 *et seq.*  
*Colorado:* Colo. Rev. Stat. §§ 7-74-101 *et seq.*  
*Connecticut:* Conn. Gen. Stat. Ann. §§ 35-50 *et seq.*  
*Delaware:* 6 Del. Code Ann. §§ 2001 *et seq.*  
*District of Columbia:* D.C. Code Ann. §§ 36-401 *et seq.*  
*Florida:* Fla. Stat. Ann. §§ 688.001 *et seq.*  
*Georgia:* Ga. Code Ann. §§ 10-1-760 *et seq.*  
*Hawaii:* Haw. Rev. Stat. §§ 482B-1 *et seq.*  
*Idaho:* Idaho Code §§ 48-801 *et seq.*  
*Illinois:* 765 Ill. Comp. Stat. 1065/1 *et seq.*  
*Indiana:* Ind. Code §§ 24-2-3-1 *et seq.*  
*Iowa:* Iowa Code §§ 550.1 *et seq.*  
*Kansas:* Kan. Stat. Ann. §§ 60-3320 *et seq.*  
*Kentucky:* Ky. Rev. Stat. Ann. §§ 365.880 *et seq.*  
*Louisiana:* La. Rev. Stat. Ann. §§ 51:1431 *et seq.*  
*Maine:* 10 Me. Rev. Stat. Ann. §§ 1541 *et seq.*  
*Maryland:* Md. Com. L. Code §§ 11-1201 *et seq.*  
*Michigan:* Mich. Comp. L. §§ 445.1901 to 445.1910.  
*Minnesota:* Minn. Stat. Ann. §§ 325C.01 *et seq.*  
*Mississippi:* Miss. Code Ann. §§ 75-26-1 *et seq.*  
*Missouri:* Mo. Rev. Stat. §§ 417.450 to 417.467.  
*Montana:* Mont. Code Ann. §§ 30-14-401 *et seq.*  
*Nebraska:* Neb. Rev. Stat. §§ 87-501 *et seq.*  
*Nevada:* Nev. Rev. Stat. §§ 600A.010 *et seq.*  
*New Hampshire:* N.H. Rev. Stat. Ann. §§ 350-B:1 *et seq.*  
*New Jersey:* N.J. Stat. Ann. §§ 56:15-1 *et seq.*  
*New Mexico:* N.M. Stat. Ann. §§ 57-3A-1 *et seq.*  
*North Carolina:* N.C. Gen. Stat. §§ 66-152 *et seq.*  
*North Dakota:* N.D. Cent. Code §§ 47-25.1-01 *et seq.*  
*Ohio:* Ohio Rev. Code Ann. §§ 1333.61 *et seq.*  
*Oklahoma:* 78 Okla. Stat. Ann. §§ 89 *et seq.*  
*Oregon:* Ore. Rev. Stat. §§ 646.461 *et seq.*  
*Pennsylvania:* 12 Pa. Consol. Stat. §§ 5301 *et seq.*  
*Rhode Island:* R.I. Gen. L. §§ 6-41-1 *et seq.*  
*South Carolina:* S.C. Code Ann. §§ 39-8-1 *et seq.*

The UTSA provides that a trade secret is:

“information, including a formula, pattern, compilation, program, device, method, technique, or process, that: (i) derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use; and (ii) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.”<sup>3</sup>

Under the UTSA, information does not qualify as a trade secret if it is “readily ascertainable by proper means.”<sup>4</sup> Information has been held to be readily ascertainable by proper means where it can be obtained, developed, or compiled without significant difficulty, effort, or expense, for example, from trade journals, reference books, or other published materials.<sup>5</sup> Generally, the more difficult information is to obtain, and the more time and resources expended by an employer in gathering it, the less likely that information will be deemed readily ascertainable by proper means.<sup>6</sup> Note that some jurisdictions

*South Dakota:* S.D. Codif. L. §§ 37-29-1 *et seq.*

*Tennessee:* Tenn. Code Ann. §§ 47-225-1701 *et seq.*

*Texas:* Tex. Civ. Prac. & Rem. Code Ann. §§ 134A *et seq.*

*Utah:* Utah Code Ann. §§ 13-24-1 *et seq.*

*Vermont:* 143 Vt. Stat. Ann. §§ 4601 *et seq.*

*Virginia:* Va. Code Ann. §§ 59.1-336 *et seq.*

*Virgin Islands:* 11 V.I. Code Ann., Ch. 16 §§ 1001-1010.

*Washington:* Wash. Rev. Code §§ 19.108.010 *et seq.*

*West Virginia:* W.Va. Code §§ 47-22-1 *et seq.*

*Wisconsin:* Wis. Stat. Ann. §§ 134.90 *et seq.*

*Wyoming:* Wyo. Stat. Ann. §§ 40-24-101 *et seq.*

The UTSA has not been adopted by Massachusetts, New York, or North Carolina, which have their own statutory protections for trade secrets (that are not modeled after the UTSA). For a definition and discussion of the UTSA, see [http://en.wikipedia.org/wiki/Uniform\\_Trade\\_Secrets\\_Act](http://en.wikipedia.org/wiki/Uniform_Trade_Secrets_Act) (last visited December 30, 2014).

<sup>3</sup> UTSA § 1(4).

<sup>4</sup> UTSA § 1(4)(i).

<sup>5</sup> UTSA § 1, Comment. See:

*Second Circuit:* Legal Sea Foods, Inc. v. Calise, 2003 U.S. Dist. LEXIS 14527, at \*18-19 (S.D.N.Y. Aug. 19, 2003) (plaintiff's recipes did not constitute trade secrets when plaintiff's own cookbooks largely revealed the recipes).

*Sixth Circuit:* Thermofil, Inc. v. Fenelon, 1989 U.S. Dist. LEXIS 16948, 13 U.S.P.Q.2d (BNA) 1404 (E.D. Mich. Aug. 22, 1989) (a matter that is readily obtainable from public literature, through reverse engineering or otherwise, cannot be a trade secret).

#### State Courts:

*California:* DVD Copy Control Association, Inc. v. Bunner, 31 Cal.4th 864, 899, 4 Cal. Rptr.3d 69, 99, 75 P.3d 1, 26 (2003); American Paper & Packaging Products, Inc. v. Kirgan, 183 Cal. App.3d 1318, 1326, 228 Cal. Rptr. 713, 717 (1986).

<sup>6</sup> *California:* Morlife, Inc. v. Perry, 56 Cal. App.4th 1514, 1521-1522, 66 Cal. Rptr.2d 731, 735-736 (1997).

per Wikipedia  
NC  
substantially  
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have made proof of “readily ascertainable” information an affirmative defense that must be established by the defendant.<sup>7</sup>

**[2]—*Restatement of Torts***

Another important source of trade secret law is the first *Restatement of Torts*.<sup>8</sup> The *Restatement of Torts* defines trade secrets as “any formula, pattern, device or compilation of information which is used in one’s business, and which gives him [*sic*] an opportunity to obtain an advantage over competitors who do not know or use it.”<sup>9</sup> Section 757 of the *Restatement* also includes six criteria for determining the existence of a trade secret:

“(1) The extent to which the information is known outside of the business;

“(2) The extent to which it is known by employees and others involved in the business;

“(3) The extent of measures taken to guard the secrecy of the information;

“(4) The value of the information to the business and to its competitors;

“(5) The amount of effort or money expended by the business in developing the information;

“(6) The ease or difficulty with which the information could be properly acquired or duplicated by others.”<sup>10</sup>

Moreover, the *Restatement of Torts* and jurisdictions that follow it require that an enforceable trade secret must be “a process or device for continuous use in the operation of the business,”<sup>11</sup> but there is no such requirement in UTSA jurisdictions.

In comparison, the *Restatement of Unfair Competition*, which later superseded and replaced Section 757 of the *Restatement of Torts*, notes that “the definition of trade secret adopted in the Uniform Trade Secrets Act does not include any requirement relating to the duration of the information’s economic value.”<sup>13</sup> The definition adopted in Section 39 of the *Restatement of Unfair Competition* similarly contains no requirement that the information afford a “continuous or long-term

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*Indiana: Amoco Production Co. v. Laird*, 622 N.E.2d 912, 918 (Ind. 1993).

<sup>7</sup> *DVD Copy Control Association, Inc. v. Bunner*, 31 Cal.4th 864, 881, 899, 4 Cal. Rptr.3d 69, 99, 75 P.3d 1, 26 (2003); *Abba Rubber Co. v. Seaquist*, 235 Cal. App.3d 1, 21-22, n.9, 286 Cal. Rptr. 518, 529 (1991).

<sup>8</sup> *Restatement of Torts* § 757 (1939).

<sup>9</sup> *Id.*

<sup>10</sup> *Id.*

<sup>11</sup> *Id.* at Comment b.

<sup>13</sup> *Restatement (Third) of Unfair Competition* § 39, Comment d (2002).



advantage.”<sup>14</sup> The *Restatement of Unfair Competition* notes that the “concept of a trade secret” as defined by the *Restatement* “is intended to be consistent with the definition of ‘trade secret’ in Section 1(4) of the [UTSA].”<sup>15</sup>

### [3]—State Law Differences

Because not all states have adopted the UTSA and the states that have adopted the UTSA have not necessarily adopted all of it, counsel must understand and research thoroughly the forum state’s trade secret laws. Those trade secret statutes and state case law will determine the rules of law that are applicable to the case. For example, the UTSA provides that a trade secret must not be “readily ascertainable by proper means,” thereby requiring the plaintiff to establish the non-ascertainability of the trade secret as part of its case in chief.<sup>16</sup> By contrast, in adopting the UTSA, California decided that proof that a trade secret is readily ascertainable should be an affirmative defense borne by the defendant, thereby relieving the plaintiff from proving that the trade secret was *not* readily ascertainable.<sup>17</sup>

In May 2013, Texas enacted its version of the UTSA.<sup>18</sup> As a result, Texas’s trade secret law became more business friendly by allowing for attorneys’ fees,<sup>19</sup> which were not available under Texas common law, and by creating a presumption in favor of granting protective orders for the preservation of secrecy.<sup>20</sup> In addition, the Texas UTSA expanded its definition of “trade secrets” to include financial data and lists of actual or potential customers.<sup>21</sup>

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<sup>14</sup> *Id.*

<sup>15</sup> *Id.* at Comment b.

<sup>16</sup> UTSA § 1(4)(i); Wash. Rev. Code § 19.108.010.

<sup>17</sup> Legislative Comment to California Civil Code § 3426.1.

See also, DVD Copy Control Association, Inc. v. Bunner, 31 Cal.4th 864, 899, 4 Cal. Rptr.3d 69, 99, 75 P.3d 1, 26 (2003). But *cf.*, ABBA Rubber Co. v. Seaquist, 235 Cal. App.3d 1, 21-22, 286 Cal. Rptr. 518, 528-529 (1991) (a readily ascertainable defense is not available if the defendant’s knowledge came from the plaintiff’s records, rather than from the defendant’s case development or compilation).

<sup>18</sup> Tex. Civ. Prac. & Rem. Code Ann. § 134A.

<sup>19</sup> Tex. Civ. Prac. & Rem. Code Ann. § 134A.005.

<sup>20</sup> Tex. Civ. Prac. & Rem. Code Ann. § 134A.006.

<sup>21</sup> Tex. Civ. Prac. & Rem. Code Ann. § 134A.002(6).

### § 9.03 Establishing a Protectable Trade Secret

The plaintiff has the burden of showing that a protectable trade secret exists.<sup>1</sup> Three basic elements establish that information is protectable as a trade secret: (1) the trade secret must involve information, including a process or technique, (2) which provides economic value to the holder, and (3) which is not generally known to others. If these first two elements are met, the holder of the trade secret must then establish that he has taken reasonable measures to safeguard the secrecy of the information.<sup>2</sup>

Among the factors a court will consider in determining whether a trade secret exists are:

“(1) the degree of secrecy surrounding the process both inside and outside the plaintiff’s business; (2) the plaintiff’s efforts to develop the process and to preserve its secrecy; (3) its value to the plaintiff and to its competitors; and (4) the difficulty with which it could be duplicated by others.”<sup>3</sup>

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<sup>1</sup> *Federal Circuit*: Roton Barrier, Inc. v. Stanley Works, 79 F.3d 1112, 1116 (Fed. Cir. 1996).

**State Courts:**

*Connecticut*: UTC v. Turbine Kinetics, Inc., 1998 Conn. Super. LEXIS 562, at \*3 (Conn. Super. 1998).

*Illinois*: Liebert Corp. v. Mazur, 357 Ill. App.3d 265, 281, 293 Ill. Dec. 28, 827 N.E.2d 909, 925 (2005).

*Washington*: Boeing Co. v. Sierracin Corp., 108 Wash.2d 38, 48, 738 P.2d 665, 674 (1987).

<sup>2</sup> Uniform Trade Secrets Act (UTSA) § 1(4). See:

*Idaho*: Basic American, Inc. v. Shatila, 33 Idaho 726, 735-738, 992 P.2d 175, 184-187 (1999) (given plaintiff’s seven years of development and the uniqueness of the product, the trial court properly concluded that the product was not generally known or ascertainable).

*Maryland*: Tabs Associates, Inc. v. Brohawn, 59 Md. App. 330, 344-347, 475 A.2d 1203, 1211-1213 (1984) (the court noted that considerable money had been spent, that others in the industry did not use the combination of steps used by the plaintiff, and that the plaintiff’s method permitted profitable operations whereas others in the industry had not achieved this goal).

*Missouri*: A. B. Chance Co. v. Schmidt, 719 S.W.2d 854, 856-858 (Mo. App. 1986) (a trade secret’s status was established by plaintiff’s precautions to maintain the information in secrecy and the fact that no other company had developed a similar process).

*Compare*, Tyson Metal Products, Inc. v. McCann, 376 Pa. Super. 461, 464-465, 546 A.2d 119, 121-122 (1988) (price information was deemed readily available through reasonable inquiry, but more important, the employer had made no effort to place its employees on notice of its allegedly secret status).

<sup>3</sup> *Second Circuit*: Integrated Cash Management Services, Inc. v. Digital Transactions, Inc., 732 F. Supp. 370, 374 (S.D.N.Y. 1989).

*Ninth Circuit*: Tracer Research Corp. v. National Environmental Service Co., 1993 U.S. Dist. LEXIS 19076, at \*4 (D. Ariz. 1993).

**[1]—Examples of Trade Secrets**

There are no rigid requirements for establishing a trade secret. Indeed, the wide range of information that can qualify for trade secret protection is one of the most important aspects of trade secret law. As long as the information is not generally known to persons who can derive economic value from it, and it meets the other statutory requirements, a trade secret claim can be established.

The following have been held to constitute trade secrets:

- (1) Formulas for chemicals, drugs, foods, etc.<sup>4</sup>;
- (2) Technical information<sup>5</sup>;
- (3) Industrial processes<sup>6</sup>;
- (4) Blueprints or engineering drawings<sup>7</sup>;
- (5) Customer lists, price lists, and sources of supply<sup>8</sup>; and

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<sup>4</sup> *Third Circuit*: Sweetzel, Inc. v. Hawk Hill Cookies, Inc., 1996 U.S. Dist. LEXIS 11155 (E.D. Pa. July 30, 1996) (gingersnap cookies).

**State Courts:**

*New York*: Thomas v. Soft Sheen Product Co., Inc., 118 A.D.2d 493, 500 N.Y.S.2d 108 (N.Y. App. Div. 1986) (hair conditioner).

*Oregon*: Marie Callendar Pie Shops, Inc. v. Bumbleberry Enterprises, Inc., 39 Ore. App. 487, 489, 592 P.2d 1050, 1051 (1979) (pies).

<sup>5</sup> *Fifth Circuit*: Precision Plating & Metal Finishing, Inc. v. Martin-Marietta Corp., 435 F.2d 1262 (5th Cir. 1970) (process to fill pits in metal castings for the housing of missile guidance systems).

**State Courts:**

*California*: Vacco Industries v. Van Den Berg, 5 Cal. App.4th 34, 50, 6 Cal. Rptr.2d 602, 611 (1992).

*Virginia*: Dionne v. Southeast Foam Converting & Packaging, Inc., 240 Va. 297, 300-303, 397 S.E.2d 110, 112-113 (1990) (pressure process for treating expanded polystyrene for use as inner-packaging material).

<sup>6</sup> *Third Circuit*: Sperry Rand Corp. v. Pentronix, 311 F. Supp. 910 (E.D. Pa. 1970) (memory cores).

*Sixth Circuit*: Henkel Corp. v. Cox, 386 F. Supp.2d 898 (E.D. Mich. 2005) (metallic post lubrication).

**State Courts:**

*Iowa*: Basic Chemicals, Inc. v. Benson, 251 N.W.2d 220, 227-230 (Iowa 1977) (industrial cleaning and hygienic compounds).

*Pennsylvania*: Felmler v. Lockett, 466 Pa. 1, 8-9, 351 A.2d 273, 277 (1976) (soft fish lures).

<sup>7</sup> *Second Circuit*: A. H. Emery Co. v. Marcan Products Corp., 389 F.2d 11, 16 (2d Cir. 1968).

*Third Circuit*: SI Handling Systems, Inc. v. Heisley, 753 F.2d 1244, 1256 (3d Cir. 1985).

**State Courts:**

*Illinois*: Colony Corp. of America v. Crown Glass Corp., 102 Ill. App.3d 647, 58 Ill. Dec. 283, 430 N.E.2d 225 (1981).

*Washington*: Boeing Co. v. Sierracin Corp., 108 Wash.2d 38, 48, 738 P.2d 665, 674 (1987).

<sup>8</sup> *Seventh Circuit*: Schiller & Schmidt, Inc. v. Wallace Computer Services, Inc., 1991 U.S. Dist. LEXIS 18652, 19 U.S.P.Q.2d (BNA) 1942, 1947 (N.D. Ill. April 26,

(6) Business information, such as financial statements and projections, cost or margin structures, pricing, employee salary, or other benefit information<sup>9</sup>; and

(7) Compilations of information, regardless if some portion (or all) is in the public domain.<sup>10</sup>

Case law also has established that a trade secret can relate to so-called “negative know-how.”<sup>11</sup> When a plaintiff learns information

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1991) (taking and wrongful use of customer list violated traditional tort standards and was actionable misappropriation).

**State Courts:**

*California:* Morlife, Inc. v. Perry, 56 Cal. App.4th 1514, 1522, 66 Cal. Rptr.2d 731, 736 (1997).

But *cf.*, Liebert Corp. v. Mazur, 357 Ill. App.3d 265, 276-280, 293 Ill. Dec. 28, 827 N.E.2d 909, 921-924 (2005) (distinguishing customer lists not maintained in secret with price quotation and related pricing information that was kept secret).

<sup>9</sup> *District of Columbia Circuit:* Metropolitan Life Insurance Co. v. Usery, 426 F. Supp. 150, 158-165 (D.D.C. 1976) (work force analysis data is competitively sensitive because its dissemination would encourage “raiding”).

**State Courts:**

*California:* PMC, Inc. v. Kadisha, 78 Cal. App.4th 1368, 1383, 93 Cal. Rptr.2d 663, 673-674 (2000).

*Illinois:* Strata Marketing, Inc. v. Murphy, 317 Ill. App.3d 1054, 251 Ill. Dec. 595, 740 N.E.2d 1166, 1176-1177 (2000) (in reversing dismissal of misappropriation claim, court determined that cost and pricing information in addition to customer lists could qualify for trade secrets under the Illinois UTSA).

<sup>10</sup> See:

*Eighth Circuit:* AvidAir Helicopter Supply, Inc. v. Rolls-Royce Corp., 663 F.3d 966 (8th Cir. 2011) (“Compilations of non-secret and secret information can be valuable so long as the combination affords a competitive advantage and is not readily ascertainable”).

*Eleventh Circuit:* Penalty Kick Management Ltd. v. Coca Cola Co., 318 F.3d 1284, 1291 (11th Cir. 2003) (“[E]ven if all of the information is publicly available, a unique combination of that information, which adds value to the information, also may qualify as a trade secret”).

**State Courts:**

*California:* Altavion, Inc. v. Konica Minolta Systems Laboratory, Inc., 226 Cal. App.4th 26, 47, 171 Cal. Rptr.3d 714, 731 (2014) (even if some or all of the elements of design are in the public domain, “the combination was a protectable trade secret if it was secret and had independent economic value”).

*South Carolina:* Uhlig LLC v. Shirley, 2012 WL 2923242, at \*5 (D.S.C. July 17, 2012) (“A trade secret may exist in a unique combination or compilation of information otherwise publicly available.” The Court cautioned that the compilation “must work together to embody a definite methodology, process, technique or strategy”).

*Tennessee:* Medical Technology, Inc. v. Grisoni, 135 S.W.3d 561, 589 (Tenn. App. 2001) (“[E]ven if individual pieces of information may be publicly known, the integration of the information into a unified process may be confidential or a trade secret”).

<sup>11</sup> UTSA § 1, Comment. See:

*California:* Courtesy Temporary Service, Inc. v. Camacho, 222 Cal. App.3d 1278, 1287, 272 Cal. Rptr. 352, 357 (1990).

*Texas:* Stewart & Stevenson Services v. Serv-Tech, 879 S.W.2d 89, 104 (Tex. App. 1994).

through its confidential efforts that provides negative commercial value (e.g., information that a particular chemical compound will not provide desired benefits in a drug product, or that a specific manufacturing technique will not work), this negative know-how is protectable as a trade secret.<sup>12</sup> The trade secret owner is thus protected from a competitor's use of improperly obtained information regarding what is effective in order to bypass part of the development process.

## [2]—Secrecy

A trade secret must be secret in the sense that it cannot be generally known to the public or others, such as plaintiff's business competitors, who could obtain economic value from its use.<sup>13</sup>

“[T]he right to exclude others is central to the very definition of the property interest. Once the data that constitute a trade secret are disclosed to others, or others are allowed to use those data, the holder of the trade secret has lost his property interest in the data.”<sup>14</sup>

However, the secrecy requirement is not absolute.<sup>15</sup> The trade secret can be disclosed to the plaintiff's employees or to other third parties who are under an obligation to keep the information secret.<sup>16</sup>

The trade secret holder must engage in activities and conduct that are reasonable under the circumstances to maintain the secrecy of the trade secret.<sup>17</sup> What constitutes reasonable steps to protect trade

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<sup>12</sup> *Id.*

<sup>13</sup> UTSA § 1(4).

<sup>14</sup> DVD Copy Control Association Inc. v. Bunner, 31 Cal.4th 864, 881, 4 Cal. Rptr.3d 69, 84, 75 P.3d 1, 13-14 (2003) (quoting Ruckelshaus v. Monsanto Co., 467 U.S. 986, 1011, 104 S.Ct. 2862, 2877, 81 L.Ed.2d 815, 837-838 (1984)).

<sup>15</sup> *Alabama*: Mason v. Jack Daniel Distillery, 518 So.2d 130, 132-133 (Ala. Civ. App. 1987) (plaintiff's practice of limiting the number of employees with access to a recipe, and instructing them not to reveal it to others, combined with the technique of mixing the recipe out of sight of customers, was sufficient to support a finding of trade secret).

*Indiana*: Infinity Products v. Quandt, 775 N.E.2d 1144, 1146-147 (Ind. App. 2002) (restricted computer access, restricted employee access, and confidentiality provision in employee handbook together were deemed reasonable safeguards for a trade secret finding).

*New York*: General Aniline & Film Corp. v. Frantz, 50 Misc.2d 994, 272 N.Y.S.2d 600, 606 (N.Y. Sup.), *modification denied* 274 N.Y.S.2d 634 (1966) (the degree of secrecy required to maintain a matter as a trade secret need not be absolute or 100% perfect).

<sup>16</sup> *Id.*

<sup>17</sup> *California*: Courtesy Temporary Service, Inc. v. Camacho, 222 Cal. App.3d 1278, 1287, 272 Cal. Rptr. 352, 357 (1990).

*Connecticut*: Unique Boutique, Inc. v. Hylton, 1998 Conn. Super. LEXIS 83, at \*14-\*15 (Conn. Super. Jan. 8, 1998).

secret confidentiality is often a question of fact.<sup>18</sup> The following factors should be applied to assess the reasonableness of maintaining the secrecy of a trade secret:

(1) Whether documents or files containing the information were marked as confidential and/or were posted with warning or cautionary signs;

(2) Whether the plaintiff instructed its employees to treat the information as confidential;

(3) Whether the plaintiff restricted access to the information to persons who had a business reason to know the information;

(4) Whether the plaintiff kept the information in a restricted or secured area;

(5) Whether the plaintiff required employees or others with access to the information to sign confidentiality or nondisclosure agreements; and

(6) Whether the plaintiff used unnamed or code-named ingredients or components.<sup>19</sup>

### [3]—State Law Procedural Differences

California has adopted a procedural rule that is applicable to trade secret litigation.<sup>20</sup> In California state courts and applicable Ninth Circuit courts, before a trade secret plaintiff can commence discovery into the defendants' misappropriation, it must first provide the defendant with a description of its trade secrets with "reasonable particularity."<sup>21</sup>

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<sup>18</sup> *California*: In re Provident Credit Card Cases, 96 Cal. App.4th 292, 306, 116 Cal. Rptr.2d 833, 844 (2002).

*Connecticut*: Elm City Cheese Co., Inc. v. Federico, 251 Conn. 59, 50, 752 A.2d 1037, 1050 (1999).

*Louisiana*: SDT Industries, Inc. v. Leeper, 793 So.2d 327 (La. App. 2001).

*Oklahoma*: Amoco Production Co. v. Lindley, 609 P.2d 733, 744 (Okla. 1980).

<sup>19</sup> UTSA § 1, Comment. See:

*Sixth Circuit*: Shatterproof Glass Corp. v. Guardian Glass Co., 322 F. Supp. 854, 865 (E.D. Mich. 1970).

**State Courts:**

*California*: Whyte v. Schlage Lock Company, 101 Cal. App.4th 1443, 1454, 125 Cal. Rptr.2d 277, 286 (2002).

*Connecticut*: Elm City Cheese Co., Inc. v. Federico, 251 Conn. 59, 80, 752 A.2d 1037, 1050 (1999).

*New York*: Delta Filter Corp. v. Morin, 108 A.D.2d 991, 993, 485 N.Y.S.2d 143 (N.Y. App. Div. 1985).

See also, Alexander, *Trade Secrets Practice in California* §§ 4.9-4.10 (2d ed. 1996).

<sup>20</sup> Cal. Code Civ. P. § 2019.210.

<sup>21</sup> *Id.*

*Ninth Circuit*: TelSwitch, Inc. v. Billing Solutions Inc., 2012 WL 3877645 (N.D. Cal. Sept. 6, 2012); M.A. Mobile Ltd. v. Indian Institute of Technology Kharagpur, 2011 WL 92734 (N.D. Cal. Jan. 10, 2011).

The contents of this initial description of the trade secrets are an essential and hotly contested part of any trade secret case governed by California or similar law.

Although some courts outside California also have required that specific descriptions of the plaintiff's trade secrets be provided to the defendant in order to define the boundaries of discovery,<sup>22</sup> California appears to be the only state that has enacted a pleading requirement that postpones discovery until the plaintiff provides the defendant with a "reasonably particular" trade secret disclosure.<sup>23</sup>

#### [4]—Preemption

Generally speaking, state statutes that adopt the UTSA provide that the acts displace any conflicting tort or restitutionary law, as well as any other law relating to the misappropriation of trade secrets.<sup>24</sup> The UTSA, however, is not intended to supersede contractual remedies relating to the misappropriation of information, nor any civil or criminal remedies not relating to the misappropriation of trade secrets.<sup>25</sup>

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##### State Courts:

*California:* *Perlan Therapeutics v. Superior Court*, 178 Cal. App.4th 1333, 101 Cal. Rptr.3d 211 (2009); *Advanced Modular Sputtering, Inc. v. Superior Court*, 132 Cal. App.4th 826, 33 Cal. Rptr.3d 901 (2005).

<sup>22</sup> See:

*Second Circuit:* *Xerox Corp. v. International Business Machines Corp.*, 64 F.R.D. 367, 371 (S.D.N.Y. 1974).

*Seventh Circuit:* *Loctite Corp. v. Fel-Pro Inc.*, 203 U.S.P.Q. (BNA) 184, 28 Fed. R. Serv.2d 99 (N.D. Ill. 1978).

*Eighth Circuit:* *Porous Media Corp. v. Midland Brake Inc.*, 187 F.R.D. 598, 600 (D. Minn. 1999).

*Eleventh Circuit:* *Del Monte Fresh Produce Co. v. Dole Food Co.*, 148 F. Supp.2d 1322, 1324 (S.D. Fla. 2001).

##### State Courts:

*Delaware:* *Englehard Corp. v. Savin Corp.*, 505 A.2d 30, 33 (Del. Ch. 1986) (court refused to compel discovery of defendant's technical documents until plaintiff identified its trade secrets with "reasonable particularity").

<sup>23</sup> *Ninth Circuit:* *Computer Economics, Inc. v. Gartner Group, Inc.*, 50 F. Supp.2d 980, 984 n.3 (S.D. Cal. 1999). See also:

##### State Courts:

*Delaware:* *Englehard Corp. v. Savin Corp., id.*, 505 A.2d at 33 (court refused to compel discovery of defendant's technical documents until plaintiff identified its trade secrets with "reasonable particularity").

*Florida:* *Revello Medical Management, Inc. v. Med-Data Infotech USA, Inc.*, 50 So.3d 678 (Fla. Dist. App. 2010).

<sup>24</sup> UTSA § 7.

See, for example:

*Arizona:* Ariz. Rev. Stat. Ann § 44-407.

*Illinois:* 765 Ill. Comp. Stat. § 1065/8.

*Texas:* Tex. Civ. Prac. & Rem. Code Ann. § 134A.007.

*Utah:* Utah Code Ann. § 13-24-8.

*Virginia:* Va. Code Ann. § 59.1-341.

<sup>25</sup> UTSA § 7.

One critical issue is whether the UTSA controls all claims of misappropriated information, or whether the information must first be regarded as a trade secret before the UTSA can apply (leaving common law remedies available for non-secrets). This is an important distinction because if a state decides that the UTSA controls all claims of misappropriation of information, then a plaintiff may be required to litigate a claim under the UTSA but could only recover damages to the extent (if any) that the information constitutes a trade secret.

A comprehensive discussion of this distinction can be found in the 2012 Utah case, *CDC Restoration & Construction, LC v. Tradesmen Contractors, LLC*.<sup>26</sup> In *CDC*, the court sided with the majority of states holding that the UTSA preempts all claims relating to the “unauthorized use of information.”<sup>27</sup> The court reasoned that this would preserve the purpose of uniformity among state trade secret law, where otherwise the common law would survive, thus thwarting the value of the UTSA’s exclusiveness.<sup>28</sup> The *CDC* court also reiterated that contractual remedies may still exist in cases where the misappropriated information does not fall under the definition of a trade secret.<sup>29</sup>

The UTSA may also preempt non-UTSA claims depending on the relation between the non-UTSA claim and the misappropriation of information. States differ as to what level of factual similarity is needed for the UTSA to preempt a non-UTSA claim, but most agree that to make that determination it is necessary to examine the factual allegations.<sup>30</sup>

Some states, such as Illinois, take a broad approach, holding that the UTSA preempts any claim that involves the misappropriation of trade secrets.<sup>31</sup> Others, like Minnesota, will not preempt non-UTSA claims when the facts show that there is more to the allegations than misappropriation of trade secrets.<sup>32</sup> Hawaii and Tennessee use the “same proof” standard where, if proof of a non-UTSA claim would also establish proof of a UTSA claim, the non-UTSA claim is preempted.<sup>33</sup>

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<sup>26</sup> *CDC Restoration & Construction, LC v. Tradesmen Contractors, LLC*, 2012 UT App 60, 274 P.3d 317 (Utah App. 2012).

<sup>27</sup> *Id.*, 274 P.3d at 330.

<sup>28</sup> *Id.*

<sup>29</sup> *Id.*

<sup>30</sup> *BlueEarth Biofuels, LLC v. Hawaiian Electric Co., Inc.*, 123 Haw. 314, 321-322, 235 P.3d 310, 317-318 (2010).

<sup>31</sup> *Thomas & Betts Corp. v. Panduit Corp.*, 108 F. Supp.2d 968, 971-973 (N.D. Ill. 2000) (court dismissed a breach of fiduciary duty claim because it involved the theft of trade secrets).

<sup>32</sup> *Micro Display Sysms, Inc. v. Axtel, Inc.*, 699 F. Supp. 202, 205 (D. Minn. 1988) (court allowed non-UTSA claims to continue but warned that they would be dismissed if it were found, on further establishment of the factual record, that the non-UTSA claims were “merely duplicative” of the misappropriation claims).

<sup>33</sup> *BlueEarth Biofuels, LLC v. Hawaiian Electric Co., Inc.*, N. 30 supra, 235 P.3d at 318.



Finally, there are states like California, where the language of its preemption provision differs from the uniform version.<sup>34</sup> California courts have decided that the language of its preemption provision implicitly preempts all common law remedies “based on the same nucleus of facts as the misappropriation of trade secrets claim for relief.”<sup>35</sup>

Accordingly, prudent counsel will consult the forum state’s UTSA preemption provision, as well as the corresponding case law, in order to properly construct their client’s UTSA and related non-UTSA claims.

### [5]—America Invents Act (AIA)

On September 16, 2011 President Barack Obama signed the Leahy-Smith America Invents Act (“AIA”) into law.<sup>36</sup> The AIA was conceived as an attempt by Congress to reform the United States’ patent system, which was thought to be plagued by an immense backlog of patent applications and growing litigation costs, among other things.<sup>37</sup> Generally, the more significant changes enacted by the AIA include moving the U.S. from a date of invention to a “first inventor to file” system,<sup>38</sup> establishing a post-grant review process for contested patents, adding restrictions to false marking lawsuits, and altering how the U.S. Patent and Trademark Office (“PTO”) is funded.<sup>39</sup>

Although the AIA is specific to patent reform, the legislation’s impact will invariably spill over into other areas of intellectual property protection, since it is already incentivizing inventors to protect their intellectual property assets with trade secrets rather than with patents. Among other things, inventors may now look to trade secret protection for the following reasons: (1) trade secrets practiced by patent

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See also, *Hauck Manufacturing Co. v. Astec Industries, Inc.*, 375 F. Supp.2d 649, 658 (E.D. Tenn. 2004).

<sup>34</sup> See Cal. Civ. Code § 3426.7.

But see, Minn. Stat. Ann. § 325C.07 (uniform version).

<sup>35</sup> *K. C. Multimedia, Inc. v. Bank of America Technology Operations, Inc.*, 171 Cal. App.4th 939, 958, 90 Cal. Rptr.3d 247, 261 (2009).

See also *Qiang Wang v. Palo Alto Networks, Inc.*, 2013 WL 415615, at \*3-\*4 (N.D. Cal. Jan. 31, 2013) (following *K. C. Multimedia* in finding that CUTSA preempted plaintiff’s breach of confidence claim); *Silvaco Data Systems v. Intel Corp.*, 184 Cal. App.4th 210, 240, 109 Cal. Rptr.3d 27, 54 (2010) (plaintiff could not bypass CUTSA by arguing that the misappropriated information was something other than a trade secret).

<sup>36</sup> Leahy-Smith America Invents Act (“AIA”), Pub. L. No. 112-29, 125 Stat. 284 (Sept. 16, 2011).

<sup>37</sup> “Recent Legislation,” 125 Harv. L. Rev. 1290-1293 (2012).

<sup>38</sup> The first-inventor-to-file section of the AIA was effective March 16, 2013 (see AIA Section 3(n)(1), 125 Stat. 293).

<sup>39</sup> “Recent Legislation,” N. 37 *supra*.

holders can no longer be asserted as prior art by patent challengers,<sup>40</sup> (2) defendants accused of patent infringement can now assert prior use of trade secrets as a defense,<sup>41</sup> and (3) defendants are no longer allowed to assert invalidity or unenforceability by way of a patent's failure to disclose the best mode for use, allowing patent holders to seek dual protection of their inventions.<sup>42</sup>

Based on at least the above, the impacts of the AIA on trade secret protection—intentional and unintentional—will continue to evolve and coalesce as the AIA and its provisions are implemented and tested by practitioners in intellectual property law.

#### **[6]—Criminalization: Economic Espionage Act (EEA)**

Under the Economic Espionage Act of 1996 (“EEA”), the theft of trade secrets can constitute a federal crime.<sup>43</sup> Generally, the EEA protects trade secrets by criminalizing two types of misappropriation: (1) economic espionage (when the intended beneficiary is a foreign power), and (2) theft of trade secrets (when the information relates to a product in interstate or foreign commerce).<sup>44</sup>

Economic espionage by individuals is punishable by imprisonment for up to fifteen years, or a penalty of no more than \$5 million, or both.<sup>45</sup> Economic espionage by corporations is punishable by no more than the greater of \$10 million, or three times the value of the stolen trade secret.<sup>46</sup> Similarly, the theft of trade secrets by individuals under the EEA is punishable by imprisonment of up to ten years and/or a fine of up to \$5 million for organizations.<sup>47</sup>

In December 2012, the Theft of Trade Secrets Clarification Act was signed into law, expanding the reach of the EEA to include the protection of secrets relating to products or services used or intended for use in interstate or foreign commerce,<sup>48</sup> thereby eliminating a

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<sup>40</sup> Maier, “The Big Secret of the America Invents Act,” 18:12 Intellectual Property Today, at pp. 18-20 (2011). And see Congressional Record, Senate, September 8, 2011, at S5431 explaining that changes to Section 102(a) effectively revise prior use defenses to include only those “available to the public.”

<sup>41</sup> Maier, *id.* Section 5 of the AIA expands the prior commercial use defense to include all business activities, provided the trade secret process had been used for more than a year prior to other applications for a patent on that same process.

<sup>42</sup> Maier, *id.* According to Section 15 of the AIA, “failure to disclose the best mode shall not be a basis on which any claim of a patent may be canceled or held invalid or otherwise unenforceable.” Accordingly, inventors could claim patent and trade secret protection for their inventions by keeping the best mode secret.

<sup>43</sup> The Economic Espionage Act (“EEA”), Pub. L. No. 104-294, 110 Stat. 3488 (Oct. 11, 1996), codified as amended at 18 U.S.C. §§ 1831-1839 (2006).

<sup>44</sup> EEA at §§ 1831-1832.

<sup>45</sup> EEA at § 1831; Pub. L. No. 112-269, 126 Stat. 2442 (Jan. 14, 2013).

<sup>46</sup> *Id.*

<sup>47</sup> EEA at § 1832.

loophole.<sup>49</sup> This update effectively allows the EEA to cover products and services, without regard to whether or not they are actually sold or only used internally.

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<sup>48</sup> The Theft of Trade Secrets Clarification Act, Pub. L. No. 112-236, 126 Stat. 1627 (Jan. 14, 2012).

<sup>49</sup> *United States v. Aleynikov*, 676 F.3d 71, 80-82 (2d Cir. 2012). The court held that the original enactment of the EEA only applied to trade secrets that were part of a product “that is produced to be placed in interstate commerce.”

### § 9.04 Misappropriation of Trade Secrets

Trade secret misappropriation is generally accomplished through improper conduct or unfair means.<sup>1</sup> Improper means of acquiring a trade secret include theft, bribery, misrepresentation, breach of contract, breach of duty to maintain secrecy or not to use certain information, or espionage through electronic or other means.<sup>2</sup>

Misappropriation can be achieved either by the use of the trade secret information or simply by its improper disclosure.<sup>3</sup> Proof of misappropriation may be “derived from or through a person who owed a duty to the person seeking relief to maintain its secrecy or limit its use.”<sup>4</sup> For example, a competitor that hires plaintiff’s former employee may be liable if it “knew or had reason to know” that confidential information was derived from the new employee.<sup>5</sup> It generally is a question of fact “whether the competitor had constructive notice of the plaintiff’s right in the secret.”<sup>6</sup>

However, it is not improper to acquire a trade secret by using independent efforts to discover or learn of the information, obtaining the information from a license with the owner, observing the information on public display, or finding the information in public domain sources.<sup>7</sup> For example, it is proper to learn of a trade secret by purchasing a

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<sup>1</sup> Uniform Trade Secrets Action (“UTSA”) § 1(2)(ii). See:

*First Circuit:* Picker International Corp. v. Imaging Equipment Services, Inc., 931 F. Supp. 18, 37 (D. Mass. 1995).

**State Courts:**

*California:* Sargent Fletcher, Inc. v. Able Corp., 110 Cal. App.4th 1658, 1668, 3 Cal. Rptr.3d 279, 285 (2003).

<sup>2</sup> UTSA § 1(1); Cal. Civ. Code § 3426.1(a).

<sup>3</sup> UTSA § 1(2)(ii). See:

*California:* Morlife v. Perry, 56 Cal. App.4th 1514, 1527, 66 Cal. Rptr.2d 731, 736 (1997).

*Maine:* FMC Corp. v. Peats, 2 U.S.P.Q.2d (BNA) 1178, 1183-1184 (Me. Super. 1987).

*Virginia:* Collelo v. Geographic Services, Inc., 286 Va. 56, 727 S.E.2d 55 (2012) (“Accordingly, the [Virginia] Trade Secrets Act does not require that one who is accused of misappropriating a trade secret use the allegedly misappropriated trade secret to compete with the holder of the trade secret”).

<sup>4</sup> UTSA § 1(2)(ii)(B)(III).

<sup>5</sup> *California:* PMC, Inc. v. Kadisha, 78 Cal. App.4th 1368, 1383, 93 Cal. Rptr.2d 663, 673-674 (2000).

*Delaware:* E. I. Du Pont de Nemours & Co. v. American Potash & Chemical Corp., 200 A.2d 428, 436 (Del. Ch. 1964).

<sup>6</sup> *Seventh Circuit:* C & F Packing Co. v. IBP, Inc., 1998 U.S. Dist. LEXIS 3221 (N.D. Ill. March 16, 1998).

**State Courts:**

*California:* Ralph Andrews Productions, Inc. v. Paramount Pictures Corp., 222 Cal. App.3d 676, 682-683, 271 Cal. Rptr. 797, 799 (1990).

<sup>7</sup> UTSA § 1, Comment; *Restatement of Torts* § 757, Comment (f) (1939).

product and then testing or deconstructing it to understand the secret, a process often called “reverse engineering.”<sup>8</sup>

### [1]—Proof of Misappropriation

Trade secret misappropriation may be established by either direct evidence or circumstantial evidence.<sup>9</sup> Direct evidence would be the taking by employees of documents or electronic files from their employer when they leave their employment for a new job with a competitor. A portion of the documents or files taken may reflect the former employer’s confidential information and relate to the alleged trade secrets. These documents and files are often found among the employee’s documents, on his or her home or work computer, or attached to e-mails sent prior to leaving the former job.

In cases where confidential documents discussing or relating to the trade secret are found in the possession of the former employee or the new employer, actual misappropriation through disclosure is directly established.<sup>10</sup> However, it still may be difficult to prove that the new employer actually made use of the trade secret information taken from the former employer.

When the former employer’s confidential documents have not been found or where the new employer denies taking any such confidential

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<sup>8</sup> *Supreme Court*: *Kewanee Oil Corp. v. Bicron Corp.*, 416 U.S. 470, 490, 94 S.Ct. 1879, 40 L.Ed.2d 315 (1974) (“trade secret law does not forbid the discovery of the trade secret by fair and honest means, e.g., independent creation or reverse engineering”).

*Ninth Circuit*: *Chicago Lock Co. v. Fanberg*, 676 F.2d 400, 405 (9th Cir. 1982) (contract provision prohibiting reverse engineering preempted by California trade secret law).

#### **State Courts:**

*Michigan*: *Kubik, Inc. v. Hull*, 56 Mich. App. 335, 224 N.W.2d 80 (1974) (a matter that is readily ascertainable by competitors by reverse engineering is not a trade secret).

<sup>9</sup> *Third Circuit*: *Greenberg v. Croydon Plastics Co.*, 378 F. Supp. 806, 814 (E.D. Pa. 1974) (“Misappropriation and misuse can rarely be proved by convincing direct evidence. In most cases plaintiffs must construct a web of perhaps ambiguous circumstantial evidence. . .”).

*Sixth Circuit*: *Stratienko v. Cordis Co.*, 429 F.3d 592, 600-601 (6th Cir. 2005) (courts allow inferences from circumstantial evidence where there is a showing that the defendant had access to the trade secret and the defendant’s product or process shares the features of the trade secret).

*Eighth Circuit*: *Teleconnect Co. v. Ensrud*, 55 F.3d 357, 359-360 (8th Cir. 1995) (circumstantial evidence that could be the basis for finding a violation of an employment agreement constituted misappropriation).

<sup>10</sup> *Syntex Ophthalmics, Inc. v. Novicky*, 767 F.2d 901 (Fed. Cir. 1985) (the defendant had access to a matter that was claimed to be a trade secret, and expert testimony indicated that many of the documents which defendant allegedly developed independently inexplicably had the same “errors” and similarities).

information, proof that the trade secrets have been misappropriated and used can be difficult. Such misappropriation often must be established through a complicated web of circumstantial evidence. For example, the new employer may possess little, if any, development history of technology related to the areas covered by the plaintiff's trade secret, and introduction of this new technology by the new employer may coincide suspiciously with the time when the former employee joined the company. As in any civil case, proof of misappropriation of trade secrets must be established by the preponderance of the evidence, and circumstantial evidence is often adequate for this purpose.<sup>11</sup>

If misappropriation is established, the plaintiff can seek recovery of its own damages, the unjust enrichment obtained by the defendant, and in some cases, a reasonable royalty.<sup>12</sup> Valuation of trade secret damages can fluctuate significantly due to the differing facts in each case, difficult sources of proof, and variations in trade secret state and case law. Since trade secrets are less precisely defined than patents and not subject to the same scrutiny as patents, it often requires significant effort to value them. By definition, there is frequently no market valuation for trade secrets because they must be generally unknown to persons who can obtain economic advantage from them. Difficulties in proof have resulted in a patchwork of decisions by the courts, and established trade secrets damages precedents do not exist like those for patent damages.<sup>13</sup>

## [2]—Inevitable Disclosure Doctrine

Some courts have adopted the "Inevitable Disclosure Doctrine" as a substitute for proof of misappropriation.<sup>14</sup> Where it applies, the Inevitable Disclosure Doctrine will satisfy the requirement of actual misappropriation with the presumption that it is "inevitable" that a former employee will use his former employer's trade secrets in his new position. This doctrine arises in cases involving key employees with high-level access to trade secret information who subsequently

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<sup>11</sup> *Eighth Circuit: Teleconnect Co. v. Ensrud*, 55 F.3d 357, 359-360 (8th Cir. 1995) (circumstantial evidence is permissible to establish that a former employee disclosed confidential information to a third party in violation of a confidentiality agreement and the Iowa UTSA).

*Tenth Circuit: Micro Consulting, Inc. v. Zubeldia*, 813 F. Supp. 1514, 1534 (W.D. Okla. 1990).

<sup>12</sup> UTSA § 3(a).

<sup>13</sup> See *Telex Corp. v. IBM Corp.*, 510 F.2d 894, 930 (10th Cir. 1975).

<sup>14</sup> *PepsiCo, Inc. v. Redmond*, 54 F.3d 1262 (7th Cir. 1995).

See also Mahady, "Burying the Inevitable Disclosure Doctrine in the Nooks and Crannies: The Third Circuit's Liberal Standard for Trade Secret Misappropriation in *Bimbo Bakeries USA, Inc. v. Botticella*," 56 Vill. L. Rev. 699 (2012), available at <http://lawweb2009.law.villanova.edu/lawreview/wp-content/uploads/2012/03/VLR402.pdf>.

work for a competitor and perform the same or similar job. The cases tend to revolve around dishonesty or untrustworthy conduct by the former employee.<sup>15</sup>

The court may consider proven examples of the former employee's dishonesty and the similarity between the employee's old and new jobs to conclude that the employee's new employment would "inevitably" lead to the disclosure and/or use of the former employer's trade secrets.<sup>15.1</sup> Alternatively, the Third Circuit requires only that there be a "substantial threat" that the trade secret will be misappropriated if the departing employee is allowed to work for a competitor.<sup>16</sup> Although the substantial threat test is not new, the Third Circuit is the first court to conceptualize this test as separate and distinct from the inevitable disclosure test.

In jurisdictions that apply the Inevitable Disclosure Doctrine, courts may enter a broad preliminary or permanent injunction, barring both actual and "threatened" misappropriation.<sup>17</sup> Accordingly, injunctive relief can, at times, be obtained that bars the defendant from using information that the plaintiff has not yet established has actually been misappropriated.<sup>18</sup> Some courts have also ordered an injunction barring a former employee from working in his new position for some period of time.<sup>19</sup>

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<sup>15</sup> *Seventh Circuit: PepsiCo, Inc. v. Redmond, id.*, 54 F.3d at 1270-1271.

**State Courts:**

*Utah: Novell Inc. v. Timpanogos Research Group, Inc.*, 46 U.S.P.Q.2d (BNA) 1197, 1998 WL 177721 (D. Utah Jan. 30, 1998) (defendants who were former employees improperly took copies of plaintiff's software in violation of confidentiality agreements and then falsely claimed that plaintiff had invested in defendants' project).

<sup>15.1</sup> *Seventh Circuit: PepsiCo, Inc. v. Redmond, id.*, 54 F.3d at 1269-1272.

*Eighth Circuit: H&R Block Eastern Tax Services, Inc. v. Enchura*, 122 F. Supp.2d 1067 (W.D. Mo. 2000).

**State Courts:**

*Illinois: Strata Marketing, Inc. v. Murphy*, 317 Ill. App.3d 1054, 1066-1072, 251 Ill. Dec. 595, 740 N.E.2d 1166, 1175-1179 (2000).

*Ohio: Procter & Gamble Co. v. Stoneham*, 140 Ohio App.3d 260, 747 N.E.2d 268 (2000).

<sup>16</sup> *Third Circuit: Bimbo Bakeries USA, Inc. v. Botticella*, 613 F.3d 102, 113 (3d Cir. 2010).

<sup>17</sup> *Seventh Circuit: PepsiCo, Inc. v. Redmond*, 54 F.3d 1262, 1269-1272 (7th Cir. 1995).

**State Courts:**

*Missouri: A. B. Chance Co. v. Schmidt*, 719 S.W.2d 854, 856-858 (Mo. App. 1986).

<sup>18</sup> *Id.*

<sup>19</sup> *Seventh Circuit: PepsiCo, Inc. v. Redmond*, N. 17 *supra*, 54 F.3d 1269-1272 (7th Cir. 1995).

**State Courts:**

*Missouri: A. B. Chance Co. v. Schmidt*, N. 17 *supra*, 719 S.W.2d at 856-858 (where former employee was about to enter into the employ of a competitor, injunction

Although the majority of states have adopted the Inevitable Disclosure Doctrine either completely or at least in a limited form,<sup>20</sup>

issued for five years to prevent what was likely wrongful use or disclosure of plaintiff's trade secrets).

*New York:* Marietta Corp. v. Fairhurst, 301 A.D.2d 734, 754 N.Y.S.2d 62 (N.Y. App. Div. 2003) (court enjoined defendant employee from new employment with competitor for eleven-month period).

*Pennsylvania:* Air Products & Chemicals, Inc. v. Johnson, 296 Pa. Super. 405, 442 A.2d 1114 (1981) (plaintiff's former sales vice president was enjoined from engaging in certain aspects of competitive sales activity).

<sup>20</sup> States that have fully adopted the Inevitable Disclosure Doctrine include: Arkansas, Delaware, Illinois, Minnesota, New Jersey, Ohio, Utah, and Washington. See:

*Sixth Circuit:* Emery Industries, Inc. v. Cottier, 202 U.S.P.Q. (BNA) 829 (S.D. Ohio 1978).

*Seventh Circuit:* C&F Packing Co., Inc. v. IBP, Inc., 1998 U.S. Dist. LEXIS 3221, 1998 WL 1147139 (N.D. Ill. March 16, 1998).

*Eighth Circuit:* IBM Co. v. Seagate Technology, Inc., 941 F. Supp. 98 (D. Minn. 1992).

*Tenth Circuit:* Novell, Inc. v. Timpanogos Research Group, Inc., 46 U.S.P.Q.2d (BNA) 1197, 1998 WL 177721 (D. Utah Jan. 30, 1998).

**State Courts:**

*Arkansas:* Cardinal Freight Carriers, Inc. v. J. B. Hunt Transportation Services, Inc., 336 Ark. 143, 987 S.W.2d 642 (1999).

*Delaware:* American Hoechst Corp. v. Nuodex, Inc., 1985 Del. Ch. LEXIS 441, 1985 WL 11563 (Del. Ch. April 23, 1985).

*New Jersey:* National Starch and Chemical Corp. v. Parker Chemical Co., 530 A.2d 31 (N.J. Super. App. Div. 1987).

*Washington:* Solutech Corp., Inc. v. Agnew, 88 Wash. App. 1067, 1997 Wash. App. LEXIS 2130 (Dec. 13, 1997), *review denied* 136 Wash.2d 1004 (1998).

A number of states have adopted a more limited form of the Inevitable Disclosure Doctrine, usually limiting its application to technical employees. These states include: Connecticut, Iowa, Massachusetts, New York, North Carolina, and Texas. And see:

*First Circuit:* Marcam Co. v. Orchard, 885 F. Supp. 294 (D. Mass. 1995).

*Second Circuit:* PSC, Inc. v. Reiss, 111 F. Supp.2d 252 (W.D.N.Y. 2000) (restricting Inevitable Disclosure Doctrine to cases involving technical employees); Earthweb v. Schlack, 71 F. Supp.2d 299 (S.D.N.Y. 1999), *remanded* 205 F.3d 1322, *aff'd* 2000 U.S. App. LEXIS 11446 (2d Cir. May 18, 2000) (limited application of *Pepsico* to states adopting the UTSA).

*Fourth Circuit:* Glaxo Inc. v. Novapharm Ltd., 931 F. Supp. 1280 (E.D.N.C. 1996).

*Eighth Circuit:* APAC Teleservices, Inc. v. McRae, 985 F. Supp. 852 (N.D. Iowa 1997).

**State Courts:**

*Connecticut:* Aetna Retirement Services, Inc. v. Hug, 1997 Conn. Super. LEXIS 1781 (Conn. Super. June 18, 1997).

*Texas:* Conley v. DSC Communications Co., 1999 WL 89955 (Tex. App. Feb. 24, 1999).

See also, Treadway, Comment, "An Overview of Individual States' Application of Inevitable Disclosure: Concrete Doctrine or Equitable Tool?" 55 S.M.U. L. Rev. 621 (2002) (collecting cases).



California, Florida, and Virginia have rejected the Doctrine, still requiring proof of actual misappropriation before relief can be obtained.<sup>21</sup>

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<sup>21</sup> *Ninth Circuit*: Bayer Corp. v. Roche Molecular Systems, Inc., 72 F. Supp.2d 1111, 1119 (N.D. Cal. 1999).

*Eleventh Circuit*: Del Monte Fresh Produce Co. v. Dole Food Co., Inc., 148 F. Supp.2d 1326, 1337 (S.D. Fla. 2001).

**State Courts:**

*California*: Whyte v. Schlage Lock Co., 101 Cal. App.4th 1443, 125 Cal. Rptr.2d 277 (2002).

*Virginia*: Government Technology Services, Inc. v. Intellisys Technology Corp., 51 Va. Cir. 55, 1999 WL 1499548 (Oct. 20, 1999).

## § 9.05 Injunctive Relief and Exclusion Orders

### [1]—Injunctive Relief

Trade secret misappropriation, or threatened misappropriation, may be enjoined under general state law standards. Accordingly, a court may only grant an injunction when the plaintiff proves that imminent irreparable injury will otherwise result and that monetary damages are an inadequate remedy.<sup>1</sup> However, an injunction can be obtained prohibiting future use of the trade secrets, along with an award of damages for past use.<sup>2</sup>

Under the Uniform Trade Secrets Act (“UTSA”),

“an injunction shall be terminated when the trade secret has ceased to exist, but the injunction may be continued for an additional reasonable period of time in order to eliminate commercial advantage that otherwise would be derived from the misappropriation.”<sup>3</sup>

Thus, an injunction will ordinarily be limited to removing the “head-start” period that a competitor obtains by wrongfully using the plaintiff’s trade secrets rather than undertaking the time and expense of independent development.<sup>4</sup> However, some courts have entered

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<sup>1</sup> *Second Circuit*: B.U.S.A. Corp. v. Ecogloves, Inc., 2006 U.S. Dist. LEXIS 85988, at \*17 (S.D.N.Y. Jan. 31, 2006) (loss of trade secrets cannot be readily measured in money damages, and therefore irreparable harm can be presumed from the misappropriation of trade secrets).

**State Courts:**

*California*: Ajaxo, Inc. v. E\*Trade Group, Inc., 135 Cal. App.4th 21, 64 n.44, 37 Cal. Rptr.3d 221, 254 (2005).

*Colorado*: Bishop & Co. v. Cuomo, 799 P.2d 444, 446-447 (Colo. App. 1990) (where alleged damages would be readily compensable in money damages, an injunction cannot issue).

See also, Cal. Code Civ. P. § 526.

But see, *Skycam, LLC v. Bennett*, 2012 WL 4483610 (N.D. Okla. Sept. 27, 2012) (court ordered a royalty injunction rather than a prohibitory injunction because a prohibitory injunction would effectively put defendant out of business, leaving plaintiff with a virtual monopoly over the aerial camera market).

<sup>2</sup> *California*: Morlife, Inc. v. Perry, 56 Cal. App.4th 1514, 1527-1528, 66 Cal. Rptr.2d 731, 736 (1997).

*Colorado*: Sonoco Products Co. v. Johnson, 23 P.3d 1287, 1288-1290 (Colo. App. 2001).

*Idaho*: Basic American, Inc. v. Shatila, 133 Idaho 726, 732, 992 P.2d 175, 181 (1999).

*Massachusetts*: USM Corp. v. Marson Fastener Corp., 392 Mass. 334, 467 N.E.2d 1271 (1984).

<sup>3</sup> UTSA § 2(a). See also, Cal. Civ. Code § 3426.2.

<sup>4</sup> *First Circuit*: Pickler International Corp. v. Imaging Equipment Services, Inc., 1995 U.S. Dist. LEXIS 11622, at \*56-\*57 (D. Mass. July 5, 1995).

*Third Circuit*: Greenberg v. Croydon Plastics Co., 378 F. Supp. 806 (E.D. Pa. 1974).

permanent injunctions, even after the trade secret has become publicly available, in cases of severe breaches of trust that cannot be remedied.<sup>5</sup>

If a defendant can establish that it has undertaken a “material and prejudicial change of position” prior to knowing of the misappropriation, or is otherwise able to establish “exceptional conditions,”<sup>6</sup> “an injunction may condition future use [of the trade secret] upon payment of a reasonable royalty for no longer than the period of time for which use could have been prohibited.”<sup>7</sup> For example, as the comments to the UTSA indicate,

“[e]xceptional circumstances include the existence of an overriding public interest which requires the denial of a prohibitory injunction against future damaging use and a person’s reasonable reliance on acquisition of a misappropriated trade secret in good faith and without reason to know of its prior misappropriation that would be prejudiced by a prohibitory injunction against future damaging use.”<sup>8</sup>

Some courts have utilized this provision to justify the imposition of a royalty rate rather than an injunction where the equities favored the former.<sup>9</sup> Similarly, some courts have given competitors the option of using certain trade secrets for a limited period of time while paying royalties in lieu of being enjoined.<sup>10</sup> As noted by one court, “the essence of the codification is the need to balance harm to the plaintiff with the other equities in a particular case in order to award appropriate relief.”<sup>11</sup>

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**State Courts:**

*Illinois:* ILG Industries, Inc. v. Scott, 49 Ill.2d 88, 273 N.E.2d 393, 171 U.S.P.Q. (BNA) 371 (1971).

*Iowa:* 205 Corp. v. Brandow, 571 N.W.2d 548, 552-553 (Iowa 1994).

*Massachusetts:* USM Corp. v. Marson Fastener Corp., N. 2 *supra*, 392 Mass. at 354, 467 N.E.2d at 1285-1286.

*Missouri:* Carboline Co. v. Jarboe, 454 S.W.2d 540 (Mo. 1970).

<sup>5</sup> Christopher M’s Hand Poured Fudge, Inc. v. Hennon, 699 A.2d 1272, 1276-1278 (Pa. Super. 1997) (affirming a permanent injunction over the defendant’s objection, making a distinction between enjoining defendant’s further employment in the field where use of trade secrets would be virtually inevitable as opposed to enjoining the use of a particular trade secret).

<sup>6</sup> UTSA § 2(b).

<sup>7</sup> *Id.*; and see Cal. Civ. Code § 3426.3(b).

<sup>8</sup> UTSA § 2(b), Comment. (Emphasis in original.) See Republic Aviation Corp. v. Schenk, 152 U.S.P.Q. (BNA) 830 (N.Y. Sup. 1967) (the court held that enjoining a misappropriator from supplying the U.S. with a weapons control system would have endangered military personnel).

<sup>9</sup> A&H Sportswear Co. v. Victoria’s Secret Stores, 967 F. Supp. 1457 (E.D. Pa. 1997).

<sup>10</sup> Columbus Steel Castings Co. v. King Tool Co., 2011 Ohio App. LEXIS 6826 (Ohio 10th App. Dist. App. Dec. 30, 2011).

<sup>11</sup> A&H Sportswear Co. v. Victoria’s Secret Stores, N. 9 *supra*.

**[2]—Exclusion Order**

If the defendant (respondent) is a foreign entity, then the plaintiff should consider filing an action before the International Trade Commission (“ITC”). Selecting the ITC as a forum requires that the misappropriated trade secret(s) be used in the manufacture of goods being imported into the U.S. Further, the U.S.-based claimant must produce evidence that the importation of the good produced using unfair practices threatens to “destroy or substantially injure” a domestic industry.<sup>12</sup> Significantly, an ITC action can be filed against a foreign entity even when the misappropriation both occurs and is practiced outside of the U.S.<sup>13</sup>

The ITC can issue both temporary and permanent exclusion orders.<sup>14</sup> An exclusion order prohibits the importation of the product produced using the misappropriated trade secret(s). Exclusion orders are enforced by the U.S. Customs and Border Protection (under the Department of Homeland Security).<sup>15</sup>

The parties may petition the Commission to review the Administrative Law Judge’s Initial Determination.<sup>16</sup> Following the Commission’s issuance of an exclusion order, the President of the United States has sixty days to disapprove of the order for policy reasons.<sup>17</sup> Infringing articles may enter the U.S. during this presidential review period provided the importer posts a bond of an amount determined by the Commission.<sup>18</sup> Commission decisions are appealable to the U.S. Court of Appeals for the Federal Circuit.<sup>19</sup>

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<sup>12</sup> 19 U.S.C. § 1337(a)(1)(A). Evidence that the unfair practices threaten to prevent the establishment of an industry or restrains or monopolizes trade in the U.S. is also acceptable. See also *TianRui Group Co. v. ITC*, 661 F.3d 1322 (Fed. Cir. 2011).

<sup>13</sup> *TiaRui Group Co. v. ITC*, *id.*, 661 F.3d at 1333.

<sup>14</sup> 19 U.S.C §§1337(d) and 1337(e). See also, ITC Pub. No. 4105, “The U.S. International Trade Commission, Section 337 Investigations, Answers to Frequently Asked Questions,” pp. 21 and 24 (March 2009), [http://www.usitc.gov/intellectual\\_property/documents/337\\_faqs.pdf](http://www.usitc.gov/intellectual_property/documents/337_faqs.pdf) (last visited January 28, 2015).

<sup>15</sup> *Id.* (ITC Pub. No. 4105), p. 24.

<sup>16</sup> *Id.*

<sup>17</sup> *Id.*, p. 25. The Commission may also enter a cease and desist order which orders the defendant to cease its unfair acts. Cease and desist orders are enforced by the Commission and not U.S. Customs. *Id.*, p. 24.

<sup>18</sup> *Id.*

<sup>19</sup> *Id.*, p. 26.

**§ 9.06 Measures of Damages for Misappropriation**

The UTSA provides for several forms of monetary relief for misappropriation of trade secrets.<sup>1</sup> First, actual damages suffered by the plaintiff, both in terms of actual costs and lost profits, may be recovered.<sup>2</sup> The plaintiff may also recover for the defendant's unjust enrichment equal to the amount of the benefit the defendant received from its improper use of the plaintiff's trade secret, but the unjust enrichment award cannot be "taken into account in computing" the actual damages.<sup>3</sup> In other words, an award for unjust enrichment can be ordered in addition to an award of actual damages, but the two kinds of damages cannot be duplicative.<sup>4</sup>

The UTSA also provides that instead of awarding actual damages or unjust enrichment, damages for trade secret misappropriations can "be measured by imposition of liability for a reasonable royalty."<sup>5</sup> California has enacted a slightly modified version of this provision of the UTSA, providing that only if the plaintiff cannot prove either its own damages or unjust enrichment by the defendant, "the court may order payment of a reasonable royalty for no longer than the period of time the use could have been prohibited."<sup>6</sup> The failure to prove actual damages or unjust enrichment *either* as a matter of law *or* as a matter of fact is sufficient to allow the court to use its discretion to award a reasonable royalty.<sup>7</sup> The Virginia version of the UTSA provides that damages can be measured by actual loss or unjust enrichment as in the UTSA, but damages can be measured by a reasonable royalty only "[i]f a complainant is unable to prove a greater amount of damages by other methods of measurement."<sup>8</sup>

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<sup>1</sup> UTSA § 3.

<sup>2</sup> UTSA § 3(a).

<sup>3</sup> *Id.* See:

*California:* Ajaxo Inc. v. E\*Trade Group Inc., 135 Cal. App.4th 21, 61, 37 Cal. Rptr.3d 221, 254 (2005).

*Indiana:* Weston v. Buckley, 667 N.E.2d 1089, 1093 (Ind. App. 1997).

*Utah:* Water & Energy Systems Technology, Inc. v. Keil, 48 P.3d 888, 894 (Utah 2002).

<sup>4</sup> UTSA § 3(a).

<sup>5</sup> *Id.*

<sup>6</sup> Cal. Civ. Code § 3426.3(b).

See:

*Ninth Circuit:* Cacique, Inc. v. Robert Reiser & Co., 169 F.3d 619, 623 (9th Cir. 1999); O2 Micro International Ltd. v. Monolithic Power Systems, Inc., 399 F. Supp.2d 1064 (N.D. Cal. 2005) (plaintiff was entitled to an award of a "paid-up" royalty payment for use of the trade secrets while the use was prohibited).

<sup>7</sup> Ajaxo Inc. v. E\*Trade Financial Corp., 187 Cal. App.4th 1295, 1313, 115 Cal. Rptr.3d 168, 183 (2010).

<sup>8</sup> Virginia UTSA § 59.1-338.

**§ 9.07 Establishing Damages**

The parties bear differing burdens of proof in trade secret matters. This section discusses the elements that the plaintiff must prove to establish damages. Generally, the plaintiff is required to establish the existence of a causal connection between (1) the alleged theft of trade secrets and (2) the harm caused to the plaintiff and/or the misappropriator's unjust enrichment.<sup>1</sup> The importance of this requirement is that the plaintiff cannot simply assume that damages resulted from the theft.

The plaintiff's specific burden, therefore, is to establish that the use of the stolen trade secrets caused some negative economic impact to the owner or a positive economic impact to the misappropriator. After establishing this causal connection, the plaintiff is often required to establish only the lost or unjustly gained revenues that occurred concurrently with the use of the trade secrets.

Establishing a causal connection between misappropriation and damages can be a difficult and sometimes highly analytical task for plaintiffs. Unlike patent damages where the expert makes an explicit assumption of use of the patented feature (i.e., assumption of infringement by the defendant is the assumption of use of the patented feature by the defendant), trade secrets cases differ. The expert may assume the trade secrets were "taken," but the plaintiff must establish that they have been put to use in the misappropriator's business. This is a necessary step in determining whether any economic gain was experienced by the misappropriator, and also helps value the plaintiff's lost sales. In establishing whether the trade secrets were used, the damages expert may also attempt to determine exactly how the misappropriator exploited the trade secrets. An expert may assist with this determination by establishing the relative effect of the trade secrets on the business and, therefore, begin valuing the effect of the trade secrets' use.

Historically, the relative degree of certainty with which the plaintiff must prove causation has differed from court to court. Some courts have accepted a simple showing of use to justify a quantification of all revenue associated with that use, whereas others have required that the plaintiff provide (1) an acknowledgment by the misappropriator's customers of the importance of the trade secret in making their purchase decisions or (2) the equivalent of an outright confession by the misappropriators that the trade secrets drive sales or reduce costs. Clearly, there is no easy answer to the question of how much proof will be required. It is logical then to assume that the plaintiff should perform as detailed an analysis as possible with the information

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<sup>1</sup> UTSA § 3; Virginia UTSA § 59.1-338.

available to show with the greatest degree of certainty that the use of the trade secrets resulted in a gain to the misappropriator and/or loss to the plaintiff, subject to time and budget constraints. Examples of analyses allowed by law and the courts include identifying specific customers diverted to the defendant, a general decline in sales after the defendant's misappropriation,<sup>2</sup> or an increase in sales of the misappropriator and/or its profits.<sup>3</sup>

In the authors' experience, potential sources of information for determining causation include

- (1) pre- and post-misappropriation product and business plans,
- (2) pre- and post-misappropriation marketing documents,
- (3) sales representative e-mails, logs, and reports,
- (4) interviews with or depositions of product development and sales and marketing personnel from both parties,
- (5) third-party market reports on the products or technology related to the misappropriation,
- (6) customer interview or affidavits, and
- (7) pre- and post-misappropriation financial statements.

These are all good starting points.

Having proven causation, the plaintiff may then quantify damages. As previously discussed, damages may be comprised of lost profits, unjust enrichment, and a reasonable royalty, or a combination thereof.<sup>4</sup> In establishing the amount of damages, courts have recognized the inherent difficulty in establishing an exact figure, and have instead allowed considerable latitude to the plaintiff.<sup>5</sup> However, courts have required that the damages estimation be based on reasonable evidence and inferences, not on mere speculation.<sup>6</sup>

### [1]—Lost Profits

When the plaintiff establishes its lost profits from the alleged misappropriation, it has the burden of establishing the sales that were lost and the proper deductions that would have been associated with those

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<sup>2</sup> *Restatement (Third) of Unfair Competition* § 45 Comment e (1995).

<sup>3</sup> *Clark v. Bunker*, 453 F.2d 1006, 1011 (9th Cir. 1972).

<sup>4</sup> See § 9.06 *supra*.

<sup>5</sup> See:

*Ninth Circuit: Litton Systems, Inc. v. Ssangyong Cement Industries, Co.*, 1993 U.S. Dist. LEXIS 12198, 1993 WL 317266, at \*1 (N.D. Cal. Aug. 19, 1993).

**State Courts:**

*Indiana: Weston v. Buckley*, 677 N.E.2d 1089, 1093 (Ind. App. 1997).

<sup>6</sup> *Id.* (*Weston v. Buckley*); and see *Perdue Farms, Inc. v. Hook*, 777 So.2d 1047, 1052 (Fla. App. 2001).

sales had the plaintiff made them.<sup>7</sup> It is the misappropriator's burden to establish the portion of those sales that are not attributable to use of the trade secrets.<sup>8</sup> In spite of this obligation, a plaintiff should not passively wait to receive the results of the defendant's expert's analysis because the defendant may gather and rely on inadequate or inaccurate information in arriving at its opinion. Although the plaintiff can point out such errors, there will be the resulting inevitable delay caused by the need to make a new, proper determination. In addition, a plaintiff should not rely on the misappropriator to set the standard upon which an apportionment should be made. Even though the defendant may bear the burden of proof, the plaintiff should coordinate with its own experts to gather the relevant information to perform the analysis if—and when—necessary.<sup>9</sup>

### [2]—Unjust Enrichment

In performing an unjust enrichment analysis, the plaintiff bears the burden of showing that the misappropriator reaped ill-gotten sales from use of the trade secrets. Then the defendant must establish what portion of those sales is unrelated to the trade secrets, and the appropriate costs associated with the subject sales.<sup>10</sup> Although the defendant generally bears the burden to prove deductions, the plaintiff should coordinate with its own experts to gather the relevant information to perform the analysis, if and when necessary, to refute any parts of the defendant's analysis they believe is warranted.<sup>11</sup>

### [3]—Reasonable Royalty

The Uniform Trade Secrets Act and most courts have allowed the use of a reasonable royalty as a measure of damages largely as a substitute for the other forms of damages.<sup>12</sup> This procedure is generally used when there is insufficient information to establish all or only a portion of the plaintiff's lost profits or misappropriator's unjust enrichment.<sup>13</sup> There is no seminal decision in trade secret law setting

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<sup>7</sup> The proper level of profits that should be stated by the defendant has varied in court decisions. This will be discussed in greater detail in § 9.09 *infra*.

<sup>8</sup> *Cartel Asset Management v. Ocwen Financial Corp.*, 249 Fed. Appx. 63 (10th Cir. 2007). And see 17 U.S.C. § 504(b).

<sup>9</sup> See § 9.13 *infra* for admission of such an analysis.

<sup>10</sup> *Jet Spray Cooler, Inc. v. Crampton*, 377 Mass. 159, 385 N.E.2d 1349, 1359 (1979).

<sup>11</sup> See § 9.13 *infra* for a discussion of such an analysis.

<sup>12</sup> UTSA § 3(a). And see *Pioneer Hi-Bred International v. Holden Foundation Seeds, Inc.*, 35 F.3d 1226, 1244 (8th Cir. 1994). See also, § 9.06 *supra*.

<sup>13</sup> *University Computing Co. v. Lykes-Youngstown Corp.*, 504 F.2d 518 (5th Cir. 1974).



forth the proper way to determine a reasonable royalty. Rather, in determining a reasonable royalty, courts have often analogized to patent damages decisions such as *Georgia-Pacific Corp. v. United States Plywood Corp.*<sup>14</sup> Later in this chapter, we will discuss in more detail the various court decisions and economic literature which may assist a damages expert in constructing a reasonable royalty for trade secret misappropriation through the *Georgia-Pacific* methodology.

#### **[4]—Defensive Responses and Techniques**

The plaintiff is often given wide latitude in determining damages in trade secret matters. “[E]very case requires a flexible and imaginative approach to the problem of damages . . . [and] each case is controlled by its own peculiar facts and circumstances.”<sup>15</sup> As a result, the defendant often has an abundance of issues to consider in order to establish what it believes to be the correct measure of damages. This section discusses some of the more common and practical issues defendants often tackle when rebutting the plaintiff’s claim for damages. This list is not exhaustive because many unique fact-specific issues can arise in any case.

First, the defendant’s expert will want to determine whether the plaintiff expert’s methodology is proper. Second, is that methodology well-supported with proper analyses by the expert? This section discusses some of the more common areas on which an expert may focus to assess a damages claim.<sup>16</sup> These areas are particularly useful if the plaintiff has simply quantified the infringer’s revenues, permitting the defendant an opportunity to establish the final damages.

#### **[a]—Plaintiff Has Not Demonstrated That the Damages Were Caused by Misappropriation**

Asserting that the plaintiff has not demonstrated that the damages were caused by misappropriation strikes at the very core of the methodology. This is largely a direct attack on the plaintiff’s analyses as to causation. In some instances, a plaintiff may simply note that the trade secrets were used by the defendant and instantly proceed to quantify either the unjust sales or profits of the defendant or lost

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<sup>14</sup> *Georgia-Pacific Corp. v. United States Plywood Corp.*, 254 F.2d 124 (2d Cir. 1958).

<sup>15</sup> *University Computing Co. v. Lykes-Youngstown Corp.*, N. 13 *supra*.

<sup>16</sup> These examples are a product of the authors’ experience, and are meant to be only illustrative in nature. They are neither exhaustive nor complete and, of course, the use of these techniques will depend on the facts and circumstances of a particular matter.

sales of competing products of the plaintiff. However, a challenge to some or all of the damages is possible by testing whether, even if used, the trade secrets caused the claimed damages. An example of such an analysis may assist in this discussion. Assume that the defendant misappropriated a new flavor formulation for a soft drink. Further, assume that the plaintiff produced evidence that the defendant changed its drink formulation to the misappropriated formulation and began to sell the new drink. If the plaintiff were to stop its analysis at this point and simply begin quantifying damages, the defendant could then proceed to show that the plaintiff's conclusions are premature and unsupported.

Demonstrating that a product uses the trade secret does not in and of itself prove that the knowledge gleaned from the trade secret is responsible for that success. One analysis that may clarify this uncertainty is to compare the sales of the defendant's drink product before use of the trade secret to its sales after it adopted the trade secret protected formula. This pre/post analysis may show that the product was just as successful pre-use of the trade secrets as it was afterwards and that there was little, if any, harm or unjust gain from use of the trade secret. If the pre/post analysis shows a significant increase in sales of the post-trade secrets product as compared to its pre-trade secret performance, other possible explanations to a conclusion of damages may exist. For example, an investigation can be undertaken to determine which features actually drive the sales of the post-trade secret product. Customer feedback, sales logs, third-party market reports, or survey results are all potential sources for this type of analysis. If changes to the product appeared at or about the time of the use of the trade secret, an argument could be made that the plaintiff's failure to properly consider and quantify the effects of the non-trade secret features renders the plaintiff's opinions speculative or incorrect.

**[b]—Damages, or Portions of Damages, Are Not  
Related to the Trade Secrets**

To the extent that the analyses described above show that use of the trade secrets increased sales of the infringing product, quantifying this effect may prove useful in demonstrating that portions of these sales and profits are related to non-trade secret elements of the product. Similar analyses to those described above may assist in demonstrating that sales of the subject product would have occurred without the use of the trade secrets. Refining these analyses to demonstrate the effect of non-trade secrets on sales of the questionable product may allow for a reduction in the amount of the damages conclusion.

For example, if the infringing product were sold prior to use of the trade secrets, this success may be useful in demonstrating that sales

and profits would have occurred without use of the trade secrets. This may be particularly useful in a market where there are competing products sold by companies other than the plaintiff and defendant. Evidence that other competing products make sales without use of the trade secrets would support the conclusion that the pre-trade secret product sold by the misappropriator would have led to sales (without the benefit of the trade secret). Therefore, only the incremental sales (and for unjust enrichment, the associated profits) of the misappropriator would be used to adjust the plaintiff's calculation of damages.

#### **[c]—Costs or Expenses Offset Claimed Damages**

As mentioned earlier, in calculating the defendant's unjust enrichment, the plaintiff often has only the burden to show the sales associated with use of the trade secrets. To the extent this is the case, the defendant must then ensure that all costs associated with those sales are included in the analysis of profits earned by the misappropriator.<sup>17</sup> In addition, the plaintiff and defense experts must determine the appropriate profit to apply to sales which would have been made by the plaintiff as part of a lost profits analysis. Prior to determining the appropriate costs to deduct from the accused revenue, the expert must first determine what measure of profit is appropriate. As a general principle, the defendant would like to measure net profits, which include all costs of goods sold and all operating costs. However, as will be discussed later in this chapter, various courts have allowed different measures of profitability, including gross profits, incremental profits, and net profits.

#### **[d]—Shortening the Accounting Period for Damages**

Any review of a plaintiff's damages estimate must consider the period during which the plaintiff calculated damages to be a potentially significant variable. Because courts have allowed not only past damages as an appropriate measure, but also future damages, any analysis that reduces the damages period can have a major effect on the damages amounts. This will be discussed below.

#### **[e]—Calculating the Time and Money to Develop the Trade Secret Independently**

Determining the amount of time and money required to develop the trade secret can be used both (1) to place a minimum value on

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<sup>17</sup> Note that this work would also assist any analyses that calculate reasonable royalties and both lost profit and unjust enrichment damages. This will be discussed in §§ 9.09, 9.10, and 9.11 *infra*, respectively.

the trade secret in the event that the trade secrets cannot be shown to have generated any lost profits or unjust gain<sup>18</sup> and (2) to assist in establishing a defined period of damages to the extent that it can be shown that the misappropriator could have independently developed the trade secrets through legal means.<sup>19</sup>

### **[f]—Impermissible Double Recovery**

When the plaintiff has calculated both lost profit damages and unjust enrichment, the defendant can attempt to show that these figures overlap and thus equal a double recovery. The UTSA permits “[d]amages [to] include both the actual loss caused by misappropriation and the unjust enrichment caused by the misappropriation that is not taken into account in computing actual loss.”<sup>20</sup> Overlap in damages can result from many calculation approaches, including measuring lost profits and unjust enrichment by both the same unit of sales and the same measure of profits.<sup>21</sup> Hence, if there is a difference in the infringer’s profits (i.e., they are higher than the plaintiff’s), counsel should ensure that only the difference in profits per unit should be included in the additional unjust enrichment claim.

Similarly, reasonable royalty damages alleged by the plaintiff must be analyzed to ensure that infringing units that have been assigned a reasonable royalty are not also being included in lost profit or unjust enrichment. These issues will be discussed in more detail later in this chapter.

### **[g]—Multiple Injury Damages**

In many cases, multiple forms of misuse of intellectual property may be at issue in addition to trade secret misappropriation. If the various infractions bear a logical relationship to one another, the issues may be tried in the same case providing the damages do not overlap.<sup>22</sup> When a plaintiff does not attempt to prove lost profits or unjust enrichment for the misappropriation of trade secrets, damages may be based upon a reasonable royalty. The court may agree to an established royalty rate or will determine a reasonable royalty from the relevant circumstances.<sup>23</sup> However, the defendant should, again, perform analyses to show whether the same unit of sales is captured in

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<sup>18</sup> *University Computing Co. v. Lykes-Youngstown Corp.*, 504 F.2d 518 (5th Cir. 1974).

<sup>19</sup> This comports with the experience of the authors.

<sup>20</sup> UTSA § 3(a).

<sup>21</sup> *General Clutch Corp. v. Lowry*, 10 F. Supp.2d 124 (D. Conn. 1998).

<sup>22</sup> *Paine, Webber, Jackson & Curtis, Inc. v. Merrill Lynch, Pierce, Fenner & Smith*, 587 F. Supp. 1112 (D. Del. 1984).

<sup>23</sup> *Carter Products, Inc. v. Colgate-Palmolive Co.*, 214 F. Supp. 383 (D. Md. 1963).

multiple forms of injury in the event the court does not allow overlap of damages pursuant to an alleged injury.

**§ 9.08 Duration of Damages**

In general, a trade secret has no definite term. Notwithstanding the fact that the courts have recognized that "each case is controlled by its own peculiar facts and circumstances,"<sup>1</sup> according to the comment to Section 3 of the Uniform Trade Secrets Act,

"a monetary recovery for trade secret misappropriation is appropriate only for the period in which information is entitled to protection as a trade secret, plus the additional period, if any, in which the misappropriator retains an advantage over good faith competitors because of misappropriation."<sup>2</sup>

Based on the UTSA comment, it appears that the trade secrets damages period would be limited to the period that the trade secret would remain secret without the misappropriation. This period of time could represent, for example, the period that the defendant would have marketed the product without having properly obtained the trade secrets either by (1) independently developing the trade secrets or by (2) reverse engineering the trade secrets from products that are already on the market.<sup>3</sup> Accordingly, the damages period is not necessarily the date of misappropriation through the date of trial. If the trade secret could have been independently developed sooner than the date of trial, then the damages period may be limited to the development time. Alternatively, the damages period might be extended past the date of trial to account for any head start advantage the defendant may continue to enjoy as a result of the misappropriation.

Furthermore, the damages period might be limited by authorized disclosure of the trade secrets, such as issuance of a patent.<sup>4</sup> In addition to the above considerations, trade secret law is also subject to applicable statutes of limitations, which is similar to patent law.<sup>5</sup>

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<sup>1</sup> *University Computing Co. v. Lykes-Youngstown Corp.*, 504 F.2d 518, 538 (5th Cir. 1974) (quoting *Enterprise Manufacturing Co. v. Shakespeare Co.*, 141 F.2d 916, 920 (6th Cir. 1944)).

<sup>2</sup> UTSA § 3, Comment (amended 1985), 14 U.L.A. 456 (Supp. 1989).

<sup>3</sup> *Bonito Boats, Inc. v. Thunder Craft Boats, Inc.*, 489 U.S. 141, 109 S.Ct. 971, 103 L.Ed.2d 118 (1989).

<sup>4</sup> *Louis Marx & Co. v. Buddy L. Corp.*, 453 F. Supp. 392 (S.D.N.Y. 1978).

<sup>5</sup> For example, the Uniform Trade Secrets Act has a three-year statute of limitations.

**§ 9.09 Lost Profits**

Like all forms of intellectual property, lost profits may be recoverable if both defendant and plaintiff had developed and sold the product incorporating the trade secrets.

**[1]—Definition of Lost Profits****[a]—Incremental Profits Absent Infringer's Misappropriation**

Lost profits are properly measured as the incremental profits that the plaintiff would have realized absent the infringer's misappropriation. This measurement is easiest in a two-supplier market where only the plaintiff and defendant compete for sales. The calculation of lost profits is a net profit measurement, i.e., the plaintiff's incremental sales must be reduced by the expenses saved by not producing those lost sales units.<sup>1</sup> Courts have disallowed lost profits when the plaintiff has calculated only its lost gross profits.<sup>2</sup> However courts have allowed the inclusion of profits from collateral sales (i.e., sales of non-secret ancillary items) if it can be shown that additional products which do not use the trade secrets would have been sold along with the plaintiff's original lost sales.<sup>3</sup> Examples of collateral sales would include sales of any accessory products, spare parts, or maintenance or service fees that are linked to the sale of the original infringing product.

**[b]—Apportionment of Lost Profits**

In determining the lost profits of the plaintiff, a damages expert generally apportions the profits generated by the non-trade secret features from the profits that are derived from use of the trade secrets. This process of apportionment is closely aligned with the process of determining what features drive the sales of the products that use the trade secrets. Once the expert determines which features drive the products' sales and profits, the expert would then determine what profits the products would have earned "but for" the trade secrets. Subtracting the latter amount from the total profits decreases total profits to only those profits that are related to the trade secrets. Courts have issued differing opinions as to apportionment, with some supporting this approach and others not requiring such analyses.<sup>4</sup>

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<sup>1</sup> Infinity Products, Inc. v. Quandt, 775 N.E.2d 1144, 1155 (Ind. App. 2002).

<sup>2</sup> Home Pride Food, Inc. v. Johnson, 262 Neb. 701, 634 N.W.2d 774, 783 (2001).

<sup>3</sup> Sperry Rand Corp. v. A-T-O, Inc., 447 F.2d 1387, 1394 (4th Cir. 1971).

<sup>4</sup> See:

*Fourth Circuit:* Alfred W. Lathan v. National Legal Research Group, Inc., 42 F.3d 1386 (4th Cir. 1994).

**[c]—Establishing But-For Profits**

After determining whether apportionment is justified and/or required, an expert must then turn his or her attention to what level of *pro forma* profits to measure in establishing the plaintiff's but-for profits. Because the establishment of but-for profits is similar to the apportionment of damages, courts have allowed differing measure of profits, including gross, net, and incremental. For example, in *General Clutch Corp. v. Lowry*,<sup>5</sup> the court allowed unjust enrichment equal to defendants' gross profits on sales. It was defendants' trial burden to demonstrate costs that could be properly offset against its revenues in order to arrive at the final calculation of defendants' unjust enrichment.

In *Infinity Products v. Quandt*,<sup>6</sup> the Indiana Appeals Court required the award of lost profits to be measured by net profits. In *USM Corp. v. Marson Fastener Corp.*, the Massachusetts Supreme Judicial Court issued a judgment of incremental profits where deductions from gross profit were made only for costs that were directly attributable to the use of the trade secret product at issue.<sup>7</sup>

It is widely held throughout patent courts that the proper measure of lost profits is incremental profits. Incremental profits recognize that the additional sales that would have been made by the plaintiff "but-for" the theft of trade secrets would have borne only the costs that would have been borne by the exact number of such units. That is, the fixed costs already borne by the plaintiff for its actual sales would not be borne again on the incremental sales.

Therefore, each incremental sale in the "but-for" world bears only incremental costs and derives only incremental profits. One *caveat* to this discussion is the situation in which the plaintiff has yet to launch its product into the market at the time of the theft. In this instance, all costs necessary to make the first sale would be borne by the "but-for" incremental sales because fixed costs would be necessary to begin selling.

**[2]—Calculating *Pro Forma* Profits**

The various methods used to calculate the three forms of *pro forma* profits (i.e., gross, net, and incremental) range from relatively simple to complex.

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*Fifth Circuit:* DSC Communication Corp. v. Next Level Communications, 107 F.3d 322 (5th Cir. 1995).

*Ninth Circuit:* O2 Micro International Ltd. v. Monolithic Power Systems, Inc., 399 F. Supp.2d 1064 (N.D. Cal. 2005).

<sup>5</sup> General Clutch Corp. v. Lowry, 10 F. Supp.2d 124 (D. Conn. 1998).

<sup>6</sup> Infinity Products v. Quandt, 775 N.E.2d 1144 (Ind. App. 2002).

<sup>7</sup> USM Corp. v. Marson Fastener Corp., 392 Mass. 334, 467 N.E.2d 1271 (1984).



**[a]—Gross Profits**

Calculating “gross profits” is generally a simple process. Gross profits are calculated by taking the sales price of the plaintiff’s product(s) and subtracting the direct costs of the materials and labor associated with manufacturing that product(s). Often this information is easily found in the plaintiff’s profit and loss statement. Although some courts have allowed this measure of profits, other courts have found it to be unacceptable in trade secrets cases.<sup>8</sup>

**[b]—Net Profits**

Calculating net profits starts with the gross profits figure and then subtracts sales, general, and administrative (“SG&A”) costs associated with those sales. This process is more complicated than determining gross profits because many SG&A costs apply to several product lines and divisions. Companies typically allocate these costs using several different methods. The simplest of these is an allocation by revenue.

**[c]—Incremental Profits**

Calculating incremental profits can be quite complex depending on the nature of the books and records of the plaintiff. The goal is to recast the normal books and records of the plaintiff into *pro forma* profits which vary only with increases and decreases of sales. We discuss this calculation in great detail above,<sup>9</sup> and the techniques and description we include are applicable to trade secrets as well.

Determining the proper apportionment and measure of lost profits when both companies are already selling competing products requires the use of historical records of both parties. However, suppose the plaintiff had not yet entered the market at the time of the theft? In its decision in *Lucini Italia Co. v. Grappolini*,<sup>10</sup> the court ruled that although the plaintiff’s lost profits are uncertain, that does not bar an award of actual damages.<sup>11</sup>

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<sup>8</sup> Home Pride Food, Inc. v. Johnson, 262 Neb. 701, 634 N.W.2d 774, 783 (2001).

<sup>9</sup> See § 3.02[3] *supra*.

<sup>10</sup> *Lucini Italia Co. v. Grappolini*, 2003 U.S. Dist. LEXIS 7134, 2003 WL 1989605 (N.D. Ill. April 24, 2003).

<sup>11</sup> The United States Supreme Court has often held that when a defendant’s unlawful act keeps a plaintiff out of a market, specific and certain proof of the actual amount of losses is not required. *J. Truett Payne Co., Inc. v. Chrysler Motors Corp.*, 451 U.S. 557, 565-566, 101 S.Ct. 1923, 68 L.Ed.2d 442 (1981).

**[3]—Price Erosion****[a]—Already Incurred**

A calculation of the plaintiff's actual loss may also allow for price erosion. For example, to the extent the misappropriator's development costs that were avoided through theft allow the misappropriator to compete against the plaintiff at a lower sales price, the plaintiff may have been forced to lower its price or forgo any contemplated price increases.<sup>12</sup> To the extent that there is evidence to show that such circumstances occurred, the revenue derived by multiplying the additional price that would have been charged "but-for" the theft of the lost unit sales times the number of units affected would be added to any lost profits calculation. This amount would be added dollar for dollar to the lost profits calculation to the extent that no additional costs would have been incurred in charging a higher price.

Any determination of price erosion damages must consider the price elasticity of demand and the influence of price on the sales quantity. In essence, the damages expert must ensure that the "but-for" price that is estimated in calculating price erosion damages recognizes the law of supply and demand. That is, unless the price is exceptionally inelastic, increases in price will eventually reduce the quantity demanded of the product. Price elasticity of demand is calculated as the percentage change in quantity demanded divided by the percentage change in price:

$$\% \text{ quantity change} / \% \text{ price change} = \text{price elasticity of demand}$$

Products with an absolute value of greater than 1 are said to be elastic because the quantity demanded is highly responsive to changes in price. Reviewing historical prices and sales quantities of the plaintiff's relevant products may allow the expert to determine the price elasticity of demand and, therefore, aid in the determination of both the "but-for" price and the "but-for" quantity sold for a price erosion claim.

**[b]—Future Price Erosion**

In addition to determining what, if any, price erosion existed during the period of infringement, counsel or his expert may also claim future price erosion damages.<sup>13</sup> If the trade secrets have been disclosed to the public, causing the value to be "given away" to the market, or the market is unlikely to allow for permanent price increases to restore pre-trade secret theft levels, then the plaintiff may experience harm

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<sup>12</sup> Roton Barrier, Inc. v. The Stanley Works, 79 F.3d 1112 (Fed. Cir. 1996).

<sup>13</sup> *Id.*

past the date of trial and, therefore, be entitled to future price erosion damages as well. Variables such as the likely presence of substitute products and the ability to legally design around the trade secrets should be considered in setting the future “but-for” price, as well as the ultimate end point of the price erosion damages. In addition, any future calculation must consider the risk of projecting future profits when discounting those future profits to the present time.

#### **[4]—Development Costs**

In addition to awarding the plaintiff lost profits as compensation for theft of trade secrets, in *University Computing Co. v. Lykes-Youngstown Corp.* the Fifth Circuit also awarded to the plaintiff the defendant’s avoided costs to develop the trade secrets independently. The court reasoned that development costs should be taken into account as one of a number of different factors in determining the final damage figure.<sup>14</sup> Hence, in addition to causing the plaintiff harm in the form of lost profits, the defendant was also unjustly enriched by not having to spend the time and money to develop the trade secrets. There is no overlap in this argument between these two amounts because the defendant’s ill-gotten profits were not awarded on sales the plaintiff would have made. This is another example of the wide latitude courts have used to award plaintiffs and punish defendants for theft of trade secrets.

#### **[5]—Patent Law Analogies**

As we have been discussing throughout this chapter, although trade secret damages rulings have no seminal cases from which to seek formal guidance, patent law rulings have several. As such, several courts have reached out to important patent rulings and utilized them by analogy in trade secret damages matters as well. One such example is *Pioneer Hi-Bred International v. Holden Foundation Seeds, Inc.*<sup>15</sup> In this decision, the Eighth Circuit upheld a “but-for” analysis of lost profits based on the factors as set forth in *Panduit Corp. v. Stahl Brothers Fibre Works, Inc.*<sup>16</sup> The *Panduit* decision was based on patent infringement, and required that in order to prove lost profits a plaintiff must pass a four-pronged test by demonstrating the following factors:

- (1) demand for the patented product,

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<sup>14</sup> *University Computing Co. v. Lykes-Youngstown Corp.*, 504 F.2d 518 (5th Cir. 1974).

<sup>15</sup> *Pioneer Hi-Bred International v. Holden Foundation Seeds Inc.*, 35 F.3d 1226 (8th Cir. 1994).

<sup>16</sup> *Panduit Corp. v. Stahl Brothers Fibre Works, Inc.*, 575 F.2d 1152 (6th Cir. 1978).

- (2) the absence of acceptable non-infringing substitutes,
- (3) the manufacturing and marketing capability to exploit the demand, and
- (4) the amount of the profit the plaintiff would have realized.

Two key elements added by *Panduit* to a lost profits analysis in a trade secrets context are the concepts of (1) non-infringing alternatives and (2) the ability to prove manufacturing and marketing capacity. Therefore, in addition to proving causation, the appropriate apportionment, and the proper measure of profits, an expert may also need to show that there was no non-infringing path that the defendant could have taken to arrive at the same product, at the same cost, at the same time. Issues such as the possibility of reverse engineering the trade secrets and the availability of perfect or near perfect substitutes arise in these analyses. In addition the plaintiff must prove it had the capacity to make the sales. In *KW Plastics v. United States Can Co.*, the Federal District Court for the Middle District of Alabama rejected lost profits damage claims based on the fact that the plaintiff did not demonstrate the capacity to make alleged lost sales.<sup>17</sup> Analysis of the plaintiff's actual production and marketing capacity, together with reasonable projections of attainable increases, may therefore be necessary to show that the plaintiff could have made the "but-for" sales of the defendant.

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<sup>17</sup> *KW Plastics v. United States Can Co.*, 131 F. Supp.2d 1289 (M.D. Ala. 2001).

**§ 9.10 Unjust Enrichment****[1]—Definition**

The UTSA enables the plaintiff to obtain a recovery based upon “unjust enrichment caused by misappropriation that is not taken into account in computing [complainant’s] actual loss.”<sup>1</sup> Unjust enrichment is the unfair benefit or gain realized by the defendant as a result of the misappropriation, through the efforts of another; awarding damages based on unjust enrichment is an equitable resolution, not a measure of damages.<sup>2</sup> The defendant may have benefited from misappropriation in a variety of ways, including the following:

- Defendant was able to sell a product it would not otherwise have sold<sup>3</sup>;
- Defendant realized an initial advantage by entering the market earlier<sup>4</sup>;
- Defendant avoided incurring research, development, or marketing costs associated with creating the trade secrets, or due to the negative information provided by the trade secrets<sup>5</sup>; and
- Defendant saved costs.<sup>6</sup>

The first two benefits entail a calculation of the additional revenues and associated profits the defendant unjustly obtained, and may include consideration for collateral sales.<sup>7</sup> The latter two relate to the defendant’s cost savings, or avoidance of costs, either of which may be a one-time, non-recurring cost saving (e.g., reduced research and development expenses), or an on-going cost saving (e.g., cheaper manufacturing process). Each of these categories is addressed in greater detail below.

**[2]—Defendant’s Profits**

Courts frequently measure unjust enrichment based on the defendant’s profits from sale of the product resulting from misappropriation. There is neither a standard governing the actual profits determined, such as gross, operating, or net profits, nor a standard establishing a conceptual methodology for deduction of associated costs to arrive

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<sup>1</sup> UTSA § 3(a).

<sup>2</sup> C&F Packing Co. v. IBP, Inc., 224 F.3d 1296, 1304 (Fed. Cir. 2000).

<sup>3</sup> Elcor Chemical Corp. v. Agri-Sul, Inc., 494 S.W.2d 204 (Tex. Civ. App. 1973).

<sup>4</sup> Telex Corp. v. IBM Corp., 510 F.2d 894, 931 (10th Cir.), *cert. dismissed* 423 U.S. 802 (1975).

<sup>5</sup> *Id.*, 510 F.2d at 930-932.

<sup>6</sup> International Industries v. Warren Petroleum Corp., 248 F.2d 696 (3d Cir. 1957).

<sup>7</sup> “Collateral sales” generally refer to sales that are not covered by the trade secret, but are sold in connection with the products that are covered by the trade secret.

at the defendant's profits. Accordingly, courts have utilized different types of profits in calculating unjust enrichment. Typically, the plaintiff has the burden of demonstrating the defendant's revenues, and the defendant has the burden of demonstrating the related costs in determining the amount of profits.

Calculation of unjust enrichment should also reflect apportionment for non-trade secret elements and the impact of alternative options available to the defendant, such as developing the trade secret knowledge internally. In *KW Plastics v. United States Can Co.*, the court excluded plaintiff's expert testimony related to unjust enrichment because the expert did "not attempt to determine the value of the specific trade secrets used."<sup>8</sup> The court further noted that the expert must demonstrate a connection between the damages claimed and the trade secrets misappropriated, instead of assuming "that each and every penny . . . gained constitutes unjust enrichment."<sup>9</sup>

Examples of other factors besides trade secrets that may influence sales and profits include: (1) marketing campaigns, (2) other intellectual property, (3) quality of the sales force, (4) product features, etc. The types of documents or other information that may help demonstrate apportionment include: (1) customer comments, (2) focus group studies, (3) marketing studies, (4) analyst reports, and (5) internal profit/loss documentation. In addition, if the defendant can demonstrate that it had an alternative means of generating the same sales and profits without use of the trade secret information, this could reduce, or potentially eliminate, the benefit to the defendant resulting from misappropriation.

### [3]—Sample Unjust Enrichment Calculations

Let us make a hypothetical calculation of unjust enrichment based on defendant's profits by assuming that the plaintiff developed a trade secret related to a quieter vacuum cleaner motor. A damages expert might consider the following factors:

- Are all vacuum cleaner profits a result of the trade secret, or just the portion that relates to the reduced noise level? If just the reduced noise portion results in profits, then perhaps the value associated with that portion can be determined by evaluating the price of a vacuum with the quieter motor versus a similar vacuum with a standard motor.
- What profit level is appropriate? Was the defendant already in the vacuum cleaner business with investments made in manufacturing

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<sup>8</sup> *KW Plastics v. United States Can Co.*, 131 F. Supp.2d 1289 (M.D. Ala. 2001).

<sup>9</sup> *Id.*, 131 F. Supp.2d at 1295.

and distribution, so that the misappropriation allows for additional or incremental profits on a new and improved vacuum?

- Did the defendant benefit from collateral sales, such as vacuum cleaner bags, in connection with vacuum cleaner sales?
- Could the defendant have developed the reduced-volume motor by itself? If so, how much would the development have cost and how long would it have taken?
- Was the defendant able to enter the market early with a quieter vacuum cleaner due to the misappropriation and therefore gain an advantage?

Assuming the expert concludes that the defendant did not obtain a headstart advantage and that sales of the disputed vacuum cleaners were solely attributable to the misappropriation, a simplistic damage calculation could be as follows:

**Table 9-1**  
**No Headstart and No Apportionment**

Defendant's Sales Over Five Years	\$50,000
Less: Cost of Goods Sold	25,000
Less: Operating Expenses	10,000
<b>Defendant's Profits</b>	<b>\$15,000</b>

The expert could calculate the defendant's sales over five years and deduct the related cost of goods sold (50% of sales) plus any applicable operating costs (20% of sales).<sup>10</sup> In this calculation, the defendant's profits, or unjust enrichment, total \$15,000. Note that, depending on the circumstances, defendant's sales may include sales of convoyed products, and operating expenses may or may not be appropriate to include in the calculation.

In the event that only a portion of defendant's sales and profits from the vacuum cleaner is attributable to the trade secret misappropriation, the calculation should be adjusted accordingly:

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<sup>10</sup> The relevant costs to deduct will depend on the facts and circumstances of the specific matter.

**Table 9-2**  
**No Headstart and 80% Apportionment**

<b>Defendant's Sales Over Five Years</b>	<b>\$50,000</b>
Portion Attributable to Trade Secret	80%
<b>Defendant's Sales Due to Trade Secret</b>	<b>\$40,000</b>
Less: Cost of Goods Sold	20,000
Less: Operating Expenses	8,000
<b>Defendant's Profits</b>	<b>\$12,000</b>

In the example above, only 80% of the sales were attributable to the trade secret, resulting in \$12,000 in unjust enrichment. The cost of goods sold and operating expenses were recalculated at the percentage rates from Table 9-1 applied to the reduced sales base. The specific case facts, however, may require a disproportionate reduction for cost of goods sold and/or operating expenses to account for changes in incremental costs with a decrease in the sales base.

If the misappropriation allowed the defendant to enter the market earlier than it otherwise would have, and if as a result it achieved headstart advantages, then the associated gains should be quantified. This may require the determination of the defendant's actual sales compared to what the defendant would have sold "but-for" the misappropriation, i.e., if the defendant would have taken several years to internally develop the trade secret. Consider the following example of annual sales for the defendant

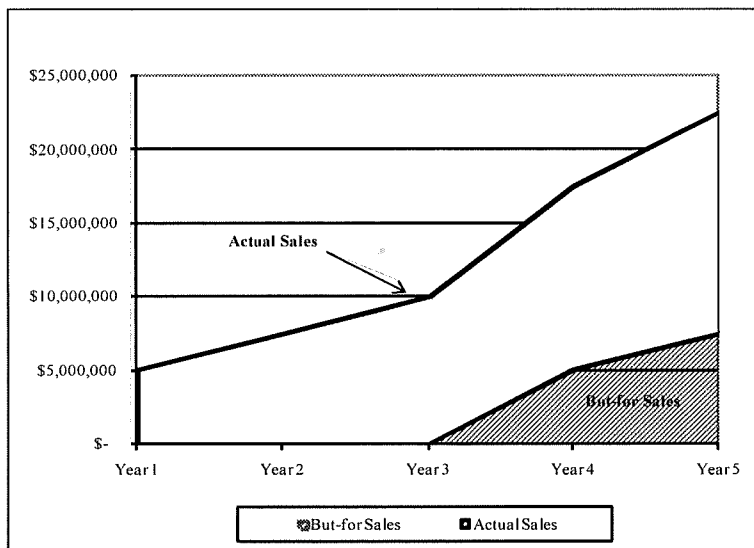
**Table 9-3**  
**Headstart Advantage**

	<b>Actual Sales</b>	<b>But-For Sales</b>	<b>Difference</b>
Year 1	\$ 5,000	\$ --	\$ 5,000
Year 2	7,500	--	7,500
Year 3	10,000	--	10,000
Year 4	12,500	5,000	7,500
Year 5	15,000	7,500	7,500
<b>Total</b>	<b>\$ 50,000</b>	<b>\$ 12,500</b>	<b>\$ 37,500</b>

In this example, the defendant gained an additional \$37,500 in sales from its head start advantage, before consideration of associated expenses. A graphical depiction of this head start advantage is shown in Table 9-4.



**Table 9-4**  
**Defendant's Actual versus But-For Sales**



In the table, the darker shaded area depicts the difference between actual and but-for sales, or the head start advantage. To perform a damages calculation, the expert could (1) calculate the sales associated with the head start advantage, (2) apportion the sales to determine the fraction attributable to the trade secrets, and (3) deduct associated costs. Separately, the expert could also calculate any cost savings that the defendant realized from misappropriation in the form of avoided internal development costs, among other things. In this hypothetical situation (Table 9-5), the calculation of unjust enrichment in nominal terms could yield the following:

**Table 9-5**  
**Headstart, 80% Apportionment,**  
**Cost Savings on Development**

Defendant's Actual Sales	\$50,000
Less: But-For Sales	12,500
Defendant's Headstart Advantage	\$37,000
Portion Attributable to Trade Secret	80%
Defendant's Sales Due to Trade Secret	\$30,000
Less: Cost of Goods Sold	15,000
Less: Operating Expenses	6,000
Defendant's Profits	\$9,000
Plus: Cost Savings on Development	1,000
<b>Defendant's Unjust Enrichment</b>	<b>\$10,000</b>

In the above example, the defendant's unjust enrichment from misappropriation of the trade secret included the ability to enter the market earlier, sell a product, and avoid development costs. In this situation, the primary means of unjust enrichment was through additional profits that the defendant would not otherwise have earned. In other situations, the primary means of unjust enrichment may be through cost savings, as described below.

#### **[4]—Defendant's Cost Savings**

The *Restatement (Third) of Unfair Competition* describes the following method for calculating the defendant's cost savings<sup>11</sup>:

"If the benefit derived by the defendant consists primarily of cost savings, such as when the trade secret is a more efficient method of production, the 'standard of comparison' measure that determines relief based on the savings achieved through the use of the trade secret may be the most appropriate measure of relief. The standard of comparison measure determines the defendant's gain by comparing the defendant's actual costs with the costs that the defendant would have incurred to achieve the same result without the use of the appropriated trade secret."

Even in circumstances where the defendant realized unjust enrichment in the form of profits, the cost savings, or avoided research and development costs, may be a more appropriate means of recovery. For example, in *Salsbury Laboratories, Inc. v. Merieux Laboratories*,

<sup>11</sup> *Restatement (Third) of Unfair Competition* § 45, Comment f (1995).

*Inc.*, the defendant's profits gained via misappropriation were deemed inadequate to make the plaintiff whole.<sup>12</sup> Instead, the court calculated Salsbury's recovery based on the notion that if Merieux "had not had the benefit of Salsbury's research, development and marketing . . . Merieux would have been required to expend approximately the same amount as Salsbury on the research, development and marketing."<sup>13</sup>

In order to appropriately capture potential costs that the defendant would have incurred to replicate the trade secret, the plaintiff should evaluate the time it took to develop the trade secret, as well as associated testing time, labor costs, and investments in property, plant, and equipment, as appropriate. These costs may all be considered as a basis for a damages calculation and are generally one-time payments to avoid development costs. The trade secret may also encompass on-going cost savings, such as when the trade secret information discloses a cheaper manufacturing process. Both the one-time and ongoing cost savings should be reviewed in determining the defendant's unjust enrichment.

The *Restatement (Third) of Unfair Competition* also considers the impact that alternatives may have on the calculation of unjust enrichment. The *Restatement* states that

"[w]hen acquisition of the trade secret by proper means is unlikely, the appropriate comparison may be between the costs of using the trade secret and the costs of alternative methods available to the defendant to achieve the same result."<sup>14</sup>

Accordingly, the expert may examine the alternatives that are available to the defendant to determine impact on development costs and/or the ongoing cost savings. For example, in the case of manufacturing cost savings realized from a misappropriated trade secret, the defendant may have had an alternative manufacturing methodology that was cheaper than the methodology used prior to misappropriation. Consideration of an alternative may also affect the calculation of defendant's profits (discussed above), such as where the defendant could have sold an alternative product rather than the product that included the misappropriated trade secret.

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<sup>12</sup> *Salsbury Laboratories, Inc. v. Merieux Laboratories, Inc.*, 908 F.2d 706, 714 (11th Cir. 1990).

<sup>13</sup> *Id.*

<sup>14</sup> *Restatement (Third) of Unfair Competition* § 45, Comment f (1995).

### § 9.11 Reasonable Royalties

The Uniform Trade Secrets Act states that, "In lieu of damages measured by any other methods, the damages caused by misappropriation may be measured by imposition of liability for a reasonable royalty. . . ."<sup>1</sup> Although some states' enactment of the UTSA provide that the use of reasonable royalty damages is appropriate if the other damage forms (i.e., lost profits and unjust enrichment) are unavailable,<sup>2</sup> experts often include such an analysis as an alternative to other damages estimates. In addition, experts can use a reasonable royalty to compensate the plaintiff for units that it would not have sold in its lost profits calculation and where unjust enrichment did not occur (i.e., if the defendant did not make profits) or the unjust enrichment could not be substantiated.

The concept of a reasonable royalty is well established in patent infringement matters, with seminal guidance given in the decision *Georgia-Pacific Corp. v. U.S. Plywood Corp.*<sup>3</sup> In *University Computing Co. v. Lykes-Youngstown Corp.*, the Court allowed the use of the *Georgia-Pacific* Factors in determining damages in a trade secrets matter. We have discussed all fifteen *Georgia-Pacific* Factors previously,<sup>4</sup> and will not list them all here. There have been commentators who agree with the use of *Georgia-Pacific* in determining damages in a trade secrets matter and have published articles in this regard.<sup>5</sup> However, it is helpful to discuss some of the key implications of using the *Georgia-Pacific* Factors to determine a reasonable royalty in a trade secrets case.

As in our previous discussion on removal of non-trade secret elements of value from the value of the trade secrets in determining lost profits and unjust enrichment, *Georgia-Pacific* Factor # 13 states that:

"The portion of the realizable profit that should be credited to the invention as distinguished from non-patented elements, the manufacturing process, business risks, or significant features or improvements added by the infringer."<sup>6</sup>

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<sup>1</sup> UTSA § 3(a).

<sup>2</sup> Cal. Civ. Code § 3426.3(b). And see *B. Braun Medical, Inc. v. Rogers*, 163 Fed. Appx. 500 (9th Cir. 2006).

<sup>3</sup> *Georgia-Pacific Corp. v. U.S. Plywood Corp.*, 318 F. Supp. 1116 (S.D.N.Y. 1970), modified & aff'd sub nom. *Georgia-Pacific Corp. v. U.S. Plywood-Champion Papers, Inc.*, 446 F.2d 295 (2d Cir. 1970), cert. denied 404 U.S. 870 (1971). And see § 6.06 *supra*.

<sup>4</sup> See Chapter 6 *supra*.

<sup>5</sup> The American Law Institute, *Restatement of the Law (Third), Unfair Competition* (1995); Warden, Bratic, and Eggleston, "Trade Secrets and Patents: Comparison and Contrasts in Royalty Determination," *Les Nouvelles* (Sept. 2000).

<sup>6</sup> *Georgia-Pacific Corp. v. United States Plywood Corp.*, N. 3 *supra*, 318 F. Supp. at 1119.

There is a general requirement that only the portion of value associated with use of the trade secret(s) be used in determining a reasonable royalty. As a result, performing a *Georgia-Pacific* analysis can separate out the features and value associated with the subject trade secrets from the features and value of the non-trade secret elements. In its decision in *Grain Processing Corp. v. American Maize-Products Co.*,<sup>7</sup> the Circuit Court for the Federal Circuit initially premised its damages opinion upon use of the *Georgia-Pacific* Factors, but is most famous for the addition of a specific analysis of non-infringing alternatives. In its decision in *Grain Processing*, the court stated that:

“... a fair and accurate reconstruction of the ‘but-for’ market also must take into account, where relevant, alternative actions the infringer foreseeably would have undertaken had he not infringed. Without the infringing product, a rational would-be infringer is likely to offer an acceptable non-infringing alternative, if available, to compete with the patent owner rather than leave the market altogether. The competitor in the ‘but-for’ marketplace is hardly likely to surrender its complete market share when faced with a patent, if it can compete in some other lawful manner. Moreover, only by comparing the patented invention to its next-best available alternative(s)—regardless of whether the alternative(s) were actually produced and sold during the infringement—can the court discern the market value of the patent owner’s exclusive right, and therefore his expected profit or reward, had the infringer’s activities not prevented him from taking full economic advantage of this right.”<sup>8</sup>

As such, a proper analysis of a trade secret’s value in a reasonable royalty context should consider non-infringing alternatives as well. This analysis dovetails well with the use of the factors articulated in *Panduit Corp. v. Stahl Bros. Fibre Works, Inc.* in determining lost profits,<sup>9</sup> a case which also focuses on the availability of non-infringing alternatives. Many other cases have followed *Georgia-Pacific* and, like *Grain Processing*, have added to the teachings of *Georgia-Pacific*. The authors see no reason why damages experts should not consider the teachings of these decisions in determining a reasonable royalty in a trade secrets matter given that the expert must ensure that he or she focuses on any differences that may exist between patents and trade secrets and, therefore, how these differences might affect application of relevant court decisions.<sup>10</sup>

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<sup>7</sup> *Grain Processing Corp. v. American Maize-Products Co.*, 185 F.3d 1341 (Fed. Cir. 1999).

<sup>8</sup> *Id.*, 185 F.3d at 1350.

<sup>9</sup> *Panduit Corp. v. Stahl Bros. Fibre Works, Inc.*, 575 F.2d 1152 (6th Cir. 1978).

Although courts and commentators have espoused the use of the *Georgia-Pacific* factors in determining a reasonable royalty in trade secrets matters, there are some differences in applying these Factors to intellectual property other than patents. In analyzing *Georgia-Pacific* Factors ## 1 and 2, which deal with an established royalty for the patents in suit and rates paid for comparable patents, little if any information tends to be available to damages experts in most trade secrets cases. For example, trade secret owners rarely license their trade secrets to anyone. Hence, no rate is established and there is rarely information available in the public domain to establish comparable trade secret rates. These cases differ from patent cases where rates may have been established for the patent(s) and many sources of market data exist that relate to various potentially comparable patent licenses and rates.

*Georgia-Pacific* Factor # 4 concerns a licensor's established policy to maintain its legal monopoly by not licensing others to use the patents. Again, although a patent holder may generally have a policy of licensing its patents and thereby not preserving its monopoly, this is not true for trade secrets owners who must maintain the secrecy of their intellectual property if it is to remain a trade secret. One author suggests that

“... the owner of the trade secrets would seek to extract a premium by demanding a higher royalty because the trade secrets now would be divulged though a license, that otherwise would not have been voluntarily executed.”<sup>11</sup>

*Georgia-Pacific* Factor # 7 relates in part to the duration of the patent, which has a finite patent life; hence, the license is assumed to last until the expiration of the patent. However, trade secrets can have an indefinite life, which may—all else being equal—add value to a trade secret. Nevertheless, this indefinite life should take into consideration the timing of any legal reverse engineering of the trade secret(s).

In a 2012 case, *Skycam, LLC v. Bennett*,<sup>12</sup> a United States District Court in Oklahoma found that due to “exceptional circumstances” a royalty injunction was preferable to a prohibitory injunction.<sup>13</sup> The Court cited public interest reasons for so concluding because a prohibitory injunction would unnecessarily stifle competition in the relatively new aerial camera market.<sup>14</sup>

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<sup>10</sup> Again, we have discussed many of these cases in Chapter 6 *supra*, and will not list them here.

<sup>11</sup> Warden, Bratic, and Eggleston, “Trade Secrets and Patents: Comparison and Contrasts in Royalty Determination,” *Les Nouvelles* (Sept. 2000).

<sup>12</sup> *Skycam, LLC v. Bennett*, 2012 WL 4483610 (N.D. Okla. Sept. 27, 2012).

<sup>13</sup> *Id.*, 2012 WL 4483610, at \*3.

Based on expert testimony, defendants were ordered to pay Skycam a royalty fee of \$5,000 per paid event for a forty-two-month period, representing the approximate time it would have taken defendants to independently develop the misappropriated technology.<sup>15</sup> This time period was amended, however, in order to reflect previously awarded damages.<sup>16</sup>

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<sup>14</sup> *Id.*

<sup>15</sup> *Id.*

<sup>16</sup> *Id.*

### § 9.12 Alternative Measures of Damages for Trade Secret Misappropriation

Sometimes lost profits, reasonable royalties, unjust enrichment, and/or cost savings are not applicable or may not be sufficient to compensate for misappropriation. For example, in *Children's Broadcasting Corp. v. The Walt Disney Company and ABC Radio Networks, Inc.*, the plaintiff's expert presented a discounted cash flow model comparing defendants' cash flows into the future with and without the misappropriated information.<sup>1</sup>

In *Spectrum Sciences & Software, Inc. v. United States*, the Court of Federal Claims described a method for quantifying damages from the misappropriation of an asset without a known market—a “lost asset”—as the amount a “willing buyer would have paid a willing seller” for the subject asset.<sup>2</sup>

Remedial costs are another example of alternative measures of damages. In *Dozor Agency, Inc. v. Rosenberg*, the plaintiff claimed damages for “out-of-pocket” expenses such as postage, printing, paper, and special sales expenses that had been incurred to ameliorate harm caused by defendant's misappropriation.<sup>3</sup>

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<sup>1</sup> *Children's Broadcasting Corp. v. The Walt Disney Company and ABC Radio Networks, Inc.*, 357 F.3d 860 (8th Cir. 2004).

<sup>2</sup> *Spectrum Sciences & Software, Inc. v. United States*, 98 Fed. Cl. 8 (Fed. Cl. 2011) (distinguishing the loss of an asset without a known market from the loss of an income-producing asset (lost profits), the court noted that market value damages are “based on future profits as estimated by potential buyers who form the market and reflect the buyer's discount for the fact that the profits would be postponed and . . . uncertain”). (Internal quotation marks omitted.)

<sup>3</sup> *Dozor Agency, Inc. v. Rosenberg*, 218 A.2d 583, 585-586 (Pa. 1966).



**§ 9.13 Apportionment of Damages Among Different Trade Secrets**

Some courts have suggested that if the plaintiff presents a case for misappropriation of multiple trade secrets, the damages expert must make an allocation of the total damages among each of those trade secrets. Thus, if the jury rejects the claim as to some of the trade secrets, but finds liability as to others, the jury needs an evidentiary basis to assess appropriate damages.<sup>1</sup> The Fifth Circuit, however, has rejected the rigid applicability of this rule, observing that the plaintiff “was not obligated to precisely apportion damages for each instance of wrongful conduct it alleged, as unitary damages models are permissible under Texas law.”<sup>2</sup>

Prudent counsel, where appropriate, should request an expert to present both a unitary damages model and, when possible, a model that allocates the effect of the misappropriation of each trade secret. Thus, the total damages award would be premised on the finder of fact accepting liability on all the proffered claims. Supporting analysis would then be offered as to the amount of damages from misappropriation of each individual trade secret and/or perhaps groups of related trade secrets, depending on the facts. For example, in a head start case, the head start obtained by a defendant that misappropriates only one or two trade secrets could be shorter than the head start accorded a defendant who misappropriated many trade secrets, depending upon the complexity and length of the applicable development processes.

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<sup>1</sup> O2 Micro International Ltd. v. Monolithic Power Systems, Inc., 399 F. Supp.2d 1064, 1076-1077 (N.D. Cal. 2005).

<sup>2</sup> DSC Communications Corp. v. Next Level Communications, 107 F.3d 322, 330 (5th Cir. 1997).

**§ 9.14 Punitive Damages and Attorneys' Fees**

In addition to providing for a damages award, the UTSA indicates that upon a finding of willful and malicious misappropriation, "the court may award exemplary damages in an amount not exceeding twice any award made" for damages, unjust enrichment or reasonable royalty."<sup>1</sup> Again, counsel must research the law of the applicable jurisdiction to determine if this part of the UTSA has been enacted. Some states, such as Ohio, have not adopted this provision, allowing greater recoveries.<sup>2</sup>

Moreover, if a finding is made that the misappropriation was willful and malicious, or that a claim of misappropriation was brought in bad faith, a court may award reasonable attorneys' fees and costs to the prevailing party.<sup>3</sup>

Most states, like Pennsylvania, have enacted an attorneys' fees provision for "misappropriation claims made in bad faith,"<sup>4</sup> but very few states have adopted an official definition of bad faith in the context of a UTSA claim, leaving those states without an official test.<sup>5</sup>

California is the only state to have officially adopted the two-prong test widely used in the federal district courts for what constitutes bad faith.<sup>6</sup> This two-prong test calls for a showing of "objective speciousness" together with an "improper purpose" (subjective bad faith) in bringing the claim.<sup>7</sup>

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<sup>1</sup> UTSA § 3(b).

<sup>2</sup> *Mid-Michigan Computer Systems, Inc. v. Marc Glassman, Inc.*, 416 F.3d (6th Cir. 2005) (the Sixth Circuit found a multiplier of 2.5 times the compensatory damages award sustainable in light of the Ohio UTSA's multiplier of three times compensatory damages).

<sup>3</sup> UTSA § 4. See also, Cal. Civ. Code § 3426.4.

<sup>4</sup> 12 Pa. Consol. Stat. § 5305.

<sup>5</sup> *Krafft v. Downey*, 2013 PA Super. 119, at 3, 68 A.3d 329, 335-336 (2013).

<sup>6</sup> *Gemini Aluminum Corp. v. California Custom Shapes, Inc.*, 95 Cal. App.4th 1249, 116 Cal. Rptr.2d 358 (2002).

See e.g.:

*Third Circuit: Hill v. Best Medical International, Inc.*, 2011 U.S. Dist. LEXIS 147853, 2011 WL 6749036 (W.D. Pa. Dec. 22, 2011).

*Sixth Circuit: Degussa Admixtures, Inc. v. Burnett*, 471 F. Supp.2d 848 (W.D. Mich. 2007).

*Ninth Circuit: CRST Van Expedited, Inc. v. Werner Enterprises, Inc.*, 479 F.3d 1099 (9th Cir. 2007); *Stilwell Development Inc. v. Chen*, 1989 WL 418783 (C.D. Cal. April 25, 1989) (origin of the two-prong test).

But see *Russo v. Baxter Healthcare Corp.*, 51 F. Supp.2d 70 (D.R.I. 1999) (Rhode Island court requiring only subjective bad faith).

<sup>7</sup> *Gemini Aluminum Corp. v. California Custom Shapes, Inc.*, *id.*, 95 Cal. App.4th at 1262 (a specious claim is defined as one which only superficially appears to have merit).

This test is sometimes used outside of California, however, as in *Krafft v. Downey* from Pennsylvania. There, the court used the two-prong test to find that attorneys' fees were warranted because of plaintiff's bad faith in bringing its claim,<sup>8</sup> although the court refused to officially adopt the test.<sup>9</sup>

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<sup>8</sup> Kraft, *supra*, at 7 (although the defendant had misappropriated information, plaintiff knew when bringing its claim that the information was in the public domain and, therefore, not a trade secret).\_

<sup>9</sup> *Id.* at 4.