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PERSPECTIVES

APPRAISING THE UNKNOWN: HOW COURTS CALCULATE THEFT OF TRADE SECRET DAMAGES

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By some estimates, theft of trade secrets costs US businesses between \$180bn and \$450bn each year. But how do US courts calculate the value of a trade secret in the context of a lawsuit? That calculation can be challenging because trade secrets are, by definition, secret. They lose protection if they become ‘generally known’ or ‘readily ascertainable’ in the relevant industry. Consequently, trade secrets are not widely available and have no market price.

Many different types of information, moreover, can qualify as a trade secret, so there are necessarily multiple ways to value them. The varied nature of trade secrets can also create other complex challenges when attempting to quantify the harm

caused by misappropriation. For example, if a trade secret is embodied in a new product that lacks a history of revenues, it can be difficult to determine what evidence best predicts that product’s future profitability.

To address the variety of issues that can arise in proving damages in trade-secret cases, courts generally permit three different methods for calculating damages: (i) actual loss; (ii) unjust enrichment, i.e., a defendant’s ill-gotten gains; and (iii) a reasonable royalty based on what a licensee would have paid if it had properly licensed the trade secret. These methods are recognised under the federal Defend Trade Secrets Act and the Uniform Trade Secrets Act that has been enacted in some

form in 48 states plus the District of Columbia. Each method has potential advantages and shortcomings. Determining which method provides the most reliable calculation depends on the circumstances of each case.

Actual loss

First, a plaintiff may recover damages for 'actual loss' caused by trade secret misappropriation. The actual-loss method of calculating damages compares the owner's position before and after misappropriation of the trade secret to determine what the owner lost. Such losses can take many forms, including decreased sales, price erosion due to the introduction of a competing product, and costs incurred in retaining or recapturing prior customers.

An actual-loss theory of damages can present numerous problems of proof. Where the trade secret relates to a product that is still under development, there is no past sales data on which to rely in proving lost profits or price erosion. And even if such data exists, a defendant will be sure to point to other perceived causes of falling profits, such as competition from other parties or changed market conditions.

One strategy plaintiffs have used to overcome these hurdles is to base proof of actual loss on diminution in enterprise value. In *Wellogix, Inc. v. Accenture, LLP*, for example, a federal court of appeals upheld a damages award based on a

determination that misappropriation of trade secrets "totally or almost totally destroyed" a company's value. The owner established a pre-misappropriation enterprise value of approximately \$27m based on a venture capital group's decision to invest \$8.5m in exchange for a 31 percent equity stake. In affirming a \$26.2m award, the court of appeals rejected the defendant's argument that damages were too speculative. While the venture capital investment was based on future projections rather than existing sales data, the court concluded it was sufficiently reliable evidence of the trade secret's total value.

Unjust enrichment

Next, trade-secret owners may recover damages for any unjust enrichment resulting from misappropriation, so long as that recovery does not duplicate damages awarded for the owner's actual losses.



Unjust-enrichment damages aim to prevent a defendant from profiting from any wrongdoing.

Damages for unjust enrichment often overlap with actual harm, and thus can address some of the difficulties of proving actual loss in connection with a new or developing product. If a trade-secret owner's sales are diverted to a defendant, then the defendant's profits provide an approximation of what the owner would have received absent the misappropriation. A similar analysis can also apply to other circumstances, such as where companies compete in bidding for contracts. In *General Electric Co. v. Siemens Energy, Inc.*, for example, General Electric alleged that Siemens' misappropriation of trade secrets caused it to lose contracts worth hundreds of millions of dollars (the parties ultimately settled that claim for an undisclosed amount).

But while an award of unjust enrichment may overlap with the trade-secret owner's losses, that is not a requirement. In *Motorola Solutions, Inc. v. Hytera Communications Corp.*, for example, a plaintiff was awarded \$136m in damages based on unjust enrichment alone. While the trial court initially viewed that award as merely a proxy for the plaintiff's actual losses, the court later revised its ruling to classify the entire award as unjust-enrichment damages (the verdict did not end the matter, as Hytera now faces federal criminal charges based on the same conduct).

Even though an unjust-enrichment theory of damages may overcome some of the difficulties of proving actual loss, it can encounter different problems of proof. For example, a defendant may not yet have reaped profits from the misappropriated trade secret, and it may argue that whether it will realise any profits is speculative. Recent cases show two paths by which trade-secret owners can seek to overcome such difficulties. In *Steves & Sons, Inc. v. JELD-WEN, Inc.*, the court permitted proof of damages based on an alleged trade-secret thief's estimated future revenues. And in *BladeRoom Group Ltd. v. Emerson Electric Co.*, unjust-enrichment damages were based on the appreciation of the defendant company's value, as reflected in a sale of its equity following the alleged misappropriation. Although the judgment was ultimately overturned on other grounds, the district court's acceptance of such proof will invite other plaintiffs to try similar theories. Future cases will thus consider anew whether unjust-enrichment damages may be based not on a defendant's past or projected product sales, but instead on increases in a misappropriator's enterprise value.

Any unjust-enrichment theory of damages can also be susceptible to attack on other grounds. For example, defendants will argue that their profits or anticipated profits are the result of something other

than misappropriation. Plaintiffs seeking to use an unjust-enrichment theory will thus need to identify

“The varied nature of trade secrets can also create other complex challenges when attempting to quantify the harm caused by misappropriation.”

causal evidence linking their trade secrets to the profits they hope to claim.


Reasonable royalty

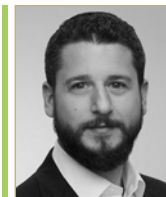
Finally, damages may be measured by a reasonable royalty. That measure is only available in lieu of recovering for actual loss or unjust enrichment. Damages based on a reasonable royalty aim to capture the value the plaintiff would receive in a hypothetical negotiation over a licence to use the trade secret. In determining the reasonable royalty, courts have borrowed from the factors commonly used to determine damages in patent cases (the 'Georgia-Pacific factors'), which include licensing rates for the trade secret at issue and similar technologies or information, the commercial relationship between the parties (i.e., whether

they are direct competitors or have collaborated in the past), the advantages of the trade secret over alternatives, the extent to which the defendant used the trade secret, and the commercial success of the trade secret.

Reasonable royalty damages have been awarded in cases where there is no history or sales. In *CardiaQ Valve Technologies, Inc. v. Neovasc Inc.*, for example, the plaintiff and the defendant had not received regulatory approval for a medical device embodying the plaintiff's trade secret, yet the jury awarded reasonable royalty damages worth \$70m. Among other things, the plaintiff's evidence of a reasonable royalty took into account proceeds from the defendant's sale of securities. That award was upheld on appeal.

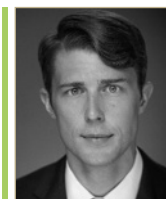
Proving a reasonable royalty, however, can also present challenges. Trade-secret owners must be sure that the reasonable royalty reflects the value of the trade secret and not other technologies. Thus, where a royalty award is based on prior licensing agreements, a trade-secret owner must identify what portion of past royalties relates to the trade secret in particular. It may also be difficult for a trade-secret owner to reliably prove a reasonable royalty for a new technology that is not yet available in the market. Without any history of prior licensing – or at least prior licensing of a similar product – a plaintiff faces a risk that, absent other credible evidence, a court may find a reasonable royalty theory to be speculative.

Trade secrets can be incredibly valuable, but there is no 'one size fits all' theory for determining just how valuable they are. It is therefore critical for businesses litigating a trade-secret claim – whether as a plaintiff or defendant – to assess early on which theory best fits their circumstances so that they can develop appropriate evidence to support it. 



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