Trade Secret -Value and Damages Considerations

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Presentation Overview

Trade Secrets

- Trade Secrets Overview
- Trade Secrets vs. Patents
- Trade Secrets Damages

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TRADE SECRETS OVERVIEW

Trade Secrets Overview
Trade Secret Defined

"Trade Secret" means 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.

- Uniform Trade Secrets Act[1]

Trade Secrets Overview
Uniform Trade Secret Act / Texas Law

- **The Uniform Trade Secrets Act ("UTSA"), published by the Uniform Law Commission in 1979 and amended in 1985, was to provide a legal framework for improved trade secret protection for industry in all 50 states.**

- **All but four states (Massachusetts, New York, North Carolina and Texas) have implemented some form of the UTSA**

- **Texas does not have a statue governing trade secrets law. Instead, it is based solely on the common law, which is the compilation of prior court decisions in the state. Like the UTSA, however, Texas law creates civil liability for "misappropriation" of someone else's trade secret(s).**

- Uniform Trade Secrets Act[1]

Trade Secrets Overview

Two Broad Categories of Trade Secrets

Technical - technical information regarding how something is designed, made, or operated

- Formulas
- Devices
- Software
- Know-how
- Designs
- Processes

Business - non-technical commercially useful information

- Business Methods
- Marketing Plans
- Customer Lists
- Pricing Information
- Strategic Plans

TRADE SECRETS v. PATENTS

Trade Secrets v. Patents

	Trade Secrets	Patents
Governing Law	State Common Law	Federal Statute
Protects	Information	Inventions
Enforcement	If Misappropriated	If Infringed, Even by "Innocent" Parties
Exclusivity	No	Yes
Registration	No	Yes
Up-front Costs	No	Yes
Prior Art/Novelty Considered	No	Yes
Duration	Indefinite	20 Years from Date of Application

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TRADE SECRET DAMAGES

Trade Secret Damages

"… every case requires a flexible and imaginative approach to the problem of damages … each case is controlled by its own peculiar facts and circumstances."

- *University Computing Company v. Lykes-Youngstown Corporation*[2]

Trade Secret Damages
Possible Remedies

Restoring parties to the position *but for* the misappropriation

Injunctive Relief

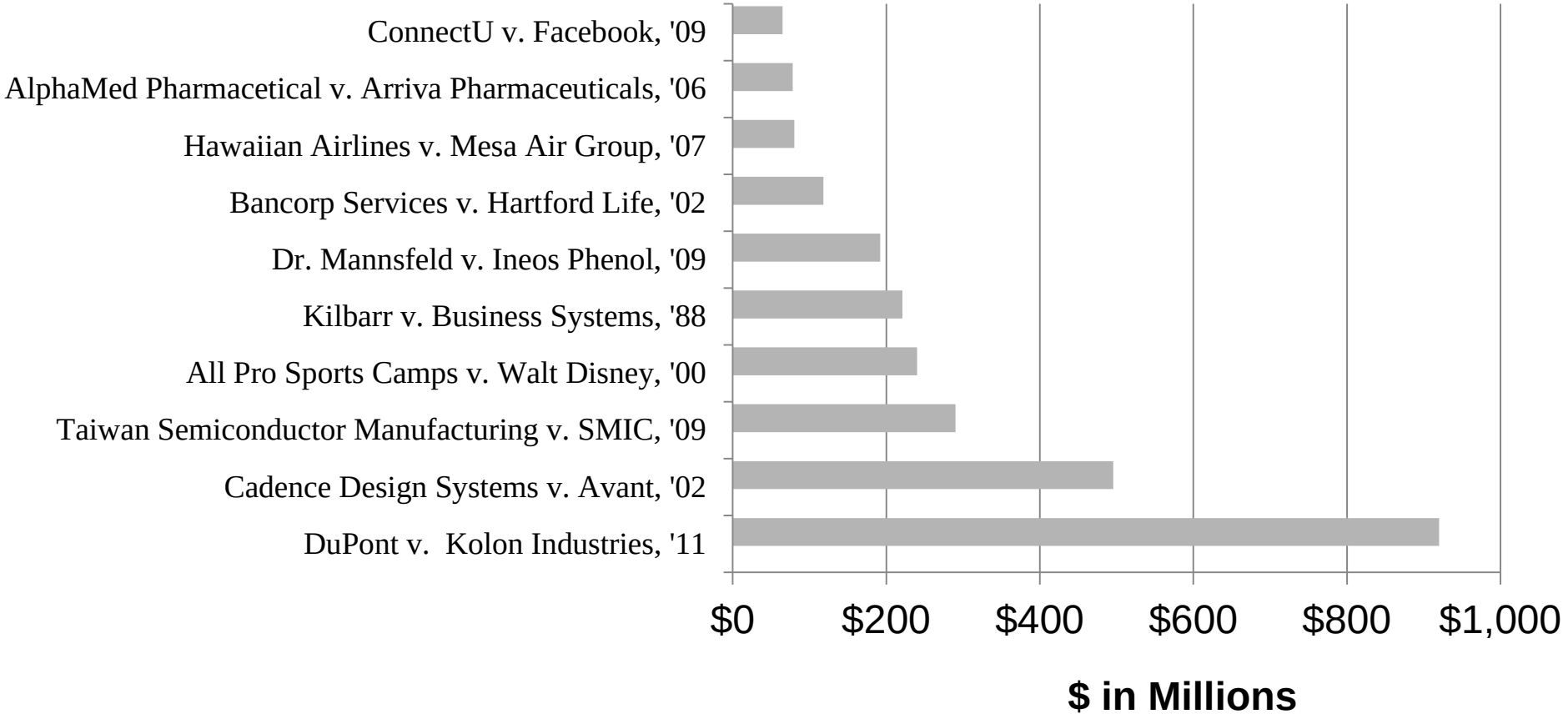
- Defendant is enjoined for a period of time representing the unfairly obtained "head start" in time-to-market (i.e. long enough to eliminate the competitive advantage)

  - "Head start" is the amount of time it takes to reverse engineer the information to discover the secret

Monetary Damages

Trade Secret Damages

Top Ten Trade Secret Awards/Settlements*



* In 2011, the trade secrets case of *Pacesetter Inc. v. Nervicon Co.*[3] settled for $2.4 billion.

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Trade Secret Damages
Recovery of Monetary Damages

Three Primary Approaches:

1. Lost Profits of the Plaintiff
2. Unjust Enrichment of the Defendant
3. Reasonable Royalty

Courts may also consider the value of the trade secret

Trade Secret Damages
Reasonable Certainty of Damages

Burden of Proof:

- Plaintiff has the burden of proving the damages caused by defendant's misappropriation with reasonable certainty
- Plaintiff must prove both the existence of a legally protectable trade secret and that the defendant had a confidential relationship as an employee or by contract
- Plaintiff must demonstrate a plausible nexus between the misappropriation and the asserted harm or unfair gain
- Defendant has the burden of proving offsets and deductions

LOST PROFIT DAMAGES

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Trade Secret Monetary Damages
Lost Profits Damages

Does not require an exact calculation, but should be based on objective information and data (i.e., reasonable certainty)

The more subjective the higher degree of uncertainty

Texas Instruments, Inc. v. Teletron Energy Management, Inc[4]

- "...evidence to establish profits must not be uncertain or speculative..."
- However the requirement "is intended to be flexible enough to accommodate the myriad circumstances in which claims for lost profits arise."

Fiberlok, Inc. v. LMS Enter., Inc.[5]

- "..not necessary that recovery…be established by exact calculation, as it is enough to have data from which these profits may be ascertained with a reasonable degree of certainty…"

Trade Secret Monetary Damages
Lost Profits Damages

Lost Profit = Lost Revenues – Incremental Costs Associated with "but for" sales

Lost profits associated with lost sales must consider:

- Portion of profits attributable to the trade secret(s)
- Market share or revenue that plaintiff would have achieved had defendant not been in the market (excluding competition for Defendant)
- Plaintiff's incremental market share or incremental profit margin

Trade Secret Monetary Damages
Other Lost Revenues

Price erosion damages may be recovered for both historical and future price erosion sales

Lost profits are not limited by the misappropriator's gains realized from the misappropriation

UNJUST ENRICHMENT DAMAGES

Trade Secret Monetary Damages
Unjust Enrichment Damages

Unjust enrichment damages can be measured as defendant's:

- Increased revenues and resulting profits
- Reduced production costs and resulting profits
- Avoided cost of development and head start

Trade Secret Monetary Damages
Unjust Enrichment Damages

Key Questions Regarding Unjust Enrichment:

- Is plaintiff entitled to recover lost profits and defendant's avoided costs?
- Is the plaintiff entitled to recover both its lost profits and defendant's profits from unjust enrichment?
- What level of profits is the appropriate measure of damage?
- What impact does the apportionment of profits have on patent v. trade secret cases?
- What is the meaning of "use" of a trade secret in a claim of misappropriation?

Trade Secret Monetary Damages
Can Plaintiff Recover Both Lost Profits and Defendant's Avoided Costs?

Sperry Rand Corp. v A-T-0, Inc.[6]

- Damages of $631,012 were awarded as follows:
  - $175,000: Value of Electronic Concepts of misappropriated documents and data, excluding bidding data and the manual used in preparing ECI's bid
  - $231,012: Loss of profit to Sperry Rand as a result of being underbid on the Coast Guard contract
  - $225,000: attorney's fees
- Court of Appeals considered:
  - Two basic methods for assessing damages for misappropriation of trade secrets: (1) damages sustained by victim (lost profits), and (2) profits earned by the wrongdoer by the use of the misappropriated material (unjust enrichment)

Trade Secret Monetary Damages
Can Plaintiff Recover Both Lost Profits and Defendant's Avoided Costs?

Sperry Rand Corp. v A-T-0, Inc.[6]

- Plaintiff lost a contract as a result of the defendant's trade secret misappropriation
- Plaintiff ***was not*** entitled to recover the amount saved by the defendant in research and development costs ($175,000) while also recovering its own losses on the contract ($231,012)
- Defendant used the misappropriated data in a single transaction, was required to return the misappropriated material and was enjoined from competition with Sperry Rand for two years

Trade Secret Monetary Damages

Can Plaintiff Recover Both Lost Profits and Defendant's Unjust Enrichment?

RRK Holding Co. v. Sears, Roebuck & Co.[7]

Plaintiff's Calculation of Damages:

- RRK Lost Profits (Home Depot / Sears) - $11.6 million;
- Consideration should be given to the impact of RRK's sale to Bosch in July 2003, but not quantified;
- Sears Unjust Enrichment (All-in-One Cutting Tool) - $16.9 million.

Defendant's Calculation of Damages:

- Lost Profits and Defendant's profits are not appropriate methods to measure damages.
- Reasonable royalty the most appropriate – lump sum royalty of $600,000 based on the sharing of Sears' profit differential (50/50) during the 6 to 9 month "time to market" period.

Jury Award

- $11.2 million for lost profits (sales to Home Depot and Sears) and $2.1 million for unjust enrichment

Trade Secret Monetary Damages

Can Plaintiff Recover Both Lost Profits and Defendant's Unjust Enrichment?

RRK Holding Co. v. Sears, Roebuck & Co.[7]

Defendant moved for judgment as a matter of law on several grounds including:

- Plaintiff failed to limit its damages claims to the time necessary to reverse engineer its trade secret, i.e. the "head-start" period. In its ruling the Court noted that while Illinois case law requires damages to be limited to a head start period for injunctive relief, it made no such requirement for damages.

- Plaintiff failed to apportion profits to just those associated with the Defendant's unlawful conduct. Court determined apportionment was not required as the evidence provided showed that the tool was new and innovative and that distributors in the market saw it as a new marketable idea.

- Plaintiff's lost profit damages should have been cut off when a competitor entered the market with a competing rotary cutting tool product. The Court determined that it was unclear whether this new competing product was similar enough to constitute a "non-infringing substitute product."

Trade Secret Monetary Damages
What Level of Profits is the Appropriate Measure of Damages?

Jet Spray Cooler, Inc. v. Crampton[8]

- Court held that it is proper to compute damages based on the defendant's ***net*** profits rather than ***gross*** profits, when accounting for the profits from misappropriating a trade secret
- Court added back several expenses the defendant deducted to appropriately determine the defendant's net profits including:
  - Legal fees to defend the action
  - Federal income taxes
  - State (MA) excise taxes
  - Losses during two years of the accounting period
  - Key life and group insurance expenses related to individual defendants
- Court allowed deductions for bad debts and salaries and consultant fees paid to the individual defendants

Trade Secret Monetary Damages
Apportionment of Profits

Jet Spray Cooler, Inc. v. Crampton[8]

- When an apportionment of the defendants' profits is not possible on the basis of the evidence, ***"[t]he fact that he may lose something of his own is a misfortune which he has brought upon himself . . .***"

- Plaintiff was awarded damages based on ***defendant's entire net profits*** from sales of units incorporating the misappropriated trade secrets

- Profits may not result from a single source. For example, they may well result from the use of the trade secret combined with management skill, capital investment, and such other factors as tend to produce profit in any enterprise. In this case, however, it appears that the defendants were unable to separate that portion of profits attributable to the use of the trade secret from that portion attributable to other profit factors.

Trade Secret Monetary Damages
Apportionment of Profits

Goldberg v. Medtronic[9]

- Dr. Edward Goldberg developed a novel type of screw-in, sutureless electrical lead for use in connecting cardiac pacemakers
- Dr. Goldberg disclosed, in confidence, the concept of the sutureless lead to certain Medtronic personnel during the period of 1965-1966
- In 1972, Medtronic began marketing its Model 6917 electrical lead. Dr. Goldberg claimed Medtronic had used his confidential disclosures in developing its Model 6917 lead
- Dr. Goldberg filed suit claiming misappropriation of trade secrets, in addition to infringement of U.S. Patent No. 4,002,745 (the "745 Patent")
- The Court ruled there had been no infringement of the '745 Patent and that certain of its claims were invalid

Trade Secret Monetary Damages
Apportionment of Profits

Goldberg v. Medtronic[9]

- Sales of Medtronic's Model 6917 lead totaled $12,842,000, with costs of production of $4,086,000, for profits of $8,756,000. Other elements of cost were not in evidence.

- With respect to the trade secrets claim, the Court ruled that Dr. Goldberg's confidential disclosures to Medtronic contributed 10% to the development of the Model 6917 lead

- The Court also noted that a reasonable royalty in this case was 10% of gross profits

- The Court awarded Dr. Goldberg $875,600, equal to 10% of the $8,756,000 in profits derived by Medtronic from the sale of the Model 6917 leads

Trade Secret Monetary Damages
What Does "Use" of a Trade Secret Mean?

Bohnsack v. Varco[10]

- Varco misappropriated and used information that a drilling fluids engineer developed for the "Pit Bull," a device that increases the efficiency of the process for drilling fluid cleaning
- Parties entered into negotiations in 2003 to manufacture and market the Pit Bull but the deal broke down
- Court defined "use" as "any exploitation of the trade secret that is likely to result in injury to the trade secret owner or enrichment to the defendant."
- Varco actions (filed patent application as co-inventor) would have
  - Lowered the market value of the Pit Bull
  - Precluded Plaintiff from finding another manufacturer to compete with Varco (Varco produced devices)

REASONABLE ROYALTY DAMAGES

Trade Secret Monetary Damages
Reasonable Royalty Damages

"[T]he court identified a reasonable royalty approach to damage calculation as an appropriate measure where, for example, the trade secret has not been destroyed, where the plaintiff is unable to prove specific injury, and where the defendant has not gained any profits by which to value the secrets."

- *Alcatel USA, Inc. v. Cisco Systems, Inc.*[11]

Trade Secret Monetary Damages
Reasonable Royalty Damages

Reasonable royalty is what would have been the negotiated royalty between a willing licensor / willing licensee at the time of first infringement

Reasonable royalty damages, however, may differ as they do not necessarily reflect a negotiation between "willing" parties due to an infringement action

Courts have awarded reasonable royalties in some cases:

*Ajaxo, Inc. v. E*Trade Fin. Corp.*[12]

- Generally used when there are no lost profits of plaintiff and financial benefit to defendant attributable to trade secret cannot be determined

Georgia-Pacific v. US Plywood[13]

- Determination of reasonable royalty may be similar to process for patents, with recognition of the basic differences between patents and trade secrets

Trade Secret Monetary Damages
Reasonable Royalty Damages

Georgia-Pacific v. US Plywood[13]

- This case involved a claims of patent infringement, rather than trade secrets misappropriation
- U.S. Plywood filed suit against Georgia-Pacific asserting the infringement of 3 of its patents
- Georgia-Pacific filed suit against U.S. Plywood for declaratory judgment of invalidity and non-infringement of the 3 U.S. Plywood patents
- The case established 15 factors that should be considered by a hypothetical licensor-licensee to determine a reasonable royalty. These 15 factors are now commonly known as the “Georgia-Pacific” or “G-P” factors

Trade Secret Monetary Damages
Reasonable Royalty Damages

15 Georgia-Pacific[13] Factors	
1. Royalties for Patents-in-Suit	9. Utility & Advantages of Invention
2. Comparable Rates for Other Comparable Patents	10. Nature of the Patented Invention & Benefits to User
3. Nature and Scope of License	11. Extent of Infringer's Use
4. Patent Owner's Willingness to License	12. Customary Royalty Rates in the Business
5. Competitive Nature of Parties	13. Profit Credited to the Invention
6. Non-Patented Sales Resulting from Use of the Patents-in-Suit	14. Opinion of Experts
7. Duration of the Patent and the Term of the License	15. Hypothetical Negotiation
8. Established Profitability / Commercial Success	

Trade Secret Monetary Damages
Reasonable Royalty Damages

Must make two determinations when calculating reasonable royalty damages:

1. Appropriate Royalty Base
2. Reasonable Royalty Rate

University Computing Co. v. Lykes-Youngstown Corp.[2]

- UCC and Lykes jointly created a new corporation, Lykes-University Computing Co. ("Lykes/UCC"), to offer computer services
- One of the computer systems Lykes/UCC was to market was a retail inventory control system called "AIMES III". UCC had previously sold the AIMES III system to Leonard's Department Store
- Lykes subsequently formed another corporation, Lykes-Youngstown Computer Services Corp. ("LYCSC"). All property jointly owned by Lykes/UCC was taken over by LYCSC
- UCC did not authorize either the formation of LYCSC or the transfer of property owned by Lykes/UCC

Trade Secret Monetary Damages
Reasonable Royalty Damages

University Computing Co. v. Lykes-Youngstown Corp.[2]

- LYCSC bribed a Leonard's employee to steal and deliver computer tapes and other materials related to the AIMES III system. After receiving these materials, LYCSC attempted to market the system, but made no sales

- UCC sued LYCSC for misappropriation of its trade secrets related to the stealing of the AIMES III computer files and related marketing efforts

- UCC prevailed on its trade secrets claims and was awarded $220,000 in damages, based on a ***reasonable royalty***, meaning a "fair price for licensing the defendant to put the trade secret to the use the defendant intended at the time the misappropriation took place."

- The reasonable royalty was measured as the value of the unrestricted rights to the AIMES III system. The royalty conclusion was predicated in part on UCC's past offer to Honeywell of exclusive rights to the AIMES III system

Trade Secret Monetary Damages
Reasonable Royalty Damages

University Computing Co. v. Lykes-Youngstown Corp.[2] – Facts Pertinent to Damage Quantification:

- Lykes/UCC's trade secrets were embodied in its AIMES III software program
- Lykes/UCC was not operating as of the date of the theft
- Defendants were not able to sell the AIMES III system, however made use of it through offering to sell
- Lykes/UCC previously offered Honeywell unrestricted rights to AIMES III for $220,000

Trade Secret Monetary Damages
Reasonable Royalty Damages

University Computing Co. v. Lykes-Youngstown Corp.[2] – Select Comments from the Opinion:

- "…normally the value of the secret to the plaintiff is an appropriate measure of damages only when the defendant has in some way destroyed the value of the secret."
- "…unless some specific injury to the plaintiff can be established – such as lost sales – the loss to the plaintiff is not a particularly helpful approach in assessing damages."
- "…the law looks to the time at which the misappropriation occurred to determine the value of the misappropriated secret…to a defendant who believes he can utilize it to his advantage…"
- "the risk of the defendant's venture…should not be placed on the injured plaintiff, but rather on the defendants' venture." (*i.e., if recovery was precluded due to defendant not having made any sales, the defendant would have made a risk free attempt to enter the market*)

Trade Secret Monetary Damages
Reasonable Royalty Damages

Alcatel USA, Inc. v. Cisco Systems, Inc.[11]

- Alcatel is a designer, developer, and marketer of highly sophisticated telecommunications equipment, including optical cross-connects. In 1995, Alcatel commenced development of its first-generation optical cross-connect, Optical Gateway Cross-Connect ("OGX"). Alcatel released OGX in 1999

- Monterey, Cisco's predecessor-in-interest, was formed in July of 1997. In late 1997, Monterey began hiring highly skilled employees from Alcatel

- By August of 1998, Monterey had hired 10 former Alcatel engineers. According to Alcatel, these employees possessed knowledge of highly confidential, technical and marketing information relating to Alcatel's products

- In a period of seven months, Monterey designed, developed and marketed a competing product called the Wavelength Router, which according to Alcatel, was comprised of the administrative software architecture and trade secrets that formed Alcatel's OGX

Trade Secret Monetary Damages
Reasonable Royalty Damages

Alcatel USA, Inc. v. Cisco Systems, Inc.[11]

- June 1999, Monterey submitted a proposal to AT&T and was selected as a finalist for the cross-connect project. In August 1999, Cisco announced its intention to acquire the remainder of Monterey's equity for $517 million
- In May 1999, Cisco acquired a 9.75% interest in Monterey for $19.5 million.
- In April 2001, Cisco cancelled the Wavelength Router project after losing its largest potential client (AT&T)
- Alcatel argued that it was entitled to recover the value of the trade secrets at the time of the misappropriation. Alcatel believed the acquisition price ($517 million) of Monterey in September 1999 was a sound basis on which to measure the value of the trade secrets, based on either a reasonably royalty or unjust enrichment
- Cisco argued that it had not profited from sales based on Alcatel's intellectual property

Trade Secret Monetary Damages
Reasonable Royalty Damages

Alcatel USA, Inc. v. Cisco Systems, Inc.[11]

- The Court ultimately granted Cisco's motion for summary judgment because Alcatel failed to meet its burden of presenting sufficient evidence demonstrating actual damages under a valid legal theory. Alcatel's damages theory was considered speculative by the Court

- The Court characterized Alcatel's theory of damages as:
  - Any of the allegedly misappropriated trade secrets was worth the value of Monterey because had Monterey not had these trade secrets, it would not have had a prototype device to show AT&T
  - If Monterey had not had a prototype in time, it would not have been selected as a finalist by AT&T
  - If Monterey had not been selected as a finalist by AT&T, Cisco would not have acquired it

Trade Secret Monetary Damages
Reasonable Royalty Damages

Alcatel USA, Inc. v. Cisco Systems, Inc.[11]

- The Court noted that while damages need not be established with mathematical precision, the evidence must provide a basis for reasonable inferences
- "No case, including *University Computing*, holds that the acquisition price of a company can provide the measure of a reasonable royalty in the absence of actual lost profits."
  - Alcatel failed to present evidence of apportionment – failed to apportion its allegedly misappropriated IP from the rest of Monterey's cross-connect product or Wavelength Router technology or purchase price
  - Alcatel essentially attempted to attribute every penny of the purchase price to the value of IP
    - No value was placed on all of its employees, goodwill and other assets.
    - Documents produced of the acquisition based the price on 3 primary components: (1) $354 million attributed to in-process R&D; (2) $102 million attributed to goodwill, and (3) $52 million attributed to other intangibles.

Trade Secret Monetary Damages
Reasonable Royalty Damages

Difference between UCC and Alcatel

- Alcatel provided no sound evidence to derive a value of a hypothetical license agreement into which Alcatel would have entered with Monterey
- UCC presented with actual evidence of prior licensing fees earned
- Alcatel presented no evidence of previous licenses into which it entered, or offered to enter, with other comparable companies based on this or similar technology
- No evidence of Alcatel's precise costs incurred for developing the trade secrets
- No evidence of the financial costs saved by Monterey

Trade Secret Monetary Damages
Reasonable Royalty Damages

Massachusetts Eye and Ear Infirmary v. QLT Phototherapeutics, Inc.[14]

- The Defendant was found liable for improperly using the Plaintiff's confidential research and other proprietary materials in the development of a "blockbuster" pharmaceutical product for the treatment of age-related macular degeneration by the Jury

- The Plaintiff was awarded a running royalty rate of 3.01 percent of the gross sales of Defendant's pharmaceutical product
  - MEEI's expert opined that a reasonable royalty could be as high as 13.5%
  - QLT's expert opined that a reasonable royalty was .5% to 2%

- The First Circuit Court of Appeals reviewed the Jury's verdict in favor of unjust enrichment

- The Court found that it met the standards under Massachusetts law in that the Plaintiff conferred a benefit on the Defendant, which here included the unauthorized use of confidential information that the Defendant knowingly accepted without payment for its value

Trade Secret Monetary Damages
Reasonable Royalty Damages

Ronald D. Russo v. Ballard Medical Products[15]

- Plaintiff, a medical device inventor, alleged Defendant misappropriated Plaintiff's trade secret and breached a confidentiality agreement by incorporating the trade secret into one of Defendant's medical devices without Plaintiff's consent
- Plaintiff asserted his trade secret was the sole value driver of the device
- Plaintiff's expert calculated the net present value of Defendant's expected net profits for the device to be $32.3 million over the 17 year life of the patent for the product incorporating the trade secret (Ballard made use of the trade secrets to secure two patents and introduce a new product to market)
- The Defendant alleged the Plaintiff's trade secret added nothing or very little value to its independent work
- The Jury awarded Plaintiff $20 million in damages; $17 million for unjust enrichment and $3 million for breach of contract.

Trade Secret Monetary Damages
Reasonable Royalty Damages

Ronald D. Russo v. Ballard Medical Products[15]

- The Appeals Court affirmed the Plaintiff's damage period as that of the 17 year life of the device's patent
- Ballard argued that unjust enrichment damages are inappropriate as a matter of law when plaintiff was willing to license the idea – the only way plaintiff could have profited from his idea was to license
- The Defendant had argued that damages should be limited to the two-year contract period discussed in a proposed Confidential Disclosure Agreement
- The Defendant also argued on appeal that a "head-start" or "lead-time" rule that would limit damages to the time the Defendant saved in getting the product to market by virtue of its misappropriation should apply
- The Appeals Court ruled however that the Defendant failed to point the Court to a single Utah case adopting the head-start rule

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LIST OF AUTHORITIES

1. Uniform Trade Secrets Act
2. *University Computing Co. v. Lykes-Youngstown Corp.*, 504 F.2d 518, (5th Cir. 1974)
3. *Pacesetter Inc. v. Nervicon Co.*, No. BC42443 (Cal. Sup. Ct. 2011)
4. *Texas Instruments, Inc. v. Teletron Energy Management, Inc.*, 877 S.W.2d 276 (Tex. 1994)
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8. *Jet Spray Cooler, Inc. v. Crampton*, 282 N.E.2d 921 (Mass. 1972)
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13. *Georgia-Pacific Corp. v. United States Plywood Corp.*, 318 F. Supp. 1116 (S.D.N.Y. 1970)
14. *Massachusetts Eye and Ear Infirmary v. QLT Phototherapeutics, Inc.*, 552 F.3d 47 (1st Cir. 2009)
15. *Ronald D. Russo v. Ballard Medical Products*, 550 F.3d 1004 (10th Cir. 2008)