Damages In Trade Secret Litigation:

It All Depends On Context and Competitive Advantage

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I. Introduction[i]

Trade secrets and patents are different types of intellectual assets, but in fact, most patents begin life as trade secrets. Both ultimately hope to provide the owner with the same economic benefit—a competitive advantage.[ii] The advantage can come in many different forms, including, but not limited to: an increase in units sold, an increase in selling price, a decrease in costs or some combination of these yielding an increase in short run or long run profits. We will discuss through several examples, in different contexts, how to think about the link between competitive advantage and trade secrets damages.

Properly assessing competitive advantage is the secret to a well-supported damage calculation and a proper calculation is highly dependent on the *context* of the situation. Unlike patents which are litigated under federal law, most trade secrets cases are litigated under state law.[iii] As a result of differing precedents, in numerous jurisdictions, trade secrets damage calculations can have much greater variance from sound economic principles than one finds in patent cases.

Because of federal jurisdiction and the creation of the Court of Appeals for the Federal Circuit, damages under patent law appears to be more established and consistent than trade secrets law. Even so, patent law damages have undergone numerous changes in the last three years.[iv] Given this backdrop, the importance of proper trade secrets damage calculations can be seen for the following reasons:

- Trade secrets litigation has dramatically increased during the last twenty years. This increase has yielded a corresponding change in the number and size of damage awards.[v]

- Increases in trade secrets filings are in part, rooted in the potential for a large damages award. The law on trade secret remedies can allow an owner to recoup unjust enrichment on the defendant's accused profit stream.

- There is the jury appeal of "the stolen secrets." Proper calculations should highlight why or why not the secrets have value.

Damages are awarded in trade secrets matters on both legal and equitable principles. Damages may be either compensatory or punitive. Compensatory damages need to flow from the harm; there should be a nexus between the competitive advantage derived from the trade secrets (broadly defined) and the damage amount awarded. We will discuss several examples, in different contexts, that will demonstrate some methods for determining the value of trade secrets based on the competitive advantage it confers to the user irrespective of whether legal or equitable principles are used.

II. Context Of Trade Secrets Litigation

While working on a trade secrets matter back in the early 1990's, I had the following conversation with Arthur J. Schwab, then a prominent trade secrets litigator:

> "Mark, if I need you as a damage expert, somebody has messed up. Either my client didn't come to us soon enough, secure their trade secrets adequately, we weren't persuasive enough on the need for an injunction, or some other reason. The secret to trade secret litigation is to keep the secrets, SECRET. That is best done by an injunction, near the time of the theft, identifying and putting the secrets back in the bottle."[vi]

As my firm and I evaluate more and more trade secrets, the genius of the above quotation becomes more and more evident. Calculating well supported damage claims can be difficult. For example, if an industry utilizes trade secret protection extensively, competitors do not know whether they are using the same or different trade secrets. Perhaps everyone is using the same easily developed process and keeping it secret. Or, in the case of truly valuable trade secrets, the litigation discovery process (even with protective orders) against one party, may merely insure that the secret gets out, damping the incentive to litigate against just one competitor.

According to a study of court cases, trade secrets are most often taken by an employee or business partner of the trade secret owner.[vii] One of the side benefits of working on trade secrets litigations is that everyone involved realizes how easy it is for an employee to ruin their life by walking out of their ex-employer's door with information the ex-employer does not think the employee should have. Even when innocent, the cost of getting one's reputation back can be extremely high. Our employees have learned this lesson the easy way, getting paid to review the transgressions of others.

There are times when secrets are intentionally taken and used to great benefit, and the theft may or may not be known until it is much too late to do anything other than to sue for damages. After all, once a secret is widely disseminated, its competitive advantage diminishes. In some cases the trade secrets are taken, but never used, or the secrets are used to a limited extent.

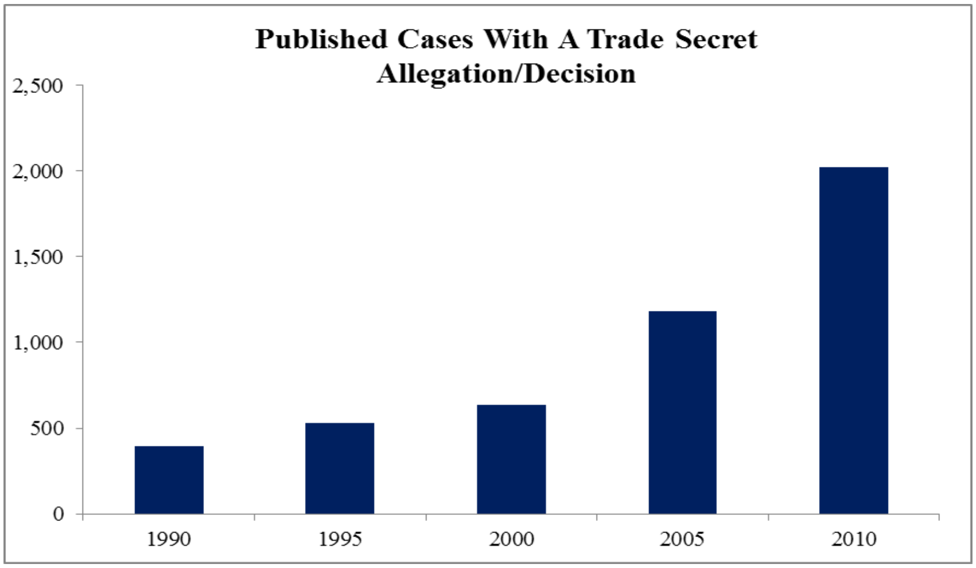
In our experience, for most litigated cases the facts regarding what *was taken* and what *was used* are in serious dispute. But often, the real reason the case does not settle is a serious disagreement on the value of what was taken as compared to other contributors to value. The litigation between Mattel, Inc. and MGA Entertainment Inc., involving the Bratz™ doll line is indicative of some of the challenges involved in high stakes intellectual property litigation. In that matter, the damage experts disagreed by well over a billion dollars in their assessment of damages.[viii] To quote from the Ninth Circuit Court of Appeals opinion in the Bratz matter:

> "When the defendant profits from the wrong it is necessary to identify the profits and recapture them without capturing the fruits of the defendant's own labors or legitimate efforts. The aim of restitution has been to avoid taking the defendant's blood along with the pound of flesh."[ix]

The challenge for damage experts is identifying and measuring the value of the secrets to both the plaintiff and defendant. Being successful in doing this often hinges on the availability and the context of the evidence. To quote more formally from Arthur Schwab: "Unfortunately deciding on the appropriate claim for damages, choosing the theory of liability, and proving damages are some of the most difficult aspects of trade secret litigation."[x]

III. Trade Secret Case Filings Are Increasing

The number of trade secret cases with some type of published opinion[xi] appears to have increased from 1990 – 2010.[xii, xiii]



There appear to be several primary reasons for this increase:

- Trade secret cases are generally considered less expensive to litigate than patent cases. With trade secret cases there are no claims construction issues, prior art searches or Markman hearings. Trade secrets such as a customer list, formula or process may be more easily explained to a jury without entering the technical world of patent claims. This contributes to decreasing the amount of time to get to litigate a trade secret case in front of a jury, as well as decreasing the expense of litigation.

- The wide spread adoption of digital media as an information storage vehicle has inevitably created an atmosphere where massive amounts of trade secret data can be easily disseminated to entities and individuals that were never supposed to have access to those trade secrets.

- Remedies for trade secret misappropriation have "the opportunity" for potentially larger damages awards than they would receive for patented assets.[xiv] Based on legal guidelines, trade secret damages have the potential to award for unjust enrichment on the entire profit stream, whereby patent damages require a link or nexus to the damages associated with the profits.

- Much of today's "knowledge" or inventions are difficult to reverse engineer (such as chemical processes and software code). As a result, companies active in these fields often decide to only patent certain aspects of an invention (such as chemical compounds), keeping the remaining peripheral technology associated with the patent as an in-house trade secret. In these cases the intellectual asset owners believe that the peripheral technology cannot be effectively reverse engineered and, if disclosed, will result in a loss of competitive advantage. This provides a two-pronged approach to intellectual property protection. Strategic decisions such as these lead to an increasing amount of valuable information being kept out of public domain and classified as a "trade secret" or "confidential and proprietary information."[xv]

- A patent is issued and granted by the United States Patent and Trademark Office. Theoretically, the Office acts as a gatekeeper, only allowing unique and non-obvious claims to receive a patent. With trade secrets there is no "gate-keeper". A company can call anything a trade secret, and subsequently file a trade secret lawsuit if misappropriated. As a result, in an effort to protect trade secrets, some companies have resorted to using a "better safe than sorry" approach claiming almost everything they do a "trade secret". One reason for this is the high fixed costs and generally low variable costs of protecting trade secrets. The incremental cost of adding something to the trade secret "vault" is low. For example, placing what amounts to the "company phone book" in one's digital vault costs very little.

Failure to adequately protect a secret will cause one to lose the damage remedies available to trade secret owners. This may be the rationale for the apparently over–inclusive behavior.

- This over-inclusive approach to trade secret classification has blurred the line between what is actually a trade secret and not generally known versus the information that is "generally known". Strategic decisions such as these have contributed to the increase in litigation, as employees leave companies with what they believe to be "generally known" knowledge, only to discover their previous employer has classified the information as a "trade secret" and wants to prevent them from using the "generally known" information. Businesses acknowledge the fact that employees are mobile and, as a result, view employees as a carrier of company knowledge. In an effort to prevent disclosure of any proprietary knowledge, companies often qualify everything as a trade secret, including "generally known" or dated information no longer trade secrets.

IV. What Governs Trade Secret Law and Trade Secret Damages

Trade secret law is generally governed by state law, not federal law. This explains, in part, why historically trade secret case opinions have at times differed significantly between jurisdictions. Different state laws have evolved different case law by jurisdiction. However, this is changing. The Uniform Trade Secrets Act was written into code in 1985, and subsequently amended in 1991.[xvi] The Uniform Trade Secrets Act (UTSA) is slowly becoming the de facto standard for trade secret litigation. However, interpretations of the UTSA still differ from state to state.

The UTSA defines a trade secret as, "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 easily 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 certain circumstances to maintain its secrecy."[xvii] In 1995, the UTSA was updated or refined via The Restatement (Third) Of Unfair Competition, which defines trade secrets as, "any information that can be used in the operation of a business or other enterprise and that is sufficiently valuable and secret to afford actual or potential economic advantage." From a damages perspective, both the UTSA and The Restatement (Third) Of Unfair Competition, afford the owner as a measure of value the competitive economic advantage.

V. What Qualifies As A Trade Secret?

What qualifies as a trade secret from the legal perspective often differs from what qualifies as a trade secret viewed through the eyes of a business entity. Our firm once had a case where the plaintiff believed almost everything in its manufacturing plant, including the layout and design of bathrooms, was a trade secret. No one in the matter ever explained the "competitive advantage" of the bathroom design (not to imply it was impossible for there to have been one).

Unlike the process of patenting, trademarking or copyrighting, there is no legislation that prevents a company from claiming everything it does, down to the location and lay-out of its restrooms, as a trade secret. Despite this over-encompassing procedure of classifying everything as a trade secret, merely calling something a trade secret does not necessarily translate into a competitive advantage or economic benefit or even ensure that the trade secret is "secret" and not generally known (i.e., fit into the definition of the UTSA).

There may not be laws preventing the wholesale approach to classifying procedures or information as trade secrets, but there are standards and laws that govern when and where damages are appropriate. The UTSA requires that a trade secret "derives independent economic value, actual or potential, from not being generally known to, and not being easily ascertainable by proper means, by other persons who can obtain economic value from its disclosure or use."[xviii] While this definition is useful for determining the existence of a trade secret, the *value* of the secret is a separate determination. Contemporaneously produced information and documents regarding the competitive advantage which the secrets are believed to generate will be useful in analyzing the compensatory damages from unauthorized use should the secrets be taken.

VI. Examples Of How To Approach Trade Secret Value

The same concept that Michael Porter says makes businesses and nations prosperous is what makes any intellectual property valuable—*competitive advantage*.[xix] Sometimes the quantification of the competitive advantage is factually hard to demonstrate. As a result, case law has developed rules in intellectual property cases designed to ensure in these hard to figure cases, the guilty does not get off without cost. In some jurisdictions the law only asks the plaintiff to demonstrate accused revenues, and requires the defendant to demonstrate relevant costs or apportionment. This burden is intuitive, as the defendant is generally in a better position than the plaintiff to demonstrate certain issues. We would argue that it is a mistake for the plaintiff to rely on the hope that the defendant does not adequately prove expenses, hoping for a large damage award. The plaintiff needs to provide some support for the competitive advantage of the trade secrets to both parties.

Other case law includes allowing both lost profits and unjust enrichment to the extent not duplicative, as well as reasonable royalties. Failure to provide the nexus between these damage claims and what makes a trade secret valuable—competitive advantage—sometimes is (and generally should be) fatal to a damage claim.[xx] The nexus between the misappropriation of a trade secret(s) and damages should be proportionate to the competitive advantage, economic or other, resulting from the use of the trade secret over and above the next best alternative. While there are certainly cases where "accused revenues" are awarded as damages, these cases are unlikely to represent compensatory damages, but more likely a form of (punitive) damages for something the defendant failed to do, or produce in the litigation.

Similarly, the award of lost profits on all accused units will be highly punitive if the competitive advantage of the trade secrets is a small contributor to the overall profits. There may be a further issue of sorting out a defendant's "unjust enrichment" from its "just enrichment". Below, we create some (admittedly incomplete) hypotheticals driven by real world situations, to highlight damage issues that are especially pertinent in trade secrets litigations.

A. The Counter-Intuitive Trade Secret

Plaintiff asserts unjust enrichment damages on the entire profit stream. Defendant asserts damages, if any, on small incremental cost savings.

The product at issue is basically an established and simple product. Manufacturing the product involves constant tinkering to get and keep the product formula, the manufacturing equipment and the resulting quality control process at its optimum. One long standing, vexing, somewhat randomly occurring, industry wide problem was significantly reduced in a number of plants by Process X. Process X utilized a simple counter-intuitive logic to function. This process did not eliminate the problem under all circumstances, but was an effective tool in solving the problem for Company A. Company A adopted Process X at most, but not all of its manufacturing lines. Everyone who worked around the manufacturing lines at Company A was aware of Process X, but customers were never aware of the process for manufacturing the product.

Company B was expanding its business and looking to hire new employees. During a job interview with a Plant Manager at Company B, a former Company A employee mentioned in one simple sentence a summary of Process X. When told that the idea was counter-intuitive, the interviewee responded "I know, but it works." Company B developed its own implementation of Process X and utilized it at some, but not all of its manufacturing lines. Sometime, but not immediately, after being accused of theft of trade secrets, Company B stopped using Process X, with no corresponding drop in product sales.

Assuming that Process X is a trade secret and assuming that the disclosure and use was inappropriate, what are relevant damage issues? One should start by focusing on some questions to determine the competitive advantage Process X generates:

1. Can the product be made without the use of Process X?
2. Can acceptable quality product be made without Process X?
3. Do customers of Company A demand different quality as opposed to the customers of Company B?
4. What are the long run historical costs of the problem at Company A? Company B? What changed (revenues, costs, profits) before and after use of Process X?
5. How often and by how much is the problem reduced by Process X at Company A? Company B?

Based on the above facts, acceptable product was made by both companies prior to the development of Process X. The trade secret process was not used on all manufacturing lines at either company and Company B continued to sell product after stopping the use of the trade secret process. As a result, there is no link between the trade secret process and demand for the product. Given this context and facts, it is hard to envision a legitimate claim for lost profits being made by Company A.

Was Company B unjustly enriched in this situation? If so, how should that enrichment be calculated? The case evidence discloses that the process was not a primary factor customers bought either company's product, but that the process definitively created an incremental cost savings advantage. As we drill down into the analyses, context and case facts will lead to different conclusions in different matters.

With respect to unjust enrichment calculations, a key issue is evaluating, the "just" versus the "unjust" enrichment. In this set of case facts, Company A may have customers that are very particular about quality (think Neiman Marcus), as opposed to Company B's customers (think Dollar General). The value of producing a product of sufficient quality to meet customer expectations could be important, but quality issues related to unjust enrichment would generally have to be determined based on Company B's customer's preferences.

A plaintiff asserting *that all of the profits* earned while using Process X is offering an inappropriate and potentially punitive damages claim, unless the plaintiff demonstrates the nexus between trade secret use and the harm sustained by the plaintiff. Given the evidence, at times it may make more sense to consider whether Company B should have taken a (hypothetical) license to the process and paid a royalty. If so, how should that royalty be determined? Case facts and context may ultimately determine whether a specific unjust enrichment claim or a reasonable royalty claim is more appropriate. In either case, competitive advantage is the measuring stick.

B. Your Opponent's Cards Trade Secret

Plaintiff and Defendant are bidding on a very large contract.
Defendant illegally acquires and uses Plaintiff's bidding information.
Neither Plaintiff nor Defendant ultimately wins the contract.

A large service contract is coming up for rebid. The new contract will be about double the size of the current contract. Company C has been performing the contract for the last 3 years. Company D approaches Company C about teaming up on the new bid, but is rebuffed. Company D realizes to bid themselves it needs a well-positioned Project Manager.

Company D offers Company C's (employee at will) Project Manager a substantial increase in salary to come over to Company D and lead the team attempting to win the rebid of the contract.

Hours before notifying Company C that he is leaving, the Project Manager goes into Company C's secure server and downloads every relevant file relating to the current contract, plans to win the rebid of the contract and other documents, onto four separate thumb drives. After doing so, the Project Manager sends his boss an e-mail announcing that as of that night the Project Manager is resigning to "pursue other options". The next day the Project Manager shows up for work at Company D and one week after joining Company D makes a presentation to Company D's senior management utilizing company C's trade secret information. Additionally, there is other forensic evidence of the various thumb drives containing Company C information being accessed on Company D's computers.

After about three months Company D gets nervous regarding the propriety of the Project Manager's actions and severs its ties with the Project Manager. The Project Manager goes to work at Company E who is also interested in bidding on the contract. Companies C, D, E, as well as others, bid on the contract. As it turns out, Company M actually wins the rebid of the contract.

Assuming that the data and information taken are trade secrets and assuming that the disclosure and use was inappropriate, what are relevant damage issues? We start by focusing on some questions to determine the competitive advantage these trade secrets might generate:

1. When should the information be valued? At taking? At contract award? Another time?

2. At the time the trade secrets were taken, did the information have value?
3. What was the impact on measures of harm of the awarding of the contract to Company M? Lost Profits of Company C? Unjust Enrichment of Company D? Reasonable Royalty owed by Company D to Company C?
4. What evidence not known when the information was taken would be relevant to use in considering the information's actual value at the time of the taking?

As a result of its prior experience, Company C was considered the favorite to win the contract. Despite being the favorite, Company C did not win the contract, Company M (an innocent party) did. Therefore, the facts do not support a claim for lost profits. Company D was ultimately not awarded the contract, thus was not "unjustly enriched" under a typical definition. Does this mean there was no harm? No. Patent law would suggest that a reasonable royalty might be appropriate here. Under the patent statute, "damages should be adequate to compensate the plaintiff, but in no event less than a reasonable royalty."[xxi] Clearly, while Company D did not earn any profits from the contract, value was transferred at the time of the taking from Company C to Company D. The question is *what was transferred* and *how to value* what was transferred?

What was transferred was *an improvement in Company D's chances* of winning the contract, and perhaps a decrease in Company C's chances of winning the contract. Although likely, the improvement in Company D's chances did not have to come entirely from a decrease in C's chances, as there were other bidders. If the information actually increased Company D's chances, it could value that and offer to pay a royalty for the information.

Company C could do the same thing, and the parties could theoretically negotiate a reasonable royalty.

Negotiating reasonable royalties (in patent litigation) often involves the consideration of the expectations of the parties at the time of the negotiation, tempered or supplemented by information that subsequently becomes available, sometimes referred to as using the "book of wisdom". The beauty of the reasonable royalty construct is that it highlights and demonstrates that even when the use by an infringer does not create any decrease in utility for the owner, the infringer at least owes "rent" for its use of the intellectual property. In this case, the logic of some form of rent is easy to understand, as a lack of profits does not insulate the defendant from paying rent for the use of the property.

For example, if you were playing poker, seeing someone else's cards (assume legally), would be worth something. This temporal information would have value. You might not win the hand, but the information at the time offered would still have value. Among value considerations would be the size of the pot, the skill of the players (especially whose cards you get to see), and how many cards you get to see.

C. The Head Start Trade Secret

The trade secrets are product designs that become disclosed once a product comes to market. After seeing a product design, it takes about a year to bring a copycat product to market. Plaintiff's designs are stolen. Defendant uses some designs, gaining a head start, some designs past the head start period, and does not use some designs.

Company F was a specialty consumer products company selling products which were replicas of historical items. Company G was the primary competitor of Company F. In this industry, bringing out a new product takes about 12 months to conceive and deliver a product to market under normal conditions. For a number of years both companies have used the *public* new product announcements of the other company in determining what products to bring to market.

Company G acquired (assume through illegal means) the drawings and market timing plans for 6 specific potential future products of Company F. Of the 6 products, 2 products based on the ill-gotten designs were brought to market by Company G just prior to Company F marketing its product. Two products based on the ill-gotten designs were brought to market by Company G over 2 years after the Company F product came on the market. Two product designs and plans that Company G acquired illegally were never marketed by either Company F or Company G.

Assuming that the data and information taken are trade secrets and the disclosure and use was inappropriate, what are relevant damage issues? Let's start by focusing on some questions to determine the competitive advantage trade secrets might generate.

1. Once a product is announced, the historical designs provide a basic insight into the likely design of what is going to be marketed. Once a design comes on the market its features and dimensions are readily replicable within 12 months to the extent not legally protected. How far can the value of the product designs and the market timing extend?
2. If Company G had not sold the accused designs, would it have sold something else?
3. Does Company G beating Company F to market with a product provide economic benefits that go beyond the profits from the products knocked off? If so, for how long?
4. For accused products not yet brought to market, are there non-monetary remedies that provide adequate relief.

Again context and specific case facts and their impact could color any of the analyses. Fundamentally, keeping the designs and market timing plans secret is important to maintaining a firm's competitive advantage. An important question becomes how long does that competitive advantage last? One advantage that might last, but difficult to quantify without the right facts, is the benefit of turning around the marketplace impression that Company F comes out with better products; as a result of quickly, legally copying Company G's announcements and improving the features slightly. Beyond proof of reputational improvement, any product has only a one year head start on copycat products. Had the theft not taken place any of the two accused products could have been made legally one year later. While case facts might argue to slightly lengthen, shorten or merely time-shift profits—the trade secrets only provide this competitive advantage for roughly one year, effectively capping compensatory (not necessarily equitable) damages under lost profits, unjust enrichment and reasonable royalty damage theories.

The actual use of the trade secrets is hard to argue on those products never manufactured or even those manufactured two years after Company F's corresponding product came out. An injunction of defined duration may be a better award than one of monetary damages. In our experience we have seen attempts in similar cases to suggest that a lump sum reasonable royalty would be negotiated for all of the secrets, used or unused, based on a hypothetical value at the time of the taking. While creative, and in some cases possibly supported by case facts, here the parties negotiating a royalty would still know that the secrets would only provide a 12 month advantage. Furthermore, the parties would likely consider that probabilities were less than 100% that the all six designs would be used. That would suggest either a running royalty based on use, or a further discount of the lump sum amount, once again shrinking the hope for a large damage calculation in a low competitive advantage situation. In some jurisdictions legal precedent allows collection of damages beyond what a reasonable head start theory would suggest. In these situations legal and economic theory appear to be at odds.

D. Valuing Confidential And Proprietary Information

How does the value of information that achieves trade secret status differ from the value of information that is merely confidential and proprietary?

In this hypothetical, Company H had several high level PowerPoint presentations which, if seen by a competitor (Company I) would allegedly telegraph Company H's strategic direction. An employee left Company H and took these presentations with him to his new job. Virtually all the information taken was publicly available with the exception of capital expenditures on plants and machinery. However, these amounts were publicly disclosed to Company H shareholders before the individual disseminated the strategic power points at Company I, and as a result, the documents did not contain any "trade secrets".

Assuming that the data and information taken are not trade secrets, but rather confidential and proprietary information, how does one value the information? Let's also assume that the disclosure and use of the strategic power points was inappropriate. What are the relevant damage issues? Let's start by focusing on some questions to determine the competitive advantage this information might generate.

1. Is the information aggregated from several documents? Is all of this information in the public domain? Could the information be obtained by other means, such as market research conducted by a consulting firm?
2. Did Company I benefit from the use of these strategic Powerpoint presentations, over and above what it could have obtained legally via a consulting firm's in-depth case study? If the answer is no, then perhaps in some contexts it might be appropriate to utilize the cost approach and use consulting fees as a basis to generate a comparable value.
3. Did Company I somehow beat Company H to the punch line, and more importantly did Company I beat Company H because it utilized the information or were there other factors that contributed to this (i.e. Company I could prove it already new this information)?
4. Was Company H harmed as a result of Company I's illicit actions? Where is the nexus between actions and harm?

Context and case facts could impact any of these analyses. The expert should be mindful of the competitive advantage of the information/knowledge and attempt to capture the value that the defendant obtained from the illicit use of the information. Sometimes, if the information is not secret and publicly available, the economic benefit can be captured by the avoided costs to create the information. Other times, the benefit might be captured by how the defendant's actions harmed the plaintiff.

In an effort to compensate the Plaintiff for any harm as a result of the taking of "information/knowledge", Plaintiffs often claim that the information might not be a trade secret but was confidential and proprietary, and more importantly was obtained illegally. Plaintiffs will claim that because of the illegal method of obtaining the information they are entitled to damages, often times claiming some form of unjust enrichment. However, in some contexts this is over-reaching. *The unjust enrichment needs to be representative of the competitive advantage of the confidential and proprietary information.* In any case, the reason the information does not qualify as a trade secret should be considered in the economic analysis of competitive advantage. Often there may not be a difference between the competitive advantage of confidential information and trade secrets, but many times there will be a difference.

E. Cost Savings

As in the hypothetical example discussed previously, a trade secret sometimes provides primarily for cost savings to the entity that committed the misappropriation. Generally, when costs savings are the primary benefit from using trade secrets the defendant was able to decrease some costs and increase profits, thereby receiving some form of unjust enrichment. The implication is that prior to these cost savings the misappropriator had other modes and means of generating profits, except it was more costly and less profitable to generate revenue without the trade secret. This analysis is similar to a *Grain Processing* analysis done in patent cases.[xxii]

Focusing on overall profitability without demonstrating the nexus between cost savings and sales is a clear economic mistake, regardless of whether big damage numbers are persuasive to some juries. In this context, a compensatory damages remedy should not be the unjust enrichment on the entire profit stream, but rather the incremental cost savings that came from utilizing the trade secret. *In some cases the cost savings may most appropriately be the driver behind an appropriately fashioned reasonable royalty.*

VII. Why Discovery Is Critical In Trade Secret Damages Cases

In firm's experience, discovery issues appear to create significant challenges in trade secrets matters, for both plaintiffs and defendants. The greater the specificity by which a plaintiff discloses its secrets, the increased potential for the defendant or other competitors to discover secrets they did not know prior to the litigation.[xxiii] On the other hand a vague description by the plaintiff puts a defendant in the position of defending against claims without knowing exactly what it is the plaintiff is accusing the defendant of doing wrong. Also, the defendant may have to disclose its own trade secrets to prove it is not utilizing the plaintiff's secrets.

An expert should form their damage theories from case evidence and appropriate assumptions. These are both derived from the document production and other discovery. Without the proper discovery a party will find challenges supporting its damages theories. Almost every expert has had experiences where they are retained near the close of discovery, effectively "in the bottom of the ninth inning". After a cursory review of the document production, the expert realizes he or she is facing a situation with two outs, two strikes and no one on base. The expert must at a minimum, scramble quickly to get their client to produce information deemed crucial (and hope that the production is allowed). If discovery is closed, it is unlikely the other side will be compelled to produce any desired documents. This situation can create significant challenges.

The decision to hire an expert early, as it relates to efficient case management, as well as document production, is prudent, even if the expert's services are kept to a minimum. Discussing damages theories with the expert early and asking the expert to assist in document production helps ensure that the proper documents will be produced that will help to either support or refute trade secret damages amounts.

VIII. Conclusion

Compensatory damages generally should be based on: (1) the competitive advantage of the intellectual property, in this case trade secrets or confidential / proprietary information, provides to the one utilizing it, or (2), to the one who lost the ability to utilize the competitive advantage. As previously stated, one must avoid the blood when taking the pound of flesh. The calculation of compensatory damages should be based on the nexus between the economic benefits and the competitive advantage. If there is truly little to no competitive advantage, the compensatory damages award should reflect that. The damages should flow from the 'harm' inflicted to the owner, or the incremental gain made by the infringer.

Plaintiffs should be able to demonstrate, through case evidence, the nexus to support damages theories based on lost profits and/or unjust enrichment theories. Defendants faced with such claims should be prepared to present evidence that the use of the secrets did not lead to the entire profit stream, and what portion of the profit stream the secrets may have affected. In many cases, the reasonable royalty method may provide a useful framework where the evidence provides context that suggests the parties may have proof challenges with either lost profits or unjust enrichment claims. As Judge Posner stated in *Schiller,* "… people who want damages have to prove them, using methodologies that need not be intellectually sophisticated, but must not insult the intelligence".[xxiv]

Determining the value of trade secrets should always be based on the specific context of the evidence available. In some cases that will equate to significant value and in others much less value. While the law has an interest in deterring the infringement of trade secrets and other forms of intellectual property, experts should provide the Court with a clear definition of value so the merits of compensation and deterrence can be properly weighed.

In other words, professing that a trade secret misappropriation is worth the entire profit stream without considering the competitive advantage of the trade secret in the context used can lead to a lopsided and inequitable damages amount. Lost profits damages are to compensate the plaintiff for profits that should have been earned. The goal of unjust enrichment damages is to take back the amount that was obtained as a result of the *unlawful activity*, not lawful activity. As a result, it is important to remember that a trade secret is a component of the profit stream and while potentially extremely valuable, not presumptively the primary driver of the profit stream unless the evidence warrants that conclusion.

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[i]The author would like to thank Markus P. Lacis for his help in researching and developing this paper.
[ii] The term "competitive advantage" as used in this paper broadly refers to anything that ultimately allows a

firm to outperform its competitors.

[iii]Patent cases are also appealed to a single court, the Court Of Appeals For The Federal Circuit.

[iv] For example, *Uniloc USA et. al.v. Microsoft, 632 F.3d 1292 (Fed. Cir.2011*), *ResQNet.com, Inc. v. Lansa, Inc. 594 F.3d 860 (Fed. Cir. 2010), i4i Limited Partnership , et al. v. Microsoft Corporation, 598 F.3d 831 (Fed. Cir. 2010), Cornell University et al. v. Hewlett Packard Company, 609 F Supp. 2d 279 (N.D. NY 2009, Lucent v. gateway 580 F.3d 1301 (Fed. Cir. 2009).* In *Lucent v. Gateway and Cornell v. HP*, the CAFC addressed the entire market value rule and explained why the plaintiffs failed to tie the patented features to consumer related demand.

[v] A recent case in point is the over $900 million in damages awarded in a recent trade secrets litigation. *E.I. E.I. du Pont de Nemours & Co. v. Kolon Industries Inc., 09-cv-58, U.S. District Court, E.D. Virginia (Richmond), 2011.*

[vi]Conversation with Arthur J. Schwab, former Chair of Litigation, Buchanan Ingersoll, P.C., circa 1992.

[vii] A Statistical Analysis of Trade Secret Litigation in Federal Courts, David S. Almeling, Darin W. Snyder, Michael Sapoznikow, Whitney E. McCollum, and Jill Weader, *Gonzaga Law Review* [Vol. 45:2 2009/10], pp. 292-334.

[viii] *Mattel, Inc. v. MGA Entertainment, Inc*. 616 F.3d 904 C.A.9 (Cal.) July 22, 2010

[ix] *Id*., quoting from Dobbs, Dan B., *Dobbs Law of Remedies: Damages-Equity-Restitution §6.6(3) (2nd Edition 1993).*

[x] Schwab, Arthur J. and Porter, David J., *Guarding The Crown Jewels: A Guide To Protecting Your Trade Secrets,* Washington Legal Foundation, Washington D. C. 2002, p.66

[xi] An "opinion" can include any opinion, except for a damages award, where the judge opined on an issue related to trade secret litigation. This data does not capture the trade secret cases that were filed, but subsequently did not have an opinion. Duplicate case entries were included only in the first year of appearance.

[xii] Our search was in *Westlaw GC* for decisions in both U.S. Federal District Courts and State Courts for the words "trade secret" in the opinion portion of the case decision. This was done in five year increments, 1990 – 2010. Cases were reviewed to remove any duplicates between years.

[xiii] See additionally, David S. Almeling, Darin W. Snyder, Michael Sapoznikow, Whitney E. McCollum, and Jill Weader. "A Statistical Analysis of Trade Secret Litigation in Federal Courts" *Gonzaga Law Review* 45.2 (2010): 291-334. David S. Almeling, Darin W. Snyder, Michael Sapoznikow, Whitney E. McCollum, and Jill Weader. "A Statistical Analysis of Trade Secret Litigation in Federal Courts" *Gonzaga Law Review* 45.2 (2010): p.302.

[xiv] Halligan, Mark R. "Trade Secrets v. Patents: The New Calculus." *Landslide* Vol 2 Number 6 July/August 2010

[xv] Dupre, John L and Smith, James M. "When To Chose Trade Secret Protection Over A Patent." Building and Enforcing Intenllectual Property Value 2011.

[xvi] www.nsi.org/Library/Espionage/usta.htm

[xvii] Mark Glick, Lara A Reymann and Richard Hoffman. Intellectual Property Damages Guidelines and Analysis; John Wiley & Sons, Inc. 2003. p. 282

[xviii] See Uniform Trade Secrets Act, 14 Uniform Laws Annot. 433-467 (1995)

[xix] Michael Porter. Competitive Advantage Creating and Sustaining Superior Performance. The Free Press-Simon & Schuster Inc. 1985 p. 33

[xx] *See Schwab,* p.73.

[xxi] Roman Weil, Michael J. Wagner and Peter B Frank. Litigation Services Handbook: The Role of the Financial Expert. Third Edition, John Wiley & Sons, Inc. 2001 p. 24.3

[xxii] *Grain Processing Corp. v. American Maize-Products Company*, 185 F.3d 1341; 1999 US App1556 Fed. Cir. Aug. 4, 1999

[xxiii] Reismeyer, Fritz and Clune, Matthew P., *Protective Orders In Trade Secrets Cases*, ABA Business Torts Journal, Fall 2010.

[xxiv] *Schiller & Schimdt, Incorporated v. Nordisco Corporation* 969 F.2d 410 July 23, 1992