THE FLEXIBILITY OF TRADE SECRET DAMAGES
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In what may be the largest-ever trade secret misappropriation verdict, a Wisconsin jury recently awarded $940 million in damages to Epic Systems, a healthcare software company, against the U.S. subsidiary of Tata Consultancy, part of the Tata Group headquartered in India.[1] Whether or not the award remains after post-trial motions, it should serve as a reminder that trade secret damages – particularly in comparison to damage calculations in patent cases – are relatively flexible, generous and difficult to predict.

A fundamental reason for this difference is that trade secret law, even though more or less codified in the various versions of the Uniform Trade Secrets Act, has from its beginning been grounded in principles of tort. Indeed, the reporters of the First Restatement classified trade secret misappropriation this way, and for decades the basic rules applied by courts were extracted from the Restatement of Torts §§ 757-759. As in other areas of tort law, it was sufficient that the plaintiff prove the *fact* of damage with reasonable certainty, but uncertainty about the *amount* would not bar recovery.[2]

When the Uniform Act was beginning in 1979, the general approach to damages was not changed. Section 3 of the UTSA allowed recovery for the plaintiff's loss from the misappropriation, together with any unjust benefit gained by the defendant that is not accounted for in determining the loss, or through the imposition of a reasonable royalty. In actual practice, this has come to mean that the plaintiff has three main avenues of recovery: first, proving its own loss; second, proving the benefit gained by the defendant from the misappropriation; and third, establishing a royalty that would have been agreed in a hypothetical negotiation. In general, the plaintiff is free to choose among these to maximize its recovery.[3]

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[1] Epic Systems Corporation v. Tata Consultancy Services Limited et al, No. 14-cv-748-wmc (W.D. Wis. 2016). The verdict covered legal theories beyond trade secret misappropriation, such as breach of contract, fraud, unfair competition and unjust enrichment. However, the damages special verdict was phrased in terms of "benefit" to the defendant from the use of a specific kind of data and from its use of "other confidential information." Therefore I think it is fair to call this a trade secret verdict.

[2] See, e.g., Bangor Punta Operations, Inc. v. Universal Marine Co., 543 F.2d 1107, 1110-1111 (5th Cir. 1976) and Tri-Tron International v. Velto, 525 F.2d 432, 437 (9th Cir. 1975).

[3] See Annotation, Proper Measure and Elements of Damages for Misappropriation of Trade Secret, 11 A.L.R.4th 12, 21 (1995) ("[T]he proper measure of damages in a trade secret misappropriation case, as between the

Loss to the trade secret owner can be determined by reference to the profits that could have been realized on sales lost to the misappropriator. The calculation need not rely on average margins, but can be based on incremental profitability, which is normally much greater.[4] Loss can also be inferred from a decline in sales following the misappropriation.[5] Damages may include the value of lost business opportunities,[6] and even profits from a product not yet put on the market, if plaintiff can show that it probably would have been successful.[7] If the defendant has publicly disclosed the secret, then damages can be assessed for its full market value.[8]

Benefit conferred on the defendant is expressed through unjust enrichment damages, and they can be awarded in addition to plaintiff's losses so long as there is no overlap. If the proof is sufficient, this can result in the defendant having to disgorge 100% of its profit from use of the information.[9] However, the defendant is usually permitted to present evidence that some portion of its profits was not derived from the misappropriation and thereby reduce its exposure.[10] If it turns out that the defendant benefited by producing its own product in a shorter time or at less cost and risk, then damages may be measured with reference to what its costs should have been, influenced by the investment that the plaintiff had to make to develop the secret information in the first place, or by the fair market value of the secret as a proxy.[11]

But perhaps the most flexible and promising route for trade secret plaintiffs is the "royalty measure of damages." This needs to be distinguished from another kind of royalty allowed by Section 2 of the Uniform Act, which is directed at injunctive relief, but which provides that in "exceptional circumstances" (usually where the defendant was unaware that the information had been misappropriated and has

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plaintiff's lost profits, the defendant's profits, the defendant's savings, and a royalty, has been that which affords the plaintiff the greatest recovery.").

[4] See C. Albert Sauter Co. v. Richard S. Sauter Co., 368 F. Supp. 501, 515 (E.D. Pa. 1973).

[5] EFCO Corp. v. Symons Corp., 219 F.3d 734, 741-42 (8th Cir. 2000).

[6] The Eagle Group, Inc. v. Pullen, 114 Wash. App. 409, 58 P.3d 292, 299 (Wash. App. 2002).

[7] DSC Communications Corp. v. Next Level Communications, 107 F.3d 322, 329 (5th Cir. 1997).

[8] Precision Plating & Metal Finishing, Inc. v. Martin-Marietta Corp., 435 F.2d 1262, 1263 (5th Cir. 1970).

[9] See C&F Packing Co., Inc. v. IBP, Inc., 224 F.3d 1296, 1304 (Fed. Cir. 2000).

[10] Medical Staffing Network, Inc. v. Ridgway, 670 S.E.2d 321, 330 (N.C. App. 2009).

[11] See Salsbury Laboratories, Inc. v. Merieux Laboratories, Inc., 908 F.2d 706, 714 (11th Cir. 1990), and R.K. Enterprises, LLC v. Pro-Comp Management, Inc., 272 S.W.3d 85 (Ark. 2008).

irretrievably incorporated it into a product or process) “an injunction may condition future use upon payment of a reasonable royalty for no longer than the period of time for which use could have been prohibited.” Normally, this sort of compulsory license is provided only where a prohibitory injunction would produce wasteful and unfair results, and is imposed as a periodic, or “running” royalty that can be ended when, for example, the secret becomes public or the relevant “head start” period has run.

In contrast, Section 3 of the Uniform Act covers damages, noting that they can consist of the plaintiff’s loss or the defendant’s gain, and that “in lieu of damages measured by any other methods” they can be “measured by imposition of liability for a reasonable royalty for a misappropriator’s unauthorized disclosure or use of a trade secret.” This approach is built on the hypothetical negotiation of a license; in other words, an attempt to reconstruct what the defendant would have been willing to pay in order to get honest access to that which was taken dishonestly. As a result, it is often used in cases where the defendant had great aspirations for the project that it planned to support with the misappropriated data, but its execution fell short and it actually lost money.[12] Using the royalty measure of damage allows the plaintiff to get at the benefit that the defendant thought it was achieving at the outset. Indeed, even if the trade secret turns out to have been short-lived, this will not affect the analysis of the hypothetical negotiation, unless the parties could have anticipated it.[13]

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[12] See Ajaxo Inc. v. E*Trade Financial Corp., 187 Cal. App.4th 1295, 1309-13 (2010) (as a result of defendant’s losses, unjust enrichment was not “provable”).
[13] See O2 Micro International Ltd. v. Monolithic Power Systems, Inc., 399 F.Supp.2d 1064. 1078 (N.D. Cal. 2005).