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TRADE SECRET DISPUTES: QUANTIFYING DAMAGES

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AG ANALYSIS GROUP

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corporatedisputes@financierworldwide.com

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EXPERT FORUM

TRADE SECRET DISPUTES: QUANTIFYING DAMAGES

PANEL EXPERTS

John M. Browning
Vice President
Analysis Group, Inc.
T: +1 (202) 530 2004
E: john.browning@analysisgroup.com

John Browning is an economist who specialises in applying microeconomic, statistical and survey techniques to IP and antitrust disputes. He has calculated damages in patent, trade secret and copyright cases and evaluated the claimed FRAND licensing terms for patents that have been asserted as essential to industry standards. His experience spans the areas of automotive, high tech, telecommunications and real estate.

Minh P. Doan
Vice President
Analysis Group, Inc.
T: +1 (214) 523 1445
E: minh.doan@analysisgroup.com

Minh Doan has more than 15 years of experience evaluating economic damages and providing expert testimony in patent infringement, copyright, trademark, trade secret and breach of contract matters. Her work includes developing damages models and determining lost sales, lost profits, unjust enrichment, reasonable royalties and price erosion damages. Ms Doan has also evaluated commercial success issues and economic criteria relevant to obtaining an injunction.

Della Cummings
Vice President
Analysis Group, Inc.
T: +1 (202) 530 2005
E: della.cummings@analysisgroup.com

Della Cummings brings her expertise in economic and financial theory to bear in complex business litigation disputes. Her IP experience includes assessing damages related to patent infringement and trade secret misappropriation, as well as analysing domestic industry, remedy and public interest issues before the US International Trade Commission. Ms Cummings has supported experts throughout the litigation process.

Thomas McGahee
Vice President
Analysis Group, Inc.
T: +1 (214) 523 1425
E: thomas.mcgahee@analysisgroup.com

Thomas McGahee specialises in economic analysis and damages quantification. He focuses on their application in complex commercial disputes, including intellectual property, antitrust, breach of contract and false advertising matters. He has evaluated lost profits and reasonable royalty damages in a range of industries, including mobile devices and applications, internet products and services, computer hardware and software, and medical devices.

Mickey Ferri
Vice President
Analysis Group, Inc.
T: +1 ((202) 530 2595
E: mickey.ferri@analysisgroup.com

Mickey Ferri specialises in applied business economics and has extensive experience in economic analysis, business strategy and data analysis. His litigation work includes economic consulting on damages, class certification, fraud, irreparable harm and commercial success in a variety of areas, including intellectual property, antitrust and competition, commercial disputes, and labour and employment.

CD: How would you characterise the current trade secret disputes landscape? As companies endeavour to protect their intellectual property (IP), to what extent are you seeing a rise in related cases?

Browning: I have seen a large increase in the number of trade secret disputes. Ten years ago, most intellectual property (IP) cases involved patent litigation in US district courts or at the US International Trade Commission. There was also a smattering of copyright and trademark-related disputes. I rarely saw cases involving claims of trade secret misappropriation. In recent years, however, I have seen many more trade secret cases, and some of those have involved substantial damages claims. The fact that juries have awarded damages in the tens and hundreds of millions of dollars in some cases has no doubt encouraged more trade secret case filings. Also, by broadening the definition of a trade secret and providing easier access for trade secret owners to federal courts, the passage of the Defend Trade Secrets Act of 2016 (DTSA) has effectively made it easier to bring misappropriation cases.

Doan: Many theft of trade secrets cases involve allegations that former employees violated restrictive covenants by taking protected information to their new place of employment. On 23 April 2024, the Federal Trade Commission (FTC) issued its final rule enacting a nationwide ban on certain employee non-compete agreements, which will become effective on 4 September 2024. The ban on non-competes shifts the focus even further toward trade secret protection when employees migrate. As a result, we are likely to see an even greater increase in trade secret misappropriation claims involving departing employees.

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>
> *Mickey Ferri, Analysis Group, Inc.*

CD: In what ways has the Defend Trade Secrets Act (DTSA) bolstered the remedies

available to those seeking to enforce their trade secret rights?

Cummings: The DTSA ensures the availability of a uniform set of remedies available to plaintiffs in trade secret matters – namely, recovery for actual loss suffered by plaintiffs and unjust enrichment gained by the defendant that is not captured by the calculation of actual loss. In lieu of damages measured by other means, it also entitles plaintiffs to a reasonable royalty for the misappropriation. Notably, however, the DTSA does not displace any remedies available to plaintiffs under state law for the misappropriation of trade secrets. In that way, the statute may expand the ability of plaintiffs to seek monetary damages for trade secret misappropriation. Furthermore, as more claims are brought under the DTSA in addition to, or in lieu of, claims under state-specific statutes, this may lead to more uniform treatment across jurisdictions – in particular, for trade secret claims brought in federal court, an option made available with the introduction of the DTSA.

Browning: The DTSA allows for damages where the trade secret misappropriation has occurred outside the US. That is unlike several state laws and unlike in a patent damages case, where damages are limited to sales with a 'made, used or sold' nexus to the US. Federal appeals courts are expected to weigh in on some of the requirements and limits of exterritoriality in the near future, but the appropriateness of damages may depend on whether there is 'an act of furtherance', such as domestic advertising, promotion or marketing of products embodying the allegedly stolen trade secrets.

> **"One of the challenges in assessing future profits or benefits to trade secret misappropriators is determining how those benefits are expected to accrue over time."**
>
> *Thomas McGahee, Analysis Group, Inc.*

CD: Could you outline some of the typical approaches to calculating damages for the purposes of trade secret disputes?

Doan: There are generally three monetary remedies, depending on the circumstances and jurisdiction of the case. Plaintiffs' actual losses are most commonly measured through lost profits on diverted sales due to the misappropriation, but they can also be measured in other ways, such as via price erosion, increased costs incurred and destruction of business value as a result of the misappropriation. To the extent there is no double counting with actual losses, a plaintiff can also be awarded a defendant's unjust enrichment. Unjust enrichment can be calculated in various ways, including sales that the defendant gained due to the misappropriation, avoided research and development costs, and the benefit of a head start in developing competing products faster than possible without the misappropriation. Finally, reasonable royalty damages are allowed to be recovered in certain circumstances. The calculation often relies on the factors outlined in the *University Computing* and *Georgia-Pacific* cases.

McGahee: In formulating approaches to calculating damages, it is often a good starting point to think about what competitive advantage the asserted trade secrets provided to the plaintiff and how the erosion or loss of that advantage may affect each party's economic and financial position. Among the *University Computing* factors are the "value of the secret to the plaintiff" – including "the importance of the secret to the plaintiff's business" – and "the resulting and foreseeable changes in the parties' competitive posture". While these factors, among others, were articulated for the purpose of determining a reasonable royalty, they also are useful for thinking about how actual loss or unjust enrichment may arise from a loss of competitive advantage caused by the misappropriation.

"As more claims are brought under the DTSA in addition to, or in lieu of, claims under state-specific statutes, this may lead to more uniform treatment across jurisdictions."

Della Cummings, Analysis Group, Inc.

CD: What state-specific issues complicate the process of calculating damages in relation to trade secrets?

Doan: The availability of reasonable royalty damages may vary by state. For example, reasonable royalty damages in California, Indiana, Georgia and Illinois are allowed only when the plaintiff's actual damages and the defendant's unjust enrichment are unable to be proven. Virginia allows a reasonable royalty measure only if a plaintiff "is unable to prove a greater amount of damages by other methods of measurement". Additionally, New York does not allow as damages remedies the defendant's avoided development costs or any other gain by the defendant that is not used as a proxy for the plaintiff's actual loss. Ultimately, this is a legal question, so should be deferred to counsel's guidance in each specific case.

McGahee: One area in which it can be helpful for counsel to provide state-specific legal guidance is determining which party bears the burden of proof on certain damages issues. For example, in an unjust enrichment analysis, once a plaintiff has identified the defendant's sales attributable to the use of a trade secret, then, depending on the jurisdiction, the burden may shift to the defendant to establish any portion of those sales not attributable to the trade secret or any expenses to be deducted in determining the associated profits. In practice, however, the burden does not shift in every jurisdiction. In addition, there may be state-specific guidance on whether disgorgement of anticipated future unjust enrichment can be awarded, especially if an injunction is issued halting further misappropriation.

CD: Drilling down, could you explain some of the challenges around assessing future profits or benefits to trade secret misappropriators? What developments are unfolding on this front?

Cummings: Depending on the timing of litigation relative to the alleged misappropriation, defendants may not yet have fully realised any benefits of misappropriation. However, because the nature of trade secrets can make future use difficult to monitor or prevent absent other, non-monetary remedies, such as injunction, compensation for future benefits that a misappropriator may enjoy can be an important consideration in analysing damages. Absent injunctive relief, if future benefits are expected to be significant but may not yet be realised in measures of actual loss or unjust enrichment as of the time of the litigation, it may bear on the type of compensation that could be appropriate. For example, if evidence indicates that such benefits were reasonably expected or anticipated as of the time of the misappropriation, compensation in the form of a reasonable royalty that the parties would have agreed to at the time of

misappropriation may be one method by which to account for such benefits.

McGahee: One of the challenges in assessing future profits or benefits to trade secret misappropriators is determining how those benefits are expected to accrue over time. For example, did the misappropriation allow the defendant to enter a market or sell to a customer that otherwise would have been foreclosed indefinitely, or did it simply confer a head start and accelerate market entry? If the former, over what period of time can a damages calculation be well supported with reliable inputs for determining reasonably expected sales, profit margins and competitive dynamics? In the case of a head start, are there benefits from entering the market earlier that will continue to accrue after the head start period, and for how long? The answers to these questions will depend on the facts and circumstances of the particular case, including the nature of the asserted trade secrets, the parties involved and the particular market context. In addition, if the plaintiff expects to obtain an

injunction to prohibit the defendant's continued use of the asserted trade secrets, this can limit the time period over which it may be appropriate to calculate anticipated future damages.

CD: What is the role of expert witnesses in establishing causation and quantifying losses in trade secret disputes? Is their testimony often crucial to the outcome of cases?

Ferri: There are three elements to any damages analysis: liability, causation and quantification. In order to have a robust damages analysis in a trade secret dispute, it is critical to define precisely what the trade secrets at issue are, the time at which the misappropriation began and the mechanism – that is, the causal link – by which the misappropriation had an impact on the plaintiff's business, the defendant's business or both. Typically, counsel will define the trade secrets and identify the timing of misappropriation, and the damages expert will typically not evaluate liability, as liability is assumed in the damages analysis. Identifying the causal link can be done by the damages witness, often with input from technical experts, industry experts and fact witnesses, any of whom can help identify the specific benefits provided by the trade secrets. Often, however, counsel presents the causation evidence and opinions from these latter witnesses only. Damages experts may also be able to identify whether and to what extent the trade secrets had any independent economic value. However, that is often an issue to which counsel pays limited pre-trial attention and which is often argued in generalities. In assessing both causation and quantification, if the expert, for example, is attempting to show that the trade secret misappropriation led to higher profits for the defendant, the expert usually needs to evaluate and account for other market factors that may have contributed to the higher profits, aside from the misappropriation, such as changes in competition or the introduction of new technology. In this instance, the expert could describe the causal

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link between the trade secret misappropriation and the higher profits, consider and account for other factors that could have contributed to the higher profits and consider alternative lawful actions the infringer could have taken. Potential ways to demonstrate the causal link and isolate the value of trade secrets versus other factors include comparing actual performance to but-for projected performance without the trade secrets, before-and-after analysis, difference-in-difference analysis and regression analysis.

Cummings: As with patent damages, establishing causation is essential to supporting trade secret damages claims. However, depending on the type of information at issue and the alleged use, misappropriation alone may not be sufficient to establish that the trade secrets had independent economic value, that the trade secret owner has suffered an economic loss or that the misappropriator has gained an economic benefit. Unlike with patents, the value of the trade secret knowledge may not be directly observable. Damages experts, often in concert with other expert or fact witnesses, can be critical to connecting, or disputing the connection between, the alleged wrongdoing and any economic harm or benefit. For example, use of the trade secret knowledge could come in the form of 'negative' know-how, such as avoiding unnecessary costs like research and development or avoiding 'wrong turns' that may result in a misappropriator being able to realise profits sooner than they otherwise would have absent the misappropriation. Such benefits, if they exist, may not be directly observable from an end product. That is, while still critical, causation can look different for trade secret cases than for other forms of IP, such as patents, and damages experts can play a critical role in identifying or disputing the causal nexus between the alleged misappropriation and any claimed economic benefit or harm.

"As we have seen with patent cases over the past 20 years, appeals court decisions will have a big role in shaping damages approaches."

John M. Browning, Analysis Group, Inc.

CD: What are some considerations for experts when there are allegations of trade secret misappropriation in

combination with patent infringement or other types of IP misappropriation?

Ferri: When there are allegations of trade secret misappropriation in combination with patent infringement or other types of IP misappropriation, it can be especially important to ascribe certain components of value to the trade secrets and the rest to other value contributors, including other IP. Experts should consider whether the benefits ascribed to the trade secrets and the other value contributors overlap or whether they are separable and distinct. Experts may consider presenting multiple analyses of damages, based on the different potential liability and causation outcomes. By identifying and isolating the impact of the trade secrets relative to other assets, experts can be confident they are attributing the appropriate value to the trade secrets. There are a variety of ways that an expert can apportion. These include methodologies such as business documents that may discuss sales drivers, performing event studies and other types of analyses of historical data, conducting consumer surveys to generate data and analysing terms in existing licences. The best approaches will depend on the availability of data and the circumstances of the case.

Browning: Complications can arise when there are allegations of patent infringement in the same matter or even in different matters. Whether working with plaintiffs or defendants, experts should first and foremost be aware of the scope of these claims and the extent to which they overlap in terms of accused products and time periods. Clients are sometimes laser-focused on the case at hand and do not have issues like apportionment top of mind. Experts should coordinate with counsel on this issue and address the extent to which the asserted trade secrets are responsible for the success of a product as opposed to non-asserted trade secrets or other IP. Important in that assessment is to understand the technical scope of the at-issue trade secrets versus the technical scope of other value contributors. For that, damages witnesses often need to rely on input from others who are more technically versed than they are.

CD: Looking ahead, what trends do you expect to shape trade secret disputes? How are approaches to calculating damages likely to evolve?

Browning: As we have seen with patent cases over the past 20 years, appeals court decisions will have a big role in shaping damages approaches. Among other things, I expect appeals courts will soon address causation and clarify the limits of claiming damages related to foreign activity. I also hope that courts provide more clarity on who

bears the burden on allocation – that is, who bears the burden to prove the value contributors and appropriately deductible expenses. Regardless, I would expect the number of trade secret cases to continue to increase and damages claims to do the same. That largely comes down to trends in the economy. For example, trade secrets likely are a more suitable method to protect potentially lucrative artificial intelligence technology than patents. Also, with the FTC's recent ban on non-compete contracts, I would expect firms to lean on trade secrets, among other tools, to keep valuable technology in-house.

Ferri: I expect both the volume and the stakes of trade secret disputes to continue to rise for the foreseeable future. Many of these disputes result from partnerships between two organisations that did not work out as planned, or employees leaving companies to join other companies or start their own. Employee churn has increased in recent years, as employees are switching companies at faster and faster rates, and more employees switching companies more frequently could lead to more scenarios that result in trade secret disputes. CD