

'Independent Economic Value' Crucial In Trade Secret Cases

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Trade secret cases frequently arise from instances of employee turnover. Disgruntled former employees are among the likeliest misappropriators of a firm's protected business practices and nonpatented technology.

And yet, despite a sustained period of nearly record-low unemployment, trade secret filings and damages awards have grown substantially in recent years.

According to a 2018 Lex Machina analysis, for example, the rate of trade secret litigation filings, which had been fairly stable from 2009 through 2016, increased by over 20% in the subsequent years. The explanations for this trend are varied and complex, touching on evolving case law, a patent litigation environment rich in invalidity challenges, and broader economic changes.

The COVID-19 pandemic has reshaped many parts of American life, and the job market has not been spared. Despite apparently steadying equity markets, the U.S. unemployment rate has hit its highest level since the Great Depression.

When the nation enters a period of recovery, whether it takes the rapid V-shape forecast by optimists or the slower U-shape that may yet emerge, companies will begin to rehire many of the workers displaced by this shock. This high turnover in the job market combined with preexisting filing trends may provide the perfect recipe for historic levels of trade secret litigation.

Before filing these suits, plaintiffs and their counsel would do well to assess the independent economic value of their alleged trade secrets. The establishment of such value is instrumental to proving that something constitutes a protectable trade secret in the first place and that damages should be awarded for such misappropriation. In such an environment, gaining an understanding of the meaning of independent economic value and the interplay between its relevance to the liability and damages sides of litigation will be essential.

If you don't, you could see your case end before it even begins, as some courts require a sufficient pleading of independent economic value to survive a motion to dismiss.[1]



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What is independent economic value?

Various jurisdictions have attempted to define "independent economic value" in case law or via jury instructions. Although not identically worded, the definitions embody the concept that the trade secret holder is provided an actual or potential business or competitive advantage over others who do not know the secret and could benefit from it if known to them. Effectively, the secrecy of the trade secret provides independent value to its holder. For example, the California Civil Jury Instructions defines independent economic value as follows:[2]

[Information] has independent economic value if it gives the owner an actual or potential business advantage over others who do not know the [information] and who could obtain economic value from its disclosure or use.

The state of Washington has a similar definition: "Information has 'independent economic value' if it gives the owner of the information a competitive advantage over others who do not know the information." The most simple examples of trade secrets providing independent economic value are the recipes for Coca Cola or Kentucky Fried Chicken. These secrets are valuable because competitors of these companies cannot offer identical products to compete in the marketplace. These examples are easy, but some trade secrets are not as easy to value or even to define. How do courts handle determining independent economic value when the case is not straightforward?

So, how do you determine whether independent economic value exists?

There is no universal answer to this question and determining whether an alleged trade secret has independent economic value is a fact-intensive inquiry. In fact, most jurisdictions provide a nonexhaustive list of factors that courts can use to determine if independent economic value exists. For example, California courts look to the following factors:

- (a) The extent to which [name of plaintiff] obtained or could obtain economic value from the [e.g., information] in keeping [it/them] secret;
- (b) The extent to which others could obtain economic value from the [e.g., information] if [it were/they were] not secret;
- (c) The amount of time, money, or labor that [name of plaintiff] expended in developing the [e.g., information];
- (d) The amount of time, money, or labor that [would be/was] saved by a competitor who used the [e.g., information].

Washington has a similar list, but adds further factors such as (1) the extent of measures that the plaintiff took to guard the secrecy of the information; (2) the ease or difficulty of acquiring or duplicating the information by proper means; and (3) the degree to which third parties have placed the information in the public domain or rendered the information readily ascertainable.[3]

When determining independent economic value, courts make clear that not all or any of the listed factors must apply and each determination is case specific. Regardless of what factors are considered in any given case there must be enough evidence to show that the information being claimed as a trade secret provides more than a "trivial" advantage by being held secret.[4] For example, "the fact finder is entitled to expect evidence from which it can form some solid sense of how useful the information is,

e.g., how much time, money, or labor it would save." [5] If a plaintiff cannot articulate sufficient evidence showing value, then its claim will almost certainly fail.

Is independent economic value the same as damages?

The short answer is "no." The distinction between economic value and economic damages can be subtle and has important implications for trade secret litigation.

Depending upon the application, an intangible asset's value could be understood in several ways, including but not limited to its fair market value (i.e., the price at which it would be transacted by a hypothetical buyer and seller), its investment value (e.g., its ability to drive future cash flows for a specific user), or the avoided costs associated with recreating an economically equivalent alternative.

What these measures of value have in common is that they attempt to describe the worth of the trade secret in its totality. From an economic perspective, any or all of these considerations may be germane to the establishment of a trade secret's independent economic value for purposes of establishing its validity and misappropriation.

The concept of economic damages differs crucially. An award of damages measures value, but not necessarily the value of the whole asset. While standard valuation methods can demonstrate that a trade secret has independent economic value, a calculation of economic damages must prove and quantify something more specific — namely, that the misappropriation has unfairly transferred some portion of that economic value either away from the plaintiff, toward the defendant, or both. Trade secret damages take, broadly, one of three forms, each of which measures a piece of the asset's value in its own context.

Trade secret damages most commonly take the form of a defendant's profits associated with the misappropriation. The relevant context for this value relates to the defendant's use of the trade secret, the defendant's level of profit, and the time period of misappropriation. It is typically the burden of the plaintiff to identify the revenues associated with the use of the misappropriated trade secrets. It is then typically the defendant's burden to demonstrate the portion of those revenues that it would have earned but for the misappropriation of the trade secret.

Once it is demonstrated that a defendant has generated excess revenue, the focus turns to the additional costs incurred by defendant and any portion of those sales attributable to factors other than the trade secret. The excess profits owing to the misappropriation, often referred to as incremental profits, capture the proper delta tied to the causal nexus needed to support a damages calculation. Importantly, this excess value is only that which has been enjoyed by the alleged misappropriator, which could be limited relative to the full economic value of a trade secret.

Second, trade secret damages can take the form of lost profits if a plaintiff can demonstrate that it has suffered a measurable loss owing to the misappropriation. Lost profits provide a measure of the actual value transferred away from the plaintiff by the misappropriation and can be the preferred form of damages when a defendant's misappropriation hinders the plaintiff's business without leading to profitability for the defendant itself. Lost profits can result from lost sales, reduced prices (or inability to increase prices), increase in cost, or lost brand equity, among other measures of lost value.

A proper lost profits calculation often reflects only a portion of the value of the standalone trade secret (e.g., in a case where only a small portion of the profits attributable to products practicing the trade

secret was lost). In such cases, the underlying drivers of the trade secret's independent economic value are relevant to the analysis, but the lost profits calculation is almost always different from a more general calculation of the trade secret's value.

Third, trade secret damages can take the form of a reasonable royalty. This form of recovery is typically only awarded when neither the defendant's profits nor the plaintiff's lost profits can be demonstrated because plaintiffs are permitted to elect the form of damages that maximizes recovery, which a reasonable royalty rarely does.

The economic value that matters in a reasonable royalty analysis typically follows the same underlying logic as the prior two forms of damages but the bar for establishing the "fact of" reasonable royalty damages is often thought to be lower. The foundations of reasonable royalty case law are conceptually similar for trade secrets as for patents, though not as well-settled.

A rational trade secret plaintiff would not be likely to license its trade secret for less than the value that they believe they are transferring away by giving up the secret and a rational trade secret defendant would be loath to pay more than the value they felt that they were receiving. Here, again, these values are highly contextual — in cases where the trade secret has far more value to defendant than plaintiff, there may be a wide range of values that willing parties could agree upon. In other cases, though, and not uncommonly, a reasoned economic analysis may reveal the trade secret to have been considerably more valuable to the plaintiff than the defendant, yielding no bargaining range that the parties would have likely agreed to ex post.

One way to resolve this is to attempt to understand whether the parties would have had different perceptions of value at the time of first misappropriation. While a defendant's ultimate failure to build a successful business around a misappropriated trade secret may reduce its profits available for disgorgement, its ex ante desire to use the secret likely implies a previous expectation of some level of success. Such an expectation would have made the defendant willing to pay a royalty to the plaintiff at a hypothetical negotiation.

When litigating a trade secret, understanding the secret's independent economic value is critical to many aspects of the case. Establishing the trade secret's existence, avoiding the case's dismissal, and proving damages may all require the ability to identify and articulate independent economic value. Each of these steps, however, requires a nuanced analysis of this value with an eye toward case circumstances and relevant case law that shows which elements of value to focus on and how to apply them.

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[1] *Plastronics Socket Partners Ltd. v. Highrel Inc.*, 2019 U.S. Dist. LEXIS 78569 at *10-11 (D. Ariz., May 9, 2019) (trade secret claim dismissed for doing nothing more than reciting statutory elements of independent economic value).

[2] Judicial Council of California Civil Jury Instructions (2017 edition) - CACI No. 4412. "Independent Economic Value."