Because the law encourages flexibility in determining damages for trade secret misappropriation, there are many potential remedies available to the trade secret owner for misappropriation of trade secrets. This article briefly mentions some of the available remedies but focuses on issues that arise when plaintiff elects to calculate damages based upon a reasonable royalty.

**Injunctive Relief**

When plaintiff seeks injunctive relief, how long should the injunction last?

The majority of jurisdictions that view trade secrets as a property right tend to hold that the right is only valuable as long as it remains secret and protect it for the period it remains a secret or for the period of time it would have taken the defendant to develop the same secret independently. The rationale for this is that trade secret law protects only against unfair competition; it is not intended to stifle legitimate competition. Therefore, the injunction should only remove the head start advantage the misappropriator might otherwise enjoy because it was not saddled with the same development time and expense as the trade secret owner.

The minority view focuses on the idea that trade secrets generally are misappropriated through some breach of a confidential relationship or breach of trust. Typically the defendant learns of the trade secret either through the former employees of the plaintiff or because plaintiff disclosed the trade secret to the defendant in confidence. Because the breach of trust cannot be remedied in any period of time, the injunction against future use or disclosure of the trade secret may be perpetual.

**Lost Profits**

When both the plaintiff and the defendant already have developed and sold the product and thus have an historical baseline, lost profits may be recoverable. However, if neither the plaintiff nor the defendant have any sales history on which to base a lost profits calculation, most courts would find lost profits too speculative to recover.

**Unjust Enrichment**

There are several ways courts have measured unjust enrichment damages. Where the defendant successfully has sold the product containing the trade secret, some courts have disgorged all of the defendant’s profits. The burden then was on the defendant to demonstrate which portion of those profits were not attributable to use of the trade secret in order to reduce the amount of damages. Other
courts have awarded as damages the amount of money saved by the defendant in using another’s trade secret. A few decisions combine this cost savings with plaintiff’s lost profits to craft a damages award.

**Reasonable Royalty**

When neither lost profits nor unjust enrichment or some combination of the two remedies are appropriate, courts have borrowed from patent law a modified version of the “reasonable royalty” measure of damages.

In calculating a reasonable royalty, the fact finder is asked to determine what amount of money a willing buyer and willing seller would determine was appropriate payment for the trade secret at the time and place of the misappropriation. This analysis is done through the guise of a “hypothetical negotiation,” where the expert and the fact finder consider at least 15 factors taken from a patent infringement case known as *Georgia Pacific v. Corp. v. United States Plywood Corp.* These factors consider such things as similar license agreements, anticipated profits, the overall contribution the trade secret makes to the product, the nature of the market, the parties’ competitive positions, and the cost of development of the same or a similar trade secret.

A “hypothetical negotiation” is by definition speculative. An expert is opining on what two unwilling parties would have agreed to be a fair price if they were willing to negotiate a deal. While each of the *Georgia Pacific* factors may not be relevant to every case, courts have held that the expert must at least consider every factor and make a decision to include or exclude each individual factor from the analysis. The key to success is to use as many provable facts as possible to reduce the amount of speculation involved in the negotiation.

Other issues arise when the reasonable royalty is used. For example, when parties actually negotiate a royalty agreement, many options are available in terms of payment structure (e.g., lump sum or over time), method of calculating the royalty, what exclusions should be permitted to be taken from profit for overhead, fixed costs, etc. The variations are limited only by the imaginations and inclinations of the negotiators. Likewise, in calculating reasonable royalty damages, there are few hard and fast rules.

One of the more popular methods of calculating a reasonable royalty is to determine a royalty rate (generally a share of the projected profit margin) and multiply it by a royalty base that generally is based on sales. For past infringement, a damage award is calculated by determining an appropriate royalty rate and multiplying it by actual sales of the infringing product. For future infractions, both the Uniform Trade Secrets Act and the Restatement (Third) of Unfair Competition contemplate some form of injunction either requiring defendant to pay a continuing royalty on sales or precluding future sales.

**Calculation Of The Royalty Rate**

In general, the rate is some percentage of the profit the defendant earns or expects to earn on sales. Courts have accepted many ways of calculating a royalty rate, including the “fair market value approach,” a discounted cash flow analysis, an “analytical approach,” the cost of development
approach and “rules of thumb.” Some courts have not employed any specific formula, instead selecting a fair price based upon analysis of the Georgia Pacific factors and expert testimony alone.

Whether the expert should consider events that occurred after the date of misappropriation has not been resolved. For example, if a trade secret is used in the development of a product in 1990 when the market for the product is booming and therefore projected profits on the product are substantial, should an expert who is testifying in 1995 concerning damages resulting from the misappropriation be entitled to consider the fact that in 1991 the bottom dropped out of the market in reducing the royalty rate? Case law on the issue goes both ways. One school of thought is that subsequent events must be considered in order to decrease the amount of speculation involved in a reasonable royalty approach. Another approach is that subsequent events may not be considered, since the analysis is supposed to take place as of the date and time the trade secrets were misappropriated.

Calculation Of The Royalty Base

When the product containing the trade secret is being marketed, the defendant’s sales may supply the royalty base, and a damage award based upon past sales may be calculated. For prospective damages, the court may enjoin future use or impose a royalty injunction on future sales that requires the defendant periodically to account to the plaintiff for sales and pay the court-ordered royalty rate on those sales. The royalty injunction is not well received by plaintiffs who prefer a lump sum payment or by courts that are then charged with monitoring compliance with the injunction.

To avoid the potential difficulties of a royalty injunction, if industry practice or the practice of the parties support it, experts may claim that in the hypothetical negotiation, the parties would have agreed to a lump sum payment rather than a continuing royalty. The issue of how the royalty base should be determined then arises. The plaintiff may look to industry’s or the defendant’s projected sales of the product to supply the royalty base, arguing that before the misappropriation and thus near the time of the hypothetical negotiation, these projections represented the defendant’s expectations and are a reasonable basis upon which to negotiate. While there is some appeal to that argument, use of projected sales may suffer from the same speculation problem as a lost profits calculation. While a few courts have considered whether projections may supply the royalty base and have found the projections to be too speculative to use in a damages model when actual sales data is available, there are no reported decisions concerning use of projections in the absence of actual sales.

Conclusion

Clearly, too much speculation will destroy the damages case. While there is no standard or “acceptable” methodology for calculating a reasonable royalty, reasonable royalty calculations still must meet the test of reasonable certainty required for recovery of damages. Certain guidelines for calculation of the royalty do emerge from the existing case law.

- The reasonable royalty analysis is not employed if either a lost profits or unjust enrichment theory could be established with reasonable certainty.
• If a rate x base analysis is employed, the defendant’s projected profits may supply the basis for determining the royalty rate.

• The expert must consider all of the Georgia Pacific factors in analyzing the appropriate royalty rate even if he or she determines that a particular factor is not relevant.

• Because the expert must opine on a hypothetical negotiation, credibility is paramount and is enhanced if he or she has licensing experience with the relevant product or at least in the relevant industry.

• While a certain amount of speculation is inherent in any hypothetical analysis, the expert must solidly ground his analysis in facts.

• The expert may not ignore actual sales data in identifying a royalty base in favor of more optimistic projections.

• If no actual sales data exists and the expert attempts to use projected profits as a royalty base in order to calculate a lump sum payment, the expert should consider events occurring after the time of the hypothetical negotiation but before verdict in order to ground the projections in market reality and thereby reduce the amount of speculation inherent in projections of future sales.

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