Trade Secret Law Evolution

Episode 51

Greenberg Traurig

Introduction (00:00):

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(00:18):

Welcome to the Trade Secret Law Evolution Podcast, where we give you comprehensive summaries and takeaways on the latest developments and trends in trade secret law. We want you to stay current and ahead of the curve when it comes to protecting your company's most valuable assets. I'm your host,

Jordan Grotzinger.

(00:39):

Welcome everybody to the show. I have with me today my colleague, Layal Bishara, out of our LA office. Hi Layal.

Layal Bishara (00:48):

Hi, Jordan. Thanks for having me.

Jordan Grotzinger (00:51):

I'm very happy about this. We've been talking about it for a while and I think it'll be fun. Why don't you say a few words about yourself and your practice?

Layal Bishara (00:59):

Sure. So, like Jordan said, I am in our Los Angeles office. I am in our litigation department. I do general litigation, but I mostly focus my practice on IP, intellectual property issues, mostly copyright and trademark infringement. And I also do a good deal of trust and estate work. So, two different things. It's both very interesting.

Jordan Grotzinger (01:25):

Excellent. All right, let's dive right in because we've got a lot to discuss here, even though we're just discussing one case, which is a case out of the Sixth Circuit from earlier this month. And the subjects we're going to be addressing are the identification of combination trade secrets, sometimes called compilation trade secrets, which we've addressed in the past.

(01:49):

The tension between trade secret protection and anti-competitive policy, which is a subject we haven't addressed, but essentially pervades every trade secret case, or most of them. Sufficient proof of misappropriation of a combination trade secret. And finally, the flexibility or leeway the trade secret

plaintiff has in proving damages. So, in this case, the plaintiff manufactured an ingredient in a nutritional supplement, one of which was made from broccoli seed extract.

(02:30):

The defendant was a customer of the plaintiffs, but wanted to break into that business. So, it is alleged to have lured away the plaintiff's director of research in order to learn the plaintiff's manufacturing process from him. So, the plaintiff sued in federal court for violation of the Kentucky Uniform Trade Secrets Act, and usually when I say sued in federal court, we'll be discussing the Federal Defend Trade Secrets Act, but this case was a diversity case. For the non-lawyers out there, that basically means that the case involved citizens of different states, which can enable the filing in federal court.

Layal Bishara (03:15):

So, the plaintiff's broccoli extract supplement was designed to harness a particular substance, which we will call the substance moving forward, which in turn creates a compound in the digestive tract that the plaintiff claimed has certain health benefits. The defendant also produced a broccoli extract supplement, but initially it had to purchase the substance in bulk from the plaintiff. Now, the defendant wanted to develop a supplement that harnessed the substance just like the plaintiff's product, instead of buying the substance itself from the plaintiff. It's alleged that instead of doing its own research and development, the defendant hired the plaintiff's director of research, who we will call the director, who worked for the plaintiff for nine years and knew about how the plaintiff's supplement harnessed the substance.

Jordan Grotzinger (04:07):

Although the director had a signed NDA, nondisclosure agreement, with the plaintiff, shortly after the defendant solicited him, he's alleged to have started sending confidential data to the defendant, and I'm saying alleged. This is what the court recited. "The director acted as a consultant for the defendant, which allowed the defendant to essentially completely skip the R&D, research and development process, and learned the method for harnessing the substance that the plaintiff had employed." So, just four months after hiring the director, the defendant was able to bring its new supplement to market, which included the substance and made $7.5 million from it between 2012 and 2019.

Layal Bishara (05:01):

So, when the plaintiff learned about this, it sued for misappropriation of trade secrets in 2014. So, the trade secrets at issue, the ones that we will discuss today are three. One, the one labeled number one, research and development on supplements, broccoli and chemical compounds. Labeled number two, the general manufacturing process detailed in plaintiff's provisional patent application. And skipping to number six, a hard drive and research notebook. Now keep those numbers in mind, one, two, six, as that's how we will be referring to them today.

Jordan Grotzinger (05:38):

Right. And please listeners, remember those definitions as we recite each number. That is a joke of course, bad law joke, but you'll be able to follow it as we go along. So, the case went to trial and the jury found in relevant part that the plaintiff had a protectable trade secret regarding trade secrets one and six, which were the R&D on supplements, broccoli and chemical compounds, and the hard drive and research notebook.

(06:09):

The jury also found that the defendant misappropriated, not just had trade secret but misappropriated trade secret number one, which again was the R&D on supplements broccoli and chemical compounds, and that the plaintiff was entitled to $2,023,000 in actual losses and $404,605 in unjust enrichment as to trade secret one, but was not entitled to damages on the other trade secrets. And finally, the jury found that the defendant willfully and maliciously misappropriated trade secrets number one and others, which, as we'll discuss, is relevant to liability for exemplary damages and attorney's fees.

Layal Bishara (07:01):

So, of course, the defendant appealed to the Sixth Circuit Court of appeal, and on appeal, the defendant argued that, "The plaintiff failed to define trade secret one adequately. The plaintiff failed to show that the defendant acquired trade secret one, plaintiff did not introduce sufficient evidence attributing its damages to the misappropriation of trade secret one. The award of $2,023,000 in compensatory damages lacked a legal and factual basis. The award of $404,605 in unjust enrichment damages lacked a legal and factual basis. And lastly, the district court improperly assessed exemplary damages and attorney's fees." Now, the defendant also argued that should the compensatory damages be vacated, the awards of exemplary damages and attorney's fees damages should be vacated as well.

Jordan Grotzinger (07:59):

That's a lot of issues on appeal, and we go through the material ones. First, the Sixth Circuit found that the plaintiff had adequately identified trade secret number one, which is research and development on supplements, broccoli and chemical compound. The Kentucky Uniform Trade Secrets Act defines a trade secret as, "Information including a formula, pattern, compilation, program, data, device, method, technique, or process that, A, derives independent economic value or potential from not being generally known to and not being readily ascertainable by proper means by other persons who can obtain economic value from its disclosure or use. And, B, is the subject of efforts that are reasonable under the circumstances to maintain its secrecy."

(08:53):

That's the definition, as many of you know, that is used in the Uniform Trade Secrets Act, which is adopted in 48 states. And as I like to say in plain English, what that means is a trade secret can basically be anything as long it as it is secret, valuable to the owner and to its competitors because of its secrecy, that's what independent economic value means. And is subject to reasonable, not perfect, but reasonable efforts by the owner to maintain its secrecy. Now, the court also referenced the restatement third of unfair competition, as it's called. And for the non-lawyers listening, restatements are collections of legal principles on various subjects like contracts and other subjects to which courts and lawyers sometimes refer.

(09:56):

And this restatement said that a trade secret is, "Any information that can be used in the operation of a business or other enterprise, and that is sufficiently valuable and secret to afford an actual or potential economic advantage over others." I thought that's a nice practical common sense definition of a trade secret.

Layal Bishara (10:21):

Now, the Sixth Circuit also recognized that trade secret one here, which again is the research and development on the supplement's broccoli and chemical compound, it was a combination trade secret. Now, the jury found protection not for one specific piece of information, but rather for its entire process of research and development. So, although a plaintiff may not show that in any individual item in a

combination trade secret is unique, it must establish that the combination of known elements or components is unique. Now, the court also noted that because all of a combination trade secrets elements might individually be publicly known, the uniqueness of the combination is critical to establishing trade secret protection.

(11:10):

So, the focus there is on the combination rather than the individual elements. Also, a plaintiff must, "Define the information for which protection is sought with sufficient definiteness to permit a court to apply the criteria for protection described in the section and to determine the fact of an appropriation. And reasonable particularity is defined as something particular enough as to separate the trade secret from matters of general knowledge in the trade or special knowledge of person skilled in the trade."

Jordan Grotzinger (11:44):

So, that's the old definition of trade secret identification, which is the most common issue in these cases, and therefore the most common issue in this podcast. The Sixth Circuit found that the plaintiff had sufficiently identified trade secret number one, because the plaintiff, "Repeatedly demonstrated that it had assembled a unique combination of processes and information that aided its research and development processes at a level of depth beyond merely listing technical concepts."

(12:24):

Now, that's great conceptually, but the court gave specific examples of why it made that finding and they included that, for example, one witness who had worked with the director at the plaintiff company testified that the director, "Seemed, in my experience, to understand the whole process. It was a compilation of discoveries they had made before, and he was working with previous discoveries by the plaintiff to work on new projects." Another example, the director, "Assembled that very large collection of information in the course of his work for the plaintiff," probably, "Curated that compilation of information, and read those articles in the course of his work for plaintiff."

(13:17):

Two more examples the Sixth Circuit gave as to why the identification was sufficient. The plaintiff, "Extensively tested the microbial contents of both its products and its competitors," which a witness agreed gave the plaintiff a competitive advantage and provided the plaintiff with important information related to product quality. And finally, plaintiff had a collection of documents that showed, "The process from the seed all the way to the making of," its broccoli supplement. And this data would've saved industry employers time and money had, "They had that document in their possession."

Layal Bishara (14:01):

Now, the defendant also argues that the verdict that the jury gave discourages competition as a matter of policy. So, this is something that comes up in a lot of intellectual property cases where the person being accused of infringement or misappropriation will argue that, "Well, if you're protecting these certain rights, then you're going to discourage competition across the industry." So, the court responded by saying there is a longstanding tension between employment law and the trade secrets doctrine. And to avoid an anti-competitive effect, a party seeking to protect trade secrets must describe the subject matter of the trade secret with sufficient particularity to separate it from matters of general knowledge in the trade, or of special knowledge of those persons who are skilled in the trade.

Jordan Grotzinger (14:53):

So, this is interesting because for the first time in this podcast anyway, we're talking about a case that uses the rules of trade secret identification essentially as a hurdle that the plaintiff must cross to avoid anti-competitive conduct. In other words, if the material that was being sued over is not really proprietary, not really a trade secret, then that policy argument starts to make sense, because why shouldn't somebody be able to quit and go somewhere else and innovate, right? It's a free country. That's what trade secret protection's all about.

(15:41):

And that trade secret identification rule is really a barrier between lawful competition and unlawful misappropriation. So, the Kentucky Supreme Court, the Sixth Circuit noted, has held that, "All of an employee's knowledge, skill, and information, except trade secrets, become a part of his or her equipment for the transaction of any business in which he or she may engage, just the same as any part of the skill, knowledge, information, or education that was received by him or her before entering upon the employment."

(16:22):

But here, the Sixth Circuit said if the plaintiff's case, "Rested on the fact that the director joined the defendant, simply joined the defendant, then this argument might be convincing." The director, however, "Did more than simply move companies." He sent confidential documents to the defendant, according to the jury, allowed the defendant to skip otherwise necessary R&D, created an outline duplicating the plaintiff's research strategy, and according to the jury, actively tried not to get caught. That, to the Sixth Circuit, was enough for trade secret liability. And so the court rejected the defendant's policy argument.

Layal Bishara (17:10):

Yeah, and I thought that that was really interesting because the court kind of provides an outline of what is okay and what's not okay. And so someone can move companies, even someone high up can move companies possessing all this important knowledge and can bring that important knowledge and those skills to another company and it would be okay, ostensibly. It's where they are giving away the secret information that the problem comes up. So, I think that to me was an interesting point. So, as to misappropriation, the defendant also argues that a combination trade secrets plaintiff must show use of the entire combination. But the Sixth Circuit said trade secrets law does not demand a mirror image between the misappropriated secrets and the eventual product derived from them.

(18:05):

And, "We see no reason not to apply this general principle to combination trade secrets. When the law grants protection over many interconnected pieces of information, an even higher threat exists of a misappropriating party changing one element of the combination to evade liability, holding otherwise would produce bizarre outcomes. A trade secret thief could misappropriate a research process, design a competing product in far less time than it would have otherwise taken, and avoid liability because it did not debut the same product as its victim competitor." So in my opinion, I think this makes a lot of sense from a policy perspective. I think it's an example of the court trying to make the law make sense, right? If you're doing one thing for one aspect of trade secret law, you have to apply the same for another aspect.

Jordan Grotzinger (18:54):

Yeah, and the law does its best to make common sense, and that is a common sense rule. Because, as the court noted, if you had to prove misappropriation of an entire combination trade secret, then

hypothetically somebody who misappropriated 95% of it, but the plaintiff couldn't prove that other 5% wouldn't be liable. That is rather nonsensical. And as you noted, Layal, the law abhors nonsense. I don't think I've read that, but I think it's a true legal cannon.

Layal Bishara (19:39):

It sounded very official.

Jordan Grotzinger (19:42):

The court also found that the trial court properly calculated damages. The jury awarded, as we mentioned, $2,023,000 in actual losses and $404,605 in unjust enrichment. The Sixth Circuit said, "The jury did not calculate these numbers randomly. Instead, for actual losses, the jury calculated plaintiff's research and development costs spanning the approximately eight years and four months for which the director worked for the plaintiff. The unjust enrichment amount represents the defendant's profits relating to the four relevant products from May 2011 through the end of 2017."

Layal Bishara (20:28):

And so the defendant argues that the damages award was calculated improperly based on the damages expert's consideration of all six asserted trade secrets. Remember going back to the beginning, there were six, but here we're only discussing a couple. Even though the plaintiff recovered damages on only trade secret one, the defendant also argued that the $2,023,000 in compensatory damages award cannot stand because the trade secret was not published or destroyed, and that the unjust enrichment award is insufficiently tied to the damages that the plaintiff proved at trial.

Jordan Grotzinger (21:06):

So, the Sixth Circuit again affirmed and recognized here the trade secret plaintiff's relative flexibility when it comes to damages in these cases. This flexibility, the court said, means, "That the plaintiff is required to prove the amount of such loss with only as much certainty as is reasonable under the circumstances." Also the court said, "Damages in trade secret cases are difficult to calculate. When the misappropriated trade secret is used to field competing products, the best measure of damages is the plaintiff's lost profits, or the defendant's illicit gains." And here, "The record provides evidence that would permit a jury to infer that the 2002 through 2011 research and development costs reflected the damages that trade secret number one's misappropriation inflicted on the plaintiff. For example, the plaintiff testified that the director's research and development efforts concerned the substance and that the goal of this research was 'To develop a commercially successful' powder with the substance like the plaintiff's product. And the plaintiff's damages expert confirmed that the company's research and development expenses related to broccoli seeds."

Layal Bishara (22:32):

As to the unjust enrichment award, the court explained that unjust enrichment is just another measure of relief in addition to the plaintiff's actual loss. So, the plaintiff can also recover the measure of the value of the secret to the defendant. So, along with the plaintiff's loss, it can recover the value to the defendant. And, "This is usually the accepted approach where the secret has not been destroyed and where the plaintiff is unable to provide specific injury." In those cases, the court said, "The appropriate measure of damages is not what the plaintiff lost, but rather the benefits, profits or advantages gained by the defendant in the use of the trade secret." So, as here, such an award can be based on the, "Value derived from savings because of increased productivity, or the value derived from savings in research

costs." So basically, as long as the unjust enrichment award is not duplicative of the award for actual loss suffered by the plaintiff, then it's permissible as well.

Jordan Grotzinger (23:41):

And finally, the court affirmed the exemplary damages award for what the jury found to be willful misappropriation. Exemplary damages and attorney's fees in trade secret cases are proper where the misappropriation was willful. Here the jury was instructed that willful and malicious misappropriation is, "Behavior motivated by spite or ill will and a disregard for the rights of another with knowledge of probable injury." Here the Sixth Circuit looked to the defendant's conduct to affirm that it rose above simply knowing that it was taking a trade secret.

(24:29):

So, for example, while the director was working for the plaintiff, the defendant requested a contact email for him outside of his employee account and immediately wrote to it asking for his collection of broccoli related research. The other findings were that the defendant, after learning that the director had an NDA, "Offered to pay him to deliver on the plaintiff's new formula for the defendant." And finally, the defendant is found to have accepted the director's advice to, "Lay on some BS," when discussing broccoli products with the plaintiff. So, an interesting and pretty comprehensive discussion by the Sixth Circuit on a lot of important principles in these cases. And now for the takeaways. Layal, why don't you start?

Layal Bishara (25:25):

Sure. So, the first takeaway was that in order to identify a combination trade secret, a plaintiff need not show that any individual item in a combination trade secret is unique, but must establish that the combination of the known elements or components is unique. So, again, rather than focusing on the individual elements, it focuses on the combination. Also, a trade secret plaintiff must define the information for which protection is sought with sufficient definiteness to permit a court to apply the criteria for protection described in the section and to determine the fact of an appropriation.

Jordan Grotzinger (26:06):

Takeaway number two is that to do so, in other words, to identify a combination trade secret and show the uniqueness in the combination, it helps to demonstrate the value of the combination trade secret and not just a list of technical concepts. For example, in our case, the plaintiff demonstrated that a unique combination of processes aided its research and development processes with evidence like documents that showed the process from the seed all the way to the making of its broccoli supplement, which would've saved companies in the business, "Time and money in R&D."

Layal Bishara (26:49):

Third takeaway. So, in the Sixth Circuit, plaintiff need not show a defendant's use of the entire combination to prove misappropriation of a combination trade secret. According to the Sixth Circuit, "Trade secrets law does not demand a mirror image between the misappropriated secrets and the eventual product derived from them." And there is no reason not to apply this general principle to combination trade secrets, because when the law grants protection over many interconnected pieces of information, an even higher threat exists of a misappropriating party changing just one element of the combination to evade liability. So, it's like the example that Jordan gave earlier, the 95% versus 100%. It wouldn't be fair to the trade secret plaintiff if they couldn't prove that 5% and allowed the

misappropriating defendant to get off easy with the 95%. So, that's the common sense that the court was trying to implement.

Jordan Grotzinger (27:51):

Fourth takeaway is that as to trade secret damages, when the misappropriated trade secret is used to create competing products, the best measure of damages is the plaintiff's lost profits or the defendant's illicit gains, that is unjust enrichment. Exact damages need not be proven, only to a level of certainty that is reasonable under the circumstances.

Layal Bishara (28:17):

And where the secret has not been destroyed and where the plaintiff is unable to provide specific injury, unjust enrichment is the best measure of recovery. So, in those cases, the court said, "The appropriate measure of damages is not what the plaintiff lost, but rather the benefits, profits or advantages gained by the defendant in the use of the trade secret." So, like in the Sixth Circuit case, such an award can be based on, "The value derived from savings because of increased productivity, or the value derived from savings and research costs."

Jordan Grotzinger (28:54):

And finally, willfulness for purposes of exemplary damages and attorney's fees in these cases means conduct rising above simply knowing that the defendant was taking a trade secret, like the conduct we saw in this case, which included the secret emails of confidential information, the "Laying down BS," and other conduct that was found to have been secretive. Interesting case for sure. And now for the fun part. Layal, have you given this some thought?

Layal Bishara (29:31):

I have.

Jordan Grotzinger (29:31):

You have?

Layal Bishara (29:34):

[inaudible 00:29:34] more interesting. But no, I have an interesting fact for you.

Jordan Grotzinger (29:38):

Let's hear it.

Layal Bishara (29:39):

Okay. My interesting fact is that I lived in about 10 countries before the age of 13, which is when I moved to the US. So, living in a bunch of countries helped me adapt, talk to different people, have a lot of stories. So, that's my interesting fact.

Jordan Grotzinger (30:00):

That's a good one. All of the interesting facts, and I'd love to talk more about each location, but maybe on another episode, I don't know that if I were a guest host like you, I don't know that I could compete with some of these stories. I mean I really don't think I could. We've had some really good ones. So, like

you as a young world traveler, we've got the Sheriff's deputy in New Jersey, the stock exchange person, the art docent, and of course, Brian Duffy breaking his arm in an arm wrestling contest against a document production vendor.

(30:49):

So, these are things that I don't know if I were in the other seat here, I'm not sure I could be that interesting. But luckily not my problem. So, Layal, thanks so much for coming on. I've been looking forward to this. I hope we do it again, and I hope we can work on one of these cases together.

Layal Bishara (31:05):

Thanks, Jordan, for having me. It was a lot of fun.

Jordan Grotzinger (31:07):

Lots of fun. Okay, bye everybody.

Layal Bishara (31:10):

Bye.

Jordan Grotzinger (31:12):

Okay, that's a wrap. Thanks for joining us on this episode of the Trade Secret Law Evolution Podcast. As the law evolves, so will this podcast, so we value your feedback. Let us know how we can be more helpful to you. Send us your questions and comments. You can reach me by email at grotzingerj@gtlaw.com or on LinkedIn. And if you like what you hear, please spread the word and feel free to review us. Also, please subscribe. We're on Apple Podcast, Stitcher, Spotify, and other platforms. Thanks everybody. Until next time.

Speaker 4 (31:44):

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Speaker 5 (32:05):

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