Trade Secret Misappropriation Damages, and The Underused "Head Start" Doctrine Defense

H. Thomas Watson and Karen M. Bray

There seems to be a surge in trade secret litigation in California, with plaintiffs seeking extensive monetary and injunctive relief. However, under the "head start" doctrine, the recovery on plaintiffs' claims should be limited to the relief needed to eliminate any "head start" in competition that the defendants gained by misappropriating trade secrets. That is, the relief available should not allow the plaintiff to recover based on the assumption that all competition by the defendant is wrongful, but should instead reflect no more than the profits lost by the plaintiff (or the unjust enrichment gained by the defendant) during the time it would have taken the defendant to discover or develop the trade secret independently, by proper means.

Unfortunately, neither the language of the relevant statutes nor the standard jury instructions on trade secret misappropriation claims clearly reflect the "head start" limitation on the scope of available relief. Accordingly, counsel defending against trade secret misappropriation claims should understand and assert the "head start" doctrine as a limitation on any court-imposed injunctive relief, and propose jury instructions tailored to account for this limitation on the scope of any damages award.

Asserting the "head start" defense to limit the relief available for misappropriation of trade secrets is important because California's statutory cause of action "preempts common law claims that are 'based on the same nucleus of facts as the trade secret misappropriation claim for relief,'" including "breach of confidence, interference with contract, and unfair competition" (*K.C. Multimedia, Inc. v. Bank of America Technology & Operations, Inc.* (2009) 171 Cal.App.4th 939, 954, 957-960), and it also preempts other general statutory causes of action, such as a claim under Business and Professions Code section 17200, based on the misappropriation of a trade secret (*Digital Envoy, Inc. v. Google, Inc.* (N.D.Cal. 2005) 370 F.Supp.2d 1025, 1034-1035 [applying California law]). (See Chin et al., Cal. Practice Guide: Employment Litigation (The Rutter Group 2012) ¶¶ 14:81.5 to 14:81.7, p. 14-10.) Accordingly, if certain claimed damages or injunctive relief is unavailable under California's statutory cause of action for misappropriation of trade secrets, that relief cannot be obtained simply by asserting a different legal theory.

The statutory backdrop.

In 1979, the Commissioners on Uniform State Laws approved the Uniform Trade Secrets Act (UTSA). (14 West's U. Laws Ann. (1998) U. Trade Secrets Act with 1985 Amendments.) In 1984, California enacted its version of the UTSA (CUTSA), which is codified at Civil Code sections 3426 et seq. (See 13 Witkin, Summary of Cal. Law (10th ed. 2005) Equity, §§ 86-90, pp. 382-389 [summarizing the history of provisions of the CUTSA].) The CUTSA closely tracks the UTSA.

	UTSA	CUTSA
DEFINITION OF TRADE SECRET	UTSA, § 1, subd. (4)	Civ. Code, § 3426.1, subd. (d)
INJUCTOVE RELIEF	UTSA, § 2	Civ. Code, § 3426.2
DAMAGES	UTSA, § 3	Civ. Code, § 3426.3

The CUTSA allows plaintiffs to recover several types of damages, none of which are expressly limited by the "head start" doctrine. First, the CUTSA allows plaintiffs to "recover damages for the actual loss caused by misappropriation" and "for the unjust enrichment caused by misappropriation that is not taken into account in computing damages for actual loss." (Civ. Code, § 3426.3, subd. (a).) Where "neither damages nor unjust enrichment caused by misappropriation are provable, the court may order payment of a reasonable royalty for no longer than the period of time the use could have been prohibited." (Civ. Code, § 3426.3, subd. (b).) Finally, where "willful and malicious misappropriation exists, the court may award exemplary damages in an amount not exceeding twice any award made" under the above provisions. (*Ibid.*) At the time the

continued on page 18

CUTSA was enacted, the UTSA similarly allowed plaintiffs to recover for actual losses, unjust enrichment, and exemplary damages, and in 1985 the UTSA was amended to allow for recovery of a reasonable royalty where actual loss or unjust enrichment could not be established. (14 U.L.A. (1985) U. Trade Secrets Act, § 3, pp. 455-456.)

The CUTSA does not expressly mention the "head start" doctrine as a limitation on the scope of available relief for the misappropriation of trade secrets, and there is scant legislative history on California's enactment of the CUTSA. The standard jury instructions governing relief available for the misappropriation of trade secrets (CACI Nos. 3903N, 4409 & 4410) are likewise silent regarding the head start doctrine. However, because the CUTSA was closely modeled on the UTSA, history regarding the enactment of the UTSA provides guidance regarding the meaning of the CUTSA. (See *Hoechst Celanese Corp. v. Franchise Tax Bd*. (2001) 25 Cal.4th 508, 519 ["Where the Legislature adopts a uniform act, the history surrounding the creation and adoption of that [uniform] act is also relevant"].) And the history of the UTSA clearly reflects a "head start" limitation on the scope of relief available in actions based on the misappropriation of trade secrets.

The UTSA incorporates the head start limitation on relief.

That the "head start" doctrine limits the relief available for the misappropriation of a trade secret is demonstrated in the official comment on the addition of the UTSA to the Uniform Laws. With respect to *injunctive relief*, the official comment states that "this act adopts the position of the trend of authority limiting the duration of injunctive relief to the extent of the temporal advantage over good faith competitors gained by a misappropriator. See, e.g., *K-2 Ski Co. v. Head Ski Co., Inc*. [(9th Cir. 1974) 506 F.2d 471 (*K-2 Ski Co.*)] (maximum appropriate duration of both temporary and permanent injunctive relief is period of time it would have taken defendant to discover trade secrets lawfully through either independent development or reverse engineering of plaintiff's products)." (14 U.L.A. (1985) U. Trade Secrets Act, § 2 cmt., p. 450; see *K-2 Ski Co.* at p. 474 ["We are satisfied that the appropriate duration for the injunction should be the period of time it would have taken Head, either by reverse engineering or by independent development, to develop its ski legitimately without use of the K-2 trade secrets"]; accord, *Lamb-Weston, Inc. v. McCain Foods, Ltd*. (9th Cir. 1991) 941 F.2d 970, 974 ["An injunction in a trade secret case seeks to protect the secrecy of misappropriated information and to eliminate any unfair head start the defendant may have gained"]; *Winston Research Corp. v. Minnesota Mining & Mfg. Co.* (9th Cir. 1965) 350 F.2d 134, 142 [injunction properly limited to the "approximate period it would require a legitimate ... competitor to develop [the trade secret] after public disclosure of the secret information"]; see also Torts: *Review of 1984 Selected California Legislation* (1984) 16 Pacific L.J. 725, 733, fn. 19 ["The modern trend is to issue a limited injunction for the approximate period a competitor would require to legitimately produce a copy after public disclosure of the secret"].)

With respect to *monetary relief*, the official comment states that, "[l]ike injunctive relief, a monetary recovery for trade secret misappropriation is appropriate only for the period in which information is entitled to protection as a trade secret, plus the additional time, if any, in which a misappropriator retains an advantage over good faith competitors because of misappropriation. Actual damages to a complainant and unjust benefit to a misappropriator are caused by misappropriation during this time alone." (14 U.L.A. (Master Ed.) com. to § 3, p. 456 [citing *Conmar Products Corp. v. Universal Slide Fastener Co*. (2d Cir. 1949) 172 F.2d 150; *Carboline Co. v. Jarboe* (Mo. 1970 454 S.W.2d 540].)

In addition to the UTSA official comment, the transcript of the commissioner's discussions at the National Conference of Commissioners on Uniform State Laws reveal the commissioners' intent to adopt a head start limitation on the available remedies. For example, the commissioners identified the limited nature of trade secret protection. During the initial conference in 1972, a commissioner explained that "[t]he tentative proposal of the Special Committee is to limit the remedies available against such a misappropriator to those which will deprive him of the benefit of the time and expense saved by his misappropriation." (1972 RT 22.) "[W]here you have a misappropriation, so someone has a short cut over his competitors in terms of being able to practice the trade secret ... [¶] [w]hat is often done in this situation is a so-called lead time injunction ... so the injunction would be for the ... period [ ] to take away this lead time." (1972 RT 23.) "[T]he defense exists from that time that a trade secret becomes readily ascertainable by proper means, by persons other than a prior misappropriator." (1972 RT 24.) "[T]he kind of remedy that is given in this kind of case is an injunction against lead time in the development of a product from a trade secret, say, because of misappropriation." (1972 RT 38.)

Similarly, during the next conference in 1978, commissioners explained that the UTSA seeks "to eliminate whatever commercial advantage had been acquired through the misappropriation, which involves the concept of the lead-time injunction" but that "no permanent injunction may issue." (1978 RT 7-8.) Instead, "[t]he injunction should be limited to the period of reverse engineering." (1978 RT 37.) In other words, the period of time required for reverse engineering "would be the duration of the relief, the head-start period you gain through misappropriation." (1978 RT 40-41.)

Then, during the final conference in 1979, a commissioner said the UTSA proposed official comment was "intended to indicate that the damages caused by misappropriation, which is a limitation on both damages and profits, is tied to the section" limiting the duration of the injunctive remedy. (1979 RT 66.) Another commissioner questioned whether, for "purposes of arriving at an unjust enrichment recovery, would the reverse engineering period that's referred to in Section 2 be used to provide a cut-off of that recovery period?" (1979 RT 68.) The response was in the affirmative. (1979 RT 68.) The same

continued on page 19

commissioner explained that, "even though you are a misappropriator, if the trade secret later ceases to exist, the injunction should be dissolved." (1979 RT 42.) "We permit reverse engineering. Once that reverse engineering has occurred, the trade secrets would no longer exist. Even a misappropriator could obtain termination of the injunction." (1979 RT 43.)

The head start limitation is also expressed in the Restatement of the Law, which explains that "injunctive relief should ordinarily continue only until the defendant could have acquired the information by proper means." (Rest.3d Unfair Competition, § 44, com. f.) "Monetary remedies, whether measured by the loss to the plaintiff or the gain to the defendant, are appropriate only for the period of time that the information would have remained unavailable to the defendant in the absence of the appropriation." (*Id.* § 45, com. h.)

Thus, both the legislative history leading to the enactment of the UTSA by the National Conference of Commissioners on Uniform State Law and the Restatement of the Law firmly support the imposition of a head start limitation on the scope of relief available in trade secret misappropriation actions.

Moreover, such a head start limitation is consistent with the UTSA goal of *encouraging* widespread use of new innovations. When enacting the UTSA, the National Commissioners explained that the UTSA was not designed to protect trade secrets: A "trade secret is not protected or withheld from the public. What is protected here is the trade secret from misappropriation, and that's all that's being protected. You can learn of the trade secret and use it by proper means, which is not the case in patent law. You have an absolute right during the patent period in the patent case. If you should discover independently the patented process, you can't use it. In trade secrecy, you can. All that's being protected against here is the misappropriation under this tort theory." (1979 RT 21.)

The commissioners expressed concern about the "chilling effect" of trade secret litigation and the need to encourage widespread use of new innovations that benefit the public, stating "[i]f you don't want to go under the patent or copyright law, then you do run the risk that somebody is liable to find out about this information, *and that's what we want*. We want people to know about things." (1979 RT 17, emphasis added.) "Every time we protect a trade secret we're giving a cost to the consumer." (1978 RT 12; see *American Can Co. v. Mansukhani* (7th Cir. 1984) 742 F.2d 314, 329 ["The primary purpose of trade secret law is to encourage innovation and development, and the law should not be used to suppress legitimate competition. [Citation.] Broader protection would stifle legitimate competition by prohibiting competitors from using their own independent discoveries, public information and reverse engineering"].)

The National Commissioners' conscious decision to limit the scope of relief available in trade secret litigation to avoid chilling innovation and driving up consumer costs is consistent with California public policy in favor of open competition and employee mobility. "[I]n 1872 California settled public policy in favor of open competition...." (*Edwards v. Arthur Andersen LLP* (2008) 44 Cal.4th 937, 945.) "The law protects Californians and ensures 'that every citizen shall retain the right to pursue any lawful employment and enterprise of their choice.' " (*Id.* at p. 946.) "It protects 'the important legal right of persons to engage in businesses and occupations of their choosing.' " (*Ibid.*) One aspect of California's policy in favor of nurturing open competition is the rule of law protecting employee mobility. (See *Silguero v. Creteguard, Inc.* (2010) 187 Cal.App.4th 60, 69 [" ' "[t]he interests of the employee in his own mobility and betterment are deemed paramount to the competitive business interests of the employers, where neither the employee nor his new employer has committed any illegal act accompanying the employment change" ' "].) California law fosters employees' ability to compete with their former employers using the skills and the general knowledge gained from their prior employment. (E.g., Rest.3d Unfair Competition, § 42 coms. d, f.) Applying the head start doctrine is consistent with California's strong public policy in favor of competition and employee mobility.

Finally, the head start doctrine is consistent with the basic tort principle in California that a "plaintiff is not entitled to be placed in a better position than he or she would have been in had the wrong not been done." (6 Witkin, Summary of Cal. Law, *supra*, Torts, § 1548, p. 1022; accord, *Metz v. Soares* (2006) 142 Cal.App.4th 1250, 1255.) By definition, the head start doctrine is designed to eliminate only the unfair advantage gained by a person who has misappropriated a trade secret. Once that advantage is eliminated, open competition is allowed and even encouraged. Awarding damages or injunctive relief based on the plaintiff's need to compete with the defendant after the head start period has elapsed would provide the plaintiff with an unwarranted windfall, by placing the plaintiff in a better position than the plaintiff would have enjoyed had no misappropriation taken place.

Asserting the "head start" doctrine as a defense.

If a plaintiff in trade secret misappropriation litigation seeks damages for loss of income spanning many years, or injunctive relief seeking to prohibit the alleged misappropriator from engaging in the competing business, defense counsel should assert the head start doctrine as a defense that limits the scope of the available monetary and injunctive relief.

continued on page 20

First, it probably is prudent, but not necessary, to plead the head start limitation as an *affirmative defense* in the answer. A general denial of the damages and other relief claimed by the plaintiffs (to which the plaintiff bears the burden of proof) should be adequate to preserve the issue. If counsel pleads the head start doctrine as an affirmative defense, counsel should be careful not to suggest that the burden is on the defense to *disprove* the damages or other relief the plaintiff is seeking.

Second, because California's statutory cause of action for misappropriation of trade secrets generally preempts all other causes of action based on the same nucleus of facts (see Chin et al., Cal. Practice Guide: Employment Litigation, *supra*, ¶¶ 14:81.5 to 14:81.7, p. 14-10), defense counsel should file a demurrer to any other causes of action, or seek summary adjudication of them, based on statutory preemption.

Third, counsel defending against trade secret misappropriation claims should, by motion in limine, object to any evidence or argument that suggests damages may be extrapolated into the future, without regard to the fact that, at some point, the defendant will have gained access to the claimed secrets through proper means.

Fourth, defense counsel should present evidence, through the testimony of defense witnesses and the cross-examination of plaintiffs' witnesses, establishing how long it would have taken the defendant to discover the trade secret, either by reverse engineering or other proper means. Counsel also should educate their expert witnesses on the head start doctrine to ensure that, in the event the plaintiff prevails on the issue of liability, the testimony provides an adequate basis for the jury's determination of damages, and/or the scope of the court's injunction, consistent with the head start limitation.

Finally, counsel should propose either special jury instructions or modifications to the standard CACI instructions modeled after the Restatement's limitation on damages under the head start doctrine. For example, CACI Nos. 4409 and 4410 could be modified as indicated in boldface below:

4409. Remedies for Misappropriation of Trade Secret

If [*name of plaintiff*] proves that [*name of defendant*] misappropriated [his/her/its] trade secret[s], then [*name of plaintiff*] is entitled to recover damages if the misappropriation caused [[*name of plaintiff*] to suffer an actual loss/ [or] [*name of defendant*] to be unjustly enriched].

[However, your award of damages, whether measured by the loss to the plaintiff or the gain to the defendant, are limited solely to the time that the information would have remained unavailable to the defendant in the absence of the misappropriation. Damages cannot be awarded to compensate for losses to the plaintiff or enrichment by the defendant that would have occurred after the defendant could have discovered or obtained the information by proper means.]

[If [*name of defendant*]'s misappropriation did not cause [[*name of plaintiff*] to suffer an actual loss/ [or] [*name of defendant*] to be unjustly enriched], *[name of plaintiff]* may still be entitled to a reasonable royalty for no longer than the period of time the use could have been prohibited. However, I will calculate the amount of any royalty.]

4410. Unjust Enrichment

[*Name of defendant*] was unjustly enriched if [his/her/its] misappropriation of [*name of plaintiff*]'s trade secret[s] caused [*name of defendant*] to receive a benefit that [he/she/it] otherwise would not have achieved.

To decide the amount of any unjust enrichment, first determine the value of [*name of defendant*]'s benefit that would not have been achieved except for [his/her/its] misappropriation. Then subtract from that amount [*name of defendant*]'s reasonable expenses[, including the value of the [specify categories of expenses in evidence, such as labor, materials, rents, interest on invested capital]]. [In calculating the amount of any unjust enrichment, do not take into account any amount that you included in determining any amount of damages for [*name of plaintiff*]'s actual loss.] **[Also, do not award unjust enrichment damages for any period after the defendant could have discovered or obtained the information by proper means.]**

(See Rest.3d Unfair Competition, § 45, com. h.)

Conclusion

In sum, the history of the UTSA clearly supports a "head start" limitation on the scope of relief available in trade secret misappropriation actions, both in the form of an injunction and monetary damages. But unless defense counsel assert the "head start" doctrine, that valuable defense will be waived.

H. Thomas Watson and Karen M. Bray are partners at Horvitz & Levy LLP, an appellate boutique that specializes in handling civil appeals and writ proceedings in jurisdictions across the nation, and who consult regularly with trial counsel on cutting-edge legal issues to enhance the odds of prevailing at trial and to preserve issues for eventual appellate review.