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Reasonable Royalties under the California Uniform Trade Secrets Act – What does "provable" mean under Civil Code section 3426.3(b)?

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By James D. Crosby, Attorney at Law

California's Uniform Trade Secrets Act ("CUTSA"), Civil Code sections 3426 et. seq., provides exclusive remedies for misappropriation of trade secrets in California. CUTSA preempts common law claims of trade secret misappropriation and other common law claims, such as conversion, unfair competition and unjust enrichment, based on the same nucleus of facts as the misappropriation claim.

Under CUTSA, a plaintiff may recover damages for the actual loss caused by the misappropriation, and also for the unjust enrichment caused by misappropriation that is not taken into account in computing damages for actual loss. If neither damages nor unjust enrichment caused by misappropriation are "provable", the court may order payment of a reasonable royalty. A reasonable royalty is a court directed fee imposed upon a defendant for use of a misappropriated trade secret. A reasonable royalty award attempts to measure a hypothetically agreed value of what the defendant wrongfully obtained from the plaintiff. By means of a "suppositious meeting" between the parties, the court calculates what the parties would have agreed to as a fair licensing price at the time that the misappropriation occurred. If willful and malicious misappropriation exists, a plaintiff may also recover exemplary damages in an amount not exceeding twice any award for actual damages and unjust enrichment or awarded royalty.

The "reasonable royalty" remedy is not cumulative to other measures of damage. It is an alternative remedy where other damages are not provable. Where damages are awarded, it is error to also order payment of royalties. CUTSA differs on this point from both the Uniform Trade Secrets Act and federal patent law, neither of which require actual damages and unjust enrichment to be unprovable before a reasonable royalty may be imposed.

Under section 3426.3(b), the statutory precondition for the payment of a

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reasonable royalty is that neither damages nor unjust enrichment caused by misappropriation are "provable". The recent case of Ajaxo, Inc. v. E*Trade Financial Corporation (2010) 187 Cal.App.4th 1295 serves to clarify the meaning of the term "provable" under the CUTSA damage provision. The Ajaxo case addresses whether unjust enrichment is "provable" under section 3462.3(b) where legally sufficient evidence of unjust enrichment has been presented to the jury and the jury rejects that evidence as a matter of fact. Or, more simply put, whether "not proven to the jury" is the same as not "provable" under section 3462.3(b).

Earlier cases have generally addressed the "reasonable royalty" remedy where actual losses and unjust enrichment were not provable. It is well-established in these cases that where damages and unjust enrichment cannot be established as a matter of law, the plaintiff may seek a reasonable royalty under section 3462.3(b).

But, the Ajaxo case appears to be the first California case to address the meaning of "provable" where the trier of fact finds that the defendant misappropriated trade secrets and plaintiff presents evidence of actual loss and/or unjust enrichment, but the trier finds, as a matter of fact, that there was no damage. In other words, assuming liability, if the plaintiff presents his damage or unjust enrichment case to a jury and the jury finds no damages, can the plaintiff then seek a reasonable royalty under section 3462.3(b) because actual loss and unjust enrichment were not "provable". This is not an uncommon circumstance in trade secret misappropriation cases, especially in troubled economic times. A steals a secret formula for a new drink from B. A starts a new business, attempts to utilize the secret formula to manufacture and sell the new drink, fails, makes no money, and shuts down. B sues A for misappropriation of the secret formula, but can't prove damages or unjust enrichment in part because A made no money from his misappropriation of the secret formula. As such, the Ajaxo case is important for plaintiffs in trade secret misappropriation litigation.

In the Ajaxo case, E*Trade had been found liable in an earlier trial for misappropriating trade secrets from Ajaxo relating to wireless stock trading. At the second trial, Ajaxo put on evidence of unjust enrichment to E*Trade arising from the misappropriation in the amount of $301 million. At the close of plaintiff's case, E*Trade moved for nonsuit. The trial judge denied that motion, finding there was enough evidence "to go to the jury" on unjust enrichment. E*Trade then presented evidence of considerably smaller losses and its expenses. The trial court instructed the jury that the amount of E*Trade's unjust enrichment was the value of E*Trade's benefit that would not have been achieved except for its misappropriation less the amount of E*Trade's reasonable expenses. The jury found that the value of the benefit conferred upon E*Trade by the misappropriation was $3.99 million and that E*Trade's reasonable expenses were $6.42 million, resulting in a significant net loss to E*Trade. In other words, because E*Trade had a net loss arising from the misappropriation, Ajaxo recovered no damages. The jury had considered and rejected Ajaxo's evidence of significant unjust enrichment to E*Trade from the misappropriation.

Following the verdict, Ajaxo asked the trial court to make an award of a reasonable royalty under the section 3462.3(b). E*Trade opposed the request, arguing that both actual losses and unjust enrichment were provable because there was evidence in the record to support either measure of damages. The trial court found that unjust enrichment was provable because the jury found that Ajaxo had proven unjust enrichment damages against E*Trade with no net amount in terms of actual damages, and denied the request for reasonable royalties.

On appeal, Ajaxo argued that unjust enrichment was not provable under section 3462.3(b) because the jury's verdict showed that E*Trade was not enriched, i.e., there was no award of damages. E*Trade argued that Ajaxo had presented evidence of unjust enrichment to the jury, but the jury had simply chosen not to believe it. In other words, unjust enrichment was "provable" but it had just not been proven. The question posed to the California court of appeal was whether unjust enrichment is provable under section 3426.3(b) where legally sufficient evidence of unjust enrichment is presented to the jury but rejected as a matter of fact. More simply, is "not proven" the same as "not provable"?

The court of appeal in Ajaxo reversed the trial court ruling denying the request for reasonable royalties. The court concluded that where a defendant has not realized a profit or other calculable benefit as a result of his or her misappropriation of trade secrets, unjust enrichment is not provable within the meaning of section 3426.3(b), whether the lack of benefit is determined as a matter of law or as a matter of fact. More simply put, not proven is tantamount to not provable under section 3426.3(b) so as to allow a request for reasonable royalties. The court stated that to hold otherwise would place the risk of loss on the wronged plaintiff, thereby discouraging innovation and potentially encouraging corporate thievery where anticipated profits might be minimal but other valuable but nonmeasurable benefits could accrue.

The lesson of the Ajaxo decision for plaintiffs is simple – be prepared to present a request for an order of reasonable royalties in the event the jury determines that you have not proven unjust enrichment or actual loss. If the jury determine, as a matter of fact, that the defendant has not realized a profit or other calculable benefit as a result of the misappropriation, the plaintiff should request a reasonable royalty under section 3462.3(b), and be prepared to offer evidence to support the request for a royalty to the extent such evidence has not already been admitted. A recent unpublished California court of appeal decision, San Jose Construction Co., v. Foust, 2010 WL 4305047 (2010), hints at the danger of not making a request for royalties where the jury awards no damages for misappropriation. In that CUTSA case, the jury found that defendants had misappropriated plaintiff's trade secrets but awarded no damages. On appeal, the plaintiff contended that the jury erred by failing to award damages for unjust enrichment. The court of appeal affirmed the judgment, finding that the plaintiff had simply failed to meet its burden. The decision, written by the same judge who wrote the Ajaxo decision, cited the Ajaxo decision in a footnote and noted "In this case, however, plaintiff did not ask the trial court to award reasonable royalties". While there may very well have been valid reasons why the plaintiff in that case did not seek royalties after its damage case was rejected by the jury, the appellate court seemed to indicate that such a request would have been properly and, possibly, favorably considered by the trial court if it had been made.

On the defense side, needless to say, the defendant must be prepared to meet a request for royalties in the event the jury finds misappropriation but no damages. A defense verdict on damages and unjust enrichment is likely not the end for the defendant in a CUTSA misappropriation action. Rather, under Ajaxo, it is likely just the beginning of a second phase of the trial directed towards determining whether a royalty is proper and what that royalty should be. From the defendant's perspective, an in limine motion for bifurcation of a request for royalties under Section 3462.3(b) from the case upon actual loss and unjust enrichment might be warranted. Evidence bearing upon issuance of a royalty order and the amount of the royalty may be inadmissible on issues of actual loss and unjust enrichment and the defense may want to keep such evidence, if harmful, away from a jury considering only actual loss and unjust enrichment.

About James D. Crosby, Attorney at Law

James D. Crosby is a civil trial attorney with 27 years experience. Mr. Crosby represents entities and individuals in general and complex business, commercial, intellectual property, unfair competition, securities, business tort and real property litigation in state and federal courts. Mr. Crosby is admitted to practice in all state and federal courts of the state of California, and has represented clients not only in California but also in state and federal courts in New York, Nevada, New Jersey, North Carolina and South Dakota. He has tried numerous jury and non-jury cases, and has represented clients in JAMS and AAA business arbitrations, as well as NAFTA arbitration under UNCITRAL Rules. Mr. Crosby is AV Preeminent peer review rated by Martindale-Hubbell for ethical standards and legal ability - the highest possible rating indicating that his peers rank Mr. Crosby at the highest level of professional excellence.

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