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California Court of Appeal Clarifies Standard for Reasonable Royalty Determination Under California's Uniform Trade Secrets Act

05 May 2020

In its recently published decision in *Ajaxo v. E*Trade Financial Corp.*,[1] a California Court of Appeal adopted for the first time a patent royalty framework to assess a reasonable royalty under the California Uniform Trade Secrets Act ("CUTSA"). In so doing, the *Ajaxo* court simultaneously solidified the shape of the CUTSA reasonable royalty analysis while injecting significant uncertainty as to that analysis's outcome. Among other things, the court:

- Reaffirmed the discretionary nature of an award of a reasonable royalty as a remedy under CUTSA;
- Adopted patent law's *Georgia-Pacific Corp. v. United States Plywood Corporation*[2] analysis for the calculation of a reasonable royalty; and
- Affirmed the trial court's ruling declining to grant a royalty award — notwithstanding previous appellate rulings affirming liability, and that the factual threshold for a royalty award had been satisfied — and its ruling that the plaintiff had failed to prove any rate of reasonable royalty.

CUTSA provides that "[i]f neither damages nor unjust enrichment caused by trade secret misappropriation are provable, then the court *may* order payment of a reasonable royalty for no longer than the period of time the use could have been prohibited."[3] Given that CUTSA allows recovery of a reasonable royalty only in limited circumstances, there has been an unsurprising dearth of published cases on how one should be calculated. *Ajaxo*'s 90-page opinion attempts to fill that void but leaves many unanswered questions.

Ajaxo's 20-year procedural history includes two jury trials and two reversals on appeal. Liability was previously determined in plaintiff Ajaxo's favor. A prior appellate decision

in the case held that trial courts have discretion to award a reasonable royalty when the plaintiff could not prove any loss and the defendant made no actual profits.

This appeal follows a bench trial on remand from that decision. The trial court ruled that Ajaxo failed to show it was entitled to a reasonable royalty and, even if it had, Ajaxo failed to prove the amount of any reasonable royalty. The trial court's holding was based, in part, on the fact that Ajaxo's principal had destroyed the only copy of the source code underlying its claim, and Ajaxo thus failed to sufficiently define its trade secret and failed to apportion its value.

The Court of Appeal first clarified the framework for assessing a reasonable royalty under CUTSA. It recognized a general trend of "patterning trade secret damages after patent damages." Keeping with this trend, to calculate a reasonable royalty under CUTSA, the court considered the 15 factors enumerated in *Georgia-Pacific* — a patent infringement case — which aims to estimate a royalty rate the parties would have agreed to as a fair price at the time the misappropriation occurred. The court emphasized the need for flexibility in calculating reasonable royalties. *Ajaxo* further held that the patent concept of apportionment applies to reasonable royalties under CUTSA.

Applying this framework, the Court of Appeal affirmed the trial court's refusal to award a reasonable royalty as well as its independent determination that the plaintiff failed to prove the amount of any reasonable royalty to which it was entitled. The court emphasized the discretionary nature of the remedy. Even if actual losses and unjust enrichment are not provable, a court retains discretion to decline to award a reasonable royalty. And here, significant evidentiary problems created both by Ajaxo's spoliation of evidence and its failure to disclose certain expert opinions timely bolstered the trial court's decision.

In some ways, the *Ajaxo* decision is unremarkable: Several federal trial courts that have addressed reasonable royalties under CUTSA have drawn the patent analogy and applied the *Georgia-Pacific* factors.[4] That a published appellate opinion of a California appellate court, applying California law, adopts the common approach, should provide some certainty for CUTSA litigants.

But *Ajaxo*'s flexible framework also injects significant uncertainty as to the likely result. The *Georgia-Pacific* factors are especially malleable when transplanted from the patent to trade secrets context. Unlike a patented invention, which requires regulatory approval and must fall within certain categories of useful items, a trade secret can be virtually anything that derives value from its secrecy. The end goal of a *Georgia-Pacific*

analysis — estimating a bargained-for royalty — is more uncertain given that the nature of trade secrets makes them much less likely to be the subject of a robust license market. And as applied to a trade secret, many of the *Georgia-Pacific* factors are indeterminate, including, for example, such considerations as "(a) the trade secret owner's … policy … to maintain his trade secret monopoly by granting licenses under special conditions designed to preserve that monopoly; (b) the duration of the trade secret's value and the term of the license; and (c) the utility and advantages of the trade secret over the old modes or devices, if any, that had been used for working out similar results."[5]

Ajaxo's emphasis on the discretionary nature of royalty awards may also give rise to uncertainty regarding whether a court will award a royalty in the first place. After all, *Ajaxo* affirmed the trial court's refusal to award any reasonable royalty even after 20 years of litigation and a strongly supported jury verdict of liability. That said, *Ajaxo*'s ultimate ruling appeared to rest heavily on the seeming overreach of the plaintiff, which appeared to seek a windfall grossly disproportionate to the economic realities shown by the evidence, and the shenanigans of the plaintiff's founder and primary "expert" witness, who appeared to have personally caused spoliation of the most critical evidence. In that light, the court's ultimate affirmance of the trial court's rulings is not particularly surprising.

In sum, *Ajaxo* clarifies the CUTSA reasonable royalty framework and confirms that a reasonable royalty may be awarded, but does little to make the calculation of reasonable royalties predictable for litigants.

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1. --- Cal. Rptr. 3d ----, No. H042999, 2020 WL 1952664, at *1 (Cal. Ct. App. Apr. 23, 2020).↩

2. 318 F.Supp. 1116, 1120 (S.D.N.Y. 1970).↩

3. Cal. Civ. Code § 3426.3 (emphasis added).↩

4. *See*, *e.g., 02 Micro Intern. Ltd. v. Monolithic Power Systems*, 399 F.Supp.2d 1064, 1078 (N.D. Cal. 2005); *Atl. Inertial Sys. Inc. v. Condor Pac. Indus. of California, Inc.*, No. 2:08-CV-02947-CAS, 2015 WL 3825318, at *15 (C.D. Cal. June 18, 2015). ↩

5. *Ajaxo*, 2020 WL 1952664, at *17 n.10 (quotations, alterations and ellipses omitted).↩

Authors

Diana Torres

Partner / Los Angeles – Century City / Palo Alto

Michael J. Shipley

Partner / Los Angeles – Downtown

Lauren Schweitzer

Associate / Los Angeles – Downtown

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