

DISTRICT OF COLUMBIA BAR

## **Secrets of the Uniform Trade Secrets Act**

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Milton Babirak, Esquire  
Babirak, Albert, Vangellow & Carr, P.C.  
1828 L Street, N.W., Suite 1000  
Washington, D.C. 20036  
202.467.0920  
mbabirak@bavcpc.com  
www.bavcpc.com

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# Secrets of The Uniform Trade Secrets Act

Milton Babirak  
Babirak, Albert, Vangellow & Carr, P.C.  
Washington, D.C.

## I. Introduction

- A. The Uniform Trade Secrets Act, codified at 14 U.L.A. 439 (1990) (“Uniform Act”), (copy attached as Exhibit 1) was originally proposed in the U.S. in 1979 and has now been enacted in most states, with many, but generally minor, modifications on a state by state basis. This seminar will cover the Uniform Act. For information on trade secret law specific to Virginia and Maryland, see Milton E. Babirak, “*The Virginia Uniform Trade Secrets Act; A Critical Summary of the Act and Case Law,*”<sup>1</sup> and Milton E. Babirak, “*The Maryland Uniform Trade Secrets Act; A Critical Summary of the Act and Case Law,*”<sup>2</sup> (Copy attached as Exhibit 2).
- B. The DC Uniform Trade Secrets Act may be found at: D.C. Official Code, 2001 Ed. § 36-401 *et seq.* (Copy attached as Exhibit 3.) The Virginia Uniform Trade Secrets Act may be found at: Code of Virginia, § 59.1-336 to 343. (Copy attached as Exhibit 4.) The Maryland Uniform Trade Secrets Act may be found at: MD Code Ann., Comm. Law II, § 11-12201 to 1209 (2000). (Copy attached as Exhibit 5.) Differences exist between the three state acts and you should consult the specific provisions of the applicable state act.
- C. Significantly, several states have authorized criminal penalties for the theft of a trade secret.<sup>3</sup> These statutes are beyond the scope of this Outline. This Outline will not cover the Economic Espionage Act.<sup>4</sup>
- D. There are contractual ways to protect trade secrets with varying degrees of success.

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<sup>1</sup> 5 Va. J.L., & Tech. 15 (Fall, 2000), available at [www.vjolt.org](http://www.vjolt.org).

<sup>2</sup> 32 no2 University of Baltimore Law Review 181, Spring 2002.

<sup>3</sup> Nevada added a section to its trade secret act imposing criminal penalties for theft of a trade secret. Nevada Code, Section 600 A.035. South Carolina did the same. Code of South Carolina, Section 39-8-90.

<sup>4</sup> P.L. 104-294. See J. Derek Mason, Gerald J. Mossinghoff, David A. Oblon, “The Economic Espionage Act: Federal Protection for Corporate Trade Secrets,” 16 No. 3 Computer Law. 14 (March, 1999).

1. Confidentiality agreements (non-disclosure of proprietary information agreements);
  2. Non-competition agreements; and
  3. Non-solicitation agreements.
  4. Problems with the above contractual methods of trade secret protection:
    - a. May not be enforceable or difficult to enforce in some jurisdictions e.g., California and other western states.
    - b. Frequently, such contractual provisions are non-existent.
    - c. Frequently, such contractual provisions are problematic: (1) the confidentiality agreement is too broad or vague; (2) the non-compete has an unreasonable time or geographic restriction.
  5. In trade secret litigation, it is unusual that the complaint only allege a misappropriation of a trade secret. Frequently, the alleged facts can support a number of causes of action:<sup>5</sup>
    - a. Duty of loyalty;
    - b. Unfair competition;
    - c. Lanham Act;
    - d. Fraud;
    - e. Waste of corporate assets;
    - f. Breach of director's duty;
    - g. Breach of fiduciary duty;
    - h. Business conspiracy;
    - i. Tortious interference;
    - j. Trade or service mark infringement;
    - k. Violation of copyright; or
    - l. Patent infringement.
- E. Common example of a misappropriation involving use or disclosure of a trade secret: an employee who properly obtains a trade secret during the course of his employment, leaves his employment and subsequently uses the trade secret for his own benefit. The departing employee may use the trade secret to start his/her own competing business, use it at his/her new job at a competing business or simply sell it to a competing business.
- F. While the Uniform Act may be relatively new, trade secret law is not new. Epigraphical and literary sources clearly establish that trade secrets have existed for many years. There is some evidence that trade secrets were protected under

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<sup>5</sup> See this Outline, Effects on Other Laws; and *Stone Castle v. FBR & Co.*, 191 F.Supp.2d 652; 2002 U.S. Dist. LEXUS 3764.

ancient Greek and Roman law.<sup>6</sup> An early English case was the 1851 case of *Morison v. Moat*<sup>7</sup> where plaintiff sought and was granted an injunction to restrain the defendant from using a secret for compounding the medicine, “Morison’s Universal Medicine,” which was not the subject of a patent, and to restrain the sale of this medicine by the defendant, who acquired knowledge of the secret in violation of a contract and in breach of “trust and confidence.” This case was not the first trade secret case of industrial England. The Vice-Chancellor, who rendered the opinion in this case, noted therein that by 1851 the Court had heard trade secret cases before: “That the Court has exercised jurisdiction in cases of this nature does not, I think, admit of any question.”<sup>8</sup>

- G. Possibly the first reported American case involving trade secrets was the 1837 case of *Vickery v. Welch*<sup>9</sup> which concerned the 1836 sale of a chocolate mill in Braintree, Massachusetts. In the sales agreement for the mill, the seller agreed to sell the mill, convey to the buyer the secret as to how to make the chocolate and deliver a written assurance that he would not give the secret to anyone else. Two or three other persons in the company had knowledge of the seller’s secret, but they had given a written oath not to divulge it. The buyer tendered the consideration. Upon advice of counsel, the seller refused to tender to the buyer the written promise not to convey his secret or art to others. The seller argued that if he so bound himself, it would be an unlawful restraint of trade. The Massachusetts court upheld the terms of the contract and ordered the seller not to disclose the secret to others. The court reached the conclusion that there was no restraint of trade in this case since it was “...of no consequence to the public whether the secret art be used by the plaintiff or defendant.”<sup>10</sup>
- H. There are several legal theories supporting the protection of trade secrets: (1) property; (2) contract; (3) fair dealing or good faith; and (4) encourage the development of technology.<sup>11</sup>

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<sup>6</sup> A. Arthur Schiller, *Trade Secrets and the Roman Law; The Actio Servi Corruptio*, 30 Colum. L.R. 837, 838 n.5 (1930).

<sup>7</sup> 68 English Reports 492, 9 HARE 241 (1851).

<sup>8</sup> *Id.*, p. 498.

<sup>9</sup> 36 Mass. 523 (1837).

<sup>10</sup> *Id.*, p. 527.

<sup>11</sup> *Trade Secrets Protection and Exploitation* by Jerry Cohen and Alan S. Gutterman, BNA Books, 1998, ISBN 1-57018-057-1; 8 no1 Geo. Mason L.R. 69-165.

## II. The Uniform Trade Secrets Act

The elements for a cause of action for trade secret misappropriation include: (1) information which is a trade secret; (2) that has been misappropriated; (3) has independent economic value; (4) is not generally known; (5) is not readily ascertainable; and (6) has been the subject of reasonable methods to maintain its secrecy.

### A. Definition of trade secret.

1. The first formal definition of a trade secret was in the First Restatement. The Commentators of the First Restatement clearly recognized that “an exact definition of a trade secret is not possible.”<sup>12</sup> The First Restatement defined a trade secret as any “formula, pattern, process, device, or compilation of information used in a business that gives the user an opportunity to obtain an advantage over nonusers.”<sup>13</sup>
2. The 1979 Uniform Trade Secrets Act defined a trade secret as any “information, including but not limited to, a formula, pattern, compilation, program, device, method, technique or process.” This definition is obviously very broad, and is very similar to the definition found in the First Restatement.
  - a. The definition not only covers high tech trade secrets – but low tech secrets as well, *i.e.*, customer lists, business leads, pricing information, financial information, marketing strategies, sales techniques and methods of conducting business. In fact, many of the reported cases throughout the country concern low tech information. An example of a low tech trade secret case is the US District Court case for the District of Columbia of *Morgan Stanley DW, Inc. v. Rothe*, 150 F.Supp.2d 67 (D.D.C. 2001) in which Judge Urbina found that “... the customer lists of a financial-services firm deserve trade secret status...” under the DC Uniform Trade Secrets Act. The Court stated that this was a case of first impression for DC but the trade secret issue in the case has already been decided many times in Virginia, Maryland and other states.
  - b. Information need not exist in a tangible format. It can be a computer file. In fact under the statutory definition, information need not be more than an idea, theory or concept.
  - c. The trade secret need not be novel – but merely secret.

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<sup>12</sup>See, Restatement of Torts, Section 757, comment b.

<sup>13</sup>Restatement of Torts, ch. Section 757 (1939).

- d. There is no limit on the length of time a trade secret can be protected – it may be protected as long as secrecy is maintained, it is not generally known and it is not readily ascertainable.
- e. With regard to trade secrets unique to a business such as a sales method or type of business relationship, the right to a trade secret need not be exclusive – two entities, which concurrently but independently develop the same trade secret, may both acquire rights to it.
- f. There is no requirement of continuous use of the trade secret in business or even any use at all (unlike the definition of trade secret in the First Restatement). This protects the trade secret of an owner who has not yet begun business, not yet had the opportunity or acquired the means to put the trade secret to use, has temporarily stopped use or has determined that the secret process or method does not work and wants to protect that negative information as a trade secret.

B. Definition of Misappropriation

1. The Uniform Act defines “misappropriation” in § 1(2), as follows:

(i) acquisition of a trade secret of another by a person who knows or has reason to know that the trade secret was acquired by improper means; or

(ii) disclosure or use of a trade secret of another without express or implied consent by a person who

(A) used improper means to acquire knowledge of the trade secret; or

(B) at the time of disclosure or use, knew or had reason to know that his knowledge of the trade secret was:

(I) derived from or through a person who had utilized improper means to acquire it;

(II) acquired under circumstances giving rise to a duty to maintain its secrecy or limit its use; or

(III) derived from or through a person who owed a duty to the person seeking relief to maintain its secrecy or limit its use; or

(C) before a material change of his [or her] position, knew or had reason to know that it was a trade secret and that knowledge of it had been acquired by accident or mistake.”

2. Significantly, misappropriation is defined as mere acquisition of a trade secret – this recognizes a reality that people who employ improper means to use or disclose a trade secret of another usually try to cover up those misdeeds, thereby making it difficult to prove their disclosure or use. Common fact pattern: Employee or former employee takes trade secret information but says he did not use it, knowing that plaintiff may have hard time proving use or disclosure since employee and his new employer are the only source of such information. But plaintiff does not have to prove use or disclosure, only acquisition. What about proving damages in such a case? The Uniform Act provides that damages may be calculated as a reasonable royalty. See this Outline, III.B.
3. “Improper means” is a critical term used in this definition of misappropriation. It is defined in § 1(1) of the Uniform Act as “theft, bribery, misrepresentation, breach or inducement of a breach of a duty to maintain secrecy, or espionage through electronic or other means.” There is no actionable misappropriation if the trade secret is not acquired by improper means.
  - a. In *Diamond v. T. Rowe Price Associates, Inc.*<sup>14</sup> the company permitted a portfolio manager and investment analyst to routinely take work home with her and work from home. The company permitted her to keep company documents at her home. She had approximately 10,000 pages of documents there. When she departed her employment, the company asked her to return the documents. For approximately one year, she did not do so. In the trade secret litigation, plaintiff claimed defendant had taken plaintiff’s trade secrets but plaintiff failed to proffer any evidence that she acquired the documents by improper means or disclosed their contents to others. The Court held that without such evidence, there was no violation of trade secret law.
  - b. In *Scheduled Airlines Traffic v. Objective*<sup>15</sup>, a provider of travel management services (SATO), contracted with Objective, to produce a software system to assist SATO in providing travel management services to its prospective customers. In the contract, Objective granted SATO “the right and license to use,

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<sup>14</sup> 852 F.Supp. 372 (D.Md. 1994)

<sup>15</sup> 180 F.3d 583 (4<sup>th</sup> Cir. 1999).

reproduce, sublicense, prepare derivative works, distribute copies, publicly perform and display such Proprietary Components for use in connection with the [software] System. SATO paid Objective in full for the software. Objective did not, however, complete the work in full. As a result of uncorrected defects in Objective's software, SATO never used the Objective programmed software, but instead constructed its own system using a different programming tool. Objective claimed that this was a misappropriation of its trade secrets by SATO. The court, however, concluded that Objective contractually granted SATO unrestricted permission to use its software system via the following provision: "Developer hereby assigns and conveys to Customer all of Developer's proprietary rights in and to the System and all "System Updates" and "System Enhancements."" In addition, Objective agreed in the contract to execute any documents required to evidence SATO's ownership of trade secrets in the System. Under the terms of the contract, therefore, there was no misappropriation by SATO – in other words, there was no acquisition by improper means.

4. It is not an "improper means" to memorize something. In the absence of an agreement to the contrary, after the termination of employment, an employee may use general information concerning the method of business of the employer and the names of the employer's customers retained in his or her memory, if not acquired in violation of any duty to the employer.<sup>16</sup> Frequently cited; take with a grain of salt.
5. *Trade secrets acquired by accident or mistake*: The Uniform Act also defines misappropriation to include a disclosure or use of a trade secret of another without expressed or implied consent by a person who, before a material change of the person's position, knew or had reason to know that it was a trade secret and that knowledge of it had been acquired by accident or mistake. *A priori*, if a person made a material change in their position before they discovered they had acquired a trade secret by accident or mistake, there is no misappropriation of a trade secret.<sup>17</sup>
  - a. Possibly, the drafters of the Uniform Act inserted this material change requirement in an attempt to balance the property interests of the trade secret owner and the interests of another who only acquired the trade secret by accident or mistake. This

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<sup>16</sup>*Peace v. Conway*, 246 Va. 278, 435 S.E.2d 133 (1993).

<sup>17</sup>There is no shame in the accidents of chance, but only in the consequence of our own misdeeds. Phaedrus, "The Cripple and the Bully," *Fables* (1st Century), tr. Thomas James.

provision may give rise to an unintended opportunity for misappropriators and can be problematic for a trade secret owner. For example, a misappropriator can falsely argue that it was not until after he used the trade secret that he found out that he had acquired a trade secret by accident or mistake. In so doing, the misappropriator may get off the hook through the use of his false argument because it may be difficult for the trade secret owner to contest the misappropriator's allegation that he did not know he had acquired a trade secret by mistake or accident until after he used or disclosed it since: (1) only the misappropriator may have information concerning the timing of his knowledge of the trade secret; and (2) the owner may have difficulty discovering independent evidence to prove the timing of the misappropriator's knowledge.

C. Requirement of independent economic value

1. The Uniform Act requires that the secret information derive "independent economic value." This has been interpreted by courts to simply mean that the trade secret information must give the owner of the secret some competitive advantage, actual or potential.<sup>18</sup> The independent economic value need not be substantial or significant but must be more than *de minimis*.
2. Usually, proving this element is not an issue. However, it was an issue in the recent Maryland case of *Padco Advisors, Inc. v. Omdahl*<sup>19</sup>. The plaintiff mutual fund company fired Defendant, a regional sales manager, who went to a competing company. Plaintiff sued Defendant for violation of the Maryland Uniform Trade Secrets Act alleging he memorized a list of registered investment advisors compiled by his former employer. He did not physically copy the list. Plaintiff obtained a TRO and preliminary injunction, lasting two years until the final court decision. The court found in the case that where the information had been memorized and over two years had past since he had been fired, it was doubtful that the Defendant would remember anything useful. The court found that the information on the list was constantly changing. There was testimony that the two year old list had substantially changed. The court held that the list was not a trade secret because plaintiff had not shown any continued value to competitors.

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<sup>18</sup>*ElectoCraft Corp. v. Controlled Motion, Inc.*, 332 N.W.2d 890, 900, 220 U.S.P.Q. 811 (Minn. 1983).

<sup>19</sup> 179 F.Supp.2d 600 (D.Md. 2002).

D. Requirement that trade secret not be generally known

1. The Uniform Act requires that the trade secret not be generally known. “Not generally known” does not mean not generally known to the public but instead means not generally known to those in the relevant industry or trade.<sup>20</sup> In trade secrets litigation, the requirement that the information not be generally known is often a vigorously contested issue and it can be a close factual issue for a judge or jury to decide. For example, consider whether a particular method of selling is or is not generally known. A company may argue that it has developed a unique program to sell a good or services and the company has spent considerable money, time and effort on that program. The company may have trained its employees to use it and maintained the secrecy of the program. On the other hand, a departing employee of that company who wants to use the same program for her new business may argue that the method is clearly generally known since you can simply read a book at your local public library on sales or marketing to find out about almost any sales method. Further, a departing employee may also contend that the sales method is generally known since other businesses use the same or similar method. This is not unlikely in a mature competitive industry.
  
2. One way to make something generally known is to post it on the Internet. It is surprising how frequently companies post critical information on their website. Courts have observed that posting works to the Internet makes them generally known. Once a trade secret is posted on the Internet, it is effectively part of the public domain and impossible to retrieve.<sup>21</sup> The case of *Religious Technology Center v. Lerma*,<sup>22</sup> is a very interesting case factually. In 1991, RTC (Church of Scientology) sued Fishman, a disgruntled former member, who then filed embarrassing Church documents in the open court file. That court refused to seal these documents until August 15, 1995. Before the documents were sealed, Lerma published them on the Internet and mailed them to *The Washington Post*. On August 14, 1995, one day before they were sealed, the *Post* also sent a reporter to the Fishman court and obtained a copy of the documents from the open court file even though the Church had been checking the file out and holding it all day, every day, so no one could see it. The file was not sealed at that time. The *Post* published an article about the Church and documents. The Church sued the *Post* for copyright infringement and trade secret misappropriation. The Court found that the

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<sup>20</sup>Uniform Trade Secrets Act, Section 1, 14 U.L.A. 439 (1990) Commissioners’ Comment.

<sup>21</sup>*Religious Technology Center v. Lerma*, 908 F.Supp. 1362 (E.D. Va. 1995); 37 U.S.P.Q.2d 1258.

<sup>22</sup>*Id.*

documents could not be trade secrets since they were in an open court file for over 28 months and therefore in the public domain. They were also published on the Internet for ten days. The court found that the person originally posting the documents to the Internet may have misappropriated them but the party downloading them from the Internet can not be liable for misappropriation.

3. You would think that another way to make something generally known is to make it public by putting it in the court record. In the case of *Hoechst Diafoil Co. v. Nan Ya Plastics Corp.*<sup>23</sup>, the U.S. Court of Appeals for the Fourth Circuit took the position, with regard to trade secrets filed in an open court file but not posted on the Internet, that information in an open court file may or may not be generally known but it is generally known if it is posted on the Internet. The court appears to be making the point that the practical availability of the information is important.<sup>24</sup>

E. Requirement that trade secrets not be readily ascertainable

1. The Uniform Act requires that a trade secret not be readily ascertainable by proper means. The Commentary to the Uniform Act lists several proper means,<sup>25</sup> including:
  - a. Discovery by independent invention;
  - b. Reverse engineering;
  - c. Discovery under a license;
  - d. Observing the product or service on public use or display; and
  - e. Review of publicly available literature.
2. There is no bright line in the sand as to when information is readily ascertainable. Sometimes the distinction between “not readily ascertainable” and “not generally known” is not great. Whether information is not readily ascertainable is a factual issue often litigated. A frequent

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<sup>23</sup>174 F.3d 411 (4th Cir. 1999).

<sup>24</sup>For thoughtful and interesting discussions of trade secrets and the Internet, see “*Trade Secrets and the Internet: A Practical Perspective*”, Victoria A. Cundiff, 14 No. 8 Computer Law 6 (August, 1997); and “*Trading Secrets in the Information Age: Can Trade Secret Law Survive the Internet?*”, Bruce T. Atkins, 1996 U. Ill. L. Rev. 1151 (1996).

<sup>25</sup>Uniform Trade Secrets Act, Section 1, 14 U.L.A. 439 (1990) Commissioners’ Comment.

defense is that the trade secret is readily ascertainable through common industry or business sources such as telephone books, trade magazines, published industry information sources, etc.

- a. A classic case. In the 1922 case of *Fulton Grand Laundry Company v. Edward Johnson*,<sup>26</sup> an employee of a laundry departed from his employer and started his own laundry business. He solicited the customers of his previous laundry route. The Court found that the identity of the laundry customers on the laundry route was not a trade secret since those identities could be readily ascertained by merely observing the driver on his laundry route.
- b. In the 1999 case of *Home Paramount Pest v. FMC Corp./Agr. Products*,<sup>27</sup> FMC, a manufacturer, purchased a customer list from York, a distributor and subsidiary of Home Paramount Pest, and gave the list to one of York's principal competitors. The plaintiff alleged this to be a misappropriation of a trade secret, and FMC argued that the information on the list was readily ascertainable. The list was a list of the top 50 customers of York with names and addresses. Apparently, the details of the prices and quantities of each product purchased by each customer were not disclosed. The Court found that the names and addresses of York's customers were obtainable through public sources such as the phone directory and trade associations. The plaintiff argued that it put substantial effort into compiling the information on the list, and that FMC actually paid for it. The Court concluded that such information could be "gathered as a matter of course as part of York's day-to-day operations."<sup>28</sup>
- c. Compare *Motor City Bagels, LLC v. American Bagel Co.*,<sup>29</sup> in which the court found that a business plan was a trade secret even though the business plan contained some facts ascertainable from the market place and some public information. In this case, two recent MBA's were investigating and negotiating the purchase of a bagel franchise and prepared an extensive business plan assessing the viability of a bagel franchise. The

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<sup>26</sup> 140 Md. 359, 117 A. 753, 23 A.L.R. 420 (1922).

<sup>27</sup> 107 F. Supp. 2d. 684 (D.Md. 2000).

<sup>28</sup> *Id.* p. 693.

<sup>29</sup> 50 F. Supp. 2d. 460 (D.Md. 1999)

franchisor with whom they were negotiating disclosed the plan to other prospective franchisees. The court held that, while the business plan at issue did contain some public information and facts ascertainable from the marketplace, it likewise included personal insights and analysis brought to bear through diligent research and by marshaling a large volume of information. An attempt to independently duplicate the plaintiff's efforts would be an onerous task.

F. Requirement of reasonable efforts to maintain secrecy

1. Possibly, this is the most frequently contested element of a cause of action for misappropriation of a trade secret. The Uniform Act provides in § 1(4)(ii) that a trade secret is protectable only if it “. . . is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.” There are no qualifications or exceptions to this requirement. However, it is also clear from this provision that complete secrecy is not required. Sensibly, trade secret protection is not lost if the trade secret is disclosed in confidence to those that need to know it, such as employees, agents, suppliers, subcontractors and others.<sup>30</sup> However, courts have also interpreted this language to require that a trade secret owner demonstrate that he pursued an active course of conduct to keep the information secret.<sup>31</sup> Doing nothing is not enough, even though doing nothing has been good enough in the past to protect the secret. It is also true that while the owner of a trade secret must demonstrate such active conduct, the trade secret owner need not take heroic measures.

a. A typical case. The Uniform Act's requirement of reasonable efforts to maintain secrecy was examined in the case of *A.F.A. Tours, Inc., v. Whitchurch*,<sup>32</sup> in which it was alleged that Mr. Whitchurch resigned from AFA Tours, a travel and tour business, and thereafter misappropriated AFA's confidential information and organized his own tour business. Mr. Whitchurch claimed the information possessed by him was not confidential. He contended that he was not under a written contract with AFA, and that AFA had never informed him the customer names were confidential, or should be returned to AFA upon his resignation.

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<sup>30</sup>*Dionne v. Southwest Foam Converting & Pkg.*, 240 Va. 297 (1990), citing *Kewanee Oil Co. v. Bicron Corp.*, 416 U.S. 470, 475 (1974).

<sup>31</sup>*Jet Spray Cooler, Inc. v. Crampton*, 282 N.E.2d 921, 925 (Mass. 1972)

<sup>32</sup>937 F.2d 82 (2<sup>nd</sup> Cir. 1991).

Rather, Mr. Whitchurch contended that AFA freely disseminated lists of the names and addresses of its customers to “countless individuals and entities.” AFA disputed these contentions, claiming that its customer list was not readily available from any public source and that the list had not been freely disseminated, sold or traded, and that Mr. Whitchurch was fully aware of the confidential nature of the information. The lower court stated that it had a “very serious question” as to whether AFA’s customer lists were trade secrets, but disposed of the case on the grounds of lack of subject matter jurisdiction. The U.S. Court of Appeals for the Second Circuit held that the dismissal on jurisdictional grounds was improper, and also noted that a summary dismissal of AFA’s trade secrets claims on the merits would also have been improper. The Court held that a genuine issue of material fact existed as to AFA’s efforts to prevent dissemination of its customer list.

2. In some cases, courts have held that not much is required to protect information as a trade secret. In *Dionne v. Southwest Foam Converting & Pkg.*,<sup>33</sup> the Virginia Supreme Court upheld the Circuit Court’s decision that the foam company had used reasonable efforts to maintain the secrecy of its trade secret, referring only to the fact that the company had required confidential information agreements from all its “employees, suppliers, customers, contractors and other plant visitors...”<sup>34</sup>
3. However, in many cases, a court will look much more closely at the facts of the case. In a Fourth Circuit case, the Court closely looked at the facts to determine if reasonable efforts were employed to maintain secrecy. In *Trandes Corporation v. Guy F. Atkinson Co.*,<sup>35</sup> the developer and owner of a software program used to design subway tunnels sued a licensee and its contractor, the Washington Metropolitan Area Transit Authority, for misappropriation of that trade secret. The defendants argued that the information was not a trade secret since the software was widely disclosed, mass marketed and its existence and its abilities were not secret. The defendants argued that the plaintiff software owner even offered a demonstration version of the software for sale for \$100. However, the Court looked closely at the facts, found that only six or seven persons inquired about the demonstration version and none were sold. In deciding the case, the Court found that the owner took measures

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<sup>33</sup>240 Va. 297 (1990).

<sup>34</sup>*Id.*, p.300.

<sup>35</sup>996 F.2d 655, certiorari denied 114 S.Ct. 443, 126 L.Ed.2d 377.

that were reasonable under the circumstances to protect the secrecy of the software. The Court found that the company licensed only two object code versions of its software and they were licensed under a confidentiality agreement, the company used a password to prevent access to the program in-house and for licensed versions and there was no other unauthorized person who had ever obtained a copy of the software.

### III. Other Provisions of the Act

#### A. Injunctive Relief

1. Because of the nature of the injury suffered from the misappropriation of a trade secret, money damages may be an inadequate form of relief and injunctive relief may be necessary. In recognition of this, § 2 of the Uniform Act provides that a court may order an injunction in the case of actual or threatened misappropriation of a trade secret. It is notable that even threatened misappropriation is the proper subject of an injunction. However, it is unclear how threatened misappropriation fits within the definition of misappropriation since, as we have seen, the definition only refers to the acquisition, use or disclosure of trade secrets and does not have any language specifically referring to the threat thereof.
2. In 1985, the following amendment was adopted to the Uniform Act, § 2(b), concerning injunctive relief in the case of exceptional circumstances: “(b) In exceptional circumstances, an injunction may condition future use upon payment of a reasonable royalty for no longer than the period of time for which use could have been prohibited. Exceptional circumstances include, but are not limited to, a material and prejudicial change of position prior to acquiring knowledge or reason to know of misappropriation that renders a prohibitive injunction inequitable.” This provision is in the Virginia and DC Uniform Trade Secret Acts but not the Maryland Act.

#### B. Damages and Exemplary Damages

1. Damages: Actual Loss, Unjust Enrichment or Reasonable Royalty
  - a. Section 3 of the Uniform Act provides that damages for the misappropriation of a trade secret can include damages for actual loss to the trade secret owner and damages for unjust enrichment of the misappropriator that is not taken into account in computing damages for actual loss. In addition, damages can be measured by a reasonable royalty in lieu of any other damages. One commentator has even argued that the Racketeer Influenced and Corruption Organizations Act (RICO) is

applicable to causes of action based on the misappropriation of trade secrets.<sup>36</sup> RICO provides for treble damages and legal fees.<sup>37</sup>

## 2. Exemplary Damages

- a. Under the Uniform Act, a court may award exemplary damages not exceeding twice the damages if there is a willful and malicious misappropriation. Some states do not have any punitive or exemplary damages provision in their state uniform trade secrets act.<sup>38</sup> Other states providing for punitive or exemplary damages in their uniform trade secrets acts have a cap on its damage provision. In *American Sales*, the court did not find the requisite willfulness and maliciousness even where the defendant's president said he wanted to "destroy" plaintiff.<sup>39</sup>
- b. Obviously, this is a particularly influential claim for plaintiffs.
- c. However, as a practical matter, many courts are very reluctant to award punitive damages.

## C. Attorneys' Fees

- a. The Uniform Act specifically provides that a court may award reasonable attorney's fees to the prevailing party if there is willful and malicious misappropriation. The Uniform Act provides that reasonable attorney's fees will be awarded if a claim of misappropriation is made in bad faith or a motion to terminate an injunction is made or requested in bad faith. A willful and malicious<sup>≡</sup> and A bad faith<sup>≡</sup> are two different standards but the use of different standards may be appropriate since the types of acts and actors are different. However, both A bad faith<sup>≡</sup> and A willful and malicious<sup>≡</sup> are interpreted by the courts to require egregious conduct of a similar degree.<sup>40</sup>

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<sup>36</sup>Thomas P. Heed, "Misappropriation of Trade Secrets: The Last Civil RICO Cause of Action That Works," 30 J. Marshall L.R. 207 (1996).

<sup>37</sup>18 U.S.C. 1964(c).

<sup>38</sup>A few of the states that do not have any punitive or exemplary damage provision in their state uniform trade secret act are Arkansas, Michigan, Mississippi and Nebraska.

<sup>39</sup>*American Sales Corp. v. Adventure Travel*, 862 F. Supp. 1476, 1481 (E.D. Va. 1994).

<sup>40</sup>For a discussion of egregiousness for punitive damages in willful and malicious cases, see *American Sales Corp. v. Adventure Travel*, 862 F. Supp. 1476 (E.D. Va. 1994). See also *American Sales Corp. v. Adventure Travel*, 867 F. Supp. 378 (E.D. Va. 1994). For a discussion of egregiousness punitive damages

#### D. Preservation of Secrecy During Trial

1. During the course of a court proceeding, Section 5 of the Uniform Act requires that a court preserve the secrecy of any alleged trade secret by reasonable means. The Uniform Act sets forth some examples:
  - a. protective orders during discovery;
  - b. in camera hearings;
  - c. sealing records;
  - d. ordering persons involved in the litigation not to disclose the information.
2. The parties and the court can also protect the secrecy of discoverable information under most court rules by stipulation and by motion for protective order. In most cases, it may be in the best interest of all of the parties in the litigation to agree to so protect this information because quite frequently in trade secret litigation the alleged trade secrets of both plaintiff and defendant are discoverable. In such cases, counsel for all of the parties may negotiate, prepare and submit to the court a joint motion for protective order with a proposed order, applicable to all parties, restricting the disclosure of such information in discovery, depositions, hearings and at trial.<sup>41</sup> A redacted copy of such a stipulation is attached as Exhibit 6. Such a protective order may have provisions allowing:
  - a. limited disclosure of specified information to counsel and parties;
  - b. limited disclosure of other specified information to counsel only or to special masters.

#### E. Statute of Limitations

1. Section 6 of the Uniform Act sets forth a statute of limitations of three years, which begins to run from the date the misappropriation is discovered or should have been discovered by the exercise of reasonable diligence. DC, Virginia and Maryland all have a three year provision. Two individual states have four and five year statute of limitations provisions in their uniform trade secrets acts.<sup>42</sup>

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in bad faith cases, see *Optic Graphics, Inc. v. Agee*, 87 Md.App. 770, cert. denied 598 A.2d 465, 324 Md. 658.

<sup>41</sup> See, 24 Hastings Comm. & Ent. L.J. 427.

<sup>42</sup> Illinois (5 years) and Maine (4 years). Uniform Trade Secrets Act, Section 6, 14 U.L.A. 439 (1990), Commissioners' Comment.

## F. Effect on Other Law

1. Section 7 of the Uniform Act states that the Act displaces conflicting existing law providing for remedies for misappropriation of trade secrets. The Uniform Act does not affect: (1) contractual remedies; (2) other civil remedies not based on misappropriation of trade secrets; or (3) criminal remedies.<sup>43</sup> The Commentary to the Uniform Act specifically states that the Uniform Act is not intended to affect the law concerning contractual provisions not to disclose trade secrets and covenants by employees not to compete against their employers.
2. The issue of whether the Virginia Uniform Trades Secrets Act preempts other related causes of action was addressed in March 2002 in *Stone Castle Financial v. Friedman, Billings, Ramsey & Co.*<sup>44</sup> Stone Castle hired defendant as an investment banker to assist it in the acquisition of a loan processing software design company. Stone Castle disclosed confidential information to defendant pursuant to a confidentiality agreement and allege the defendant passed on the information to one of plaintiff's competitors. Plaintiff alleged six specific causes of action: intentional interference with prospective business advantage; misappropriation of trade secrets; breach of fiduciary duty; fraud; breach of confidentiality agreement; and conspiracy to injure business. The court reviewed defendants' motion to dismiss in which defendants contended that these counts are preempted by the Virginia Act because all of these non-trade secret counts are all predicated on the general allegation that the defendants misappropriated the plaintiff's trade secrets. Plaintiff argued it had a right to assert alternative theories of recovery, and the other causes of action are not preempted by the Virginia Act because they have different elements. In the case, whether the information was a trade secret was contested. The court held, in the context of a motion to dismiss, that the plain meaning of the statute was unless it can be clearly discerned that the information is a trade secret, the court can not dismiss alternative theories of relief as preempted by the Act.

## III. HOT TOPICS

### A. Size

Under the Uniform Act's definition of a trade secret, the size of or the amount of information contained in the trade secret does not matter, assuming the other statutory requirements are met. The Uniform Act defines a trade secret

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<sup>43</sup> Uniform Trade Secrets Act, Section 7, 14 U.L.A. 439 (1990).

<sup>44</sup> 191 F.Supp.2d 652; 2002 U.S. Dist. LEXIS 3764.

simply as “information”<sup>45</sup> without any limitation as to the amount of the information. In many cases, the size of the trade secret is not a factor since the trade secret at issue is specific, singular and limited, such as a source code, object code,<sup>46</sup> or customer or patient list.<sup>47</sup> However, there has been recent trade secret litigation in which relatively large amounts of information are alleged to be trade secrets.

Certain courts have found that a whole franchise system can be protected as a trade secret. In *Big O tires, Inc. v. Granada Enterprises Corp., et al.*,<sup>48</sup> the Court upheld plaintiff’s claim that its whole “Big O System”, comprised of “techniques, systems, details as to the Big O system, theory and practices, supplier lists, equipment standards, special uses of equipment and equipment supplier lists” is a trade secret. In *Gold Messenger, Inc. v. McGuay*,<sup>49</sup> a franchisor developed a comprehensive system for setting up and operating an advertising circular business. This system was compiled in an apparently voluminous manual. Plaintiff sought to enforce its written covenant not to compete against defendant in Colorado which statutorily voided such agreements unless the covenant is to protect a trade secret.<sup>50</sup> The Court found the whole manual to be a trade secret. There are other cases locally<sup>51</sup> and outside the Washington, DC metropolitan area<sup>52</sup> finding large volumes of information to be protected as trade secrets.

If the Uniform Act allows employers or franchisors to protect such large volumes of information as trade secrets, the protection of such expansive information could lead to a unintended result. In the case of a departing employee, it may mean that he can not continue to work in the same industry, severely limiting his job mobility, since the information claimed by the former employer, if it is a trade secret, is so broad, possibly covering the whole industry, that the employee will by necessity

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<sup>45</sup> 11-1201(e).

<sup>46</sup> *Trandes Corp. v. Guy F. Atkinson Co.*, 996 F.2d 655 (4<sup>th</sup> Cir.1993).

<sup>47</sup> *Dworkin D.D.S., P.A. v. Blumenthal, et al.*, 77 Md. App. 770 (1989).

<sup>48</sup> Business Franchise Guide (CCH), Paragraph 11, 607 (C.D. Cal. 1990), Case No. CV98-2298DT.

<sup>49</sup> 937 P.2d 907 (Ct. App. Co. 1997).

<sup>50</sup> Section 8-2-113(2)(b), C.R.S. (1986 Repl. Vol.)

<sup>51</sup> *Motor City Bagels, L.L.C., v. The American Bagel Co.*, 50 F.Supp. 2d 460 (D.Md. 1999).

<sup>52</sup> *ISC-Bunker Ramo Copr. V. Atlech*, 765 F.Supp. 1310 (N.D.Ill. 1990); *Comprehensive Tech v. Software Artisans*, 3 F.3d 730 (4<sup>th</sup> Cir. 1993).

use or disclose some of that information at his next job in the same industry. In effect, if an employer can protect large volumes of information as a trade secret, the protection of such information can be the functional equivalent of a non-compete agreement without reasonable limitations as to time or geography. This is antithetical to Maryland and Virginia case law on non-compete agreements which require them to be reasonable as to time and geography.<sup>53</sup>

B. *Respondeat Superior*

1. The Virginia Uniform Trade Secrets Act does not preclude *respondeat superior* liability in trade secret cases. In *Newport News Industrial, et al. v. Dynamic Testing, Inc., et al.*,<sup>54</sup> an employee of a ship building company invented and helped develop a shock mount for electrical equipment for use by the US Navy. The shipbuilding company asked DTI, a testing company, to test the mount. The employee who invented the mount, was hired by the testing company and immediately began work on developing a competing shock mount. From the employee's computer at the shipbuilding company, and while still employed by it, the employee had detailed the design of a competing mount. The shipbuilding company brought an action against the testing company and its subsidiaries on numerous counts, including misappropriation of trade secret. Defendants claimed they could not be vicariously liable for misappropriation committed by their employee because the Virginia Uniform Trade Secrets Act fails to explicitly provide for *respondeat superior* liability and the Virginia Act's preemptive provision precludes the application of the doctrine of *respondeat superior*. Defendants also argued that the Virginia Act only imposes liability if defendant employer knew or had reason to know of the misappropriation. The Court cited the Restatement of Agency (Second)<sup>55</sup> and Virginia case law<sup>56</sup>, and found "the doctrine of *respondeat superior* is thoroughly ensconced in Virginia law. . . ." and the preemptive provision of the Virginia Act does not displace the doctrine of *respondeat superior* since that doctrine is a ". . . legal precept that presupposes the existence of an underlying claim and assesses liability not because of the act giving rise to the claim but because of a certain status."<sup>57</sup> The doctrine is not a

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<sup>53</sup> Becker v. Bailey, 368, Md. 93, 96-97, 299 A. 2d 835 (1973).

<sup>54</sup> 130 F.Supp.2d 745.

<sup>55</sup> Sections 219,216 and 248.

<sup>56</sup> 130 F.Supp.2d 745, 750.

<sup>57</sup> 130 F.Supp.2d 745, 751.

“remedy” and thus, does not “conflict” with the statute. The Court noted that reaching this result is consistent with the application of the doctrine of *respondeat superior* in the analogous contexts of Virginia’s conspiracy to injure others in trade or business statute and the federal Lanham Act.<sup>58</sup> The court also held that if the defendant did not know of its employee’s misappropriation, the damages and injunctive relief provisions of the Virginia Act might be a “defense.”<sup>59</sup>

2. In this regard, it may be helpful to include a provision in a standard employment agreement that the employee has not and will not disclose any trade secrets she acquired during any previous employment and must not utilize the same in her current employment.

### C. Inevitable Disclosure Doctrine

1. The inevitable disclosure doctrine is controversial and the topic of much discussion.<sup>60</sup> The doctrine has not been accepted in Maryland, Virginia or the District of Columbia.<sup>61</sup> Other states have adopted the doctrine.<sup>62</sup> California may have rejected the doctrine.<sup>63</sup> It has been argued in several local cases. It is informative because it is where the public policy of job mobility collides with the right to protect trade secrets.

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<sup>58</sup> *Id.* p. 754, n. 8.

<sup>59</sup> *Id.* at 752.

<sup>60</sup> For a fuller discussion and differing views of this doctrine and the related case law, see Terrence P. McMahon *et al.*, “*Inevitable Disclosure: Not So Sure In The West*,” Nat’l L.J., May 12, 1997, at C35; and Lawrence I. Weinstein, “*Revisiting the Inevitability Doctrine: When Can A Former Employee Who Never Signed A Non-compete Agreement Nor Threatened To Use Or Disclose Trade Secrets Be Prohibited From Working For A Competitor?*,” 21 Am. J. Trial Advoc. 211.

<sup>61</sup> “The doctrine of inevitable disclosure has not been expressly adopted by Maryland state courts.” *Padco Advisors, Inc. v. Omdahl*, 179 F.Supp.2d 600 (D.Md. 2002) at p. 611.

<sup>62</sup> For a list by state, see 36 no4 Tort & Ins L.J. 917-48, Appendix B at p. 945.

<sup>63</sup> 24 no3 Hastings Comm. & Ent. L.J. 403 at p. 406.

2. The three initial inevitable disclosure cases are: *B.F. Goodrich Co. v. Wohlgemuth*,<sup>64</sup> *Allis-Chalmers Manufacturing Co. v. Continental Aviation & Engineering Corp.*,<sup>65</sup> and *E.I. duPont de Nemours & Co. v. American Potash & Chemical Corp.*<sup>66</sup> All three of these cases were decided in the mid 1960s and all involved a similar fact pattern. The employer was a leader in its industry because of the technology it developed. In the *Goodrich* case, the technology was the development of space suits. In the *American Potash* case, it was pigments and in the *Allis-Chalmers* case it was advanced fuel injection pumps. In each of these three cases, the competitors of these companies (which owned the trade secrets) could not compete successfully because those competitors lacked the technology owned by the industry leader. The competitors attempted to get the technology by hiring away one of the industry leader's senior scientists or executives who was directly involved with and intimately familiar with the subject technology of the trade secret. The competitor's purpose was to obtain the technology and develop the same technology to successfully compete with the plaintiff. In each of these cases, the departing employee had not signed a non-disclosure of proprietary information agreement or non-competition agreement. Moreover, the employee had not threatened to use or disclose his former employers' trade secrets. In each case, the argument was made that it was inevitable that the employee would use or disclose the trade secret of his former employer while he was engaged in the duties for which he was hired by his new employer.<sup>67</sup>
  
3. Courts have applied this doctrine to enjoin or limit the subsequent employment of a departing employee who leaves the employment of his employer to work for a competitor of his employer at a job where it is alleged that it is inevitable that the employee will use or disclose the trade secrets of his employer in order to perform his new job at the employer's competitor. It is employed in cases where the employee is not a senior employee, has not signed a non-competition agreement with his prior employer, and where the employee has not threatened to use or disclose the trade secrets of his former employer to his new employer. The controversy over the doctrine stems from the idea that

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<sup>64</sup> 117 Ohio App. 493, 192 N.E.2d 99 (1963).

<sup>65</sup> 255 F. Supp. 645 (E.D. Mich. 1966).

<sup>66</sup> 41 Del. Ch. 533, 200 A.2d 428 (1964).

<sup>67</sup> See Lawrence I. Weinstein, "Revisiting the Inevitability Doctrine: When Can A Former Employee Who Never Signed A Non-compete Agreement Nor Threatened To Use Or Disclose Trade Secrets Be Prohibited From Working For A Competitor?," 21 Am. J. Trial Advoc. 211, footnote 72. See also *Electro Optical Industries, Inc. v. Stephen White*, 90 Cal. Rptr. 2d 680, 53 U.S.P.Q. 2d 1206 (1999).

it eliminates or limits a worker's right to move to a better job even though he has not signed a non-compete agreement and has not threatened to use or disclose any trade secret.

D. Trade Secret Protection Program

The increasing number of trade secret law suits all over the country suggest that many companies still do not take measures that are reasonable under the circumstances to protect their trade secrets. A trade secret owner may well consider the implementation of a trade secret protection program, designed by counsel, to protect such secrets from disclosure and to increase the owner's probability of success in future litigation involving the misappropriation of trade secrets.

1. Efforts that are reasonable under the circumstances will vary from case to case. Some examples are:
  - a. Classifying and labeling certain documents as trade secrets;
  - b. Restricting access to certain materials or areas;
  - c. Limiting disclosures within the company only to those individuals who need the trade secrets in order to perform their jobs properly;
  - d. Implementing badge or other electronic monitoring systems;
  - e. Advising employees of the existence of trade secrets and conditioning employment on signing confidentiality agreements;
  - f. Requiring consultants, customers, vendors, and ancillary service providers to sign confidentiality agreements;
  - g. Implementing periodic internal review procedures regarding inventions, periodicals, marketing materials, and government filings;
  - h. Restricting access to computers, copiers, fax machines, and trash receptacles;
  - i. Performing security checks of employees, visitors, and others with access to trade secrets;
  - j. Using protective orders when disclosing trade secrets in the course of litigation; and

- k. Performing exit interviews with departing employees to require protection of trade secrets.

2. A Practical Method for Trade Secret Protection.<sup>68</sup>

- a. External Security Procedures – to assure that trade secrets will not be lost by carelessly disclosing trade secrets to third parties who do not have a confidential relationship with the company:
  - i. Maintain information under lock and key and place special restrictions on external disclosure to individuals outside of the business -- unrestricted disclosure to even one third party on a non-confidential basis may remove indicia of secrecy necessary for trade secret protection.
  - ii. Trade secrets should be disclosed to customers or vendors only under confidentiality agreements.
- b. Internal Security – examples of reasonable internal security procedures:
  - i. Storing confidential information in locked files in locked rooms;
  - ii. Limiting access to confidential information to employees on a need-to-know basis;
  - iii. Using passcodes for computer access, which are changed on a periodic basis;
  - iv. Limiting computer access for certain types of information;
  - v. Restricting access to visitors by requiring visitors to sign in at a receptionist desk and to be escorted by an employee;
  - vi. Using magnetic card entrance restrictions;

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<sup>68</sup>This “method” and “checklist” is from an article written by Richard C. McCrea, Jr., “*Protecting Trade Secrets & Confidential Business Information (with Forms)*,” 44 No. 5 Prac. Law. 71 (July, 1998). For another checklist, see Sheryl J. Willert, “*Safeguarding Trade Secrets in the Information Age*,” 49 no1 Prac. Law. 11 (Feb. 2003), Appendix 4.

- vii. Placing labels or legends on all confidential information and materials to inform employees that the company considers them confidential;
  - viii. Implementing an employee awareness program with periodic reminders regarding the handling of confidential company information; and
  - ix. Conducting periodic security audits to determine whether confidentiality procedures are being followed.
3. Not only does the trade secret owner have to take measures that are reasonable under the circumstances to protect the secrecy of the trade secret, the trade secret owner must also make sure its licensees and agents do so as well. In *Home Paramount Pest Control Companies, Inc. v. FMC Corp./Agric. Products Group*,<sup>69</sup> the Court held that even if the owner of a trade secret meets the secrecy requirements, it must also make sure that, if it licenses the trade secret to another, the owner take steps to make sure that the licensee also treats the information as secret. If the owner does not, any disclosure by the licensee of the information to others may not be protected.

#### E. Reasonable Royalty

##### 1. Advantages to plaintiffs of measuring damages by a royalty amount:

- a. Plaintiffs may not be able to readily determine their own actual losses because the plaintiff may not be aware of or be able to reasonably calculate the effects of the defendant's misappropriation of plaintiff's trade secret on plaintiff's business.
- b. Plaintiffs may not be able to calculate defendant's unjust enrichment because the defendant may not fully disclose or properly calculate the amount defendant has profited by the misappropriation. Further, defendant may not have fully utilized the trade secret so as not to disclose the misappropriation.
- c. A royalty amount may be much easier for the plaintiff to prove since it has the information concerning its own trade secret and is already aware of its value.

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<sup>69</sup> 107 F.Supp.2d 684, 693 (D.Md. 2000).

2. Disadvantages to defendants of measuring damages by a royalty amount:
  - a. Defendant may have only had the secret for a short time, may not have been able to use it to its full potential and not generated much money from it because it was wrongfully obtained.
  - b. Defendant may not have all of the facts concerning the secret to be able to disprove the alleged value which the plaintiff attributes to the secret.
3. There is little case law on reasonable royalty as damages but one such case is an interesting Virginia case. In *American Sales Corp. v. Adventure Travel, Inc*<sup>70</sup>, American Sales Corp. was granted summary judgment on its trade secret claim that Adventure Travel, Inc. misappropriated its customer list. American Sales sells discount services for a fee called a “Passport” membership through independent distributors. Adventure Travel provided the discount travel services for Passport members under a contract with American Sales. American Sales provided Adventure Travel the list of its 28,000 Passport members, but the contract emphasized the importance of keeping the list confidential and prohibited Adventure Travel from using the list for its own gain. After the contract terminated, Adventure Travel created its own multi-level marketing company offering discount services very similar to American Sales’, allegedly using the confidential customer list. The amount of plaintiff’s damages was the sole issue at trial. The court found that the plaintiff’s loss plus the defendants unjust enrichment (less than \$1,000) would have provided an inadequate sum for the plaintiff. In such a case, the court held that a “reasonable royalty” should be the exclusive measure of damages under the Virginia Uniform Trade Secrets Act. The court relied on expert testimony to arrive at the amount the defendant would have paid for a fictional license to use the customer list in order to determine a reasonable royalty award of \$22,500.00.

#### IV. Conclusion

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<sup>70</sup>862 F. Supp. 1476 (E.D. Va. 1994).