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New York's Highest Court Weighs in on the Availability of Defendant's Cost Savings as a Measure of Damages in Trade Secret Cases

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Client Advisory

May 11, 2018 by Jeffrey S. Boxer, John M. Griem, Jr. and Alexander G. Malyshev

In a recent decision, the Court of Appeals, New York's highest court, addressed an open question under New York law: "Whether a plaintiff asserting claims of misappropriation of a trade secret, unfair competition, and unjust enrichment can recover damages that are measured by the costs the defendant avoided due to its unlawful activity." *E.J. Brooks Co. v Cambridge Sec. Seals*, __ NY3d __, 2018 NY Slip Op 03171, *3 (2018). In a closely divided, 4-3 decision, the Court said that these types of damages are not available.

Writing for the majority, Judge Paul G. Feinman first found that in the case of unfair competition claims, damages must correspond to "the amount which the plaintiff would have made except for the defendant's wrong . . . , not the profits or revenues actually received or earned" by the defendant. *E.J. Brooks Co.*, 2018 NY Slip Op 03171, *3. While the Court recognized that unjust gains may be awarded "as a proxy for compensatory damages in an unfair competition case" it found that method of computation is appropriate only if a plaintiff first shows there is "some approximate relation of correspondence, a casual relation not wholly unsubstantial and imaginary, between the gains of the aggressor and those diverted from his [or her] victim." *Id*. at *4, *quoting Underhill v. Schenck*, 238 N.Y. 7, 17 (1924). Therefore, a damages model that looks solely at the defendant's avoided costs (as was the case in *E.J. Brooks*), without showing any relation to the lost profits of the plaintiff, will not do.

The Court next recognized that it had not previously addressed whether "trade secret damages may be measured by avoided costs – or, for that matter, by any other measure of the defendant's own gains." *E.J. Brooks*, 2018 NY Slip Op 03171, at *4. Surveying prior case law from the appellate divisions, the Court held that "damages in trade secret actions must be measured by the losses incurred by the plaintiff, and that damages may not be based on the infringer's avoided development costs." *Id*. The Court observed that cases from other jurisdictions which embrace "the avoided cost method of damages almost universally consider them a measure of the *defendant's* unjust gains, rather than plaintiff's losses" which "does not consider the effect of the misappropriation on the *plaintiff*." *Id*. (collecting authorities). The Court found that the "avoided cost" method is not a permissible measure of damages under New York law because the figure is tied to defendant's gains rather than plaintiff's losses. *Id*.[1]

With respect to unjust enrichment, the Court found that "where a defendant saves, through its unlawful activities, costs and expenses that otherwise would have been payable to third parties, those avoided third-party payments do not constitute funds held by the defendant 'at the expense of' the plaintiff." Therefore, "a plaintiff bringing an unjust enrichment action may not recover as compensatory damages the costs that the defendant avoided due to its unlawful activity in lieu of the plaintiff's own losses." *Id*. at * 5.

In a lengthy dissent by Judge Rowan D. Wilson, the minority strongly disagreed with the Court's reasoning, pointing to the "unique nature of trade secret theft and the policy concerns at issue[.]" *E.J. Brooks*, 2018 NY Slip Op 03171, at *5. Specifically, the dissent argued that, in the trade secret context, "the injury encompasses many things, including the lost profits plaintiff might have made without the theft, the loss in potential

exclusive licensing opportunities, the loss in the value of the secret once exposed and, perhaps most importantly, the lost incentive for others to expend their time and efforts on innovation." *Id*. at * 7 (stating that the majority's "narrow interpretation" of what constitutes damages "fails to engage meaningfully with the unique nature of trade secrets, as well as the differences between profits and development costs."). The dissenters also argued that the majority opinion "ignores crucial precedent: under New York law, a defendant's ill-gotten gains are available as an *equitable remedy*, particularly in trade secret and unfair competition cases." *Id*. at *6. Therefore, in the dissenters' view, the majority opinion concerns only the availability of avoided costs as a legal, not equitable, remedy.

In the wake of *E.J. Brooks*, the law in New York is that a defendant's cost savings cannot serve as a measure of damages for unfair competition or misappropriation of trade secrets. The dissent strongly disagreed with the majority's reasoning and noted that the majority did not address directly the question of whether these damages are available for equitable, rather than legal, claims. It therefore remains possible that the Court may reexamine the proper measure of damages for equitable unfair competition or misappropriation claims in the future. It also is likely that there will be further litigation examining the availability of defendant's cost savings as a measure of damages in purely equitable claims of unfair competition and trade secret misappropriation.

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[1] As in the case of unfair competition, the Court recognized that other calculations of damages (such as the destruction of a plaintiff's competitive edge) are available, but held that "it is neither automatically nor presumptively the case that the costs avoided by the *defendant* will be an adequate approximation of the *plaintiff's* investment losses[.]" *E.J. Brooks*, 2018 NY Slip Op 03171, at *4

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