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New York State of Mind: The Second Circuit Restricts Trade Secret Damages

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On May 25, 2023, the U.S. Court of Appeals for the Second Circuit in *Syntel Sterling Best Shores Mauritius Ltd. v. TriZetto Grp., Inc.* issued a ruling severely limiting the availability of avoided costs as a measure of damages in trade secret cases brought under the Defend Trade Secrets Act (DTSA). — F. 4th —, 2023 WL 3636674 (2d Cir. May 25, 2023).

Avoided costs refers to "the costs a trade secret holder had to spend in research and development that a trade secret misappropriator saves by avoiding development of its own trade secret." *Id.* at *13. Despite acknowledging that "avoided costs are recoverable as damages for unjust enrichment under the DTSA" and while affirming a jury's finding of liability over Syntel's misappropriation of TriZetto's trade secrets, the Second Circuit vacated the jury's award of $285 million in compensatory damages on the ground that avoided development costs was not an available measure of damages "under the particular facts of th[at] case." *Id.* at *13, *17-18.

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The Second Circuit very narrowly interpreted the DTSA as permitting an award based on avoided costs only in instances where a plaintiff's injury "is not adequately addressed by lost profits," such as "where the value of the secret is damaged, or . . . destroyed." *Id.* at *13. The court opined that Syntel's misappropriation did not injure TriZetto beyond any loss of profits because "TriZetto retain[ed] the use and value of its trade secrets and the district court permanently enjoin[ed] Syntel from using TriZetto's secrets." *Id.* at *14. The court so held despite acknowledging that Syntel had "unjustly benefitted from misappropriating TriZetto's trade secrets" and earned $27 million in revenue. *Id.* at *15.

Syntel is the latest chapter in the hostility of New York appellate courts to avoided development costs as a measure of damages

in trade secrets cases. On May 3, 2018, in a 4-3 split decision, the New York Court of Appeals held that New York law does not permit avoided development costs damages in a trade secret misappropriation, unfair competition, or unjust enrichment claim. *E.J. Brooks Co. v. Cambridge Sec. Seals*, 31 N.Y.3d 441, 444 (N.Y. 2018). The Court of Appeals reasoned that, under New York law, compensatory damages "must be measured by the loss of the plaintiff's commercial advantage," *id.* at 449, and avoided costs were a measure of a defendant's "unjust gains, rather than the plaintiff's losses." *Id.* at 454.

In a dissenting opinion, Judge Rowan Wilson—now the court's chief judge—admonished the majority for relying on inapposite cases, *id.* at 459, ignoring "crucial precedent" that makes "a defendant's ill-gotten gains . . . available as an *equitable* remedy," *id.* at 460 (emphasis in original), refusing to "engag[e] with the unique nature of trade secret theft and the policy concerns at issue," and adopting an "unnecessarily narrow interpretation of damages." *Id.* at 458.

Wilson further criticized the majority for turning a blind eye to the fact that avoided costs as a measure of damages in trade secret cases is "the predominant rule accepted by most states and the Restatement." *Id.* at 476. By limiting a plaintiff's damages to lost profits only, Judge Wilson opined, the majority's decision incentivized the theft of trade secrets rather than innovation. *Id.* at 477. He reasoned that one could now take a calculated risk and still make a net profit by stealing trade secrets, because the only damages a plaintiff could recover would be the lost sales, if any, it could prove at trial. *Id.* at 476.

Wilson acknowledged the "difficult or impossible" task trade secret holders face to prove lost sales in a reliable manner at trial. *Id.* at 461; *see* Restatement (Third) of Unfair Competition § 45, comment c (Am. L. Inst. 1995) ("The nature of a competitive marketplace, however, often makes it difficult for a plaintiff to prove lost sales or other losses attributable to the appropriation of a trade secret."); *Atlas Biologicals, Inc. v. Kutrubes*, No. 19-1404, 2022 WL 2840484 at *7 (10th Cir. Jul. 21, 2022) ("'[d]amages in trade secret appropriation cases are often difficult to ascertain with certainty'" (citation omitted) (brackets in original)).

Following this decision by the Court of Appeals, we opined in this paper that victims of trade secret theft would likely turn away from the New York state court system and bring claims in federal court under the DTSA to receive adequate legal protection and practical remedies. (*See* Daniel B. Goldman & Sam M. Koch, *The End Is Near: Trade Secret Cases In the New York State Court System*, 260 N.Y. L.J. 62 (2018).)

Now, in light of *Syntel*, it is unclear whether bringing an action in federal court in New York under the DTSA would provide a plaintiff with any advantage over a state law claim in New York state court other than, possibly, the venue of federal court itself.

In our previous column, we also noted that every state in the Union except New York had passed some version of the Uniform Trade Secrets Act (the "UTSA"), which was

the model for the DTSA and which provides for avoided development costs as a form of damages.

As Wilson stated in his dissent in *E.J. Brooks*, "[w]here [the New York Court of Appeals] should lead, [it] now refuse[s] even to follow." *E.J. Brooks*, 31 N.Y.3d at 458. So too the Second Circuit.

Indeed, other federal courts have repeatedly interpreted the DTSA as permitting avoided costs as a measure of "unjust enrichment"—even where, as in *Syntel*, lost profits otherwise existed or the plaintiff retained the use of the secret. *See, e.g.*, *Caudill Seed & Warehouse Co. v. Jarrow Formulas, Inc.*, 53 F.4th 368, 389, 392-93 (6th Cir. 2022) (per curiam) (upholding jury award of actual losses and avoided costs; even though plaintiff retained the use of the trade secret, the jury was able to take that into consideration in awarding less than the amount requested); *Steves & Sons, Inc. v. JELD-WEN, Inc.*, No. 3:16-cv-545, 2018 WL 2172502 at *2, *6 (E.D. Va. May 10, 2018) (permitting avoided costs as unjust enrichment damages where counter-plaintiff "had suffered some actual loss, [but] did not have enough information to calculate those losses"); *Motorola Sols., Inc. v. Hytera Comm'cns Corp.*, 495 F.Supp.3d 687, 709-10 (N.D. Ill. 2020) (ratifying jury's award of lost profits and defendant's avoided research and development costs on trade secret claim).

While other jurisdictions have adopted flexible and practical approaches to trade secret damages, New York appellate courts continue to establish onerous standards that make assessing damages in New York a burdensome task for victims of trade secret theft. The most troubling aspect of these decisions is the belief, as in the case of *Syntel*, that "Syntel's onetime use of [TriZetto's] trade secrets" coupled with a permanent injunction against continued use "did not jeopardize their continued value to TriZetto." *Syntel*, 2023 WL 3636674 at *17.

Wilson's dissenting opinion—written years before *Syntel*—specifically warned that damages in trade secret cases "'are not, unlike in other commercial tort cases, confined to a single incident of loss of use and depreciation,'" and, thus, an injunction alone may not restore a trade secret plaintiff to its original state. *E.J. Brooks*, 31 N.Y.3d at 460 (citation omitted). The injury a plaintiff suffers "encompasses many things," only one of which is its lost profits. *Id.* at 461. Only time will tell whether New York will remain "the nation's commercial center and a hub of innovation," as Judge Wilson believed, in light of the legal constraints and costs trade secret holders face in proving damages. *Id.* at 476.

In light of *E.J. Brooks* and *Syntel*, we call for New York to join all the other states in this country by passing legislation modeled after the UTSA. That way, the New York state courts can assume a leadership role in trade secret actions. There is, in fact, a draft bill pending in the New York state legislature to adopt a version of the UTSA. Now is the time finally to pass it.

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