

Introduction

Shawn Fox is a managing director in the dispute advisory practice of Sikich. He has 20 years of accounting and consulting experience. As a certified public accountant, Shawn provides dispute advisory and litigation services, fraud and forensic accounting investigative services, and valuation services to organizations and their counsel.

Shawn directs forensic investigations and analysis across a wide range of areas, including complex damages, lost profits, intellectual property infringement, merger and acquisition, class action, and bankruptcy litigation, as well as valuation and insurance coverage disputes.

With significant experience in the preparation of expert reports, Shawn assists clients in all phases of litigation, including case assessments, discovery, document review, damages analysis, and demonstrative exhibits. He has testified in approximately 40 different cases at deposition, trial, and arbitration as an expert witness and has served as



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Damages Expert's Perspective

Remedies Available to Plaintiff

- Equitable relief (preliminary injunction or permanent injunction)
- Monetary damages (compensatory, unjust enrichment, or restitution damages)
- Legal fees
- Most of these cases are filed in state court, which have varying state laws impacting damages remedies



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Monetary Damages Remedies Available to Plaintiff

- Plaintiff's actual loss (make the plaintiff "whole" after the alleged event)
- Defendant's unjust enrichment (measuring the financial gain realized by the defendant)
- Valuation of trade secrets
- Reasonable royalty
- Depends on facts and circumstances of each case



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Section 1.4 of the UTSA

Section 1.4 of the UTSA states that a trade secret “means information, including a formula, pattern, compilation, program, device, method, technique, or process that

- (i) derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can **obtain economic value from its disclosure or use**, and
- (ii) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.”



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Section 3(a) of the UTSA

“Damages can include both the actual loss caused by misappropriation and the unjust enrichment caused by misappropriation that is not taken into account in computing actual loss. In lieu of damages measured by any other methods, the damages caused by misappropriation may be measured by imposition of liability for a reasonable royalty for a misappropriator’s unauthorized disclosure or use of trade secret.”



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Section 3(b) of the UTSA

“If willful and malicious misappropriation exists, the court may award exemplary damages in an amount not exceeding twice any award under Subsection 3(a).”



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Plaintiff's Actual Loss (1 of 2)

- Profits that the plaintiff would have received but for the defendant's act of misappropriation (including lost sales on conveyed/ancillary products or services that would be sold together with the product or service using the trade secret)
- Plaintiff's increased costs caused by defendant's act of misappropriation
- Value of the trade secrets to the plaintiff as of the date of the misappropriation if they had been destroyed; otherwise their diminution



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Plaintiff's Actual Loss (2 of 2)

- Decline in the value of the plaintiff's business
- Plaintiff's costs of research and development of the trade secret
- Plaintiff's cost to restore the effects of the misappropriation of the trade secret
- Price erosion because the plaintiff had to lower prices to compete with the defendant's use or disclosure of the trade secret



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Unjust Enrichment (1 of 2)

- Defendant's profits on sales attributable to use of the trade secrets through increased revenue
- Defendant's saved research and development
- Defendant's time savings and/or acceleration to market (referred to as head-start damages)
- Defendant's cost efficiencies and increased operating profits



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Unjust Enrichment (2 of 2)

- Defendant's risk reduction and increased business value from lower risk associated with future cash flow
- Value of the trade secrets taken by the defendant as of the date of the misappropriation



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Valuation of the Trade Secret (1 of 2)

- Cost approach. The general principle of the cost approach is that a prudent investor would pay no more for a trade secret than the cost necessary to replace and/or protect the trade secret. The value of the trade secret is determined by aggregating the costs (direct, indirect, developer's profit, and entrepreneurial incentive) involved in its development.
- Market approach. The market approach is based on an analysis of trade secret acquisition transactions (sales comparison method) or trade secret licenses (relief from royalty method) to value the subject trade secret(s).



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Valuation of the Trade Secret (2 of 2)

- Income approach. The income approach is used to estimate a value of a trade secret if the trade secret produces any measure of either operating income or license income.
- There are three primary components of an income approach (1) projected amount of income attributable to trade secret; (2) duration of the income projection period – remaining useful life of the trade secret; and (3) income capitalization rate (discount rate minus growth rate)



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Reasonable Royalty

- Reasonable royalty = royalty base x royalty rate
- A reasonable royalty can generally be based on a percentage of gross revenue, percentage of net revenue, percentage of cost savings, percentage of profits, per unit, lump sum, or some other basis agreed to by the parties
- Calculate a royalty rate paid by a third-party licensee to a third-party licensor



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Methods Used to Calculate Reasonable Royalty Rate

- Comparable uncontrolled transaction method (market approach)
- Incremental profit method (income approach)
- Differential income method (income approach)
- Comparable profit margin method (income approach)



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Comparable Uncontrolled Transaction Method

- This analysis compares the intangible asset to third-party comparable uncontrolled transaction involving the license of similar intangible assets.
- This market-derived, third-party license royalty rate analysis considers factors such as:
 1. The relevant time period of the third party licenses
 2. The financial condition of both licensor and licensee parties
 3. The exclusivity of the license
 4. Any relevant government regulations
 5. Any non-monetary compensation included in the license
 6. The remaining useful life of the licensed intangible asset



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Incremental Profit Method (1 of 2)

- Using a weighted average cost of capital analysis, the analyst compares the owner/operator to other companies in the marketplace that don't own the intangible asset.
- The investment method considers the expected return (profits) from all of the company assets (including both tangible assets and intangible assets), including the infringed intangible asset.
- A weighted average return on assets (based on the returns of other companies) is applied to the assets of the alleged infringing company. This results in an estimate of the profits that the company would earn if it did not utilize the infringed intangible asset.



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Incremental Profit Method (2 of 2)

- This profits measure (in other words, as if no infringement event occurred) is then compared to the actual profits of the infringing company. This comparison results in a measure of the incremental profits from the alleged infringement.
- This measure of infringement-related incremental profits can then be used to estimate a reasonable royalty rate.



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Differential Income Method

- The analyst uses a discounted cash flow analysis in which the analyst prepares two alternative cash flow projections.
- The first cash flow projection is prepared to reflect the owner/ operator's prospective results of operations with the effects of the damages event.
- The second cash flow projection is prepared to reflect the owner/operator's prospective results of operation without the effects of the damages event.
- The difference between these two analyses indicates the damages amount. The differential income (that is, the difference between the two cash flow analyses) is divided by the owner/operator's annual revenue to estimate a reasonable royalty rate.



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Comparable Profit Margin Method

- Also known as the analytical method
- A reasonable royalty rate can be based on the expected (or historical) profit margin of the owner/operator company compared to a normal profit margin (based on guideline companies operating in the same or similar industry that do not use a comparative intangible asset).



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ZeniMax Media Inc. v. Oculus VR, LLC, et al. (1 of 3)



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- The seven legal claims included (1) misappropriation of trade secrets; (2) copyright infringement; (3) breach of contract; (4) unfair competition; (5) unjust enrichment; (6) trademark infringement; and (7) false designation
- This case dealt with virtual reality technology related to the Rift headset
- The lawsuit alleged that Oculus improperly used code and stole trade secrets from ZeniMax in order to build its Rift headset
- Oculus was a subsidiary of Facebook Inc.
- John Carmack joined the Oculus team in 2013 as Chief Technology Officer from ZeniMax

ZeniMax Media Inc. v. Oculus VR, LLC, et al. (2 of 3)

- Six employees from ZeniMax joined Oculus
- The intellectual property included copyrighted computer code, trade secret information, and technical know-how
- Jury found that Palmer Lucky (the founder of Oculus), Brendan Iribe (former CEO of Oculus) and Oculus violated the terms of a non-disclosure agreement, false designation, and copyright infringement



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ZeniMax Media Inc. v. Oculus VR, LLC, et al. (3 of 3)



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- Facebook purchased Oculus VR for \$2 billion in 2014
- Jury found that Palmer Lucky (the founder of Oculus), Brendan Iribe (former CEO of Oculus) and Oculus violated the terms of a non-disclosure agreement, false designation, and copyright infringement
- Jury found defendants did not steal the trade secrets
- ZeniMax Media was seeking a reported \$6 billion in the case in compensation (\$2 billion) and punitive damages (\$4 billion)
- The jury awarded \$500 million
 - \$200 million was to be paid by Oculus for breach of non-disclosure agreement
 - \$50 million was to be paid by Oculus for false designation
 - \$50 million was to be paid by Oculus for copyright infringement
 - \$50 million was to be paid by Palmer Luckey for false designation
 - \$150 million was to be paid by Brendan Iribe for false designation

Dalmatia Import Group Inc. v. FoodMatch Inc. and Lancaster Fine Foods, Inc. (1 of 2)



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- This is the first reported federal award under Defend Trade Secrets Act enacted in 2016
- Dalmaticia is a jam maker
- Case dealt with recipe for a fig spread sold to consumers in the U.S. and Canada
- The defendants were former manufacturer and distributor
- Defendants developed a competing fig jam spread called “Divina Fig Spread”
- Case was moved from state court to federal court
- The parent company of Lancaster is Earth Pride Organics

Dalmatia Import Group Inc. v. FoodMatch Inc. and Lancaster Fine Foods, Inc. (2 of 2)

- Jury awarded \$500,000 award for theft of trade secrets and another \$2 million for other claims for a total of \$2.5 million in damages
- Federal law allows for trebling the damages related to counterfeiting
- Judge granted \$5.2 million in treble damages
- Defendants appealing because they have alleged jury instructions were improper because the jury was not specifically instructed on how to differentiate between the claims under state Pennsylvania Uniform Trade Secrets Act and the federal Defend Trade Secrets Act



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Waymo LLC v. Uber Technologies Inc.



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- Waymo was the driverless car unit of Google until it was spun out of Google in December 2016
- This matter deals with self-driving car technology
- It is alleged that a Waymo engineer, Anthony Levandowski, took 14,000 files with him to Uber in January 2016
- This may be the most lucrative business in history
- Waymo has alleged that Uber stole its trade secrets and intellectual property and of infringing on patents related to its lidar systems
- Uber awarded Levandowski 5 million shares of company stock worth \$250 million

Key Considerations for Defendant's Strategies for Damages Calculations (1 of 3)

- The plaintiff has not proved that its damages were caused by defendant's misappropriation of trade secrets—no nexus between the misappropriation of trade secrets and the actual loss
- The damages amounts claimed or portions thereof, are unrelated to the alleged trade secret misappropriation
- The loss period for damages for the time it would have taken to independently develop the trade secret or reverse engineer the trade secret is reduced
- Some portion of the damages is comprised of an impermissible double-recovery
- Defendant did not use the trade secret information



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Key Considerations for Defendant's Strategies for Damages Calculations (2 of 3)

- Whether the plaintiff has not adequately defined/identified its trade secrets
- The plaintiff only included a damages model based on misappropriation of all of the trade secrets and failed to apportion damages among trade secrets or other legal claims
- Alleged trade secret information is already in public domain and knowledge through public disclosure is not due to any act of the defendant
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Key Considerations for Defendant's Strategies for Damages Calculations (3 of 3)

- Alleged trade secret information was not kept secret in confidence and treated as confidential
- Alleged trade secret information can be easily reverse engineered
- Alleged trade secret information does not provide competitive advantage
- Losses to the business were caused by changes in consumer demand for a product or service incorporating the trade secret or noninfringing alternative products
- Plaintiff's damages do not meet the test of reasonable certainty for recovery of damages
- The remaining economic useful life of the trade secret is lower than the period asserted by the plaintiff



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