More than just source code qualifies as trade secrets

THE CASE:

Business Logic Holding Corporation v Ibbotson Associates and Morningstar, Inc
Circuit Court of Cook County, Illinois
17 July 2014

An Illinois trade secret dispute that settled for over $60m revealed the liability and damages issues of litigating a complex software misappropriation case. The plaintiff's lawyers, **Stephen Fardy** and **Peter Skiko** detail the major takeaways

The authors recently prosecuted a complex case in Illinois state court (Cook County) involving the misappropriation of trade secrets related to computer software. The litigation resulted in a $61m settlement paid by Ibbotson Associates, Inc and Morningstar, Inc to the authors' client, Business Logic Holding Corporation, now operating as NextCapital Group, Inc.

In litigating the case, the parties dealt with many issues related to the definitions and interpretations of the terms "misappropriation", "trade secret", "software" and the potential damages stemming from that misappropriation, as well as who determines the amount of those damages. The following is intended to provide an overview of the authors' research into Illinois and other law related to two of those issues.

What can a software-related "trade secret" consist of in Illinois?

A. Statutory and common law description of trade secrets.

Illinois law defines a trade secret as:

"information, including but not limited to, technical or non-technical data, a formula, pattern, compilation, program, device, method, technique, drawing, process, financial data, or list of actual or potential customers or suppliers, that:

(1) is sufficiently secret to derive economic value, actual or potential, from not being generally known to other persons who can obtain economic value from its disclosure or

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use; and

(2) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy or confidentiality."
Illinois Trade Secret Act, 765 ILCS 1065/2(d).

The first step in seeking recovery under the Illinois Trade Secret Act ("ITSA") is to prove that a trade secret exists. In addition to the factors set forth in ITSA, courts look to six common-law factors to assist with determining whether a trade secret exists: "(1) the extent to which the information is known outside of the plaintiff's business; (2) the extent to which the information is known by the employees and others involved in the plaintiff's business; (3) the extent of measures taken by the plaintiff to guard the secrecy of the information; (4) the value of the information to the plaintiff and to the plaintiff's competitors; (5) the amount of effort or money expended by the plaintiff in developing the information; and (6) the ease or difficulty with which the information could be properly acquired or duplicated by others. See *Stenstrom Petroleum Servs Group, Inc v Mesch*, 375 Ill App 3d 1077, 1090 (2d Dist 2007); *Lucini Italia Co v Grappolini,* 2003 US Dist LEXIS 7134, at *47-48.

Depending upon your specific set of facts, these factors at least potentially bring software-related materials other than source code into the realm of trade secrets. In *ISC-Bunker Ramo Corp v Altech, Inc,* the court granted the plaintiff's motion for preliminary injunction, in part, to prevent the defendant from further misappropriating the plaintiff software company's "technical bulletins, [its] service manuals, and the information and procedures set forth therein that pertain to the installation, service, maintenance, diagnosis and repair of [its] computer systems". See 765 F Supp. 1310, 1333 (ND Ill. 25 June, 1990). The Northern District found that these materials constituted trade secrets under Illinois law.

B. Under Illinois law, can compilations and programs combining secret and non-secret information qualify as a trade secret?

The plain language of ITSA and well-established case law recognise that entire

software programs and other "compilations" and "programs" that combine secret and non-secret elements are entitled to trade secret protection. See 725 ILCS 1065/2.

"Under Illinois law, trade secrets can include 'a combination of characteristics and components, each of which, by itself, is in the public domain, but the unified process, design and operation of which, in unique combination, affords a competitive advantage and is a protectable secret.'" *Optionmonster Holdings, Inc v Tavant Techs, Inc,* No 10 C 2792, 2010 US Dist LEXIS 64799, at *19 (ND Ill 29 June, 2010) (quoting *3M v Pribyl*, 259 F 3d 587, 595-96 (7th Cir 2001). Likewise, in *PRG-Schultz Int'l, Inc v Kirix Corp*, the defendants challenged the designation of the "entire SUREFIND program as a trade secret" because it included "elements contained in commercially available software." No 03 C 1867, 2003 US Dist LEXIS 25994, at *18 (ND Ill 22 Sept, 2003). Relying on 3M, the court rejected that argument and held that "the ITSA specifically contemplates the protection of a computer program as a trade secret." Id. See also, *Computer A Associates Int'l v Quest Software, Inc*, 333 F Supp 2d 688, 695 (ND Ill 2004) (citing *Unix Sys Lab, Inc v Berkeley Software Design, Inc*, 1993 US Dist LEXIS 19505 (DNJ 1993)); *Lynchval Sys v Chicago Consulting Actuaries*, No 95 C 1490, 1998 US Dist LEXIS 3998, at *15 (ND Ill, 27 March, 1998).

In short, when the "trade secrets [are] based on a unique combination of both protected and unprotected material, a plaintiff should not be obligated to identify which components of the protected material is secret. *Mike's Train House, Inc v Lionel, LLC*, 472 F 3d 398, 411 (6th Cir 2006) (relying on 3M).

C. What about jurisdictions outside of Illinois?

Courts applying the Uniform Trade Secret Act in other jurisdictions agree that entire software programs, including secret and non-secret parts, are entitled to trade secret protection and plaintiffs need not distinguish between "secret" and "non-secret" in those instances. In *Decision Insights, Inc v Sentia Group, Inc* 311 Fed App'x 586, 593 (4th Cir 2009), the Court of Appeals reversed summary judgment for the defendant, holding that it is unnecessary to identify which portions of a software program are publicly available when the claim is that the "software program, as a total compilation, could qualify as a trade secret." Id at 593-94. See also, *Rivendell Forest Prods, Ltd v Georgia-Pacific Corp,* 28 F 3d 1042, 1045 (10th Cir 1994).

Courts have taken a less-expansive view where source code and software-related

trade secrets are inadequately defined. In *AgencySolutions.com, LLC v Trizetto Group, Inc,* the plaintiff attempted to claim trade secret protection in (1) conversations between plaintiff and defendant regarding *knowledge common to an expert* in the particular industry and (2) documents that described features of software that were *obvious to an end user of the software*. 819 F Supp 2d 1001, 1011-1012 (ED Cal 2011). The court refused to grant a preliminary injunction because it concluded the plaintiff failed to identify any trade secrets at all, not because of the presence or absence of source code. Id at 1018-1025.

In reaching its conclusion, the *AgencySolutions* court, interpreting the California Uniform Trade Secret Act (which does not provide trade secret protection

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for technical and non-technical data), relied heavily on *Silvaco Data Systems v Intel Corp*, 184 Cal App 4th 210 (Cal App Ct 2010), which holds that *end users* of software who obtained such software in good faith are not liable for trade secret misappropriation.

In both *Silvaco* and *AgencySolutions*, the plaintiffs failed to allege that the actual trade secrets, or "recipes," had been misappropriated. Rather, the *AgencySolutions* court determined that plaintiff's claimed trade secrets were evident to anyone running the software program and were thus not entitled to protection. The court, in *dicta*, listed general categories of what it would consider not to be a trade secret, including: 1) general knowledge in the trade; 2) ideas or concepts; 3) proprietary ways of doing the same thing that others in the same field do; and 4) plans, flows, inputs, outputs, rules of operation, priorities of operation, and the like[.] *AgencySolutions*, 819 F Supp at 1017.

Notably, the rationale behind the *Silvaco* and *AgencySolutions* rulings has not been followed in situations where the alleged trade secrets are manifested in materials other than source code. *Burroughs Payment Sys v Symco Group, Inc,* 2012 US Dist LEXIS 67198, at *51 (ND Cal 14 May, 2012); *AtPac, Inc v Aptitude Solutions, Inc ,* 787 F Supp 2d 1108, 1114 (ED Cal 2011) ("plaintiff argues that it protects as secrets not only its source code but also the finished product and processes, so *Silvaco* might not be controlling when the merits of the trade secret claim are considered").

Finally, proof of copying source code (or even a review of source code) is not necessary for a plaintiff to prove misappropriation of

a trade secret in computer software cases. See *Integrated Cash Management Services, Inc v Digital Transactions, Inc*, 732 F Supp 370, 377 (SDNY 1989), aff'd 920 F 2d 171 (2d Cir 1990). In *Integrated Cash*, the court granted an injunction based on trade secret misappropriation claims related to computer software because there were, "many similarities in the structure, functionality, organisation, and logic flow," even though "no direct copying [of source code] occurred." Id at 377-78. See also, *Versata Software, Inc v Internet Brands, Inc*, 902 F Supp 2d 841, 852 (ED Tex 9 October, 2012).

Who determines the amount of exemplary damages – court or jury?

Once a plaintiff has established trade secret misappropriation, ITSA provides plaintiffs with a powerful tool: the ability to recover exemplary damages.

If wilful and malicious misappropriation exists, the court may award exemplary damages in an amount not exceeding any award made under subsection (a).765 ILCS 1065/4(b).

However, the issue of whether the court or the jury decides the amount of exemplary damages remains unresolved under Illinois law.

The contention that the jury determines the amount of exemplary damages rests on long-standing Illinois punitive damages law. This position is supported by Illinois Pattern Instruction ("IPI") 35.01, which instructs the jury to determine "punitive/exemplary" damages based on wilful and wanton conduct, as well as several Illinois federal court cases that have allowed the jury to determine the amount of exemplary damages under ITSA.

In contrast, the position that the court should determine exemplary damages rests upon a plain reading of ITSA, as well as out-of-state cases that have interpreted the Uniform Trade Secrets Act ("UTSA") to favour a court determination, as opposed to a jury determination, on this issue.

A. The jury should determine the amount of exemplary damages.

IPI 35.01 instructs the jury to determine "punitive/exemplary" damages based upon certain factors. This instruction implies that "punitive" and "exemplary" are analogous terms, supporting the position that the jury should determine these damages. IPI 35.01 is further consistent with a series of Illinois state court opinions holding that the determination as to the amount of punitive damages is left for the jury. *See Kelsay v Motorola, Inc,* 74 Ill 2d 172, 186-188 (1978); *Dethloff v Ziegler Coal Co*, 82 Ill 2d 393, 408 (1980); *Franz v Calaco Dev Corp,* 352 Ill App 3d 1129 (2d Dist 2004).

A number of Illinois federal court cases have followed this line of reasoning to allow the jury to determine exemplary damages under ITSA. See *Mangren Research & Development Corp*, 87 F.3d 937, at 937-39, (7th Cir 1996); *RRK Holding Company v Sears, Roebuck & Company,* 563 F Supp 2d 832 (ND Ill 2008); *Learning Curve Toys, Inc v Playwood Toys, Inc*, 342 F.3d 714, 730-731 (7th Cir 2003).

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B. The court, not the jury, should determine the amount of exemplary damages.

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ITSA specifically states that the *court* may award exemplary damages if wilful and malicious misappropriation evidence exists. *See* 765 ILCS 1065/4(b). The term "jury" is noticeably absent from the statutory language.[1]

Additional support for this position rests on the fact that the term "the court" has been interpreted under the attorney fees provision of the ITSA to mean that the court, and not the jury, determines an award of attorney fees. See *Chemetall GmbH v ER Space Energy Inc*, No 99-cv-4334, 2002 US Dist LEXIS 158 (ND Ill 8 Jan, 2002).[2] Arguably, the same interpretation of "the court" should then apply to ITSA's exemplary damages provision.

Finally, outside jurisdictions have interpreted

the UTSA, which serves as the foundation for ITSA, to find that the court rather than the jury should determine the amount of exemplary damages to be awarded. See, *O2 Micro Int'l Ltd v Monolithic Power Sys, Inc*, 399 F Supp 2d 1064 (ND Cal 2005), aff'd 221 Fed Appx 996 (Fed Cir 2007).

Summary

Courts across the US have provided broad parameters with respect to what types of materials can (and likely cannot) constitute software related trade secrets. Companies prosecuting or defending against trade secret claims involving software can rely upon certain general standards that apply to trade secret claims in Illinois and in other jurisdictions.

One does not have to prove that someone copied source code in order to prove misappropriation of a software-related trade secret. Depending upon your jurisdiction, combinations of components and the overall organisation of source code will likely qualify as trade secrets, even if those combinations contain third-party software and open source applications or information that is already in the public domain.

Once misappropriation has been established, both parties need to be cognisant of the unresolved issue under ITSA of who will determine the amount of exemplary damages.

Footnotes

1. In contrast, and for example, the Colorado Trade Secret Act specifically allows the judge *or* the jury to award exemplary damages. Colo Trade Secret Act § 7-74-104(2).
2. Note, however, that the jury decided exemplary damages in the *Chemetall* decision.

Authors

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