

ERP Failure #8: Actual Case – Proving Misappropriated Trade Secrets

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The System and the Parties

Hi, this is Warren Reid. This case started out as a copyright infringement case, and it ended up being won mostly based upon testing and estimates to build the stolen module from scratch.

The party our firm represented was a small systems applications developer (the "Developer") who wanted to sell his very highly rated, popular wholesale distribution application software.

The opposing party (the "Acquirer") was a billion dollar systems developer which believed an best-in-class complementary wholesale distribution module would complete its already existing ERP offering.

The Complaint

The Acquirer gave the Developer a letter of intent to purchase with the right, in its sole judgment, to cancel if the software didn't meet its needs. The Acquirer generally knew about the Developer's organization, the software, its functionality and capabilities, and its high reputation in the marketplace.

It then painstakingly reviewed the Developer's software code, technical architecture and design; upcoming upgrades; conducted interviews and site visits; and then applied its own tests, to be sure that the system worked as promised. Since applicable law required that the Acquirer act in good faith, this all seemed reasonable. The letter of intent gave this intense review a timeline of 45 days.

On the 45th day exactly, the Acquirer canceled the acquisition alleging the system did not meet the performance requirements promised and the profitability requirements needed.

The Developer sued alleging copyright infringement, because the Acquirer in a very short time came out with a similarly configured system, albeit with a GUI which matched the Acquirer's other software. Later, based upon our opinions, the Developer's attorney also added "bad faith" and "trade secret misappropriation" to the charges -- a very difficult thing to prove!

The Analyses, Strategies and Opinions

During our research we discovered the following:

- 1) ***Targeted Markets*** - The Acquirer was targeting the \$2-\$20 million dollar wholesaler distribution market. We discovered the Acquirer's performance tests were designed for companies in the \$200 million dollar plus range - orders of magnitude larger than they needed to be, and were, in fact, **intended to make the system fail**. This finding encouraged the Developer's attorney to

add **bad faith** to the charges. We went on to prove that with appropriate loads, the system met the promised response time 98% of the time.

- 2) **Backup Requirements** - Information about backup requirements was in the Developer's Operations manual before the letter of intent was signed. We argued the Acquirer "must have known" those requirements and could not use them to void the letter of intent.
- 3) **Motives For Bad Faith** - Even with proof about the intentions and bad faith of the Acquirer, the jury needed motives for the Acquirer's actions. We uncovered several motives:
 - a) To quickly bring their product to market with certain complex algorithms
 - b) To learn the best available system's design
 - c) To adopt critical functionalities evolved over 17 years (i.e., the Trade Secrets).
 - d) To learn about future enhancements, their estimated costs and benefits.

Four of the six people who performed the excruciatingly detailed review of the Developer's system went on to develop the Acquirer's own system from scratch.

- 4) **Trade Secret Misappropriation** - We argued that the particular features and functions were a trade secret of the Developer. Copying the Developer's work, allowed the Acquirer to bring its product to market more quickly, and win away customers – which could only be accomplished by having unprecedented access under false pretenses.
- 5) **"Curiouser and Curiouser"** - We showed stunning similarities regarding 12 critical functionalities between the Developer's system and the Acquirer's newly developed one. an astronomically low probability if no copying occurred.
- 6) **Meets Profitability Needs** - And, we showed that the Acquirer would **achieve the profit goals and margins in its business plan.**

The Verdict

After four years of arguing this case, it was settled almost literally on the courthouse steps in favor of a happy Developer and his attorneys.

We are here to help. More information about WSR Consulting Group, LLC, is available at <http://wsrcg.com>

Questions or comments?

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