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INSIGHTS

DAMAGES QUANTIFICATION IN TRADE SECRET LITIGATION

LESSONS FROM *SHAVER-KUDELL MANUFACTURING INC. V. KNIGHT MANUFACTURING INC.*

by Greg McEvoy and Aaron Wong

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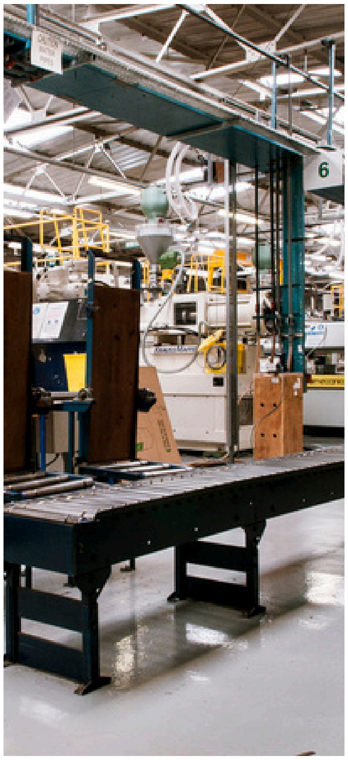
The Ontario Superior Court's decision in Shaver-Kudell Manufacturing Inc. v. Knight Manufacturing Inc., 2024 ONSC 829, provides a useful example of how Canadian courts may approach the quantification of damages arising from the misappropriation of trade secrets.



Shaver-Kudell Manufacturing Inc. operated a machine shop producing metal sleeves used in electric motor bearing repair applications. Its trade secrets used in the production process were an important element in allowing for a lower cost production.

The defendants were found liable for misappropriating the plaintiff's trade secrets and manufacturing process to establish a competing operation. The competing entity entered the market and sold products at prices approximately 40% lower than the plaintiff's pricing.

While the liability findings related to breach of confidence and misuse of trade secrets are noteworthy, the damages component of the decision is particularly instructive for forensic accountants and business valuators involved in economic loss quantification.

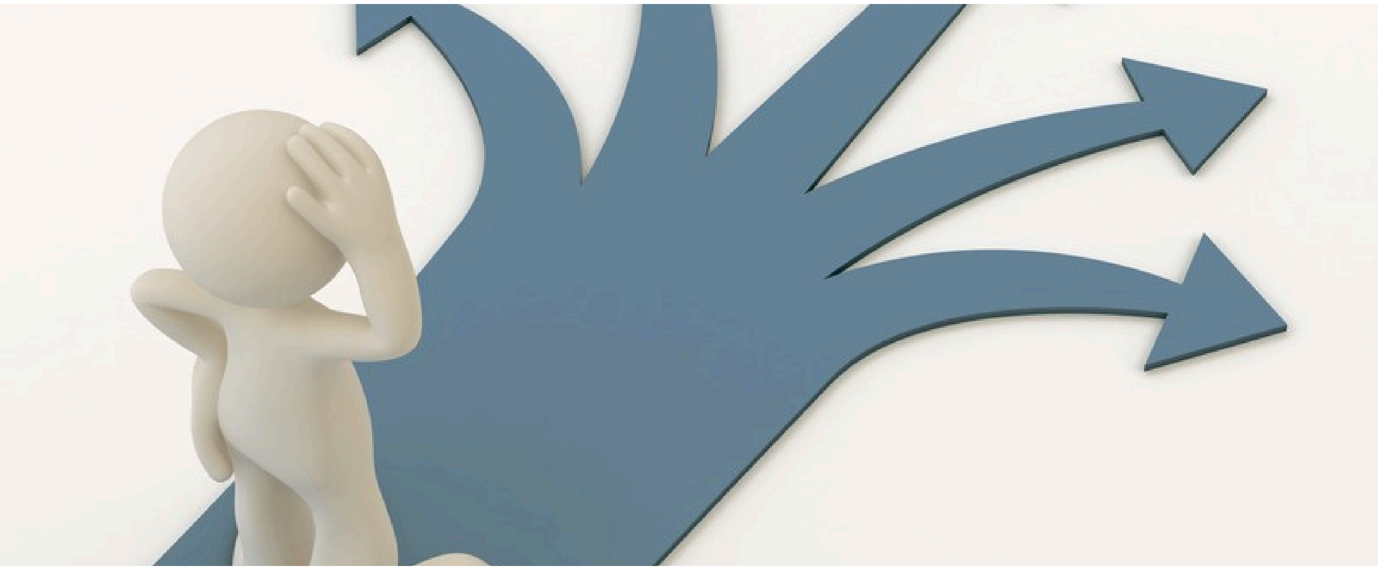
The Damages Theory Accepted by the Court

The damages model adopted by the Court, as presented in the expert report of Greg McEvoy of Cohen Hamilton Steger & Co. Inc., was fundamentally a lost profits framework.

The expert concluded that the plaintiff suffered economic harm from two primary sources:

1. lost sales diverted to the competing business; and,
2. an inability to continue increasing prices at historical levels because of unlawful competition.

This distinction is important. In many trade secret cases, experts focus narrowly on diverted revenue. But the economic effects of trade secret theft often extend beyond volume displacement. Improper competition may suppress prices, compress margins, shorten product life cycles, or accelerate customer attrition.



Key Damages Considerations for Experts

The *Shaver-Kudell* decision underscores several practical issues that damages experts should consider when quantifying losses arising from the misuse of trade secrets. While each case will turn on its own facts, the damages analysis often requires more than a simple comparison of the plaintiff's pre- and post-incident sales. Experts must carefully assess how the alleged misconduct affected the plaintiff's competitive position, pricing power and profitability, while ensuring that the damages model remains grounded in the evidentiary record.

1. Developing the "But For" World

Trade secret damages analysis almost always turns on the construction of a credible "but for" scenario. In order to develop this "but for" world, experts will need to make assumptions regarding:

- Historical pricing trends;
- Customer retention patterns;
- Production capacity;
- Historical margins;
- Pre-incident forecasts;
- Industry conditions; and,
- Contemporaneous management records.

An expert should avoid unsupported extrapolations. For example, assuming indefinite price escalation without considering market elasticity, industry competition, inflation, or customer sensitivity may weaken reliability.

The most persuasive "but for" analyses usually rely on multiple sources of market and historical evidence rather than relying on a single metric.

2. Separating Lawful Competition from Unlawful Competition

A major issue in trade secret matters is distinguishing losses caused by wrongful conduct from losses attributable to legitimate market forces. Not every lost customer or pricing decline is recoverable. An expert may have to consider whether:

- Competitors could have independently developed similar products;
- The market was already becoming more competitive;
- Technological changes affected pricing;
- Macroeconomic conditions contributed to declining performance; and,
- Customer purchasing decisions were unrelated to the alleged misuse.

For example, suppose a defendant enters a market using stolen manufacturing specifications, but simultaneously introduces operational efficiencies that legitimately reduce its production costs. In such a case, any potential damages may need to be apportioned between the misappropriation of trade secrets and other factors that would negatively impact sales.

In *Shaver-Kudell*, the Court accepted the causal link between the defendants' conduct and the plaintiff's economic losses because the evidentiary record appears to have established direct competitive harm arising from the misuse of the manufacturing process.

3. Pricing Suppression Damages

In many commercial damages cases, experts overlook the economic impact of a plaintiff being forced to maintain or reduce prices because of improper competition. Yet this may be one of the largest sources of loss.

Consider a manufacturer with stable annual sales volume of 100,000 units. If unlawful competition prevents a 5% price increase on a product line generating $10 million annually, the resulting margin erosion may exceed the profits lost from diverted sales.

Experts should examine:

- Historical pricing practices;
- Customer contracts;
- Gross margin trends;
- Evidence of abandoned price increases;
- Competitor pricing changes; and,
- Internal communications regarding pricing pressure.

Damages model may require separating:

- Volume losses;
- Price suppression losses; and,
- Incremental cost effects.

4. The Importance of Contemporaneous Documentation

In *Shaver-Kudell*, the Court relied on contemporaneous pricing records obtained from historical price catalogues. These historical records created the evidentiary basis to support damages from price suppression.

In trade secret matters, particularly where damages span multiple years, contemporaneous records often become central to establishing:

- Historical pricing behaviour;
- Customer relationships;
- Production processes;
- Competitive responses; and,
- Management expectations.

When available, experts should request contemporaneous documentation to support assumptions that will be used in developing the "but for" world.

5. Alternative Damages Frameworks

Although Shaver-Kudell proceeded using a lost profits framework, trade secret cases may involve several different damages methodologies depending on the facts.

Potential alternative approaches include:

- Disgorgement of defendant profits;
- Reasonable royalty; and,
- Loss of business value.

An expert should be cognizant of these alternative approaches. The determined "but for" world will inform which of these approaches is most appropriate for the expert to use.

Final Observations

The *Shaver-Kudell* decision illustrates that damages arising from trade secret theft may extend beyond simple customer diversion. The economic harm may include broader impairment of a plaintiff's competitive position, including pricing suppression and margin erosion.

For damages experts, the central challenge remains constructing a reliable and evidence-based "but for" world while carefully isolating the effects of wrongful conduct from ordinary competitive forces. Experts must be cognizant of all the factors involved to calculate damages and create compelling testimony that is supported by the case facts and evidence.

Awareness and consideration of these facts often determines whether a damages opinion is persuasive.

Damages Quantification in Trade Secret Litigation Lessons from *Shaver-Kudell Manufacturing Inc. v. Knight Manufacturing Inc.*

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With offices in Toronto and Ottawa, CHS is a leading Canadian boutique specializing in damages quantification, business valuation and forensic accounting services. Our Principals have been involved in many of Canada's largest financial quantification mandates and provided expert testimony in matters in various Canadian and international courts and arbitrations.

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