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Current Cases

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CURRENT CASES

PER SE UNLAWFUL TYING ARRANGEMENTS UNDER THE SHERMAN AND CLAYTON ANTITRUST ACTS: SUFFICIENT ECONOMIC POWER IN THE TYING PRODUCT TO APPRECIABLY RESTRAIN COMPETITION IN THE TIED PRODUCT MARKET FOUND TO EXIST. *Digidyne Corp. v. Data General Corp.*, 734 F.2d 1336 (9th Cir. 1984), *cert. denied*, 105 S. Ct. 3534 (1985).

The Ninth Circuit Court of Appeals has held a computer systems manufacturer's method of marketing its hardware and software to be a per se illegal tying arrangement in violation of both the Sherman and Clayton Antitrust Acts. The circuit court found the district court had erred in setting aside the jury's finding that the defendant had unlawfully restrained competition in the market for central processing units by use of a program license agreement tying sales of its popular software program to its central processing units.[1]

The *Data General* case involves a complex, multi-district antitrust lawsuit. The defendant,[2] Data General, designs, manufactures and markets various computer systems including NOVA which consists of a central processing unit ("CPU") bearing the NOVA trademark, and a popular copyrighted operating system (software) called "RDOS" containing basic operating commands specifically designed for use with the NOVA CPU. As part of its marketing stategy, Data General sold the RDOS software pursuant to a Program License Agreement which precluded purchasers of RDOS

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1. The litigation focuses on three of Data General's marketing practices. For the sake of brevity this casenote will focus primarily on the tying arrangement between the RDOS operating software and NOVA central processing units. The tying arrangements between the RDOS operating software and Data General's minimum hardware purchase requirements and between Data General's CPUs and minimum memory equipment purchase requirements are subject to similar antitrust analysis.

2. In seven of eleven consolidated actions, Data General is aligned as the sole defendant. In the remaining four actions, Data General is nominally the plaintiff. Because all of the antitrust claims place Data General in a defensive posture, Data General will be referred to herein as the defendant, and all of the non-Data General parties will be referred to collectively as the plaintiffs. *See* In re Data General Corp. Antitrust Litigation, 490 F. Supp. 1089, 1097, n. 3 (N.D. Cal. 1980) and In re Data General Corp. Antitrust Litigation, 529 F. Supp. 801, 804, n. 1 (N.D. Cal. 1981).

software from using the program with any CPU not designated by Data General. With two exceptions not relevant here, Data General designated only its own NOVA CPUs for use with its licensed RDOS software. In effect, this required purchasers of Data General's RDOS software to also purchase Data General CPUs. Data General further required its CPU purchasers and software licensees to purchase a minimum equipment configuration of memory devices and peripheral products, or to pay a substantial license charge.

Legal action against Data General based upon its marketing methods commenced in June, 1978,[3] when Digidyne Corporation ("Digidyne") amended its complaint to allege that Data General's refusal to license RDOS operating software except to purchasers of NOVA CPUs constituted an unlawful tying arrangement in violation of section 1 of the Sherman Act[4] and section 3 of the Clayton Act.[5] Six more actions were subseqently filed against Data General by other computer companies alleging similar antitrust violations and in four trade secret actions initially filed by Data General, four antitrust counter-claims were filed.[6]

In all, eleven antitrust actions were filed challenging the marketing methods of Data General. These actions were consolidated in the Northern District of California for pretrial proceedings.[7] The antitrust issue was bifurcated by segregating the issues of liability and damages for trial.[8]

The plaintiffs[9] manufacture and market CPUs in competition with Data General. Plaintiffs' CPUs are "NOVA emulators" designed to be functionally compatible with the RDOS software marketed by Data General. Plaintiffs' marketing strategy offered

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3. Digidyne Corp. v. Data General Corp., No. C-78-1261 (N.D. Cal., filed June 1978).

4. Section 1 of the Sherman Act, 15 U.S.C. § 1 (1982), states in pertinent part: "Every contract, combination . . . or conspiracy, in restraint of trade or commerce . . . is declared to be illegal. . . ."

5. Section 3 of the Clayton Act, 15 U.S.C. § 3 (1982), states in pertinent part:
   It shall be unlawful for any person engaged in commerce, in the course of such commerce, to lease or make a sale or contract for sale of goods . . . for use, consumption or resale . . . on the condition, agreement or understanding that the lessee or purchaser thereof shall not use or deal in goods . . . of a competitor . . . where the effect of such lease, sale or contract for sale or such condition, agreement or understanding may be to substantially lessen competition. . . .

6. *See* In re Data General, 529 F. Supp. 801, 804, n. 1, for a list of the cases involved.

7. 529 F. Supp. at 804, n.1. Of the eleven actions filed, only two, Fairchild Camera & Instrument Corp. v. Data General Corp., No. C-78-2418 (N.D. Cal., filed Oct. 1978) and Digidyne Corp. v. Data General Corp., No. C-78-1261 (N.D. Cal., filed June 1978) actually proceeded to trial. The remaining actions were settled prior to commencement of trial.

8. 490 F. Supp. at 1099.

9. *See supra* note 2.

consumers the option of assembling a multi-brand computer system composed of plaintiffs' "NOVA emulator" CPUs and Data General's RDOS software.[10]

Following extensive discovery,[11] cross-motions for summary judgment were filed. Plaintiffs contended Data General's tying arrangement possessed the required elements of a per se antitrust tying violation. Data General contended it lacked the requisite economic power in the tying product (RDOS operating software) market to appreciably restrain competition in the tied product (NOVA CPU) market.[12]

Considering the cross-motions, the district court first defined a tying arrangement as "an agreement by a party to sell one product but only on the condition that the buyer also purchases a different (or tied) product, or at least agrees that he will not purchase that product from any other supplier."[13] The court then identified the three elements necessary to establish a per se illegal tying arrangement:

> First, there must be two separate products, with purchase of one (the "tying product") conditioned upon the purchase of the other (the "tied product"). Second, the seller must possess sufficient economic power in the tying product market appreciably to restrain competition in the tied product market. Third, a not insubstantial amount of commerce in the tied product must be affected.[14]

In addition to these three elements, plaintiffs were also required to prove actual damages causally linked to Data General's antitrust violation.[15]

Ruling on the summary judgment motions, the district court found in favor of plaintiffs on all issues except the second element of economic power. The court found there was no dispute of material

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10. 490 F. Supp. at 1098.

11. Discovery encompassed the production of over 600,000 documents, the taking of nearly 150 depositions and the exchange of hundreds of interrogatories and requests for admissions. 490 F. Supp. at 1097.

12. 490 F. Supp. at 1098.

13. 490 F. Supp. at 1100.

14. *Id.*, citing as support Fortner Enterprises, Inc. v. United States Steel Corp., 394 U.S. 495, 499 (1969) (hereinafter cited as "Fortner I").

15. Plaintiffs were successful in establishing damage and causation. The record contained undisputed facts indicating customers had been deterred from purchasing plaintiffs' NOVA emulator CPUs. This alone was sufficient to support a finding of damages. The causation requirement was satisfied upon a mere showing that there existed a reasonable probability that foregone CPU sales were a result of RDOS software purchasers feeling bound by the tie-in to use Data General's CPUs rather than plaintiffs'. 490 F. Supp. at 1118-19.

fact as to the existence of the first element.[16] Evidence of separate availability, separate pricing, and separate manufacturing and marketing of CPUs and software by both Data General and other computer companies served to establish that RDOS operating software and NOVA CPUs were separate and distinct products, notwithstanding the fact neither could function without the other.[17] These findings, together with Data General's Program License Agreement which restricted the RDOS software to use with NOVA CPUs, fully satisfied the first requisite element of an unlawful tie-in.[18] Similar considerations supported the court's conclusion that Data General's memory devices and CPUs were separate products required to be purchased pursuant to a tying scheme.[19]

The district court also found no dispute of material fact as to the existence of the third element. The court stated that in determining whether the effect of a tying arrangement on interstate commerce is not insubstantial, the relevant inquiry is whether the total volume of sales of the product tied by the sales policy under challenge is more than "de minimis."[20] The court found the sale of 52,700 NOVA CPUs during an eight year span, with shipments in one year alone valuing $245 million dollars, to be a non "de minimis" amount of commerce affected by the tying arrangement.[21] With respect to the CPU-memory tie-in, Data General's admission of substantial sales coupled with the admission that all CPUs sold from its regular price list were packaged together with at least one memory board constituted a sufficient amount of commerce affected by the tie-in to satisfy the third requisite element.

However, the court found disputed issues of material fact with respect to the second requisite element. In its analysis of the economic power element, the court stated that although three alternative indicia of economic power have been recognized, the appropriate economic power inquiry in the instant case was whether the RDOS operating software (tying product) was sufficiently unique to have some advantage not shared by its competitors in the CPU (tied product) market.[22]

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16. In order to satisfy the first element of an unlawful tying arrangement, it must be established that two separate products are being marketed and that both are required to be purchased pursuant to a tying scheme. 490 F. Supp. at 1103.

17. 490 F. Supp. at 1103-04.

18. 490 F. Supp. at 1106-07.

19. 490 F. Supp. at 1107-11.

20. 490 F. Supp. at 1116-17.

21. *Id.*

22. 490 F. Supp. at 1111-12. The three alternative indicia of economic power that have been recognized are as follows:

Relying on *United States v. Loew's, Inc.,*[23] plaintiffs claimed that the copyrights concededly attached to the RDOS software created legal barriers from which the requisite economic power could be presumed. The district court rejected this claim noting that not only was the presumption of economic power not conclusive, but the sole fact of copyright notice was insufficient to establish the requisite economic power.[24] Plaintiffs alternatively argued that Data General enjoyed economic advantage by having customers "locked-in" to its computer software.[25] Plaintiffs contended that because customers spend millions of dollars designing applications software tailored to a particular operating system, they become financially committed to using only one software operating system, such as Data General's RDOS. This "lock-in" of customers to RDOS operating software effectively insulated Data General from the marketplace to enable it to impose discriminatory prices or terms upon its customers.[26] Noting the competitiveness of Data General's prices, the court rejected this argument and similar others relating to the CPU-memory tie-in.

The court ultimately concluded that whether Data General

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(1) A showing that the seller occupies a dominant position in the tying product market;

(2) a showing that the seller's product is sufficiently unique that he has some advantage not shared by his competitors in the market for the tying product; and

(3) a showing that a substantial number of customers have accepted the tie-in and there are no explanations other than the seller's economic power for their willingness to do so.

23.   371 U.S. 38, 45 (1962).

24.   490 F. Supp. at 1112.

25.   490 F. Supp. at 1114. The court of appeals explained the "lock-in" theory as follows:

> Briefly, defendant sells RDOS and NOVA CPUs primarily to original equipment manufacturers (OEMs) who combine them with application software (a set of instructions that allows the system to accomplish a particular task) to create a complete computer system for resale. Application system software for particular uses is developed by OEMs at substantial expense. . . . However, application software is designed to function with only a particular operating system. OEMs who construct their application software to function with defendant's RDOS therefore must purchase an RDOS for each computer system they assemble using that application software. Because of the tying condition, they must also purchase one of defendant's NOVA instruction set CPUs for each such computer system they sell.
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> An OEM can free itself from this "lock-in" only by abandoning its application software compatible with defendant's RDOS, in which it has a substantial investment, or converting the software so that it may be used with another operating system.

734 F.2d at 1342.

26.   490 F. Supp. at 1114-16.

possessed sufficient power in the tying product (RDOS software) market to raise prices or to require purchasers to accept burdensome terms that could not be exacted in a completely competitive market was a disputed issue of material fact.[27] Thus, summary judgment on this issue was precluded.

Lastly, the court considered legitimate business justificiation as an affirmative defense to the per se rule against tying arrangements. Data General argued that restricting RDOS software to use with NOVA CPUs was necessary to protect business good will and minimize service problems. The use of foreign CPU's with Data General's software would cause the software to malfunction more frequently and require greater field servicing which Data General would be unable to economically provide, with the end result being dissatisfied customers and the tarnishing of Data General's reputation. In rejecting this argument, the court first noted that legitimate business justifications are few and narrowly construed, prevailing only in the absence of less restrictive alternatives. Thus, even if Data General's assertions were accepted as true, the restraint on competition was not justifiable as less restrictive alternatives existed such as providing lesser warranties on software licensed for use with foreign CPUs.[28]

Alternatively, Data General argued it was required to bundle together software and CPUs in order to recover its substantial investment in software research and development; therefore, to permit manufacturers of NOVA emulators to reap the benefits of Data General's research and development by selling competing CPUs for use with Data General's software would be unfair.[29] The court rejected this argument stating recovery of investment costs were explicitly excluded from the narrowly construed business exceptions to the per se rule against tie-ins.[30]

Other business justifications were asserted and similarly rejected by the court on the grounds that less restrictive alternatives

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27. 490 F. Supp. at 1103.

28. 490 F. Supp. at 1121. The "good-will" defense is the most frequently raised defense in tie-in cases. 490 F. Supp. at 1120. The only situation in which the protection of good will may necessitate the use of tying clauses is where specifications for a substitute would be so detailed they could not practically be supplied. Standard Oil Co. v. U.S., 337 U.S. 293, 306 (1949). The ninth circuit has also suggested in dictum that a good will justification might be accepted where specifications could not be supplied because to do so would divulge trade secrets. Siegel v. Chicken Delight, Inc., 448 F. 2d 43, 51 (9th Cir. 1971), *cert. denied*, 405 U.S. 955 (1972).

29. 490 F. Supp. at 1121-22.

30. 490 F. Supp. at 1121.

were available.[31]

Thus, the sole issue of whether Data General possessed sufficient economic power in the tying product market to appreciably restrain competition in the tied product market proceeded to trial. After a 45 day trial, the jury rendered a verdict for the plaintiffs. Data General moved for judgment *non obstante veredicto* (judgment n.o.v.) or, in the alternative, reconsideration of the court's grant of partial summary judgment and for a new trial. Plaintiffs moved for an injunction and for trial on the issue of damages. The court granted Data General's motion for (judgment n.o.v.) or in the alternative for a new trial, and denied plaintiffs' motions.

In reconsidering the evidence on economic power, the court focused on the definitions of the relevant markets for the tying and tied products, and the degree of market analysis necessary to prove economic power in a tying case. Data General argued that extensive market analysis of such factors as suitability, cross-elasticity of demand and potential competition was required.[32] Plaintiffs argued proof of relevant markets was unnecessary in per se tying cases where economic power is predicated on uniqueness of the tying product, and that economic power over an appreciable number of buyers was all that was required.[33] The court held that although intricate market analysis and detailed evidence of certain factors was not required in the context of per se tying cases, some degree of market analysis was necessary.[34]

In reviewing the jury's findings on this issue, the district court concluded that no reasonable jury could have found that Data General possessed sufficient economic power in the tying product market to appreciably restrain competition in the tied product market as those markets had been defined.[35] Specifically, the court found that the existence of "locked-in" customers did not insulate Data General from competitive business restraints of the general market; that Data General's prices were competitive; and that Data Gen-

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31. 490 F. Supp. at 1122-23. The court rejected similar business justification defenses in connection with the CPU-memory tie finding less restrictive alternatives available, such as offering CPUs without main memory under a lesser warranty package than that accompanying a CPU-memory package, or providing specifications that foreign memory boards would be required to meet in order to be used with Data General's CPUs.

32. 529 F. Supp. at 807.

33. *Id.*

34. 529 F. Supp. at 808.

35. 529 F. Supp. at 814. The court did note, however, that the jury's definition of the relevant tying and tied product markets was clearly supported by the evidence. 529 F. Supp. at 812.

eral's software line, although inherently superior, was not unique.[36] Competitors were not prevented from developing functionally equivalent software, despite the existence of economic or legal barriers such as copyright, trade secret and trademark protection.

The court also found that plaintiff's failure to prove that Data General possessed the requisite economic power in the relevant tying product market necessarily meant that Data General could not exercise such power to restrain competition in the relevant tied product market.[37]

Plaintiffs appealed the district court's grant of Data General's motion for judgment n.o.v. or for a new trial.

On appeal, the Ninth Circuit Court of Appeals held that the district court had properly granted summary judgment on the first and third elements, adopting the district court's reasoning on those issues.[38] The court of appeals noted that the district court's separate product determination was supported by the recent United States Supreme Court case of *Jefferson Parish Hospital District No. 2 v. Hyde*[39] in that a demand existed for NOVA CPUs separate from the RDOS software, and each element of the NOVA computer system could have been provided separately and selected separately by customers if they had not been compelled by Data General to take both.[40]

The court of appeals also agreed with the district court's grant of summary judgment in favor of plaintiffs on the issues of whether plaintiffs had been damaged by the tie-in and whether the tie-ins were justified by legitimate business considerations.[41] However, the court of appeal held the district court erred in setting aside the jury's verdict for plaintiffs on the issue of economic power.[42]

Specifically, the court of appeals found the district court erred in interpreting the "sufficient economic power" standard in the case of *U.S. Steel Corp. v. Fortner Enterprises, Inc.*[43] as requiring proof that Data General had a monopoly or even a dominant position throughout the market for the tying product. The court of appeals explained that whereas possession of monopolistic power or market dominance are sufficient to establish per se illegality, they are not

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36. 529 F. Supp. at 814-18.
37. 529 F. Supp. at 818.
38. 734 F.2d 1336, 1339 (9th Cir. 1984), *cert. denied*, 105 S. Ct. 3534 (1985).
39. 104 S. Ct. 1551, 1561-65 (1984).
40. 734 F.2d at 1339.
41. 734 F.2d at 1339, n. 1.
42. 734 F.2d at 1339-40.
43. 429 U.S. 610 (1977) (hereinafter cited as "Fortner II").

required.[44] What is required in a per se case is a type of market power referred to as "leverage," which the court in *Jefferson Parish Hospital* defined as a supplier's ability to induce customers for one product to buy a second product they normally would not buy.[45] Thus, the appropriate inquiry was not whether Data General had power over the whole market for the tying product (RDOS software), but whether Data General's RDOS was sufficiently unique and desirable to an appreciable number of buyers to enable Data General to force those buyers to also buy a substantial volume of Data General's NOVA CPUs.[46] This standard is well supported by the cases cited in the court of appeals' opinion.[47]

In applying this standard to the instant case, the court of appeals found a jury could have reasonably concluded that the standard had been met. The admitted superiority and consumer popularity of RDOS in comparison with competing operating systems, and the fact that RDOS software could not be reproduced by competitors without copyright infringement and utilization of trade secrets, constituted abundant evidence that RDOS was particularly desirable to a substantial number of buyers and could not be readily produced by other sellers.[48] Furthermore, the lock-in of Data General's customers to the use of RDOS together with the minimum equipment configuration program provided additional support of the existence of Data General's possession of economic power.

The court of appeals explicitly rejected the district court's suggestion that the presumption of economic power from the existence of a copyright is inappropriate in the context of computer software: "The RDOS copyright established both the distinctiveness of RDOS and a legal bar to its reproduction by competitors. 'The requisite economic power is presumed when the tying product is patented or copyrighted.' The copyright confers upon defendant 'some advantages not shared by his competitors in the market for the tying product.' " (citations omitted.)[49]

The court of appeals also found the district court erroneously imposed the burden of proof on the issue of economic power on the

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44. 734 F.2d at 1339-40.

45. 104 S. Ct. at 1558.

46. 734 F.2d at 1341.

47. *See generally*, United States v. Loew's, Inc. 371 U.S. 38, (1962); Fortner I, 394 U.S. at 502-04; and Fortner II, 429 U.S. at 620.

48. 734 F.2d at 1341-42.

49. 734 F.2d at 1341. The premise of the district court's position was laid to rest in Apple Computer, Inc. v. Formula Int'l., Inc., 725 F.2d 521 (9th Cir. 1984) and Apple Computer, Inc. v. Franklin Computer Corp., 714 F.2d 1240, 1249-54 (3rd Cir. 1983). 734 F.2d at 1344, n. 5.

plaintiffs. The presumption of economic power created by the RDOS copyright shifted the burden to Data General to rebut the presumption.[50]

The court of appeals further found the district court's concern with whether there were reasonably interchangeable substitutes for RDOS in the operating systems market as a whole was misplaced. Noting that this question was of critical importance in monopoly cases, the court stated the concern with tying arrangements is not with the restraint on competition in the tying product market (operating software), but the restraint on competition in the tied product market (CPUs).[51] The focus with respect to the tying product was its uniqueness and desirability, not its market power. Thus, the crucial inquiry was not whether other operating systems with which RDOS competed were as good as or better than RDOS, but whether RDOS, available only from Data General, was sufficiently attractive to some customers to enable Data General to require those who wished to obtain RDOS to also buy NOVA CPUs.[52] The court of appeals found ample evidence of Data General's possession of such power. The fact that Data General's NOVA CPUs were competitively priced was irrelevant as Data General still could and did force the tie-in upon some buyers who, if free to choose, would have bought RDOS from Data General but "NOVA emulator" CPUs from others.[53]

Lastly, the court of appeals held that the district court erred in analyzing competitive conditions in the tied product market and in its conclusion that plaintiffs failed to prove an appreciable restraint in the market for the tied product. The court of appeals reaffirmed the rule that all that is required in per se cases is a showing that a substantial volume (an amount greater than "de minimis") of commerce has been foreclosed, which the court found clearly satisfied in this case.[54] Detailed analysis of competitive conditions in the tied product market is inappropriate.[55]

Accordingly, the court of appeals reversed the district court's decision to grant the judgment n.o.v. or, alternatively, a new trial. The United States Supreme Court denied Data General's petition for writ of certiorari on July 1, 1985,[56] and on August 28, 1985 a

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50.   734 F.2d at 1344.
51.   734 F.2d at 1345.
52.   734 F.2d at 1345-46.
53.   734 F.2d at 1346.
54.   734 F.2d at 1347.
55.   734 F.2d at 1347.
56.   105 S. Ct. 3534 (1985).

petition for rehearing was denied.[57] Trial on the issue of damages is still pending.

The court of appeals' holding in this case carries an important warning to those in the computer industry. In the highly competitive computer industry arena, a strong customer base and loyalty is an essential ingredient of survival. Marketing techniques such as tying arrangements which tend to assure the continued existence of customers and sales are tempting. However, as *Data General* illustrates, courts will not hesitate to strike down such arrangements and subject those who participate therein to substantial damages.

Tempted computer manufacturers and distributers should be aware that consistent with the harsh treatment of tying arrangements by antitrust law,[58] proving a per se illegal tying arrangement is not very difficult. For example, the "not an insubstantial effect on commerce" element is satisfied by a showing that the volume is merely not "de minimis." In *United States v. Loew's, Inc.* the Supreme Court held the sum of $60,800 to be a non de minimis amount,[59] and in *Fortner I* the sum of almost $200,000 was not looked upon as "paltry or insubstantial."[60]

It should also be noted that an illegal tying arrangement does not necessarily require that one party or entity offer both the tying product and the tied product. A violation may be found if the offeror of the tying product has an economic interest in the tied product, even though the latter is manufactured or otherwise produced by another party or entity.[61] Thus, where the owner of the tying product exerts its coercive power to restrict the trade of the tied product sold by a third person in exchange for the extra benefit extorted from the latter, such is sufficient to be a violation.[62] Furthermore, with respect to the computer industry in particular, two computer products may be illegally tied. This would occur when the technological relationship between the two computer products compels the dual purchase which ties the products, rather than to achieve some technologically beneficial result.[63]

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57.   106 S. Ct. 18 (1985).

58.   490 F. Supp. at 1099.

59.   371 U.S. 38, 49 (1962).

60.   394 U.S. at 501 (1969).

61.   Suburban Mobile Homes v. Amtac Communities, 101 Cal. App. 3d 532, 547, 161 Cal. Rptr. 811, 819 (1980).

62.   *Id.* at 548, 161 Cal. Rptr. at 820. *See also* Osborn v. Sinclair Refining Co., 286 F.2d 832, 839-40 (4th Cir. 1960): "an amount which yields the defendant an extraneous recovery is sufficient."

63.   Response of Carolina, Inc. v. Leasco Response, Inc., 537 F.2d 1307, 1330 (5th Cir. 1976).

In addition, separate availability of the tying product will not preclude antitrust liability where a pricing policy has been established in such a way that the only viable economic option is to purchase the tying and tied products in a single package.[64] Also, as illustrated in *Data General*, even competitive pricing will not protect a seller from an otherwise unlawful tying arrangement.

Lastly, *Data General* reaffirms the rule that in determining whether sufficient economic power exists in per se unlawful tying arrangement cases, all that need be shown is that the tying product is sufficiently unique and desirable to an appreciable number of buyers to enable the seller to force buyers to purchase products they otherwise would have preferred not to buy, or would have preferred to buy elsewhere. This element is relatively simple to establish considering the fact that most computer products are either copyrighted or patented, and sufficient economic power may be presumed from copyright or patent of the tying product.

In conclusion, in developing a marketing strategy, marketing managers, strategists and promoters should heed the warning of *Data General* by carefully avoiding the tying of any two separate products together in the hopes of guaranteeing future sales and customers.

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64. *See, e.g.,* Colorado Petroleum Marketers Ass'n v. Southland Corp., 476 F. Supp. 373, 376-77 (D. Colo. 1979).

CRIMINAL PROSECUTION OF TRADE SECRET THEFT
People v. Gobal, 171 Cal. App. 3d 524, 217 Cal. Rptr. 487 (1st Dist. 1985).

The California Court of Appeal for the 1st district has affirmed a judgment against Peter K. Gopal, finding the defendant guilty of trade secret theft under California Penal Code section 499c, and receipt of stolen property under California Penal Code section 496. The court held that an "article"[1], representing a trade secret also includes a "copy" of such article, and anything which may be the subject of theft can also be "property" under section 496. The court further held that the receipt of a copy of stolen trade secrets is a crime in violation of section 496. *People v. Gopal*[2] represents the first reported case dealing with Penal Code section 499c since *People v. Serrata* in 1976,[3] and only the second reported decision to date involving criminal prosecution for trade secret theft.

The *Gopal* case arose out of a "sting" operation relating to the alleged theft of trade secrets from "Silicon Valley" firms manufacturing semiconductor devices and computer chips. The defendant offered to sell and did deliver stolen property to undercover corporate security officers, resulting in his arrest.[4] Thereafter, a warrant was obtained to search the defendant's condominium and business premises. With the assistance of several engineers and security officers from Intel Corporation and National Semiconductor Corporation,[5] police found large quantities of articles relating to the manufacture of semiconductors. These articles of the computer chip manufacturing process, such as data base tapes, reticles, and overlays, can enable a competitor to bypass the substantial time and expenses involved in circuit design, digitizing, and checking. Possession of these components can save a manufacturer the costs involved in reverse engineering an end product.[6]

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1. 499c(a)(1)(4) states in part that an "article means any object, material, device, or substance or copy thereof. . . ." Section 499c was amended in 1983, yet this provision remains. Unless otherwise indicated, references to section 499c are to the version in effect during the alleged offenses.

2. 171 Cal. App. 3d 524, 217 Cal. Rptr. 487 (1st Dist. 1985).

3. 62 Cal. App. 3d 9, 133 Cal. Rptr. 144 (1st Dist. 1985).

4. 171 Cal. App. 3d at 528, 217 Cal. Rptr. at 489.

5. The validity of this search was upheld in People v. Superior Court, 104 Cal. App. 3d 1001, 163 Cal. Rptr. 906 (1st Dist. 1980).

6. "Reverse engineering" is an accepted and lawful practice in industry. It involves starting with a known product and working backwards to discover the process by which it

The prosecution based its case on the defendant's possession, copying, and marketing of the articles relating to the manufacture of semiconductors. The defendant acquired the articles and information from National Semiconductor Corporation and Intel Corporation employees who were obligated not to disclose them.[7] After a thirty-one day court trial, Gopal was found guilty of conspiracy to commit a crime, offering a bribe to acquire a trade secret, and four counts of possession of stolen property.

On appeal, the court stated the legislature expressly declared the purpose for enacting section 499c was to "clarify and restate existing law with respect to crimes involving trade secrets and to make clear that articles representing trade secrets, including trade secrets represented thereby, constitute goods, chattels, materials, and property, and can be the subject of criminal acts."[8] With the legislative intent in mind, the court interpreted the statute and held that an "article" representing a trade secret includes a "copy" of such article.[9] The court focused on the content of the information and not the form in which it is reproduced in determining that the property possessed by the defendant embodied trade secrets belonging to Intel Corporation.

In affirming the district court's findings as to the embodiment of trade secrets within the stolen property, the court of appeals noted the language of section 499c. It provides that, "a trade secret shall be presumed to be secret when the owner thereof takes measures to prevent it from becoming available to persons other than those selected by the owner to have access thereto."[10] The court of appeals examined the evidentiary record of the district court and found that detailed and elaborate security measures were taken by the owners of the articles used to manufacture semiconductors. At Intel Corporation, physical access to the plant was controlled through the use of guards, employee identification badges, visitor escorts, and special sign-in procedures. Security measures at National Semiconductor Corporation were similar. The check-out of proprietary items was controlled by requiring a manager's approval, confidential materials were kept locked up, and documentary materials were shredded when no longer needed. Employees at

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was developed and manufactured. Kewanee Oil Co. v. Bicron Corp., 416 U.S. 470, 476 (1974).

    7.   Proceedings against these defendants were severed from the case against Gopal. *See* 171 Cal. App. 3d at 529, 217 Cal. Rptr. at 489.

    8.   171 Cal. App. 3d at 541, 217 Cal. Rptr. at 498.

    9.   CAL. PENAL CODE § 499c(a)(1), (4).

   10.   CAL. PENAL CODE § 499c(a)(3).

both corporations were required to sign nondisclosure agreements when hired, upon termination, and periodically during the course of their employment.[11]

The court of appeals, in citing *People v. Serrata*, stated that these measures compared favorably with security precautions taken at IBM Corporation.[12] In *Serrata*, security precautions were a central issue as the defense alleged IBM Corporation had not taken reasonable measures to protect the secrecy of its information.[13] The standard of care regarding security precautions in trade secret cases continues to evolve as technology and security advances are utilized by more businesses. Accordingly, the court found sufficient evidence to indicate that Intel Corporation and National Semiconductor Corporation had taken sufficient measures to allow the presumption of secrecy set forth in section 499c, to be applied.[14]

In addition to being a trade secret within the meaning of section 499c, the information, design, process or procedure must also be generally unavailable to the public, and it must give the owner an advantage over competitors who do not know of or use the trade secret.[15] On the issue of general unavailability to the public, the defense focused on the end product rather than the articles which he possessed. Strictly applying the language of section 499c, the court of appeals held that the statutory definition refers not only to the end product, but also to "any portion or phase of any scientific or technical information, design. . . ."[16] The "trade secret" at issue, the court held, was not the end product, but it was embodied in the various articles relating to the manufacture of the end product. The design information contained in these articles was overwhelmingly found to be not generally available to the public.[17]

Consequently, the court of appeals also found that the unavailability of these products gave the owner an advantage over competitors who did not know of or use them.[18] Even though an end

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11. 171 Cal. App. 3d at 538, 217 Cal. Rptr. at 495.

12. *Id.*

13. "IBM has taken numerous measures to protect its trade secrets, e.g., stamping all secret drawings as, "IBM confidential," auditing the files of employees for the unauthorized possession of documents, requiring countersignatures when documents were checked out, and installing special magnetic locks on "high security" buildings . . . ." 62 Cal. App. 3d at 23, 133 Cal. Rptr. at 152.

14. CAL. PENAL CODE § 499c(a)(3).

15. 171 Cal. App. 3d at 539, 217 Cal. Rptr. at 496 (in reference to section 499(c) subd. (a)(3)).

16. *Id.* (citing section 499c(a)(3)).

17. *Id.*

18. *Id.*

product was on the market and susceptable to reverse engineering, having copies of the articles used to manufacture semiconductors would substantially reduce the amount of time necessary to reverse engineer. The court of appeals concluded that there was sufficient evidence to support the district court's findings that the various articles, relating to the manufacture of semiconductors, were "the embodiment of trade secrets."[19]

As a guide to future practice, *People v. Gopal* provides some important points. The court of appeals rejected the defendant's contention that receipt of stolen trade secrets is not a crime. Yet, section 499c does not create a new crime so much as it defines a particular species of theft. The utilization of criminal prosecutions for trade secret theft may be the most valuable precedent of *Gopal*. The unique nature of trade secret property need no longer inhibit prosecutors from bringing criminal actions for theft or wrongful misappropriation.

Kevin Gerry

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19. *Id.*