

**TRADE SECRETS AND NONCOMPETE AGREEMENTS IN TEXAS:  
THE LAW IS CHANGING. ARE YOU KEEPING UP?**

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**TEXAS BAR CLE**



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## I. INTRODUCTION

This paper provides a comprehensive summary of current Texas law regarding: (1) the inevitable disclosure doctrine; (2) covenants not to compete; (3) non-recruitment covenants; (4) the fiduciary obligations of at-will employees; (5) protecting or obtaining trade secrets in state and federal court litigation; (6) misappropriation of trade secrets cases; and (7) the duty of preservation and spoliation issues in discovery.

## II. THE CURRENT STATE OF THE “INEVITABLE DISCLOSURE” DOCTRINE IN TEXAS

### A. What Is The “Inevitable Disclosure” Doctrine?

#### 1. Background Regarding Trade Secret Misappropriation

To understand the inevitable disclosure doctrine, it is necessary to first have an understanding of the law regarding trade secret misappropriation. Under Texas law, trade secret misappropriation is established by showing that a trade secret existed, the trade secret was acquired through a breach of a confidential relationship or was discovered by improper means, and the defendant used the trade secret without the plaintiff’s authorization. *See Tex. Integrated Conveyor Sys., Inc. v. Innovative Conveyor Concepts, Inc.*, 300 S.W.3d 348, 366-67 (Tex. App.–Dallas 2009, pet. denied); *Avera v. Clark Moulding*, 791 S.W.2d 144, 145 (Tex. App.–Dallas 1990, no writ); *CQ, Inc. v. TXU Mining Co.*, 565 F.3d 268, 273 (5th Cir. 2009); *Alcatel USA, Inc. v. DGI Tech.*, 166 F.3d 772, 784 (5th Cir. 1999). Upon the formation of an employment relationship certain duties arise apart from any written contract. For example, an employee is prohibited from using confidential or proprietary information acquired during the relationship in a manner adverse to his employer. This obligation survives termination of employment. Furthermore, though it does not bar the former employee from using the general knowledge, skill, and experience acquired during employment, this duty does prevent him from utilizing confidential information or trade secrets acquired during the course of employment. *See Rugen v. Interactive Bus. Sys., Inc.*, 864 S.W.2d 548, 551 (Tex. App.–

Dallas 1993, no writ); *Executive Tele-Communication Sys., Inc. v. Buchbaum*, 669 S.W.2d 400, 403 (Tex. App.–Dallas 1984, no writ). Injunctive relief is an appropriate remedy to curtail violation of this duty. *Thermotics, Inc. v. Bat-Jac Tool Co.*, 541 S.W.2d 255 (Tex. Civ. App.–Houston [1st Dist.] 1976, no writ); *Hyde Corp. v. Huffines*, 158 Tex. 566, 314 S.W.2d 763 (1958).

A trade secret is “any formula, pattern, device or compilation of information which is used in one’s business and presents an opportunity to obtain an advantage over competitors who do not know or use it.” *In re Bass*, 113 S.W.3d 735, 739 (Tex. 2003). To determine whether a trade secret exists, a court weighs six fact-intensive factors: (1) the extent to which the information is known outside of the business; (2) the extent to which it is known by employees and others involved in the business; (3) the extent of measures taken to guard the secrecy of the information; (4) the value of the information to the business and to its competitors; (5) the amount of effort or money expended in developing the information; and (6) the ease or difficulty with which the information could be properly acquired or duplicated by others. *See id.* (citing Restatement of Torts § 757 cmt. b. (1939); Restatement (Third) of Unfair Competition § 39 reporter’s note cmt. d. (1995)); *In re Cooper Tire & Rubber Co.*, 313 S.W.3d 910, 915 (Tex. App.–Houston [14th Dist.] 2010, no pet.) (concluding trade secret protection existed). The party claiming a trade secret need not satisfy all six factors because trade secrets do not fit neatly into each factor every time. *In re Bass*, 113 S.W.3d at 740; *In re Cooper Tire & Rubber Co.*, 313 S.W.3d at 915. The status of the information claimed as a trade secret must be determined through a comparative evaluation of all the relevant factors, including the value, secrecy, and definiteness of the information as well as the nature of the defendant’s misconduct. *In re Bass*, 113 S.W.3d at 739.

Under the umbrella of protected data are compilations of information which have a substantial element of secrecy and provide the employer with an opportunity for advantage over competitors. *See In re Bass*, 113 S.W.3d at 739; *Rugen, Inc.* 864 S.W.2d at 552; *Luccous v. J.C. Kinley Co.*, 376 S.W.2d 336, 338 (Tex. 1964). Examples of such

data include pricing information, customer lists, client information, customer preferences, buyer contacts, and market strategies. *See Rugen*, 864 S.W.2d at 552; *Murrco Agency, Inc. v. Ryan*, 800 S.W.2d 600, 604-605 & n. 5 & 6 (Tex. App.–Dallas 1990, no writ); *Bertotti v. C.E. Shepherd Co.*, 752 S.W.2d 648, 654-55 (Tex. App.–Houston [14th Dist.] 1988, no writ); *see also Rimkus Consulting Group, Inc. v. Cammarata*, 688 F. Supp. 2d 598, 668 (S.D. Tex. 2010) (Rosenthal, J.) (surveying Texas law on this issue and concluding that “[b]ased on the evidence presented at the injunction hearing held in 2008, this court concluded that Rimkus’s client database, pricing information, and business plan were the type of information that courts had recognized as entitled to trade secret protection.”).

Moreover, the mere fact that knowledge of this information may be acquired through proper means does not preclude protection from those who would secure that knowledge by unfair means. *See Weed Eater, Inc. v. Dowling*, 562 S.W.2d 898, 901 (Tex. Civ. App.–Houston [1st Dist.] 1978, writ ref’d n.r.e.). When deciding whether to grant or deny a request for a temporary injunction, the trial court does not decide whether the information sought to be protected is a trade secret; rather it determines whether the applicant has established that the information is entitled to trade secret protection until a trial on the merits. *See INEOS Group Ltd. v. Chevron Phillips Chemical Co., LP*, 312 S.W.3d 843, 848 (Tex. App.–Houston [1st Dist.] 2009, no pet.); *Sharma v. Vinmar Int’l, Ltd.*, 231 S.W.3d 405, 424 (Tex. App.–Houston [14th Dist.] 2007, no pet.); *Ctr. for Econ. Justice v. Am. Ins. Ass’n*, 39 S.W.3d 337, 343 (Tex. App.–Austin 2001, no pet.); *T-N-T Motorsports, Inc. v. Hennessey Motorsports, Inc.*, 965 S.W.2d 18, 23-24 (Tex. App.–Houston [1st Dist.] 1998, no pet.). That an order is issued granting trade secret protection does not mean the protected information is a trade secret. *See Ctr. for Econ. Justice*, 39 S.W.3d at 343. When an effort is made to keep material important to a particular business from competitors, trade secret protection is warranted. *See INEOS Group Ltd.*, 312 S.W.3d at 854; *Rugen*, 864 S.W.2d at 552; *Gonzales v. Zamora*, 791 S.W.2d 258, 265 (Tex. App.–Corpus Christi 1990, no writ).

When a defendant possesses trade secrets and is in a position to use them, harm to the trade secret owner may be presumed. *See T-N-T Motorsports, Inc.*, 965 S.W.2d at 24 (holding that appellant possessed confidential information and was in a position to use it; thus, appellant was likely to use information to former employer's detriment). The threatened disclosure of trade secrets constitutes irreparable injury as a matter of law. *Williams v. Compressor Eng'g Corp.*, 704 S.W.2d 469, 471 (Tex. App.–Houston [14th Dist.] 1986, writ ref'd n.r.e.) (citing *FMC Corp. v. Varco Int'l, Inc.*, 677 F.2d 500, 503 (5th Cir. 1982)).

## **2. The Inevitable Disclosure Doctrine**

The inevitable disclosure doctrine builds on these legal rules relating to trade secrets, and holds as follows:

[T]here are circumstances in which trade secrets inevitably will be used or disclosed, even if the defendant swears that he or she will keep the information confidential. Courts applying the doctrine have differed over its reach and the circumstances required for its application, but, generally speaking, the doctrine applies when a defendant has had access to trade secrets and then defects to the trade secret owner's competition to perform duties so similar that the court believes that those duties cannot be performed without making use of trade secrets relating to the previous affiliation.

*See Cardinal Health Staffing Network, Inc. v. Bowen*, 106 S.W.3d 230, 242 (Tex. App.–Houston [1st Dist.] 2003, no pet.) (quoting Linda K. Stevens, *Trade Secrets & Inevitable Disclosure*, 36 Tort & Ins. L.J. 917, 929 (Summer 2001)).

### **B. Have Texas Courts Adopted The “Inevitable Disclosure” Doctrine?**

No Texas case *expressly* adopts the inevitable disclosure doctrine. *Cardinal Health Staffing Network, Inc.*, 106 S.W.3d 242 (“We have found no Texas case expressly adopting the inevitable disclosure doctrine . . .”). The court in *Cardinal Health Staffing*

*Network, Inc.* refused to apply the doctrine based on the particular facts of the case, which showed the plaintiff's ex-employee was perfectly capable of performing his job with his new employer without using his ex-employer's trade secrets or confidential information. Likewise, in *M-I, L.L.C. v. Stelly*, Slip Copy, Civil Action No. H-09-CV-01552, 2009 WL 2355498, at \*7 (S.D. Tex., July 30, 2009), Judge Gray H. Miller declined to apply the inevitable disclosure doctrine based on the *Cardinal Health Staffing Network, Inc.* case, and the fact that the "[p]laintiff has similarly failed to show that Stelly and Squyres took any confidential information with them or that they are using such information at Wellbore; the Court will therefore not apply the inevitable disclosure doctrine." *Id.*

But, there are several Texas cases that implicitly rely on a probable or inevitable disclosure theory to enjoin an ex-employee from performing specific types of work for a new employer even where there is no proof that the ex-employee misappropriated his or her ex-employer's trade secrets or confidential information. *See* 36 A.L.R. 6th 537, *Applicability of Inevitable Disclosure Doctrine Barring Employment of Competitor's Former Employee* (2008) (summarizing Texas cases applying the probable or inevitable disclosure theory as a basis to enjoin an ex-employee from working in a specific area for a competitor). One such case is *Baker Petrolite Corp. v. Spicer*, No. 06-1749, 2006 WL 1751786 at \*10-11 (S.D. Tex. 2006). There, a former employee, Spicer, was accused of misappropriating his former employer's trade secrets and confidential information. *See id.* at \*3. Judge Gray H. Miller found that Spicer's covenant not to compete was unenforceable because it was not "ancillary to or part of" an otherwise enforceable agreement, as required by Section 15.50 of the Texas Business and Commerce Code. *See id.* at \*7. There was also no proof that Spicer misappropriated or used Baker Petrolite's trade secrets or confidential information. *Id.* at \*9.

Nevertheless, Judge Miller applied a probable or inevitable disclosure theory and granted a preliminary injunction in favor of the former employer. *See id.* at \*11. The injunction was carefully tailored to allow Spicer the maximum amount of freedom to

pursue new employment, while still protecting the former employer's confidential information. *See id.* at \*10. In addition to being generally enjoined from disclosing any of his former employer's trade secrets, Spicer was specifically enjoined from working with any customers of his former employer with which he had sales contact during the last eighteen months of his employment, at the specific locations at which he worked for his former employer. *See id.* at \*10-11. The court determined that the injunction would not unfairly limit Spicer's freedom to advance his career because of the large number of non-Baker Petrolite customers he could work with, and the numerous other locations at which he could work. *See id.* Therefore, the court held that it was appropriate and necessary to enjoin Spicer from working with particular customers at particular locations where the risk of using or disclosing Baker Petrolite trade secrets was particularly high. *See id.* As the court held:

Due to the inherent threat of disclosure, the nature of the information at issue, and the direct competitive relationship between Baker and Multichem, Spicer is further enjoined from working with Baker customers with which he had contact in a sales capacity during the last eighteen months of his employment with Baker.

*Id.* at \*11.

*Spicer* did not use the phrase "inevitable disclosure." But, it applied the doctrine. *Spicer* relied on *FMC Corp.*, 677 F.2d at 503 and *Weed Eater, Inc.*, 562 S.W.2d at 901. In *FMC Corp.*, the defendant, Best Industries, having tried unsuccessfully to develop its own version of FMC's technology, recruited an FMC engineer involved in research and product development to come work for Best. *See id.* FMC and the former employee, Witt, had no covenant not to compete, but Witt had signed FMC's standard nondisclosure agreement as part of his employment. *See id.* at 505. FMC sought a preliminary injunction enjoining Witt from using or disclosing any FMC trade secrets, and enjoining Best from placing Witt in a position that would create the threat of inherent disclosure. *See id.* at 501.

The district court denied the application, but the Fifth Circuit Court of Appeals reversed, holding that FMC had proved all four requirements necessary for preliminary injunctive relief. *See id.* at 502. The Fifth Circuit rejected the defendant's assertion that Witt would be able to decide for himself what information he could or could not properly disclose to Best while working on the same technology he had worked on for FMC. *See id.* at 504. Instead, the Court noted that "[e]ven assuming the best of good faith, Witt will have difficulty preventing his knowledge of FMC's 'Longsweep' manufacturing techniques from infiltrating his work." *Id.* In the Court's view, the only way to safeguard FMC's trade secrets was to grant the requested injunction, enjoining Witt from divulging any of FMC's trade secrets, and enjoining Best from placing or maintaining Witt in a position that would pose an inherent threat of disclosure or use of FMC's trade secrets. *Id.* at 505.

In *Weed Eater, Inc. v. Dowling*, a former employee of the plaintiff was enjoined from working for a competitor who manufactured and developed lawn and garden products. The defendant was a former vice president of manufacturing who had designed and organized an assembly line for the production of string-line trimmers. He left the plaintiff's employment to supervise an assembly line at a company that wanted to start producing the trimmers itself, rather than buy them from Weed Eater. The court found that prohibiting the defendant from using the plaintiff's trade secrets would be insufficient because the defendant inevitably would disclose his knowledge of the trade secrets if allowed to work in the same area of production. Thus, the court prohibited the defendant from working in any capacity relating to the manufacturing of trimmers. As the court reasoned:

Even in the best of good faith, Dowling can hardly prevent his knowledge of his former employer's confidential methods from showing up in his work. The only effective relief for Weed Eater is to restrain Dowling from working for Hawaiian Motor Company in any capacity related to the

manufacture by Hawaiian Motor Company of a flexible line trimming device.

562 S.W.2d at 902.

In *Conley v. DSC Communications Corp.*, No. 05-98-01051-CV, 1999 WL 89955, at \*3 (Tex. App.–Dallas Feb. 24, 1999, no pet.) (not designated for publication) the Dallas Court of Appeals adopted what might be viewed as a modified version of the inevitable disclosure doctrine, holding that enjoining an employee from using an employer’s confidential information is appropriate when it is *probable* that the former employee will use the confidential information for his benefit (or his new employer’s benefit) or to the detriment of his former employer. *Conley*, 1999 WL 89955, at \*4 (emphasis in original); *see also* *Rugen*, 864 S.W.2d at 552 (“Rugen is in possession of IBS’s confidential information and is in a position to use it. Under these circumstances, it is probable that Rugen will use the information for her benefit and to the detriment of IBS.”); *Williams*, 704 S.W.2d at 471 (applying doctrine, but not by name). The court also rejected the notion that the new employer’s alleged efforts to protect against the disclosure or use of the ex-employer’s trade secrets defeated the ex-employer’s right to an injunction. As the court stated, “[w]e reject Conley’s suggested factor of the new employer’s efforts to protect the trade secrets of the former employer. At best, relying on the new employer to protect the trade secrets of the former employer when those trade secrets could work to the new employer’s advantage is little better than asking the fox to guard the henhouse. The richer the henhouse, the less wise it is to trust even the most responsible and reliable of foxes.” *Id.* at \*6. Likewise, the court held that an injunction was proper notwithstanding the lack of proof of misconduct against the ex-employee, and the fact that there was no non-competition agreement.

In *Rugen*, 864 S.W.2d at 552, the court held that it was not an abuse of discretion to enter a temporary injunction against a former employee, a sales account manager, prohibiting the employee from using any confidential information obtained from her former employer to solicit or transact business with the employer’s consultants or

customers, where the evidence indicated that the employee possessed confidential information of the employer and operated a firm in direct competition with employer, so it was “probable” that she would use the confidential information. The employee worked as an account manager for a personnel company providing computer consulting and contracting services. She left the former employer and started her own firm in the same business. The former employer sought an injunction against the employee to enforce a noncompetition agreement she had signed and to prevent her from using confidential information she had gained while working for the former employer. The trial court determined that the noncompetition agreement was unenforceable, but enjoined the employee from calling on, soliciting, or transacting business with consultants employed or retained by the former employer or customers of the former employer and from using confidential business information, methods, and trade secrets that she learned while employed by the former employer. The court recognized that an injunction was appropriate when necessary to prohibit an employee from using confidential information to solicit the former employer’s clients. The employee argued that the injunction should not have been granted because the evidence did not show that she had wrongfully used and would continue to use any confidential information. However, the court found evidence indicating that the employee possessed confidential information of the former employer and operated a firm in direct competition with the former employer. She was in possession of the former employer’s confidential information and was in a position to use it. Under these circumstances, the court found it probable that the employee would use the information for her benefit and to the detriment of the former employer. The court noted that at times, an injunction was the only effective relief that an employer had when a former employee possessed confidential information and did not believe that the trial court abused its discretion by granting the temporary injunction.

### **C. What Factual Factors Militate Towards Application Of The “Inevitable Disclosure” Doctrine?**

From an analysis of the above-referenced cases in this area, it appears that an inevitable disclosure doctrine claim is most likely to be accepted by a Texas court when:

- An employer targets specialized employees for hire specifically because they are weak in the technology areas and need to obtain talent from competitors to catch up. *Compare Cardinal Health Staffing Network, Inc.*, 106 S.W.3d at 241-42 (declining to apply the inevitable disclosure doctrine, in part because the new employer had devised a business plan for its own interim pharmacy staffing business over a year before it hired the plaintiff's ex-employee and it was clear that the new employer would have started this business with or without him) *with FMC Corp.*, 677 F.2d at 505 (applying doctrine because plaintiff company had clearly superior product that it invested heavily in and the company that hired plaintiff's ex-employee was far behind in technology). *But see Conley*, 1999 WL 89955, at \*4-5 (noting that this type of evidence is not required in all cases to support the imposition of the inevitable disclosure doctrine).
- The case involves research and product development employees – the key employees a company relies on to develop and refine valuable new technologies and give it a competitive edge. *See FMC Corp.*, 677 F.2d at 505 (applying doctrine because plaintiff company had clearly superior product that it invested \$85 million dollars and took extraordinary steps to protect its secrecy).
- The case involves an employee who went to work for a company that will become more competitive in the at-issue technology areas more quickly because it hired the employee. *Weed Eater, Inc.*, 562 S.W.2d at 902 (relying on same proof in granting injunctive relief).
- The company the employee went to work for has rejected requests to describe the employee's duties or to ensure the ex-employer's confidential information will not be utilized. *See Spicer*, 2006 WL 1751786 at \*9-11 (relying on the fact that the new employer had done nothing to ensure that the former employer's confidential information would not be used by the

defendant in applying the legal equivalent of the inevitable disclosure doctrine); *FMC Corp.*, 677 F.2d at 504 (same). Note: Even when the new employer has taken such efforts, some courts still apply the inevitable disclosure doctrine. *See Conley*, 1999 WL 89955, at \*6 (noting that “the richer the henhouse, the less wise it is to trust even the most responsible and reliable of foxes”).

- The facts show the employee’s duties are significantly the same or similar at their new employer as they were at their former employer. *Conley*, 1999 WL 89955, at \*5 (noting that this type of evidence is relevant to support the imposition of the inevitable disclosure doctrine).
- The employee could easily memorize his or her ex-employer’s confidential information and trade secrets. *See Spicer*, 2006 WL 1751786 at \*9-11 (relying on such evidence in applying the legal equivalent of the inevitable disclosure doctrine); *Williams*, 704 S.W.2d at 471 (noting that plaintiff’s ex-employee testified that he “had a photographic memory and is able to observe the way something is made and then copy it” in applying doctrine).
- The new employer refuses to acknowledge that the information is a trade secret – so that any promise not to use or disclose our confidential or trade secret information is not truly an effective protection for the former employer. *See FMC Corp.*, 677 F.2d at 505 (applying inevitable disclosure doctrine partially because the new employer argued that some information that was clearly a trade secret was not and, therefore, “without the injunction, Witt [the ex-employee] may, out of ignorance of what information constitutes a trade secret, reveal the confidential matters FMC seeks to protect”).
- The former employee worked on projects in specific technology areas for their former employer that they are now working on at their new employer.

*Conley*, 1999 WL 89955, at \*4-5 (noting that this type of evidence tends to support the imposition of the inevitable disclosure doctrine).

- The fact that the former employer would not know for years if the former employee's use of its trade secrets has resulted in harm helps prove irreparable harm. *See Williams*, 704 S.W.2d at 471 (relying upon same evidence in similar case to enjoin plaintiff's former manufacturing manager).
- The information and expertise that the ex-employee took with him or her (if even just in his or her head) regarding the technology areas are: (a) information the employee must have to do their jobs with his or her new employer; and (b) truly the former employer's trade secrets, not general concepts and information that are publicly available. *See Cardinal Health Staffing Network, Inc.*, 106 S.W.3d at 241-42 (declining to apply the inevitable disclosure doctrine, in part because the information that the plaintiff's ex-employee needed to develop business contacts for the new employer was available publicly).
- Note that proof of misconduct or wrongdoing by the ex-employee is not required under Texas case law, though it is helpful. *See Conley*, 1999 WL 89955, at \*4-5 (noting that proof of ex-employee's misconduct is helpful to a plaintiff seeking an injunction based on inevitable disclosure, but it is not required in all cases); *FMC Corp.*, 677 F.2d at 504 (applying doctrine without proof of actual misappropriation).

### **III. UPDATE ON COVENANTS NOT TO COMPETE LAW IN TEXAS**

#### **A. Requirements Of An Enforceable Noncompetition Agreement In Texas**

A noncompetition covenant's enforceability is ultimately a question of law for the court. *Light v. Centel Cellular Co.* 883 S.W.2d 642, 644 (Tex. 1994). To be enforceable, a noncompetition covenant must: (1) be ancillary to an otherwise enforceable agreement

at the time that the agreement is made; and (2) contain limitations of time, geographic area, and scope of activity that are reasonable and that do not impose greater restraint than necessary to protect the company's goodwill or other business interests. TEX. BUS. & COM. CODE ANN. § 15.50 (Vernon 2002). The Court must find only one non-illusory promise to support a noncompetition agreement. *Ireland v. Franklin*, 950 S.W.2d 155, 158 (Tex. App.–San Antonio 1997, no pet.). Both of these two requirements are discussed below.

**1. Ancillary To An Otherwise Enforceable Agreement**

a. In General

A covenant not to compete is “ancillary to or part of” an otherwise enforceable agreement at the time it was made if: (a) the consideration given by the employer in that agreement gives rise to the employer's interest in restraining the employee from competing; and (b) the covenant is designed to enforce the employee's consideration or return promise in that agreement. *Light*, 883 S.W.2d at 647; *see also Alex Sheshunoff Mgmt Servs., L.P. v. Johnson*, 209 S.W.3d 644, 648-51 (Tex. 2006).<sup>1</sup> Under *Light*, the clearest type of consideration that satisfies this requirement is an employer's promise to give an employee confidential information or trade secrets in exchange for the employee's promise not to disclose such information. *Light*, 883 S.W.2d at 647 fn. 14. “[B]usiness goodwill and confidential or proprietary information” are examples of interests that warrant protection by a non-compete covenant. *Sheshunoff*, 209 S.W.3d at 649. *See also Curtis v. Ziff Energy Group, Ltd.*, 12 S.W.3d 114, 118 (Tex. App.–Houston [14th Dist.] 1999, no pet.) (finding a noncompete covenant ancillary to an otherwise enforceable agreement where “the covenant not to compete [was] designed to enforce [the employee's] consideration not to disclose or use the confidential information or trade secrets after employment”); *Ireland*, 950 S.W.2d at 158 (finding a noncompete covenant

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<sup>1</sup> Note: non-solicitation of customer agreements are subject to the same analysis as covenants not to compete. *See Miller Paper Co. v. Roberts Paper Co.*, 901 S.W.2d 593, 600 (Tex. App.–Amarillo 1995, no writ) (stating that “other than the moniker assigned it, nothing truly differentiates the [non-solicitation] promise at bar from a covenant not to compete”).

ancillary to an otherwise enforceable agreement where “the covenant not to compete [was] designed to enforce [the employee’s] consideration not to disclose or use . . . trade secrets”).

A wide variety of confidential information can satisfy this first requirement, and give rise to an interest worthy of protection through a non-compete agreement. For example, knowledge of a unique customer base and knowledge of the equipment or products used by each of the employer’s customers are protectable interests. *See Stone v. Griffin Comm. & Security Systems, Inc.*, 53 S.W.3d 687, 694 (Tex. App.–Tyler 2001, no pet.). Likewise, information concerning acquisition strategies, compensation and benefits formulas, and payment rates may be considered confidential information that is protectable through a non-compete. *See TransPerfect Translations, Inc. v. Leslie*, 594 F. Supp. 2d 742, 754 (S.D. Tex. 2009); *Teel v. Hospital Partners of America, Inc.*, No. H-06-cv-3991, 2008 WL 346377, \*7 (S.D. Tex. Feb. 6, 2008). The information need not be a trade secret: “Moreover, a covenant not to compete is enforceable not only to protect trade secrets but also to protect proprietary and confidential information.” *Gallagher Healthcare Ins. Services v. Vogelsang*, 312 S.W.3d 640, 652 (Tex. App.–Houston [1st Dist.] Aug 21, 2009, pet. filed) (citing *Light*, 883 S.W.2d at 647 n. 14). “Customer information is a legitimate interest which may be protected in an otherwise enforceable covenant not to compete.” *Id.* (citations omitted).

After *Light*, the courts struggled with the question of whether the employer had to give the employee the confidential information at the very moment the employee signed the non-compete agreement for the agreement to be enforceable. In 2006, the Texas Supreme Court resolved that question in a pro-enforcement fashion. It held that non-compete covenants can be considered unilateral contracts, made at the time a non-compete is signed, that become binding once an employer provides the employee confidential information. *Sheshunoff*, 209 S.W.3d at 651. *Sheshunoff* overruled *Light*, which had interpreted § 15.50 to require that the non-compete covenant must be supported by a valid promise and actual performance at the very time the agreement is

made. Under *Sheshunoff*, employers may enforce non-compete agreements even if they do not provide the employee with the confidential information until days, weeks, months, or even years after the agreements are executed.

After *Sheshunoff*, yet another question remained: must the employer's agreement to provide confidential information to the employee be express, or may it be implied? In 2009, the Texas Supreme Court resolved that question in a pro-enforcement way, and held that such a promise may be express or implied. See *Mann Frankfort Stein & Lipp Advisors, Inc. v. Fielding*, 289 S.W.3d 844 (Tex. 2009). Regarding implied promises, in *Mann Frankfort* the Court concluded that a non-compete agreement is enforceable even if the employer does not expressly promise to provide the employee with any confidential information in the non-competition agreement, so long as: (a) the employee promises not to disclose or use the employer's confidential information; and (b) the nature of the contemplated employment will reasonably require the employer to furnish the employee with confidential information. In such an instance, the court held that an employer impliedly promises to provide the employee confidential information. In that case, Mann Frankfort required the defendant to sign an agreement promising not to disclose any confidential information he obtained during his employment. It then provided the defendant access to its client database, containing clients' names, billing information, and tax and financial information, which constitute confidential information. The court found that Mann Frankfort provided sufficient consideration to support a non-disclosure agreement and, thus, the non-competition agreement was ancillary to or part of an otherwise enforceable agreement under the typical "employer promises to give employee confidential information or trade secrets and in return employee promises not to disclose such information" analysis set out in footnote 14 of *Light*. See *Light*, 883 S.W.2d at 647 fn. 14. Since *Mann Frankfort* has been decided, several courts have enforced non-competition agreements applying its holding that even an employer's implied agreement to provide an employee with trade secrets or confidential information can support a non-competition agreement. See, e.g., *Gallagher Healthcare Ins. Services*, 312 S.W.3d at

650-51 (decision enforcing non-compete agreement under *Mann Frankfort* standard); *York v. Hair Club for Men, L.L.C.*, No. 01-09-00024-CV, 2009 WL 1840813 (Tex. App.–Houston [1st Dist.] June 25, 2009, no pet.) (unpublished) (same).

b. Stock Options Issue

On April 9, 2010, the Texas Supreme Court granted the petition for review in *Marsh USA, Inc. v. Cook*, No. 09-0558, which involves a split in the Texas courts of appeals as to whether and when employee stock options provide the requisite consideration under Texas law to support a covenant not to compete. The Houston First Court of Appeals held in 1998 that employee stock options could support a covenant not to compete. In 2009, the Dallas Court of Appeals rejected that conclusion, holding instead that employee stock options cannot support such a covenant. *Compare Marsh USA, Inc. v. Cook*, 287 S.W.3d 378, 381 (Tex. App.–Dallas 2009, pet. granted), *with Totino v. Alexander & Assocs., Inc.*, 1998 WL 552818, 1998 Tex. App. LEXIS 5295 (Tex. App.–Houston [1st Dist.] Aug. 20, 1998, no pet.). The *Marsh* court rejected *Totino*, and instead relied on *Olander v. Compass Bank*, 172 F. Supp. 2d 846, 855 (S.D. Tex. 2001), *aff'd*, No. 01-21151, 44 Fed. Appx. 651 (5th Cir. 2002), a decision that found that stock options do not give rise to either the employer’s goodwill interests it seeks to protect or to an interest in restraining an employee from competing. Having granted review in *Marsh*, the Texas Supreme Court is expected to resolve this split.

As explained above, an “otherwise enforceable agreement” that regularly satisfies the “ancillary” requirement is an employer’s giving trade secrets or other confidential information to the employee, in return for the employee’s promise to maintain the materials’ confidentiality. In contrast, an employer’s payment of money routinely has been found not to “give rise” to an interest in restraining competition. Courts reason that a company’s goodwill is dependent, in part, on keeping trade secrets confidential, and that customer goodwill is an interest protectable through a competitive restraint. However, a financial payment does not directly invoke goodwill or any other interest in restricting the employee’s ability to compete. *See Marsh*, 287 S.W.3d at 381.

Somewhere in between these two extremes lie stock options. A stock option may appear analogous to financial compensation. But the Houston First Court of Appeals in *Totino* found that stock options involved an interest worthy of a competitive restraint. In that case, the evidence showed that the stock options awards were offered in recognition of the employee's contributions to the employer's business, were one part of a long-term employee incentive plan, and were meant to reaffirm management's commitment to linking employee interests to those of the company's shareholders. In other words, the options were offered to encourage the employee's loyalty and continued employment. The *Totino* court held that this interest may be protectable through a competitive restraint, and upheld the noncompetition covenant as "ancillary to" the stock option agreement. *See Totino*, 1998 WL 552818, at \*7.

2. **The Agreement Contains Limitations Of Time, Geographic Area, And Scope Of Activity That Are Reasonable And That Do Not Impose Greater Restraint Than Necessary To Protect The Employer's Goodwill Or Other Business Interest**

a. In General

The noncompetition provision must also contain limitations of time, geographic area, and scope of activity that are reasonable and that do not impose greater restraint than necessary to protect the employer's goodwill or other business interest. TEX. BUS. & COM. CODE ANN. § 15.50 (Vernon 2002). In determining the reasonableness of a noncompetition agreement's restraints, the court is to consider the restraints "in combination one another, rather than as stand alone requirements. *M-I LLC v. Stelly*, Civil Action No. 4:09-cv-1552, 2010 WL 3257972, at \*31 (S.D. Tex. Aug. 17, 2010).

Regarding time, a non-competition agreement of one or two years is typically reasonable under Texas law, and some courts also find much longer time periods reasonable. *See, e.g., Stone*, 53 S.W.3d at 696 (upholding a five year restraint and stating that "two to five years has repeatedly been held a reasonable time restriction in a non-competition agreement.") (citing *AMF Tuboscope v. McBryde*, 618 S.W.2d 105, 108 (Tex. Civ. App.—Corpus Christi 1981, writ ref'd n.r.e.), citing *Arevalo v. Velvet Door*,

*Inc.*, 508 S.W.2d 184 (Tex. Civ. App.–El Paso 1974, writ ref’d n.r.e.); *Electronic Data Systems Corp. v. Powell*, 508 S.W.2d 137 (Tex. Civ. App.–Dallas 1974, writ ref’d n.r.e.); *Weber v. Hesse Envelope Co.*, 342 S.W.2d 652 (Tex. Civ. App.–Dallas 1960, no writ).

Texas courts generally require some geographic limitation in a valid covenant not to compete. *See, e.g., Goodin v. Jolliff*, 257 S.W.3d 341, 352 (Tex. App.–Fort Worth 2008, no pet.) (citing cases); *Zep Mfg. Co. v. Harthcock*, 824 S.W.2d 654, 660-61 (Tex. App.–Dallas 1992, no pet.). “A reasonable geographic scope is generally considered to be the territory in which the employee worked for the employer.” *TransPerfect Translations, Inc.*, 594 F. Supp. 2d at 754 (citing *Harthcock*, 824 S.W.2d at 660). “[N]on-compete covenants with restrictions covering a wide geographic area may be reasonable if they are limited in scope to a firm’s current or prospective clients such that they do not pose a greater restraint than necessary to protect the firm’s goodwill.” *TransPerfect Translations, Inc.*, 594 F. Supp. 2d at 754 (citing cases). Covenants with wide geographic areas have been upheld frequently in Texas courts, especially when the area covered constitutes the employee’s actual sales or work territory. *See, e.g., Vais Arms, Inc. v. Vais*, 383 F.3d 287, 295 (5th Cir. 2004).

A reasonable restriction on scope of activity can substitute for a geographic restriction, even without a geographic restriction – for example, limiting the employee from contacting customers they had contact with during a reasonable time frame before they left their employer is generally reasonable and enforceable. *See, e.g., Sheshunoff*, 209 S.W.3d at 657 (holding covenant prohibiting employee from soliciting or providing services to employer’s clients for period of one year following termination reasonable); *Gallagher Healthcare Ins. Services*, 312 S.W.3d at 654-55 (restraints tied to employee’s own work at the prior employer are reasonable); *Drummond American, LLC v. Share Corp.*, 693 F. Supp. 2d 650 (E.D. Tex. 2010) (enforcing restriction prohibiting employees from calling on any customer of theirs from whom they solicited orders or to whom they sold competitive products on behalf of the company during the last year of their employment for a period of two years following termination of their employment).

On the other hand, extremely broad restraints likely are unenforceable. See *Weatherford Oil Tool Co. v. Campbell*, 340 S.W.2d 950, 951-52 (Tex. 1960) (geographic scope described as “any area where Weatherford Oil Tool Company, Inc., may be operating or carrying on business” held overbroad); *McNeilus Companies, Inc. v. Sams*, 971 S.W.2d 507, 511 (Tex. App.–Dallas 1997, no writ) (holding covenant prohibition on former employee from working “in any capacity” for competitor of former employer was overbroad in scope); *Recon Exploration, Inc. v. Hodges*, 798 S.W.2d 848, 853 (Tex. App.–Dallas 1990, no writ) (non-competition covenant prohibiting employment in any business of type and character engaged in and competitive with former employer presented question of reasonableness); cf. *Butler v. Arrow Mirror & Glass, Inc.*, 51 S.W.3d 787 (Tex. App.–Houston [1st Dist.] 2001, no pet.) (“Restraints are ‘easier to justify if . . . limited to one field of activity among many that are available to the employee’”).

In the context of sales employees, “a covenant not to compete that extends to clients with whom a salesman had no dealings during his employment is unenforceable.” *Wright v. Sport Supply Group, Inc.*, 137 S.W.3d 289, 292 (Tex. App.–Beaumont 2004, no pet.). In other words, “[i]n the case of covenants applied to a personal services occupation, such as that of a salesman, a restraint on client solicitation is overbroad and unreasonable when it extends to clients with whom the employee had no dealings during his [or her] employment.” *John R. Ray & Sons, Inc. v. Stroman*, 923 S.W.2d 80, 85 (Tex. App.–Houston [14th Dist.] 1996, writ denied); *EMS USA, Inc. v. Shary*, 309 S.W.3d 653 (Tex. App.–Houston [14th Dist.] 2010, no pet.) (“A restraint on client solicitation in a personal services contract is overbroad and unreasonable if it extends to clients with whom the employee had no dealings during his employment.”) (citation omitted); *Poole v. U.S. Money Reserve, Inc.*, No. 09-08-137CV, 2008 WL 4735602, at \*8 (Tex. App.–Beaumont Oct. 30, 2008) (mem. op., not designated for publication); *Daytona Group of Tex., Inc. v. Smith*, 800 S.W.2d 285, 288 (Tex. App.–Corpus Christi 1990, writ denied). Recently, in *Safeworks, LLC v. Max Access, Inc.*, No. H-08-2860, 2009 WL 959969, at

\*5 (S.D. Tex. Apr. 8, 2009), Judge Nancy Atlas found that such an overbroad restraint on salespersons was unenforceable as a matter of law.

Where the employee at-issue is not merely a salesperson, however, the above-mentioned rule does not necessarily apply. For example, in *M-I LLC v. Stelly*, Civil Action No. 4:09-cv-1552, 2010 WL 3257972 (S.D. Tex. Aug. 17, 2010), Judge Keith Ellison reviewed a non-compete agreement that prohibited the employee from all contact with his former employer's customers, not merely the customers he had dealings with. *Id.* at \*31. Nevertheless, Judge Ellison upheld the non-compete agreement, stating:

Three important factors bring the Court to this conclusion. First, the short six-month duration of the covenant not to compete imposes a limited burden on Knobloch. During that six-month period, Knobloch still had several options: he could have chosen to work outside the wellbore completion industry, to work in that industry but outside of the Americas, or not to work and launch a competing business six months later. The Court is convinced that, given Knobloch's scientific background and in-depth knowledge of the industry, all of those options remained open to him when he left his employment with SPS/GCS.

The second factor is the upper management position held by Knobloch at SPS/GCS. M-I has submitted evidence showing that Knobloch was much more than a manager and salesman for his former employer. He oversaw SPS/GCS's relationships with major international clients. (Knobloch Dep. 85:15-86:25; Doc. No. 196, Exs. 25-27.) An engineer by training, Knobloch participated in the design of SPS/GCS's tools and in facilitating wellbore completions. He delivered technical presentations internationally, formulated company growth strategies, and discussed product development with engineers. (Doc. No. 196, Ex. 16.) Given Knobloch's high level of involvement in the company's growth and development, the Court believes

that restricting him from contacting SPS/GCS's customer base was reasonable.

The third, and perhaps most important, factor goes to SPS/GCS's protectable interest. Texas courts are generally concerned about customer contract restrictions where the client base is the protectable business interest. *See, e.g., Peat Harwich Main & Co. v. Haass*, 818 S.W.2d 381, 387 (Tex. 1991) (defining the business interest in that case to include preserving the firm's client base). M-I has made a strong case that the business interest in this case extends beyond SPS/GCS's client base, given Knobloch's intimate knowledge of tool designs and functionality. Knobloch had access to sensitive company information, including many trade secrets. The Court is convinced that the definable business interests in this case involve not just preserving a client base, but also maintaining trade secrets and other sensitive information. The restriction on all customer contact is accordingly not an unreasonable restraint of trade as to this particular employee. *See Weed Eater, Inc. v. Dowling*, 562 S.W.2d 898, 902 (Tex. Civ. App.—Houston [1st Dist.] 1978, writ ref'd n.r.e.).

In reaching his decision in *M-I LLC*, Judge Ellison relied on *Curtis v. Ziff Energy Group*. That case also teaches that a combination of factors, including the high rank of the departing employee and unique aspects of the industry involved, may make a seemingly overbroad non-competition agreement reasonable and enforceable. In *Curtis*, the employee worked for the employer as the Vice President of Pipelines and Energy Marketing. The relevant covenant not to compete prohibited the employee from engaging in competitive business in Canada or the United States. In the ensuing litigation over the covenant's enforceability, the employee claimed that he was restricted from working for any oil and gas company in North America. The employer disagreed, and submitted evidence to show the court that it limited its competitors to twenty companies, which were comprised of oil and gas consulting firms. 12 S.W.3d at 119.

The Court sided with the employer, holding that, based on the employee's "job description and responsibilities, it was reasonable to restrict [him] from working in other oil and gas consulting firms in North America for a six month period." *Id.* (citing *Weed Eater, Inc. v. Dowling*, 562 S.W.2d 898, 902 (Tex. Civ. App.–Houston [1st Dist.] 1978, writ ref'd n.r.e.).

b. Reformation Of Overbroad Non-Compete Agreements

Instead of invalidating overbroad covenants not to compete, Texas courts reform them by revising the unenforceable provisions to those that would be reasonable under the circumstances. *See Butler v. Arrow Mirror & Glass, Inc.*, 51 S.W.3d 787, 794 (Tex. App.–Houston [1st Dist.] 2001, no pet.) (reforming and then enforcing an overbroad non-compete agreement). Specifically, where a covenant not to compete is ancillary to a separate, enforceable agreement, but its limitations on time, geographic area, or scope of activity impose greater restraint than is necessary, the court must reform the covenant to make the restraints reasonable. *Evan's World Travel, Inc. v. Adams*, 978 S.W.2d 225, 233 (Tex. App.–Texarkana, 1998, no pet.); *Am. Nat'l Ins. Co. v. Cannon*, 86 S.W.3d 801, 808 (Tex. App.–Beaumont 2002, no pet.). The court has the power to reform the agreement even if neither party pleads for reformation. *TransPerfect Translations, Inc.*, 594 F. Supp. 2d at 756.

Regarding the timing of reformation, in *TransPerfect Translations, Inc.*, Judge Ellison recently noted that some Texas appeals courts have suggested, but not held, that reformation is appropriate at the temporary injunction stage. 594 F. Supp. 2d at 756. Judge Ellison decided to reform the non-compete agreement and grant a preliminary injunction based on it. *Id.* As he stated, "In light of this unsettled law, the Court will enter a limited injunction and reform the contract as necessary based on the current evidence, noting that any reformation or permanent injunction to be entered may differ from this temporary reformation based on arguments presented in the parties' dispositive motions or at trial." *Id.* In reforming the covenant, the court should take the individual

circumstances of the case into account. *Am. Nat'l Ins. Co.*, 86 S.W.3d at 808. The court must then enforce the covenant as reformed. TEX. BUS. & COM. CODE § 15.51(c).

Section 15.51(c) “precludes a damages award for conduct prior to any necessary reformation of the scope of the covenant.” *Mann Frankfort*, 289 S.W.3d at 855 (Hecht, J., concurring); *see also Safeworks*, 2009 WL 959969, at \*5 (“If a court reforms a covenant not to compete in order to make it reasonable and enforceable, ‘the court may not award the promisee damages for a breach of the covenant before its reformation and the relief granted to the promisee shall be limited to injunctive relief.’”) (quoting TEX. BUS. & COM. CODE § 15.51(c)); *Butler*, 51 S.W.3d at 796 (“Applying section 15.51 to this case, once the trial judge reformed the covenant, money damages were precluded. No damages can be awarded for breach prior to the reformation; after reformation, the current injunction was in place preventing ReGlaze from competing with, and thus, harming Arrow.”). *See also Rimkus Consulting Group, Inc.*, 688 F. Supp. 2d at 673 (granting summary judgment against employer’s claim for monetary damages based on breach of non-compete because all of the conduct that caused the damages occurred prior to the court’s reformation of the overbroad non-compete).

## **B. Noncompetition Agreements Concerning Physicians**

Special rules apply to noncompetition agreements concerning physicians. Specifically, sections 15.50(b) and (c) of the Texas Business and Commerce Code provide as follows:

(b) A covenant not to compete relating to the practice of medicine is enforceable against a person licensed as a physician by the Texas Medical Board if such covenant complies with the following requirements:

(1) the covenant must:

(A) not deny the physician access to a list of his patients whom he had seen or treated within one year of termination of the contract or employment;

(B) provide access to medical records of the physician's patients upon authorization of the patient and any copies of medical records for a reasonable fee as established by the Texas Medical Board under Section 159.008, Occupations Code; and

(C) provide that any access to a list of patients or to patients' medical records after termination of the contract or employment shall not require such list or records to be provided in a format different than that by which such records are maintained except by mutual consent of the parties to the contract;

(2) the covenant must provide for a buy out of the covenant by the physician at a reasonable price or, at the option of either party, as determined by a mutually agreed upon arbitrator or, in the case of an inability to agree, an arbitrator of the court whose decision shall be binding on the parties; and

(3) the covenant must provide that the physician will not be prohibited from providing continuing care and treatment to a specific patient or patients during the course of an acute illness even after the contract or employment has been terminated.

(c) Subsection (b) does not apply to a physician's business ownership interest in a licensed hospital or licensed ambulatory surgical center.

In *Greenville Surgery Center, Ltd. v. Beebe*, --- S.W.3d ---, No. 05-08-01045-CV, 2010 WL 2698779, at \*3 (Tex. App.–Dallas, July 9, 2010, n.p.h), the Dallas Court of Appeals applied this section to invalidate a non-compete that did not comply with it, stating:

Section 15.50(b) outlines the situations in which a covenant not to compete is enforceable against a person licensed as a physician by the Texas State Board of Medical Examiners. Here, the record demonstrates the Doctors

are licensed physicians. Section 15.50(b)(2) requires the covenant to include a buy-out provision if the covenant is to be enforceable against a physician. TEX. BUS. & COM. CODE ANN. § 15.50(b)(2). This buy-out clause requirement provides physicians with the unique opportunity to buy out their covenants that is not available to any other employee subject to a covenant. See Mike Kreager, *The Physician's Right in § 15.50(b) to Buy Out a Covenant Not to Compete in Texas*, 61 *Baylor L.Rev.* 357, 419 (Spring 2009). The covenant before us, however, contains no buy-out clause as required by section 15.50(b)(2). Therefore, the covenant is unenforceable against the Doctors. See *Gulf Coast Cardiology Group, P.A., v. Samman*, No. 09-02-009-CV, 2002 WL 1877175 (Tex. App.—Beaumont Aug. 15, 2002, pet. denied) (covenant not to compete unenforceable since it did not contain a buy-out provision).

### **C. Attorney's Fees Issues**

#### **1. For Prevailing Employees**

Under section 15.51 of the Texas Business and Commerce Code a court may award costs and attorneys' fees incurred by an employee in defending an action to enforce covenants not to compete and covenants not to solicit clients if:

- (a) the primary purpose of the agreement to which the covenant is ancillary is to obligate the promisor to render personal services;
- (b) the employer knew, at the time the agreement was executed, that the agreement did not contain reasonable limitations as to time, geographical area, and scope of activity to be restrained;
- (c) the limitations were unreasonable; and
- (d) the employer sought to enforce the agreement to a greater extent than necessary to protect its goodwill or business interests.

In *Rimkus Consulting Group, Inc.* 688 F. Supp. 2d at 678, Judge Lee Rosenthal found that the prevailing employee was not entitled to attorneys' fees under this section,

stating that, “[a]lthough Texas case law on noncompetition and nonsolicitation restrictions was clear in 1996, there is no evidence that Rimkus knew that the relevant provisions of Cammarata’s Employment Agreement were unreasonable under Texas law.” (citing *Safeworks, LLC*, 2009 WL 959969, at \*7 (granting summary judgment on a claim for attorneys’ fees under § 15.51 because even though Texas law was clear, there was “no evidence that Safeworks representatives actually knew that the relevant non-solicitation provisions were unreasonable under Texas law”)). On the other hand, in *Kenyon Intern. Emergency, Services, Inc. v. Malcolm*, No. Civ. A. H-09-3550, 2010 WL 2303328 (S.D. Tex. Jun 07, 2010), Judge Lynn Hughes awarded attorneys’ fees to the prevailing employees in defending against their former employer’s attempt to enforce a covenant not to compete. Judge Hughes found that the ex-employees were entitled to recover their fees under section 15.51 because the non-competition clause was unreasonably broad; the employer demonstrated no investment in training that would justify any restriction; and the employer knew when the agreements were signed that the covenants were unreasonable.

There is a question under Texas law regarding whether a employee who fails to satisfy the requirements of section 15.51 may still be entitled to attorneys’ fees under a declaratory judgment action or private agreement with the employer that provides for attorneys’ fees to the prevailing party. The court in *Perez v. Tex. Disposal Sys., Inc.*, 103 S.W.3d 591, 594 (Tex. App.–San Antonio 2003, pet. denied) held that section 15.52’s preemption language (set forth in the section below) applied to employees, so that the only way prevailing employees could obtain attorneys’ fees is if they were entitled to them under section 15.51’s criteria (set out above). Several courts, however, have taken a contrary position, and have held that because section 15.52’s preemption language only covers actions “to enforce a covenant not to compete,” a prevailing employee may be entitled to attorneys’ fees under a declaratory judgment theory or a private agreement, even if they did not fulfill the criteria set out in section 15.51. *See, e.g., Hardy v. Mann Frankfort Stein & Lipp Advisors, Inc.*, 263 S.W.3d 232, 256 (Tex. App.–Houston [1st

Dist.] 2007), *rev'd on other grounds*, 289 S.W.3d 844 (Tex. 2009); *Contemporary Contractors, Inc. v. Strauser*, No. 05-04-00478-CV, 2005 WL 1774983, at \*2, (Tex. App.–Dallas July 28, 2005, no pet.) (mem. op.); *Gage Van Horn & Assocs., Inc. v. Tatom*, 26 S.W.3d 730, 732 (Tex. App.–Eastland 2000), *pet. denied improvidently granted*, 87 S.W.3d 536 (Tex. 2002) (per curiam).

## **2. For Prevailing Employers**

Section 15.52 of the Texas Business and Commerce Code provides that:

The criteria for enforceability of a covenant not to compete provided by Section 15.50 of this code and the procedures and remedies in an action to enforce a covenant not to compete provided by Section 15.51 of this code are exclusive and preempt any other criteria for enforceability of a covenant not to compete or procedures and remedies in an action to enforce a covenant not to compete under common law or otherwise.

The only provision regarding attorneys' fees in the Covenants Not to Compete Act is the one mentioned above, in section 15.51 of the Texas Business and Commerce Code. That provision makes no mention of an award of attorneys' fees to a prevailing employer. Under section 15.52, section 15.51 preempts all other claims for attorneys' fees that could be brought (under a declaratory judgment theory, a private agreement that provided for attorneys' fees, or Chapter 38 of the Civil Practice and Remedies Code). *See Perez*, 103 S.W.3d at 594 (“section 15.52 preempts an award of [attorney’s] fees under any other law.”). Thus, under this logic, prevailing employers are not entitled to attorneys' fees in an action brought under the Covenants Not to Compete Act to enforce a non-compete agreement in any circumstances. *See Glattly v. Air Starter Components, Inc.*, --- S.W.3d ---, ---, NO. 01-09-00098-CV, 2010 WL 3928480, at \*20 (Tex. App. –Houston [1st Dist.] Oct 07, 2010) (“We hold that the trial court properly denied Air Starter’s requests for attorney’s fees because the Covenants Not to Compete Act does not permit employers to recover their attorney’s [fees] in suits to enforce their rights under the Act.”)

## **D. Choice Of Law And Choice Of Forum Clauses**

### **1. Choice Of Law Clauses**

In Texas, contractual choice-of-law provisions are typically enforced, unless the provision violates a fundamental public policy of Texas or the contract bears no reasonable relation to the chosen state. TEX. BUS. & COMM. CODE § 1.301; *Smith v. EMC Corp.*, 393 F.3d at 598; *Exxon Corp. v. Burglin*, 4 F.3d 1294, 1298 n. 5 (5th Cir. 1993); *Access Telecomm., Inc. v. MCI Telcomms. Corp.*, 197 F.3d 694, 705 (5th Cir. 1999) (citing *DeSantis v. Wackenhut Corp.*, 793 S.W.2d 670, 677-78 (Tex.1990)).

In 1990, the Texas Supreme Court held that the law governing enforcement of non-competition agreements is fundamental policy in Texas. *DeSantis*, 793 S.W.2d at 681. *DeSantis* remains good law. *In re AutoNation, Inc.*, 228 S.W.3d 663, 669 (Tex. 2007) (declining to overrule *DeSantis* following the enactment of § 15.50 and *Sheshunoff*); *Turford v. Underwood*, 952 S.W.2d 641 (Tex. App.–Beaumont 1997, orig. proceeding) (following *DeSantis* and applying Texas law because Texas has a greater interest in enforcing non-compete covenants in Texas than does Michigan).

A choice-of-law provision will not be applied if another jurisdiction has a more significant relationship with the parties and their transaction than the state they choose, that jurisdiction has a materially greater interest than the chosen state, and the jurisdiction's fundamental policy would be contravened by the application of the law of the chosen state. *See* Restatement (Second) of Conflict of Laws ("Restatement") § 187; *Access Telecom, Inc. v. MCI Telecommunications Corp.*, 197 F.3d at 705; *International Interests, L.P. v. Hardy*, 448 F.3d 303, 308 (5th Cir. 2006). To reject the parties' choice-of-law, each element of the Restatement's test must be met. *Mary Kay Inc. v. Woolf*, 146 S.W.3d 813, 816-17 (Tex. App.–Dallas 2004, pet. denied). To understand whether a state has a more significant interest than the chosen state, the Restatement emphasizes several factors: (a) the place of contracting; (b) the place of negotiation of the contract; (c) the place of performance; (d) the location of the subject matter of the contract; and (e) the domicile, residence, nationality, place of incorporation and place of business of the

parties. Restatement §§ 6, 188(2); *Minnesota Mining & Manufacturing Co. v. Nishika, Ltd.*, 955 S.W.2d 853, 856 (Tex. 1996); *DeSantis*, 793 S.W.2d at 678. These contacts are evaluated by their importance, not their number. *Minnesota Mining & Manufacturing Co.*, 955 S.W.2d at 856.

Based on these factors, courts sometimes conclude that a choice of law clause must be disregarded, and Texas law applied – under *DeSantis*, this is especially the case if the employee worked most or all of their tenure in Texas and the proposed enforcement would occur in Texas. *See DeSantis*, 793 S.W.2d at 679 (holding that where the “gist” of the agreement, including the non-compete, was the performance of services in Texas, the relationship of the parties to Texas was more significant than the Florida state law identified in the choice of law clause and Texas law applied); *Turford*, 952 S.W.2d at 642-43 (disregarding Michigan choice of law clause and applying Texas law based on *DeSantis* because Texas has a greater interest in enforcing non-compete covenants in Texas than does Michigan).

## **2. Choice Of Forum Clauses**

In the 2007 case of *In re Autonation, Inc.*, the Texas Supreme Court faced an argument that enforcement of a forum-selection clause in a covenant not to compete, selecting an out-of-state forum (in this case Florida) for a suit against a Texas resident, would violate Texas public policy. *In re Autonation, Inc.*, 228 S.W.3d at 668. The clause would have compelled a Texas worker, working in Texas, to litigate his challenge to his non-compete agreement in Florida, where his nationwide employer was headquartered. The employee argued that such a result would violate public policy and the forum selection clause should be disregarded. The court rejected the argument. *Id.* at 668-69.

The primary reason for the court’s decision in *In re Autonation, Inc.* was that neither Texas courts nor the Texas Legislature had ever declared a fundamental Texas policy requiring every employment dispute with a Texas resident be litigated in Texas. The court explained that therefore its decision was not inconsistent with *DeSantis*:

Our decision today in no way questions the reasoning of *DeSantis*, but we decline Hatfield’s invitation to superimpose the *DeSantis* choice-of-law analysis onto the law governing forum-selection clauses. While *DeSantis* and the instant case both concern Texas citizens working in Texas for a Florida-based company, there are critical distinctions. *DeSantis*, decided before the now-applicable version of the Covenants Not to Compete Act and our recent decision in *Sheshunoff* construing the Act, did not concern a mandatory forum-selection clause or first-filed litigation in the parties’ chosen jurisdiction. *DeSantis* concerned how Texas courts should construe employment contracts of Texas employees. We observed that “Texas has a materially greater interest than Florida in deciding whether the noncompetition agreement in this case should be enforced.” But we have never declared that fundamental Texas policy requires that every employment dispute with a Texas resident must be litigated in Texas. We recognized in *AIU* that even where Texas statutory provisions specify the application of Texas law, these provisions are irrelevant to the enforceability of a forum-selection clause where no statute “requires suit to be brought or maintained in Texas.” Along similar lines, even if *DeSantis* requires Texas courts to apply Texas law to certain employment disputes, it does not require suit to be brought in Texas when a forum-selection clause mandates venue elsewhere. No Texas precedent compels us to enjoin a party from asking a Florida court to honor the parties’ express agreement to litigate a non-compete agreement in Florida, the employer’s headquarters and principal place of business.

*Id.* at 669 (footnotes omitted).

## **E. Obtaining Injunctive Relief Based On A Non-compete Agreement**

### **1. In General**

To obtain a temporary injunction in state court, an applicant must plead and prove: (1) a cause of action against the defendant; (2) a probable right to the relief sought; and (3) a probable, imminent, and irreparable injury in the interim. *Reach Group, L.L.C. v. Angelina Group*, 173 S.W.3d 834, 837 (Tex. App.–Houston [14th Dist.] 2005, no pet.). To show a probable right of recovery, an applicant need not establish that it will finally prevail in the litigation, but it must, at the very least, present some evidence that, under the applicable rules of law, tends to support its cause of action. *Camp v. Shannon*, 162 Tex. 515, 348 S.W.2d 517, 519 (1961).

To obtain a preliminary injunction in federal court, an applicant must prove four elements: (1) a substantial likelihood of success on the merits; (2) a substantial threat that plaintiffs will suffer irreparable harm if the injunction is not granted; (3) that the threatened injury outweighs any damage that the injunction might cause the defendant; and (4) that the injunction will not disserve the public interest. *Nichols v. Alcatel USA, Inc.*, 532 F.3d 364, 372 (5th Cir. 2008). *Compare Courtroom Sciences, Inc. v. Andrews*, NO. CIV. A. 3:09-CV-251-0, 2009 WL 1313274 (N.D. Tex. May 11, 2009) (granting injunction based on non-compete agreement where substantial evidence showed bad acts by ex-employee, including misappropriation of employer’s critical information) *with M-I, L.L.C. v. Stelly*, 2009 WL 2355498, at \*6 (assuming non-competition agreements were enforceable and still refusing to enter injunction where there was no such evidence).

Texas Rule of Civil Procedure 682 provides that “[n]o writ of injunction shall be granted unless the applicant therefor shall present his petition to the judge verified by his affidavit and containing a plain and intelligible statement of the grounds for such relief.” However, a verified petition for injunctive relief is not required to obtain an injunction when a full evidentiary hearing on evidence has been held. *Nguyen v. Intertex, Inc.*, 93 S.W.3d 288, 298 (Tex. App.–Houston [14th Dist.] 2002, no pet.).

To obtain injunctive relief based on a non-compete agreement, the employer must still prove that that it will suffer irreparable injury if an injunction is not granted. Specifically, a covenant not to compete “will not be enforced by an injunction where the party seeking the injunction has failed to show that without injunctive relief he will suffer irreparable injury for which he has no adequate legal remedy.” *Reach Group, L.L.C.*, 173 S.W.3d at 837-38; *see also Cardinal Health Staffing Network, Inc.*, 106 S.W.3d at 241. That is not always an easy burden to carry. *See Cardinal Health Staffing Network, Inc.*, 106 S.W.3d at 241(holding that since employer could calculate its damages, it failed to prove irreparable harm even though its non-compete agreement was valid and enforceable); *Shoreline Gas, Inc. v. McGaughey*, 2008 WL 1747624, at \*12 (Tex. App.—Corpus Christi April 17, 2008, no pet.) (not designated for publication) (although non-compete agreement was enforceable, employer was not entitled to a temporary injunction because it failed to prove probability of irreparable injury); *W.R. Grace & Co. - Conn v. Taylor*, No. 14-06-01056-CV, 2007 WL 1438544 (Tex. App.—Houston [14th Dist.] May 17, 2007, no pet.) (same). However, note that Texas law provides that “proof that a highly trained employee is continuing to breach a non-competition covenant gives rise to a rebuttable presumption that the applicant is suffering irreparable injury.” In *Electro-Motor, Inc. v. Industrial Apparatus Services, Inc.*, 390 B.R. 859, 867 (Bankr. E.D. Tex. 2008) (quoting *Cardinal Health Staffing Network, Inc.*, 106 S.W.3d at 236).

An injury is irreparable if the injured party cannot be adequately compensated in damages or if the damages cannot be measured by any certain pecuniary standard. *See Butnaru v. Ford Motor Co.*, 84 S.W.3d 198, 204 (Tex. 2002). Because a company’s loss of goodwill, clientele, marketing techniques, and office stability are not easily assigned a dollar value, they qualify as “probable injury” for purposes of injunctive relief. *Graham v. Mary Kay Inc.*, 25 S.W.3d 749, 753 (Tex. App.—Houston [14th Dist.] 2000, pet. denied). However, the evidence must show a probable loss of goodwill, clientele, marketing techniques, or office stability to obtain injunctive relief. *See id.* (holding that loss of goodwill and business stability was established by evidence that Graham actively

sought Mary Kay salespersons who were willing to breach their contracts); *see also Armendariz v. Mora*, 526 S.W.2d 542, 543 (Tex. 1975) (holding that applicant has the burden of offering some evidence establishing probable injury); *W.R. Grace & Co. – Conn*, 2007 WL 1438544, at \* 2 (“Although Taylor admitted that, while working for SIKA, he has had discussions with several WRG customers, there is no evidence that WRG lost sales, marketing advantage, or goodwill, or otherwise suffered an irreparable injury; or that it has no adequate remedy at law for any such violation”).

Recently, in *York*, 2009 WL 1840813 at \*4-6 the Houston First Court of Appeals upheld the trial court’s entry of a temporary injunction against Hair Club for Men’s ex-employees and new employer under the ex-employees’ non-competition (customer non-solicitation) agreements as well as under a misappropriation of trade secrets theory. The court observed that the non-competition agreements at-issue in the case were similar to the one at issue in *Mann Frankfort*. *Id.* at \*5. Likewise, in *Vaughn v. Intrepid Directional Drilling Specialists, Ltd.*, 288 S.W.3d 931, 938 (Tex. App.–Eastland 2009, no pet.), the Eastland Court of Appeals affirmed the trial court’s issuance of an injunction to enforce non-competition agreements. The Forth Worth Court of Appeals in *O’Brien v. Rattikin Title Co.*, NO. 2-05-238-CV, 2006 WL 417237 (Tex. App.–Fort Worth Feb. 23, 2006, pet. dis’d w.o.j.) also affirmed the trial court’s entry of a temporary injunction enforcing the terms of a non-competition agreement.

Under Texas state court practice, every order granting an injunction must set forth the reasons for its issuance. TEX. R. CIV. P. 683. The trial court is not required to explain its reasons for believing that the applicant has shown a probable right to final relief, but it must give the reasons why injury will be suffered if the interlocutory relief is not ordered. *Transp. Co. of Tex. v. Robertson Transp.*, 152 Tex. 551, 261 S.W.2d 549, 553 (1953). The reasons given by the trial court for granting or denying a temporary injunction must not be mere conclusionary statements. *Int’l Bhd. of Elec. Workers Local Union 479 v. Becon Const. Co., Inc.*, 104 S.W.3d 239, 244 (Tex. App.–Beaumont 2003, no pet.). The requirement of specifying the reasons for granting a temporary injunction is mandatory,

and noncompliance amounts to an abuse of discretion. *Toby Martin Oilfield Trucking, Inc. v. Martin*, 640 S.W.2d 352, 355 (Tex. Civ. App.–Houston [1st Dist.] 1982, no writ).

Rule 683 further provides, in relevant part, that orders granting injunctions “shall be specific in terms” and “shall describe in reasonable detail and not by reference to the complaint or other document, the act or acts sought to be restrained.” This does not necessarily mean that each customer the restrained party is not to solicit must be specifically named in the injunction order. *See Vaughn*, 288 S.W.3d at 938 (rejecting that argument); *Amalgamated Acme Affiliates, Inc. v. Minton*, 33 S.W.3d 387, 397-98 (Tex. App.–Austin 2000, no pet.) (a temporary injunction that did not specifically name the applicant’s customers and advertisers complied with Rule 683 where the party enjoined admitted it could identify the customers and advertisers.); *Safeguard Bus. Sys., Inc. v. Schaffer*, 822 S.W.2d 640, 644 (Tex. App.–Dallas 1991, no writ) (in reviewing a permanent injunction, the court stated that “[o]rders generally restraining solicitation of customers and not specifically listing the individual customers have not been found to be overbroad.”).

The trial court is required to set a bond when it grants a temporary injunction. TEX. R. CIV. P. 684. The applicant must post the bond, and it is payable to the adverse party if the temporary injunction is dissolved at trial. *Id.* The purpose of a bond is to provide protection to the enjoined party for any possible damages occurring as a result of the injunction. *Bayoud v. Bayoud*, 797 S.W.2d 304, 312 (Tex. App.–Dallas 1990, writ denied). The determination of the adequacy of the bond set by the trial court is to be made on a case-by-case basis based upon the record before the reviewing court. *Maples v. Muscletech, Inc.*, 74 S.W.3d 429, 431 (Tex. App.–Amarillo 2002, no pet.); *Stone*, 53 S.W.3d at 696. The amount of a bond is within the trial court’s sound discretion and will not be disturbed on appeal absent an abuse of that discretion. *Four Stars Food Mart, Inc. v. Tex. Alcoholic Beverage Comm’n*, 923 S.W.2d 266, 269 (Tex. App.–Fort Worth 1996, no writ); *Khaledi v. H.K. Global Trading, Ltd.*, 126 S.W.3d 273, 286 (Tex. App.–San Antonio 2003, no pet.); *Maples*, 74 S.W.3d at 431.

## **2. Successor Companies' Rights To Seek Injunctive Relief Enforcing A Noncompetition Agreement**

In *Dittmer v. Source EDP, Texas, Inc.*, 595 S.W.2d 877, 881 (Tex. Civ. App.—Dallas 1980, no writ), the Dallas Court of Appeals found that the trial court had not erred in inferring that the plaintiff corporation was the successor-in-interest to the company that had entered the non-compete agreement with the defendant-employee. The district court entered an injunction in the successor's favor enforcing its predecessor's non-compete agreement, and the appeals court affirmed on that issue.

There is a limitation, however: Specifically, Texas courts have held that when a business is sold and the covenant not to compete is assigned to the purchaser, the reasonable geographic restriction must be “no larger than to protect the business sold.” *Williams v. Powell Elec. Mfg. Co.*, 508 S.W.2d 665, 668 (Tex. Civ. App.—Houston [14th Dist.] 1974, no writ) (citing *Barrett v. Curtis*, 407 S.W.2d 359 (Tex. Civ. App.—Dallas 1966, no writ)). In *M-I LLC v. Stelly*, Civil Action No. 4:09-cv-1552, 2010 WL 3257972, \*27 (S.D. Tex. Aug. 17, 2010), Judge Keith Ellison reiterated this rule.

## **3. The Effect Of Contractual Stipulations Of Irreparable Harm**

Non-compete agreements often contain recitations that the employer will suffer irreparable harm if the agreement is breached. Most courts hold that such clauses are not dispositive and do not do away with the need to present independent evidence of irreparable harm in order to obtain an injunction. See *W.R. Grace & Co.—Conn*, 2007 WL 1438544, at \* 2 n. 7 (“such stipulations have been held insufficient to support a finding of irreparable harm for injunctive relief”) (citing *Dominion Video Satellite, Inc. v. Echostar Satellite Corp.*, 356 F.3d 1256, 1266 (10th Cir. 2004); *Smith, Bucklin & Assocs., Inc. v. Sonntag*, 83 F.3d 476, 481 (D.C. Cir. 1996); *Baker's Aid, Inc. v. Hussmann Foodservice Co.*, 830 F.2d 13, 16 (2d Cir. 1987); *Traders Int'l, Ltd. v. Scheuermann*, No. H-06-1632, 2006 WL 2521336, at \*8 (S.D. Tex. Aug. 30, 2006) (not designated for publication); *Sec. Telecom Corp. v. Meziere*, No. 05-95-01360-CV, 1996 WL 87212, at \*2 (Tex. App.—Dallas Feb. 28, 1996, no writ.) (not designated for

publication)); *see also Shoreline Gas, Inc. v. McGaughey*, 2008 WL 1747624, at \*11 (“Shoreline has pointed us to no Texas case holding that an agreement such as this establishes, for injunction purposes, that remedies at law will be inadequate or that irreparable injury will necessarily be suffered.”). However, one Texas court found that such contractual clauses are themselves at least some evidence of irreparable harm. *See Wright*, 137 S.W.3d at 293-94 (relying on such a clause to conclude that some evidence supported the trial court’s finding of irreparable harm).

#### 4. **The Effect Of A Party’s Delay On Its Ability To Obtain Injunctive Relief**

Texas state courts hold that delay alone is not sufficient to bar a plaintiff from obtaining injunctive relief. As one court explained, “Texas caselaw does not prevent injunctive relief merely because a potential plaintiff did not file a claim as quickly as possible.” *Garth v. Staktek Corp.*, 876 S.W.2d 545 (Tex. App.–Austin 1994, writ dismissed w.o.j.) (citing *K & G Oil Tool & Serv. Co. v. G & G Fishing Tool Serv.*, 158 Tex. 594, 314 S.W.2d 782, 790-91 (Tex. 1958)). In *K & G*, laches was not a bar where the defendant in an action for an injunction and damages based on misappropriation of trade secrets argued that the plaintiff’s action, even though filed within the limitations period, should be barred by laches because the defendant continued to develop and market the product with the information the plaintiff claimed to be proprietary. *K & G*, 314 S.W.2d at 790-91. In another trade secrets misappropriation case, the Austin Court of Appeals followed *K & G* and issued the same holding. *See Garth*, 876 S.W.2d at 550-51. Rather, a party asserting the defense of laches must show both an unreasonable delay by the other party in asserting its rights and harm resulting to it because of the delay. *Rogers v. Ricane Enters. Inc.*, 772 S.W.2d 76, 80 (Tex. 1989).

Federal courts appear tend to take a somewhat harsher view of parties who delay seeking injunctive relief. *See Safeworks, LLC*, 2009 WL 959969, at \*6-7 (“In addition, SafeWorks’ delay in seeking a preliminary injunction weighs heavily against a finding of irreparable injury.”); *Rimkus Consulting Group, Inc. v. Cammarata*, 255 F.R.D. 417, 438-

39 (S.D. Tex. 2008) (“Rimkus’s delay in seeking injunctive relief in this court weighs heavily against a finding of irreparable injury.”); *Gonannies, Inc. v. Goupair.Com, Inc.*, 464 F. Supp. 2d 603, 609 (N.D. Tex. 2006) (“Delay in seeking a remedy is an important factor bearing on the need for a preliminary injunction. Absent a good explanation, a substantial period of delay militates against the issuance of a preliminary injunction by demonstrating that there is no apparent urgency to the request for injunctive relief. Evidence of an undue delay in bringing suit may be sufficient to rebut the presumption of irreparable harm.”) (citation omitted).

## 5. Court Ordered Equitable Extensions Of The Period Of Restraint

Regarding equitable extension of the contractual period of restraint, in *Guy Carpenter & Co. v. Provenzale*, 334 F.3d 459, 464 (5th Cir. 2003), a case arising out of Texas law, the Fifth Circuit held that the expiration of the contractually agreed upon period of non-competition did not render an appeal moot because “[i]f this Court remands, the district court has the power under Texas law to craft an injunction that extends beyond the expiration of the non-solicitation covenant. Exercising this equitable power might be particularly appropriate given the district court’s year-long delay before ruling on the motion to reconsider.” *See also Premier Indus. Corp. v. Tex. Indus. Fastener Co.*, 450 F.2d 444, 448 (5th Cir. 1971) (applying Texas law and stating that “[an] argument that the trial judge exceeded his discretion by enjoining the appellants beyond the time specified in the . . . contract is without merit”).

In *RenewData Corp. v. Strickler*, No. 03-05-00273 CV, 2006 WL 504998, at \*5 (Tex. App.–Austin Mar. 03, 2006, no pet.), the employer, Renew, complained that the district court refused to equitably extend the term of the non-compete agreement. The appeals court rejected the employer’s complaint, stating, “[t]his chronology shows that the delays in the enforcement of the covenant not to compete were not simply “inherent to litigation” but were attributable to Renew. We find that Renew did not diligently pursue its remedies under the covenant not to compete and that the district court, in the

exercise of its equity jurisdiction, did not abuse its discretion in denying Renew’s motion for equitable extension of the covenant not to compete.”

In *Farmer v. Holley*, 237 S.W.3d 758 (Tex. App.–Waco 2007, pet. denied), the district court equitably extended the term of the non-competition agreement. The Waco Court of Appeals found this was error, stating, “[w]e do not hold that a covenant not to compete cannot be equitably extended, but hold that the record does not support Holley’s argument that the violations of the covenant, if any, were “continuous and persistent.” Thus the trial court erred in equitably delaying the start of the covenant not to compete until the date of the judgment rather than the date of the agreement.”

Most recently, in *Safeworks, LLC*, 2009 WL 959969, at \*6-7, Judge Nancy Atlas agreed that the expiration of the term of restraint did not preclude her from entering an injunction based on the court’s equitable powers. However, Judge Atlas declined to enter an injunction anyway because the movant had failed to establish a substantial likelihood of success on the merits.

## **6. The Unclean Hands Defense**

In *Central Texas Orthopedic Products, Inc. v. Espinoza*, NO. 04-09-00148-CV, 2009 WL 4670446 (Tex. App.–San Antonio Dec. 09, 2009, pet. filed) (unpublished), the employee tried to avoid the enforcement of his non-competition agreement by raising the defense of “unclean hands.” The equitable doctrine of “unclean hands” requires that a party seeking equity must come to court with clean hands. *In re Eagle Global Logistics, L.P.*, 89 S.W.3d 761, 766 (Tex. App.–Houston [1st Dist.] 2002, orig. proceeding [mand. denied]). The doctrine of unclean hands will be applied only to “one whose conduct in connection with the same matter or transaction has been unconscientious, unjust, or marked by a want of good faith, or one who has violated the principles of equity and righteous dealing.” *In re Jim Walter Homes, Inc.*, 207 S.W.3d 888, 899 (Tex. App.–Houston [14th Dist.] 2006, orig. proceeding) (quoting *Thomas v. McNair*, 882 S.W.2d 870, 880-81 (Tex. App.–Corpus Christi 1994, no writ.)).

In *Central Texas Orthopedic Products, Inc. v. Espinoza*, CTOP sued Espinoza after he resigned his employment and went to work for a direct competitor in violation of a noncompetition agreement he signed with CTOP. Espinoza contended that the noncompetition agreement could not be enforced against him because CTOP had violated a separate Compensation Agreement by failing to pay all wages and commissions owed to him. The trial court agreed and granted summary judgment for Espinoza. The San Antonio Court of Appeals reversed the judgment for Espinoza and held that since CTOP's alleged failure to pay Espinoza did not grow out of the obligations outlined in the noncompetition agreement, the alleged breaches of the separate Compensation Agreement could not, as a matter of law, constitute an unclean hands defense to the noncompetition agreement. *See also French v. Community Broadcasting of Coastal Bend, Inc.*, 766 S.W.2d 330, 334 (Tex. App.—Corpus Christi 1989, writ dismissed w.o.j.) (evidence did not require finding that the employer's allegedly unclean hands barred enforcement of covenant not to compete against former general manager for television station; the covenant itself stated it was to be construed as agreement independent of any other contractual provision and that other causes of action should not constitute defense to covenant, and the contract contained a clause allowing for recovery of damages for breach of contract).

#### **IV. UPDATE ON NON-RECRUITMENT COVENANTS UNDER TEXAS LAW**

Texas courts generally enforce employee non-recruitment or non-solicitation agreements as they would any other contract, holding that they are not restraints of trade and, therefore, not subject to the requirements of section 15.05(a) of the Texas Business and Commerce Code. *See Spicer*, 2006 WL 1751786 at \*4 (finding such an agreement enforceable as an ordinary contract); *Nova Consulting Group, Inc. v. Engineering Consulting Servs., Ltd.*, 2005 WL 2708811, \*17-18 (W.D. Tex. 2005) (finding such an agreement enforceable as an ordinary contract after reviewing Texas law); *see also Smith, Barney, Harris Upham & Co., Inc. v. Robinson*, 12 F.3d 515, 518 (5th Cir. 1994) (finding that employee "nonrecruitment covenants . . . do not necessarily restrict a former

employee's ability to compete . . . [and] should not significantly restrain trade"). There is one Texas court that analyzed such an employee non-recruitment agreement under section 15.50(a) of the Texas Business and Commerce Code, but found it enforceable anyway. *See Totino*, 1998 WL 552818, at \*8–9.

Where the requirements of a temporary injunction are satisfied, an ex-employee who breaches a non-recruitment agreement may be enjoined from further breaches, as may anyone working in concert with him, including his new employer. *Compare Totino*, 1998 WL 552818, at \*8–9 (affirming grant of injunction barring not only ex-employees who had signed non-recruitment agreements, but also their new employer, from soliciting the former employer's current employees) (not designated for publication) *with Spicer*, 2006 WL 1751786 at \*4-5 (finding such a non-recruitment agreement enforceable under Texas law but refusing to enforce it through a preliminary injunction because the court concluded that the employer did not clearly demonstrate that a substantial threat existed that it would suffer irreparable injury if the preliminary injunction was denied.).

## **V. UPDATE ON AT-WILL EMPLOYEES' FIDUCIARY OBLIGATIONS IN TEXAS**

In Texas, an at-will employee breaches his or her fiduciary duty to their employer if, during his or her employment, he or she: (1) misappropriates the employer's trade secrets; (2) solicits the employer's customers while still working for the employer; (3) solicits the departure of other employees while still working for the employer; or (4) carries away confidential information. *See Johnson v. Brewer & Pritchard, P.C.*, 73 S.W.3d 193, 202 (Tex. 2002); *Abetter Trucking Co., Inc. v. Arizpe*, 113 S.W.3d 503, 512 (Tex. App.–Houston [1st Dist.] 2003, no pet.). In *Rimkus Consulting Group, Inc.*, 688 F. Supp. 2d at 669-70, Judge Lee Rosenthal denied summary judgment against the former employer's breach of fiduciary duty claim because there were disputed fact issues on whether the employee-defendant breached his fiduciary duty to Rimkus by misappropriating confidential, proprietary, or trade secret information obtained while he

was an officer of Rimkus and then using that information to solicit Rimkus customers and compete against Rimkus.

Aside from the above limitations, however, Texas law is clear that taking preparatory steps to compete with an employer while still working for that employer is not actionable. *See Navigant Consulting, Inc. v. Wilkinson*, 508 F.3d 277, 284 (5th Cir. 2007) (“[U]nder Texas law, an at-will employee may properly plan to go into competition with his employer and may take active steps to do so while still employed. Even the existence of a fiduciary relationship between employee and employer does not preclude the fiduciary from making preparations for a future competing business venture; nor do such preparations necessarily constitute a breach of fiduciary duties.” (quotation marks and citations omitted)); *Ameristar Jet Charter, Inc. v. Cobbs*, 184 S.W.3d 369, 374 (Tex. App.–Dallas 2006, no pet.) (holding there was no breach of fiduciary duty when an employee formed a competing business while still employed but did not actually compete with the employer until he resigned); *Abetter Trucking Co.*, 113 S.W.3d at 510; *Augat, Inc. v. Aegis, Inc.*, 409 Mass. 165, 565 N.E.2d 415, 419 (1991) (quoted by the Texas Supreme Court in *Johnson v. Brewer & Pritchard, P.C.*, 73 S.W.3d 193, 201 (Tex. 2002)). Indeed, in Texas, as a legal matter, to resign from one’s employment and go into business in competition with one’s former employer is, under ordinary circumstances, a constitutional right. *Abetter Trucking Co.*, 113 S.W.3d at 510.

The employee has no general duty to disclose his plans and may secretly join with other employees in the endeavor without violating any duty to the employer. *Id.*; *M P I, Inc. v. Dupre*, 596 S.W.2d 251, 254 (Tex. Civ. App.–Fort Worth 1980, writ ref’d n.r.e.). Further, an employee may use his general knowledge, skill, and experience acquired in the former employment to compete. *Abetter Trucking Co.*, 113 S.W.3d at 512. Moreover, the possibility of crippling, or even destroying, a competitor is inherent in a competitive market. *Id.* at 510; *Augat*, 565 N.E.2d at 422.

On May 17, 2010, the Fifth Circuit U.S. Court of Appeals affirmed a \$1.43 million award against a company’s two former employees and the new company they formed to

compete against their former employer. *See Meaux Surface Protection, Inc. v. Fogleman*, 607 F.3d 161 (5th Cir. 2010). Judge David Hittner was the trial court judge. The defendants challenged the damages award, claiming that there was no evidence their breaches of fiduciary duty caused plaintiff any harm. *Id.* at 169. The court rejected that argument, stating:

A jury may infer proximate cause from circumstantial evidence. . . . In *Navigant*, the evidence showed that the defendants solicited fellow employees to join them in defecting to a competitor. *Id.* at 290. Following the defendants' departure, their erstwhile employer lost many key employees to the competitor and experienced a drop-off in business. *Id.* We held that the jury could reasonably conclude, based on this evidence, that the defendants' actions sent the plaintiff's business into a maelstrom. *Id.* at 290-91. "Alert avoidance of the classical fallacy of *post hoc, ergo propter hoc* does not require rejection of common sense inferences." *Id.* at 291 (quoting *Swanner v. United States*, 406 F.2d 716, 718 (5th Cir. 1969)). The evidence showed that Fogleman and Kotrla set up CleanBlast several months before they resigned from Meaux. Defendants informed many of Meaux's foremen and staff that they would form a new company, and indicated that several of Meaux's jobs would be commandeered by CleanBlast. Patricia Duhon, an employee of Meaux, testified that prior to resigning, Kotrla actively recruited many of Meaux's employees. Duhon's testimony was that Kotrla said that once Meaux's foremen were working for CleanBlast, CleanBlast would get business from Meaux's clients, because the clients "pretty much followed the foremen." Within days of Fogleman's and Kotrla's resignation from Meaux, several of Meaux's work crews were working under CleanBlast's ensign. In suspiciously short order, CleanBlast also procured insurance, master service agreements

(“MSAs”), and job contracts with several of Meaux’s largest customers. Meaux’s sales to those customers sank like an anchor.

Defendants say Meaux’s fusillade of evidence fails to strike below the waterline because Ennemann did not have direct knowledge of the above facts, and because other factors could have caused a drop-off in business. Defendants note that 2006 was a bumper year for their industry due to repairs necessitated by hurricanes Katrina and Rita, and business was somewhat becalmed in 2007. Defendants also say that their lawful competition could have caused a drop in Meaux’s business, and note that there is a high degree of turnover in their industry. But defendants cannot navigate a perilous shoal: such arguments are matters for the trier of fact. They do not undermine the legal sufficiency of properly admitted evidence in support of the verdict.

Based on the evidence submitted at trial, the jury was well within its province to find that defendants’ recruitment of Meaux’s employees was not mere palaver, but rather, directly caused Meaux to suffer a loss in business. *See id.* at 290-91. The district court properly denied defendants’ motions for judgment as a matter of law as to causation.

*Id.* at 170.

The defendants also argued that the jury’s \$1.43 million damages award for lost profits was too speculative to be affirmed. *Id.* The court rejected that argument too, stating:

The Texas Supreme Court instructs that “[r]ecovery of lost profits does not require that the loss be susceptible to exact calculation.” *Szczepanik v. First S. Trust Co.*, 883 S.W.2d 648, 649 (Tex. 1994) (citing *Tex. Instruments v. Teletron Energy Mgmt., Inc.*, 877 S.W.2d 276, 279 (Tex. 1994)). Nevertheless, the party claiming injury must show more than some lost

profits; “[t]he amount of the loss must be shown by competent evidence with reasonable certainty.” *Id.* This inquiry is fact intensive. *Id.* (citing *Holt Atherton Indus., Inc. v. Heine*, 835 S.W.2d 80, 84 (Tex. 1992)). “At a minimum, opinions or estimates of lost profits must be based on objective facts, figures, or data from which the amount of lost profits may be ascertained.” *Id.* (quoting *Heine*, 835 S.W.2d at 84). The proper measure is lost net profits. *Heine*, 835 S.W.2d at 83 n. 1. Unless the issues concerning lost profits are “highly technical,” expert testimony is not required. *Fairmont Supply Co. v. Hooks Indus., Inc.*, 177 S.W.3d 529, 532 n. 1 (Tex. App.–Houston [1st Dist.] 2005, pet. denied).

Texas law recognizes that for enterprises with a record of profitability, records of past profits, with other relevant facts and circumstances, may support a finding of lost profits. *See Sw. Battery Corp. v. Owen*, 131 Tex. 423, 115 S.W.2d 1097, 1098-99 (Tex. 1938). In contrast, new or unestablished ventures must meet more exacting standards to prove that the profits claimed are not “too uncertain or speculative.” *See id.* The “requirement of ‘reasonable certainty’ in the proof of lost profits is intended to be flexible enough to accommodate the myriad circumstances in which claims for lost profits arise.” *Tex. Instruments*, 877 S.W.2d at 279. The proper focus is not on the business entity, but on whether the activity in which it engages is generally profitable. *See id.* at 280.

The jury heard an estimate from Carsten Ennemann that Meaux had suffered a \$2.3 million loss of treasure in 2007 thanks to their employees-turned-freebooters. Ennemann was personally familiar with the drop in business suffered by Meaux. Ennemann compared 2007 sales figures for several major clients with the budget projections which were prepared by Fogleman himself before he jumped ship. At trial, Fogleman stood by the projections as reasonable estimates of Meaux’s likely business, taking into

account the factors he deemed relevant. Fogleman's testimony supported Meaux's case; he was keelhaunched by his own windlass. In light of the evidence tending to show that defendants' acts harmed Meaux, the jury was entitled to find that Fogleman's and Kotrla's acts in derogation of a fiduciary duty to Meaux harmed it to the tune of \$1.43 million. *See Navigant Consulting*, 508 F.3d at 291.

*Id.* at 170-71.

## **VI. UPDATE ON PROTECTING OR OBTAINING TRADE SECRETS DURING DISCOVERY IN STATE AND FEDERAL COURT**

The issue of protecting or obtaining trade secrets during discovery arises in both Texas state court and federal court litigation. Cases regarding this subject in state and federal court are summarized below.

### **A. Protecting Or Obtaining Trade Secrets During Discovery In Texas State Court**

Rule 507 of the Texas Rules of Evidence provides for the protection of trade secrets:

A person has a privilege, which may be claimed by the person or the person's agent or employee, to refuse to disclose and to prevent other persons from disclosing a trade secret owned by the person, if the allowance of the privilege will not tend to conceal fraud or otherwise work injustice. When disclosure is directed, the judge shall take such protective measure as the interests of the holder of the privilege and of the parties and the furtherance of justice may require.

TEX. R. EVID. 507.

The trade secret privilege seeks to accommodate two competing interests. *In re Continental Gen. Tire., Inc.*, 979 S.W.2d 609, 612 (Tex. 1998) (orig. proceeding). First, it recognizes that trade secrets are an important property interest, worthy of protection. *Id.*

Second, it recognizes the importance placed on fair adjudication of lawsuits. *Id.* Rule 507 accommodates both interests by requiring a party to disclose a trade secret only if necessary to prevent “fraud” or “injustice.” *Id.* Disclosure is required only if necessary for a fair adjudication of the requesting party’s claims or defenses. *Id.*

The party asserting the trade secret privilege has the burden of proving that the discovery information sought qualifies as a trade secret. *In re Bass*, 113 S.W.3d 735, 737 (Tex. 2003) (orig. proceeding). If the resisting party meets its burden, the burden shifts to the party seeking the trade secret discovery to establish that the information is necessary for a fair adjudication of its claim. *Id.* It is an abuse of discretion for the trial court to order production once trade secret status is proven if the party seeking production has not shown necessity for the requested materials. *Id.* at 738.

As mentioned above, to determine whether a trade secret exists, the following six factors are weighed in the context of the surrounding circumstances: (1) the extent to which the information is known outside of the business; (2) the extent to which it is known by employees and others involved in the business; (3) the extent of measures taken to guard the secrecy of the information; (4) the value of the information to the business and to its competitors; (5) the amount of effort or money expended in developing the information; and (6) the ease or difficulty with which the information could be properly acquired or duplicated by others. *In re Union Pac. R.R. Co.*, 294 S.W.3d 589, 592 (Tex. 2009) (orig. proceeding) (per curiam). The party claiming a trade secret is not required to satisfy all six factors because trade secrets do not fit neatly into each factor every time. *In re Bass*, 113 S.W.3d at 740.

The Texas Supreme Court has not stated conclusively what would or would not be considered necessary for a fair adjudication; instead, the application depends on the circumstances presented. *In re Bridgestone/Firestone, Inc.*, 106 S.W.3d 730, 732 (Tex. 2003) (orig. proceeding). The degree to which information is necessary depends on the nature of the information and the context of the case. *Id.* However, “the test cannot be satisfied merely by general assertions of unfairness.” *Id.* “Just as a party who claims the

trade secret privilege cannot do so generally but must provide detailed information in support of the claim, so a party seeking such information cannot merely assert unfairness but must demonstrate with specificity exactly how the lack of the information will impair the presentation of the case on the merits to the point that an unjust result is a real, rather than a merely possible, threat.” *Id.* at 732-33. An appellate remedy does not exist if a trial court orders a party to produce privileged trade secrets absent a showing of necessity. *In re Bass*, 113 S.W.3d at 745. Hence mandamus is an appropriate vehicle to challenge such an order. *Id.*

On May 27, 2010, the Houston First Court of Appeals decided *In re Cooper Tire & Rubber Co.*, 313 S.W.3d 910 (Tex. App.–Houston [14th Dist.] 2010, no pet.). The plaintiffs were involved in a head-on collision when the tread came off a Cooper Weather Master S/T tire on Dustin Langstaff’s vehicle, causing him to lose control. They sued Cooper in the Harris County 127th District Court for strict liability, negligence, and defects in design, manufacturing and marketing. The suit alleged specifically that Cooper failed to use belt edge gumstrips, or BEGs, in the Weather Master, which purportedly would have made the tire safer.

The plaintiffs sought documents on a different model Cooper tire in order to show that the company had added and removed BEGs from that tire. They claimed the data could establish that Cooper knew of the Weather Master defect and that BEGs would rectify the problem but continued to produce the defective tires. Cooper countered that the information was not relevant and that the documents contained trade secrets. The trial court ordered Cooper to disclose the documents under a protective order but did not rule on the trade secret issue. The tire maker then filed a petition for writ of mandamus, asking the appeals court to set aside the trial judge’s order. Granting the petition, the court found that five of the six factors that determine whether trade secrets exist all weighed in favor of Cooper’s argument. The factors involved the extent to which people inside and outside Cooper’s business already know the information, what measures Cooper took to guard the data, the information’s value to Cooper, and the ease or

difficulty with which other parties could properly obtain or duplicate the data. The court concluded that the plaintiffs did not establish that they needed the trade secret information for a fair hearing on their claim. Accordingly, the panel concluded that the trial court abused its discretion in ordering Cooper to produce the documents. *Id.* at 919.

Even more recently, on June 23, 2010, the Dallas Court of Appeals issued a very similar decision. *See In re Goodyear Tire & Rubber Co.*, NO. 05-10-00485-CV, 2010 WL 2510371 (Tex. App.–Dallas Jun. 23, 2010) (also finding that the trial court abused its discretion in ordering the production of trade secrets).

### **B. Protecting Or Obtaining Trade Secrets During Discovery In Federal Court**

The federal rules allow a court, in the discovery context, to “make any order which justice requires to protect a party or person from . . . undue burden or expense, including . . . that a trade secret or other confidential research, development, or commercial information not be revealed or be revealed only in a designated way . . . .” FED. R. CIV. P. 26(c)(7). Federal courts applying this rule recognize that “[t]here is no absolute privilege for trade secrets and similar confidential information.” *Federal Open Mkt. Comm. v. Merrill*, 443 U.S. 340, 362, 99 S. Ct. 2800, 61 L.Ed.2d 587 (1979) (quoting 8 Wright & Miller, *Federal Practice and Procedure* § 2043, at 300 (1970)); *see also Centurion Indus. v. Warren Steurer & Assocs.*, 665 F.2d 323, 325 (10th Cir. 1981); *National Util. Serv., Inc. v. Northwestern Steel & Wire Co.*, 426 F.2d 222, 227 (7th Cir. 1970); *A.H. Robins Co. v. Fadely*, 299 F.2d 557, 561 (5th Cir. 1962); *Kleinerman v. United States Postal Serv.*, 100 F.R.D. 66, 69 (D. Mass. 1983); 6 Moore’s *Federal Practice* § 26.46[16], at 26.144 (3d ed. 1998). Rather, federal courts apply a balancing test with shifting burdens.

Specifically, in federal court, the party resisting discovery must establish that the information sought is indeed a trade secret and that disclosure would be harmful. The burden then shifts to the requesting party to establish that the information is “relevant and necessary” to his or her case. If the trial court orders disclosure, it should enter an appropriate protective order. *See, e.g.*, 8 Wright & Miller, *Federal Practice & Procedure* §

2043 (1994); *see also, e.g., American Standard, Inc. v. Pfizer Inc.*, 828 F.2d 734, 740- 41 (Fed. Cir. 1987); *Heat & Control, Inc. v. Hester Indus.*, 785 F.2d 1017, 1025 (Fed. Cir. 1986); *Centurion Indus. v. Warren Steurer & Assocs.*, 665 F.2d 323, 325 (10th Cir. 1981); *In re Independent Serv. Org. Antitrust Litig.*, 162 F.R.D. 355, 356 (D. Kan. 1995); *Exxon Chem. Patents, Inc. v. Lubrizol Corp.*, 131 F.R.D. 668, 671 (S.D. Tex. 1990); *Culligan v. Yamaha Motor Corp.*, 110 F.R.D. 122, 125 (S.D.N.Y. 1986). *Cf. Kleinerman v. United States Postal Serv.*, 100 F.R.D. 66, 69 (D. Mass. 1983) (discovery of trade secrets required where “the issues cannot be fairly adjudicated unless this information is available”) (quoting *Melori Shoe Corp. v. Pierce & Stevens, Inc.*, 14 F.R.D. 346, 347 (D. Mass. 1953)); *Duplan Corp. v. Deering Milliken, Inc.*, 397 F. Supp. 1146, 1185 (D. S.C. 1974) (“[T]he courts are loath to order disclosure of trade secrets absent a clear showing of an immediate need for the information requested.”) (quoting 4 Moore’s Federal Practice, ¶ 26.60[4], at 242-45 (2d ed.1970)).

This is ultimately a balancing test, in which the trial court must weigh all pertinent facts and circumstances. *See Wright & Miller*, § 2043 at 559 (“[T]he burden is on the party seeking discovery to establish that the information is sufficiently relevant and necessary to his case to outweigh the harm disclosure would cause to the person from whom he is seeking the information.”). *See also Centurion Indus.*, 665 F.2d at 325 (“The district court must balance the need for the trade secrets against the claim of injury resulting from disclosure.”).

Earlier this year, in *Farouk Systems, Inc. v. Costco Wholesale Corp.*, 700 F. Supp. 2d 780 (S.D. Tex. 2010), Judge Keith Ellison found that although “supplier information [regarding Costco’s suppliers] sought by Farouk is a trade secret, Farouk has adequately demonstrated that it needs this information to effectively adjudicate its claims and defenses.” *Id.* at 788. Judge Ellison rejected Costco’s argument that disclosure only occur after Farouk made out a colorable claim. *Id.* Judge Ellison entered a protective order limiting disclosure to Farouk’s outside counsel “unless, after receiving the information, outside counsel finds that it cannot reasonably use the disclosed information,

[in which case] it may make a motion with this Court to designate a neutral third party with knowledge of the industry to examine the issue.” *Id.* at 789. Costco also proposed that the protective order restrict Farouk from using the information found in Costco’s trade secrets to sue suppliers that sold Farouk products to Costco. Judge Ellison rejected that proposal, stating that “the Court does not consider it appropriate to require Farouk to relinquish its substantive rights simply to obtain discovery in this matter.” *Id.*

Even more recently, in *M-I LLC v. Stelly*, Civil Action No. 4:09-cv-1552, 2010 WL 3257972 (S.D. Tex. Aug. 17, 2010), Judge Ellison again ordered discovery of trade secrets. This time, the lawsuit was a misappropriation of trade secrets case. The defendants, however, still resisted discovery of its alleged trade secrets. In rejecting the defendants’ arguments, Judge Ellison stated:

Parties are generally given wide latitude in conducting discovery, even as to trade secret matters. Indeed, in most cases concerning trade secret discovery, “the key issue is not whether the information will be disclosed but under what conditions.” 8 CHARLES ALAN WRIGHT, ARTHUR R. MILLER & RICHARD L. MARCUS, FEDERAL PRACTICE AND PROCEDURE § 2043 (2d ed. 1994). The Supreme Court has recognized that “orders forbidding any disclosure of trade secrets or confidential commercial information are rare.” *Fed. Open Market Comm. of the Fed. Reserve Sys. v. Merrill*, 443 U.S. 340, 363 n. 24 (1979). “More commonly, the trial court will enter a protective order restricting disclosure to counsel, or to the parties.” *Id.* (internal citations omitted). Defendants have failed to cite to any federal cases that prohibited trade secret disclosure outright. Indeed, from the Court’s own research, it is clear that such action is exceedingly rare. Defendants have failed to set forth compelling reasons for why this material should be entirely exempt from discovery. The Court finds that the material is relevant and necessary to the claims at issue in this case.

*Id.* at \*37.

Regarding third-party discovery, if a subpoena “requires disclosure of a trade secret or other confidential research, development, or commercial information,” and the party seeking discovery “shows a substantial need for the . . . material that cannot otherwise be met without undue hardship . . . , the court may order . . . production only upon specified conditions.” FED. R. CIV. P. 45(c)(3)(B). The court must balance the need for discovery by the requesting party and the relevance of the discovery to the case against the harm, prejudice or burden to the other party. *Truswal Systems Corp. v. Hydro-Air Engineering, Inc.*, 813 F.2d 1207, 1210 (Fed. Cir. 1987). One factor to be considered in assessing the burden of complying with a subpoena is whether the moving party is a non-party to the litigation. *Truswal Systems Corp.*, 813 F.2d at 1210. Modification of a subpoena is preferable to quashing it. *Tiberi v. CIGNA Ins. Co.*, 40 F.3d 110, 112 (5th Cir. 1994).

Rule 45 provides that a court may place conditions upon the production of documents where the request requires disclosure of a trade secret or other confidential commercial information and the party seeking discovery shows a substantial need for the material that cannot otherwise be met without undue hardship. FED. R. CIV. P. 45(c)(3)(B). The moving party has the burden to establish that the information sought is a trade secret and that its disclosure might be harmful. *Exxon Chemical Patents, Inc.*, 131 F.R.D. at 671. Disclosure to a competitor is presumptively more harmful than disclosure to a non-competitor. *Echostar Communications Corp. v. The News Corp. Ltd.*, 180 F.R.D. 391, 395 (D. Co. 1998). If the moving party meets its burden of proof, the burden then shifts to the party seeking discovery to show that the requested information is relevant and necessary. *Id.* The court then balances the need for the trade secrets against the claim of injury resulting from disclosure. *Id.* Even if the requested documents are relevant, discovery will not be permitted if the party seeking discovery fails to show need or if the potential harm caused by production outweighs the benefit. *Mannington Mills, Inc. v. Armstrong World Industries, Inc.*, 206 F.R.D. 525, 529 (D. Del. 2002).

In *Cmedia, LLC v. LifeKey Healthcare, LLC*, 216 F.R.D. 387, 391 (N.D. Tex. 2003), the court applied these rules and found that the third-party's trade secrets and confidential information had to be produced, but "in such a manner as to assure confidentiality. These documents will be produced subject to a protective order which restricts disclosure of privileged documents to the attorneys involved in the litigation and independent experts, and which ensures return of all documents, including copies, to Koeppel within a reasonable time after conclusion of the litigation or certification of destruction thereof."

## **VII. KEY MISAPPROPRIATION OF TRADE SECRETS CASES SINCE OCTOBER 1, 2009**

### **A. Damages Issues In Trade Secrets Cases**

In *Calce v. Dorado Exploration, Inc.*, 309 S.W.3d 719 (Tex. App.–Dallas 2010, no pet.), the court held that the evidence was not legally sufficient to support jury's award of \$400,000 in reasonable royalty damages to exploration company on its claim for misappropriation of trade secrets. As the court noted, an appropriate measure of damages in a misappropriation of trade secrets case is a "reasonable royalty." *Id.* at 738 (citing *Univ. Computing Co. v. Lykes-Youngstown Corp.*, 504 F.2d 518, 536 (5th Cir. 1974)). "This does not mean a simple percentage of actual profits; instead, the trier of fact . . . must determine 'the actual value of what has been appropriated.'" *Metallurgical Indus. Inc. v. Fourtek, Inc.*, 790 F.2d 1195, 1208 (5th Cir. 1986) (quoting *Vitro Corp. v. Hall Chem. Co.*, 292 F.2d 678, 683 (6th Cir. 1961) and citing *Univ. Computing Co.*, 504 F.2d at 537). While every case involving misappropriation of trade secrets requires a "flexible and imaginative approach" to the problem of damages, certain standards have emerged from the cases. *Univ. Computing Co.*, 504 F.2d at 538-39. As stated by the Fifth Circuit,

If the defendant enjoyed actual profits, a type of restitutionary remedy can be afforded the plaintiff-either recovering the full total of defendant's profits or some apportioned amount designed to correspond to the actual contribution the plaintiff's trade secret made to the defendant's commercial

success. Because the primary concern in most cases is to measure the value to the defendant of what he actually obtained from the plaintiff, the proper measure is to calculate what the parties would have agreed to as a fair price for licensing the defendant to put the trade secret to the use the defendant intended at the time the misappropriation took place.

*Id.* at 539.

In calculating what a fair licensing price would have been had the parties agreed, the trier of fact should consider such factors as the resulting and foreseeable changes in the parties' competitive posture; prices past purchasers or licensees may have paid; the total value of the secret to the plaintiff, including the plaintiff's development costs and the importance of the secret to the plaintiff's business; the nature and extent of the use the defendant intended for the secret; and whatever other unique factors in the particular case might have been affected by the parties' agreement, such as the ready availability of alternative processes. *Id.* (citing *Metallurgical Indus. Inc.*, 790 F.2d at 1208 (citing *Univ. Computing Co.*, 504 F.2d at 540)). "Estimation of damages, however, should not be based on sheer speculation." *Id.* If too few facts exist to permit the trier of fact to calculate proper damages, then a reasonable remedy in law is unavailable. *Id.* In that instance, a permanent injunction is a proper remedy for the breach of a confidential relationship. *Id.* (citing *Zoecon Indus. v. Am. Stockman Tag Co.*, 713 F.2d 1174, 1180 (5th Cir. 1983) (citing *Hyde Corp. v. Huffines*, 158 Tex. 566, 314 S.W.2d 763, 778 (1958)). In *Calce*, the court concluded there was no evidence to support the jury's \$400,000.00 damages award. *Id.* at 740-41.

In *Rusty's Weigh Scales and Service, Inc. v. North Texas Scales, Inc.*, 314 S.W.3d 105 (Tex. App.—El Paso 2010, no pet.), the court noted that damages to the owner of the trade secret are an element of a claim for damages based on a misappropriation claim. *Id.* at 109. The court held that the evidence was insufficient to support an award of lost profit damages, in an industrial weigh scale company's action against a competitor for misappropriation of trade secrets based on the competitor's alleged use of the company's

software. The company's owner asserted that the company lost \$2 million in profits, but did not prove through documentation that such profits were lost, and did not demonstrate that the alleged loss of profits was caused by loss of customers due to the competitor's use of the company's software. *Id.* at 110-11. The court found that such "proof" amounted to mere speculation of lost profits, and was not sufficient to support any award of damages. *Id.* The court also found that the plaintiff had failed to present clear and convincing proof of "malice," so no award of punitive damages was justified. *Id.* at 113.

### **B. Temporary Injunction Standard In Trade Secrets Cases**

In *INEOS Group Ltd. v. Chevron Phillips Chemical Co., LP*, 312 S.W.3d 843 (Tex. App.—Houston [1st Dist.] 2009, no pet.) the Court of Appeals held that the trial court did not abuse its discretion by finding that the plaintiff-manufacturer was sufficiently vigilant in guarding its polyethylene manufacturing technology such that it was entitled to trade secret protection by a temporary injunction pending trial on the merits. In *INEOS Group Ltd.*, the court observed that, on appeal, the scope of review is limited to the validity of the temporary injunction order. *Id.* at 848. The appellate court does not review the merits of the underlying case. *Id.* Instead, the appellate court determines whether there has been an abuse of discretion by the trial court in granting or denying the relief. *Id.* In making this determination, the appellate court may not substitute its judgment for that of the trial court unless its decision was so arbitrary that it exceeded the bounds of reasonableness. *Id.* Abuse of discretion does not exist if the trial court heard conflicting evidence, and evidence appears in the record that reasonably supports the trial court's decision. *Id.* A trial court abuses its discretion in granting or denying a temporary injunction when it misapplies the law to the established facts. *Id.* Given the abuse-of-discretion-standard, the appellate court reviews the evidence submitted to the trial court in the light most favorable to the court's ruling, draws all legitimate inferences from the evidence, and defers to the trial court's resolution of conflicting evidence. *Id.*

The court noted that “when deciding whether to grant trade-secret protection through a temporary injunction, a trial court does not determine whether the information sought to be protected is, in law and fact, a trade secret; rather, the trial court determines whether the applicant has established that the information is entitled to trade secret protection pending the trial on the merits.” *Id.* at \*8 (citing *Sharma v. Vinmar Int’l, Ltd.*, 231 S.W.3d 405, 424 (Tex. App.–Houston [14th Dist.] 2007, no pet.)).

In this case, the main issue was whether the plaintiff had taken adequate steps to protect its trade secrets. The defendant argued that the plaintiff had not, and, therefore its use of the alleged trade secrets was proper and the trial court had erred in enjoining it from using the alleged trade secrets. The appeals court disagreed. The court noted that the plaintiff introduced testimony that it is unaware that any of the expired secrecy obligations cited by the defendant actually resulted in the unauthorized public disclosure of its trade secrets and that the defendant presented no evidence to the contrary. The court observed that the vast majority of the licenses given by the plaintiff over the past 50 years regarding the alleged trade secrets contain perpetual secrecy clauses. The court also found it noteworthy that the plaintiff introduced evidence detailing the strict security measures it had implemented and maintained over the years to keep the at-issue technology confidential, aside from the secrecy agreements. Accordingly, it found that trade secret protection was warranted at the temporary injunction stage. *Id.* at 854-55. Here are some other trade secrets cases where courts of appeals found that district courts had not erred in granting temporary injunctions:

- *IAC, Ltd. v. Bell Helicopter Textron, Inc.*, 160 S.W.3d 191, 203 (Tex. App.–Fort Worth 2005, no pet.) (affirming trial court’s decision to issue an injunction in a trade secrets case).
- *Fox v. Tropical Warehouse, Inc.*, 121 S.W.3d 853, 860 (Tex. App.–Fort Worth 2003, no pet.) (enjoining ex-employee from selling fish to Wal-Mart, his ex-employer’s main customer, because the only way he won the

Wal-Mart account was through his misappropriation and use of his ex-employer's trade secrets).

- *T-N-T Motorsports, Inc. v. Hennessey Motorsports, Inc.*, 965 S.W.2d 18, 21-22 (Tex. App.–Houston [1st Dist.] 1998, pet. dismiss'd) (affirming grant of temporary injunction against former employees who set up competing business based on their knowledge of their former employer's confidential information; although ex-employees could stay in business, they could not utilize any of their ex-employer's trade secrets to do business).
- *Rugen v. Interactive Bus. Sys., Inc.*, 864 S.W.2d 548 (Tex. App.–Dallas 1993, no writ) (grant of temporary injunction against former employee prohibiting employee from using any confidential information obtained from former employer to solicit or transact business with employer's consultants or customers was not abuse of discretion).
- *Collins v. Ryon's Saddle & Ranch Supplies, Inc.*, 576 S.W.2d 914, 915-16 (Tex. Civ. App.–Fort Worth 1979, no writ) (affirming temporary injunction prohibiting employee from soliciting or contacting all persons who placed orders with former employer during employee's term of employment so that the employee "could not benefit from breach of the confidential relationship.").
- *Elcor Chem. Corp. v. Agri-Sul, Inc.*, 494 S.W.2d 204, 212 (Tex. Civ. App.–Dallas 1973, writ refused n.r.e.) (entering injunction against former employees who left plaintiff's employment and established their own company based on the fruits of their fiduciary breaches and stating that "the equitable cloak of protection must, of necessity, be full and complete so that those who have acted wrongfully and have breached their fiduciary relationship, as well as those who willfully and knowingly have aided them in doing so, will be effectively denied the benefits and profits flowing from the wrongdoing.").

In the following cases, courts of appeals found that the district courts had properly refused to enter temporary injunctions based on alleged trade secret misappropriation:

- *Dallas Anesthesiology Associates, P.A. v. Texas Anesthesia Group, P.A.*, 190 S.W.3d 891 (Tex. App.–Dallas 2006, no pet.) (denial of plaintiff anesthesiology professional association’s application for temporary injunction was not an abuse of discretion, where there was conflicting evidence as to whether defendants had breached their fiduciary duties, misappropriated confidential information, or tortiously interfered with business relationships; in light of such conflicting evidence, plaintiff failed to prove a probable right to the relief sought).
- *TMC Worldwide, L.P. v. Gray*, 178 S.W.3d 29 (Tex. App.–Houston [1st Dist.] 2005, no pet.) (district court properly denied application for temporary injunction because the evidence was sufficient to support finding that former employer did not show a probability of success in proving that its customer list was entitled to trade secret protection so as to grant temporary injunction in trade secret action against former employee; there was no evidence that former employee used the list to obtain 16 customers which were on that list, but rather former employee testified that the 16 customers were obtained through other sources or they sought to continue business with former employee due to his prior relationship with them).
- *Sands v. Estate of Buys*, 160 S.W.3d 684 (Tex. App.–Fort Worth 2005, no pet.) (district court properly denied application for temporary injunction because estate of deceased owner of accounting corporation did not establish a probability of success in proving that clients’ identities deserved trade secret protection, so as to entitle estate to temporary injunction to prohibit former accountant from contacting clients; clients’ identities were known by many people outside the corporation, including other former accountants and the clients themselves, corporation made little effort to

guard identities or compile a client list, and information regarding the identities could be acquired by others fairly easily).

- *EMSL Analytical, Inc. v. Younker*, 154 S.W.3d 693 (Tex. App.–Houston [14th Dist.] 2004, no pet.) (district court properly denied application for temporary injunction where there was no evidence former employee was currently violating nondisclosure clause or that there was any likelihood that she would in the future, so as to show a probable, imminent, and irreparable injury necessary to support a temporary injunction; even though she was working for former employer’s customer; evidence only established theoretical possibility that former employee could take customer away from former employer or that she could divulge confidential information).

### **C. Whether Information Is Truly A “Trade Secret”**

In *Texas Integrated Conveyor Systems, Inc. v. Innovative Conveyor*, 300 S.W.3d 348 (Tex. App.–Dallas 2009, pet. denied), the Court of Appeals held that genuine issues of material fact existed on whether former employer’s customer information constituted a “trade secret,” thus precluding traditional summary judgment to the former employees-defendants on the former employer’s claim against them for misappropriation and theft of trade secrets.

## **VIII. UPDATE ON DUTY OF PRESERVATION AND SPOILIATION ISSUES**

In *Rimkus Consulting Group, Inc.*, 688 F. Supp. 2d 598, a case decided in February 2010, an executive left his company with a few other employees to start a competing enterprise. Initially, the ex-employees sought a declaratory judgment that their noncompetition and nonsolicitation agreements with their former employer, Rimkus Consulting Group, were unenforceable. Rimkus then sued the ex-employees for breach of these agreements, as well as use of trade secrets and proprietary information. In this action, Rimkus alleged that the defendants (the ex-employees) spoliated evidence and moved for sanctions against them.

The spoliation allegations included “destroying evidence, failing to preserve evidence after a duty to do so had arisen, lying under oath, failing to comply with court orders, and significantly delaying or failing to produce requested discovery.”

In a lengthy and meticulously detailed opinion, Judge Rosenthal addressed the “grave” concern that spoliation and sanctions motions essentially threaten to derail the civil discovery process. Judge Rosenthal, in the context of explaining the framework to be applied in examining spoliation allegations, stressed that (a) there are no litmus tests or “negligence per se” rules that can be quickly applied in this area, and (b) what a party must do to preserve information is proportional to the case at hand:

[A]pplying [the general rules regarding preservation] to determine when a duty to preserve arises in a particular case and the extent of that duty requires careful analysis of the specific facts and circumstances. It can be difficult to draw bright-line distinctions between acceptable and unacceptable conduct in preserving information and in conducting discovery, either prospectively or with the benefit (and distortion) of hindsight. Whether preservation or discovery conduct is acceptable in a case depends on what is reasonable, and that in turn depends on whether what was done—or not done—was proportional to that case and consistent with clearly established applicable standards. FN8 As Judge Scheindlin pointed out in *Pension Committee*,<sup>2</sup> that analysis depends heavily on the facts and circumstances of each case and cannot be reduced to a generalized checklist of what is acceptable or unacceptable.

*Id.* at 613 (emphasis and footnote added)(footnote 8 in original text cited THE SEDONA PRINCIPLES: SECOND EDITION, BEST PRACTICES RECOMMENDATIONS & PRINCIPLES FOR ADDRESSING ELECTRONIC DOCUMENT PRODUCTION 17 cmt. 2.b. (2007) (“Electronic discovery burdens should be proportional to the amount in

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<sup>2</sup> *Pension Comm. of the Univ. of Montreal Pension Plan v. Banc of Am. LLC*, No. 05 Civ. 9016, 2010 WL 184312 at \*3 (S.D.N.Y. Jan. 15, 2010).

controversy and the nature of the case. Otherwise, transaction costs due to electronic discovery will overwhelm the ability to resolve disputes fairly in litigation.”)).

Before proceeding to the remainder of the opinion, Judge Rosenthal also recognized that “sanctions (as opposed to other remedial steps) require some degree of culpability.” *Id.*

### **A. When Deletion Of Evidence Becomes Spoliation**

Spoliation is the destruction or the significant and meaningful alteration of evidence. *Id.* at 612. The routine deletion of electronically stored information transforms into spoliation when three elements are present: (a) the duty to preserve the information, (b) a culpable breach of that duty, and (c) resulting prejudice. *Id.*

#### **1. Duty To Preserve Information**

A party has a duty to preserve information when that party “has notice that the evidence is relevant to litigation, or . . . should have known that the evidence may be relevant to future litigation.” *Id.* The duty to preserve information encompasses documents or tangible things by or to individuals “likely to have discoverable information that the disclosing party may use to support its claims or defenses.” *Id.* This articulation makes clear that the scope of the preservation duty is directly proportional to the matter at hand and not an abstract, unbounded duty.

#### **2. A Culpable Breach Of The Duty To Preserve Information**

A “culpable” breach of a duty is one that is blameworthy – in other words, not an innocent mistake. Judge Rosenthal specifically notes that mere negligence in most courts is generally not enough to warrant an instruction on spoliation. *Id.* at 614. Also, Judge Rosenthal observes that in most circuits, courts do not impose the severe sanctions of granting default judgment, striking pleadings, or giving adverse inference instructions unless there is evidence of “bad faith.” *Id.* Judge Rosenthal further notes that her analysis and conclusions are, in part, at odds with the framework established in *Pension Committee* due to the rubric of case law developed in the Second Circuit. *Id.* at 615.

### **3. Resulting Prejudice**

The third element of spoliation, “resulting prejudice,” is important because not all destruction or alteration of evidence negatively impacts the other party’s ability to present its case. Both “culpability” and “prejudice” are case-by-case determinations, in which notions of reasonableness and proportionality are paramount. *Id.* at 616-17. Thus, Judge Rosenthal’s opinion provides guidance to courts deciding a spoliation claim to consider the nature of the case, the amount in controversy, and the degree to which the conduct in question actually impairs the innocent party’s ability to present its case.

#### **B. Determining Whether Spoliation Merits An Adverse Inference Instruction**

Judge Rosenthal’s decision identifies the elements of a request for an adverse inference instruction due to spoliation as similar, but not identical, to those of spoliation itself. The requesting party must establish that: (a) the party with control over the evidence had an obligation to preserve it at the time it was destroyed; (b) the evidence was destroyed with a culpable state of mind; and (c) the destroyed evidence was “relevant” to the party’s claim or defense such that a reasonable trier of fact could find that it would support that claim or defense. *Id.* at 615-16. Judge Rosenthal noted that courts further divide the “relevance” factor of this analysis into three subparts: (i) whether the evidence is relevant to the lawsuit, (ii) whether the evidence would have supported the inference sought, and (iii) whether the non-destroying party has suffered prejudice from the destruction of the evidence. *Id.* at 616.

#### **1. Demonstrating The Relevance Of Lost Information**

The burden on the innocent party to demonstrate the “relevance” of lost information begs the question: How is this possible, if the information is lost? Often, as in *Rimkus*, the party seeking discovery can replace some deleted information, or obtain extrinsic evidence of its content. *Id.* For example, a forensic analysis of Rimkus’ computer system revealed that, three days before his departure from the company, the executive sent a flurry of work documents to his personal e-mail account. *Id.* at 644.

Rimkus was able to mine its own server for these e-mails, which contained income statements for several company offices. Yet, even if Rimkus had been unable to recover the e-mails, the circumstances under which they were sent would probably have satisfied the relevance criterion.

Requiring parties to show that lost information is relevant and prejudicial is an important check on spoliation allegations and sanctions motions. *Id.* at 616. Still, courts realize the difficulty inherent in demonstrating the nature of something that is missing. Speculative or generalized assertions that the missing evidence would have been favorable to the party seeking sanctions are insufficient. However, sometimes the evidence in the case as a whole sufficiently indicates that the lost information would have helped the requesting party support its claims or defenses. In *Pension Committee*, the court found that, even for severe sanctions, relevance and prejudice may be presumed when the spoliating party acts in a grossly negligent manner. In *Rimkus*, because much lost information was recovered or its relevance shown by circumstantial evidence, Judge Rosenthal determined that there was “neither a factual or legal basis, nor need, to rely on a presumption of relevance or prejudice.” *Id.* at 618.

## **2. The Role Of Prejudice In *Rimkus***

The case generated voluminous discovery. Defendants produced some records, Rimkus was able to retrieve many of the deleted records from other sources (such as internet service providers), and deposition testimony was plentiful. Judge Rosenthal concluded that, taken together, these sources of evidence provide sufficient material for Rimkus to present its case, thus mitigating the prejudicial effect of the defendants’ conduct. *Id.* The court also emphasized the fact that some of the lost information appears to favor the defendants, further reducing the prejudice to Rimkus. *Id.*

## **3. The Adverse Jury Instruction In *Rimkus***

Ultimately, Judge Rosenthal crafted the following adverse inference instruction:

[The jury will] hear evidence about the deletion of emails and attachments and about discovery responses that concealed and delayed revealing the deletions ... [The jury will learn that, after a certain date] the defendants had a duty to preserve emails and other information they knew to be relevant to anticipated and pending litigation. If the jury finds that the defendants deleted emails to prevent their use in litigation with Rimkus, the jury will be instructed that it may, but is not required to, infer that the content of the deleted lost emails would have been unfavorable to the defendant. In making this determination, the jury is to consider the evidence about the conduct of the defendants in deleting emails after the duty to preserve had arisen and the evidence about the content of the deleted emails that cannot be recovered.

*Id.* at 620, 653.

The nature of this inference – permissive rather than mandatory – is consistent with the inferences used in other spoliation cases cited by Judge Rosenthal. *See id.* at 646 n. 34. Notably, however, the instruction is significantly shorter than the instruction in *Pension Committee*, in part because the instruction in *Rimkus* concerns only the favorability of the evidence, whereas the instruction in *Pension Committee* deals with both relevance and favorability.

The instructions also differ in terms of a defendant's ability to overcome the negative inference. In *Pension Committee*, the jury instruction permitted jurors to presume that the lost evidence was both relevant and favorable to the defendants, but then asked jurors to assess whether the individual defendants had successfully rebutted this presumption. If jurors found that a defendant had done so, then they were to discard the negative inference. In contrast, the jury instruction in *Rimkus* was silent as to the defendants' ability to rebut the presumption, thereby increasing the likelihood that jurors would apply the negative inference. Neither instruction places the jury in the role of assessing when the duty to preserve arose or the scope of the duty.