Noncompetes, Trade Secrets, Fiduciary Duties, and the Inevitable Disclosure Doctrine — A Cutting Edge Update

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I. Inevitable Disclosure Doctrine

What is the "inevitable disclosure" doctrine?

It's going to happen …

"[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."

Cardinal Health Staffing Network, Inc. v. Bowen, 106 S.W.3d 230, 242 (Tex. App.–Houston [1st Dist.] 2003, no pet.).

When does it apply?

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.

Cardinal Health Staffing Network, Inc. v. Bowen, 106 S.W.3d at 242.

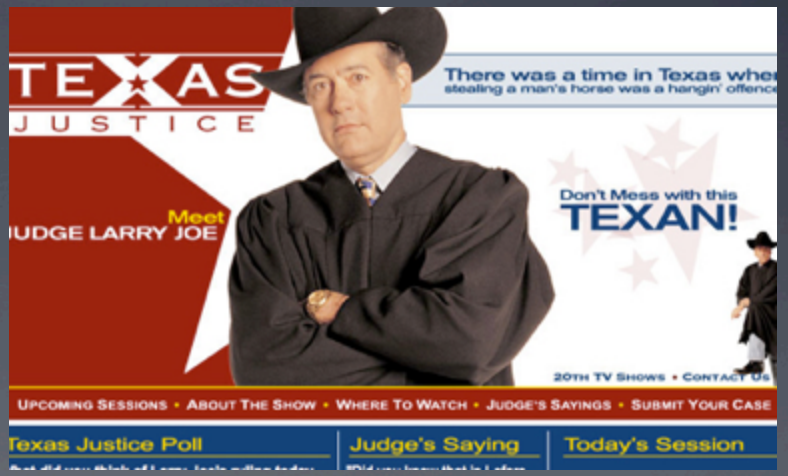
Have Texas Appellate Courts Adopted The Doctrine?

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 . . . .").

BUT . . .

Several Texas cases have applied the doctrine to grant injunctive relief.

See 36 A.L.R.6th 537, *Applicability of Inevitable Disclosure Doctrine Barring Employment of Competitor's Former Employee* (2008); *see also* Paper at pages 3-5.



What Facts Militate In Favor Of Applying The Inevitable Disclosure Doctrine?

1. An employer targets specialized employees for hire specifically because they are weak in the technology areas and needed to obtain talent from competitors to catch up. (*FMC Corp.*).

2. The new employer has rejected requests to describe the employee's duties or to ensure the ex-employer's confidential information will not be utilized. (*Spicer).* (Not all courts require this proof. *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")).

What Facts Militate In Favor Of Applying The Inevitable Disclosure Doctrine?

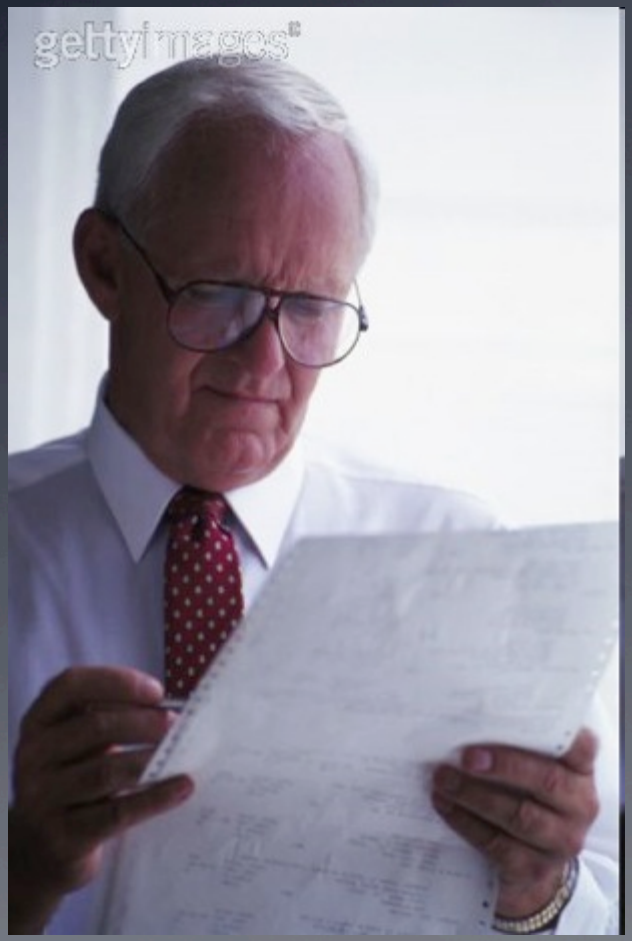
3. The employee's duties are significantly the same at the new employer as they were at their former employer. *Conley*, 1999 WL 89955, at *5.

What Facts Militate In Favor Of Applying The Inevitable Disclosure Doctrine?

4. The case involves research and product development employees – the key employees a company relies on to develop and refine highly valued 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 in and took extraordinary steps to protect its secrecy).

What Facts Militate In Favor Of Applying The Inevitable Disclosure Doctrine?



5. The employee could easily memorize his ex-employer's confidential information and trade secrets.

   See Spicer, 2006 WL 1751786 at *9-11; *Williams*, 704 S.W. 2d at 471 (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").

What Facts Militate In Favor Of Applying The Inevitable Disclosure Doctrine?

6. The new employer refuses to acknowledge that the information is a trade secret.

   See FMC Corp., 677 F.2d at 505.

II. Texas Non-Compete Update

1. Regarding first prong: An implied promise to provide confidential information sufficient to uphold non-compete. *See Mann Frankfort Stein & Lipp Advisors, Inc. v. Fielding*, 289 S.W.3d 844 (Tex. 2009).

2. Also, stock options grant sufficient to uphold a non-compete. *See Marsh USA Inc. v. Cook, 354 S.W.3d 764 (Tex. 2011).*

Texas Non-Compete Update

3. Heavy focus on "reasonableness" prong now (the second prong). In the context of sales employees: "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."

   EMS USA, Inc. v. Shary, 309 S.W.3d 653, 660 (Tex. App.–Houston [14th Dist.], 2010 no pet.).

   But see M-I LLC v. Stelly, 733 F. Supp. 2d 759 (S.D. Tex. 2010) (enforcing much broader restraint when employee wasn't just a mere salesman).

4. Still not necessarily a lay down to get an injunction, because of the irreparable harm requirement. *See infra.*

Texas Non-Compete Update

Money damages are not available based on breached of overbroad non-compete prior to reformation.

Rimkus Consulting Group, Inc. v. Cammarata, 688 F. Supp. 2d 598, 673 (S.D. Tex. 2010) (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 non-compete).

Non-Competes That Impose Monetary Penalties For Competing

- Subject to same analysis, per *Peat Marwick* case.
- If there are no limitations as to time, geographical area and scope of activity to be restrained, they will not be enforceable under Texas law. *See Drennan v. Exxon Mobile Corp*., 367 S.W.3d 288, 295 (Tex. App.–Houston [14th Dist.] 2012, pet. filed).

Non-Compete & Attorneys' Fees Issues

1. For prevailing employer. Perhaps never.
2. For prevailing employees.

- Some courts say only if employee satisfies section 15.51 (*see Perez*).
- Other courts say prevailing employee may obtain fees even if they do not satisfy section 15.51 (*see Hardy*).

Obtaining Injunctive Relief For Breach of a Non-Compete

- Do you still have to prove "irreparable harm?
  - Most courts say "yes." *See, e.g., Cardinal Health Staffing Network, Inc.*
  - But some say "no" based on Section 15.51(a). *See, e.g., Heritage Operating, L.P*.
- Proof that a highly trained employee is continuing to breach a non-competition agreement gives rise to a rebuttable presumption that the applicant is suffering irreparable harm. *Cardinal Health Staffing Network, Inc.*
- Irreparable harm issue often turns on equitable considerations and black hat / white hat facts.

Obtaining Injunctive Relief For Breach of a Non-Compete

- Successor companies' rights to seek injunctive relief enforcing a noncompetition agreement.
- The effect of contractual stipulations of irreparable harm.
- The effect of delay on a party's ability to obtain injunctive relief.
- Equitable extensions of the period of restraint – possible if violation has been "consistent and persistent."

See Cases in paper.

Choice of Law and Forum Clauses

- Choice of law of other state won't be enforced if the employee worked exclusively (or probably even primarily) in Texas. *See DeSantis* and *Drennan*.
- Choice for Forum clauses requiring all litigation to occur in another state are, however, enforceable. *See In re AutoNation* (Tex. 2007).

Non-recruitment Covenants Under Texas Law

Much easier to enforce than noncompete agreements.

Most courts say Section 15.50 does not apply to them – but see interesting *Marsh USA* dicta on that point.

But, typically much more difficult to obtain an injunction to halt such activity.

III. At-Will Employee Fiduciary Duty Update

An at-will employee breaches their fiduciary duty to their employer if, during their employment, they: (1) misappropriate the company's trade secrets; (2) solicits the employer's customers while still working for their employer; (3) solicits the departure of other employees while still working for the employer; or (4) carries away confidential information.

Johnson v. Brewer & Pritchard, P.C., 73 S.W.3d 193, 202 (Tex. 2002).

At-Will Employee Fiduciary Duty Update

Aside from those limitations, taking preparatory steps to compete with an employer while still working for that employer is not actionable.

Navigant Consulting, Inc. v. Wilkinson, 508 F.3d 277, 284 (5th Cir. 2007) (under 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).

At-Will Employee Fiduciary Duty Update

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. 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.

* But, there are fact specific exceptions. *See Navigant Consulting, Inc.* (failure to disclose plans to form competitive business while simultaneously signing long term lease for employer in order to put employer in vulnerable position was a breach of fiduciary duty).

At-Will Employee Fiduciary Duty Update

- In 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 ex-employer.

  Meaux Surface Protection, Inc. v. Fogleman, 607 F.3d 161 (5th Cir. 2010).

  They had solicited many of their coworkers to leave and join their competitive venture before they resigned from plaintiff' s employment.

At-Will Employee Fiduciary Update

PAS, Inc. v. Engel, 350 S.W.3d 602, 612 (Tex. App.–Houston [14th Dist.] 2011, no pet.) (holding that if a fiduciary employee obtains a release from a non-compete agreement under such circumstances a jury could find that the employee committed a breach of fiduciary duty, and fraud).

Practical Pointers For Departing Employees:

1. Give 2 weeks or more of notice in writing.
2. Offer to help transition in writing, and follow through.
3. Don't take anything, and put that you did not in writing.
4. Don't destroy electronic information. Even if you are just "cleaning up."
5. Be honest about where you are going to work.
6. Don't solicit customers or coworkers before you leave. Don't even tell customers or coworkers you are leaving before you do.
7. Don't start showing up to the office at odd, off-hours, or accessing the server at odd hours.
8. Provide a carefully worded resignation letter that truthfully reveals where you are going to work, and the name of your new job title.
9. Respond to any post-termination threatening letters honestly after visiting with legal counsel. Don't "blow off" the letters.
10. Work to the end - closing a big sale for your employer before leaving pays huge dividends if they come after you.
11. Tell the new potential employer about your restrictions in advance – before you accept the offer, and have a joint plan. Otherwise, you may end up without any job after you quit and your ex-employer sends a nasty letter to your new employer.

Practical Pointers For New Employers:

1. Do due diligence on agreement and other issues before hiring.

2. Have employee sign agreement representing they took nothing from former employer and will not use or disclose any of former employer's confidential information or trade secrets, and no one can order them to do otherwise.

3. Include in agreement that employee can and will do job without using or disclosing any of ex-employer's confidential information or trade secrets.

4. Have a plan on a response before hiring, if it is a "hairy" hire (employee has non-compete, history of litigation with company, *etc*.)

5. Have employee sign off on job description that does not violate an enforceable non-compete agreement during its term.

Practical Pointers For Ex-Employers:

1. Forensics dig asap, with expert report to reflect results and present to court if need be.

2. Don't always walk employee out the door. Rather, consider shutting off all access, and then have them answer critical questions in a signed writing on the spot. This can provide *awesome* evidence to use in court.

3. Put ex-employee and new employer on notice with a strong letter, and demand for information. Often, this will lead to an acceptable resolution, especially when sophisticated counsel represent all the parties.

4. Act fast in going to court, but not too fast (before you have evidence locked down).

5. Before you sue, ask: Does the employee have claims against us that our suit may stimulate them to bring? (*e.g.*, FLSA class action example).

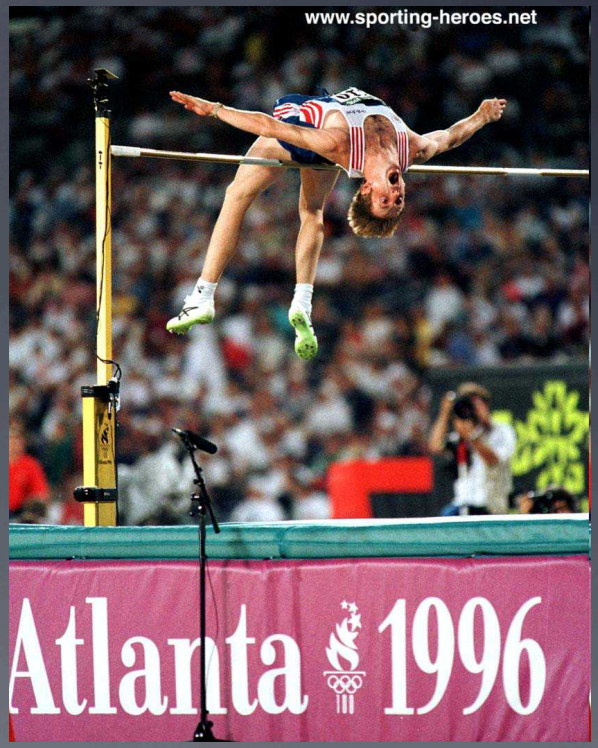
IV. Trade Secrets In Discovery

Rule 507 of TRE.

High standard to meet to obtain trade secrets in state court discovery.

In re Cooper Tire & Rubber Co., 313 S.W. 910 (Tex. App.–Houston [14th Dist.] 2010, no pet.) (reversing trial court's order to produce trade secrets under a protective order under Rule 507).

* New law addresses this point.



V. Texas Adopts The UTSA

- Takes effect September 1, 2013.
- Wipes away common law, although the UTSA is not vastly different from the common law of Texas.
- Defines trade secret as "Information, including a formula, pattern, compilation, program, device, method, technique, process, financial data, or list of potential customers or suppliers."
- Texas added the financial data and customer list part (a Texas twist).
- Remedies include:
  - Injunction
  - Damages (unjust enrichment or reasonable royalty damages)
  - Punitive damages if malice is proven
  - Attorneys' fees in some instances (big change here)
  - Encourages protective orders in trade secrets cases

VI. Some Trade Secrets Cases

1. Damages issue.

   Wellogix, Inc. v. Accenture, L.L.P., __ F.3d __, No. 11–20816, 2013 WL 2096356 (5th Cir. May 15, 2013), the court, applying Texas law, affirmed a verdict of more than $40 million in compensatory and punitive damages in a trade secrets misappropriation case, based on actual harm to the plaintiff.

   But see Bohnsack v. Varco, L.P., 668 F.3d 262 (5th Cir. 2012) (affirming $600,000 award in trade secrets case based on what a reasonable investor would have paid, and emphasizing the flexible nature of the damages inquiry).

Some Trade Secrets Cases

2. Temporary Injunctive Standard

   INEOS Group Ltd. v. Chevron Phillips Chemical Co., LP, 312 S.W.3d 843 (Tex. App.–Houston [1st Dist.] Dec. 17, 2009, no pet.) (holding that the trial court did not abuse its discretion by finding that manufacturer was sufficiently vigilant in guarding its polyethylene manufacturing technology such that manufacturer was entitled to trade secret protection by a temporary injunction pending trial on the merits).

Some Trade Secrets Cases

3. Whether Information Is Truly A "Trade Secret"

Texas Integrated Conveyor Systems, Inc. v. Innovative Conveyor, 300 S.W. 3d 348 (Tex. App.–Dallas 2009, pet. denied) (holding that genuine issues of material fact existed as whether former employer's customer information constituted a "trade secret").

Thank You

THE END

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