

Client Alert

Business Litigation Practice Group

October 23, 2013

Texas Adopts the Uniform Trade Secrets Act

Texas recently adopted the Uniform Trade Secrets Act, making it effective on September 1, 2013. S.B. 953, 83rd Leg., Reg. Sess., § 4 (Tex. 2013) (the “Act”). The Act has been adopted by 46 other states, plus the U.S. Virgin Islands and the District of Columbia. The Act creates a new chapter 134A in the Civil Practice & Remedies Code that applies to “the misappropriation of a trade secret made on or after the effective date.” *Id.* at § 3. Thus, pre-Act law still applies in cases where the alleged misappropriation occurred before September 1, 2013, even if the case is filed on or after that date. The Act materially changes prior Texas trade secret law, which combined the common law and a statutory scheme including a portion of the Texas Penal Code.

Texas Law Before the Act

Before the Act’s effective date, there were two sources of law available to a party who believed that its trade secret had been misappropriated: (1) the common law of trade secret misappropriation and (2) the Texas Theft Liability Act.

The common law test for whether information constituted a trade secret was a six factor balancing test derived from both the Restatement of Torts § 757 (1939) and the Restatement (Third) of Unfair Competition § 39 (1995):

- (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 the measures taken to guard the secrecy of the information;
- (4) the value of the information to him and to his competitors;
- (5) the amount of effort or money expended in developing the information; and

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- (6) the ease or difficulty with which the information could be properly acquired or duplicated by others.

In re Bass, 113 S.W.3d 735, 739 (Tex. 2003). None of the six factors were dispositive, nor were they all required to be present for information to constitute a trade secret. *Id.* at 740. Texas courts considered the six factors “in the context of the surrounding circumstances” to make the determination. *Id.*

The second avenue of recovery was the Texas Theft Liability Act (“TTLA”), which provides a civil cause of action for certain violations of the Penal Code, including Section 31.05, which criminalizes theft of trade secrets. TEX. PENAL CODE § 31.05(b). Under the TTLA, trade secret “means the whole or any part of any scientific or technical information, design, process, procedure, formula, or improvement that has value and that the owner has taken measures to prevent from becoming available to persons other than those selected by the owner to have access for limited purposes.” *Id.* at § 31.05(a)(4). Notably, either party was entitled to recover its attorneys’ fees if it prevailed on a claim brought under the TTLA. . TEX. CIV. PRAC. & REM. CODE § 134.005(b).

Under either theory of recovery, “[t]he methods used to calculate damages include the value of the plaintiffs’ lost profits, the defendant’s actual profits from the use of the secret, the value that a reasonably prudent investor would have paid for the trade secret, the development costs the defendant avoided by the misappropriation, and a reasonable royalty.” *Lamont v. Vaquillas Energy Lopeno Ltd.*, 2013 WL 5228500, at *20 (Tex. App.—San Antonio, Sep. 18, 2013, no pet h.).

Texas Law After the Act

The Act “displaces conflicting tort, restitutionary, and other law of this state providing civil remedies for misappropriation of a trade secret.” TEX. CIV. PRAC. & REM. CODE § 134A.007. In addition to creating a new statutory scheme for misappropriation of trade secret claims that displaces the common law, the Act specifically deletes the reference to Penal Code section 31.05 in the TTLA, making clear that a theft of trade secret claim may no longer be brought under the TTLA. S.B. 953, § 2.

New Definitions

One immediately apparent difference between prior Texas law and the Act is that there is now a single definition of trade secret:

[I]nformation, including a formula, pattern, compilation, program, device, method, technique, process, financial data, or list of actual or potential customers or suppliers that (A) derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use; and (B) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.

TEX. CIV. PRAC. & REM. CODE § 134A.002(6). In many ways, this definition is broader and easier to satisfy than either the common law or TTLA definitions. Gone are the specific inquiries about the extent to which the information is known both inside and outside of the plaintiff’s business. The value inquiry is also very different, because it is now clear that even information with *potential* value is protected. The common law and TTLA both implied that the information needed to be of actual value to be a trade secret. Under the common law, one factor was also whether the

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plaintiff had expended actual effort or money to develop the information. That factor is also missing from the current definition.

The current law is also stricter in some ways. For example, under the TTLA and the Penal Code, information could be a trade secret so long as *any* measures were taken to protect it from disclosure, regardless of the reasonableness or effectiveness of those measures. *See* TEX. PENAL CODE § 35.01(a)(4) (requiring only that owner of the trade secret “has taken measures” to prevent its disclosure). The Act requires that measures be taken to protect the secrecy of the information “that are reasonable under the circumstances.” TEX. CIV. PRAC. & REM. CODE § 134A.002(6)(B). This is similar to the prior common law rule, though not identical.

A number of other terms that were previously subject to varying interpretations by courts are now set forth in the statute, including: improper means, misappropriation, proper means, and reverse engineering. *See generally Id.* at § 134A.002.

Changes to Injunctive Remedy

As under prior law, plaintiffs may obtain injunctive relief to protect a trade secret. *Id.* at § 134A.003(a). The Act also creates a new injunctive remedy where, under “exceptional circumstances,” the party that obtained the trade secret may continue to use it so long as it pays “a reasonable royalty for no longer than the period of time for which use [of the trade secret] could have been prohibited.” *Id.* at § 134A.003(b). The Act does not describe all situations that constitute “exceptional circumstances,” but states that they “include a material and prejudicial change of position before acquiring knowledge or reason to know of misappropriation that renders a prohibitive injunction inequitable.” *Id.* In other words, if the recipient of the trade secret began using the trade secret without knowing that it had been wrongfully obtained, he may be able to keep using it if he can show that it would be inequitable to force him to stop using it and he pays a reasonable royalty for his use of it.

This change is especially noteworthy because it may work a substantive change in Texas law on injunctions and temporary restraining orders. To obtain such relief, a plaintiff typically needs to establish a number of elements, including that the defendant’s conduct would cause irreparable harm that cannot be fully compensated with monetary damages or that the amount of such damages cannot be measured with certainty. *Butnaru v. Ford Motor Co.*, 84 S.W.3d 198, 204 (Tex. 2002). Under the Act, it appears that a plaintiff is specifically authorized to obtain an injunction, even when the monetary harm can be calculated using the “reasonable royalty” methodology, though cases interpreting other states’ version of the Act disagree on this point.

A federal court in Ohio, interpreting Ohio’s version of the Act, refused to impose such a “royalty injunction” because it found that the plaintiff was adequately compensated by the damages award, and thus had not shown irreparable harm. *Allied Erecting & Dismantling Co. v. Genesis Equip. & Mfg., Inc.*, 2010 WL 3370286, at *3 (N.D. Ohio Aug. 26, 2010). According to this reading, the irreparable harm element remains in place, and a royalty injunction may only be imposed when the plaintiff satisfies that element. A Georgia court interpreting Georgia’s version of the Act found that such a “royalty injunction” was proper based on the “public’s interest in competition, [the plaintiff’s] delays in bringing the matter to a resolution, . . . the adequacy of a royalty to protect the parties’ respective interests” and the fact that the defendants had not made a profit on their use of the trade secret, without ever discussing irreparable harm. *Electronic Data Sys. v. Heinemann*, 493 S.E.2d 132, 135 (Ga. 1997). Georgia courts generally require irreparable to be shown for an injunction to issue, so the Heinemann decision appears to interpret the Act as an

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exception to that general rule. *See Am. Mgmt. Servs. East, Inc. v. Fort Benning Fam. Communities, LLC*, 734 S.E.2d 833, 838 (Ga. Ct. App. 2012) (no error dissolving injunction because plaintiff did not show irreparable harm). No Texas appellate court has interpreted any portion of the Texas version of the Act yet, so it is not clear what effect this provision will have on Texas injunction law going forward.

Damages

The three categories of damages available under the Act were all previously available under the common law and TTLA: (1) actual loss suffered by the plaintiff; (2) the amount by which the defendant was unjustly enriched; and (3) a reasonable royalty. TEX. CIV. PRAC. & REM. CODE § 134A.004. Exemplary damages are also available, as they were under prior law. *Id.* Because the Act specifically displaces all prior law in civil actions for misappropriation, it appears that two of the damages calculation methodologies from the pre-Act period are no longer available: (1) the amount a reasonably prudent investor would have paid for the trade secret and (2) the development costs the defendant avoided by the misappropriation.

Attorneys' Fees

Another material change is the availability of attorneys' fees. Like under the TTLA, and unlike the common law, any prevailing party may be entitled to its attorneys' fees under the right circumstances. TEX. CIV. PRAC. & REM. CODE § 134A.005. Thus, under the old regime, a plaintiff with a relatively weak trade secrets claim could bring a common law claim only and avoid the downside risk of paying the defendant's attorneys' fees if it lost. Now, a defendant may collect its attorneys' fees if the plaintiff brings the claim "in bad faith." *Id.* at § 134A.005(1). Bad faith is not defined, but courts are likely to apply the standard set forth in Rule 13 of the Texas Rules of Civil Procedure, which requires that pleadings not be "groundless and brought in bad faith." Courts interpreting that provision have held that "[b]ad faith is not simply bad judgment or negligence; rather, it is the conscious doing of wrong for dishonest, discriminatory, or malicious purposes." *Parker v. Walton*, 233 S.W.3d 535, 539–40 (Tex. App.—Houston [14th Dist.] 2007, no pet.). This is a very high bar, and thus, as a practical matter, it will be very difficult for a defendant to collect its attorneys' fees, even if it defeats the plaintiff's misappropriation claim.

On the other hand, the plaintiff now must show that the misappropriation was "willful and malicious" to recover its attorneys' fees. *Id.* at § 134A.005(3). Under the TTLA, prevailing on a trade secret claim—and thus recovering attorneys' fees—required only a showing that the defendant's conduct was done "knowingly." *Id.* at § 134.005(b); TEX. PENAL CODE § 31.05(b). The upshot is that collecting attorneys' fees for prevailing on a trade secret claim is now available to defendants in all cases, but very unlikely, and available to plaintiffs in all cases, but more difficult than it was before under the TTLA.

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