EMPLOYMENT LAW COMMENTARY

Volume 25, Issue 11
November 2013

San Francisco
Lloyd W. Aubry, Jr., Editor
James E. Boddy, Jr.
Karen J. Kubin
Linda E. Shostak
Eric A. Tate

Palo Alto
Christine E. Lyon
Raymond L. Wheeler
Tom E. Wilson

Los Angeles
Timothy F. Ryan
Janie F. Schulman

New York
Miriam H. Wugmeister

Washington, D.C./Northern Virginia
Daniel P. Westman

London
Ann Bevitt

Berlin
Hano Timner

Beijing
Paul D. McKenzie

Hong Kong
Stephen Birkett

Tokyo
Toshihiro So

TRADE SECRET PROTECTION FROM THE SILICON VALLEY TO THE SILICON PRAIRIE: TEXAS ADOPTS THE UNIFORM TRADE SECRETS ACT

By Eric Akira Tate and Camilla Tapernoux

For the two million Californians who have left the state in the past decade, Texas has been the most popular destination.[1] Further, 254 California companies moved some or all of their work and jobs out of state—frequently to Texas—in 2011.[2] Of the 225 companies that moved into the Austin area between 2004 and 2011, 63 were from California. What accounts for Texas's newfound popularity? Texas Governor Rick Perry boasts that his state's "low taxes, sensible regulations, and fair legal system are just the thing to get your business moving to Texas," and Texas's strong university system and focus on commercializing intellectual property also have been touted as a lure for out of state businesses.[3] While California Governor Jerry Brown described a recent campaign by Governor Perry to entice businesses to Texas as "barely a fart," the estimated $19B Texas spends each year on tax breaks and other incentives to attract companies from other states may have something to do with movement of some businesses from other states to Texas.[4]

continued on page 2

Financial incentives may be attractive, but businesses in the Silicon Valley and elsewhere that rely heavily on intellectual property may also consider the ability to protect their IP when deciding whether to move to a new location. Indeed, in more than 90 percent of all trade secret misappropriation cases, the alleged misappropriator previously had been either the trade secret owner's employee or business partner. California and Texas are the top two venues for state court trade secret litigation with 16% of cases coming from California and 11% from Texas.[5] In light of Texas's newfound popularity among former Californians, companies in the Silicon Valley and elsewhere have every reason to concern themselves with trade secret law in the Silicon Prairie.

On September 1, 2013, Texas became the 47th state to adopt the Uniform Trade Secrets Act ("UTSA").[6] The Texas Uniform Trade Secrets Act ("TUTSA") is codified at chapter 134 of the Texas Civil Practice and Remedies Code. TUTSA provides litigants in Texas with a consolidated and more predictable statutory framework for pursuing trade secret misappropriation disputes. But while TUTSA is based on the same model code as the California UTSA ("CUTSA"), the two states' trade secrets statutes differ in certain key respects, which this article will address. We also will highlight a few important aspects of how covenants not to compete, another way for businesses to protect trade secrets, are approached in each jurisdiction.

Defining Trade Secrets

First, the California and Texas trade secret statutes differ in how they define trade secrets. Both states modify the model statute's definition of a "trade secret"—a formula, pattern, compilation, program, device, method, technique, or process that (1) derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable via proper means by, other persons who can obtain economic value from its disclosure or use, and (2) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.

The Texas statute expands the model statute's trade secret definition by including financial data and lists of actual or potential customers or suppliers. This type of information is frequently involved in litigation concerning customer solicitation by competitors allegedly in violation of noncompetition and nonsolicitation agreements. TUTSA's broader statutory definition should help knowledge-based companies whose value significantly rests on business information like customer profiles, customer and supplier lists, and sales and distribution strategies. For instance, prior to TUTSA, it was not clear under Texas law whether information had to be in continuous use to qualify as a trade secret. But TUTSA expressly eliminates the continuous use requirement. This change strengthens the protections in Texas for proprietary knowledge about what does not work or has failed (known as "negative know-how"); as such information often was not considered as being "used" by the business under the common law.

On the other hand, whereas TUTSA explicitly references trade secret protection for customer lists, under California's UTSA ("CUTSA"), whether customer lists are protected as trade secrets is determined on a case by case basis. Generally, as noted in *Morlife, Inc. v. Perry*, 56 Cal. App. 4th 1514 (1997), California courts are reluctant to protect customer lists as trade secrets where the information can be easily obtained from public sources, such as business directories. On the other hand, trade secret protection may be extended to a customer list where the employer has (1) expended time and effort identifying customers with particular needs or characteristics whose identities were not readily ascertainable, and (2) taken reasonable steps to maintain its secrecy.

Damages

Attorney's Fees

Before TUTSA, attorney's fees traditionally were not recoverable under Texas common law (the Texas Theft Liability Act does provide a separate cause of action for actual damages and attorney's fees, but caps the additional damages at $1,000). Rather, damages available to prevailing plaintiffs included: the value of the plaintiff's 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, or a reasonably royalty. *See, e.g., Southwestern Energy Production Co. v. Berry-Helfand*, 12-11-00370-CV, 2013 WL 3461644 (Tex. App. July 10, 2013).

TUTSA creates a statutory basis for recovery of attorney's fees. Prevailing parties under TUTSA may recover attorneys' fees and costs if a claim of misappropriation was made in bad faith, or if a motion to terminate an injunction was made or resisted in bad faith, or misappropriation was willful and malicious. CUTSA provides for an award of attorney's fees and costs to the prevailing party under the same circumstances.

Equitable Relief

Injunctive relief also is available under CUTSA and TUTSA to enjoin either actual or threatened

continued on page 3

misappropriation. Additionally, the Texas and California UTSAs both provide that a court may compel affirmative action of a party in order to protect trade secrets under "appropriate circumstances." TUTSA's explicit coverage of threatened misappropriation and grant of authority to compel affirmative action goes beyond what generally had been available under Texas common law. However, whether these additional forms of relief are granted is a matter of discretion for the courts, and how judges will define "appropriate circumstances" remains to be seen in Texas. Interestingly, TUTSA contains a "uniformity of application and construction" clause that directs courts and attorneys to look at how other states have addressed particular issues under UTSA. Thus, it is possible that California court rulings on "appropriate circumstances" may provide guidance for judges in Texas considering the issue.

Protection of Trade Secrets During Litigation

Before TUTSA, Texas common law allowed trial courts to grant a protective order or seal court documents related to trade secrets. But the presumption was that court records were to be open to the general public. In contrast, TUTSA, like CUTSA, adopts the model statute's mandate to preserve "the secrecy of an alleged trade secret by reasonable means." TUTSA goes even further than CUTSA's statute on this front, however, explicitly creating a presumption in favor of granting protective orders to maintain the secrecy of trade secrets. Protective orders under both statutes may include measures such as in camera review, sealing court records, and limiting access to confidential information to the attorneys and their experts.

TUTSA's statutory presumption may indirectly impact the frequency of trade secret litigation and enforcement of covenants not to compete in Texas. For example, before TUTSA, businesses that suffered trade secret misappropriation or breaches of non-competes may have been reluctant to file suit out of concern that they would have to disclose in the court of litigation the very trade secrets they sought to protect from public disclosure. By establishing a presumption in favor of issuing a confidentiality order, TUTSA could encourage more employers to litigate alleged breaches or misappropriation.

Preemption

TUTSA and CUTSA both contain preemption or displacement provisions. TUTSA provides that the statute "displaces conflicting tort, restitutionary, and other law of this state providing civil remedies for misappropriation of a trade secret." CUTSA states that it does not otherwise "supersede any statute relating to misappropriation of a trade secret, or any statute otherwise regulating trade secrets." Both statutes also provide that they do not affect contractual remedies, criminal remedies, and other civil remedies that are not based upon trade secret misappropriation.

Only a few California opinions have directly considered CUTSA's preemption provision. *KC Multimedia, Inc. v. Bank of America Technology & Operations, Inc.*, 171 Cal. App. 4th 939 (2009) held that CUTSA preempts common law claims that are "based on the same nucleus of facts as the misappropriation of trade secrets claim for relief." The Court of Appeal in *Silvaco Data Systems v. Intel Corp.*, 184 Cal. App. 4th 210 (2010) noted that CUTSA "does not affect…other remedies that are not based upon misappropriation of a trade secret" and held that tort claims for conversion, intentional and negligent misrepresentation, and unfair business practices were "superseded" by CUTSA, where the claims were premised on the theft of trade secret source code. Most recently, the Court of Appeal in *Angelica Textiles* overturned the trial court's preemption ruling and held that claims for breach of fiduciary duty, unfair competition, interference with business relations, and conversion claims were not displaced by CUTSA because each had "a basis independent of any misappropriation of a trade secret." A*ngelica Textile Services, Inc. v. Park*, 2013 Cal. App. Lexis 818 (Cal. Ct. App. Oct. 15, 2013). It remains to be seen how Texas courts will apply TUTSA's preemption clause.

Covenants Not To Compete

While TUTSA is the newest development in Texas trade secret law, covenants not to compete provide businesses with another mechanism for protecting proprietary information. California and Texas courts have developed diverging jurisprudence in this area, and companies seeking to enforce non-competes should be familiar with the legal framework in each state.

Enforcement

Post-termination non-compete agreements in the employment context are unenforceable in California subject to a few specific statutory exceptions. *Edwards v. Arthur Andersen*, 44 Cal. 4th 937 (2008) (non-compete arrangement invalid under Section 16600 of the California Business and Professions Code even if narrowly drawn). The Code lists three exceptions, for non-competes executed (1) in conjunction with the dissolution or sale of a business entity by business owners, (2) by members of limited liability companies, or (3) by partners in partnerships. A non-compete that meets one of these exceptions may be allowed where a person sells his or her business entity, the seller

continued on page 4

Meet Meet Hanno Timner, Berlin Employment + Labor Partner

1. **You and your colleagues have just joined MoFo. What is the best feature of the Berlin office?**
   It's people. We have a team of very friendly and highly qualified lawyers, many of whom have worked together for years and still enjoy collaborating on cross-border and national transactions. Our team of nearly thirty lawyers is highly regarded for its expertise in a wide range of sectors including technology, media and telecommunications, litigation, corporate, tax, privacy and of course employment and labor law.
2. **What changes in the employment law sector can we expect in the new legislative period?**
   The Coalition Government negotiations have just concluded and the future German government has decided to introduce binding rules on minimum wages of €8.50 per hour, which will become effective in January 2015. Collective bargaining agreements providing for lower wages will remain in force until December 2016, allowing low wage industries to adapt to the new regime; other exemptions will not apply. Additionally, the new government will introduce regulations granting employees working part-time a right to return to a full-time position, if they wish to do so.
3. **What do you like best about your job?**
   The variety it offers – it just doesn't get boring. My daily practice includes a wide range of tasks such as litigation, transactions and providing general advice in employment and privacy matters. Employment law constantly changes, which prevents too much routine. I also really enjoy working in an international environment and with clients and colleagues from many different countries.
4. **What is your favorite thing about your city?**
   For me, Berlin is the perfect mix of tradition and modernity, very laid back and rather hectic and vibrant at the same time, almost a "city that never sleeps". It is also much more international and culturally diverse than it was prior to the German unification. At the same time, Berlin is still a very green city with many quiet and family-friendly areas, which are easy to reach. However, looking out the window now, I recommend avoiding Berlin in November.

promises the buyer not to conduct a similar competing business within a specified geographic area, and the buyer carries on a like business in that area. Any such non-compete under these exceptions still must be deemed reasonable in scope to be enforceable.

Texas, on the other hand, has allowed enforcement of non-compete agreements under the Texas Covenants Not to Compete Act, *Tex. Bus. & Comm. Code §§ 15.50 to 15.52 (2011)*. In order to be enforceable under Texas law, a non-compete must be ancillary to or part of an otherwise enforceable agreement when the agreement is made, be reasonable concerning time, geographical area and scope of activity to be restrained, and impose no greater restraint than necessary to protect the employer's goodwill or other business interest. Time restrictions up to five years have been enforced in non-competes (*Gallagher Healthcare Ins. Serv. v. Vogelsang*, 312 S.W.3d 640 (Tex. Ct. App. 2009)), as have geographical limitations consisting of the former employee's territory during his employment or, in some instances, the area of the employer's operations (*Goodin v. Jolliff*, 257 S.W.3d 341 (Tex. Ct. App. 2008)).

The 2006 opinion *Alex Sheshunoff Mgmt. Servs., L.P. v. Johnson*, 209 S.W.3d 644 (Tex. 2006) strengthened the value of non-compete agreements by ruling such agreements enforceable where (1) the parties sign the agreement as part of a confidentiality contract, (2) the restrictions are reasonable, and (3) the employer provides confidential information to the employee at some point after he signs the non-compete but during the employment term. The Texas Supreme Court further eased the requirements for enforcement in *Mann Frankfort Stein & Lipp Advisors, Inc. v. Fielding*, 289 S.W.3d 844 (Tex. 2009) by holding that it would imply a promise to provide confidential information to an employee when the employee agreed not to disclose information that was reasonably necessary for the employee's work. Prior to these decisions, many courts in Texas held that agreements in the at-will employment setting were unenforceable if the employer performed its promise (such as to provide training, confidential information, or other trade secrets) in the future and not at the time the agreement was made.

continued on page 5

Blue Pencil Rules

California courts exercise their discretion in determining whether to modify or blue pencil overbroad restrictive covenants. For example, the court in *Swenson v. File*, 3 Cal. 3d 389 (1970), supported blue penciling of a non-compete agreement made in connection with the sale of a business to allow it to be enforced under one of the statutory exemptions. But the court in *Strategix, Ltd. v. Infocrossing West, Inc.*, 142 Cal. App. 4th 1068 (2006), declined to enforce overbroad non-solicitation provisions in their entirety stating that it would "not strike a new bargain for the parties for the purposes of saving an illegal contract."

Similarly, Texas courts can reform an overbroad non-compete agreement to make it enforceable by blue penciling the time, geographic and scope limitations. For example, in *Evans Consoles, Inc. v. Hoffman Video Systems*, Inc., 3-01-CV-1333-P, 2001 WL 36238982 (N.D. Tex. Dec. 1, 2001), the court found an unlimited geographic restriction in a non-compete to be unreasonable but, using the blue pencil rule, limited the covenant to restrict the employee from soliciting former clients with whom he had dealings at the time he left his former employer. Blue penciling can also affect the damages awarded to a prevailing party in Texas. If reformation of a non compete is required for enforcement, courts cannot award monetary damages for the period before the modification (although injunctive relief remains available).

Inevitable Disclosure

Under the inevitable disclosure doctrine, an employee can be prevented from working for a competitor where employment with the competitor would cause "inevitable disclosure" of trade secrets known by the former employee. *PepsiCo Inc. v. Redmond*, 54 F.3d 1262 (7th Cir. 1995). California has specifically rejected the doctrine of inevitable disclosure. Whyte v. Schlage Lock Co., 101 Cal. App. 4th 1443 (2002) (barring inevitable disclosure and holding that the doctrine creates an after-the-fact covenant not to compete in violation of public policy).

While not described by the same moniker, however, the inevitable doctrine concept is alive and well in Texas. For instance, the Dallas Court of Appeals in *Cardinal Health Staffing Network, Inc. v. Bowen*, 106 S.W.3d 230 (Tex. App. 2003), held 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, for his new employer's benefit, or to the detriment of his former employer.

Conclusion

Much remains to be seen regarding how TUTSA will be interpreted by the courts and the impact it will have on how trade secret and restrictive covenant enforcement actions proceed in Texas. Nonetheless, the Lonestar State's decision to adopt the Uniform Trade Secrets Act is a step towards promoting greater uniformity in trade secret law across the United States. This in turn can help businesses set more predictable trade secret protection programs. While the new law will not end the fact-specific nature of trade secret litigation, it will provide clearer guidance for companies seeking to protect their proprietary information in Texas.

Eric Akira Tate is Co-Chair of Morrison & Foerster's Employment and Labor Practice and represents companies in trade secrets and employee mobility matters across the country. He can be reached at (415) 268-6915 or etate@mofo.com. Camilla Tapernoux is a recent Morrison & Foerster summer associate who will be joining the firm upon completion of law school.

To view prior issues of the ELC, click here.

1 http://www.nbclosangeles.com/news/local/Californias-Population-Moving-Out-182914961.html
2 http://www.ocregister.com/articles/moved-342887-companies-texas.html
3 http://www.reuters.com/article/2013/02/13/us-usa-jobs-texas-california-idUSBRE91C0PZ20130213
4 http://www.sfgate.com/business/bottomline/article/Texas-tries-to-lure-California-businesses-4258193.php
5 https://www.law.gonzaga.edu/law-review/2011/01/31/a-statistical-analysis-of-trade-secret-litigation-in-state-courts/
6 The U.S. Virgin Islands and District of Columbia also have adopted the UTSA.

Wende Arrollado | Morrison & Foerster LLP
12531 High Bluff Drive, Suite 100 | San Diego, California 92130
warrollado@mofo.com