PROTECTING AND RAIDING INTELLECTUAL PROPERTY

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I. Practical Considerations in Dealing with Intellectual Capital

All too often, employers ask their in-house counsel or outside lawyers to draft a standard covenant not to compete for their employees. With those instructions in hand, lawyers present their clients with an agreement. If the attorney is an employment lawyer, the form agreement sometimes contains cutting edge language that incorporates the most recent cases in the area of covenants not to compete. Loaded with the "perfect" agreement, employers go forward believing they have protected their intellectual capital.

Form agreements that contain every imaginable protection for an employer bring with them a number of practical problems. First, the agreement itself may lead to a round of negotiations with a prospective employee. Few employees, particularly those in positions that truly merit a covenant not to compete, sign every piece of paper they are presented without questions. Is it really worth management's time to continually negotiate over a covenant not to compete? Does an employer really want to start an employment relationship with a valuable employee by haggling over a document that by its nature deals with termination of employment? In larger companies, line managers sometimes "forget" to get an employee to sign an covenant not to compete rather than deal with the hassle of negotiating with a resisting employee.

Second, a comprehensive agreement inevitably leads to selective or no enforcement. Many employers want the most protection that they can get out of an agreement. That way, they are covered no matter what a former employee does. Few, however, are willing to actually enforce covenants not to compete to their fullest extent. In a slowing economy, many employers are more understanding (or compassionate) when a laid-off employee who goes to work for a competitor. Some employers take the view that as long as the former employee doesn't solicit "his" customers, they can work for a competitor. Others only care about the use of confidential information. Some only want to prosecute the high-profile defector. Given the belt-tightening that all companies have gone through recently, you can't blame a company for avoiding attorneys' fees when the breach of a covenant not to compete doesn't matter.

Selective enforcement, while equitable, has its problems. If you believe that the real value in a covenant not to compete is that the very document deters violations, then widespread selective enforcement diminishes that deterrent effect. While the employer may have an actual strategy behind the selective enforcement, it is difficult for employees to glean that strategy when they learn that one of their former colleague is working for a competitor with no apparent repercussions.

Another problem with selective enforcement is that it can affect the outcome of an actual case. Let's face it, if a judge hears that the employer never enforces its covenant not to compete, she may be less inclined to enforce one in a close case. Smart lawyers can argue that the employer's selective enforcement is evidence that the covenant is not necessary to protect a legitimate interest. If it was so necessary, why wasn't it enforced in the past? In the case of trade secrets and confidential information, the fact that an employee has failed to take steps to protect the information is actually part of the legal test for determining if it is entitled to protection.

A. Know What You Need to Protect and Only Protect What You Need

In order to avoid the problems associated with kitchen-sink covenants not to compete, an employer has to identify what intellectual property is really worth protecting and narrowly tailor an agreement to protect those interests. Easier said than done. Far too often, employers and their lawyers want to protect against the case that they can't anticipate. Business involves taking risks. Lawyers can't eliminate all risks, all we can do is help our clients understand the real risks in a given course of action.

1. Is it Competition or the Use of Information That is the Real Problem?

Far too often, employers attempt to protect confidential information through a blanket covenant not to compete. If an employer really isn't worried about a former employee competing but is instead worried that the employee will use confidential information unfairly, a broad covenant not to compete may not be necessary. If an employer wants to protect confidential information, the following techniques may be more effective:

- Use a confidentiality/non-disclosure agreement;

- Make sure you protect your "confidential" information from disclosure by taking visible steps such as using passwords, confidential stamps, and document control logs to ensure that you have access to common law protection of trade secrets; and

- Use a non-solicitation agreement that is limited to customers that the employee serviced or learned about through her employment if customer lists are the information you are trying to protect.

Each of these techniques is easier to defend in court, cheaper to enforce, less likely to draw objections from a potential employee, and easier to consistently enforce. If information is easy to protect through other means, why bother with a covenant not to compete?

2. Are you Worried about Employee Raiding?

If an employee is truly the employer's intellectual capital, then employee raiding, by competitors and former employees, is a real concern. Once again, don't reflexively assume that to be the case. A sales person is a company's key asset. That does not mean that the sales person is the intellectual capital that needs protection. Losing a sales person is manageable so long as confidential information and other employees don't follow suit. Even losing a group of sales people is manageable, in some cases.

On the other hand, software companies and other similar industries really have employees who are the company's intellectual capital. A group of software engineers working on the latest release of a software product can leave to work for a non-competitor and still cause damage. Here, a covenant not to compete won't always help. You can include one to keep the employee from going to a competitor, but what you really need is good management and strong confidentiality and non-solicitation of employee agreements to prevent one defection from leading to a mass exodus.

3. How Broad Should A Covenant Not to Compete Be?

Finally the covenant not to compete itself should be tailored to an employer's reasons for asking for one. Management level employees probably deserve a covenant not to compete because a customer non-solicitation agreement doesn't solve the problems of the person leaving. Management level employees are privy to sensitive information and strategies that may only be protected by a covenant not to compete. Even so, should the covenant bar competition locally or nationally? It doesn't make sense to overreach if it doesn't hurt the company for a management level employee to work for a competitor in another city. If an employer needs a covenant not to compete for a sales person, does it really matter if they work for a competitor as an accountant? If not, then limit the covenant to performing similar duties as the former employee did for the employer.

II. Covenants Not to Compete and Other Restraints on Competition

Covenants not to compete are governed by Section 15.50 of the Tex. Bus. & Com. Code. The relevant provisions read:

> Notwithstanding Section 15.05 of this code, a covenant not to compete is enforceable if it is ancillary to or part of an otherwise enforceable agreement at the time the agreement is made to the extent that it contains limitations as to time, geographical area, and scope of activity to be restrained that are reasonable and do not impose a greater restraint on trade than is necessary to protect the goodwill or other business interest of the promisee.

Tex. Bus. & Com. Code Ann. § 15.50 (Vernon 1987).

Section 15.50 is not limited to traditional covenants prohibiting an employee from working for or engaging in a competing business. Any provision that has the practical effect of restraining competition will be analyzed as a covenant not to compete. *See, e.g., Peat Marwick Main & Co. v. Haass*, 818 S.W.2d 381 (Tex. 1991) (agreement which provided liquidated damages for employer if former employee performed services for former customers analyzed as covenant not to compete because practical effect was to restrict competition). Thus, agreements that prohibit solicitation of customers are regularly analyzed as covenants not to compete. *Id*.; *See also John R. Ray & Sons, Inc. v. Stroman*, 923 S.W.2d 80 (Tex. App. – Houston[14th Dist.] 1996, writ denied) (treating a non-solicitation agreement as a covenant not to compete).

The leading case on covenants not to compete is *Light v. Centel Cellular Co. of Texas*, 883 S.W.2d 642 (Tex. 1994). In it, the Texas Supreme Court set out the requirements for an enforceable covenant not to compete:

(1) The covenant must "be ancillary to or part of an otherwise enforceable agreement at the time the agreement is made"; and

(2) The covenant must contain reasonable restrictions that are not greater than what is necessary to protect the goodwill or other business interests of the promisee.

Id. at 644. The enforceability of a covenant not to compete is a question of law for the court. *Id*.

A. The Covenant Not to Compete Must Be Ancillary to or Part of an Otherwise Enforceable Agreement

The first inquiry in the enforceability of a covenant not to compete under *Light* is whether there is an enforceable agreement separate and apart from the covenant not to compete itself. *Id*. ("Section 15.50 requires us to make two initial inquiries . . . (1) is there an otherwise enforceable agreement, to which (2) the covenant not to compete is ancillary to . . . at the time the agreement is made"). Because the statute requires the Court to determine the validity of a covenant "at the time the agreement is made," the question of whether there is an otherwise enforceable agreement is made at that time as well.

As a result, at-will employment is not an otherwise enforceable agreement that will support a covenant not to compete. *Id*. at 645. If the consideration given for a promise is illusory at the time the promise is made, then the promise will not support a covenant not to compete because it is not enforceable at the time the covenant is made. Thus, in at-will employment situations, a promise by an employer to do something that is dependant on future employment, will fail to support a covenant not to compete. That is not to say that a covenant not to compete is not enforceable in an at-will situation. What is necessary is an agreement between the employer and employee that does not depend on illusory consideration such as the employer promising to provide something to the employee if the employee is still employed in the future. *Id*. ("In short, we hold that 'otherwise enforceable agreements' can emanate from at-will employment so long as the consideration for any promise is not illusory.").

The next step is determining whether the covenant is "ancillary" to that otherwise enforceable agreement.[1] The Texas Supreme Court has adopted the "designed-to-enforce-a-contractual-obligation" standard for determining whether a covenant is ancillary to an otherwise enforceable agreement. *Id*. at 647 (adopting the dissent in *Business Electronics v. Sharp Electronics*, 485 U.S. 717 (1988)). Under that standard, there must be a separate agreement that the covenant is intended to enforce and that agreement must give rise to an "interest worthy of protection." *Id*. (citations omitted). Thus, the Texas Supreme Court set out a two-prong test for determining whether a covenant not to compete is "ancillary" to an otherwise enforceable agreement. They are:

(1) the consideration given by the employer in the otherwise enforceable agreement must give rise to the employer's interest in restraining the employee from competing; and

(2) the covenant must be designed to enforce the employee's consideration or return promise in the otherwise enforceable agreement.

Id. Both parts of the test must be met. *Id*.

The first prong of the test focuses on the consideration that the employer gives in the otherwise enforceable agreement. The key question is whether the employer has provided the employee some consideration that is worthy of protection. The Texas Supreme Court indicated

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[1] For all practical purposes, the Texas Supreme Court has collapsed the language of the statute that requires that the covenant be "ancillary to or part of" an otherwise enforceable agreement into the "ancillary" test.

that business goodwill and confidential or proprietary information are examples of interests worthy of protection. *Id*. at 647 (citing *DeSantis v. Weekenhut Corp.*, 793 S.W.2d 670, 683 (Tex. 1990)). *See also* RESTATEMENT (SECOND) OF CONTRACTS §188 cmt. b, g (1981); *Light*, 883 S.W.2d at 647 n. 14 (acknowledging that if an employer gives an employee confidential and proprietary information in return for a promise not to disclose the information, then the covenant not to compete would be ancillary to that agreement).

It is important to note that under *Light* an agreement to provide consideration such as confidential information in the future will not satisfy the first prong of the ancillary test. *Light* makes clear that an employer cannot argue, after the fact, that the employer did provide the employee with confidential information. Instead, the promise to provide such information must require the employer to provide that information and must exist and be enforceable at the time the agreement is signed. *Id.* at 645 n. 6. If the employer can fire the employee and avoid providing the consideration to the employee, the consideration will be considered illusory. The court will ask whether at the time the agreement was signed was there an enforceable promise by the employer to provide confidential information to the employee.

Whether the employer provided confidential information to the employee in the past or actually provided the information to the employee after the employment agreement was signed is irrelevant. *CRC-Evans Pipeline Intern v. Myers*, 927 S.W.2d 259, 263 n.3 (Tex. App.–Houston [1st Dist.] 1996, no writ) (refusing to enforce covenant not to compete when the employee had received the confidential information before ever signing the agreement). Because *Light* requires that the consideration given by the employer actually give rise to the employer's interest in restraining competition, it requires an exchange of enforceable promises.

The second prong of the test focuses on the return promise of the employee and whether the covenant is actually designed to enforce that return promise. This is an essential element that many employers fail to consider. In order for a covenant to be ancillary, it must be designed to enforce a return promise by the employer that is linked to the consideration worthy of protection. In *Light*, the employer promised to train the employee. The Court assumed that there would be an exchange of confidential information. Because there was no return promise in the agreement by the employee to keep the information confidential, the Court held that the covenant not to compete was not designed to enforce the any of the employee's return promises. *Id*. at 647.

Because the question of whether a covenant is ancillary to an otherwise enforceable agreement is such a fact intensive inquiry, each case will be decided differently. Below are some cases that will serve as a guide to how courts tackle the issue:

Rimkus Consulting Group, Inc. v. Dupre, No. 14-99-01338-CV (Tex. App. – Houston [14th Dist.] Sept. 6, 2001) (not designated for publication), 2001 WL 1013834 (refusing to enforce a covenant not to compete in an at-will employment relationship because promises by the employer were illusory);

Security Telecom Corp. and Law Enforcement Technologies, Inc. v. Meziere, No. 05-98-00059-CV (Tex. App.–Dallas March 22, 2000) (not designated for publication), 2000 WL 295098 (Covenant not to compete was not ancillary because it was not designed to enforce an obligation of the employee);

Terminex International Co. v. Denton, No. 04-99-00563-CV (Tex. App.–San Antonio, Jan. 26, 2000) (not designated for publication), 2000 WL 84888 (Contract provides for at-will employee to receive confidential information throughout employment. Contract illusory and employee had information before he signed the contract);

Ad Com, Inc. v. Helms, No. 05-96-01706-CV (Tex. App.–Dallas, Jan. 21, 2000) (not designated for publication), 2000 WL 45880 (Contract provides for at-will employee to receive confidential information throughout employment. Contract illusory and employee had information before she signed the contract);

Cutris v. Ziff Energy Group, Ltd., 125 S.W.3d 114, 118 (Tex. App.–Houston [14th Dist.] 1999, no pet.) (Promise to provide confidential information supports a covenant not to compete);

Evan's World Travel, Inc. v. Adams, 978 S.W.2d

225, 232 (Tex. App.– Texarkana 1998, no pet.) (Employer gives employee access to customer files and client information in exchange for non-disclosure agreement. Covenant not to compete is ancillary to the otherwise enforceable non-disclosure agreement);

Totino v. Alexander & Associates, Inc., No. 01-97001204-CV (Tex. App.–Houston [1st Dist.] 1998) (not designated for publication), 1998 WL 552818 (Court enforces covenant not to compete where at-will employee was promised confidential information because employee received the confidential information immediately);

Ireland v. Franklin, 950 S.W.2d 155, 158 (Tex. App.–San Antonio 1997, pet. denied) (Covenant not to compete is ancillary to agreement to share trade secrets in exchange for non-disclosure agreement);

Donahue v. Bowles, Troy, Donahue, Johnson, Inc., 949 S.W.2d 746 (Tex. App.–Dallas 1997, pet. denied) (Recognizing that a covenant not to compete would be ancillary to an agreement by an employer to provide confidential information in exchange for a non-disclosure agreement);

CRC-Evans Pipeline Intern v. Myers, 927 S.W.2d 259, 263 n.3 (Tex. App.–Houston [1st Dist.] 1996, no writ) (Covenant not to compete unenforceable when employee had worked at company for some time and already had the confidential information before he signed a covenant not to compete);

John R. Ray & Sons, Inc. v. Stroman, 923 S.W.2d 80 (Tex. App.–Houston [14th Dist.] 1996, writ denied) (In a personal services occupation a restraint on solicitation can only extend to clients with whom the employee actually had dealings during his employment); and

America Express Financial Advisors, Inc. v. Scott, 955 F.Supp. 688, 691-92 (N.D. Tex. 1996) (Employee training, confidential information and trade secrets are protectable interests).

B. The Restraint Must be Reasonable

1. The Covenant Not to Compete Must Contain Reasonable Restrictions as to Time and Geographic Area

Covenants not to compete that contain no geographical limitations or fail to limit the scope of activity to be restrained are unreasonable and unenforceable. *Juliette Fowler Homes, Inc. v. Welch Associates, Inc.*, 793 S.W.2d 660, 663 (Tex. 1990) (an agreement that contained no limit on geographic area or scope of activity was "an unreasonable restraint of trade and unenforceable on grounds of public policy"). Generally, a reasonable area of restraint consists only of the territory in which the employer worked while employed by the former employer. *Diversified Human Resources Group, Inc.* v. *Levinson-Polakoff*, 752 S.W.2d 8, 12 (Tex. App. – Dallas 1998, no writ).

Courts have refused to enforce agreements with nationwide applicability when the employee did not truly have nationwide responsibilities for the former employer. *Allan J. Richardson & Associates, Inc. v. Andrews*, 718 S.W.2d 833, 835-36 (Tex. App.–Houston [14th Dist.] 1986, no writ). *See also Posey v. Monier Resources, Inc.*, 768 S.W.2d 915, 919 (Tex. App. – San Antonio 1989, writ denied) (reforming nationwide restriction to the area of work of the former employee).

Examples of other cases analyzing these limitations include:

Butler v. Arrow Mirror & Glass, Inc., 51 S.W.3d 787 (Tex. App.–Houston [1st Dist.] 2001, no pet.) (reforming a covenant not to compete by narrowing the geographic area and scope of activity);

Stone v. Griffin Communications and Security Systems, Inc., 53 S.W.3d 687 (Tex. App.–Tyler 2001, no pet.) (enforcing broad covenant covering 22 counties in Texas with a five year duration); and

Curtis v. Ziff Energy Group, Ltd., 12 S.W.3d 114 (Tex. App.–Houston [14th Dist.] 1999, no pet.) (enforcing a covenant not to compete for all of the United States and Canada).

2. The Covenant Not to Compete Must be Reasonable as to the Scope of Activity Restrained

To be enforceable, a covenant not to compete must restrain no more activity than is necessary to protect the legitimate business interest of the employer. In the context of the agreements prohibiting solicitation of customers or clients, Texas courts have insisted that such covenants be narrowly designed to negate the competitive advantage and knowledge the former employee might have gained about the clients *because of* his former employment. *Peat Marwick Main & Co. v. Haass*, 818 S.W.2d 381 (Tex. 1991) (finding non-solicitation agreement unreasonable where it prohibited former employee from soliciting client with whom former employee had no contract through employer); *Juliette Fowler Homes Inc. v. Welch Associates Inc.,* 793 S.W.2d 660, 663 (Tex. 1990). *See also John R. Ray & Sons, Inc. v. Stroman*, 923 S.W.2d 80 (Tex. App.–Houston [14th Dist.] 1996, writ denied) (refusing to enforce covenants not to compete that include an industry-wide prohibition).

In *Haass*, the court stated that the "fundamental legitimate business that may be protected by such covenants is in preventing employees . . . from using the contacts and rapport established during the relationship . . . to take the firm's customers with him." *Haass*, 818 S.W.2d at 387. Accordingly, the only customers to whom the non-solicitation agreement could reasonably apply would be those with whom the defendant was "personally involved." *Id.* ("[T]he restrictive covenant must bear some relation to the activities of the employee. It must no restrain his activities into a territory into which his former work has not taken him or given him the opportunity to enjoy some undue advantages in later competition with his employer.") (Internal quotation marks omitted).

Texas courts have refused to enforce agreements that vaguely prohibit all competitive activity or prohibit employment in any capacity for a competitive entity. *See, e.g., Posey v. Monier Resources, Inc.*, 768 S.W.2d 915, 918 (Tex. App.–San Antonio 1989, writ denied); *McNeilus Companies, Inc. v. Sams,* 971 S.W.2d 507 (Tex. App.–Dallas 1997, no pet.). Texas courts have also refused to enforce agreements that prohibit activity unrelated to the work the employee performed for the former employer. *Bertotti v. C.E. Shepherd Co.,* 752 S.W.2d 648, 656 (Tex. App.–Houston [14th Dist.] 1988, no writ) (language "selling or offering to sell goods or materials of any kind" was overbroad and reforming agreement to allow employee to sell non-competing products); *Diversified Human Resources Group, Inc. v. Levinson-Polakoff*, 752 S.W.2d 8, 11 (Tex. App.–Dallas 1988, no writ) (holding that agreement prohibiting recruiter from placing any type of employee was overbroad).

III. Confidentiality Agreements

One method of protecting confidential information and trade secrets is through a non-disclosure agreement. As opposed to covenants not to compete, non-disclosure agreements covering confidential information and trade secrets are easily enforceable. *See Zep Manufacturing Co., v. Harthcock*, 824 S.W.2d 654, 663 (Tex. App.–Dallas 1992, no writ). Even if the non-disclosure agreement is in the same agreement as an invalid covenant not to compete, some courts have agreed to enforce a valid non-disclosure agreement. *Miller Paper Co. v. Roberts Paper Co.,* 901 S.W.2d 593, 603 (Tex. App.–Amarillo 1995, no writ) (noting that a bar on the use of confidential information to solicit is not a restriction on solicitation); *Rugen v. Interactive Business Systems, Inc.* 864 S.W.2d 548, 551 (Tex. App.–Dallas 1993, no writ).

The strongest case for enforcing a non-disclosure agreement is in the case of trade secrets, which are also entitled to common law protection. A trade secret may consist of any formula, pattern, device, or compilation of information which is used in one's business and which gives him an opportunity to obtain an advantage over competitors who do not know or use it. *Computer Associates Int'l, Inc. v. Altai, Inc.*, 918 S.W.2d 453, 455 (Tex. 1996). *See also* RESTATEMENT OF TORTS § 757 cmt. b (1939). The criteria for determining whether a trade secret exists include: (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 competitors; (5) the amount of effort or money expended in developing the information; (6) the ease or difficulty with which the information could be properly acquired or duplicated by others. RESTATEMENT OF TORTS § 757 cmt. b (1939).

Not all valuable confidential information qualifies as a trade secret. According to the Restatement of Torts, "A trade secret . . . is not simply information as to single or ephemeral events in the conduct of the business, as, for example, the amount or other terms of a secret bid for a contract . . ." *Id*.

Customers lists are a common subject of trade secret litigation. Whether a customer list is a trade secret depends on multiple factors: (1) the extent to which the information is known outside the business; (2) the extent to which it is known by employees and others involved in the business; (3) the extent of measures taken by the employer to guard the secrecy of the information; (4) the value of the information to the employer; (5) the amount of effort or money expended by the employer in developing the information; and (6) the ease or difficulty with which the information could be properly acquired or duplicated by others. *American Derringer Corp. v. Bond*, 924 S.W.2d 773, 777 n. 2 (Tex. App.–Waco 1996, no writ).

The advantage of a written non-disclosure agreement is that an employer may be able to secure greater protection for confidential information than the common law affords to "trade secrets." To the extent the employee's use of confidential information – whether or not an actual "trade secret" – is in violation of the employee's confidentiality agreement, the employer is enforcing a contractual right and not a common law duty. Although there is limited authority on the enforceability of non-disclosure agreements that impose duties that are more restrictive than the duties imposed under the common law, there is a good basis for arguing that courts should award a remedy in the event of a breach, at least where the non-disclosure agreement does not prohibit the employee from using his general knowledge. *See Zep Manufacturing Co. v. Harthcock,* 824 S.W.2d 654, 663 (Tex. App.–Dallas 1992, no writ) (holding that non-disclosure agreements are not restraints of trade, at least where they do not restrict the employee's use of the "*general* knowledge, skill, and experience acquired in former employment"). *But see* RESTATEMENT (THIRD) OF UNFAIR COMPETITION § 41 cmt. d (1995) (noting that non-disclosure agreements that protect more than actual trade secrets "may be unenforceable as an unreasonable restrain of trade"). Some court decisions do imply or suggest, however, that an injunction will be awarded only to the extent necessary to protect the employer's trade secrets. *See Miller Paper Co. v. Roberts Paper Co.*, 901 S.W.2d 593, 603-604 (Tex. App. – Amarillo 1995, no writ).

Whether or not the information is the type that can be classified as a trade secret, it is important that an employer maintain the secrecy of the information. Although courts have prohibited employees from using information that is no longer secret, those cases involve unique circumstances. In one case, a Texas court found that business forms were misappropriated by a former employer even though the forms were available in manuals distributed by a State agency. *See Gonzales v. Zamora*, 791 S.W.2d 258 (Tex. App.–Corpus Christi 1990, no writ). The central factor was the former employee's breach of confidence. Because the employee obtained the information through a confidential relationship, he was prohibited from using or disclosing the information that subsequently became public knowledge. *Id. See also American Derringer Corp. v. Bond*, 924 S.W.2d 773, 777 (Tex. App.–Waco 1996, no writ) (the mere fact that knowledge of a product might be acquired through lawful means such as inspection, experimentation, and analysis does not preclude protection from those who would secure that knowledge by unfair means); *Miller Paper*, 901 S.W.2d at 601 n.3 (refusing to follow cases that fail to follow the rule that one who obtains information due to a confidential relationship can be prohibited from using the information, even if such information was readily discoverable through proper means). One Texas court case has held that confidential information cannot be protected unless it as at least somewhat secret. *Stewart & Stevenson Services, Inc. v. Serv-Tech, Inc.*, 879 S.W.2d 89 (Tex. App.– Houston [14th Dist.] 1994, writ denied).

IV. Common Law Protection of Confidential Information and Trade Secrets

The common-law tort duty not to disclose is, according to some courts, "breached only when the information disclosed can be properly classified as a trade secret." *Zoecon Industries v. American Stockman Tag Co.,* 713 F.2d 1174, 1179 (5th Cir. 1983); *T-N-T Motorsports, Inc. Hennessey Motorsports, Inc.*, 965 S.W.2d 18, 21-24 (Tex. App.–Houston [14th Dist.] 1998, no pet.) (enjoining the use of trade secrets in the absence of a confidentiality agreement). Nonetheless, even if the information is not a "trade secret" and even if there is no contractual duty not to disclose the information, disclosure of the information may violate a duty arising out of a confidential relationship. One who receives information in a confidential relation or discovers it through improper means may be under a duty not to disclose or use it, regardless of whether the information is a trade secret. RESTATEMENT OF TORTS § 757, cmt. b.

A. Elements of the Claim

The tort claim of misappropriation of trade secrets requires a showing that: (1) a trade secret existed; (2) the trade secret was acquired through a breach of a confidential relationship or discovered by improper means, and (3) the trade secret was used or disclosed without authorization from its owner. *See, e.g., Phillips v. Frey*, 20 F.3d 623, 627 (5th Cir. 1994); *Murrco Agency, Inc. v. Ryan*, 800 S.W.2d 600, 605 (Tex. App.–Dallas 1990, no writ).

Anyone who discloses or uses another's trade secret without a privilege to do so is liable if he: (1) discovered the secret by improper means; (2) disclosed or used the information in violation of a confidence reposed in him by another; (3) learned a secret from a third person with notice that the third person discovered it by improper means or disclosed it in violation of a breach of duty to another; or (4) learned the secret with notice of the fact that it was a secret and that its disclosure was made to him by mistake. *Computer Associates, Int'l v. Altai, Inc.*, 918 S.W.2d 453 (Tex. 1996).

The most common misappropriation case involves the confidential relationship between an employer and an employee and the subsequent use or disclosure by the former employee.

The new employer of a former employee can also be held liable for misappropriation of trade secrets. Under *Computer Assoc.*, one who discloses or uses another's trade secret after discovering it by "improper means" or after learning it with notice that it is being disclosed in violation of a confidence may be held liable for misappropriation. A company that benefits from a wrongfully misappropriated trade secret can therefore be liable for the misappropriation if the company was aware that the trade secret was wrongfully appropriated. The company must, however, engage in commercial use of the trade secret to be liable. "Commercial use" has been broadly defined to include any misappropriation followed by an exercise of control or domination. *Garth v. Staktek Corp.*, 876 S.W.2d 545, 548 (Tex. App.–Austin 1994, writ dism'd w.o.j.). Still, some courts indicate that the company must at least seek to profit from use of the information. *Atlantic Richfield Co. v. Misty Products, Inc.*, 820 S.W.2d 414, 422 (Tex. App.–Houston [14th Dist.] 1991, writ denied).

B. Employee's General Knowledge, Skills and Experience

A former employee is permitted to use his general knowledge, skills and experience acquired during his prior employment, even to compete with his former employer and do business with the employer's customers. *Miller Paper Co. v. Roberts Paper Co.*, 901 S.W.2d 593, 600-01 (Tex. App. – Amarillo 1995, no writ); *American Derringer Corp. v. Bond*, 924 S.W.2d 773 (Tex. App. – Waco 1996, no writ). Such skill, knowledge and experience are not trade secrets, but belong to the employee. If the subject matter of the alleged trade secret is created through the initiative of the employee, the employee may then have an interest in the subject matter at least equal to that of his employer or in any event, such knowledge is part of the employee's skill and experience and is not misappropriation. Thus, an employee who takes nothing from his former employer other than his memory will be in a better position to defend against a claim of misappropriation of trade secrets.

C. "Inevitable Disclosure"

In limited circumstances, a court will dispense with a showing that there has been an actual disclosure of a trade secret. These inevitable disclosure cases involve situations where the former employee's new job is so similar to the former job that the former employee cannot prevent his knowledge of his "former employer's confidential methods from showing up in his work." *Electronic Data Systems Corp. v. Powell*, 524 S.W.2d 393, 398 (Tex. Civ. App.–Dallas 1975, writ ref'd n.r.e.). *See also Conley v. DSC Communications Corp.*, No. 05-98-01051 (Tex. App. – Dallas Feb. 24, 1999) (not designated for publication), 1999 WL 89955 (enjoining former employee based on inevitable disclosure); *Williams v. Compressor Engineering Corp.,* 704

S.W.2d 469, 472 (Tex. App.–Houston [14th Dist.] 1986, writ ref'd n.r.e.) (citing *Electronic Data Systems,* 524 S.W.2d at 397-98, for the same proposition). *But see Conley*, 1999 WL 89955 (James, J., dissenting) (arguing that the inevitable disclosure doctrine should not be recognized under Texas law).

V. Preventing Employee Raiding

There is no clear way to prevent employee solicitation or employee raiding. All an employer can do is take prophylactic measures to protect itself and pursue legal remedies when those measures fail.

A. Covenants Not To Compete

The most common measure employers take to prevent employee raiding is to require all or key personnel to sign an enforceable covenant not to compete. The degree to which such covenants not to compete will be successful is discussed above.

With an enforceable covenant not to compete, an employer can prevent employee raiding in two ways. First, it provides an employer with a clear path to an injunction against the employee. In addition, as discussed below, it sets forth a basis for a tortious interference with contract claim against a competitor who raids the employer's employees.

Of course, the covenant not to compete will not prevent a former employee from soliciting the employer's current employees to join a business that does not compete with the employer.

B. Non-Solicitation Agreements

Another common method to prevent employee raiding, and one that is effective against employers who do not compete, is a contractual provision that prohibits existing employees from soliciting other employees after the termination of their employment. To be even more effective, the agreement should prohibit the employee from assisting another in soliciting an employee. The prohibitions should apply both during and after the employee's employment.[2]

It is unclear whether a Texas court will evaluate a non-solicitation agreement as a covenant not to compete. Texas courts have analyzed agreements prohibiting the solicitation of customers as covenants not to compete because the practical effect of the non-solicitation agreement is a restrain on competition. *See, e.g., Peat Marwick Main & Co. v. Haass,* 818 S.W.2d 381 (Tex. 1991). In *Miller Paper*, the court analyzed an agreement prohibiting solicitation of both customers and employees as a covenant not to compete. In that case, however, the court's analysis was focused entirely on the language prohibiting solicitation of customers. *Miller Paper*, 901 S.W.2d at 599.

Despite the decision in *Miller Paper*, there is a strong argument that an agreement prohibiting solicitation of employees should not be analyzed as a covenant not to compete. The practical impact of the agreement is not to prevent an employee from competing against his former employer. Absent that practical effect, the rationale in *Haass* should not apply.

Because the issue is unsettled in Texas case law, an employer drafting a non-solicitation agreement should follow the same steps that they would in drafting a covenant not to compete. By addressing each of the elements set out in *Light*, an employer can avoid the risk that a future court may find that a non-solicitation agreement is subject to the same restrictions as covenants not to compete.

Some employers attempt to argue that a former employee's knowledge of her co-workers is a protectable trade secret. There is some authority for that proposition. *See Rugen v. Interactive Business Systems, Inc.*, 864 S.W.2d 548, 552 (Tex. App.–Dallas 1993, no writ). That case, however, involved a former employee who was soliciting consultants of a staffing company. In that case, the former employee wasn't really soliciting co-workers but instead was using information she learned about her former employee's end product, the consultants.

C. Tortious Interference

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[2] Imagine a situation where a current employee gives a competitor the names and phone numbers of key employees and then quits to go work for the competitor. A provision that only applies post-termination is worthless.

When a former employee has gone to work for a competitor, employer may seek a remedy by asserting a tortious interference claim against that third party.

The elements of a tortious interference claim are (1) the existence of a contract, (2) an act of willful interference, (3) causation, (4) and actual damages. *Victoria Bank & Trust Co. v. Brady*, 811 S.W.2d 931 (Tex. 1991).

An employer can bring a claim for tortious interference against a competitor if the competitor causes the former employee to breach a contract with the employer. A breach is necessary. If an employee merely exercises a contractual right, such as a right to terminate after a notice period, than a tortious interference claims does not exist. *Juliette Fowler Homes v. Welch Associates, Inc.*, 793 S.W.2d 660, 667 (Tex. 1990).

In Texas, a claim for tortious interference with contract may lie for interference with an at-will employment agreement. *Sterner v. Marathon Oil Co.,* 767 S.W.2d 686 (Tex. 1989). In order for such inferences to be actionable, the third party must exceed to bounds of permissible competition. *See, e.g., Times Herald Printing Co. v. A.H. Belo Corp.*, 820 S.W.2d 206, 215 (Tex. App.–Houston [14th Dist.] 1991, no writ). *See* RESTATEMENT (SECOND) OF TORTS § 768(1) (setting forth the privilege of competition for termination of a contract terminable at-will). Under the Restatement, some "wrongful means," such as physical violence, fraudulent misrepresentations, and the threat of civil or criminal litigation is necessary for a competitor to be held liable for tortious interference with a contract terminable at-will. RESTATEMENT (SECOND) OF TORTS § 768(1) cmt. e. This heightened requirement of wrongful conduct does not apply outside of contracts terminable at-will.

In addition, tortious interference claim may lie for a breach of a covenant not to compete. However, if the covenant not to compete is void, a claim for tortious interference is not available. *Travel Masters, Inc. v. Star Tours, Inc.*, 827 S.W.2d 830 (Tex. 1991). *See also Juliette Fowler Homes, Inc. v. Welch Associates, Inc.*, 793 S.W.2d 660, 667 (Tex. 1990).

If a new employer uses a former employee to solicit other employees in violation of a non-solicitation agreement, a tortious interference claim is also possible. Since these contracts are not terminable at-will, the heightened requirement of wrongful conduct does not apply.

VI. CHOICE OF LAW

If an employer has national operations or is hiring a former employee of a competitor with national operations, then the employer will ultimately face issues involving the enforcement of covenants not to compete drafted or enforced in different jurisdictions. In deciding whether to hire an employee or enforcing a covenant not to compete in a foreign jurisdiction, the threshold question will be what law is applicable?

The normal rule in employment cases is that the law of the state were services, or a major portion of services, are rendered will govern. *Maxus Exploration Co. v. Moran Bros. Inc.*, 817 S.W.2d 50, 53 (Tex. 1991); *DeSantis v. Wackenhut Corp.*, 793 S.W.2d 670, 679 (Tex. 1990).

If a contract has a choice of law provision, many jurisdictions will respect that choice of law provision. How courts outside of Texas will decide the issue is outside the scope of this paper, but as a general rule, a choice of law provision will be enforced unless (1) another state has a materially greater interest in the issue and (2) the chosen law would violate a fundamental policy of the state with the greater interest. RESTATEMENT (SECOND) OF CONFLICTS OF LAWS § 187.

Texas courts will generally apply Texas law despite a choice of law provision to the contrary. In *DeSantis*, the Court applied Texas law to a dispute between a Florida employer and a Texas resident employee where the parties had chosen Florida law. Despite the fact that the employee sometimes flew to his employer's headquarters in Florida, the Texas court applied Texas law because Texas' interest in employment activities in Texas outweighed any generalized interest Florida might have.

In the context of covenants not to compete, a Texas court might find that enforcement of a different state's non-compete laws would violate Texas' public policy against such covenants. In *DeSantis*, the Texas Supreme Court noted that holding to the contrary would encourage employers "to invoke the most favorable state law available to govern their relationship with their employees in Texas." *DeSantis*, 793 S.W.2d at 680.

VII. Conclusion

Employers seeking to protect their intellectual capital from raiding have two important steps to take. First is the business of decision, guided by Texas law on what is permissible, of what assets to protect and how. The second is to fashion the agreements that comply with the sometimes strict standards of Texas law.