PROTECTING YOUR STARTUP CLIENT'S INTELLECTUAL PROPERTY AND CUSTOMER RELATIONSHIPS: THE INTERSECTION OF TRADE SECRETS, CONFIDENTIALITY AGREEMENTS, AND COVENANTS NOT TO COMPETE

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PUBLICATIONS

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TABLE OF CONTENTS

PROTECTING YOUR STARTUP CLIENT'S INTELLECTUAL PROPERTY AND CUSTOMER RELATIONSHIPS: THE INTERSECTION OF TRADE SECRETS, CONFIDENTIALITY AGREEMENTS, AND COVENANTS NOT TO COMPETE

I. INTRODUCTION

When it comes to advising a start-up business, there's perhaps no more important initial consideration than making a determination as to how that business is going to protect its intellectual property and customer base. This new business is likely coming together because its members have a great new product or service that they want to offer the public. But in the day of electronic files and employee mobility, how is that new business going to protect its new concept from falling into the hands of a competitor? The answer is an understanding of trade secrets law coupled with an employee agreement that contains both a non-disclosure and non-compete provision.

II. TRADE SECRETS

The Defend Trade Secrets Act of 2016 (DTSA) creates a body of federal trade secret law that compliments and largely mirrors the Uniform Trade Secrets Act (UTSA), adopted in 48 states. Combined, the DTSA and UTSA now govern trade secret protection in almost every jurisdiction in the United States. Texas adopted its form of the UTSA—called the Texas Uniform Trade Secrets Act (TUTSA) on September 1, 2013. Because neither DTSA nor TUTSA preempt the application of either act, misappropriation of trade secrets is now governed by both state and federal law.

Broadly speaking, a trade secret is any information not publically known, which provides a company a competitive edge. 18 U.S.C. § 1839(3) (2016); TEX. CIV. PRAC. & REM. CODE ANN. § 134A.006 (Westlaw 2017). Under both the DTSA and TUTSA, trade secrets can consist of any information, including a formula, pattern, compilation, program, device, method, technique, or process. *Id.* DTSA expands this illustrative list to include all forms and types of financial, business, scientific, technical, economic, or engineering information, whether tangible or intangible, and wherever stored, compiled, or memorialized physically, electronically, graphically, photographically, or in writing. 18 U.S.C. § 1839(3). For simplicity, this article focuses on protecting trade secrets under TUTSA.

A. Defining Trade Secrets

The first step in protecting a trade secret is to identify the type of information that qualifies as a trade secret. Under TUTSA, information must meet two requirements in order for it to qualify as a trade secret: (1) it must derive 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 (2) it must be the subject of efforts that are reasonable under the circumstances to maintain its secrecy. TEX. CIV. PRAC. & REM. CODE ANN. § 134A.002(6).

1. <u>Information Must Derive Independent Economic Value From Not Being Generally Known or Readily Ascertainable</u>

The first prong of TUTSA's trade secret definition is the secrecy requirement. There must be some value to the trade secret because of the fact that it is unknown and not ascertainable to others. Perhaps the best known example of a trade secret with this economic value is Coca-Cola's secret recipe. The recipe itself has value because Coca-Cola's competitors do not know its contents and therefore cannot offer the same product.

Typically, the economic value of a trade secret is established through the testimony of an expert or corporate representative. Furthermore, this value is not limited to positive economic value—e.g., resources spent in development of trade secret or profits derived from the sale of the trade secret. TUTSA also protects "negative know-how"—i.e., "information that has commercial value from a negative viewpoint, for example the results of lengthy and expensive research which proves that a certain process will not work could be of great value to a competitor." UTSA § 1 cmt.

Of course, if the information is known or can be readily ascertained by proper means, the information will not qualify as a trade secret. Information that can be readily ascertained by proper means is information discovered by (1) independent development, (2) reverse engineering unless prohibited (such as by a license agreement), or (3) any other means that are not improper. TEX. CIV. PRAC. & REM. CODE ANN. § 134A.002(4). Improper means of discovery includes "theft, bribery, misrepresentation, breach or inducement of a breach of a duty to maintain secrecy, to limit use, or to prohibit discovery of a trade secret, or espionage through electronic or other means." *Id.* § 134A.002(2).

2. Subject of Efforts That Are Reasonable Under the Circumstances to Maintain Its Secrecy

The second prong of TUTSA's trade secret definition is the maintenance requirement. It is not enough for the information to be secret; the owner must also maintain that secrecy through efforts that are reasonable under the circumstances. *Id.* § 134A.006. Reasonableness will vary based on the size of the business and the importance of the trade secret. What is reasonable for a three-person startup will rarely be reasonable for a multi-national publicly-traded corporation. Evidence of reasonable efforts to protect a trade secret can include:

- Labeling the information as confidential;
- Requiring the signing of a non-disclosure agreement to view the information;
- Implementing employee guidelines that require that certain information be kept confidential;
- Maintaining access controls over the information such as passwords or printing and copying restrictions;
- Storing the information in a separate protected server or file cabinet;
- Tracking who accesses the information; and
- Conducting exit interviews with departing employees to ensure all copies of the information have been returned.

See Cleveland, J., *Mum's the Word: Protecting Company Information Under the Texas Uniform Trade Secrets Act*, 79 TEX. B.J. 86 (February 2016)

B. Claim for Misappropriation of Trade Secrets

The elements of a TUTSA misappropriation claim are: (1) plaintiff owned or a had a license to use or possess the trade secret and (2) the trade secret was misappropriated. TEX. CIV. PRAC. & REM. CODE ANN. § 134A.002.

1. Plaintiff Owned or Had a License to Use and Possess the Trade Secret

TUTSA does not provide much guidance as to who is a proper plaintiff to sue for misappropriation of trade secrets. The owner of the trade secret is generally understood to have standing to sue for misappropriation. Hammond, *Texas Uniform Trade Secrets Act*, Advanced Intellectual Property Law Course, State Bar of Texas CLE, ch. 13, p. 5 (2014). However, at least one federal court has held that a licensee of the trade secret also has standing to sue. *LBDS Holding Co., LLC v. ISOL Tech. Inc.*, No. 6:11-CV-428, 2014 WL 892126, at *1 (E.D. Tex. Mar. 2, 2014) ("The Texas Uniform Trade Secrets Act does not require ownership of trade secrets to sustain a misappropriation claim or to recover damages.").

2. Defendant Misappropriated the Trade Secret

TUTSA's definition of misappropriation is complicated, and it is frequently misinterpreted by both the courts and litigants. *See His Co., Inc. v. Stover*, No. 4:15-CV-00842, 2016 WL 4376611, at *4 (S.D. Tex. Aug. 15, 2016), *vacated as moot*, No. 4:15-CV-00842, 2016 WL 6134939 (S.D. Tex. Sept. 8, 2016) (collecting cases). Under TUTSA, there are six alternative paths to liability:

a. Acquisition of a trade secret of another by a person who knows or has reason to know that the trade secret was acquired by improper means [§ 134A.002 (3)(A)]

Under path one, the mere acquisition of another's trade secret is a basis for liability so long as that person has reason to know that the trade secret was acquired by improper means. For example, an employer who hired an employee with information about his former employer could be liable for misappropriation if the new employer had reason to know that the information provided by the new employee was acquired by improper means. The employee could also be liable under this path. However, if that employee obtained the information through proper means—such as disclosure pursuant to the former employer's confidentiality or non-disclosure agreement—neither the new employer nor the new employee would be liable under this path. *Educ. Mgmt. Servs., LLC v. Tracey*, 102 F. Supp. 3d 906, 913–15 (W.D. Tex. 2015).

b. Disclosure or use of a trade secret of another without express or implied consent by a person who used improper means to acquire knowledge of the trade secret [§ 134A.002 (3)(B)(i)]

Under path two, any person who discloses or uses another's trade secret and who acquired that trade secret through improper means could be liable for misappropriation. For example, an employee who steals a password to obtain access to his employer's trade secret could be liable for misappropriation. However, an employee who merely misuses or discloses trade secrets that were properly disclosed to him—such as through a confidentiality or non-disclosure agreement—would not be liable under this path. *Id.*

c. Disclosure or use of a trade secret of another without express or implied consent by a person who, at the time of disclosure or use, knew or had reason to know that the person's knowledge of the trade secret was derived from or through a person who had utilized improper means to acquire it [§ 134A.002 (3)(B)(ii)(a)]

Path three is similar to path two, but it imposes liability on defendants who are further removed from the improper means of acquisition. Under path three, the employer who discloses or uses the new employee's information is liable if the employer knew or had reason to know that the new employee utilized improper means to obtain the trade secret.

d. Disclosure or use of a trade secret of another without express or implied consent by a person who, at the time of disclosure or use, knew or had reason to know that the person's knowledge of the trade secret was acquired under circumstances giving rise to a duty to maintain its secrecy or limit its use [§ 134A.002 (3)(B)(ii)(b)]

Path four is for persons who misuse or improperly disclose trade secrets that were acquired under the proper means. For example, if an employee received trade secret information pursuant to a non-disclosure agreement and then disclosed that information to a competitor in violation of the non-disclosure agreement, the employee would be liable under path four. *His Co.*, 2016 WL 4376611, at *6–7.

e. Disclosure or use of a trade secret of another without express or implied consent by a person who, at the time of disclosure or use, knew or had reason to know that the person's knowledge of the trade secret was derived from or through a person who owed a duty to the person seeking relief to maintain its secrecy or limit its use [§ 134A.002 (3)(B)(ii)(c)]

Path five imposes liability on a person who discloses or uses trade secret information obtained from the person in path four—i.e., it imposes liability on the employer who discloses or uses the trade secrets obtained through the new employee who owed a duty to maintain the secrecy or limit the use of his or her former employer's trade secret.

f. Disclosure or use of a trade secret of another without express or implied consent by a person who, before a material change of the person's position, knew or had reason to know that it was a trade secret and that knowledge of it had been acquired by accident or mistake [§ 134A.002 (3)(B)(ii)(c)]

Path 6 imposes liability on the person who obtained the trade secret through accident or mistake. For example, if the new employer did not know that its new employee had obtained the trade secret through improper means or pursuant to a duty to maintain its confidentiality or limit its use, the new employer may still be liable if it later had reason to discover the trade secret and had not materially changed its position. There is currently no Texas case law as to what constitutes a material change in position. A material change in position might be a company's investment in the production of a product that unknowingly contained another's trade secret. In that situation, even if the company was later put on notice of the trade secret, the company may not be liable for future production if it can prove that it has materially changed its position.

C. Injunctive Relief

TUTSA provides that "[a]ctual or threatened misappropriation may be enjoined." TEX. CIV. PRAC. & REM. CODE ANN. § 134A.003(a). A handful of courts have interpreted the phrase "threatened misappropriation" to allow injunctive relief not just when a trade secret is disclosed but also when a trade secret will be inevitably disclosed. *See, e.g.*, *Bayer Corp. v. Roche Molecular Sys.*, 72 F. Supp. 2d 1111, 1117–20 (N.D. Cal. 1999) (collecting cases). Under the "inevitable disclosure" doctrine, a court can enjoin a former employee from using or disclosing the former employer's trade secrets if the former employee performed duties that would necessarily cause that employee to use or disclose the former employer's trade secrets. *Cardinal Health Staffing Network v. Bowen*, 106 S.W.3d 230, 242 n.12 (Tex. App.—Houston [1st Dist.] 2003, no pet.). A Texas court of appeals has noted that "no Texas case [has] expressly adopt[ed] the inevitable disclosure doctrine, and it is unclear to what extent Texas courts might adopt it . . . ." *Id.* at 242. However, Texas courts of appeals have adopted or applied modified tests with similar attributes to the inevitable disclosure doctrine, holding that an employee could be enjoined from using a former employer's confidential information "when it is *probable* that the former employee will use the confidential information for his benefit (or his new employer's benefit) or to the detriment of his former employer." *See, e.g., Conley v. DSC Commc'ns Corp.*, Cause No. 05-98-01051, 1999 WL 89955, at *4 (Tex.

App.—Dallas Feb. 24, 1999, no pet.) (emphasis in original); *see also T-N-T Motorsports v. Hennessey Motorsports*, 965 S.W.2d 18, (Tex. App.—Houston [1st Dist.] 1998, pet. dism'd); *Rugen v. Interactive Bus. Sys., Inc.*, 864 S.W.2d 548, 552 (Tex. App.—Dallas 1993, no writ); *Williams v. Compressor Eng'g Corp.*, 704 S.W.2d 469, 470–72 (Tex. App.—Houston [14th Dist.] 1986, writ ref'd n.r.e.). Neither TUTSA nor its case law have conclusively determined what "threatened" misappropriation means under the statute. *See St. Jude Med. S.C., Inc. v. Janssen–Counotte*, No. A-14-CA-00877-SS, 2015 WL 11438611, at *3 (W.D. Tex. Oct. 30, 2015) (applying the common law test from *Conley* and *Cardinal Health Staffing*); *see also* Harrell, A, *Is Anything Inevitable?*, 76 TEX. B.J. 757 (Sept. 2013).

Regardless of the standard used, the injunctive relief provided may either be prohibitive—such as barring the use of trade secret or even barring certain employment—or may be affirmative—such as returning the trade secret or destroying copies of the trade secret. TEX. CIV. PRAC. & REM. CODE ANN. § 134A.003(c); UTSA § 2 cmt. The court in exceptional circumstances can even order an injunction that conditions future use of the trade secret upon payment of a reasonable royalty for no longer than the period of time for which use could have been prohibited. TEX. CIV. PRAC. & REM. CODE ANN. § 134A.003(b). TUTSA defines exceptional circumstances as including "a material and prejudicial change of position before acquiring knowledge or reason to know of misappropriation that renders a prohibitive injunction inequitable." *Id.* For example, if the defendant under path six already produced the product incorporating the trade secret before learning of the misappropriation, it might be more appropriate for the court to order the defendant to pay a reasonable royalty rather than enjoin the sale of the product.

An injunction granted under TUTSA will last only until the trade secret has ceased to exist or "for an additional reasonable period of time in order to eliminate commercial advantage that otherwise would be derived from the misappropriation." TEX. CIV. PRAC. & REM. CODE ANN. § 134A.003(a). For example, if good faith competitors have caught up with the misappropriator by the time the case is decided, the injunction should be dissolved. UTSA § 2 cmt.

D. TUTSA Damages

Damages under TUTSA include both (1) the actual loss caused by misappropriation and (2) the unjust enrichment caused by misappropriation that is not taken into account in computing actual loss. TEX. CIV. PRAC. & REM. CODE ANN. § 134A.004(a). An example of actual loss would be lost profits, and an example of unjust enrichment would be the defendant's profits. *Carbo Ceramics, Inc. v. Keefe*, 166 Fed. Appx. 714, 722 (5th Cir. 2006). Alternatively, the plaintiff can seek a reasonable royalty for a misappropriator's unauthorized disclosure or use of a trade secret. TEX. CIV. PRAC. & REM. CODE ANN. § 134A.004(a). These damages are "[i]n addition to or in lieu of injunctive relief," making clear that an injunction under TUTSA does not foreclose the right to recover damages as well. *Id.*

Exemplary damages are available if "wilful and malicious misappropriation is proven by clear and convincing evidence." *Id.* § 134A.004(b). TUTSA fails to define "wilful," "malicious," or "clear and convincing." Presumably, "clear and convincing" would have the same definition as the one found in Texas Civil Practice and Remedies Code section 41.001(2), which defines "clear and convincing" as "the measure or degree of proof that will produce in the mind of the trier of fact a firm belief or conviction as to the truth of the allegations sought to be established." Courts in other jurisdiction have defined "wilful and malicious misappropriation" as "an intentional misappropriation as well as a misappropriation resulting from the conscious disregard of the rights of another." *Learning Curve Toys, Inc. v. PlayWood Toys, Inc.*, 342 F.3d 714, 730 (7th Cir. 2003) (interpreting the Illinois Uniform Trade Secret Act). Exemplary damages under TUTSA are limited to an amount not exceeding twice any award of actual damages. TEX. CIV. PRAC. & REM. CODE ANN. § 134A.004(b).

E. Attorneys' Fees Under TUTSA

A prevailing plaintiff may recover attorneys' fees under TUTSA only if it proves that (1) a motion to terminate an injunction was made in bad faith or (2) wilful and malicious misappropriation exists. *Id.* § 134A.005. In contrast, a prevailing defendant may recover attorneys' fees under TUTSA only if it proves that (1) a claim of misappropriation was made in bad faith or (2) motion to terminate an injunction was resisted in bad faith. *Id.* TUTSA does not define the terms "wilful and malicious" or "bad faith." Nor does it provide a definition of "prevailing."

F. Miscellaneous TUTSA Provisions

1. Preservation of Secrecy

Under TUTSA the trial court must "preserve the secrecy of an alleged trade secret by reasonable means." *Id.* § 134A.006. To accomplish that, TUTSA establishes a "presumption in favor of granting protective orders to preserve the secrecy of trade secrets." *Id.* TUTSA further states that protective orders may include: (1) provisions limiting access to confidential information to only the attorneys and their experts, (2) holding in camera hearings, (3) sealing the records of the action, and (4) ordering any person involved in the litigation not to disclose an alleged trade secret without prior court approval. *Id.* The intent of this provision was to eliminate the hurdles to protecting trade secret information to litigants, including eliminating Texas Rule of Civil Procedure's 76(a)'s burdensome and outdated procedure to seal court records. *See also id.* § 134A.007(c) ("To the extent that this chapter conflicts with the Texas Rules of Civil Procedure, this chapter controls.")

In 2016, the Texas Supreme Court case of *In re M-I L.L.C.* addressed TUTSA's provision on limiting access to confidential information to only the attorneys and their experts. No. 14-1045, - - S.W.3d - - , 2016 WL 2981342 (Tex. May 20, 2016). Specifically, *In re M-I L.L.C.* addressed whether due process required a defendant's representative's presence at a hearing that featured testimony on the plaintiff's trade secrets. *Id.* at 3. Rather than grant an absolute due process right to be present at the hearing, the Court stated that the trial court was required to balance the due process presumption in favor of the defendant's participation at trial against the degree of competitive harm the plaintiff would have suffered from the dissemination of the trade secret. *Id.* at 4. To make that determination, the trial court needed to consider the following factors:

- **The relative value of the plaintiff's trade secrets.** The higher the value of the trade secret, the more competitive harm would come from the trade secret's dissemination;
- **Whether defendant's representative acts as a competitive decision-maker for defendant.** According to the Court, if the representative acted as competitive decision maker, then the disclosure of plaintiff's trade secrets to him "would necessarily entail greater competitive harm because, even when acting in good faith, [the representative] could not resist acting on what he may learn." (The Court's language here seems to be an implicit acknowledgement of the inevitable disclosure doctrine.)
- **The degree to which the defendant's claims would be impaired by the representative's exclusion.** To make this determination, the trial court needed to consider the representative's role at the defendant and whether, by virtue of that role, the representative possessed specialized expertise that would not be available to defendant's outside experts.
- **The stage of the proceedings.**

2. <u>Statute of Limitations</u>

A trade secret claim is governed by the three-year statute of limitations period found in Texas Civil Practice and Remedies Code 16.010.

3. <u>Effect on Other Law</u>

TUTSA displaces conflicting tort, restitutionary, and other law of this state providing civil remedies for misappropriation of a trade secret. TEX. CIV. PRAC. & REM. CODE ANN. § 134A.007(a). TUTSA, however, does not affect (1) contractual remedies, whether or not based upon misappropriation of a trade secret; (2) other civil remedies that are not based upon misappropriation of a trade secret; or (3) criminal remedies, whether or not based upon misappropriation of a trade secret. *Id.* § 134A.007(b).

TUTSA eliminated civil liability under Texas Theft Liability Act. *His Co., Inc. v. Stover*, No. 4:15-CV-00842, 2016 WL 4376611, at *3 (S.D. Tex. Aug. 15, 2016), *vacated as moot*, No. 4:15-CV-00842, 2016 WL 6134939 (S.D. Tex. Sept. 8, 2016). However, at least one case suggests in dicta that common law misappropriation may not have been eliminated by TUTSA. *Raybourne & Dean Consulting, Ltd. v. Metrica, Inc. & Metrica Relocations Plus, Inc.*, No. SA-14-CA-918-OLG, 2015 WL 12866214, at *10 (W.D. Tex. Apr. 10, 2015). The language in this case is in direct conflict with TUTSA.

4. <u>Uniformity of Application and Construction</u>

TUTSA it to "be applied and construed to effectuate its general purpose to make uniform the law with respect to the subject of this chapter among states enacting it." TEX. CIV. PRAC. & REM. CODE ANN. § 134A.008. Therefore, Texas courts may look to other jurisdictions' cases interpreting UTSA for guidance on TUTSA's provisions.

III. NON-DISCLOSURE AGREEMENTS

A non-disclosure agreement is a contract that allows a trade secret owner to impose contractual liability for any disclosure or misappropriation of its trade secrets. Non-disclosure agreements allow companies to disclose their trade secrets to new employees or to third-parties (like potential customers or investors) with less danger of destroying the secrecy of the trade secret. A typical non-disclosure agreement requires the other party to keep trade secrets in the strictest confidence, prohibits the other party from disclosing the information without prior written consent, and warns the other party that it cannot make use of the trade secret for his or her personal benefit. If the non-disclosure agreement is tied to an employment agreement, it should make clear that the duty to maintain confidentiality remains even after termination of the employment, and it should mirror the language in the company's trade secret policies.

A. Benefits of Non-Disclosure Agreements

1. Setting Employee Expectations

A specific non-disclosure agreement that sets forth the consequences of a breach is a great tool for employers to emphasize to both new and existing employees the importance of maintaining the confidentiality of a company's trade secrets. It can also provide written guidance for how an employee can and cannot handle the company's trade secrets. For example, the company might place restrictions on the employee's ability to use trade secret files on personal devices.

If an employee is later caught misappropriating a trade secret, a signed non-disclosure agreement can be an effective tool to counter any arguments from the employee that he or she did not believe certain information to be secret.

2. Establishing Employer Best Practices for Maintaining Secrecy

The existence of non-disclosure agreements is great evidence to establish that a company takes steps that are reasonable under the circumstance to maintain the secrecy of a trade secret. Plus, the process of explaining a non-disclosure agreement to a new employee can serve as a reminder to the employer to reevaluate its trade secrets policies and procedures.

3. Allowing for the Sharing of Trade Secret Information with Third Parties

Often, an investor or customer will need to know the details of a company's trade secrets. A company's disclosure of trade secrets to third parties, however, will often destroy the secrecy of the trade secret. Non-disclosure agreements prevent this problem by allowing the company to provide a limited disclosure of the trade secret under circumstances designed to maintain its confidentiality, thus preserving the confidentiality of the trade secret.

4. Providing an Additional Cause of Action

As mentioned, TUTSA does not affect contractual remedies, whether or not based upon misappropriation of a trade secret. *Id.* § 134A.007(b). This provides companies with an additional cause of action against a misappropriating employee, which is helpful, especially since a breach of contract claim is potentially simpler to litigate than navigating the various paths for a TUTSA misappropriation claim. Plus, unlike TUTSA, which requires a "wiful and malicious" misappropriation to recover attorneys' fees, attorneys' fees are generally available to a prevailing plaintiff in a breach of contract claim. TEX. CIV. PRAC. & REM. CODE § 38.001.

5. Ease of Enforcement

Unlike covenants not to compete, confidentiality agreements are not viewed as restraints on trade and therefore are not presumptively against public policy. *Zep Mfg. Co. v. Harthcock*, 824 S.W.2d 654, 663 (Tex. App.—Dallas 1992, no writ). Thus, they are not subject to reasonable time, geographic, and scope of activity limitations that apply to covenants not to compete. *Id.*

B. Notice Requirements

A company may consider specifying in its non-disclosure agreement that under TUTSA, it is authorized to obtain a court order to stop any actual or threatened misappropriation and that it may seek damages and attorneys' fees. Additionally, with the enactment of DTSA, all non-disclosure agreements entered into or amended after May 11, 2016 are expected to provide notice of certain trade secret disclosure immunities to its employees, contractors, or consultants. 18 U.S.C. § 1833. These immunity provisions apply when an employee, contractor, or consultant: (1) discloses a trade secret in confidence to a federal, state, or local official for the purpose of reporting or investigating a suspected violation of law, or (2) discloses a trade secret in a complaint or other document filed in a lawsuit under seal. *Id.* Failure to comply with the notice requirement forecloses the employer's right to recover exemplary damages or attorneys' fees in subsequent DTSA suits against individuals who did not receive the notice. *Id.* § 1833(b)(3). Thus, companies should include a notification clause in their non-disclosure agreements regarding whistleblower protections and immunities.

IV. COVENANTS NOT TO COMPETE: NON-COMPETE AND NON-SOLICITATION AGREEMENTS

Covenants that limit former employees' professional mobility or restrict their ability to solicit former customers or employees of the employer are restraints on trade and are governed by the Texas Covenants Not to Compete Act (the "Act"). TEX. BUS. & COM. CODE ANN. §§ 15.50–.52 (Westlaw 2017); *DeSantis v. Wackenhut, Corp.*, 793 S.W.2d 670, 682 (Tex. 1990); *see also Rimkus Consulting Grp., Inc. v. Cammarata*, 255 F.R.D. 417, 438 (S.D. Tex. 2008) (noting that non-solicitation agreements are subject to the Act). Because covenants not to compete limit an employee's ability to work after termination of the employment relationship, they have traditionally been disfavored in Texas. However, over the last 20 years, the Texas Supreme Court has increasingly looked upon covenants not to compete in a favorable light.

In its most recent shift away from a strict construction of the Act, the Texas Supreme Court looked to the purpose of the Act as articulated by the House Business and Commerce Committee:

> It is generally held that these covenants, in appropriate circumstances, encourage greater investment in the development of trade secrets and goodwill employee training, providing contracting parties with a means to effectively and efficiently allocate various risks, allow the freer transfer of property interests, and in certain circumstances, provide the only effective remedy for the protection of trade secrets and good will [sic].

Marsh USA Inc. v. Cook, 354 S.W.3d 764, 769 (Tex. 2011) (quoting House Comm. on Bus. & Commerce, Bill Analysis, Tex. S.B. 946, 71st Leg., R.S. (1989)). Preventing employees from disclosing trade secrets or confidential information is a valid business interest that is worthy of protection under Texas law. However, because the hallmark of enforcement is whether or not a covenant not to compete is reasonable, and reasonableness is necessarily a fact-intensive, case-by-case inquiry, covenants not to compete must be tailored to the employee's position and the business involved. Thus, a careful review of the cases interpreting the statutory requirements for covenants not to compete is required.

This third section of the article will explore the enforceability of non-compete and non-solicitation agreements (collectively, "covenants not to compete") under the Act, the remedies for a breach of a covenant not to compete, and the practical tips for drafting agreements containing covenants not to compete.

A. Enforceability of Covenants Not to Compete

Under the Act, a covenant not to compete is enforceable if it is: (1) ancillary to or part of an otherwise enforceable agreement at the time the agreement is made; and (2) contains limitations as to time, geographical area, and scope of activity to be restrained that are reasonable and do not impose a greater restraint than necessary to protect the goodwill or other business interest of the employer. TEX. BUS. & COM. CODE ANN. § 15.50(a). Additional requirements exist if the covenant not to compete relates to the practice of medicine. *Id.* § 15.50(b).

1. <u>Ancillary To or Part of an Otherwise Enforceable Agreement</u>

For many years, based on the Texas Supreme Court's decision in *Light*, an employer had to prove that consideration for the otherwise enforceable agreement "gives rise" to the interest in restraining the employee from competing. *See Light v. Centel Cellular Co. of Texas*, 883 S.W.2d 642, 647. However, in *Marsh USA*, the court retreated from this restrictive requirement, and found that by requiring a covenant to be "ancillary to or part of" an otherwise enforceable agreement, the Legislature intended that there only be "a nexus" between the covenant and the agreement. *See Marsh USA*, 354 S.W.3d at 775–76.

Courts often break this "ancillary to or part of" element down into two separate inquiries: (1) whether there is an "otherwise enforceable agreement;" and (2) whether the covenant not to compete is "ancillary to or part of" that agreement at the time the otherwise enforceable agreement was made. *See Mann Frankfort Stein & Lipp Advisors, Inc. v. Fielding*, 289 S.W.3d 844, 849 (Tex. 2009).

a. Otherwise enforceable agreement

To prove a breach of a covenant not to compete, the employer must establish that there is an enforceable agreement between the parties that is separate from the covenant not to compete. *See* TEX. BUS. & COM. CODE § 15.50(a). The otherwise enforceable agreement requirement is satisfied when the covenant is "part of an agreement that contain[s] mutual non-illusory promises." *Alex Sheshunoff Mgmt. Servs., L.P. v. Johnson*, 209 S.W.3d 644, 648–49 (Tex. 2006). Employment contracts that meaningfully limit an employer's right to terminate an employee, such as for "good cause" or in certain specified instances, are enforceable agreements sufficient to satisfy the "otherwise enforceable agreement" requirement of a non-compete agreement. *See Curtis v. Ziff Energy Grp.*, 12 S.W.3d 114, 118 (Tex. App.—Houston [14th Dist.] 1999, no pet.).

At-will employment agreements alone will not satisfy this requirement because either party retains the option of discontinuing employment for any reason. An at-will employment agreement, however, can be enforced if it is a bilateral contract supported by mutual non-illusory promises. *See Marsh USA,* 354 S.W.3d at 773. In *Marsh USA*, the court found promises to be non-illusory where the employer promised to sell shares of the company at a discounted price to employees who exercised the stock option in return for the employees' promise not to solicit the employer's clients or employees or to disclose confidential information after termination. *Id.*

In *Sheshunoff*, the Texas Supreme Court held that an at-will employment agreement can satisfy the "otherwise enforceable agreement" requirement if it is a unilateral contract that later becomes binding. 209 S.W.3d at 649–50. This marked a substantial shift in Texas covenant not to compete law. In *Sheshunoff*, the employer agreed to provide confidential information and specialized training in exchange for the employee's agreement to keep the information confidential and an agreement not to compete for 48 months. *Id.* at 647. Relying on *Light*, the trial court found the employer's promises to be illusory at the time they were made because the employer could terminate the employee before providing the training or confidential information. *Id.* However, the Texas Supreme Court held that "[t]here is no sound reason why a unilateral contract made enforceable by performance should fail under the Act." *Id.* at 651. Because the employer later provided confidential information after the agreement, the promise "became non-illusory at that point." *Id*. Thus, "there is no requirement under Texas law that the employee receive consideration for the noncompete agreement prior to the time the employer's interest in protecting its goodwill arises." *Marsh USA*, 354 S.W.3d at 778.

b. Ancillary to or a part of

In order for a covenant not to compete to be "ancillary to or part of" an otherwise enforceable agreement, the employer must prove: (1) the consideration given by the employer in the agreement is reasonably related to an interest worthy of protection; and (2) the covenant not to compete is designed to enforce the employee's consideration or return promise in the agreement. *See Marsh USA*, 354 S.W.3d at 775.

i. Consideration given by the employer is reasonably related to an interest worthy of protection

The adoption of this "reasonably related" standard was a dramatic shift from the much more restrictive *Light* "give rise" requirement. Harrell, A., *Light Fades Further: The Texas Supreme Court Changes Direction on Covenants Not to Compete*, 75 TEX. B.J. 438, 440–42 (June 2012). In *Marsh USA*, the employee received stock options as part of an employee incentive plan, and in return executed a non-solicitation agreement and a covenant not to compete. 354 S.W.3d at 767. The court concluded that stock options are reasonably related to the protection of business goodwill because the employee's ownership status gives him an incentive to foster goodwill between his employer and its clients. *Id.* at 776–77. Therefore, the court held the covenant not to compete was ancillary to an otherwise enforceable agreement.

Business goodwill, confidential or proprietary information, trade secrets, and customer information all constitute interests which are "worthy of protection." *See Marsh USA*, 354 S.W.3d at 777; *Sheshunoff*, 209 S.W.3d at 651; *Lazer Spot, Inc. v. Hiring Partners*, 387 S.W.3d 40, 46 (Tex. App.—Texarkana 2012, pet. denied); *Gallagher Healthcare Ins. v. Vogelsang*, 312 S.W.3d 640, 652 (Tex. App.—Houston [1st Dist.] 2009, pet. denied). Additionally, specialized training is an interest some courts have found to be worthy of protection. *See Neurodiagnostic Tex, L.L.C. v. Pierce*, No. 12-14-00254-CV, 2016 WL 3704807, at *7 (Tex. App.—Tyler July 12, 2016). In *Pierce*, the Tyler Court of Appeals found that paying for the employee's exam preparation courses and training to receive two additional board certifications was sufficiently specialized training to be worthy of protection. *Id.* at *6. Importantly, the court limited its holding to the facts of the case and did not determine generally what level of training is required to qualify as "specialized." *Id.* at *7.

Recent case law affirms that the provision of confidential information and trade secrets to employees are adequate consideration for covenants not to compete. *Tranter, Inc. v. Liss*, No. 02-13-00167-CV, 2014 WL 1257278 (Tex. App.—Fort Worth Mar. 27, 2014, no pet.) (mem. op.) (holding the consideration requirement was met when [employer] gave [employee] confidential information in exchange for [employee's] implied promise to keep the information confidential).

Interests that are not worthy of protection under this analysis include (1) general skills and knowledge developed by the employee during employment, (2) personal good will, and (3) sources of professional referrals. *Hill v. Mobile Auto Trim, Inc.*, 725 S.W.2d 168, 171 (Tex. 1987); *Evan's World Travel, Inc. v. Adams*, 978 S.W.2d 225, 231 (Tex. App—Texarkana 1998, no pet.); *Philip H. Hunke, D.D.S., M.S.D., Inc. v. Wilcox*, 815 S.W.2d 855, 858 (Tex. App.—Corpus Christi 1991, writ denied).

ii. Covenant not to compete is designed to enforce the employee's consideration or return promise in the agreement

Under this second part of the "ancillary to or part of" analysis, the effect of the covenant not to compete must be to prevent the employee from breaching the promise he or she gave as consideration. For example, if the employee's only promise to the employer was to give 14 days notice and provide an inventory upon termination, the covenant not to compete would not be designed to enforce the employee's consideration or return promise. *Light v. Centel Cellular Co. of Texas*, 883 S.W.2d 642, 648 n.15 (Tex. 1994) *overruled on other grounds, Marsh USA Inc. v. Cook*, 354 S.W.3d 764 (Tex. 2011). But if the employee's promise was to not disclose trade secrets, the covenant would be designed to enforce the employee's consideration or return promise. *Id.*

2. Reasonable Limitations as to Time, Geographical Area, and Scope of Activity

Any restrictions in the covenant not to compete as to time, geographic area, or scope of activity must be: (1) reasonable and (2) no greater than necessary to protect the goodwill or other business interest the agreement is intended to protect. TEX. BUS. & COM. CODE ANN. § 15.50(a); *Marsh USA*, 354 S.W.3d at 771. Although deciding the reasonableness of the covenant's limitations is necessarily fact-intensive, whether a covenant's limitations are reasonable is a question of law. *DeSantis,* 793 S.W.2d at 682. As the Texas Supreme Court stated in *Marsh USA,* "the hallmark of enforcement is whether or not the covenant is reasonable." *Id.* at 777. In determining reasonableness and "whether and to what extent a restraint on competition is justified," courts will consider the amount of information an employee has received, its importance, its true degree of confidentiality, and the time period over which it is received. *Sheshunoff,* 209 S.W.3d at 655–56.

a. Reasonable time

In determining the reasonableness of time restrictions contained in the covenant, the court should consider: (1) whether the employer's interests need protection, and (2) whether these interests outweigh the hardship imposed on the employee by enforcing the restriction. *See Bob Pagan Ford, Inc. v. Smith*, 638 S.W.2d 176, 178 (Tex. App.—Houston [1st Dist.] 1982, no writ). Texas courts generally uphold time restrictions of between two and five years. *See Gallagher Healthcare*, 312 S.W.3d at 655. However, even if a covenant contains a time limitation within this range, the court will strike down the time limitation as being too long if it finds that the limitation is a greater restraint than necessary to protect the particular business interest at stake. *See Bob Pagan Ford*, 638 S.W.2d at 178.

Additionally, although the lack of a fixed time limitation generally will not render a covenant unreasonable in and of itself, courts may strike down the covenant if the time limitation can be construed as lasting too long. *See Oliver v. Rogers,* 976 S.W.2d 792, 800 (Tex. App.—Houston [1st Dist.] 1998, pet. denied); *see also Dale v. Hoschar*, No. 05-13-01135-CV, 2014 WL 3907997 (Tex. App.—Dallas Aug. 12, 2014, no pet.). In *Dale,* the employer argued that the phrase "[a]gent agrees to take no action . . . to attempt to replace business with any policyholder by soliciting or offering competing policies of insurance" limited the duration of the covenant to the duration of the current policy held by each insured client. The court of appeals disagreed and found the covenant not to compete unenforceable in part because the agreement did not exclude renewal coverage of policyholders "who could renew repeatedly for decades." *Id.* at *3.

Since the Texas Supreme Court's ruling in *Marsh USA*, analyzing the reasonableness of the time restriction is more complicated. *See* Harrell, A., *Light Fades Further*, 75 TEX. B.J. at 443. Prior to *Marsh USA*, courts analyzed the reasonableness of the time limitation by determining at what point in time the consideration given by the employer could no longer be used to secure a competitive advantage. *See id.* Likely, this relatively simple analysis is still applicable post-*Marsh USA* to covenants supported by consideration in the form of disclosure of trade secrets or confidential information. But because *Marsh USA* expanded the types of consideration that may support a covenant beyond confidential information or trade secrets to consideration such as stock options, which are not susceptible to competitive use by the employee post-employment, analyzing the reasonableness of time limitations in such cases may become more complicated. *See id.*

b. Reasonable geographic scope

The geographic scope of a covenant not to compete refers to the specific locations in which the employee is prohibited from competing with the employer. "The breadth of enforcement of territorial restraints in covenants not to compete depends upon the nature and extent of the employer's business and degree of the employee's involvement." *Butler v. Arrow Mirror & Glass, Inc.*, 51 S.W.3d 787, 793 (Tex. App.—Houston [1st Dist.] 2001, no pet.). Thus, restraining an employee from competing in an area where the employer does not conduct business would be unreasonable. However, geographic limitations that cover only the area where the employee worked during his employment are reasonable. *Cobb v. Caye Publishing Grp., Inc.*, 322 S.W.3d 780, 784 (Tex. App.—Fort Worth 2010, no pet.); *Butler,* 51 S.W.3d at 793 (stating that "[g]enerally, a reasonable area for purposes of a covenant not to compete is considered to be the territory in which the employee worked while in the employment of his employer").

Geographic limitations that are indefinite or unlimited are unreasonable. *See Juliette Fowler Homes, Inc. v. Welch Assocs.*, 793 S.W.2d 660, 663 (Tex. 1990). Likewise, worldwide and nationwide restraints will generally be held to be overbroad. However, if an employer has substantial business nationwide or an employee was in charge of business across the country, a nationwide limitation might be upheld. *See Vais Arms, Inc. v. Vais,* 383 F.3d 287, 295–96 n.20 (5th Cir. 2004) (holding that a nationwide restraint was reasonable where business sold by restrained party was national in character); *Curtis v. Ziff Energy Grp., Ltd.,* 12 S.W.3d 114, 118 (Tex. App.—Houston [14th Dist.] 1999, no writ) (holding a covenant preventing competition in competitive businesses in Canada or the United states was reasonable because the employee was the Vice President of Pipelines and Energy Marketing and responsible for developing business in the United States and Canada).

Covenants not to compete may limit competition state wide if the employee actually performed duties in such a large area. However, if the employee did not perform duties statewide, courts will find that a restriction covering the entire state of Texas too broad. *See Morrell Masonry Supply, Inc. v. Coddou,* No. 01-13-00446-CV, 2014 WL 1778285 (Tex. App.—Houston [1st Dist.] May 1, 2014, no pet. h.) (mem. op.) (holding that a covenant covering the entire State of Texas was unreasonable and overbroad because [employer's] business did not extend beyond San Antonio, Houston, and Beaumont); *Evan's World Travel v. Adams*, 978 S.W.2d 225, 232 (Tex. App.—Texarkana 1998, no writ) (striking down a statewide prohibition and reforming the covenant to restrict the employee form working in the county where she had worked previously).

A number of courts have held that a covenant not to compete limited to the employee's clients is a reasonable alternative to a geographical limit. *See Gallagher Healthcare,* 312 S.W.3d at 654 (citing cases and holding that an agreement which precluded employee from working with clients who she worked with in the past two years and from engaging in any activity with these clients for two years after termination was a reasonable alternative to a geographic limitation). Whether limitations against an employee's solicitation of "existing customers" is unreasonable turns on the level of contact the employee had with those customers. *EMS USA, Inc. v. Shary,* 309 S.W.3d 653, 660 (Tex. App.—Houston [14th Dist.] 2010, no pet.). Covenants that prohibit employees from dealing with clients with whom the employee had no contact during his employment are unreasonable. *See U.S. Risk Ins. Grp. v. Woods,* 399 S.W.3d 295, 301 (Tex. App.—Dallas 2013, no pet.).

When drafting a covenant that restricts an employee from engaging in certain activities with "clients" or "customers," these terms should be carefully defined in the agreement. *See Premier Polymers, LLC v. Wendt,* No. H-15-1812, 2015 WL 443451, at *4 (S.D. Tex. July 17, 2015). In *Wendt,* the parties disputed whether the term "customer" referred only to those businesses the employer actually sold product or whether it also included the targeted group of potential customers with whom sales representatives were instructed to meet, negotiate, and cultivate a relationship, even though no transactions had occurred. *Id.* Importantly, "customers" was not defined, and in the non-solicitation segment of the Agreement, the employee was limited from soliciting customers "with whom [employer] had transacted business." *Id.* Based on these facts, the court held the covenant only prevented the employee from dealing with customers that had transacted business with his employer, not potential customers. *Id.* Thus, where client development is a key aspect of an employee's job, the covenant not to compete should define "client" or "customer" to include potential customers with whom the employee has had contact.

c. Reasonable scope of activity

The Act requires that a covenant not to compete reasonably limit the scope of activity the employee is restricted from performing. TEX. BUS. & COM. CODE § 15.50(a). "Scope of activity" refers to the specific business activity in which the employee cannot engage after he or she leaves employment with the employer. Generally, the scope of activities restricted should be narrowly drawn to apply only to activities related to the work the employee provided for the employer. *See Butler,* 51 S.W.3d at 794; *Peat Marwick Main & Co. v. Haass,* 818 S.W.2d 381, 387 (Tex. 1991) (holding industry-wide bar unenforceable).

Recent decisions reinforce these principles regarding limitations on the scope of activity to be restrained. In *U.S. Risk Insurance Group, Inc. v. Woods*, the Dallas Court of Appeals concluded that the covenant contained unreasonable limitations on the scope of activity the employee could perform because it limited him from pursuing all "business currently engaged in by the Company" instead of limiting him from conducting the type of work that he actually performed for the company. 399 S.W.3d 295, 301 (Tex. App.—Dallas 2013, no pet.). Similarly, the Tyler Court of Appeals held that a covenant not to compete which restricted a cardiologist from practicing all medicine, not just cardiology, within 10 miles of the city limits was overbroad. *Nacogdoches Heart Clinic, P.A. v. Pokala*, 12-11-00133-CV, 2013 WL 451810, at *4 (Tex. App.—Tyler Feb. 6, 2013, pet. denied). The court also found the covenant violated public policy because imposing such restrictions on a small community with only a few cardiologists would adversely affect the medical care of the people. *Id.*

Courts have held that an employee who possesses trade secrets belonging to a former employer and accepts employment with one of its competitors, even if acting in good faith, will have difficulty preventing this knowledge from becoming a part of his work. *Daily Instruments Corp. v. Heidt*, 998 F. Supp. 2d 553, 566-67 (S.D. Tex. 2014). Thus, covenants that prohibit an employee with knowledge of its employer's trade secrets from working for the employer's direct competitors have been upheld as reasonable restraints. *See M-I LLC v. Stelly*, 733 F. Supp. 2d 759, 794–95 (S.D. Tex. 2010); *Daily Instruments*, 998 F. Supp. 2d at 567-68. In *Daily Instruments*, the employee was a high-level sales manager who had access to his former employer's confidential information regarding its clients and sales worldwide. *See id.* at 569–70. Because the covenant only prevented the employee from competing with his former employer by assisting any competitor through the provision of confidential information regarding the narrow field of reactor thermometry, the scope of the covenant was reasonable and not greater than necessary to protect the former employer's interests.

B. Remedies for Breach of a Covenant Not to Compete

For any breach of the covenant not to compete, the Act permits the court to award the employer damages, injunctive relief, or both. TEX. BUS. & COM. CODE ANN. § 15.51(a). Most employers seek injunctive relief for violations of covenants not to compete. Thus, few cases have discussed the proper measure of damages available for an employee's breach of the covenant. Damages are likely limited to compensatory damages for actual losses sustained as a proximate result of the employee's breach. *See Butts Retail, Inc. v. Diversifoods, Inc.*, 840 S.W.2d 770, 775 (Tex. App.—Beaumont 1992, writ denied) (upholding jury award of lost profits for breach of covenant not to compete).

Additionally, the employer may seek temporary or injunctive relief. *See* TEX. BUS. & COM. CODE ANN. §§ 15.51, 15.52. Section 15.51 governs permanent injunctive relief. *EMSL Analytical, Inc. v. Younker*, 154 S.W.3d 693, 695 (Tex. App.—Houston [14th Dist.] 2004, no pet.) (Covenants not to Compete Act only governs final remedies and does not preempt the common law relating to temporary injunctive relief). To obtain a permanent injunction, the employer must show that the covenant meets the criteria for enforceability under Section 15.50 of the Act. *Butler*, 51 S.W.3d at 795. To obtain a temporary injunction, the employer must plead and prove that there is a probable, imminent, and irreparable injury for which there is no adequate legal remedy, and a probable right to recover for the injury. *Shary*, 309 S.W.3d at 657.

Also, the employer and employee can seek the equitable remedy of reformation. *See* TEX. BUS. & COM. CODE ANN. § 15.51(c). If the court finds the covenant not to compete contains limitations on time, geographic area, or scope of activity that are not reasonable and impose a greater restraint than necessary, but it is ancillary to an otherwise enforceable agreement, the court must reform the covenant to make the restraints reasonable. *Id.*; *Sentinel Integrity Solutions, Inc. v. Mistras Group, Inc.*, 414 S.W.3d 911, 924 (Tex. App.—Houston [1st Dist.] 2013, pet. denied). According to the Act, the court is required to enforce the covenant as reformed. TEX. BUS. & COM. CODE ANN. § 15.51(c). Importantly, the court may not award the employer damages for a breach that occurred before the reformation. *Id.*; *Cardinal Health Staffing Network, Inc. v. Bowen*, 106 S.W.3d 230, 238–39 (Tex. App.—Houston [1st Dist.] 2003, no pet.). The employer is limited to injunctive relief. TEX. BUS. & COM. CODE ANN. § 15.51(c).

Although employees may recover attorneys' fees in certain situations, attorneys' fees are not available under the Act to a prevailing employer. *See* TEX. BUS. & COM. CODE ANN. §§ 15.51(a), (c). The employer is limited to damages and injunctive relief under the Act, and cannot recover attorneys' fees incurred in prosecuting a suit against the employee for breach of a covenant not to compete. *See Franklin, Inc. v. GJMS Unlimited, Inc.*, 401 S.W.3d 705, 712 (Tex. App.—Houston [14th Dist.] 2013, pet. denied).

The court may award an employee costs and attorneys' fees if it is proven that: (1) the employer knew at the time of the execution of the agreement that the covenant did not contain limitations as to time, geographical area, and scope of activity to be restrained that were reasonable and the limitations imposed a greater restraint than necessary to protect the employer's goodwill or other business interest; and (2) the employer sought to enforce the covenant to a greater extent than was necessary to protect its goodwill or other business interest. *See* TEX. BUS. & COM. CODE ANN. § 15.51(c); *Sentinel*, 414 S.W.3d at 924.

C. Practical Considerations in Drafting the Covenant Not to Compete

The Act and its associated case law provide attorneys with guidance to draft an enforceable covenant not to compete.

1. <u>Ancillary To or Part of an Otherwise Enforceable Agreement</u>

Because a covenant not to compete must be ancillary to or part of an otherwise enforceable agreement, include the covenant as part of an enforceable employment agreement that specifies the employer interest the covenant is designed to protect. Valid employer interests include confidential or proprietary information or customer information. If the company is entering into a covenant not to compete with an existing employee, the company should provide additional consideration to support the agreement.

2. Reasonable Limitations as to Time, Geography, and Scope of Activity

Be specific about the covenant's limitations. A covenant not to compete should never last longer than five years and probably should be less than that. When determining the length of time of the covenant not to compete, consider the interest the company seeks to protect. For example, if the company's trade secrets will only give the company a competitive advantage for the next three years, limit the covenant not to compete to three years.

Remember that the geographic scope of the covenant not to compete is based on the employee's activities, not the employer's. If the company has customers across the United States, but the employee's territory was limited to Dallas-Fort Worth, the geographic scope of the covenant not to compete should be limited to Dallas-Fort Worth. Generally, only employees in management may have regional or nationwide geographic restrictions. The covenant not to compete should be specific in the listing of cities, counties, and states that the employee is not allowed to compete.

Like geographic restrictions, scope of activity restrictions should be based on the employee's activities, not the employer's. Thus, the covenant not to compete should detail the employee's position and job duties and then limit the employee to those specific job duties. An industry-wide covenant not to compete is rarely, if ever, acceptable.

If a non-solicitation clause is included, it, too, should be tailored to the employee and not the employer. Include only customers or prospective customers that the employee had contact with or received confidential information from. A non-solicitation clause that prohibits employees from soliciting customers with whom the employee never worked is not going to be enforceable.

3. Other Provisions

Consider including the following additional provisions:

- A notification provision that requires a departing employee to disclose the identity of his new employer and the nature of his new position. This may help an employer determine if there is any risk of the employee breaching the covenant.
- A provision that requires the employee to return all company property, including confidential information and trade secrets, upon termination of the employment relationship. Often, employees inadvertently keep company property. A contractual requirement to return that property combined with an exit interview reminding the employee of this obligation can help decrease this problem.
- Include a choice-of-law provision. The jurisdiction whose law is chosen to govern the parties' agreement should bear a substantial relationship to the parties or the transaction.

V. CONCLUSION

An understanding of trade secrets law coupled with an employment agreement featuring both a non-disclosure provision and a covenant not-to-compete can provide an important first step in protecting any client's new business. Without these tools, a client with a great new idea for a start-up may find itself out-of-business, the victim of competitors who were able to legally copy the client's ideas.

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