

YOU CAN'T DO THAT!  
PROTECTING TRADE SECRETS AND ENFORCING  
NON-COMPETE COVENANTS IN THE WORKPLACE

Presentation to  
THE ASSOCIATION OF CORPORATE COUNSEL

October 14, 2008

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# OVERVIEW:

- The law of trade secrets and covenants not to compete
- Drafting appropriate protection for employers to protect trade secrets
- Drafting enforceable covenants not to compete
  - What you don't know CAN hurt you!

# THE LAW OF TRADE SECRETS

- What constitutes a “trade secret?”

# LAW OF TRADE SECRETS

- A trade secret may be a device or process which is patentable; but it need not be that. It may be a device or process which is clearly anticipated in the prior art or one which is merely a mechanical improvement that a good mechanic can make. A trade secret may consist of any formula, pattern, device, or compilation of information that is used in one's business, and which gives one an opportunity to obtain an advantage over competitors who do not know or use it.
- *K & G Oil Tool & Serv. Co. v. G & G Fishing Tool Serv.*, 314 S.W.2d 782, 789 (1958).

# THE LAW OF TRADE SECRETS:

## *In Re Bass*

**The six factors that will be considered by Texas courts to determine whether a trade secret exists are:**

- • The extent to which the information is known outside of the business;
- • The extent to which the information was known to employees and others involved in the business;
- • The extent of the measures taken by the business to protect the secrecy of the information;

***In re Bass* 113 S.W.3d 735, 739 (Tex. 2003).**

# THE LAW OF TRADE SECRETS :

## *In Re Bass* (cont'd)

- •The value of the information to the business and its competitors;
- •The amount of effort or money expended by the business in developing the information;
- •The ease or difficulty with which the information could be properly acquired or duplicated by others.

# PROTECTING TRADE SECRETS

- Texas recognizes a common law right of a company to protect its trade secrets
- Therefore, Texas law does not require that a company have any signed agreement with an employee concerning protection of trade secrets

# PROTECTING TRADE SECRETS: *TNT Motorsports*

- Certain duties, apart from any written contract, arise upon the formation of an employment relationship.
  - One of those duties forbids an employee from using confidential or proprietary information acquired during the relationship in a manner adverse to the employer.
- ***T-N-T Motorsports, Inc. v. Hennessey Motorsports, Inc.*, 965 S.W.2d 18 (Tex. App.—Houston [1<sup>st</sup> Dist. 1998)**

# PROTECTING TRADE SECRETS:

## *TNT Motorsports (cont'd)*

- This obligation survives termination of employment.
- Although this duty does not bar use of general knowledge, skill, and experience, it prevents the former employee's use of confidential information or trade secrets acquired during the course of employment.

# TRADE SECRETS vs. COVENANTS NOT TO COMPETE

- Texas recognizes covenants “not to disclose” confidential information regardless of compliance with the Texas Business and Commerce Code because these are not construed as restraints of trade.
- *Zep Manufacturing Co. v. Harthcock*, 824 S.W.2d 654 (Tex. App. -- Dallas 1992).

# PROTECTING TRADE SECRETS

- When a claim of improper disclosure or use of trade secrets arises from a confidential relationship, the injured party is not required to rely upon an express agreement that the offending party will hold the trade secret in confidence.
- However, the employer must show that the information was, in fact, a trade secret.

# PROTECTING TRADE SECRETS:

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# PROTECTING TRADE SECRETS

- Texas law ascribes considerable power to employment personnel manuals
- This derives from Texas' interpretation of such manuals as "agreements" between employers and at-will employees (as well as other employees whose agreements do not cover all topics that could be covered by such manuals)

# PROTECTING TRADE SECRETS

- Parties have the power to modify their contracts. A modification must satisfy the elements of a contract: a meeting of the minds supported by consideration.
- In employment at will situations, either party may impose modifications to the employment terms as a condition of continued employment.
- *Hathaway v. General Mills*, 711 S.W.2d 227 (Tex. 1986)

# PROTECTING TRADE SECRETS

- Texas law therefore permits an employer's imposing requirements upon its employees concerning trade secrets and confidential or proprietary information.
- The following is sample language for use in a personnel manual.

# PROTECTING TRADE SECRETS: Sample Manual Language

- **Trade Secrets; Confidential Information**

- “The Company’s Trade Secrets are among its most valuable assets. Trade Secrets may take many forms, and may include matters or information developed internally by the Company or acquired from third parties.
- In general, information constitutes a Trade Secret if:
  - It is not generally known outside the Company by persons or entities not bound by agreement or otherwise to maintain the confidentiality of such information; and it has value to the Company by providing the Company with an advantage over existing or would-be competitors.”

# PROTECTING TRADE SECRETS: Sample Manual Language (cont'd)

- “Absolute secrecy is not a requirement for information to be a Trade Secret; information known but not utilized by the Company may nonetheless be a Trade Secret.
- The following types of information and things are considered to be Trade Secrets (examples).
- This description is provided as guidance for Employees and should NOT be interpreted as a limitation on what other matters the Company might consider Trade Secrets.
- Employees should refer questions as to the Trade Secret or Confidential status of any information or thing to his or her supervisor before releasing or distributing such information or things outside the Company”

# PROTECTING TRADE SECRETS: Sample Manual Language (cont'd)

- “The Company also possesses Confidential Information which, because it has little to do with competitive advantage may not qualify as Trade Secrets, but nonetheless must still be protected as confidential and not disclosed outside the company. Again as a guide to Employees, without intending to be limiting, the Company identifies the following types of information to be considered as Confidential unless and until they become public (examples):”

# PROTECTING TRADE SECRETS: Sample Manual Language (cont'd)

- “All Employees are expected not to disclose confidential information as a condition of employment, and are acknowledging specifically this obligation by signing in the space provided below.
- Employees who disclose or use without authorization trade secrets or confidential information will be subject to disciplinary action, up to and including termination of employment and legal action, even if they do not actually benefit from any such disclosure.”

# PROTECTING TRADE SECRETS: Court Proceedings

A person has a privilege, which may be claimed by the person or the person's agent or employee, to refuse to disclose and to prevent other persons from disclosing a trade secret owned by the person, if the allowance of the privilege will not tend to conceal fraud or otherwise work injustice. When disclosure is directed, the judge shall take such protective measure as the interests of the holder of the privilege and of the parties and the furtherance of justice may require.

TEX.R. EVID. 507; FED.R.CIV.P. 26(c); 45(c)(3)

# PROTECTING TRADE SECRETS: Court Proceedings (cont'd)

- Texas courts should apply Rule 507 as follows:
  - First, the party resisting discovery must establish that the information is a trade secret.
  - The burden then shifts to the requesting party to establish that the information is necessary for a fair adjudication of its claims.

# PROTECTING TRADE SECRETS: Court Proceedings (cont'd)

- If the requesting party meets this burden, the trial court should ordinarily compel disclosure of the information, subject to an appropriate protective order.
- In each circumstance, the trial court must weigh the degree of the requesting party's need for the information with the potential harm of disclosure to the resisting party.
- ***In re Continental General Tire, Inc.*, 979 S.W.2d 609 (Tex. 1998)**

# COVENANTS NOT TO COMPETE: Introduction

- What's all the fuss about?
- Why can't an employer just scribble on a piece of paper "I promise not to compete with the company," and have the employee date and sign it at any time during the course of employment?
- [HINT: note the placement of the statute in a chapter addressing "restraints of trade"]

# COVENANTS NOT TO COMPETE: Applicable Law

- What does the law say?
- The covenant must (1) be “ancillary to or part of an otherwise enforceable agreement” and (2) contain “limitations as to time, geographical area, and scope of activity to be restrained that are reasonable and do not impose a greater restraint than is necessary to protect the goodwill or other business interest of the promisee.”
- *Tex. & Bus. Comm. Code §15.50*

# COVENANTS NOT TO COMPETE:

## *Light v. Centel Cellular*

- The leading Texas case on covenants not to compete was *Light v. Centel Cellular, Co.*, 883 S.W.2d 642 (Tex. 1994).
- *Light* reinforced the principle that an otherwise enforceable agreement can emanate from at-will employment so long as the consideration for any promise is not illusory.

# COVENANTS NOT TO COMPETE:

## *Light v. Centel Cellular* (cont'd)

- *Light* also established the principle that such things as providing training or disclosing confidential information CAN constitute valid consideration to support a covenant not to compete.
- Unfortunately, *Light* also contained footnote 6, which called into question whether such consideration was “ancillary to an otherwise enforceable agreement.”

# COVENANTS NOT TO COMPETE:

## *Light v. Centel Cellular* (cont'd)

- That is, in the at-will employment context, the whole notion of enforceability focuses upon the obligations imposed upon the employer and the employee who are parties to such an “agreement.”
- The problem in application of the statute is illustrated by the discussion in footnote 6 of the *Light* opinion:

# COVENANTS NOT TO COMPETE:

## *Light v. Centel Cellular* (cont'd)

- “Suppose an employee promises not to disclose an employer's trade secrets and other proprietary information, if the employer gives the employee such specialized training and information during the employee's employment.
- If the employee merely sought a promise to perform from the employer, such a promise would be illusory because the employer could fire the employee and escape the obligation to perform. If, however, the employer accepts the employee's offer by performing, in other words by providing the training, a unilateral contract is created in which the employee is now bound by the employee's promise.”

# COVENANTS NOT TO COMPETE:

## *Light v. Centel Cellular* (cont'd)

- “The fact that the employer was not bound to perform because he could have fired the employee is irrelevant; if he has performed, he has accepted the employee's offer and created a binding unilateral contract.... Such a unilateral contract existed between Light and United as to Light's compensation. But such unilateral contract, since it could be accepted only by future performance, could not support a covenant not to compete inasmuch as it was not an "otherwise enforceable agreement at the time the agreement is made" as required by § 15.50.”

# COVENANTS NOT TO COMPETE: “Darkness” After *Light*

- The confusion that arose from the *Light* decision was what an employer could promise to an at-will employee that would establish the kind of agreement enforceable under §15.50.
- The chaotic jurisprudence that resulted reached its nadir in cases that essentially held that an employer could NEVER have an enforceable covenant not to compete against an at-will employee because . . .

# COVENANTS NOT TO COMPETE: “Darkness” After *Light*

- . . . at the very moment the ink was drying on an agreement between the two, the employer could simply terminate the employee’s employment (at-will employment being terminable at “any” time) and then enforce the non-compete clause.

# COVENANTS NOT TO COMPETE: The Impact of *Sheshunoff*

- The legal landscape changed in 2006 when the Texas Supreme Court handed down its decision in *Alex Sheshunoff Management Services, L.P. v. Kenneth Johnson and Strunk & Associates, L.P.*, 209 S.W.3d 644 (Tex. 2006).

# COVENANTS NOT TO COMPETE: The Impact of *Sheshunoff* (cont'd)

- The “breakthrough” effected by the Texas Supreme Court in the *Sheshunoff* was epitomized by the following statement:
- “[W]e disagree with footnote six insofar as it precludes a unilateral contract made enforceable by performance from ever complying with the Act because it was not enforceable at the time it was made.”

# COVENANTS NOT TO COMPETE: The Impact of *Sheshunoff* (cont'd)

- The *Sheshunoff* Court went on to state:
- “[W]e must disagree with *Light's* view that a unilateral contract can never meet the requirements of the Act because such a contract is not immediately enforceable when made.”

# COVENANTS NOT TO COMPETE: The Impact of *Sheshunoff* (cont'd)

- “There is no sound reason why a unilateral contract made enforceable by performance should fail under the Act.
- We understand why the Legislature and the courts would not allow an employer to spring a non-compete covenant on an existing employee and enforce such a covenant absent new consideration from the employer.
- The Act, as we now read it, addresses this concern. The covenant **cannot be a stand-alone promise from the employee** lacking any new consideration from the employer.”

# COVENANTS NOT TO COMPETE: The Impact of *Sheshunoff* (cont'd)

- “An employer's promise to provide an employee with confidential or proprietary information and an employee's reciprocal promise not to disclose such confidential information would meet the requirement that the covenant be designed to enforce the employee's consideration provided in the agreement.”

# COVENANTS NOT TO COMPETE: Practice Pointers

- What does NOT constitute valid consideration to support a covenant not to compete with an employee?
- Money
- Extra Notice of Termination
- Extra Severance
- WHY?

# COVENANTS NOT TO COMPETE: The Impact of *Sheshunoff*

- This is the second, and VERY subtle, point of the *Sheshunoff* decision: not only must the covenant be ancillary to an otherwise enforceable agreement, but consideration given for it must also must give rise to “the employer's interest in restraining the employee from competing.”

# COVENANTS NOT TO COMPETE: The Impact of *Sheshunoff*

- As the *Sheshunoff* Court explained:
  - “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 if this particular consideration is never provided by the employer, the covenant not to compete cannot be enforced.
  - Absent such consideration, the covenant is not “ancillary to or part of the otherwise enforceable agreement” under the Act as interpreted by *Light*.

# COVENANTS NOT TO COMPETE: The Impact of *Sheshunoff*

- “To hold otherwise would mean that an employer could enforce a covenant merely by promising to pay a sum of money to the employee in the agreement, a result inconsistent with *Light's* requirements that the covenant must give rise to the employer's interest in restraining the employee from competing and the covenant must be designed to enforce the employee's consideration or return promise.”
- A covenant not to compete is not designed to enforce a notice provision and, thus, even a “non-illusory promise” to give at least two weeks' notice before terminating an employee does not give rise to the employer's interest in restraining the employee from competing.

# COVENANTS NOT TO COMPETE: Practice Pointers

- Providing access to trade secrets in exchange for an employee's promise to keep such secrets confidential following execution of an at-will employment agreement containing a covenant not to compete provides sufficient consideration to support enforceability of the covenant not to compete.
- A court need only find one non-illusory promise to support consideration. The law is clear that a clause calling for the disclosure of trade secrets by the employer to the employee is such a non-illusory promise.

# COVENANTS NOT TO COMPETE: Practice Pointers

- A promise by an employer to provide an employee confidential information and a return promise by the employee not to disclose such information creates a valid and enforceable contract and supports a finding that a covenant not to compete is part of an otherwise enforceable agreement.

# COVENANTS NOT TO COMPETE: Practice Pointers

- The Non-Compete statute also imposes the requirement that any covenant, to be enforceable
  - must “contain limitations as to time, geographical area, and scope of activity to be restrained that are reasonable and do not impose a greater restraint than is necessary to protect the goodwill or other business interest of the promisee.”
- Tex. Bus. & Comm. Code §15.50(a).

# COVENANTS NOT TO COMPETE: Practice Pointers

- The Statute contains the interesting provision that if a Court determines that there are problems with the scope of the covenant, the covenant can be reformed and still enforced.
- Tex. Bus. & Comm. Code §15.51.

# COVENANTS NOT TO COMPETE

## Sample Provision

“In consideration of the terms and conditions of this Agreement, including but not limited to Employer’s agreement to provide Employee training and access to Confidential Information, Employee agrees that while employed by Employer, and for twelve (12) months after termination of all such employment, without the prior written consent of Employer, Employee will not directly or indirectly either:

# COVENANTS NOT TO COMPETE

## Sample Provision (cont'd)

“provide or perform services of any kind or character to any customer made known to Employee or contacted by Employee during the term of employment, whether as an employee, representative, owner, director, shareholder, partner, proprietor, agent, consultant, independent contractor, lender or otherwise, for any business which is in competition in any manner with the business of Employer; or provide or perform services of any kind or character for any of Employer’s representatives or independent contractors for whom Employee performed services or supervised the performing of services during Employee’s employment with Employer.”

# CONCLUSION

- We hope we have enlightened you.
- If we have not, you know where to find us.
- Then again, if we have, you also know where to find us.

# ABOUT THE PRESENTERS

- Mr. Schooler is a graduate of the University of Pennsylvania (A.B.) with departmental honors and of the University of Texas Law School. Following his completion of a clerkship with the Hon. U.S. District Judge Carl O. Bue, Jr., of the United States District Court for the Southern District of Texas in Houston in 1976, Mr. Schooler has practiced continually in Houston since that time. He specializes in employment law, business litigation and arbitration.
- Mr. Ver Weire is a graduate of Texas Christian University (BBA, Accounting), University of Richmond School of Law (J.D.) and University of Arkansas in Fayetteville (L.L.M.). Licensed in 1993 in Arkansas and now licensed in Texas, Mississippi, Oklahoma and Arizona. Prior to becoming Associate General Counsel for Scientific Drilling International, Inc. in 2006, Mr. Ver Weire worked for several firms handling cases in the areas of: securities fraud, shareholder derivative suits, corporate litigation, medical malpractice, and nursing home negligence.