

## Texas Puts its Lone-Star Spin on Trade Secret Protection

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Effective on September 1, 2013, trade secret owners in Texas will have a statutory framework for litigation in an actual or threatened misappropriation of trade secrets.<sup>1</sup> Texas recently joined the other forty-seven states<sup>2</sup> in implementing a version of the Uniform Trade Secrets Act (UTSA). The Texas Senate passed the bill unanimously, and the House approved the bill almost unanimously: with only one nay vote.

Texas, however, did not adopt the UTSA in whole cloth, but instead put its Lone Star brand on the Act, providing, for example, a broader list of protectable information. The Texas Uniform Trade Secret Act (TUTSA) changes existing common law governing trade secrets in Texas in several significant ways. An examination of the TUTSA against the backdrop of the current common-law framework highlights some of this Texas spin.

### Trade Secrets Defined Texas Style

Under the current Texas common law, a trade secret constitutes any formula, pattern, device or compilation of information which is used in one's business and presents an opportunity to obtain an advantage over competitors who do not know or use it.<sup>3</sup> Texas courts also utilize a six-factor test to analyze whether the information qualifies as a trade secret.<sup>4</sup> The Texas criminal theft statute defines a trade secret as the "whole or any part of any valuable scientific or technical information, design, process, procedure, formula, or improvement," and which an owner takes measures to prevent such information from becoming available to unauthorized others.<sup>5</sup>

The new definition of trade secrets under the TUTSA covers:

"information, including a formula, pattern, compilation, program, device, method, technique, process, *financial data, or list of actual or potential customers or suppliers*, that: (A) derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by other persons who can obtain economic value from its disclosure or use; and (B) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy."<sup>6</sup>

TUTSA expands the UTSA definition to include financial data and lists of actual or potential customers or suppliers, which is not protected by trade secrets statutes in several states, like California and Florida. This statutory protection will be appreciated by many knowledge-based

businesses, whose value rests significantly on business information like customer profiles, customer and supplier lists, and sales and distribution strategies.

TUTSA also eliminates the common-law requirement for the information to be in continuous use to qualify as a trade secret.<sup>7</sup> Thus, trade secrets that have been abandoned or are not actively used or are developed for future use may enjoy TUTSA protection, provided that they meet the remaining statutory requirements. This also strengthens the common-law protections in Texas for "negative know-how," which is the proprietary knowledge about what does not work or has failed, and is information usually not "used" by the business.<sup>8</sup>

#### **Status Quo for the Statute of Limitations**

Under the current Texas law, a person must bring a suit for misappropriation of trade secrets no later than three years after the misappropriation is discovered, or by the exercise of reasonable diligence should have been discovered.<sup>9</sup> A misappropriation of trade secrets that continues over time is a single cause of action and the limitations period begins running without regard to whether the misappropriation is a single or continuing act. TUTSA provides no independent provision for the statute of limitations. Moreover, TUTSA applies only to misappropriation of a trade secret made on or after the effective date of September 1, 2013.

#### **Texas Expands Definition of "Improper Means"**

In addition to breaches of the duty to maintain secrecy, TUTSA has expanded the definition of improper means to include "breach or inducement of a breach of a duty to limit use, or to prohibit discovery of a trade secret." Owners of trade secrets should take the time to revise confidentiality policies, employees' duties and responsibilities, and non-disclosure agreements to add these duties in addition to the duty to maintain the secrecy of the trade secrets. Employers should take affirmative actions, like training employees and monitoring employees' activities, to ensure that any third party trade secret information is used to the limited purpose and adequate measures are taken to prohibit the discovery of such information.

#### **Securing Trade Secrets by "Proper Means"**

The best defense to a trade secret misappropriation claim is the securing of information by proper means. TUTSA defines proper means as "discovery of the information by independent development, reverse engineering unless prohibited, or any other proper means." This is similar to current common law defenses. Businesses that engage in these proper means would be well-advised to document any reverse engineering processes, so that their processes and practices continue to fall within the "proper means" of acquiring a trade secret. Trade secret owners should proceed judiciously with agreements such as non-disclosure agreements and end-user licenses to prevent unauthorized reverse engineering.

#### **Texas Offers Strong Economic Remedies**

Under Texas common law, the basis of a trade secret claim affected the proof required and the remedies available. Usually the common law causes of action may be based on several theories, including breach of a confidential relationship, breach of an express or implied contract, and/or unfair competition or conspiracy. Plaintiffs received both money damages and injunctive relief, but did not usually recover attorney fees. A separate cause of action for recovery under the Texas Theft Liability Act provided for attorney fees and actual damages, but capped the additional damages to no greater than \$1000.

The remedies available under TUTSA are the exclusive civil remedies available for trade secret owners, because TUTSA has a preemption provision that displaces conflicting tort, restitutionary, and other civil remedies for trade secret misappropriation.<sup>10</sup> TUTSA also removes any liability for theft of trade secrets under the Texas Theft Liability Act.<sup>11</sup> But TUTSA does not affect any of the other contractual or criminal remedies. TUTSA is also silent on the proof required for a trade secret misappropriation claim but provides a broad range of possible remedies. As to economic remedies, TUTSA provides for both actual loss and the unjust enrichment caused by the misappropriation, and provides for exemplary damages not exceeding twice any such damage award.

Moreover, TUTSA has created a basis for recovery of attorney's fees for the prevailing party in bad faith or willful and malicious circumstances. This makes it easier for plaintiffs to bring a lawsuit against defendants in instances where the actual damages are low or the only remedy is an injunction. Prevailing defendants may have an opportunity to recover attorney fees, which is not possible under the current law.

### **Texas Offers Strong Protection of Trade Secrets During Litigation**

Usually parties in litigation are subject to discovery relating to their trade secrets and confidential information. Parties may agree to protective orders where there is a duty of nondisclosure or limited disclosure to protect such information. Under Texas common law, a trial court may grant a protective order or seal court documents related to trade secrets, but the presumption is that court records are to be open to the general public. TUTSA embraces the UTSA mandate that courts preserve "the secrecy of an alleged trade secret by reasonable means." More importantly, TUTSA provides a presumption in favor of granting protective orders to maintain the secrecy of trade secrets in any action under this statute. This should reduce any disputes regarding the availability of protective orders for trade secrets during litigation.

### **Bottom Line: Texas Continues to be Friendly for Business**

TUTSA contains a "uniformity of application and construction" clause that directs courts and attorneys to look at how other states have addressed particular issues. Considering that Texas is one of the last states to adopt the model rules, it will be interesting to see the extent Texas courts adopt constructions from other states or rely on Texas precedent in construing particular provisions of the statute. Greater uniformity in the law across the states may provide trade secrets a rather equal footing as patents, copyrights, and trademarks. This relative standardization of the law will help businesses set standard trade secret and employment policies, and also provide greater certainty in valuation of trade secrets. Choosing Texas as the governing law in your agreements and for business locations can be extremely beneficial. Comporting with the meaning of its name,<sup>12</sup> the Lone Star State has adopted a business-friendly trade secret statute.

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<sup>1</sup> Act of May 2, 2013, 83<sup>rd</sup> Leg., R.S., Ch. 10, § 1, 2013 Tex. Sess. Law. Serv. 1 (Vernon) (to be codified at Tex. Civ. Prac & Rem. Code § 134A).

<sup>2</sup> Only New York and Massachusetts have yet to adopt a version of the UTSA.

<sup>3</sup> See *Computer Associates Int'l, Inc. v. Altai, Inc.*, 918 S.W.2d 453, 455 (Tex. 1996) and *Hyde Corp. v. Huffines*, 158 Tex. 566, 314 S.W.2d 763, 776 (Tex. 1958) (quoting Restatement of Torts § 757 (1939)).

<sup>4</sup> *In re Bass*, 113 S.W.3d 735, 739 (Tex. 2003)(holding that a party claiming a trade secret need not satisfy all six factors).

<sup>5</sup> Tex. Penal Code Ann. § 31.05(a)(4) (2011).

<sup>6</sup> Information emphasized in italics indicates the categories of trade secrets not protected under the UTSA.

<sup>7</sup> Texas courts have not consistently applied the continuous use requirement. See, e.g., *Elcor Chemical Corp. v. Agri-Sul, Inc.*, 494 S.W.2d 204, 213 (Tex.Civ.App.-Dallas 1973, writ ref'd n.r.e.)(affirming judgment enjoining use of trade secrets despite evidence that Elcor had ceased to produce product and had financial issues) and *CQ Inc. v. TXU Mining Co.*, 565 F.3d 268, 274 (5th Cir. 2009) (finding that CQ's proposed strategy was not a trade secret under Texas law because it was not a "process or device for continuous use.")

<sup>8</sup> See, e.g., *Metallurgical Industries Inc. v. Fourtek, Inc.*, 790 F.2d 1195, 1202-03(5th Cir. 1986) ("Knowing what not to do often leads automatically to knowing what to do.") and *T-N-T Motorsports, Inc. v. Hennessey Motorsports, Inc.*, 965 S.W.2d 18, 22-23 (Tex.App.—Houston [1st Dist.] 1998; pet. dism'd) (acknowledging the value of knowing "which components work and which do not.")

<sup>9</sup> Tex. Civ. Prac & Rem. Code § 16.010.

<sup>10</sup> Act of May 2, 2013, 83<sup>rd</sup> Leg., R.S., Ch. 10, § 1, 2013 Tex. Sess. Law. Serv. 1 (Vernon) (to be codified at Tex. Civ. Prac & Rem. Code § 134A).

<sup>11</sup> Act of May 2, 2013, 83<sup>rd</sup> Leg., R.S., Ch. 10, § 2, 2013 Tex. Sess. Law. Serv. 1, 4 (Vernon).

<sup>12</sup> The name Texas is derived from the Caddo Indian word "teyshas" (meaning "friends" or "allies") and the state motto is "friendship."