

**PROTECTING TRADE SECRETS UNDER  
THE INEVITABLE DISCLOSURE DOCTRINE**

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# **PROTECTING TRADE SECRETS UNDER THE INEVITABLE DISCLOSURE DOCTRINE**

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## **I. Introduction**

Until recently in most states, a departing employee who had a memory of his employer's confidential information and trade secrets could not be enjoined from taking a similar job with a competitor unless an enforceable non-competition agreement had been executed. An injunction against contacting certain customers and using certain types of information is often not sufficient to prevent the real danger of inherent use of the information retained in the memory of the employee in the new position. With the advent of the Uniform Trade Secrets Act and, more recently, the "inevitable disclosure" doctrine, this has changed in many jurisdictions.

Under the inevitable disclosure doctrine, a court may enjoin a defecting employee from working for a competitor for a period of time necessary to render the trade secrets within his knowledge stale. An additional requirement is that the new position has such similar duties and responsibilities that he will "inevitably" resort to his knowledge of trade secrets as opposed to his general expertise to fulfil his job duties.

Importantly, the inevitable disclosure doctrine does not require proof that the former employee actually took documents or other materials containing trade secrets with him, that the employee is actually using or disclosing trade secrets in his new position, or even that he intends to disclose such information. Rather, the court only needs sufficient evidence to infer that from the nature of the new employee's new position, his duties and responsibilities will "inevitably" cause him to disclose the former employer's trade secrets, even if acting in good faith. In

essence, the inevitable disclosure doctrine is a judicially established inference drawn by courts to enjoin “threatened” misappropriation of trade secrets.

## **II. The Inevitable Disclosure Doctrine**

### **A. Roots of the Doctrine**

The inevitable disclosure doctrine has its roots in the Uniform Trade Secrets Act (“UTSA”) adopted by forty-one states not including Texas. Under the UTSA, the court may enjoin not only actual misappropriation of trade secrets, but also “threatened” misappropriation. This is the statutory foundation of the inevitable disclosure doctrine.<sup>1</sup>

A similar provision is contained in the RESTATEMENT OF LAW THIRD, UNFAIR COMPETITION promulgated by the American Law Institute in 1995 (“Restatement”). Under § 44(1) of the Restatement a court may award an injunction to prevent either actual misappropriation or “threatened” misappropriation of trade secrets.

The inevitable disclosure doctrine is simply a judicial inference arising from all of the circumstances of an employee’s defection that misappropriation of trade secrets is “threatened.” *See National Starch Chemical Corp. v. Parker Chemical Corp.*<sup>2</sup> In *National Starch*, the court rejected a claim that the inevitable disclosure doctrine constituted mere speculation as opposed to legitimate judicial inference:

The defendants say that a finding of “inevitability” would be no more than a “prophecy” here. Nonetheless, in the context of determining whether a threat of disclosure exists, it is but a finding as to the probable future consequences of a course of voluntary action undertaken by the defendants. Courts are frequently called upon to draw such conclusions based on a weighing of the probabilities,

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<sup>1</sup> Restatement at § 3426.2(a).

<sup>2</sup> 530 A.2d 31 (N.J. App. Div. 1987).

and while a conclusion that a certain result will probably follow may not ultimately be vindicated, the courts are nonetheless entitled to decide or “predict” the likely consequences arising from a given set of facts and to grant legal remedies on that basis.<sup>3</sup>

## **B. *Pepsico and the Cases Following***

The seminal case applying inevitable disclosure doctrine is *Pepsico v. Redman*.<sup>4</sup> In *Pepsico*, the former employer sued Redman, its former general manager for non-cola drinks, for misappropriation of trade secrets upon his defection to Quaker Oats, which was Pepsico’s direct competitor for “sports drinks.”<sup>5</sup> Concluding that the “threat of misappropriation was real,” the trial court issued a preliminary injunction prohibiting Redman from working with Quaker Oats for six months.<sup>6</sup>

The Court of Appeals upheld the preliminary injunction and considered the following factors:

1. Pepsico and Quaker Oats were “fierce” direct competitors;
2. The employee’s new position was functionally equivalent to his old one;
3. The employee had access to Pepsico’s annual “strategic plan”;
4. The employee had detailed knowledge of Pepsico’s “pricing architecture” and “margins”;
5. The employee and Quaker Oats lacked “candor” in the way they handled the employee’s recruitment.<sup>7</sup>

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<sup>3</sup> *Id.* at 163.

<sup>4</sup> 54 F.3d 1262 (7th Cir. 1995).

<sup>5</sup> *Id.* at 1263-64.

<sup>6</sup> *Id.* at 1267.

<sup>7</sup> *Id.* at 1265, 1270, 1271.

Taken together, these factors presented a sufficient threat of misappropriation of trade secrets that the court found injunctive relief necessary.<sup>8</sup>

It is also significant to consider those factors the *Pepsico* court did not consider in reaching its decision. The court issued its injunction without any applicable covenant not to compete, evidence of explicit theft of customers, or evidence that the employee had taken any documents, computer disks, or other tangible material from Pepsico. The court's decision emphasized that the injunction issued merely because of what the employee knew and the risk he would disclose it.<sup>9</sup> The court concluded by stating that the employee's departure placed Pepsico "in the position of a coach, one of whose players had left, play book in hand, to join the opposing team, before the big game."<sup>10</sup>

A growing number of decisions following *Pepsico* have applied and developed the inevitable disclosure doctrine, sometimes expanding on it. In *Merck v. Lyon*,<sup>11</sup> the court applied the inevitable disclosure doctrine to enjoin the new employer from discussing certain categories of trade secret information with the employee. The court found that "[a]lthough plaintiffs . . . did not know [the employee] took particular documents with him, his memory is sufficient."<sup>12</sup> In *Uncle B's Bakery v. O'Rourke*,<sup>13</sup> the court applied the inevitable disclosure doctrine to preclude a bagel maker's plant manager from working for another bagel manufacturer as provided in a non-

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<sup>8</sup> *Id.* at 1271.

<sup>9</sup> *Id.* at 1269.

<sup>10</sup> *Id.* at 1270.

<sup>11</sup> 941 F. Supp. 1443 (N.D.N.C. 1996).

<sup>12</sup> *Id.* at 1459.

<sup>13</sup> 920 F. Supp. 1405, 1411-12, 1435 (N.D. Iowa 1996).

compete agreement even though the two companies sold in two different segregated portions of the market.

In *Lumex, Inc. v. Highsmith*,<sup>14</sup> the court found disclosure inevitable in granting a preliminary injunction to enforce a non-compete agreement, even after expressly finding that both the former employee and the new employer acted reasonably and in good faith up until the point of the injunction. In *DoubleClick, Inc. v. Henderson*,<sup>15</sup> the court granted a preliminary injunction enjoining the ex-employee from competitive activities in the absence of a non-compete agreement. The court limited the injunction to six months, reasoning that the defendant's knowledge of the plaintiff's operations will likely lose value to such a degree that the purpose of a preliminary injunction will have evaporated before the year is up.

In *Solutech Corp. v. Agnew*,<sup>16</sup> the court affirmed the granting of a permanent injunction against two ex-employees to refrain for any competition for a period of six (6) years in the absence of a non-compete agreement. The court placed an inference of threatened misappropriation of trade secrets on the fact that two defecting employees lacked college-level degrees in chemistry or chemical engineering while they intended to chemically engineer food products that competed directly with their former employer's products.<sup>17</sup>

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<sup>14</sup> 919 F. Supp. 624, 633-34 (N.D.N.Y. 1996).

<sup>15</sup> 997 N.Y. Misc. LEXIS 577 \* 23 (N.Y. Co. Ct. Nov.5, 1997).

<sup>16</sup> 88 Wash. 1067, 1997 Wash. App. LEXIS 2130, \*23, (Dec. 30, 1997).

<sup>17</sup> *Id.* at \*24.

### **C. Elements of the Inevitable Disclosure Doctrine**

We may distill the following evidence of what will probably be required to prove a case for the application of the inevitable disclosure doctrine:

1. The two employers are direct competitors in a highly competitive industry;
2. The defecting employee has knowledge of trade secrets that are integral to the products or services of the former employer;
3. The former employees' job duties and responsibilities for the new employer are substantially similar to his old ones;
4. The new employer has not provided adequate assurances or measures to prevent the disclosure of trade secrets; and
5. As a practical matter, courts will likely want to see circumstantial evidence of an intent to misappropriate such as lack of candor or actual misappropriation of other trade secrets or confidential information.

### **III. Will Texas Courts adopt the Inevitable Disclosure Doctrine?**

Texas courts have not specifically applied the inevitable disclosure doctrine in a case that did not involve a non-competition covenant. As stated in *Conley v. DSC Communications Corp.*,<sup>18</sup> courts considering the issue “have found no Texas case referring to a ‘inevitable disclosure doctrine’ but one case from this court has recognized a former employee may be enjoying from using or disclosing the former employer’s confidential or proprietary information if the employee is in a situation where use and disclosure is probable.”<sup>19</sup> Whether Texas courts will adopt the inevitable disclosure doctrine is open to serious question, especially since Texas has not adopted the UTSA. In an early decision the Texas Supreme Court adopted the

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<sup>18</sup> No 0598-01051-CV, 1999 W.L. 89955 at \*3 (Tex. App.—Dallas Feb. 24, 1999, no writ).

<sup>19</sup> 1999 W.L. 89955 at \*3 (citing *Rugen v. Interactive Sys. Inc.*, 864 S.W. 2d 548, 551 (Tex. App.—Dallas 1993, no writ)).

Restatement of Torts § 759 rule for misappropriation of trade secrets in *Hyde v. Huffines*.<sup>20</sup> Accordingly, there is good reason to believe that the Texas Supreme Court will also adopt the Restatement of Law Third, Unfair Competition § 44(1) rule that a court may award an injunction to prevent either actual misappropriation or “threatened” misappropriation of trade secrets when a trade secret case comes before that court. If that occurs, the court will have the same rule to apply for “threatened” misappropriation as *Pepsico* and its progeny have applied under the UTSA.

There is a line of Texas cases holding that injunctions may be issued in situations involving non-competition covenants where “disclosure is threatened” without a showing of bad faith. For example, in 1978 in *Weed Eater, Inc. v. Dowling*,<sup>21</sup> an appellate court in Texas modified an injunction by the trial court, finding error under for failing to issue a broad injunction to prevent a former employee from working in a similar capacity for a competitor. In *Weed Eater*, the vice-president of manufacturing left Weed Eater to take an equivalent position at Hawaiian Motor Company. The employee had signed restrictive covenants to refrain from (1) using or revealing any trade secrets and (2) engage in direct competition with Weed Eater in the area of lawn and garden care for a period of one year. The employee testified that he was not aware that any of the information he had was confidential. The trial court enjoined the employee from disclosing any confidential information or trade secrets, but did not enjoin him from using such information in his new employment. The appellate court held that the employee “can hardly prevent his knowledge of his former employer’s confidential methods from showing up in his work. The only effective relief for Weed Eater is to restrain (the employee) from working for

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<sup>20</sup> 314 S.W.2d 763, 769 (Tex. 1958), *cert. denied*, 358 U.S. 898 (1958).

<sup>21</sup> 562 S.W.2d 898, 902 (Tex. Civ. App.—Houston [1st Dist.] 1978, writ ref’d n.r.e.).

Hawaiian Motor Company in any capacity related to the manufacture . . . of a flexible line trimming device.”<sup>22</sup>

By 1982, a federal court of appeals court, sitting in diversity jurisdiction and applying Texas law, reversed the district court, and granted a preliminary injunction against the new employer “from placing or maintaining [the employee] in a position that poses an inherent threat of disclosure” in the absence of any non-competition agreement. *FMC Corporation v. Varco International, Inc.*<sup>23</sup> In *FMC*, the employee was an engineering manager at FMC until he took a position as a vice-president of engineering at a competitor. The employee had signed a restrictive covenant not to divulge any confidential information, but had not agreed not to engage in competitive activities. The evidence showed that engineering breakthroughs that gave FMC a decided economic advantage could not be engineered, or reverse-engineered, by the competitor. The employee was to be in charge of the competitor’s efforts to duplicate the engineering breakthrough. FMC was granted a temporary restraining order to restrict the employee from divulging confidential information, as well as a preliminary injunction restraining the competitor from employing the employee in a position with an “inherent threat of disclosure.”<sup>24</sup>

The lower court found that the employee was not sure what information he had would constitute a trade secret. It also found that the competitor did not place restrictions on the employee’s use of trade secrets. The appellate court, citing *Weed Eater*, held that, “[e]ven assuming good faith, (the employee) will have difficulty preventing his knowledge of FMC’s . . .

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<sup>22</sup> *Id.* at 902.

<sup>23</sup> 677 F.2d 500, 505 (5th Cir. 1982).

<sup>24</sup> *Id.* at 501.

manufacturing techniques from infiltrating his work.”<sup>25</sup> The holding in *FMC* was cited with approval later by the Seventh Circuit in *Pepsico*. The holding in *FMC* seems to go beyond the proper application of Texas law and applies *Weed Eater* in a case that does not involve a non-competition covenant.

After *FMC*, Texas courts have continued to cite *Weed Eater* as the basis for enforcing non-competition covenants. Citing *Weed Eater* as precedent, one court held that a temporary injunction was warranted to enforce the non-competition and non-disclosure provisions of an employment agreement:

Even when he operates in the best of good faith, the former employee working in a similar capacity can hardly prevent his knowledge of his former employer’s confidential methods from showing up in his work.<sup>26</sup>

Another federal district court applied Texas trade secret law in a case involving both non-disclosure and non-competition covenants in *Picker Int’l, Inc. v. Blanton*.<sup>27</sup> The court held an injunction can be granted to enforce both covenants when an employee is employed in a position where he is likely to breach a confidentiality agreement. In *Picker*, the court also held that an injunction is proper to enforce confidentiality agreements even if there is good faith if the employee can “hardly prevent” himself from using another’s trade secret.<sup>28</sup>

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<sup>25</sup> *Id.* at 504.

<sup>26</sup> *Williams v. Compressor Engineering Corp*, 704 S.W.2d 469, 472 (Tex. Civ. App.—Houston [1st Dist.] 1986, writ ref’d n.r.e.).

<sup>27</sup> 756 F. Supp. 971, 981 (N.D. Tex. 1990).

<sup>28</sup> *Id.* at 981 (citing *Weed Eater*).

Through an unpublished and non-precedential opinion, a Texas court of appeals in *Conley* analyzed a proposed “checklist” for deciding whether to apply the inevitable disclosure doctrine. *Conley* involved a former employee of DSC Communications Corp. who went to work for Advanced Fibre Communications, Inc. (“AFC”), a competing manufacturer of digital loop carriers. When Conley left DSC, Sprint, a telecommunications company, was actively seeking digital loop carrier vendors, a marketing response that Conley had been involved in preparing for DSC before leaving to work for AFC. On May 22, 1998, DSC sued Conley seeking a temporary restraining order and temporary and permanent injunctions prohibiting Conley from using or disclosing DSC’s confidential and proprietary information. In an amended temporary injunction, the trial court found that Conley would inevidently disclose or use confidential information and/or trade secrets of DSC in connection with his employment with AFC.<sup>29</sup> On review, The Dallas Court of Appeals refused to adopt a checklist for determining whether a temporary injunction was valid.<sup>30</sup> Though the court refused to adopt the checklist, the court held “evidence of these factors may support the trial court’s decision whether to issue a temporary injunction to the extent the factors show whether the employee is in possession of confidential information of his former employer and whether he or his new employer is in a position to use this information to the new employer’s advantage or the former employer’s disadvantage.”<sup>31</sup> Considering the first proposed factor, the existence of misconduct on the part of the departing employee, Judge LaGarde stated “we agree that misconduct on the part of an employee in taking or threatening to

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<sup>29</sup> *Conley v. DSC Communications Corp.*, 1999 W.L. 89955 at \*1; see *Maxxim Medical, Inc. v. Michelson*, 51 F. Supp.2d 773, 786 n.15 (S.D. Tex. 1999) (citing *Conley* in support of following *PepsiCo*).

<sup>30</sup> *Id.* at \*3.

<sup>31</sup> *Id.* at \*4 (citing *Rugen*, 864 S.W.2d at 552).

use a former employer's confidential information is a factor supporting issuance of a temporary injunction on the probable disclosure theory."<sup>32</sup> In reference to the second proposed factor, the new employer's apparent need for the trade secret information of its competitors because of its lack of comparable technology, Judge LaGarde stated "we agree that the new employer's ability to use a trade secret information to its benefit or to the former employer's detriment is a factor because it shows whether the employee is in a position to use the confidential information."<sup>33</sup> With regard to the third proposed factor, a significant degree of similarities between the employer's current and former positions, the court stated that this similarity "can be a factor in determining whether a temporary injunction should issue only to the extent whether the evidence shows whether the former employee is in a position to use the former employer's confidential information"<sup>34</sup> Turning to the fourth proposed factor, the absence of efforts of the employer to protect the trade secrets of the former employer, Judge LaGarde mused that this factor "is little better than asking the fox to guard the hen house" and rejected this suggested factor. Turning to the fifth factor, the existence of a non-competition agreement, Conley sought an inference that a signing of a non-competition agreement "is an employee's tacit omission that he will likely use confidential information if working for a competitor."<sup>35</sup> The existence of non-competition agreement is not evidence of a former employer's discretion to disclose confidential

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32 *Id.* at \*4 (stating "the lack of misconduct does not demonstrate that the trial court abused its discretion in issuing the temporary injunction.").

33 *Id.* at \*5 ("the focus should be whether the new employer should use the trade secret information to its benefit or to the detriment of the former employer.").

34 *Id.*

35 *Id.* at \*6.

information.<sup>36</sup> Relying on *Rugen*, the court held that “the existence of a non-competition agreement is not a viable factor to be considered in determining whether the employee has possession of these former employer’s confidential information and whether he has any position to use it to his or [her] new employer’s benefit or to his former employer’s detriment.”<sup>37</sup> After considering these factors, the court concluded that the trial court did not error in issuing the temporary injunction because Conley was in a position to use DSC’s confidential information for his or AFC’s benefit or to DSC’s detriment.<sup>38</sup> Though this non-precedential, non-binding opinion from the court of appeals does not usher an official inevitable disclosure doctrine or probable disclosure doctrine in the courts of Texas, it represents the persuasive foreshadowing of how Texas courts will handle the eventual adoption of the inevitable disclosure doctrine. Though *Conley* included a non-competition agreement, which Conley unsuccessfully attempted to argue should weigh against the issuance of a temporary injunction, the Dallas Court of Appeals focused the issue on the “protection of the former employer’s proprietary information” in stead of “preventing competition.”<sup>39</sup> The *Conley* court’s upholding of the temporary injunction independently of the non-competition agreement, even in light of a dissent, represents a signal that Texas will “inevitably” adopt the inevitable disclosure doctrine to protection a former employer’s proprietary and confidential information independently of non-competition agreements.

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<sup>36</sup> *Id.* (“Preventing that competition is not the issue; protection of the former employer’s proprietary information is the issue.”).

<sup>37</sup> *Id.* at \*6.

<sup>38</sup> *Id.* at \*8, \*11 (James, J. dissenting) (refusing to accept the doctrine of inevitable disclosure and recommending that the injunction be limited to the pending Sprint bid and to contacting other DSC customers to whom Conley has made a proposal that remains pending).

<sup>39</sup> *See id.* at \*6.

#### **IV. Strategies Based on the Inevitable Disclosure Doctrine**

##### **A. Consult Counsel**

Promptly consulting counsel is the best course of action when confronted with a defection of an employee who has access to significant trade secrets to a competitor. In addition, the following are some suggestions for how to make the best of the inevitable disclosure doctrine.

##### **B. When a Key Employee Defects**

1. **Conduct an exit interview of the employee** with at least one additional witness present in which you ask the employee about what he or she considers trade secrets of the company and what assurances, if any, you have that he or she will not use the trade secrets for the new employer.

2. **As part of the exit interview, also make specific inquiries of the employee as to the identity of his new employer** and what is his or her new position and duties will be with the employer. This will help determine whether trade secrets will be comprised and it also gives the employee the opportunity to demonstrate the candor (or lack thereof) which courts find significant in accessing whether a threat of misappropriation exists.

3. **Immediately interview departing the employee's coworkers.** Determine whether they have observed the employee removing materials from the office or engaging in other activities that suggest misappropriation of trade secrets. You should also determine whether the employee has attempted to recruit fellow employees to leave work, thereby suggesting a "raid," an enhanced threat to the business. Ask whether the employee has

made any remarks regarding plans to use information that might be confidential in the new position.

4. **Send a letter to the new employer** advising him of the types of secret information to which the employee had access and indicating that this information is trade secret.

5. **In the letter to the new employer, ask what assurances they can provide** that the departing employee will not disclose your company's trade secrets in his new position. No response or an inadequate response will provide strong evidence of threatened disclosure.

6. **Promptly decide whether to institute legal action** and, if you decide to do so, proceed quickly. A prompt response will not only have a better chance of safeguarding trade secrets, but it will impress the court that the information at issue has true value to the company and is truly at risk.

7. **If you decide not to institute legal action for the time being, write a letter to the employer** reminding him or her not to disclose trade secrets, and what you consider to be trade secrets. Make it clear that you consider the situation grave and that you are still accessing your legal options.

8. **If you expect repeated defections of employees knowledgeable about important trade secrets, find an outside law firm** or your internal legal department to put together forms to hold on reserve in the event an injunction is needed. Early drafting of portions of the brief, such as sections describing what constitutes a trade secret and how your business

would suffer damage because of disclosure of trade secrets, could save valuable time in the event of a defection and could be used for a variety of employees who might defect.

### **C. When You Wish to Hire a Competitor's Employee**

1. **Ask the new employee** in writing not to bring to his or her new job any documents or other materials whatsoever. Also ask the employee not to disparage his or her former employer to customers or anyone else and, at least for the short term, not to attempt to recruit other employees to leave. Such a letter could help avoid the appearance that you are raiding or exploiting the old employer.

2. **Behave with the utmost candor** and try to make sure that the new employee does as well. The *Pepsico* court relied upon the perceived truthfulness of those involved in reaching the decision that a “threat” of misappropriation existed.

3. **Make sure the new employee does not provide services to your company** until he has resigned his position with the old employer. Particularly if you are a competitor, the employee is provided services for you at the same time he is employed by the old employer may constitute a serious breach of his duties to the old employer and suggests to the court that there is an improper threat to the old employer's business—as well as encouraging the claim that you induced the employee's breach of duty.

4. **Refrain from signing an employment agreement with the new employee** until the controversy is over with the former employer, or include terms that anticipate the possibility the new employee could be enjoined from working. For example, an employment agreement could provide the employee would expend his vacation time if for reason he cannot perform services.

5. **In recruitment, do not present to the new employee with an overly optimistic view** of whether the old employer will sue or whether such a suit will succeed. If the employee later surfaces an injunction precluding him from accepting his new job and if the old employer refuses to hire him which is likely, the new employee could be prompted to assert a claim against your company for fraud in improperly inducing him to quit his old job.

6. **Ask the employee to sign a short agreement that he or she will not use the old employer's trade secrets.** This will help deter the new employee from acting improperly and will provide further evidence of good faith.

## **V. Conclusion**

It is inevitable that Texas will accept this doctrine independent of a non-competition covenant. As the inevitable disclosure doctrine gains more widespread acceptance, it will significantly raise the stakes in litigation between competitors.

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