

Mediating and Arbitrating Non-Competes and Trade Secrets Cases

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A Typical Noncompete Case

- Skywalker works as salesperson for Empire Light Saber Company. When Skywalker went to work for Empire, Skywalker signed an agreement that
 - Empire would provide Skywalker with confidential information, including sales information and customer leads and Skywalker would not disclose/use such information
 - Included two- year restrictive covenants prohibiting working for any other light saber company where Empire did business, as well as soliciting Empire employees and customers
 - Had an arbitration agreement for all claims arising out of or relating to Skywalker's employment but provided for injunctive relief to preserve status quo pending arbitration
- Skywalker had previously worked for Planet Light Sabers and had built a base of light saber customers that Skywalker brought to Empire
- Skywalker quits Empire and goes to work for its biggest competitor, Republic Light Sabers
- Skywalker took a customer list and sales data when he left Empire and loaded onto Republic's computer



Basic law on Noncompetes

- Covenant not to compete is enforceable
 - If it is ancillary to or part of an otherwise enforceable agreement at the time the agreement is made
 - To the extent that it contains limitations as to time, geographical area and scope of activity to be restrained
 - That are reasonable and
 - Do not impose a greater restraint than is necessary to protect the goodwill or business interest of the promisee



Basic law on Noncompetes

- Overly broad covenant may be reformed but no damages prior to reformation
- Attorney's fees for knowingly enforcing an overly broad covenant
- Since 2006, focus has been on scope, not form, of covenant



Basic law on Noncompetes

- Physician agreements “relating to the practice of medicine ... against a person licensed as a physician by the Texas Medical Board”
- Additional requirements
 - List of patients
 - Provide access to medical records of patients upon authorization
 - Provide for a “buy out of the covenant by the physician at a reasonable price or, at the option of either party, as determined” by an arbitrator
 - Not interfere with continuing care to patients during the course of an acute illness



Litigation of a Typical Noncompete Case

- Former employer may sue or bring arbitration against only the employee (Skywalker) or both the employee and the new employer (Republic)
- Former employer (Empire) wants a temporary restraining order and temporary injunction against the employee (Skywalker) and the new employer (Republic) prohibiting use and disclosure of confidential information and solicitation of customers
- Both sides may want/resist discovery on expedited basis
- Case often turns on whether the former employer is successful on first round



Who Decides the TRO and Temporary Injunction?

- Arbitration Agreement

- May be silent as to any exception for court relief before *arbitration*—*RGI, Inc. v. Tucker & Assoc., Inc.*, 858 F.2d 227 (5th Cir. 1988)(affirming preliminary injunction to preserve status quo but noting circuit split)
- May exclude an action to enforce the CNC completely from the scope of *arbitration*—*Wee Tots Pediatrics, P.A. v. Morohunfolu*, 268 S.W.3d 784 (Tex. App.—Fort Worth 2008, orig. proceeding)(granting motion to compel arbitration of employee counterclaims when scope of arbitration clause excepted injunctive relief for CNC)
- May exempt only TRO and temporary/preliminary injunction to preserve status quo pending arbitration — *Gray Wireline Service, Inc. v. Cavanna*, 374 S.W. 3d 464 (Tex. App.—Waco 2011, no pet.)(court held that employee's request for reformation was for arbitrator); *Digital Generation, Inc. v. Boring*, 869 F. Supp. 2d 761 (N.D. Tex. 2012).



Who Decides the TRO and Temporary Injunction?

- Arbitrator has authority to grant injunctive relief. *Myer v. Americo Life, Inc.*, 232 S.W.3d 401 (Tex. App.--Dallas 2007, no pet.).
- Arbitrators had power to equitably extend noncompetition period. *Nationsbuilders Ins. Services, Inc. v. Houston Intern. Ins. Group, Ltd.*, 2013 WL 3423755 (Tex. App.—Dallas 2013).



AAA Rules

- Commercial Rules—Rules 37 and 38
 - Rule 37(a): Arbitrator may take whatever actions deemed “necessary, including injunctive relief and measures for the protection or conservation of property and disposition of perishable goods.”
 - Rule 37 (c): Request to court for interim measures shall not be deemed waiver of right to arbitrate.
 - Rule 38 (b): For clauses or contracts entered into after 10/1/13, Party in need of emergency relief shall notify AAA and all other parties of relief sought and reasons, given immediately by email or facsimile, with certification of service.
 - Rule 38(c): AAA shall appoint emergency arbitrator within one day; expedited procedure for disclosures and objections
 - Rule 38(d)-(g): Expedited procedure for interim award



AAA Rules

- Employment Rules
 - Rule 32: Arbitrator may “may grant any remedy or relief that would have been available to the parties had the matter been heard in court, as stated in Rule 39(d), Award.” Request to court for interim measures shall not be deemed waiver of right to arbitrate.
- Optional Rules:
 - O-1: Parties must adopted by “special agreement or in their arbitration clause.” Party in need of emergency relief shall notify AAA and all other parties of relief sought and reasons, given immediately by facsimile or other reliable means, with certification of service.
 - O-2: AAA shall appoint emergency arbitrator within one business day; expedited procedure for disclosures and objections
 - O-3: Emergency arbitrator shall ASAP, no later than two business days, establish schedule for consideration of application for emergency relief with opportunity to all parties be heard.
 - O-4 through O-6: Emergency arbitrator may grant interim award; modification only on changed circumstance; may require bond or security.



JAMS Rules

- Employment Rule 27(e): Arbitrator “may grant whatever interim measures are deemed necessary, including injunctive relief and measures for the protection or conservation of property and disposition of disposable goods.” No waiver of right to arbitrate by applying to court.
- Comprehensive Arbitration Rule 2: Provides for expedited application, disclosure, and consideration of request for injunctive relief. (Applies only to arbitrations filed and served after 7/1/2014)



Pros and Cons of Court vs. Arbitrator for Injunctive Relief

- Enforcement of order and power of contempt in court
- Speed of obtaining relief—State Court vs. Federal Court vs. Arbitrator. *See, e.g., Joseph Chris Personnel Services v. Rossi*, 249 Fed. Appx. 988 (5th Cir. **2007**)(suit filed in **2003** but after removal to federal court, filed for arbitration on August 19 when it became apparent could not quickly obtain hearing).
- Potential that court may punt to arbitration anyway—*Smart Technologies ULC v. RAPT Touch Ireland Ltd.*, 197 F. Supp. 3d 1204 (N.D.Cal. 2016).
- Right to arbitrate price in physician CNC can lead to confusion—*Sadler Clinic Assoc., P.A. v. Hart*, 403 S.W.3d 891 (Tex. App.—Beaumont 2013, pet. denied).



Non-Signatories to the Agreement

- Non-Signatory Enforcing Arbitration Clause Against Signatory---*In re Vesta Ins. Group, Inc.*, 192 S.W. 3d 759 (Tex. 2006) (orig. proceeding)(non-signatory could enforce arbitration against signatory on tortious interference claim because signatory sought to derive a direct benefit from the contract containing the arbitration provision); *In re EGL Eagle Global Logistics, L.P.*, 89 S.W. 3d 761 (Tex. App.—Houston [1st Dist.] 2002, orig. proceeding)(new employer could enforce arbitration clause against former employer in CNC action)
- Signatory Enforcing Arbitration Clause Against Non-Signatory—*Per Group, L.P. v. Dava Oncology, L.P.*, 294 S.W. 3d 378 (Tex. App.—Dallas 2009, no pet.) (court enforced clause when non-signatory sues based on a contract containing arbitration clause)



Non-Signatories to Agreement

- Signatory could not enforce FINRA arbitration against non-signatory suing on covenant not to compete—*Bank of America, N.A. v. UMB Financial Services, Inc.*, 618 F.3d 906 (8th Cir. 2010).
- When arbitration granted as to some but not all defendants, entire action stayed when collateral litigation addresses the same issues as arbitration--*Gray Wireline Service, Inc. v. Cavanna*, 374 S.W. 3d 464 (Tex. App.—Waco 2011, no pet.)



Ethical Issues

- Preserving the attorney-client privilege
 - Pre-Hire Communications
 - Communications between Employee and New Employer Post-Hire
 - Hiring Separate Counsel for Employee
- Joint Representation
 - Potential for conflicts between Employee and New Employer
 - Employee has other bad acts
 - Employee brought confidential information
 - Disagreements on legal strategy and settlement
 - Employee does not work out and New Employer wants to fire Employee
 - Joint Representation Agreement



Mediating a Noncompete Case

- Who is affected by the case?
 - The Former Employer
 - The Employee
 - The New Employer
 - Customers
 - Other employees
- Who determines the case?
 - The parties if they can settle
 - Shifting Texas law in favor of noncompetes
 - Attitudes and prior opinions of the Judge or Arbitrator



Mediating a Noncompete Case

- What kind of a case is it?
 - Covenant not to compete seeking to bar the employee entirely from employment
 - Covenant not to solicit customers by the former employee
 - Covenant not to solicit employees
 - Theft of trade secrets or confidential information
- Variations on the theme
 - The Cookie Jar Case—Employee caught taking confidential information
 - “I Know It But Just Can’t Prove It” Case-- Employer “knows” the employee is out there doing wrong but cannot prove it
 - The Slaughtered Hog Case—The New Employer has taken four employees from the Former Employer and the Former Employer “has to do something”



Mediating a Noncompete Case

12 Months of Trial Work Crammed Into Six Weeks

- TRO
- Motion for expedited discovery
- Litigation hold and backup
- Massive amounts of ESI
- Depositions
- Temporary Injunction that approximates trial
- Appeal
- What happens next?



Mediating the Noncompete Case

Opening Session?

- How early in the case? (Remember, though, the case may be two weeks old and the parties have already spent \$50k each)
 - If the parties have not seen each other, may be good to see arguments from other side
 - If there have already been several hearings, counsel/parties may find it a waste of time
- How sophisticated are the parties and their counsel?
- How likely is that opening session will “blow up” the mediation?
- Is the Current Employer Backing the Former Employee?



Mediating the Noncompete Case

What are the interests of the affected persons (both those in the room and those not in the room)

- The Former Employer
 - Protect the customer base
 - May have sought TRO even with weak case to allow it to hold on to customers
 - Avoid the problem of alienating customers through the lawsuit
 - Get back the confidential information
 - Set an example for other employees
 - Stop the bleeding of employees
 - Limit the expense but use superior financial position to get as much as it can



Mediating the Noncompete Case

Questions to Ask the Former Employer's representative

- What do you want from this case?
- Has the other side asked for any depositions of your customers?
- How do you think your customers being deposed will affect your relationship with them?
- How much have you spent?
- What evidence do you have that the former employee is.....?
- If the Judge denies the TRO/TI, how do you think that will affect your case?
- Have you taken employees from competitors?
- What do you do to protect your confidential information?



Mediating the Noncompete Case

The Former Employer's Downsides

- Proving that the covenant is not enforceable.
- Ticking off customers who have to testify.
- Alienating the workforce.
- Attorney's Fees.
- Losing.
- Paying the Other Side's Attorney's Fees.
- Time and expense in dealing with an accelerated lawsuit.



Mediating the Noncompete Suit

- The Employee's interests
 - Earning a living and keeping the job
 - Attorney's fees
 - Potential criminal liability
 - Reputation and ability to work in the industry
- Potential Strengths for the Employee
 - Sympathy
 - “Hypocrisy defense”
 - Relationship with customer/witnesses
 - May be judgment proof
- Potential Weaknesses
 - Conduct
 - Shift in Texas law



Mediating the Noncompete Suit

- Questions to Ask the Former Employee
 - What do you want from this case?
 - How do you think your deposition went (or will go)?
 - What is the best result you can get in this case?
 - How much will you spend?
 - How do you think this case will affect your reputation in the industry?
 - Why did you download all of that information?
 - If the Judge grants the TRO/TI, how do you think that will affect your case? Your livelihood?
 - What can you give the plaintiff that would work towards settling this case?



Mediating the Noncompete Suit

- The Current Employer
 - How much aligned with the employee?
 - Have its own noncompetes to enforce?
 - Past history with the Former Employer?
 - What precautions did the Current Employer take with regard to Former Employer's Confidential Information?
 - Time and expense?
 - What is the best result you can get in this case?
 - How do you think this case will affect your reputation in the industry?
 - If the Judge grants the TRO/TI, how do you think that will affect your case? What can you give the plaintiff that would work towards settling this case?



Mediating the Noncompete Suit

- Common Settlement Terms
 - Stay away from certain parts of the company business or customers
 - How do you define the customers such that the Former Employer is not giving the Current Employer a hit list for expiration?
 - Agreed Injunction—Former Employer wants fear of contempt
 - Forensic inspection of computers
 - Agreement not to hire any more employees from Former Employer
 - Antitrust concerns, particularly if Current Employer wants mutual obligation
 - Attorney's Fees and costs
 - Damages
 - Confidentiality and Publicity



Conclusion

- Arbitrating noncompetes
 - Law of noncompetes is shifting, complex, and varies from State to State
 - Request for temporary restraining order and preliminary injunction complicates forum and arbitrability questions
 - Main event is often the TRO and the Temporary Injunction
- Mediating noncompetes
 - It's really not about the money (except when it is)
 - Complexity of settlement terms on non-monetary items
 - Parties will have spent more money more quickly



Further Reading and Source Materials

- Fowler & Mitchell, “Covenants Not to Compete: The Swinging Pendulum of Enforceability,” 31 Corp. Coun. Rev. 1 (May 2012)
- Scott M. McElhaney, *Enforcing and Avoiding Arbitration Clauses Under Texas Law*, 37 Corporate Counsel Review 109 (2018).’
- Zach Wolfe, Wolfe on Texas Non-Compete Litigation 1.2 (Dallas Bar Association, 2021)

