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Recent Development

RECENT DEVELOPMENTS IN TRADE SECRET LAW

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In a theft of trade secrets case in Texas against a subsequent employer with no knowledge, when does the statute of limitations begin to run -- when the theft effects an injury or when the injury is "discovered?"

I. Introduction

The applicable statute of limitations for trade secrets cases lies in Texas Civil Practice and Remedies Code § 16.003:[1]
A person must bring suit for trespass for injury to the estate or to the property of another, conversion of personal property, taking or detaining the personal property of another, personal injury, forcible entry and detainer, and forcible detainer not later than two years after the day the cause of action accrues.[2]

Generally, a cause of action accrues when "the wrongful act effects an injury, regardlessof when the plaintiff learned of such injury."[3] There are, however, several well-recognized exceptions to this general rule. One is the "discovery rule."[4] The discovery rule provides that accrual occurs on, and limitations run from, the date the plaintiff discovers or should have discovered, in the exercise of reasonable care and diligence, the nature of the injury.[5]

Another exception is "fraudulent concealment." Under Texas law fraudulent concealment is an affirmative defense, a form of estoppel, that, strictly speaking, "tolls" the statute of limitations.[6] Generally, in a case of fraudulent concealment, as in the discovery rule, "the statute of limitations begins ***172** to run from the time the fraud is discovered, or could have been discovered by the defrauded party's exercise of reasonable diligence."[7]

The existence of a fiduciary relationship, or a relationship of trust, occasions a third common exception to the general rule of accrual.[8] A "relationship of trust and confidence" between the parties prevents the running of the statute until the party asserting the right had actual knowledge of that right.[9] The Texas Supreme Court approved such a holding in *Baker* and referred to the approval in *Barfield.*[10]

When an initial possession of property is not wrongful, there is a further exception to the general rule of accrual for the purposes of the running of the statute of limitations.[11] When the original possession of property is not wrongful, the cause of action is said to accrue, and the statute begins to run when notice of the adverse claim is made apparent to the owner of the property.[12]

II. The Case That Raised the Issue

Computer Associates International, Inc. v. Altai, Inc.[13] has raised, as an issue of first impression for Texas law, whether the discovery rule should apply in trade secret cases in certain circumstances.[14] The circumstances do not include a suit against the ex-employee who was in a position of "trust," who "fraudulently concealed," or who was once in "rightful possession" of the trade secrets. Rather, the question is whether the rule should be extended to the so-to-speak "innocent" subsequent employer with no knowledge of the theft, no fraudulent concealment, no relationship of trust and no period of rightful possession, but who certainly unknowingly benefitted.[15]

The District Court of the Eastern District of New York, in its August 1993 decision, refused to so apply the discovery rule in this situation and dismissed the cause of action.[16] The court, finding no Texas precedent precisely on point and finding instances where the Texas Supreme Court had refused to extend the discovery rule,[17] reasoned that it would be presumptuous for a federal district court in New York to so expand Texas' law.[18] The decision is now on appeal to the Second Circuit.

To form a better opinion on the issue, it is instructive to review the facts:

III. *Computer Associates v. Altai* Facts

Williams, current president of Altai, left Computer Associates (CA) in 1980 to go to work for (a predecessor of) Altai.[19] At CA, Williams had possessed no responsibilities regarding the computer program embodying the trade secrets in question, nor had he actually seen that program's code. Needing ***173** an additional programmer for a project in 1984, Williams approached Arney, who had been an employee of CA since 1978. Williams and Arney had been long-standing friends and co-workers, even prior to their days at CA. Arney left CA in 1984 and took with him copies of the source code of the program embodying the trade secrets in question. Arney recognized that this was contrary to the agreements he had signed prohibiting employees from retaining such copies.[20] No one at Altai, other than Arney, knew that Arney had the program code in question or that he referred to it in his work for Altai.[21]

At trial the parties stipulated that CA did not know, or have reason to know, of the 1984 misappropriation until 1988.[22] The court had previously found that Altai (i.e. Williams) also learned for the first time that Arney had copied code from a CA program in 1988, when the lawsuit was commenced.[23]

Subsequent to receipt of the complaint, Arney disclosed to Williams the extent of the copying.[24] Williams immediately secured a rewrite of the Altai program to cure the improper copying.[25]

IV. This Author's Analysis

To properly sort out the issue, causes of action for injuries to, or for the conversion of, property should be distinguished from other causes of action covered by the Texas Civil Practice and Remedies Code § 16.003.[26] The distinguishable causes of action are, for instance, injury to the person, libel and slander, contracts, warranties, professional negligence, professional malpractice, labor and employment cases, civil rights cases, consumer remedies, antitrust claims, and securities cases. Each cause of action carries its own particular equities. It was not clear that the district court's opinion made this distinction.[27] Focusing on cases involving conversion of property, or injury to property, Texas courts have determined that in causes of action for permanent damage to real property, the cause of action accrues upon discovery of the first actionable injury.[28] Such cases typically involve an allegation of damage to land due to saltwater migration, undisclosed sewer lines, gas leaks, and changes in the drainage of surface water.[29]

Perhaps, however, a closer analogy to the *Altai* fact situation lies in the line of conversion of property cases related to "commercial paper." There, the Texas courts have refused to extend the discovery rule.[30] The court in *Southwest* applied the Texas Supreme Court balancing test found in *Robinson v. Weaver,*[31] weighing the statutory policy of repose against the injustice created by barring ***174** a suit.[32] In *Southwest,* the cause of action was against a bank and a Mr. Scott for damages resulting from the bank's permitting Scott to convert three cashiers checks and to deposit the checks in his own checking account. Scott admitted the conversion and the bank was charged with negligence. The bank defended itself on the basis of the two year statute of limitations applicable to suits of negligence and conversion.[33]

The court of appeals in *Southwest* noted that the "discovery problems" of the plaintiff in the case stemmed from Mr. Scott's fraudulent concealment of the deposit; no discovery problems were inherent on the part of the bank's actions.[34] Finding the injustice unrelated to the bank's actions, the court held that the discovery rule did not toll the statute of limitations where the bank was concerned. The statute of limitations could be tolled only if there were proof of the bank's fraudulent

concealment.[35] The court in *Stone,* upon similar facts,[36] followed the holding of *Southwest.*[37]

It is important to be clear about what is at stake here. Upon the facts of *Altai,* the defenses of fraudulent concealment, the existence of a relationship of trust and/or an initial rightful possession of the property should exist for CA with respect to any statute of limitations plea on a suit against Arney. The issue here is not that the discovery rule should not apply against Arney. The issue is whether the discovery rule should be extended when the cause of action is extended to the subsequent innocent, so-to-speak, employer of Arney.

In the interest of repose, the reasoning found in both *Southwest* and *Stone* may be the best reasoning. Since no discovery problems are inherent in the innocent subsequent employer's actions, the discovery rule does not toll the statute of limitations with respect to the subsequent employer.

Stay tuned. Arguably, this is a close call. The case has been appealed to the Second Circuit who could certify the issue to the Texas Supreme Court.

Footnotes

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1 TEX. CIV. PRAC. & REM. CODE ANN. § 16.003 (West 1986).

2 *Id.* at § 16.003(a).

3 Moreno v. Sterling Drug, Inc., 787 S.W.2d 348, 351 (Tex. 1990); Saenz v. Keller Indus. of Tex., Inc., 951 F.2d 665, 668 (5th Cir. 1992); Robinson v. Weaver, 550 S.W.2d 18, 19 (Tex. 1977).

4 *Moreno,* 787 S.W.2d at 351; *Robinson,* 550 S.W.2d at 19; Weaver v. Witt, 561 S.W.2d 792, 793-94 (Tex. 1977).

5 *Witt,* 561 S.W.2d at 793-94; *Moreno,* 787 S.W.2d at 351.

6 Arabian Shield Dev. Co. v. Hunt, 808 S.W.2d 577, 584 (Tex. App.-- Dallas 1991, writ denied).

7 Jackson v. Speer, 974 F.2d 676 (5th Cir. 1992); *see also Arabian Shield,* 808 S.W.2d at 584.

8 Baker v. Cook, 15 S.W.2d 600, 601 (Tex. Com. App. 1929); Barfield v. Howard M. Smith Co. of Amarillo, 426 S.W.2d 834, 839 (Tex. 1968).

9 *Baker,* 15 S.W.2d at 601; *Barfield,* 426 S.W.2d at 839.

10 426 S.W.2d at 839.

11 Federal Elec. Co. v. Johnson, 187 S.W.2d 410, 411 (Tex. Civ. App.--Galveston 1945, writ dism'd w.o.j.).

12 *Federal Elec.,* 187 S.W.2d at 411; Pierson v. GHR Fin. Servs. Corp., 829 S.W.2d 311, 314 (Tex. App.--Austin 1992, n.w.h.); Hofland v. Elgin-Butler Brick Co., 834 S.W.2d 409, 414 (Tex. App.--Corpus Christi 1992, n.w.h.).

13 775 F. Supp. 544 (E.D.N.Y. 1991)("*Altai I*").

[14] *Id.* at 546.

[15] *Id.* at 553-54.

[16] Computer Assoc. Int'l, Inc. v. Altai, Inc., 832 F. Supp. 50, 54 (E.D.N.Y. 1993)("*Altai III*").

[17] *Id.* at 53.

[18] *Id.* at 54.

[19] *See Altai I,* 775 F. Supp. at 553.

[20] *Id.*

[21] Computer Assoc. Int'l, Inc. v. Altai, Inc., 982 F.2d 693, 700 (2d Cir. 1992)("*Altai II*").

[22] *Altai I,* 775 F. Supp. at 566.

[23] *Altai II,* 982 F.2d at 700.

[24] *Id.*

[25] *Id.* In a phase of the case not discussed herein, Computer Associates won a copyright infringement charge for the first Altai program and lost a copyright infringement charge for the second program. *See Altai I,* 775 F. Supp. 544.

[26] TEX. CIV. PRAC. & REM. CODE ANN. § 16.003 (West 1986).

[27] *See generally Altai I,* 775 F. Supp. 544.

[28] Bayouth v. Lion Oil Co., 671 S.W.2d 867 (Tex. 1984); Waddy v. City of Houston, 834 S.W.2d 97, 102 (Tex. App.--Houston [1st Dist.] 1992, writ denied); Yancy v. City of Tyler, 836 S.W.2d 337, 340 (Tex. App.--Tyler 1992, writ denied); Hues v. Warren Petroleum Co., 814 S.W.2d 526, 529 (Tex. App.-- Houston [14th Dist.] 1991, writ denied).

[29] Reflected, respectively, in the cases cited just above.

[30] Southwest Bank & Trust v. Bankers Commercial Life Ins., 563 S.W.2d 329, 331 (Tex. Civ. App.--Dallas 1978, writ ref'd n.r.e.); Stone v. First City Bank of Plano, N.A., 794 S.W.2d 537 (Tex. App.--Dallas 1990, writ denied).

[31] 550 S.W.2d at 19.

[32] 563 S.W.2d at 331.

[33] *Id.* at 330.

[34] *Id.* at 332.

[35] *Id.*

[36] *Stone,* 794 S.W.2d at 539.

[37] *Id.* at 542-43.