DBA ENERGY LAW SECTION

Texas Trade Secret Cases Affecting the Oil and Gas Business

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Trade secret misappropriation is front and center in Texas law, with two recent court decisions and adoption of the Uniform Trade Secrets Act. The goal of prospect generators is to attract and keep drilling partners without losing control over their maps, analyses, and other valuable trade secrets. We hope this paper will be a guide, a warning if you will, to what your clients could experience when they share their valuable information.

SOUTHWESTERN ENERGY PRODUCTION CO. V. BERRY-HELFAND AND MUNCEY[1]

The Prospect Generator's Nightmare

The Facts

Toby Berry-Helfand and Gery Muncey worked for years generating James Lime prospects in a five-county area in East Texas, Nacogdoches, Shelby, Angelina, San Augustine and Cherokee. Some wells had been drilled in the James Lime formation before 1997 but few were profitable. In late 1997 Helfand and Muncey began studying materials on a 2,750,000 acre area, and reviewed the materials for three and one-half years before drilling a well. In 2000, the first well drilled as a direct result of this work was a failure. Muncey left the project in 2001 (retaining a 20% interest) and Helfand continued to work on the project and in 2003 started working with another geologist, Leon Wells. By 2004, Helfand and

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Wells had determined two promising locations and began working with investors to take leases.

During this same time, Southwestern Energy Production Co. had also been looking at the James Lime. In 2002 and 2003, a Southwestern geologist had determined that the James Lime was not profitable and Southwestern declined to participate in a play proposed by Sonerra Resources. In April 2004, Wells' son, Jeff, went to work for Southwestern and in July Jeff told Helfand that Southwestern might be interested in the James Lime prospects.

In February 2005, Helfand, Wells and their lawyer, calling themselves "Team Works", presented to Southwestern's chief landman their findings, including an analysis of the "sweet spots" in the James Lime formation. Before the presentation Team Works had Southwestern sign a confidentiality agreement. After the meeting Southwestern requested additional information, but ultimately declined to participate. Later Southwestern bought acreage with other participants in two of the five counties, their objectives being the Travis Peak and the Cotton Valley. Virtually all of the leases taken by Southwestern after seeing Helfand's presentations were in Helfand's top 10 sweet spots. Southwestern ultimately participated in over 80 James Lime wells, all of which are successful and all of which are clustered in the area of Helfand's sweet spots. Revenues from the wells exceed $382 million by the time of trial.

On the other hand, Southwestern had ongoing operations in East Texas before it met Helfand; by 2003 the James Lime was a known producing formation; Southwestern declined to participate with another operator in a James Lime prospect in 2003, based on its own study; Southwestern started pursuing Travis Peak Exploration in 2004 and some of its leases did not include James Lime rights; and Southwestern continued extensive Travis Peak drilling after the February 2005 meeting at the cost of close to $80 million.

The Claims

Helfand sued 15 parties, alleging fraud and misappropriation of her proprietary information relating to the James Lime formation. All defendants other than Southwestern and Wells settled before trial. Other claims were based on fraud, breach of contract, breach of fiduciary duty, violation of the Theft Liability Act, tortious interference, and conspiracy. These are all the kinds of claims commonly associated with trade secret cases.

Misappropriation – What the Plaintiff Must Prove

Four elements are required to prevail on a claim of misappropriation:

(1) a trade secret existed,

(2) the trade secret was acquired through breach of a confidential relationship or was discovered by improper means,

(3) the defendant used the trade secret without authorization; and

(4) plaintiff suffered damages as a result.[2]

The Incriminating Evidence

To prove trade secret misappropriation the plaintiff must often rely upon circumstantial evidence. Southwestern argued that Helfand's case relied solely on the fact that Southwestern had not drilled a James Lime well prior to its meeting with Helfand in February 2005, but by 2008 had over 80 wells in the area. Southwestern offered evidence to explain why it eagerly pursued James Lime prospects after its meeting with Helfand, including the fact that it learned a lot about the James Lime while developing the Travis Peak.

However, Southwestern was unable to show the paper trail one would expect if the prospects were based on its own geology and engineering. The sweet spots covered a miniscule portion of the 2.75 million acres covered by the Helfand study and the majority of the leases that Southwestern took were in or extremely close to the sweet spots. Southwestern's leasing and drilling activity corresponded directly with Helfand's sweet spots, but Southwestern was unable to produce a body of independent research comparable to Helfand's. Southwestern's petroleum engineer claimed that the documents that had been produced were destroyed; however, the court found that claim improbable as the drilling program was still ongoing.

Based upon on this evidence the court found that it was not unreasonable for the jury to conclude that Southwestern's success was a product of information it obtained through misappropriation. The jury had the right to consider circumstantial evidence, determine credibility of the witnesses, and make reasonable inferences from the evidence.[3]

Southwestern also argued that independent study that led Southwestern to drill; however, the jury did not find this argument convincing, as there was no evidence to back up this claim.

It was permissible for the jury to rely on circumstantial evidence to deduce the fact that Southwestern had indeed used the information from Helfand to develop an interest in the James Lime formation. The appellate court agreed that the jury's finding was reasonable based on the circumstantial evidence.

The Defense—Limitations

Given that almost five years had passed between Southwestern's access to the information and Helfand's suit, Southwestern asserted that limitations barred the claims. A person must bring suit for misappropriation of a trade secret no later than three years after the misappropriation is discovered, or by the exercise of reasonable diligence should have been discovered. [4]

The discovery rule allows the tolling of limitations until a claimant learns or in the exercise of reasonable diligence should have learned of her injury.[5] Tolling of the statute ends when a party learns facts that would lead a reasonable person to make a further inquiry.[6]

Helfand filed suit on February 17, 2009 and Southwestern first gained access to the information in February 2005. Southwestern had the burden of proving that by February 17, 2006 Helfand knew or should have known that Southwestern has misappropriated her trade secret. Southwestern cited several emails from Helfand in 2005 stating that she was fearful that all the information she had developed was being used by "entitled parties" and that she had provided enough information that one could effectively map out the formations. However, within days of these emails Southwestern returned all the materials and assured Helfand they had retained nothing.

Hefland knew that virtually every presentation to sell a prospect comes the possibility for the recipient to misappropriate the data. While Helfand was concerned by the tardiness of Southwestern's return of her materials, she was also entitled to rely on Southwestern's assurance that they retained none of her information. The record showed that even if Helfand had made inquiries into possible misappropriation by Southwestern in late 2005 or 2006 she would have turned up nothing, as Southwestern's pattern of drilling in the sweet spots did not emerge until late 2007. Helfand claimed that she first learned of Southwestern's misappropriation in January 2009 during discovery when her suit was focused on other entities. There was no evidence that could conclusively prove that Helfand knew or should have known of the misappropriation prior to February 2006; therefore, the jury could rely on Helfand's testimony that she learn of the misappropriation in January 2009.

The Damages

The good news for plaintiffs (bad news for defendants) in Texas misappropriation cases is that courts are entitled to be "flexible and imaginative" when determining damages for misappropriation.[7] The methods could include the value of the plaintiff's lost profits, the defendant's actual profits from the use of the trade secret, the value a reasonably prudent investor would have paid for the trade secret, development costs that the defendants avoided, and a "reasonable royalty". This approach allows a plaintiff to recover even if she has suffered no loss herself.

Helfand's expert, a reservoir engineer, calculated the present value of the revenues Southwestern could be expected to gain from its exploitation of the trade secrets and determined the fraction of those revenues that should be apportioned to Helfand, using as a guide a Southwestern prospect agreement with Petrohawk for the same properties. That, he said, was Helfand's damages. Helfand was also entitled to three percent of Southwestern's $355 million sale of its deep rights, based on what she testified was her typical override on her prospects. He estimated her total damages at $45 million. The jury, accepting some of his conclusions but not others, found the damages to be $11 million.

Other Claims

The court concluded there was no support in the record the jury's finding that Southwestern committed theft of Helfand's trade secrets. That portion of the jury verdict and judgment was reversed. The Penal Code provides that a person commits theft of a trade secret if, without the owner's consent, he knowingly (1) steals a trade secret, (2) makes a copy of an article representing a trade secret, or (3) communicates or transmits a trade secret.[8] The jury instruction was as follows:

> A person commits theft of a trade secret if, without the owner's effective consent, knowingly: (1) steals a trade secret; or (2) communicates or transmits a trade secret.

Because Southwestern returned all materials to Helfand, the court concluded that there was no evidence that it "deprived" her of her trade secrets as "deprived" is defined in the penal code. Further, the court found that there was no evidence of the requisite in can't to deprive her of her trade secret, or that Southwestern communicated or transmitted Helfand's trade secret.

As this paper is concerned mostly with trade secrets, we will only briefly touch on the breach of fiduciary duty and fraud claims. Southwestern owed no fiduciary duty to Helfand. The confidentiality agreement set forth the obligations Southwestern owed Helfand regarding the trade secret. The parties' confidentiality agreement was an expression of their formal relationship. The court held that for an informal fiduciary relationship to exit, the party claiming the relationship must have been accustomed to being guided by the judgment or advice of the other.[9] There was no evidence on which one could infer a fiduciary relationship; furthermore, there was no evidence that a special relationship of trust and confidence existed.

Helfand claimed that Southwestern made three fraudulent representations. The court found that there was no evidence to support the elements of an untrue statement and reliance, both of which are necessary for a recovery for fraud.[10]

Lamont et al v. Vaquillas Energy Lopeno Ltd., LLP et al[11]

The Departing Shareholder

The Facts

Ricochet, owned by Hamblin and Lamont, entered into Prospect Generation Agreements with Vaquillas Energy Lopeno and JOB Energy Partners whereby Ricochet would propose prospects and Vaquillas / JOB would have the first right to invest. In September 2004, Ricochet's geologist identified the Lopeno Prospect beneath two contiguous tracts — Worley and El Milagro— and created a seismic map of the prospect at a cost approaching $1 million invested in analyzing and developing the map.

The value and significance of the map is suggested by the name by which it became known among the parties: the "Treasure Map." Vaquillas and JOB agreed to participate in the prospect as working-interest owners. Ricochet then obtained an oil and gas lease over the Worley property, but not the El Milagro property because it was in litigation over a previous lease. Regular meetings that were held from 2004 to 2006 to discuss the prospect among Ricochet, Vaquillas and JOB were considered by everyone to be confidential and the seismic information was to be kept secret. Lamont attended the meetings as an officer of Ricochet.

In August 2006, Lamont notified Hamblin that he wished to separate from Ricochet. In February 2007, two agreements dividing Ricochet's prospects and separating Lamont from Ricochet were signed, an agreement dividing up the prospects and a master separation agreement. Lamont resigned as director, officer and chief operating officer, all retroactive to December 31, 2006. Lamont then signed a Joint Operating Agreement for the Lopeno Prospect as a 29% working-interest owner. Thereafter Ricochet's geologist sent Lamont a copy of the Treasure Map without requiring him to sign a confidentiality agreement. The parties drilled the Worley well in early 2007.

In January 2007, Lamont met Carranco and in February provided Carranco with seismic maps of four different prospects, including Lopeno. In late February, Lamont received a copy of the Worley well log and based on the Worley log, Lamont and Carranco immediately began efforts to lease the El Milagro property under the name of Montecristo. In March, Lamont informed Ricochet that Crazy Horse, a company of Carranco's, had purchased 10% of Lamont's 29% working-interest.

Lamont and Carranco, using Montecristo, were successful in leasing the El Milagro property by paying a bonus of over $1 million, thereby outbidding Ricochet. Montecristo then sold a 60% working interest in the El Milagro lease to LOG, owned by Lamont. LOG and Carranco drilled a well on El Milagro "in direct competition to Ricochet", said the court. According to the court, that well depleted the Lopeno Prospect reservoir, thereby depriving Vaquillas of the opportunity to produce from the prospect reservoir.

The Incriminating Evidence

Lamont and Carranco could not show independent research to support their large investment in the El Milagro tracts. It was only after viewing the seismic data and the well log that Lamont and Carranco sought to lease El Milagro. In order to secure a bank loan to pay the lease bonus, Lamont submitted a letter containing information that was drawn directly from the seismic data and Treasure Map. Lamont and Carranco claimed the well-log led them to pursue the El Milagro property; however, the log only provided information regarding the Worley well, and Lamont and Carranco began drilling El Milagro without attempting to obtain any seismic data on that property.

Misappropriation – What are "Improper Means"

The court identified the elements of a claim for misappropriation of trade secret in the same way as the court in *Helfand*, however citing different authority.[12] The defendants agreed that in this case the Treasure Map was a trade secret.

Recall from the *Helfand* discussion above that a trade secret can be misappropriated if it was acquired through "improper means". The court instructed the jury on "improper means" as follows:

> For the defendant to have acquired knowledge of a trade secret by "improper means", the defendant must have known or had reason to know that the information was trade secret. A person discovers another's trade

> secret through "improper means" by acting below the generally accepted standards of commercial morality and reasonable conduct.
>
> A Defendant does not acquire knowledge of trade secret by improper means if it discovers the plaintiff's trade secret by independent development or independent discovery.

There was no objection to the jury charge.

Was the Treasure Map discovered by improper means? Obtaining knowledge of a trade secret without spending time and resources to discover it independently is improper unless the secret is voluntarily disclosed or reasonable precautions were not taken to ensure its secrecy.[13]

In these matters courts often conform their analysis of the law to the good or bad nature of the parties' behavior. The activities of Lamont and Carranco were deemed by the court to be underhanded. They began leasing the El Milagro tract the day after they received the Worley well log and in securing a bank loan to pay the million dollar bonus on El Milagro they used information obtained directly from Ricochet's seismic data and the Treasure Map. Third, Carranco formed Montecristo without disclosing Lamont's identity. Thereafter, Montecristo sold 50% of the El Milagro leasehold to LOG, Lamont's company. The Worley No. 1 well log provided no information regarding sand depth on the El Milagro property.

The "improper means" test is vague, as it should be. More often than not, deceit is the determining factor.

The Defense – It Wasn't a Trade Secret.

An owner must take "reasonable precautions" to protect a trade secret.[14] If the information appropriated is not a trade secret there is no liability for misappropriation no matter how reprehensible the defendant's conduct. Thus, secrecy is a key part of the definition of a trade secret.

The defendants argued first that the Treasure Map was voluntarily provided to Lamont when he was no longer an officer, director or a chief operating officer at

Ricochet and he had the right to access the data as a working interest owner. Thus, there was nothing improper in his use of the Treasure Map. If he acquired the map properly, so did Carranco, using Montecristo. The defendants argued that they did not rely on the Treasure Map to lease the El Milagro tract and drill the El Milagro well, but relied only on the Worley No. 1 log, which was acquired by proper means.

Lamont also claimed that the Treasure Map lost its trade secret status as a result of Ricochet's failure to require confidentiality agreements and by showing the map to potential investors. Potential problems for Ricochet were that its employees did not have confidentiality agreements and that the Treasure Map was shown to potential working interest investors.

In denying this assertion, the court relied on several factors. First, there is the longstanding rule in Texas that employees are forbidden from using trade secret information acquired during employment.[15] This obligation survives the termination of employment.[16] The court responded to Lamont's argument that he was no longer an officer or employee by pointing out that Lamont "went to great lengths" to ensure his resignation became effective on December 31, 2006.

Second, the court found that trade secret status is not destroyed simply by showing protected items to prospective buyers or customers.[17] The court reasoned that limited disclosure to Lamont and other potential investors did not destroy the secrecy of the documents.

The Result

The court concluded that it was not unreasonable for the jury to determine that Lamont and Carranco improperly used the Treasure Map and it was likewise not unreasonable to determine that it was the Treasure Map, and not the Worley No. 1 log, that motivated Lamont and Carranco to undertake million-dollar negotiations for the El Milagro lease and spend millions of dollars to develop wells on that lease. Neither Lamont nor Carranco had authority from Ricochet to use the Treasure Map for that purpose. Thus, it was not unreasonable for the jury to determine that they misused the map and thus, that their actions fill "below the generally acceptance standards of commercial morality and reasonable conduct."

It was meaningful to the court that neither Carranco nor Lamont conducted any independent research of the reservoir. One could discover a process or trade secret by reverse engineering applied to the finished product, but he is allowed to do that only if he discovers it by his own independent research.

Other Claims

The jury also found, and the appellate court upheld, that Lamont and Carranco tortiously interfered with Ricochet's Prospect Development Agreements with Vaquillas and JOB Energy. The defendants' conduct lessened the value of the Treasure Map. The court held that to establish tortious interference with an existing contract a plaintiff is not limited to showing that the contract was actually breached.[18] The court relied on the rationale that any interference is actionable if it makes performance more burdensome or difficult or of less or no value to the one entitled to performance.[19]

There was also a civil conspiracy claim, to which the jury answered "yes".

The Damages

Vaquillas recovered $4.9 million in lost profits, based on the assumption that another operator would not have drilled on the Lopeno Prospect. The only evidence of an attempt by any operator other than Montecristo to lease the El Milagro property was the effort by Ricochet. Even if another operator had obtained the lease, reasoned the court, without the Treasure Map they would have drilled blindly, not knowing the best drilling locations. There was enough evidence for the jury to believe that the Worley well, owned by Ricochet, would have drained the reservoir before another operator could interfere.

***Hamblin v. Lamont*[20]**
Must the Victim Indemnify the Wrongdoer?

A related case has nothing to do with trade secrets, but we mention it because it arises directly out of the agreements underlying *Lamont v. Vaquillas Energy Lopeno, LLP*. Lamont, the former shareholder and the wrongdoer, sued Hamlin and Ricochet Energy, Inc. under an indemnity obligation in the agreements the parties executed when Hamblin submitted his resignation. Lamont was seeking to be excused and protected from his intentional acts, and the question was whether the express negligence doctrine applied. The trial court rendered judgment in favor of Lamont, the wrongdoer, enforcing the contractual indemnity provision. The court of appeals reversed and rendered in favor of Hamblin and Ricochet.

The indemnity agreement in Lamont's favor was very broad, but did not expressly indemnify Lamont for the consequences of his own intentional torts. The trial court concluded that because the claim against Hamblin was not for negligence, the express negligence doctrine did not apply. The appellate court disagreed. The same public policy associated with the extraordinary risk-shifting in negligence cases should apply with equal or greater force to intentional torts.[21]

In Texas, a New Trade Secret Act

On September 1, 2013, the Texas Uniform Trade Secrets Act took effect.[22] By its language, intends to replace all statutory or common law trade secret law now in place. The Act strengthens protection for trade secret owners. The Texas version of the Act:

- provides consistent and predicable statutory language for trade secret protection;
- updates the definition of 'trade secret' to reflect current business practices and technologies; and
- clarifies that certain business practices do <u>not</u> constitute misappropriation of trade secrets.

The new law offers easily applied standards and a longer term for injunctive relief. In addition, the claimant may pursue damages:

- for the actual loss caused by misappropriation;
- for the unjust enrichment caused by misappropriation;
- a royalty for unauthorized use or disclosure;

- Exemplary damages in an amount not exceeding twice any award granted, for willful and malicious misappropriation; and
- Attorneys' fees for the plaintiff or the defendant.

The new law puts to rest plaintiffs' concern that their secrets might be disclosed during court proceedings to enforce their rights by establishing a presumption in favor of a protective order to preserve the secrecy of trade secrets, limiting access to confidential information to only the attorneys and their experts, holding in-camera hearings, and sealing the record, among others.

CONCLUSION

Do not jump to the conclusion that one passes on a proposed drilling project, or leave his employment, he cannot ever later drill on his own in the same area. However, he would be wise to be prepared to establish that the knowledge and information relied on to take the new lease and drill the new wells is not based on confidential information belonging to others. Leasing and drilling new prospects is an expensive and risky endeavor; reasonable operators do not haphazardly invest millions in leasing and drilling without extensive and well-researched information on which to base their decisions. The jury and the court can and will look at circumstantial evidence to determine how, where, and when the information necessary to drill was obtained.

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[1] 411 SW 3d 581 (Tex. App.-Tyler, 2013).

[2] *Trilogy Software, Inc. v. Callidus Software, Inc.*, 143 S.W.3d 452, 463 (Tex. App.—Austin 2004, pet. denied); *IBP, Inc. v. Klumpe*, 101 S.W.3d 461, 476 (Tex. App.—Amarillo 2001, pet. denied).

[3] *SI Handling Sys, Inc. v. Heisley*, 753 F.2d 1244, 1261 (3d Cir. 1985).

[4] TEX. CIV. PRAC. & REM. CODE ANN. § 16.010(a) (West 2002).

[5] *PPG Indus., Inc. v. JMB/Houston Center*, 146 S.W.3d 79, 93 (Tex. 2004).

[6] *Pirtle v. Kahn*, 177 S.W.3d 567, 571 (Tex. App.—Houston [1st Dist.] 2005, pet. denied).

[7] *Univ. Computing Co. v. Lykes-Youngstown Corp.*, 504 F.2d 518, 535 (5th Cir. 1974).

[8] Tex. Penal Code § 31.05(b).

[99] *Thigpen v. Locke*, 363 S.W.2d 247, 253 (Tex. 1962).

[10] *Exxon Corp. v. Emerald Oil & Gas Co., LC*, 348 S.W. 3d 194, 195 (Tex. 2011).

[11] *Lamont v. Vaquillas Energy Lopeno Ltd.*, LLP, 421 S.W.3d 198 (Tex. App.--San Antonio, 2013).

[12] *Twister B.V. v. Newton Research Partners, LP*, 364 S.W.3d 428, 437 (Tex. App.—Dallas 2012, no pet.); *Rusty's Weigh Scales & Serv., Inc. v. N. Tex Scales, Inc.*, 314 S.W.3d 105, 109 (Tex. App.—El Paso 2010, no pet.).

[13] *E.I. Dupont deNemours & Co. v. Christopher*, 431 F.2d 1012, 1015-16 (5th Cir. 1970) (applying Texas law); Alcatel *USA, Inc. v. DGI Technologies, Inc.*, 166 F.3rd 772, 785 (5th Cir. 1999) (looking at the evidence in light of the reasonable jury).

[14] *J.C. Kinley Co. v. Haynie Wire Line Serv., Inc.,* 705 S.W.2d 193, 196-198 (Tex. App.—Houston 1985, writ ref'd n.r.e.).

[15] *Reliant Hospital Partners, LLC v. Cornerstone Healthcare Grp. Holdings, Inc.*, 374 S.W.3d 488, 499 (Tex. App.—Dallas 2012, pet. filed); *Sharma v. Vinmar Int'l Ltd*., 231 S.W.3d 405, 424 (Tex. App.—Houston [14th Dist.] 2007, no pet.).

[16] *Reliant Hospital Partners*, 374 S.W.3d at 499.

[17] Restatement (3d) of Unfair Competition § 41 cmt.(b) (1995); *H.E. Butt Grocery Co. v. Moody's Quality Meats, Inc.*, 951 S.W.2d 33, 35 (Tex. App.—Corpus Christi 1997, pet. denied).

[18] *Kohn v. GBAK Props, Inc.,* 371 S.W.3d 347, 359-360 (Tex. App.—Houston [1st Dist.] 2012, no pet.).

[19] *Id.*

[20] *Hamblin v. Lamont*, 2013 WL 6492152 (Tex. App.—San Antonio, Dec. 11, 2013).

[21] *Dresser Industries, Inc. v. Page Petroleum, Inc.*, 853 S.W.2d 505, 507-509 (Tex. 1993); *Ethyl Corp. v. Daniel Construction Co.*, 725 S.W.2d 705, 708 (Tex. 1987).

[22] The Texas version is Tex. Civ. Prac. & Rem. Code § 134A. Find the Louisiana version at La. R.S. 51:1431-39.