Practical Considerations for Recovering Damages in Restrictive Covenant and Misappropriation Cases

Vanessa Griffith
E. Phileda Tennant
J. Robert Sheppard, III
Vinson & Elkins LLP
2001 Ross Avenue, Suite 3700
Dallas, TX 75201

TABLE OF CONTENTS

I. INTRODUCTION 1

II. METHODS OF CALCULATING DAMAGES FOR BREACH OF A COVENANT NOT TO COMPETE 1

1. General Rules 1

a. Reasonable Certainty 2

b. Methodologies 3

c. Pitfalls 6

2. Practical Advice in Selecting a Methodology for a Damages Model Based on the Breach of a Restrictive Covenant 9

a. Untested Ventures 9

b. Issues Arising from the Expectancy or Duration of Customer Relationships 10

c. At-Will Employees 14

d. Impact of Changes in the Marketplace 15

e. Time Horizon for Recovery of Damages 16

III. RESTITUTION AND DISGORGEMENT AS REMEDIES IN LIEU OF LOST PROFITS 18

IV. METHODS OF CALCULATING DAMAGES FOR TRADE SECRETS MISAPPROPRIATION 19

1. General Rules 20

a. Plaintiff's Lost Profits 20

b. Defendant's Unjust Enrichment 21

c. Saved Development Costs 21

d. Reasonable Royalty 22

e. Other – Taking a "Flexible Approach" 23

V. LIQUIDATED DAMAGES 24

VI. ATTORNEYS' FEES 25

1. Contractual Attorneys' Fee Provisions 25

2. Attorneys' Fees as Provided by Statute or Common Law 26

I. INTRODUCTION

In litigation arising from restrictive covenants and trade secrets, the plaintiff often will focus on obtaining a temporary restraining order ("TRO") or injunction at the outset of the litigation. This involves a flurry of activity, with detailed briefing, expedited discovery, and trial-like evidentiary hearings. The TRO and preliminary injunction process unfolds swiftly.

But, beyond securing early injunctive relief, prospective plaintiffs often fail to give adequate consideration to whether compensatory remedies are available, and if so, the evidentiary standard and costs associated with obtaining (and keeping) such remedies. This is understandable; a business victimized by the apparent violation of a valid restrictive covenant is primarily focused on preventing further harm. But, if damages are available, it is important to immediately begin developing a damages strategy. Failing to do so can be a costly oversight because the recovery of damages in restrictive covenant and trade secrets litigation is subject to strict legal standards. If the business believes it has been harmed financially, it is vital that the business conduct an early and thorough analysis as to whether – and how – pecuniary damages may be recovered.

This paper provides an in-depth discussion of the types of injunctive relief and pecuniary remedies that are commonly available and pursued in restrictive covenant litigation, including analysis and practical guidance to practitioners on how to guide the client through this area of law.

II. METHODS OF CALCULATING DAMAGES FOR BREACH OF A COVENANT NOT TO COMPETE

1. General Rules

Arising out of the maxim that damages for breach of contract should restore the non-breaching party as nearly as possible to the position it was in prior to injury, a plaintiff's lost profits are an important measure of calculating damages in cases involving the breach of a restrictive covenant.[1] Proving such damages may be challenging, but it can be done.[2] For example, lost profit damages

[1] *See, e.g.*, *Corson v. Universal Door Sys., Inc.*, 596 So. 2d 565, 570 (Ala. 1991); *Nat'l Bank of Alaska v. J. B. L. & K. of Alaska, Inc.*, 546 P.2d 579, 590 (Alaska 1976); *Gann v. Morris*, 596 P.2d 43, 45 (Ariz. Ct. App. 1979); *Hyde v. C M Vending Co.*, 703 S.W.2d 862, 865 (Ark. 1986); *Rocky Mountain Rhino Lining, Inc. v. Rhino Linings USA, Inc.*, 37 P.3d 458 (Colo. App. 2001), *overruled on other grounds by Rhino Linings USA, Inc. v. Rocky Mountain Rhino Lining, Inc.*, 62 P.3d 142 (Colo. 2003); *Camel Invs., Inc. v. Webber*, 468 So. 2d 340, 342 (Fla. Dist. Ct. App. 1985); *Dunn v. Ward*, 670 P.2d 59, 61 (Idaho Ct. App. 1983); *Coffman v. Olson & Co.*, 906 N.E.2d 201, 210 (Ind. Ct. App. 2009); *Lenco Pro, Inc. v. Guerin*, No. 9454, 1998 WL 15936, at *1 (Mass. App. Ct. Jan. 13, 1998); *Faust v. Parrott*, 270 N.W.2d 117, 120 (Minn. 1978); *Earth Alterations, LLC v. Farrell*, 21 A.D.3d 873, 873 (N.Y. Sup. Ct. 2005); *Moses H. Cone Mem'l Health Servs. Corp. v. Triplett*, 605 S.E.2d 492, 497 (N.C. Ct. App. 2004); *Briggs v. GLA Water Mgmt.*, Nos. WD-12-062 & 063, 2014 WL 1413934, at ¶ 30 (Ohio Ct. App. 2014); *Scobell, Inc. v. Schade*, 688 A.2d 715, 719 (Pa. Super. Ct. 1997); *Baker v. Hooper*, 50 S.W.3d 463, 470 (Tenn. Ct. App. 2001); *TruGreen Cos. v. Mower Bros., Inc.*, 199 P.3d 929, 932 (Utah 2008); *Vt. Elec. Supply Co. v. Andrus*, 373 A.2d 531, 532 (Vt. 1977). Of course, lost profits may not be the correct measure of damages where the benefit conferred by the restrictive covenant is not only the retention of business but also the non-solicitation of employees. Ordinarily however, the purpose and intention of the covenant is to protect profits.

[2] *TAS Distrib. Co. v. Cummins Engine Co.*, 491 F.3d 625, 633 (7th Cir. 2007) ("Lost profits damages are difficult to recover in any case . . . ."); *Trugreen Cos. v. Mower Bros.*, No. 1:06-CV-00024, 2007 WL 1696860, at *4 (D. Utah June 8, 2007) ("The court recognizes that calculating damages in these types of cases can be extremely difficult . . . but this difficulty does not excuse TruGreen from its obligation to provide reasonably specific damages calculations

may not lend themselves to mathematical precision,[3] but can be proven with sufficient allegations and evidence presented to enable the fact finder to make a fair and reasonable finding that damages were actually suffered.[4]

a. Reasonable Certainty

Almost all jurisdictions require a plaintiff to show lost profits with reasonable certainty. The formulation of that standard differs based on the jurisdiction, but regardless of the jurisdiction, a "reasonably certain" lost profits calculation generally requires "objective facts, figures, or data from which the amount of lost profits can be ascertained."[5] The standard does *not* necessitate "exact calculation" or "accurate proof."[6] In some jurisdictions, "[w]here the fact of damages is certain, the amount of damages need not be calculated with absolute certainty."[7] Rather, the law requires only that some reasonable bases of computation be used, and the damages may be

---

for each defendant when operating under a lost profits theory of damages."); *Foreign Acad. & Cultural Exch. Servs., Inc. v. Tripon*, 715 S.E.2d 331, 336 (S.C. 2011) (Hearn, J. concurring in part and dissenting in part) ("Because proving lost profits and loss of goodwill can be difficult, only reasonable certainty, as opposed to mathematical precision, is required."); *Scobell Inc. v. Schade*, 688 A.2d 715, 719 (Pa. Super. Ct. 1997); *Rambo v. Galley*, 199 N.W.2d 14, 17 (Neb. 1972) (noting that calculating plaintiff's damages in a non-compete case is "not easily susceptible of accurate proof").

[3] *See, e.g., Brown & Brown, Inc. v. Ali,* 592 F. Supp. 2d 1009, 1049 (N.D. Ill. 2009) ("[T]he evidence shows that Starich had no intention of keeping the JPA account with Brown once Ali announced his departure. Although Ali facilitated the JPA's move in violation of his Employment Agreement, it would be speculative to conclude that absent Ali's breach, the JPA account would have stayed with Brown for an additional two years."); *Radiant Fin., Inc. v. Bagby*, No. 05-16-00268-CV, 2017 WL 2927825, at *5 (Tex. App.-Dallas July 10, 2017) (finding that conclusion that nineteen investors would have invested with Radiant instead of Paladin but for former sales representatives' violations of their respective Sales Representatives Agreements and trade secret misappropriation, would have required court "to stack assumption upon assumption," which it would not do); *AZZ Inc. v. Morgan*, 462 S.W.3d 284, 296-97 (Tex. App.-Ft. Worth 2015) (assumptions in damages model, including assumptions that employer had or would lose six customers who had signed letters of intent with competitor; that these customers would have continued to do the same amount of business for a three- or five-year future lost profits term; among others, rendered model inherently speculative).

[4] *See*, e.g., *Price-Orem Invest. Co. v Rollins, Brown & Gunnell, Inc.*, 784 P.2d 475, 478 (Utah Ct. App. 1989).

[5] *Horizon Health Corp. v. Acadia Healthcare Co., Inc.*, 520 S.W.3d 848, 859-60 (Tex. 2017); *see also Schonfeld v. Hilliard*, 218 F.3d 164, 172 (2d Cir. 2000) (requiring the "measurement" of lost profits "based upon known reliable factors without undue speculation"); *Drews Co. v. Ledwith-Wolfe Assocs*., 371 S.E.2d 532, 536 (S.C. 1988) ("The proof must pass the realm of conjecture, speculation, or opinion not founded on facts, and must consist of actual facts from which a reasonably accurate conclusion regarding the cause and the amount of the loss can be logically and rationally drawn.").

[6] *Horizon Health Corp.*, 520 S.W.3d at 859-60; *Rambo*, 199 N.W.2d at 17; *see also Aon Consulting, Inc. v. Midlands Fin. Benefits, Inc.*, 748 N.W.2d 626, 642 (Neb. 2008) ("There is no precise formula for determining lost profits, and the only requirement in Nebraska is that the calculation be supported by some financial data which would permit an estimate of the actual loss to be made with reasonable certitude and exactness"); *TruGreen Cos.*, 199 P.3d at 932 (quoting *Trilogy Network Sys., Inc. v. Johnson*, 172 P.3d 1119, 1122 (Idaho 2007)); *Delahanty v. First Pa. Bank, N.A.*, 464 A.2d 1243, 1257 (Pa. Super. Ct. 1983) (noting that a plaintiff is only required to furnish "a reasonable quantity of information from which the fact-finder may fairly estimate the amount of damages").

[7] *Sargon Enters., Inc. v. Univ. of S. Cal*., 55 Cal. 4th 747, 774 (2012).

UT LAW CLE THE UNIVERSITY OF TEXAS TEXASLAW

Find the full text of this and thousands of other resources from leading experts in dozens of legal practice areas in the UT Law CLE eLibrary (utcle.org/elibrary)

Title search: Practical Considerations for Recovering Damages in Restrictive Covenant and Misappropriation Cases

Also available as part of the eCourse
2018 Labor and Employment Law eConference

First appeared as part of the conference materials for the
25th Annual Labor and Employment Law Conference session
"Damages in Trade Secret and Non-Compete Cases"