<![endif]-->

TEXAS LAWYER

Limit Damage of Employee Defection When Crafting Noncompetes

Lizzette Palmer, Texas Lawyer

December 02, 2013

While it can be tempting to draft extremely broad noncompetition agreements in an effort to protect the company, in-house counsel must take a nuanced approach in this area of the law.

Counseling the executive team and midlevel management about technical legal issues in noncompete enforcement can be challenging. Texas prohibits restraints of trade, but it allows reasonable covenants not to compete in at-will employment. Texas Business & Commerce Code §15.50 sets enforceability criteria. The case law continues to evolve, and a case pending now at the Texas Supreme Court could provide further clarity.

Almost 20 years ago, in *Light v. Centel Cellular*, the Texas Supreme Court frustrated employers' efforts to enforce noncompetes. But, beginning with *Sheshunoff v. Johnson* (2006) and more recently with *Marsh v. Cook* (2011), the court has smoothed the way to enforceable noncompetes.

Like a cairn, *Light*'s infamous footnote No. 6 marked a seemingly simple path that many employers followed. Businesses connected their noncompetes to their at-will employees' promises to safeguard confidential information or trade secrets.

But the path of *Light* was instead the narrowest of treacherous paths. Technical arguments unfolded in lower courts. Did at-will employment render illusory any employer promise? Did the employer's promise give rise to the need for the noncompete? Was the noncompete designed to enforce the employee's promise? Was the consideration timely?

Hypercautious lawyers encouraged contemporaneous exchanges of confidential information for noncompetes. Not only did the process seem contrived, it also often happened outside a natural work context and, at times, before the employee's first day of work.

Shesunoff changed that landscape. The high court held that employers provided consideration for the

noncompete when they promised to provide confidential information and later made good on that promise.

Three years later, *Mann Frankfort v. Fielding* (2009) granted greater latitude, allowing implied employer promises to constitute consideration, if the employee's work requires using confidential information.

Then *Marsh* cleared the way for other employer promises, if they reasonably relate to an interest worthy of protection. In *Marsh*, stock-option grants supported a noncompete, by advancing legitimate employer interests, such as building and protecting goodwill.

The court in *Sheshunoff* and *Marsh* cautioned against overly technical disputes and stressed that reasonability is the hallmark of enforcement. The rule-of-reason analysis focuses on whether noncompetes are tailored reasonably for duration, geographical area and the scope of restrained activities. Noncompetes must not impose a greater restraint on employees than necessary to protect goodwill or other employer business interests.

Get Specific

While it may be tempting for in-house counsel to create overly broad noncompetes in an effort to protect the company, this may be unwise. Overbroad noncompetes shift focus during subsequent litigation away from employers' equitable claims and toward efforts that plaintiffs may portray as employer overreaching, and they extend the time and cost of proceedings.

It's true that courts must reform overbroad noncompetes, but employers can't recover money damages for breaches prior to reformation. Further, if a former employee shows that his employer knew that the covenant not to compete did not contain reasonable terms on the required criteria (time, geography and scope), he may be entitled to costs, including attorney fees, in defending against noncompete litigation.

What is an in-house counsel to do? First, ensure that noncompetes include employee promises to keep employer information confidential. Second, noncompetes only should restrain employees for a reasonable length of time, in a reasonable geographic area and from reasonably defined activities. One size does not fit all. Employers should avoid form agreements not tailored to the employment situation at hand.

In-house counsel can improve enforceability by gathering information and talking with managers. How could employees use specialized training, confidential information or trade secrets to harm the company? Those details are relevant to drafting an effective noncompete. Key details include:

• roles and responsibilities, geographic work areas and business lines;

• critical relationships;

• confidential information employees receive and efforts to protect it;

• cost, nature and duration of specialized training;

• why certain relationships, information and training are critical;

• how the covenants generate employer goodwill; and

• the time needed to meet former employees in fair competition.

Tracking all confidential information delivered to employees may not be feasible. However, employers can shore up noncompetes by documenting initial delivery of specific confidential information, writing job descriptions to require employee confidentiality, limiting access to confidential information by labeling it confidential and securing it (physically and electronically), and using monitoring software to discover improper access or use of confidential information.

Plan Ahead

Even as the Texas Supreme Court tends the landscape of noncompetes, technical arguments still arise in lower courts. In-house counsel should expect debate as to whether:

• covenants include express or implied employer promises;

• the employer delivered promised consideration;

• consideration constitutes past consideration or not consideration at all;

• information is confidential or qualifies as a trade secret;

• employers own confidential information;

• employers are proper parties to the noncompetes; and

• asset sales adequately transfer good will in support of noncompetes.

The *Marsh* concurrence and dissent question whether courts will find that other workplace benefits—such as bonuses, raises or promotions—support noncompetes. If financial incentives motivate employees to increase employer goodwill, will employers be able to buy noncompetes? For a long time, Texas courts have considered such conduct an impermissible restraint of trade. *Marsh* did not decide whether nonownership financial incentives can support noncompetes.

In *Exxon Mobil v. Drennen*, currently on appeal to the Texas Supreme Court, the parties contest whether stock grants and earnings bonus units are noncompetes because the employer canceled them due to detrimental activity: working for a competitor. Upcoming oral arguments and opinions by the court may clarify further the court's thinking on the relationship between financial incentives, goodwill and noncompetes. In the meantime, employers tying noncompetes to stock grants should be ready to detail how such agreements develop employer goodwill.

Employers can take heart that the court recognizes that reasonable noncompetes help protect the cost of developing human capital from competitors. Still, employee defection happens.

Employers should provide departing employees copies of noncompetes, reiterate expectations regarding non-competition, and obtain written confirmation that they understand and will abide by their agreements.

Likewise, employers should exercise sound judgment when buying experience in the labor market. If applicants disclose they signed noncompetes, prospective employers should proceed with caution, assessing the risk of claims, including theft of trade secrets, conspiracy to violate noncompetes and

tortious interference with at will employment. In-house counsel can provide value and mitigate risk by being mindful of the shifting ground in noncompete law and employers' rights and risks as employees with noncompetes flow in and out of organizations.