

Martin E. Thornthwaite
Partner
469.287.3958
martin.thornthwaite@strasburger.com



NON-COMPETITION AGREEMENTS: DRAFTING, LITIGATING AND RELATED ISSUES

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Overview Of Topics

Texas Non-Compete Law

- Background on Texas Non-Compete Law
- Drafting the Enforceable Non-Compete Agreement
- Litigation
 - Obtaining the TRO/Injunction
 - Preventing the TRO/Injunction



Texas Non-Competes

- In Texas, non-competes are seen as restraints on trade that are generally not enforceable
- Strict requirements govern non-competes under Tex. Bus. & Com. Code §15.50
- Historically more difficult to enforce...
- But, in late 2006, the *Sheshunoff* case and its progeny changed non-compete law by making the requirements more flexible and more likely to be enforced.



Background: The Statute

- Under Tex. Bus. & Comm. Code § 15.50(a) a non-compete is enforceable if:
- it is ancillary to or part of an otherwise enforceable agreement at the time the agreement is made;
 - sufficient consideration (e.g., training, confidential); and
 - 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 other business interest of the promisee.



Sheshunoff v. Johnson



209 S.W.3d 644 (Texas, Oct. 20, 2006)

- The Supreme Court agreed that under *Light*, the agreement was not enforceable at the time it was made because “ASM could fire Johnson after the agreement was signed, and before it provided any confidential information or specialized training...”
- The Court observed that a non-compete need only be “ancillary to or part of” the agreement when the agreement is made
 - This is one reason you want an employment agreement
 - Cannot be one-sided, it must be an agreement
- **Holding:** A covenant not to compete is enforceable even if the employer's promise is executory when made *as long as* employer later performs on his promise to provide confidential information. If the employer later performs on his promise to provide confidential information, then a unilateral contract is formed, and the non-compete is enforceable so long as the other requirements of Section 15.50(a) are met.

Sheshunoff Legacy: What did it mean?

- There is no requirement of contemporaneous exchange at the time the non-compete is made
- Employer must promise in the agreement to provide confidential information or training (during the period of employment)
- Employer must provide the confidential information or training
 - Justice Jefferson indicates that employers should beware of the “last minute agreement” (i.e. providing confidential information on the eve of an employee’s termination for the purpose of making the non-compete binding)
- There must be a return promise by the employee to keep the information confidential

Stock Options – *Marsh v. Cook*

➤ *Marsh USA Inc. v. Cook* (Tex., 2011)

- Cook resigned from Marsh about 3 years after signing a non-compete in exchange for stock options
- The stock option program gave choice employees the opportunity to become part owners of Marsh and motivate them to contribute
- Consideration for an enforceable non-compete agreement must only be (i) reasonably related to the employer's interest in (ii) protecting a legitimate interest
- Stock options are reasonably related to protection of company goodwill, and goodwill is a business interest worthy of protection under a non-compete
- *Important Dicta*: Employee Non-Solicitation subject to 15.50.

Consideration for Non-competes

- The consideration for the non-compete must be tied to the employer's reason for requesting the non-compete, such as providing.
 - the employer's confidential information and trade secrets;
or
 - specialized training
 - stock options
- What past consideration?
 - Money is not sufficient consideration.
 - Beware of including non-competes in severance agreements.



Practice Tips - Drafting the Enforceable Non-compete



➤ Non-competes require:

- Adequate consideration / justification for a non-compete
- Properly-drafted promises
- Reasonable restrictions
 - Time
 - Scope
 - Geography
- Do you have evidence supporting consideration?

Nondisclosure/Confidentiality Agreements



- Describe in reasonable detail what you consider confidential, proprietary information
- “Promise” to give access to the confidential information to the employee whether now or sometime in the future
 - **BUT SEE:** *Mann Frankfort* (Tex. 2009) – found an implied promise to provide consideration (confidential information) given the nature of the employee’s work (as a CPA), which was fulfilled by the employer at a later time
- Have the employee agree:
 - Not to disclose the information to third parties and
 - Not to use it to your competitive disadvantage



Texas Uniform Trade Secrets Act (2013)

- “Trade Secret” - Processes, programs, devices, methods, formulas, financial data, actual or potential customer or supplier lists that
 - have value because they are not generally known and are not readily ascertainable by proper means and
 - are subject of reasonable efforts to maintain their secrecy.
- In other words,
 - Information must be confidential
 - Limited access to information; employees signed confidentiality agreements



Nondisclosure/Confidentiality Agreements



- Consider whether what you are calling confidential information is in fact confidential
- In *DeSantis v. Wackenhut*, 793 S.W.2d 670 (Tex. 1990):
 - “Wackenhut also claims that it possessed confidential information that DeSantis learned the identity of Wackenhut’s customers, their special needs and requirements, and Wackenhut’s pricing policies, cost factors and bidding strategies during his employment.
 - Wackenhut failed to show that its customers could not readily be identified by someone outside its employ, that such knowledge carried some competitive advantage, or that its customers’ needs could not be ascertained simply by inquiry addressed to those customers themselves.
 - Also, Wackenhut failed to show that its pricing policies and bidding strategies were uniquely developed, or that information about its prices and bids could not, again, be obtained from the customers themselves.”

- Beware your webpage



Enforceable Non-competes

- Even if prepared by a lawyer, one size does not fit all
 - Do not use a form/generic non-compete
 - Product lifecycle in one industry may not match another
 - Reasonable scope may vary from employee to employee
 - Must match your actual business practice
- Discussion of your business practice – what do you truly treat as confidential or proprietary?
- Do you need a Non-Solicitation agreement?
 - Clients/customers?
 - Other employees?
 - Are the restrictions reasonable?

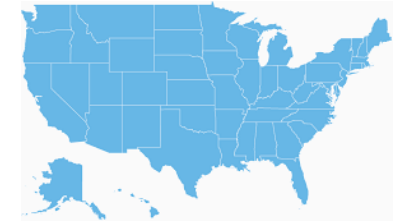




Reasonable: Duration & Scope

- Must be reasonable in scope of duration, activity restrained and geographic restriction
- Reasonable Duration/Time
 - 1 to 3 years generally enforceable. Most common is 1 or 2 years.
 - Exception: Sale of Business
 - May be longer - 5 years is typical duration; some are 7-10 years or even longer.
- Scope/Nature of Activity Being Restrained
 - Limited to the services Employee provided for the Company.
 - Limited to the clients that with whom Employee or his subordinates had direct contact or received confidential information about.
 - The industry in which the Company competes

Reasonable: Geography



- Avoid prohibiting contact with any/all company clients
- Don't claim an international or nationwide area of responsibility just because the company has that presence
- Focus on where the employee actually worked or had oversight
- Territory/County/Contiguous Counties/Radius
- Evidence
 - Sales territories
 - Job descriptions/Performance reviews
 - E-mails
 - Invoices/Expense reimbursements



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Other Tips



- Add provision that Company may obtain TRO/Injunction in state court even if there is an arbitration provision
- Include language that the non-compete will be extended during the period of breach.
- Federal Defend Trade Secrets Act Notice Provision (signed into law on May 11, 2016) – Must have in order to recover exemplary damages and attorneys' fees.
- Choice of law
 - *DeSantis v. Wackenhut* (Tex. 1990) – Held that the law regarding non-compete agreements is Texas fundamental policy; therefore, court will apply Texas law in cases regarding Texas employees and non-competes
 - **BUT:** *Exxon v. Drennen* (Tex. S. Ct. 2014) - applied New York law in stock forfeiture provision
 - *Merritt, Hawkins & Assocs., LLC v. Caporicci*, (Tex. App. -- Dallas 2016)
 - Applying law of California where employees applied for their jobs and performed most of their jobs in California despite reporting to managers in Texas.
- Reformation/Blue Pencil

Physician Non-competes Have Special Rules

- Non-Compete must include a buy-out provision based on a reasonable price
- Not deny the physician access to a list of his/her patients whom he/she had seen or treated within 1 year of termination of contract/employment
- Provide access to medical records of the physician's patients upon authorization of the patient and any copies of medical records for a reasonable fee



Best Practice Tips



- Show reasonable efforts to maintain secrecy
 - Confidentiality/non-disclosure agreements/policies acknowledged by employees
 - Right to monitor employee/no right to privacy
 - Limit access to confidential information and trade secrets
 - Encryption
 - Labeling material as confidential/trade secrets
 - Passwords/firewalls
- Document efforts and costs of compiling confidential information and trade secrets, especially customer lists

Best Practice Tips



➤ Post-Termination

- Prior to termination, surveillance of suspected employee
- After termination, immediately cut off access to company PDAs and computer system, e-mail, electronic documents and all other property
- Collect all property from employee – badges, key fobs, etc.
 - Confidential Information at home/on “the cloud”
- Send letter reminding employee of non-compete/non-solicitation and confidentiality requirements
 - Ask employee to acknowledge that all proprietary and confidential information has been returned to Company
- Review e-mails, print and computer logs to determine if employee took confidential information/trade secrets

Texas Uniform Trade Secrets Act

➤ Relief

- Injunctive Relief
 - “Actual or threatened misappropriation may be enjoined”
 - May be a permanent injunction - *Halliburton v. Axis Technologies, LLC* (Tex. App. – Dallas 2014)
- Damages
 - Actual damages/Unjust enrichment/Royalty fees
 - Exemplary damages - double damages for willful violations
- Possible Attorneys’ Fees
- Preempts Common Law Tort Claims but NOT Nondisclosure/Contractual Remedies

Federal Defend Trade Secrets Act

- Provides private civil action in federal court for misappropriation of trade secrets “if the trade secret is related to a product or service used in, or intended for use in interstate or foreign commerce.”
- Employee includes contractor or consultant
- Rejects “inevitable disclosure” doctrine
- Remedies: **Injunctive, damages and civil seizures**
 - Includes exemplary damages up to 2x the amount of actual damages awarded if the misappropriation is willful and malicious
 - Criminal Penalties: Increased from \$5 million to the greater of \$5 million or 3x the value of the stolen trade secret to the organization found guilty of trade secret theft



Best Practice Tips - Non-Compete/Trade Secret Litigation Action Plan²²



➤ Investigate - Fact Gathering and Legal Analysis

- Conducted at Direction of Counsel
- What agreements did employee sign? NDA/Non-compete
- E-mail Review, Preservation of Documents and Electronic Data/Devices, Review of Agreement(s), Social Media, Witness Interviews
- Pre-Suit Deposition, Private Investigation?
- Forensic Experts?

➤ Assessment

- Cease & Desist
- Mediation; settlement negotiation
- Litigation – Impact on business, morale, precedent, etc.
- Costs vs. Benefits
- Any potential counter-claims? (FLSA, Discrimination, Retaliation)



Obtaining the TRO

- Evidence of probability of harm
 - Description of employee's job and enforceable non-compete
 - Examples of former employee soliciting or competing with new employer
 - Lost business/sales
 - Misappropriation of trade secrets
- *Ex parte* orders
- Request for expedited discovery prior to temporary injunction hearing
 - E-discovery



Resisting TRO



24

- Show lack of irreparable injury
 - Lack of damages
 - No evidence employee in same position and contacting same customers in same territory
 - No evidence of solicitation
- Unenforceable or Overbroad non-compete/non-solicitation
 - No provision of confidential information and/or specialized training during employment.
 - No reciprocal promise by the employee to not disclose.
 - Not reasonable in terms of time, scope and/or geographic limitation.
 - No new consideration for non-compete signed in middle of employment

Application For Injunctive Relief

➤ Requirements for temporary injunction

1. A cause of action against the defendant;
2. A probable right to the relief sought; and
3. A probable, imminent and irreparable injury in the interim.

➤ TI Hearing

- Evidentiary hearing
- Make sure key witnesses are prepped and at hearing
- Make arguments quick and to the point. Emphasize strongest points.
 - Applies to briefing too.

Texas Non-Compete Law - Misconceptions ²⁶

- Non-competition agreements are not enforceable for at-will employees. FALSE.
- Employers can get their attorneys' fees for an employee's violation of a covenant to compete. FALSE.
- Non-Solicitation Agreements are not subject to Section 15.50. FALSE.



