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CLIENT ALERT ON COVENANTS NOT TO COMPETE AND NON-SOLICITATION AGREEMENTS: IT'S TIME TO REVIEW YOUR NONCOMPETE AGREEMENTS

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Is Your Covenant Not to Compete Enforceable?

Noncompete agreements are governed by state statutes and a detailed body of case law that dictates: (1) the required consideration for a covenant not to compete; (2) permissible restrictions on time and geographic scope for your employee's post-employment work with another organization; and (3) legal restrictions on your former employee's ability to solicit clients and former co-workers.

The Law on Noncompetes

In 1989 and 1993, the Texas Legislature passed and then amended the Covenants not to Compete Act ("Act") of the Texas Business and Commerce Code, Sections 15:50-52. The Act states that a covenant not to compete is enforceable if it is ancillary to or part of an otherwise enforceable agreement that contains reasonable limitations as to time, geographical area and scope of activity to be restrained and does not impose a greater restraint than is necessary to protect the employer's legitimate business interest. However, when the Act was passed and then amended, the Texas Supreme Court was hostile to covenants not to compete; and in 1994 the Court made it virtually impossible to enforce a covenant not to compete in an at will employment setting. However, by 2011 the Court reversed its course, and now non-competes are enforceable as long as they impose reasonable restraints to protect a legitimate business interest and are based upon sufficient consideration to the employee. Since 2011, Texas courts have developed the parameters of non-competes and have made it easier to draft enforceable ones.

What Makes a Noncompete Enforceable?

The Courts have defined the kinds of agreements to which non-competes can be ancillary or a part of, the consideration that will support a non-compete and reasonable restraints, including the scope of the activity restrained, the geographic area or customers covered and the temporal duration. The activity should be limited to the job the employee performed. A geographic restraint should be limited to the specific area where the employee worked or limited to the customers and prospects with whom the employee had substantial involvement. An employee can also be restricted from soliciting other employees of the employer, but should be limited to those employees with whom the employee worked. The temporal duration of the restraint must be reasonable, and periods of two years are often upheld.

With Texas being an at will employment state and with the Supreme Court's 1994 opinion making non-competes so difficult to enforce, many employers stopped using them; or, if they have them, they have not revisited them in light of the changing and developing case law.

In 2014, the Texas Supreme Court found that an agreement mandating the forfeiture of any right to restricted, unvested stock options if the employee engaged in activity that was detrimental to his employer was not a covenant not to compete covered by the Act because the employee was free to work for a competitor. Instead, the Court found the provision was one that encouraged continued employment and loyalty to the employer. At the time the shares were forfeited, they were worth \$5,000,000.00. Under prior law, the employee had a good argument that the provision was a covenant not to compete. With this change in the law, employers now have another means of incentivizing an employee to continue employment and be loyal to the employer.

What Should Employers Do?

In light of the developments in the law over the past seven years, if you have non-competition or non-solicitation agreements with your employees that have not been reviewed in several years, now would be a good time to examine your noncompete agreement.

Important Considerations Include:

- What interests, property, and information are you trying to protect?
- What restrictions on an employee post-employment best accomplish your objectives?
- Can you identify the consideration you have given that employee to support your noncompete? (Confidential or proprietary information, customer lists, trade secrets, financial projections?) This information is the key to enforcement of your agreement.
- Are the restrictions in your agreement overbroad on time, geographic scope, or on the employee's post-employment activity?

Spending a little time now shoring up your noncompete agreement form can protect your company later on.