Update on Texas Non-Competition Law

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The Basics

Brief History of Texas Non-Compete Law

- *Light*
  - At-Will employment not "otherwise enforceable"
- *Sheshunoff*
  - Employer's promise need not be cotemporaneous
- *Mann*
  - An employer's implied promise can be "ancillary"
- *Marsh*
  - Consideration is ok if it is reasonably related to business interest that the employer is seeking to protect

Statutory Requirements

- **Texas Business & Commerce Code § 15.50**
  - Ancillary to or part of an otherwise enforceable agreement
  - Contains reasonable limitations:
    - ✓ Time period
    - ✓ Geographical area
    - ✓ Scope of activity

Time and Geographic Restrictions

Time Restrictions

- **6 months is a reasonable time period.**
  - *Curtis v. Ziff Energy Group, Ltd.*, 12 S.W.3d 114 (Tex. App—Houston [14th Dist.] 1999, pet. denied).
- **Much longer time periods have been ruled reasonable by Texas courts:**
  - *AMF Tuboscope v. McBryde*, 618 S.W.2d 105, 108 (Tex. Civ. App.—Corpus Christi 1981, writ ref'd n.r.e.) ("Two to five years has repeatedly been held a reasonable time in a noncompetition agreement.").
  - *Property Tax Assocs., Inc. v. Staffeldt*, 800 S.W.2d 349, 350 (Tex. App.—El Paso 1990, writ denied) ("The courts of this state have upheld restrictions ranging from two to five years as reasonable.")

Geographic Restrictions

- **Reasonableness of geographic area depends on employee's activities.**
  - Generally, a reasonable geographic area is the territory in which the employee worked while in the employment of the employer. *Curtis v. Ziff Energy Group, Ltd.*, 12 S.W.3d 114 (Tex. App—Houston [14th Dist.] 1999, pet. denied).
  - A broad geographical scope is unenforceable, particularly when no evidence establishes the employee actually worked in all areas covered by the covenant. *Evan's World Travel, Inc. v. Adams*, 978 S.W.2d 225 (Tex. App.—Texarkana 1998, no pet.) (reforming covenant not to compete to apply only in county in which former employee worked).
  - Courts will also look at the type of company and determine if geographic scope is reasonable. *Weed Eater, Inc. v. Dowling*, 562 S.W.2d 898 (Tex. Civ. App.—Houston [1st Dist.] 1978, writ ref'd n.r.e.).
  - *Spirent* case – Sold to customers throughout the United States. Nationwide accounts.

Scope of Activity Restrictions

Scope-of-Activity Restrictions

- Not as much case law on these types of restrictions
- Start with the statute:
  - The restriction must be "reasonable" and must "not impose a greater restraint than is necessary to protect the goodwill or other business interest of the promisee."

Tex. Bus. & Com. Code § 15.50(a).

Scope-of-Activity Restrictions

- A couple of general principles:
  - ✓ The covenant must bear some relation to the activities of the employee.

    Weatherford Oil Tool Co. v. Campbell, 340 S.W.2d 950, 952 (Tex. 1960).

  - ✓ An industry-wide exclusion is unreasonable.

    John R. Ray & Sons, Inc. v. Stroman, 923 S.W.2d 80, 85 (Tex. App.—Houston [14th Dist.] 1996, writ denied).

Scope-of-Activity Restrictions

- Three basic types of scope-of-activity restrictions:

1) Those that prohibit the employee from soliciting the employer's customers

2) Those that prohibit the employee from engaging in competitive business

3) Those that contain some combination of Type 1 and Type 2

Example of Type 1

Employer	Employee
Accounting firm	Partner

- Two accounting firms merged.
- Merger agreement contained a non-compete clause, which provided that any partner who left the firm and, during the 2 years thereafter, "solicit[ed] or furnish[ed] accounting or related services to Firm clients" would have to pay liquidated damages to the Firm.
- Partner resigned and opened a new accounting firm; clients followed.
- ***Result → Unreasonable restriction***

Peat Marwick Main & Co. v. Haass, 818 S.W.2d 381 (Tex. 1991).

Example of Type 1

Employer	Employee
Insurance brokerage company	Insurance broker

- Employee resigned to join direct competitor of Employer.
- Non-compete prohibited employee, for a period of 2 years, from soliciting or working for any customer of Employer "for which he performed any [work] during the two-year period immediately preceding [his] termination."
- ***Result → Reasonable restriction***

Gallagher Healthcare Ins. Servs. v. Vogelsang, 312 S.W.3d 640 (Tex. App.—Houston [1st Dist.] 2010, pet. denied).

Example of Type 2

Employer	Employee
TransPerfect, a $200 million-per-year translation firm with more than 50 offices worldwide	High-level salesperson focusing on e-Learning

- Employee resigned to join direct competitor of TransPerfect.
- Non-compete prohibited Employee from "competing with TransPerfect 'in any activities' in all of states and countries in which TransPerfect maintains offices…in all of its business areas" for 1 year.
- ***Result → Unreasonable restriction***

Transperfect Translations v. Leslie, 594 F. Supp. 2d 742 (S.D. Tex. 2009)

Example of Type 2

Employer	Employee
90% manufacture and installation of shower stalls and mirrors; 10% reglazing	Operations Manager

- Employee resigned to start his own reglazing business.
- Non-compete prohibited Employee from engaging in "a business that is in competition with [Employer]" in seven counties within the Houston metropolitan area, and in any other area where Employer began doing business during the term of Employee's employment, for 2 years.
- ***Result → Restriction reformed by trial court***

Butler v. Arrow Mirror & Glass, Inc., 51 S.W.3d 787 (Tex. App.—Houston [1st Dist.] 2001, no pet.)

Example of Type 3

Employer	Employee
Manufacturer and distributor of dog grooming products	VP of Sales and Education Director (former pet handler and groomer)

- Employee resigned to join direct competitor of Employer.
- Non-compete prohibited Employee from soliciting "any clients or accounts with whom the Employee had direct contact at any time during [his] employment", and from working for any company "engaged in providing or manufacturing pet supplies and related products manufactured and distributed by [Employer]."
- ***Result → Reasonable restriction***

Salas v. Chris Christensen Systems, Inc., No. 10-11-00107-CV, 2011 WL 4089999 (Tex. App.—Waco Sept. 14, 2011, no pet.)

Scope-of-Activity Restrictions: What's the Bottom Line?

- ***If your client wants to prohibit an employee from soliciting customers after he/she leaves….***
  - Limit the non-compete agreement to customers with whom the employee had contact during his/her employment.
- ***If your client wants to prohibit an employee from engaging in competitive business….***
  - If your client engages in a single, narrow type of business, a wholesale restriction is more likely to pass muster.
  - If the client engages in a number of different types of business, limit the non-compete agreement to the specific type of business in which the employee worked.

The Inevitable Disclosure Doctrine

The Inevitable Disclosure Doctrine

- Setting the scene—typical facts when doctrine is at issue.

- Doctrine is based on the notion that no matter how good an employee's intentions are, it is impossible to compartmentalize the knowledge or experience gained from prior employment. Thus, ***it is unavoidable that the employee will disclose the information if required to do same/similar tasks for new employer.***

History of the Doctrine

- *PepsiCo v. Redmond*, 54 F.3d 1262 (7th Cir. 1995) set the landscape and triggered wide prominence of the doctrine.
  - Applied the Doctrine to a non-technical employee working in a non-technical field;
  - Upheld an injunction preventing an employee from taking a position for a period of time, rather than enjoining merely the disclosure of trade secrets; and
  - Upheld an injunction where former employee had not signed a covenant-not-to-compete;

Application of the Doctrine in Texas

- Alluded to in several opinions; however, still unclear whether the majority of Texas courts are willing to embrace it.
- Texas continues to follow the Restatement of Torts' concept that a trade secret is not misappropriated until it is ***actually used***. This is inherently in conflict with the doctrine.
- There are multiple Texas opinions that can be relied on collectively to make a good faith argument for the application of the doctrine.

Texas Authority

- *Rugen v. Interactive Bus. Sys.*, 864 S.W.2d 552 (Tex. App.—Dallas 1993, no pet.), "the Defendant in possession of [Plaintiff's] confidential information and is in position to use it. Under these circumstances, ***it is probable*** [Defendant] will use the information for her benefit and to the detriment of [Plaintiff]."
- *TNT Motorsports, Inc. v. Hennessey Motorsports, Inc.*, 965 S.W.2d 18 (Tex. App.—Houston [1st Dist.] 1998, pet. dism'd), "[Defendants] possess [Plaintiff's] confidential information and are in a position to use it to compete directly with [Plaintiff]" despite the absence of a non-compete or confidentiality agreement.
- ***Unlike PepsiCo, these cases the courts made actual finding that former employees had possession of trade secrets, were in direct competition with former employees, and were in a position to use the trade secrets.***

Recent Interpretations/Application of Doctrine

- *Cardinal Health Staffing Network, Inc. v. Bowen*, 106 S.W.3d 230 (Tex. App.—Houston [1st Dist.] 2003, no pet.), "…it is unclear to what extent Texas courts might adopt it or might view it as relieving an injunction applicant from showing irreparable injury." Of significance was the Court's recognition and discussion of the doctrine (Dallas Court of Appeals' variation) without a decision on whether to ultimately accept/decline the doctrine.
- *Baker Petrolite Corp. v. Spicer*, 2006 WL 1751786 (S.D. Tex. June 20, 2006), found covenant-not-to-compete was unenforceable but upheld injunction. Did not use the phrase "inevitable disclosure" but essentially applied the doctrine.
- *M-I, LLC v. Stelly*, 2009 WL 2355498 (S.D. Tex. July 30, 2009), declined to apply the doctrine considering open question found in *Cardinal Health* and the fact Plaintiff failed to show it took/had any confidential information.

Important Factors to Consider

- Comparisons between employee's old and new jobs and between old and new company. Must determine whether employee is taking a job with a company that produces same products/services, for the same market, and the employee's new role is identical to previous.
- Whether the information at issue qualifies as a trade secret, that it is both a source of the former company's competitive advantage and would be extremely beneficial to the new employer.
- Doctrine is not a mystical doctrine or absolute rule of law. Just a limited extension of existing law protecting against disclosure of trade secrets and its applicability should depend on the facts of the cast at issue.

DRAFTING NON-COMPETE AGREEMENTS

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Drafting Non-Compete Agreements

- *Light* – "At-will" employment is not an otherwise enforceable agreement

- Provision of confidential information or specialized training can be an otherwise enforceable agreement
  - Non-compete becomes enforceable at the point the information or training is actually given

Drafting Non-Compete Agreements

Primary Consideration:

What is the business interest being protected

vs.

No indentured servitude

Drafting Non-Compete Agreements

- It is the employer's burden to show a legitimate business interest that needs protection

AND

- It is the employer's burden to show that a non-compete is a reasonable way to protect that interest

Drafting Non-Compete Agreements: Protectable Business Interest

- Confidential Information
  - Must truly be confidential (not known to the public or the industry)
    - ✓ Pricing lists
    - ✓ Customer lists
- Specialized Training
- Unique formulas/processes
- Goodwill

Drafting Non-Compete Agreements: Protectable Business Interest

- Courts will consider *how* the individual obtained the confidential or protectable information!

Drafting Non-Compete Agreements: Reasonableness

- There is a reasonable relationship between the time period, geographical scope, and business interest

Time Period:	***Geographical Scope:***
• Staleness • Loss of value • Public domain • Patents	• What was the employee doing? • How was the employee using the consideration given by the employer?

A Final Comment

- Non-solicitation/Non-Disclosure
  - Court can review under Tex. Bus. & Com. Code § 15.50

THANK YOU!