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## Covenants Not to Compete

### Who, What, Why . . .

*Who does it apply to:* Any employer who fears its employees might go out and start a competing business or work for a competitor and share the employer's secrets.

*What is a "covenant not to compete":* Non-competes, also known as non-competition agreements, are a specially designed type of contract creating an obligation with current and former employees not to go into competition with your business within a certain geographic area for a certain period of time.

*Are non-compete agreements legal:* Several years ago non-compete agreements were on the verge of extinction. The way the Texas Supreme Court interpreted the law made it almost impossible for an employer to successfully create a non-compete that a court would uphold. Then, in 2006, the Court did an about-face pushing covenants not to compete back into the limelight and making them enforceable again.

*How long can I prevent a former employee from competing:* Generally, Texas courts will uphold non-compete agreements up to two years, but the court will examine the time to determine whether it is reasonable in the particular situation. It is best to get it right the first time, but the court can adjust it and leave the non-compete in place if the time you choose is determined unreasonable.

*How wide of an area can I prevent competition in:* The appropriate geographic scope depends largely on the area in which it is reasonably necessary to prevent competition. If you have an employee who works nationally, you will have a hard time getting a Texas court to send him to Canada to make a living. In that case, you should look at only restricting the former employee from soliciting existing customers of your business wherever he lands a new job. If your business draws customers from a 10 mile area, that is what the geographic area should be. Like the timeframe, the geographic area can be adjusted by a court and the agreement may still be enforced.

*What do I have to give my employee in exchange for the non-compete:* You have to give the employee something that is worthy of preventing them from competing with you. Examples

that are acceptable include sharing trade secrets (see last month's EH piece), confidential information, and/or specialized training. As much as some employers might like to do so, you cannot buy an employee's agreement not to compete.

*Can I have a non-compete with an "at-will" employee:* At-will employees are those you can fire anytime you like and that can quit anytime they want. While it is somewhat more difficult to make a non-compete agreement with an at-will employee as opposed to a term contract employee, it can be done.

*What does the agreement look like:* Unless the non-compete is part of a term contract with an employee, it will usually be the subject of a specialized stand alone contract. In the agreement, the employer promises to provide the employee with secrets and training, etc., and the employee promises in turn not to compete after leaving the company for a period of time. You and the employee can negotiate the geographic area and length of prohibition in the agreement. Non-compete agreements are usually drafted by an attorney because courts are so picky about enforcing them (even after the Supreme Court's change of position).

### Common Situations:

*Fired employee:* After 15 years of loyal service, Joe Sixpack is fired from his job. He begins looking for a new position, but is asked by many prospective employers whether he has a non-compete with his former employer. Joe explains that he does not, thinking that the non-compete that he signed is unenforceable because he was fired. Is he right? No. Covenants not to compete are enforceable even if the employee is fired. Think about it. If firing an employee would invalidate the non-compete, anyone who wanted to get out of their non-compete could just steal money to get out of it.

*New hire:* Sara's Soda Company is hiring a new sales representative for its Texas region. After interviewing several candidates, Sara decides on hiring Genie, who formerly worked for another regional bottler who knows the businesses in the area and can start making sales to new customers right away. Shortly after Genie begins making calls, Sara is served with a lawsuit from Genie's former employer in which Genie has been

sued for violating a non-compete and Sara has been sued for “tortious interference with a contract”. Sara is incensed. What has she done wrong? Sara should ultimately be able to extricate herself from the lawsuit – if she can prove she didn’t know about Genie’s non-compete. That said, Sara will incur legal fees to get out and will probably have to fire Genie, thus incurring a loss for the time she has invested. Employers need to be careful to ask if prospective employees have a non-compete with their former employers to avoid these hassles.

*New non-compete – Existing employees:* So you’ve now read my non-compete piece and you have decided to have a non-compete written for your employees. As part of creating a valid non-compete, you are supposed to provide the employee with secrets or training, but your existing employees already have all of your customer lists and access to your other trade secrets. Will the non-competition agreement be enforceable? It depends. If the employee receives new secrets or training, the non-compete will become enforceable when the employees receive the information. I often advise employers to try to roll out a non-compete near the time they are providing some new training to try to reinforce that the non-compete will be enforceable.

*No more secrets:* Tommy Tactical runs a private investigative firm. He was already suspicious of every employee that works for him and keeps everything about his business on a “need to know” basis. After reading last month’s EH piece on Trade Secrets and Confidentiality, Tommy has withdrawn even more, keeping every possible piece of information about his company locked up like the formula to a certain soft drink. Seeking even additional protection after reading this piece, Tommy has all of his employees – down to the copy boy – sign a non-competition agreement. As an employee leaves, he is quick to jump on

them with a lawsuit after they start with a competitive company. Tommy has just one problem. He has worked so hard not to share the secrets of his business with his employees, that he has invalidated the non-compete. For a non-compete to be justified and to prevent someone from working in a competitive business, courts have to see that the person poses a risk to your business. If you keep all the secrets there will be no justification. Another situation where this particular example comes up is with new hires that quickly are let go or quit. Courts are reluctant to enforce the non-compete because the new hire didn’t learn anything or so little that the prohibition is not justified.

### **What should I do:**

*Good:* I’m not sure this qualifies as “good” but you can try to draft your own non-compete agreement. Make sure to cover the length of time, the geographic area, the type of secrets you are promising to provide, and the scope of the employee’s promise not to engage in competition.

*Better:* Use your attorney to draft a bare-bones non-compete for the employees you feel are most risky to you and have the employees execute the agreements. Be careful, you might have the employee quit instead of signing it.

*Best:* Prepare a solid non-compete agreement with your attorney and include: (1) a non-solicitation of customers provision; (2) non-disclosure provision; (3) non-solicitation of employees away from the company after leaving; and (5) corporate opportunity provision.



Michael Kelsheimer focuses his practice on the employment law needs of Texas businesses and executive employees. He recognizes that the cost and expense of litigation make resolving employment disputes challenging. To help avoid these concerns, he utilizes his experience in and out of the courtroom to prevent or quickly resolve employment disputes through proactive employer planning and timely advice. When a dispute cannot be avoided, Michael relies upon his prior experience as a briefing attorney for the United States District Court and his extensive experience in employment and commercial lawsuits to secure favorable resolutions for his clients.

This guide is one in a series. For more information, or to receive the entire collection contact Michael Kelsheimer by email at [mkelsheimer@grayreed.com](mailto:mkelsheimer@grayreed.com) or by phone at **469.320.6063**