

## **PROTECTING CORPORATE ASSETS AND THE USE OF EMPLOYMENT AGREEMENTS**

### **I. Employment Contracts**

Texas recognizes two distinct forms of employment. Employment agreements that have a definite or ascertainable time period are commonly referred to as “term” employment relationships. If the contract does not prescribe a specific period of time the employment is deemed to be “at will.”

#### **A. Term Employment**

An employer may choose a “term” employment arrangement for higher-level employees to ensure stability and continuity throughout the company. Because the contract often provides that removal may be “for cause” only, the employee will remain in the position unless the termination is justified because of poor performance or some other identified reason affecting job performance. The primary disadvantage to this type of arrangement is that many employers feel the need to gather evidence against the employee to ensure that when the employee is dismissed, there is ample support for the dismissal. While this may be a worthwhile task for higher-level employees, it can be tedious and bind the employer to continue the employment relationship even when an employee is not performing as expected or is simply not fitting into the workplace environment.

#### **B. Employment at Will**

The “employment at will” doctrine has governed employment relationships in Texas for more than a century. The doctrine provides that any such employment relationship is terminable at any time by either the employer or the employee for any reason or no reason at all. The employment will be considered at will unless there is a specific agreement, either oral or written, limiting the employer’s ability to terminate the employment.

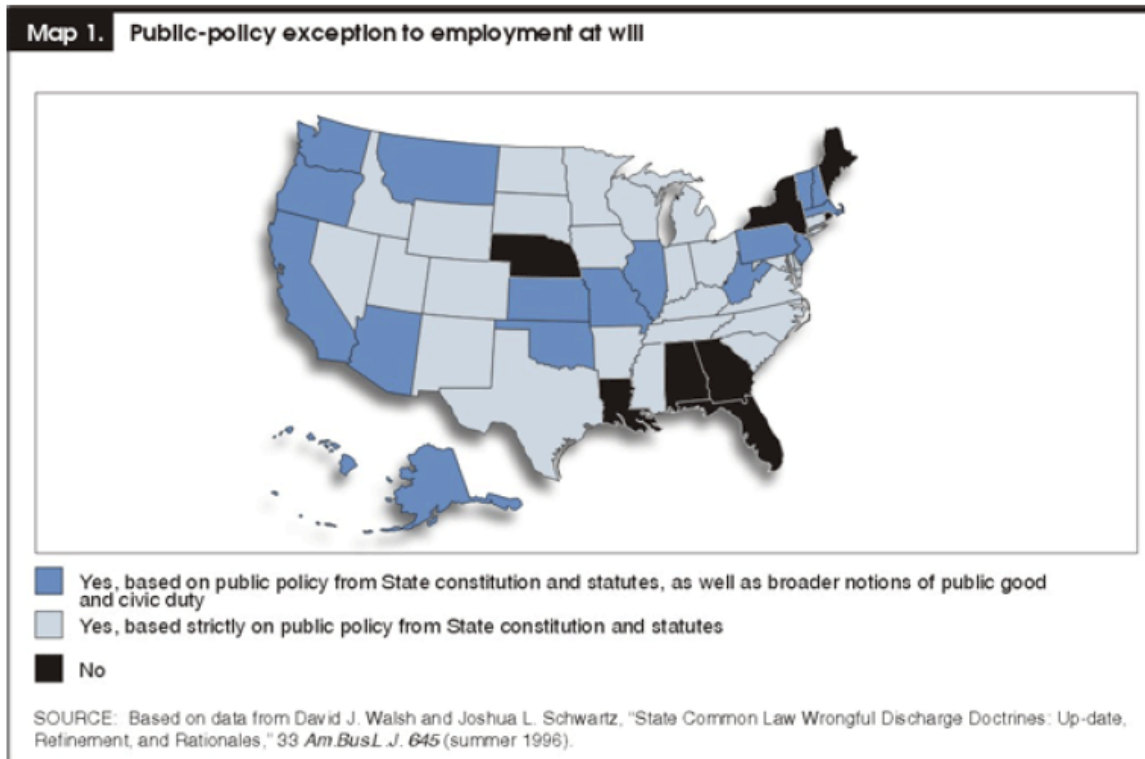
The at will presumption exists to preserve the employer’s need to make difficult managerial decisions vital to the effective operation of a business organization without unnecessary interference. It grants the employer the latitude to fill open positions as the employer sees fit and to make necessary changes quickly and efficiently without the need for costly contract buyouts and potential litigation due to contract termination. Additionally, the at will doctrine is beneficial for the employee because it allows them to pursue other options if they are unsatisfied with their current position.

This type of agreement provides a great deal of flexibility to both parties, and from an employer’s perspective, increases efficiency in the decision making process. One Texas appellate court articulated the effect of the employment at will doctrine, “observing that in the absence of an applicable statutory or judicially-created exception, an at will employee may be terminated for a good reason, a bad reason, or no reason.”<sup>1</sup>

As an employer, it is imperative to understand that the principles of at will employment are by no means absolute. For example, as illustrated by *Map 1* below, forty-three states, including Texas, recognize public policy as an exception to the at will doctrine.<sup>2</sup> Under the public policy exception, an employer may not fire an employee if it would violate the state’s public policy or a state or federal statute. Similarly, most states specifically prohibit an employer from terminating an employee for filing a worker’s compensation claim after being injured on the job or for refusing to break the law at the request of the employer. Texas narrowly tailors its public policy exceptions to two primary areas: (1) prohibition of discriminatory employment practices; and (2) prohibition against dismissal when the employee engages in a specific activity, such as jury duty, union involvement

<sup>1</sup> *Urdiales v. Concord Tech. Del., Inc.*, 120 S.W.3d 400, 407 (Tex. App.—Houston [14th Dist.] 2003, pet. denied).

<sup>2</sup>



or political activity. These narrow exceptions further demonstrate Texas's strong commitment to the employment at will doctrine.

An employment relationship may be modified at any time through either oral or written modifications. A written modification results when an employee establishes that he and his employer had a contract or agreement specifically prohibiting the employer's right to terminate at will. Likewise, the agreement may be modified orally, which can often be harder to prove and, without careful guidance, the employer may inadvertently modify the employment relationship orally. For example, a common type of oral modification results when an employer makes oral assurances to an employee that the employee will be terminated only for good cause or as long as his work remains satisfactory. Thus, a comment such as "you won't be fired as long as you keep up the good work" may be deemed an oral assurance that could limit the employer's right to terminate the employment relationship. However, absent such a modification, the employment will continue at will without restrictions as to termination.

## **II. Restrictive Employment Contracts**

Regardless of whether the employee relationship is considered at will or term, the employer and employee may enter into an additional contract that does not affect the employer's ability to terminate the employment. Such provisions may include protection of the company's trade secrets, market share, corporate goodwill, customer information and other privileged information unique to the company. In order to protect this type of information, the company may wish to contract with its employees in the following ways:

### **A. Non-Compete Agreements**

In addition to protecting business goodwill and other confidential or proprietary information, companies use non-compete agreements to deter competition from former employees and discourage employees from job hopping. Texas law has recently changed to allow greater freedom for an employer to contract with its employees to restrict future employment through a non-compete agreement, also known as a covenant not to compete. Generally, a non-compete agreement is a contractual provision in which one party agrees to refrain from conducting business similar to that of the other party.

Non-compete agreements must be carefully drafted to be narrowly focused to achieve the employer's goals without improperly impeding the former employee's ability to obtain future employment. The restraint on competition must be only as much as necessary to protect the employer's rights. In drafting a non-compete agreement, it is important to consider the reasonableness of the duration and

geographic territory of the agreement, whether the scope of activities that the employee cannot perform will be considered to be overly-broad, and whether the agreement is otherwise enforceable.

- **An otherwise enforceable agreement must exist**

Both the employer and the employee must make binding promises for the non-compete agreement to be enforced. Usually, employee promises such as not to disclose confidential information are binding promises and, thus, not an issue. The more often litigated issue is whether the employer has made a binding promise to the employee; especially in at will employment situations. Usually, the employer's promise of at will employment is not binding. Because the employee may be fired at any time, the promise is viewed by courts as meaningless, or "illusory." However, in a term employment situation, this is not the case. Also, if the employer promises to give the employee a thirty-day notice before termination, this will often suffice.

If there is no binding promise between the employer and employee, an otherwise enforceable agreement may still exist if the employer has given something of value or "consideration" in return for the employee's promise not to compete. Such consideration includes confidential information or specialized training. After the Texas Supreme Court's opinion in the *Sheshunoff* case, a promise to do something for an at will employee at a future date (pay bonuses, stock options, etc.) can create an enforceable contract as well.<sup>3</sup> However, that contract would not effectuate until after the employer makes good on the promise. But once an at will employee receives the consideration promised by the employer, an otherwise enforceable contract exists. It is important to note that past consideration is not sufficient. If the only consideration given to the employee was given before the non-compete agreement was made, an otherwise enforceable contract will not exist. After the *Sheshunoff* ruling, a delay between the employee making the agreement and his receipt of the consideration will not void the agreement, but the agreement is still not effective until the employee receives the consideration.

If the agreement is based on an otherwise enforceable contract, the next question is whether the agreement was "ancillary" to the otherwise enforceable agreement; that is, it was reasonable at the time it was made.

- **Restriction must be reasonable in scope, time and geographic territory**

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<sup>3</sup> *Alex Sheshunoff Mgmt. Servs., L.P. v. Johnson*, 124 S.W.3d 678 (Tex. 2006).

To be enforced, the provision should be tailored to the employee's activities with the company. For example, an employer could restrict its former salesman from selling similar products for a competitor to the employer's customers, especially those customers with whom the salesman interacted; however, the agreement could not generally prohibit the salesman from selling *any* products in that industry. Similarly that same salesman might be restricted from selling similar products in Houston, but not from doing so in Austin. Typically, enforceable agreements are for one or two years but agreements of even five years have been held as valid in some circumstances. If the agreement not to compete is part of the sale of a business, the term could be even longer.

If a court finds that the agreement was unreasonable in scope, time or territory, it may still uphold the non-compete agreement while simply reforming the unreasonable provision.

- **Remedies**

Most courts allow an employer to obtain a temporary injunction against a former employee who is in violation of their non-compete agreement. This is granted if the employer can show that, without the injunction, the employer will suffer irreparable harm. This is usually proven when the employer can show that the magnitude of the harm is so hard to quantify or unique that money damages alone will not compensate the employer for their damages. Irreparable harm can also be shown by proving that a highly-trained former employee has or is continually breaching the non-compete agreement.

Lost profits resulting from the breach of the agreement can also be awarded in the form of money damages to the employer. However, if the agreement contains a liquidation provision, a pre-determined amount the employee must pay for any breach, the provision must be a reasonable forecast of the actual damages which would be suffered as a result.

If the former employee can prove in court that the scope of the agreement was too broad, they may also be eligible to recover their attorney's fees from the employer. Texas courts conflict with regards to whether an employer may recover the same if it successfully prosecutes a breach against the former employee.

## **B. Non-Solicitation Agreements**

Another type of non-compete agreement is a non-solicitation agreement. In addition to disclosing an employer's confidential information, which is unlawful, solicitation of its customers, clients and employees by a former employee is considered fair competition and, therefore, lawful. An exception to this general

rule is when the employer and employee have a non-solicitation agreement. Like a non-compete agreement, the scope of a non-solicitation agreement must also be reasonable.

A non-solicitation agreement is treated the same as a non-compete agreement in terms of enforceability. Therefore, the agreement must be reasonable with respect to the duration, geographic territory and the scope of activities that the employee cannot perform and the agreement must be otherwise enforceable. Specifically, a provision which prohibits the former employee from soliciting any of the employer's customers would likely be considered overbroad and either reformed or struck down by the court. However, a provision which prohibits the former employee from soliciting the employer's customers with whom he personally dealt would likely be enforced.

Solicitation of customers, clients, or employees is difficult to prove and the former employer should be cognizant of this fact. The departing employee usually claims that the customers, clients or employees contacted him and not the other way around. Further, the customers, clients or employees usually side with the former employee. Before filing suit for breach of a non-solicitation agreement, an employer should be confident that it can prove the solicitation occurred. Also, in these cases, counterclaims by the former employee of harassment, unpaid wages, etc, are common.

To avoid a suit for tortious interference with a contract or misappropriation of trade secrets, an employer should make sure, to the extent possible, that any employee it hires is not a party to a non-disclosure or non-compete agreement which might apply to the job for which the employee is being hired.

### **C. Non-Disclosure Agreements & Trade Secrets**

Another important contract provision that a company should consider is the non-disclosure of confidential information or trade secrets, especially when a technology company is involved. Although Texas common law imposes a duty of non-disclosure, a company should include a contract provision outlining the specifics of the employee's duty to refrain from releasing sensitive information. This may include customer lists, specific product support or any other unique attribute of the company.

Additionally, when seeking to protect information, the company should set up policies and procedures demonstrating an intention to keep the information confidential. For example, the company should keep an inventory of the information that is disseminated, make sure the information is collected when the employee leaves the company, and restrict access to the confidential information

from employees who have not executed non-disclosure agreements. Since a non-disclosure agreement is different from a non-compete agreement, the enforceability requirements applicable to non-compete agreements do not apply.

There are many additional contractual provisions that should be evaluated when hiring new employees; however, the foundation of any such agreement will be the non-compete and non-disclosure of confidential information agreements. More detailed and specific information is needed to fully evaluate the type of contractual provisions that are important and necessary for each company.