

Texas Supreme Court Eases the Requirements on Covenants Not to Compete

On October 20, 2006, the Supreme Court of Texas revisited and revised its landmark ruling in *Light v. Centel Cellular Co.*, 883 S.W.2d 642 (Tex. 1994), the seminal case concerning covenants not to compete in Texas. In *Alex Sheshunoff Management Services, L.P. v. Johnson*,¹ the Court held that an at-will employee's promise not to disclose confidential information became an enforceable agreement to support a non-compete covenant when his employer later performed its corresponding promise to provide training and access to confidential information. By reaching this decision, the Court removed its *Light*-imposed requirement that the agreement containing the covenant had to be enforceable the *instant* the agreement was made.

Under the Texas Non-Compete Act,² a covenant is enforceable if it (a) is ancillary to or part of an otherwise enforceable agreement, and (b) contains reasonable limitations on the time, geographical area, and scope of the activity to be restrained, which do not impose a greater restraint than necessary to protect the employer's goodwill or business interest. To be "ancillary" to an "otherwise enforceable agreement," the consideration typically consists of an employer's promise to provide an employee confidential information, which makes the non-compete covenant necessary to enforce the employee's return promise not to disclose the confidential documents or materials.

In *Sheshunoff*, an employer required a four-year, at-will employee, several months after being promoted, to sign an employment agreement containing a covenant not to compete. In the covenant, the employee agreed that, for one year after his termination, he would not: (1) provide services to any of the employer's clients to whom the employee had provided services or conducted significant sales activity within the last year of his employment (without geographical limitation); and (2) solicit or aid any other party in soliciting the employer's clients or prospective clients. The covenant was ancillary to a confidentiality/non-disclosure agreement in which the employer agreed to provide the employee with confidential information and special training regarding its business methods and, in turn, the employee agreed not to disclose the confidential information. After the employee signed the agreement, the employer *later* provided the employee with the confidential information and training on an on-going basis.

Subsequently, the employee resigned and went to work for a competitor, and the employer sued the employee to enforce the restrictive covenant. The trial and appellate courts determined, relying on *Light*, that the confidentiality/non-disclosure provision was not "an otherwise enforceable" agreement because the employer did not make a promise that was enforceable *at the time* the parties entered into the agreement. The employer appealed the ruling to the Supreme Court of Texas.

Based on *Light*, a split among the Texas appellate courts developed concerning what promises between the employer and employee are sufficient to create an "otherwise enforceable agreement." The majority viewpoint has been that the "otherwise enforceable agreement" cannot be dependent on any future performance. Instead, the agreement must be enforceable "at the time the agreement is made." The *Sheshunoff* Court resolved this post-*Light* confusion. Initially, the Supreme Court agreed that, under *Light*, the employer's promise to provide confidential information and training was not enforceable at the time the confidentiality/non-disclosure agreement was made. Rather, the employer could have

¹ No. 03-1050, ___ S.W.3d __ (Tex. Oct. 20, 2006).

² TEX. BUS. & COM. CODE § 15.50.

terminated Sheshunoff's at-will employment *before* it provided the confidential information and training, which made the employer's promise illusory at that point in time. Under the reasoning in *Light*, the non-compete was unenforceable because the promise giving rise to the employer's interest in restraining the employee from competing (providing confidential information) was not enforceable at the time the agreement was made. However, in *Sheshunoff*, the Court departed from this view of Texas non-compete law.

The Court observed that the Covenant Not to Compete Act's core inquiry is whether a covenant "contains limitations as to time, geographical area, and the 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 promise." Therefore, the Court explained that "overly technical disputes" regarding whether a covenant is ancillary to an otherwise enforceable agreement have obscured this "core inquiry." One such "technical dispute" was the prevailing viewpoint that the "otherwise enforceable agreement" promises had to be binding and enforceable at the moment the agreement was made. Accordingly, in rejecting this viewpoint, the Texas Supreme Court concluded that a covenant not to compete is enforceable if: (1) it is part of, or ancillary to, an agreement that contains a promise giving rise to the employer's interest in restraining the employee from competing; (2) the employer then makes good on its promise and delivers the confidential information or specialized training; and (3) the covenant not to compete contains reasonable limitations as to time, geographical area, and scope of activity to be restrained. Based on this test, the Texas Supreme Court reversed and remanded, explaining that Sheshunoff's agreement became enforceable when the employer later performed its promise by providing him with confidential information and training.

The Court further rejected the employee's arguments that the covenant was overbroad because, among other things, the restriction on solicitation of certain clients and prospective clients was unrelated to any training or confidential information he received after he entered into the employment agreement. The Court disagreed. In Sheshunoff's position, he continued to develop clients after he executed the agreement and was privy to on-going confidential information relevant to competing with his employer.

Based on *Sheshunoff*, employers are no longer required to contemporaneously provide an employee confidential information and training when the employee signs an agreement containing a covenant not to compete. However, the *Sheshunoff* case is not expected to end litigation over such restraints. Rather, the Supreme Court shifted the focus to analyzing disputes over whether a covenant is ancillary to an otherwise enforceable agreement within the broader context of "whether and to what event a restraint on competition is justified." Thus, employers should consider reviewing with counsel their existing non-compete agreements to assess their enforceability in light of these new standards announced by the Court.

If you have any questions regarding the foregoing, please feel free to contact one of the attorneys listed below.

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