McGLINCHEY STAFFORD

A Second Look at Non-Competes

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Executive Summary
In a recent decision the Texas Supreme Court has made covenants not to compete much more enforceable. In Texas, employers no longer must provide valuable consideration to their employees at the very instant of signing the agreement. Rather, the Supreme Court has emphasized that covenants not to compete are enforceable as long as they are reasonable with regard to geography, time and scope. This represents a major shift in this area of the law.

Analysis
Texas law regarding covenants not to compete has significantly changed. Texas has long been thought to be one of the most difficult states in which to enforce covenants not to compete. The Texas Supreme Court in Alex Sheshunoff Mgmt. Servs., L.P. v. Kenneth Johnson and Strunk & Assocs., L.P., No. 03-1050, Slip. op. (Tex. Oct. 20, 2006) has altered this thinking by holding:

> Today we modify our holding in Light[1] and hold that an at-will employee's non-compete covenant becomes enforceable when the employer performs the promises it made in exchange for the covenant. In so holding, we disagree with language in Light stating that the Covenant Not To Compete Act[2] requires the agreement containing the covenant to be enforceable the instant the agreement is made.

Thus, the Texas Supreme Court has removed one of the greatest barriers to the enforcement of covenants not to compete – that consideration must be given to the employee the instant the agreement is signed.

Most businesses provide consideration to at-will employees over time. Whether it is training, access to trade secret information, or participation in developing good will, these things are not handed in bulk to employees at the moment of signing the agreement. Defendants inevitably seek to have a covenant declared unenforceable under Light because the exchange of this consideration by the employer in an at-will employee situation is not instantaneous. Employees' attorneys then argue that the employers' consideration' per Light is illusory. Sheshunoff eliminates this defense.

The benefits to employers of the Sheshunoff decision do not end with the holding that consideration may be provided over time. The Sheshunoff decision carefully goes through the legislative history of the Covenant Not To Compete Act and notes that, "the Act was passed to expand the enforceability of covenants not to compete."[3] The court states that, "the legislative history also indicates that one of the primary purposes of one of the amendments to the Covenant Not To Compete Act was to make clear that covenants not to compete were applicable to at-will employment situations and that the statute prevailed over contrary common law."[4] The court summarizes its review of the legislative history by stating:

- The 1989 and 1993 legislative initiatives sought to expand the enforceability of covenants not to compete.
- Covenants could be signed after the employment relationship began so long as there was new consideration.
- Covenants not to compete would apply in at-will employment situations.

One of the two concurring opinions in the case offer caution with regard to when the additional consideration must be supplied. In the first concurrence, the three justices who write the concurrence state that the time within which this additional consideration must be supplied after signing the agreement must be "reasonable."[5] The majority did not agree.

This concurrence also provides additional help to employers by noting that good will is one of the business interests that may be protected.[6] The Light opinion seemed to suggest that the only acceptable form of consideration was trade secrets.[7] At page 12, the concurring justices also note that trade secrets may be continuously created by updating data to support a covenant given during the term of an employee's employment. Thus, customer lists may supply new consideration for existing employees as the trade secrets they embody change over time.

The second concurring opinion provides perhaps some of the best language for employers. This concurrence finds that the Light decision improperly added the two requirements that the confidentiality agreement "must give rise to the employer's interest in restraining the employee from competing," and the non-compete "must be designed to enforce the employee's consideration or return promise" not to disclose confidential information."[8] The second concurrence went on to note that this judge-made law was dicta since the Light decision did not deal with trade secrets. If the court were to actually adopt the reasoning of the second concurring opinion, this would also broaden enforcement of covenants not to compete.

Finally, the second concurrence wonders why an employer has to provide any consideration beyond initial employment or continued employment. It points out that employees, merely by virtue of their employment, have a fiduciary duty not to reveal an employer's trade secrets. The concurring opinion wonders why any additional consideration is needed to support a covenant not to compete. Once again, if the court actually adopts this position, employers will more easily enforce covenants.

The majority opinion focuses near the end on what it concludes is the real test. This test is not a technical dispute over whether a covenant "is ancillary to an otherwise enforceable agreement."[9] The majority opinion states that the real inquiry is whether or not the covenant is reasonable within the traditional standards of geography, scope and time. Such a rational and business sensitive approach will do much to improve business's ability to enforce existing covenants not to compete and to write new covenants not to compete that will protect their genuine interests.

Questions Businesses May Want to Consider:
Do our covenants not to compete take full advantage of the ruling?

Can we detect situations where prospective employees may be subject to restrictive agreements and make allowances for such restrictions?

Is any recent hiring by our competitors potentially subject to legal action based upon the standards set out in Sheshunoff?

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[1] Light v. Centel Cellular Co. of Tex., 883 S.W.2d 642 (Tex. 1994).

[2] Tex. Bus. & Comm. Code Ann. §§ 15.50-15.52.

[3] Alex Sheshunoff Mgmt. Servs., L.P. v. Kenneth Johnson and Strunk & Assocs., L.P., No. 03-1050, Slip. op. at 13 (Tex. Oct. 20, 2006).

[4] Id. at 14.

[5] Id. at 1 & 8.

[6] Id. at 3 & 6.

[7] Light v. Centel Cellular Co. of Tex., 883 S.W.2d 642, 647 n.14 (Tex. 1994).

[8] Alex Sheshunoff Mgmt. Servs., L.P. v. Kenneth Johnson and Strunk & Assocs., L.P., No. 03-1050, Slip. op. at 2 (Tex. Oct. 20, 2006).

[9] Id. at 18.