

**COVENANTS NOT TO COMPETE: THE SWINGING PENDULUM
OF ENFORCEABILITY**

**W. GARY FOWLER
SARAH DOBSON MITCHELL**

Jackson Walker L.L.P.
901 Main Street, Suite 6000
Dallas, Texas 75202
(214) 953-6000
(214) 953-5822 (fax)
gfowler@jw.com
smitchell@jw.com

State Bar of Texas
20th ANNUAL ADVANCED EMPLOYMENT LAW COURSE
January 26 - 27, 2012
Dallas

CHAPTER 23

W. GARY FOWLER



- *Partner*
- **Labor**
- B.A., Texas Christian University
- J.D., Yale Law School
- gfowler@jw.com



W. Gary Fowler's practice includes both counseling and defending clients in employment related matters. He advises clients in specific difficult workplace situations, provides preventative services in employee handbooks, documentation, and in-house seminars, and prepares and analyzes employment contracts and related documents to protect his client's interests.

Mr. Fowler tries cases and defends employers in federal and state courts and before all labor administrative tribunals. He is an expert in employment contracts, noncompetition covenants, workplace situations, preventative employment issues, protection of employer interests, and disability and discrimination lawsuits. Mr. Fowler has represented employers in nationwide collective actions under the Fair Labor Standards Act and has defended employers in discrimination, covenant not to compete, and employment contract cases. He also has defended employers before the Department of Labor, the National Labor Relations Board, and the Occupational Safety and Health Administration. Mr. Fowler is recognized for his experience in the Americans with Disabilities Act and for his knowledge of covenants not to compete, which are particularly complex under Texas law.

He served as Adjunct Professor in teaching Disability Discrimination Law, at the Dedman School of Law at Southern Methodist University in 1996 and 1997.

Mr. Fowler is Board Certified in Labor & Employment Law by the Texas Board of Legal Specialization.

MEMBERSHIPS

Mr. Fowler is a member of the Labor and Employment Council of the Dallas Bar Association and served as its Chair in 2009. He is a board member of the Greater Dallas Youth Orchestra and served as its President from 2008-09 and as its Chair from 2009 to 2011.

W. GARY FOWLER

AWARDS

Mr. Fowler was named a “Super Lawyer” (2003-2011) by Thomson Reuters. He is also listed in the 2006-2012 editions of *The Best Lawyers in America* under Labor and Employment Law. He was named as one of the “Best Lawyers in Dallas” in the 2007, 2009 and 2011 issues of *D Magazine*.

ADMITTED

- Texas, 1984
- United States Supreme Court
- United States Court of Appeals for the Fifth Circuit
- United States District Court for the Northern District of Texas
- United States District Court for the Southern District of Texas
- United States District Court for the Eastern District of Texas
- United States District Court for the Western District of Texas

EDUCATION

Mr. Fowler received his B.A. degree, summa cum laude, from Texas Christian University and earned his J.D. degree from Yale Law School. He served as briefing attorney to Hon. Sam D. Johnson, Judge, United States Court of Appeals for the Fifth Circuit. He is a member of Phi Beta Kappa and is the 1979 Harry S. Truman Scholar for the State of Texas.

SARAH DOBSON MITCHELL



- *Associate*
- **Labor and Employment**
- B.A., Baylor University
- J.D., Texas Tech University
- smitchell@jw.com

Sarah Mitchell's practice consists of representing clients in employment litigation in federal and state courts and related proceedings. Ms. Mitchell has also represented employers before the Equal Employment Opportunity Commission, the U.S. Department of Labor, the Office of Federal Contract Compliance Programs, and state agencies and has defended claims brought under the Age Discrimination in Employment Act, the Americans with Disabilities Act, the Fair Labor Standards Act, the Family and Medical Leave Act, the Texas Commission on Human Rights Act, Title VII, Executive Order 11246, and the anti-retaliation provisions of the Texas Workers' Compensation Act.

Ms. Mitchell's nonlitigation practice includes advising and counseling employers regarding legal compliance and risk management on a variety of employment and human resources issues. Ms. Mitchell has assisted clients in drafting and implementing personnel policies and practices, provided clients with guidance and recommendations relating to the removal of architectural barriers, and advised clients regarding terminations, reductions in force, hiring, leaves of absence, drug testing, wages, restrictive covenants, workers' compensation, and disability-related accommodations. Additionally, Ms. Mitchell has advised clients regarding issues under the Texas Staff Leasing Services Act and has assisted clients in drafting and updating affirmative action plans.

MEMBERSHIPS

Ms. Mitchell is a member of the State Bar of Texas, the Texas Young Lawyers Association, the Employment Law Section of the Dallas Bar Association and the Dallas Association of Young Lawyers. She is also a member of the American Bar Association.

COMMUNITY INVOLVEMENT

While attending Baylor University, Ms. Mitchell was a volunteer for Habitat for Humanity. She is currently a member of the Dallas Women's Foundation Grants Review Committee and is annually involved in the Warren Center's Fantasy Football Fundraising Event.

ADMITTED

- Texas

SARAH DOBSON MITCHELL

- United States District Court for the Northern District of Texas
- United States District Court for the Eastern District of Texas
- United States District Court for the Western District of Texas

EDUCATION

Ms. Mitchell received her B.A. degree, *magna cum laude*, from Baylor University, where she became a member of *Phi Beta Kappa*. She received her J.D. degree, *summa cum laude*, from Texas Tech University, where she was inducted as a member of the *Order of the Coif*.

PUBLICATIONS & SPEAKING ENGAGEMENTS

Ms. Mitchell is the author of “Rules Implementing USERRA Will Become Effective on January 15,” which was published on Martindale.com. She has also co-authored “Understanding and Complying With Barrier-Free Design and Accessibility Requirements” and the “Fair Labor Standards Act” chapter of the *Texas Employment Law Handbook* (2005-2007, 2007-2009, 2009-2010 and 2011-2012 editions).

Ms. Mitchell also spoke on “Recent FMLA Developments: The National Defense Authorization Act of 2008, the Proposed FMLA Regulations, and a Brief Primer on the EEOC’s Guidelines Concerning Caregivers” at the *2008 Jackson Walker Labor & Employment Law Symposium*.

TABLE OF CONTENTS

I.	A BRIEF HISTORY OF NONCOMPETE LAW IN TEXAS.....	1
A.	The First “Reasonable” Period.....	1
B.	Section 15.50.....	3
C.	The Incredible Darkness of <i>Light</i>	3
1.	“An Otherwise Enforceable Agreement at the Time the Agreement is Made.”.....	3
2.	“Ancillary” to an Otherwise Enforceable Agreement.....	4
D.	The <i>Light</i> Dims with <i>Sheshunoff</i>	5
1.	An “Otherwise Enforceable Agreement” and Sheshunoff and Mann Frankfort.....	5
2.	<i>Marsh</i> Turns Out the Final Part of <i>Light</i>	7
II.	TIME, GEOGRAPHY AND SCOPE OF ACTIVITY.....	9
1.	Time.....	9
2.	Geography and Scope of Activity.....	10
III.	ACCOMPANYING PROVISIONS TO THE COVENANT NOT TO COMPETE.....	11
A.	Non-disclosure/Confidentiality Agreements.....	11
B.	Non-Piracy Provisions.....	12
C.	Stock and Stock Options.....	13
D.	Liquidated Damages and Forfeiture Provisions.....	13
E.	Severance and Settlement Agreements.....	13
F.	Arbitration Clauses.....	15
G.	Tolling Provision.....	16
H.	No Violation Clause.....	16
I.	The Sale of a Business.....	16
J.	Choice of Law and Forum Selection Clauses, and AutoNation.....	17
K.	Other Clauses.....	18
IV.	CONCLUSION.....	19

COVENANTS NOT TO COMPETE: THE SWINGING PENDULUM OF ENFORCEABILITY

For the past twenty-five years, the pendulum on covenants not to compete has swung from a common law “reasonable standard” to a “common calling” test and then to an “ancillary to an otherwise enforceable agreement test.” From finding no covenant enforceable from 1987 to 1994 and then not taking up the issue again until 2006, the Supreme Court of Texas has now upheld every covenant to come before it since then. The pendulum has swung from the middle to “anti” noncompete and now to “pro” noncompete.

Prior to 1987, Texas courts generally adopted a reasonableness standard for reviewing covenants not to compete. From 1987 to 1994, the Texas Supreme Court held non-competition covenants to be unenforceable in a series of decisions, starting with *Hill v. Mobile Auto Trim Inc.*, 725 S.W.2d 168, 170-171 (Tex. 1987), and culminating in *Light v. Centel Cellular Co. of Texas*, 883 S.W.2d 642 (Tex. 1994). These decisions, and particularly *Light*, engendered substantial confusion over abstract questions that seemed to have little to do with the parties’ intentions in drafting the covenant but, at the same time, made it difficult to enforce a covenant not to compete.

After twelve years of almost complete silence, the Supreme Court waded into the murky waters of non-competition covenants and brought a new era of Texas judicial interpretation of non-competition covenants. In *Alex Sheshunoff Management Services, L.P. v. Johnson*, 209 S.W.3d 644 (Tex. 2006), the Texas Supreme Court moved away from the highly technical analysis of non-competition agreements that had been emphasized in *Light* and announced a restoration of the focus for the enforcement of non-competition agreements to the reasonableness of the agreement’s restrictions.

The trend of “pro-enforcement” continued in 2009 in *Mann Frankfort Stein & Lipp Advisors, Inc. v. Fielding*, 289 S.W.3d 844 (Tex. 2009). Taking up a question unanswered in *Sheshunoff*-- whether a covenant not to compete would be enforceable without an explicit promise by the employer to give the employee confidential information--the Court again signaled that it would enforce non-competition agreements as written.

Most recently, the Supreme Court of Texas held that a stock option can give rise to an employer’s interest in restraining competition and provide the consideration necessary for upholding a covenant not to compete. *Marsh, Inc. v. Cook*, -- S.W.3d--, 2011 WL 2517019 (Tex. June 24, 2011).

This paper will first look generally at the law of non-competition and non-solicitation provisions as they existed before *Hill*, then during the 12-year run of *Light*, and now back again with *Sheshunoff* through *Marsh*. While *Sheshunoff*, *Mann Frankfort*, and *Marsh* have undoubtedly removed the traps of *Light* and thus ended years of confusing and sometimes even nonsensical court decisions, the paper will argue that *Marsh* has left courts and practitioners with few guidelines as to the enforceability of a covenant not to compete other than “reasonableness,” which will differ greatly from judge to judge and from county to county. The paper will then offer an analysis of provisions that a practitioner should include in a covenant not to compete.

I. A BRIEF HISTORY OF NONCOMPETE LAW IN TEXAS

The *Marsh* opinions provide a ready reference for both the historically and philosophically minded. Justice Willett’s scholarly concurrence cites English common law, St. Thomas Aquinas, Ralph Waldo Emerson, Voltaire, and Franklin D. Roosevelt. *Marsh*, 2011 WL 2517019, at *17. Indeed, while covenants not to compete may seem esoteric, they go to fundamental ideas of freedom of contract, providing labor at the highest obtainable wage, and third-party customers getting the best prices from competing businesses. The Supreme Court should be commended for a thorough, thoughtful analysis from all three of the opinions in its 5-1-3 judgment.¹ As Justice Willett said, “Amid increasing labor fluidity, there is no shortage of debate surrounding the propriety of enforcing restrictive covenants that tie up skills, knowledge, ideas, and expertise. The fault line runs between first principles—freedom of contract versus freedom of competition—and judicial treatment of noncompetes has been, well, eclectic.” *Id.* at *14.

A. The First “Reasonable” Period

Prior to *Hill*, the courts of the State of Texas held that “reasonable noncompete clauses in contracts pertaining to employment are not considered to be contrary to public policy as constituting an invalid restraint of trade.” *Id.* at *5. The reasonableness requirement was the “core inquiry” of the common law test. As noted by the Court decades ago in *Weatherford Oil Tool Co. v. Campbell*, “A covenant not to compete is a restraint of trade and its terms are enforceable only if they are reasonable.” *Weatherford*

¹ Justice Wainwright delivered the opinion of the Court in which Justices Hecht, Medina, Johnson and Guzman joined. Justice Willett wrote an opinion concurring in the judgment. Justice Green, joined by Chief Justice Jefferson and Justice Lehrmann, dissented.

Oil Tool Co. v. Campbell, 340 S.W.2d 950, 951 (Tex. 1960). A covenant is unreasonable “if it is greater than is required for the protection of the person for whose benefit the restraint is imposed or imposes undue hardship upon the person restricted.” *Id.*; *Henshaw v. Kroenecke*, 656 S.W.2d 416, 418 (Tex. 1983). Accordingly, under the common law test, the limitations as to time, territory and activity in a covenant not to compete must be reasonable for the covenant to be enforceable. *See Frankiewicz v. National Comp Assocs.*, 633 S.W.2d 505, 507 (Tex. 1982); *Justin Belt Co. v. Yost*, 502 S.W.2d 681, 685 (Tex. 1973).

In one of the two cases cited in *Marsh* for this proposition, *Chenault v. Otis Eng’g Corp.*, 423 S.W.2d 377, 381-82 (Tex. Civ. App.—Corpus Christi 1967, writ ref’d n.r.e.), the Court upheld a covenant that would have almost certainly been held invalid under *Hill* or *Light*. In *Chenault*, the employee, Louis Chenault, had been a district manager for Otis in the Victoria area. Otis wanted Chenault to move to another district, and Chenault asked for, and received, a leave of absence during which he intended to sell insurance. Otis and Chenault entered into a contract where Otis promised Chenault a position and seniority if he returned within a year, and Chenault promised, in return, that he would not compete with Otis in the Victoria area for three years. The insurance business not being to Chenault’s liking, he initially sought active employment with Otis, who offered him positions outside the Victoria area. Ultimately, Chenault went into business for himself against Otis. Otis obtained a judgment enforcing the covenant, and Chenault appealed.

Chenault argued that the covenant was unenforceable because it had nothing to do with the beginning of his employment but instead with the granting of a leave of absence from which he did not return. Chenault argued that the covenant was “not ancillary to an employment contract because it was not executed as a condition of beginning work with Otis, but at the time of termination of employment, and after appellant had left Otis’ employ and had gone to work for the insurance company.” 423 S.W.2d at 382.

The Court rejected Chenault’s “ancillary” argument. The Court stated, “The rule is well established in Texas that non-competition clauses in contracts pertaining to employment are not normally considered to be contrary to public policy as constituting an invalid restraint of trade.” *Id.* at 381. The Court held that Chenault’s agreement was reasonable, as it was restricted to the Victoria area, and that he had entered into it freely to obtain the leave of absence.

The Supreme Court’s citing of *Chenault* in the *Marsh* opinion as the state of the law is significant

because, in *Chenault*, there was no link between the consideration given—a leave of absence—and the reasons that gave rise to a covenant not to compete. After all, the point of the leave was that Chenault did no work and presumably received no confidential information or training from Otis while on leave, nor did he, presumably, develop any goodwill for Otis while he was selling insurance.

The *Marsh* Supreme Court also cited *DeSantis v. Wackenhut Corp.*, 793 S.W.2d 670 (Tex. 1990), as standing for the proposition that, under the common law, “reasonable noncompete clauses in contracts pertaining to employment are not considered to be contrary to public policy as constituting an invalid restraint of trade.” *Marsh*, at 5.

In *DeSantis*, the Texas Supreme Court summarized the test for non-competes as follows:

An agreement not to compete is not a reasonable restraint of trade unless it meets each of three criteria. First, the agreement not to compete must be ancillary to an otherwise valid transaction or relationship. Such a restraint on competition is unreasonable unless it is part of and subsidiary to an otherwise valid transaction or relationship which gives rise to an interest worthy of protection. Such transactions or relationships include the purchase and sale of a business, and employment relationships. Second, the restraint created by the agreement not to compete must not be greater than necessary to protect the promisee’s legitimate interest. Examples of legitimate, protectable interests include business goodwill, trade secrets, and other confidential or proprietary information. The extent of the agreement not to compete must accordingly be limited appropriately as to time, territory, and type of activity.... Third, the promisee’s need for the protection afforded by the agreement not to compete must not be outweighed by either the hardship to the promisor or any injury likely to the public. Before an agreement not to compete will be enforced, its benefits must be balanced against its burdens, both to the promisor and the public.

670 S.W.2d at 681-82 (citations omitted).² In *DeSantis*, the Supreme Court rejected the enforcement

² Whether these criteria as stated survive is an interesting question. While the majority in *Marsh* states that the purpose of the Act was to restore the common law, the majority in *Light* said the opposite. *See Light*, 883 S.W.2d at 644 (noting Covenants Not to Compete Act intended “to

of the covenant. As to goodwill, the Court noted that “there is no showing that [the employee, DeSantis] did or even could divert that goodwill to himself for his own benefit after leaving Wackenhut.” 670 S.W.2d at 683. The Court noted that only one or two of the former customers had followed DeSantis to his new employer. As for confidential information like customer preferences, pricing, and other customer information, the Court held that “Wackenhut failed to show that its customers could not readily be identified by someone outside its employ, that such knowledge carried some competitive advantage, or that its customers’ needs could not be ascertained simply by inquiry addressed to those customers themselves.” *Id.* at 684. Finally, the *DeSantis* court held that it need not reach whether the newly enacted statute (addressed below) should be retroactive since the covenant failed under both the common law reasonableness test and the new statute. *Id.* at 685.

B. Section 15.50

The statute that the *DeSantis* court referenced had been enacted in its initial form while that case was pending. The new Sections 15.50-52 of the Texas Business & Commerce Code were “intended to reverse the Court’s apparent antipathy to covenants not to compete and specifically to remove the obstacle to their use presented by the narrow ‘common calling’ test instituted by *Hill*, and to ‘restore over 30 years of common law developed by Texas Courts and remove an impairment to economic development in the state.’” *Marsh*, at *6 (citing House Research Org., Bill Analysis, Tex. S.B. 946, 71st Leg., R.S. (1989)).

While the statute had the desired result of overruling *Hill*, which the Supreme Court did in *DeSantis* even without the Legislature’s help, the statute did not restore the common law but instead launched the Supreme Court on a new analysis of exactly what the statute meant.

largely supplant the Texas common law relating to enforcement of covenants not to compete” and thus courts apply the Act “in lieu of ‘any other . . . procedures and remedies in an action to enforce a covenant not to compete under common law or otherwise’). The Act itself provides that the “procedures and remedies in an action to enforce a covenant not to compete provided by Section 15.51 of this code are exclusive and preempt any other . . . procedures and remedies in an action to enforce a covenant not to compete under common law or otherwise.” TEX. BUS. & COMM. CODE § 15.52.

C. The Incredible Darkness of *Light*

Section 15.50 of the Texas Business & Commerce Code appeared to track the first two elements of the *DeSantis* reasonableness test. The statute provides two basic requirements for a covenant not to compete to be valid and enforceable:

- The covenant must be “ancillary to or part of an otherwise enforceable agreement at the time the agreement is made”; and
- The covenant must contain “limitations as to time, geographical area, and 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 promisee.” See TEX. BUS. & COM. CODE § 15.50.

We turn first to the Supreme Court’s analysis of “ancillary to or part of an otherwise enforceable agreement at the time the agreement is made” under *Light*.

1. “An Otherwise Enforceable Agreement at the Time the Agreement is Made.”

The Supreme Court in *Light* examined what constitutes “an otherwise enforceable agreement at the time the agreement is made.” TEX. BUS. & COM. CODE § 15.50. In *Light*, the Supreme Court held that an “otherwise enforceable agreement” occurs only when both the employer and the employee can enforce some promise against the other at the time that the agreement is made.

Much to the dismay of those wishing to enforce non-competition covenants, the Court’s analysis in *Light*, and subsequent interpretations by the Courts of Appeal, appeared to require that the contract unequivocally promise that the employee *will* get the trade secrets or confidential information, *regardless of whether the employer continues the employment relationship*, and that those secrets had to be given to the employee *immediately* upon the employee signing the agreement.³ Thus, during the *Light* era, courts that strictly enforced *Light* required either one or both of these items to be met, before any analysis of the reasonableness of the covenant commenced. Thus, if the agreement did not use words like, “Regardless of whether the employee is terminated or not, the Employer *shall* provide the Employee with confidential information,” the covenant and the

³ *Strickland v. Medtronic, Inc.*, 97 S.W.3d 835, 839 (Tex. App. – Dallas 2003, pet. dismissed w.o.j.). See *31-W Insulation Co., Inc. v. Dickey*, 144 S.W.3d 153 (Tex. App. – Fort Worth 2004, no pet.); *Trilogy Software, Inc. v. Callidus Software, Inc.*, 143 S.W.3d 452 (Tex. App. – Austin 2004, pet. denied).

employer's lawsuit was DOA. And even if that occurred, some courts required, particularly in an employee-at will context, that the employer immediately provide confidential information upon the inception of employment. The theory was that, in an employee-at-will context, there was no "otherwise enforceable agreement" because the employer could simply fire the at-will employee before providing confidential information, training, or goodwill to the employee. Under the strict view of *Light*, it simply did not matter whether the employee later received the information and competed against the employer. Many drafters of noncompetes were dismayed to find that they were being blamed for the covenant not being enforceable.

2. "Ancillary" to an Otherwise Enforceable Agreement

Having analyzed what was meant by the phrase "an otherwise enforceable agreement," the Supreme Court in *Light* then provided a two part test for what was required by the word "ancillary." To be ancillary, the Court stated in *Light* that the employer must show:

- (1) the consideration given by the employer in the otherwise enforceable agreement must give rise to the employer's interest in restraining the employee from competition; and
- (2) the covenant must be designed to enforce the employee's consideration or return promise in the otherwise enforceable agreement.

In a footnote, the Court noted that this would occur when the employer gives an employee trade secrets in exchange for the employee's promise not to disclose them. *Id.* at 647 n.14. In *Light*, the Supreme Court held that the employer promised to give Ms. Light trade secrets, but that the "ancillary" test was not met because Ms. Light did not explicitly promise not to disclose trade secrets after she left her employer.

In later opinions, many courts held that the consideration given in the otherwise enforceable agreement must give rise to the employer's interest in restraining competition and held, as a matter of law, that certain forms of consideration were inadequate. Particularly, cash considerations and stock options were not deemed to be consideration that gave rise to an employer's legitimate interests. Even in the later *Sheshunoff* opinion, the Court stated that it would be inconsistent with this "gives rise" test to allow an employer to "enforce a covenant merely by promising to pay a sum of money to the employee in the agreement." 209 S.W.3d at 650. Stock option agreements generally fared no better. *Olander v.*

Compass Bank, 172 F. Supp. 2d 846, 851 (S.D. Tex. 2001)(on denial of preliminary injunction), *aff'd*, *Olander v. Compass Bank*, No. 01-21151 (5th Cir. June 3, 2002) (unpublished) (holding that offering stock option did not create an enforceable restriction because the employer failed to demonstrate that the stock option gave rise to the employer's interest in restraining competition). Likewise, even providing a term of employment, by itself, was generally not sufficient consideration to meet the first part of the *Light* test. For instance, the Tyler Court of Appeals held that a twelve month notice provision did not comply with *Light* because the former employer's "promise to give notice of termination does not give rise to [the former employer]'s interest in restraining [the employee] from competing." *American Fracmaster, Ltd. v. Richardson*, 71 S.W.3d 381, 387 (Tex.App.—Tyler 2001, pet. granted w.r.m). The Court relied on an earlier opinion, *Donahue v. Bowles, Troy, Donahue, Johnson, Inc.*, 949 S.W. 2d 746, 752 (Tex. App.—Dallas 1997, writ denied), in which the Court held that merely giving the employee a 30-day notice provision was insufficient to meet *Light*. In *Donahue*, the Court stated that even "if the thirty-day notice provision precludes the employment relationship from being at-will, an issue we need not and do not decide, the covenant would not be ancillary to such an agreement." *Id.* at 751 n.4. Similarly relying upon *Donahue*, the Amarillo Court of Appeals agreed and held that a mutual 10-day notice provision did not give rise to any enforceable interest by the employer. *Anderson Chemical Co. v. Green*, 66 S.W.3d 434, 439 (Tex. App.—Amarillo 2001, no pet.). It appeared that only providing confidential information or, perhaps, truly specialized training could be consideration that would give rise to the employer's interest in restraining competition.⁴

⁴ The majority in *Marsh* argued that the dissent's view, which strove to maintain the *Light* ancillary test, limited itself only to confidential information and specialized training. See *Marsh*, at *7, *13 (citing Paul & Crawford, *Refocusing Light: Alex Sheshunoff Management Services, L.P. v. Johnson Moves Back to the Basics of Covenants Not to Compete*, 38 ST. MARY'S L.J. 727, 752 (2007)). Likewise, if Mr. Chenault had been so fortunate as to bring his case against Otis in the late 1990s or early 2000s, the ancillary test would have surely allowed him to be free of the restrictive covenant given in exchange for a leave of absence. Compare *Chenault v. Otis Eng'g, supra*.

D. The *Light* Dims with *Sheshunoff*

1. An “Otherwise Enforceable Agreement” and *Sheshunoff* and *Mann Frankfort*

The first blow to the *Light* test came against the requirement of what constitutes an “otherwise enforceable agreement.” As noted above, several courts interpreting *Light* had held that the employer must make an explicit promise to provide confidential information (or another interest that would give rise to the employer’s interest) and other courts went so far as to require that the promise be fulfilled at the inception of employment. In *Sheshunoff*, the Court backed down from the highly technical requirements set forth in *Light* and agreed that it is impractical to expect employers to hand over trade secrets at the moment the employee signs the agreement.⁵ Nevertheless, the *Sheshunoff* opinion purported to not overturn the decision in *Light* but, instead, interpreted *Light* differently than it had been by the Courts of Appeals. The Court focused on footnote 6 of *Light*, which had caused most of the trouble. The Court relegated footnote 6 to the dustbin of dicta and held that it is no longer required that the employer hand over confidential information contemporaneously with the employee’s signing the covenant not to compete. In other words, the Court found that unilateral contracts that involve covenants not to compete in an at will situation are enforceable. Once the employer gives the employee the confidential information or trade secrets, the covenant not to compete becomes enforceable. However, prior to the employer giving trade secrets, the employer’s promise is still illusory, as in *Light*.

While not yet abrogating *Light*, the Court shifted its position as to the importance of the phrase “ancillary to an otherwise enforceable agreement” and emphasized that courts should focus more on the reasonableness of the restrictions as to time, geographical area and scope of activity to be restrained. In fact, the *Sheshunoff* Court described the analysis of the limitations of time, geographical area and scope of activity as the “core inquiry” of section 15.50(a). The Court stated:

We also take this opportunity to observe that section 15.50(a) does not ground the

enforceability of a covenant not to compete on the overly technical disputes that our opinion in *Light* seems to have engendered over whether a covenant is ancillary to an otherwise enforceable agreement. Rather, the statute’s core inquiry is whether the covenant “contains limitations as to time, geographical area, and 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 promisee.” TEX. BUS. & COMM. CODE § 15.50(a). Concerns that have driven disputes over whether a covenant is ancillary to an otherwise enforceable agreement — such as the amount of information an employee has received, its importance, its true degree of confidentiality, and the time period over which it is received — are better addressed in determining whether and to what extent a restraint on competition is justified. We did not intend in *Light* to divert attention from the central focus of section 15.50(a). To the extent our opinion caused such a diversion, we correct it today.

Sheshunoff, 209 S.W.3d at 655.

Unfortunately, as under *Light*, *Sheshunoff* left unanswered whether a non-compete contract would fail if it did not contain an *explicit* promise by the employer to provide confidential information to the employee or an acknowledgment by the employee of the receipt of such information, or both. After a few years of speculation, this question was finally answered on April 17, 2009 when the Court published its opinion in *Mann Frankfort Stein & Lipp Advisors, Inc. v. Fielding*, 289 S.W.3d 844 (Tex. 2009).

In *Mann Frankfort*, Fielding and Hardy, two accountants who both formerly worked for Mann Frankfort, left their employment, started their own firm, and began contacting their former clients. Fielding had originally gone to work for a predecessor to the firm and had promised not to disclose confidential information, but the agreement did not explicitly provide that he would be given confidential information or access to such information. Fielding’s original agreement called for him to pay a price for the value of the business for former clients if he did business for them after he left the firm. *Mann Frankfort Stein & Lipp Advisors, Inc. v. Fielding*, 263 S.W.3d 232, 239 (Tex. App. - Houston [1st Dist.] 2007, pet. granted).

Later, Hardy was employed by the firm and likewise signed an employment agreement. In the employment agreement, Hardy acknowledged he would have access to the firm’s clients. The

⁵ However, in his concurring opinion, Chief Justice Jefferson takes a more narrow view of this than the Court generally. While he agrees with the Court that the exchange of consideration does not have to be contemporaneous, he believes that it must occur within a “reasonable time.” *Sheshunoff*, 209 S.W.3d at 657. The Chief Justice believed *Sheshunoff*’s time of acceptance was reasonable; however, he does not believe that the employer may make the covenant not to compete enforceable at any time simply by performing their side of the bargain.

agreement also provided that Hardy would not “during or after the period of active employment, disclose . . . proprietary information of [his employer] such as financial records, data, programs, etc.” Hardy also agreed that he would “neither call nor solicit, either for himself or for any other Person any of the clients of the firm for a period of twenty-four (24) months immediately following [his] period of active employment.” The agreement stated that if Hardy provided accounting services for any of his employer’s clients during the 24-month period, he would pay the employer 150% of the amount of the fees billed to the client by the employer in the previous year. *Id.*

Later, Fielding and Hardy both signed limited partnership agreements. Like Fielding’s original contract, the limited partnership agreement provided for the “purchase” of clients solicited by the departing limited partner in the amount of 90% of the accounts receivable and the unbilled time and the total of the time billed by the firm in the previous year.

The accounting firm attempted to enforce the covenant and initially argued that the agreements were not a covenant not to compete but instead merely a requirement to purchase the value of those accounts that the departing accountants took with them. Relying upon the Supreme Court’s decision in *Peat Marwick Main & Co. v. Haass*, 818 S.W.2d 381, 385 (Tex.1991), in which a similar provision was ruled to be subject to Texas law on covenants not to compete, the appellate court quickly dispensed with this issue. *Mann Frankfort*, at 242-243.

The appellate court then turned to the limited partnership agreement signed by both Hardy and Fielding. The court found that although Fielding and Hardy agreed that Mann Frankfort had invested time and money to obtain valuable confidential information, there was no agreement for Mann Frankfort to disclose confidential information to Fielding and Hardy or that Fielding or Hardy would gain access to confidential information. Moreover, the agreement failed to include a promise by Fielding or Hardy not to disclose any confidential information belonging to Mann Frankfort.

In analyzing Fielding’s employment agreement, the court of appeals again found the agreement failed to meet the “ancillary” test because the agreement did not contain either a promise by the employer to disclose confidential information or an acknowledgement by the employee that he would receive confidential information. The court noted that it had “previously treated an employee’s acknowledgment that he has or will receive confidential information from his employer as an implied promise that the employer will provide trade secrets and confidential information.” *Id.* at 247 (citing *Beasley v. Hub City Texas, L.P.*, 01-03-00287-

CV, 2003 WL 22254692 (Tex. App. – Houston [1st Dist.] Sept. 29, 2003, no pet.) (mem. op.)). However, Fielding’s agreement did not contain such an implied promise. The court stated:

Fielding did not acknowledge that he had received or would receive confidential information. Nor did the agreement contain representations that Fielding was receiving consideration for agreeing to the non-disclosure and client-purchase provisions. Thus, Fielding’s employment agreement did not contain an implied promise by Mann Frankfort that obligated Mann Frankfort to disclose confidential information to Fielding.

Id. The court found that Hardy’s covenant not to compete met *Sheshunoff* but that the covenant was overly broad because its pricing requirement was too restrictive and the covenant prohibited Hardy from contacting clients that he did not personally serve. Because the accounting firm sought only damages, the covenant was not susceptible to reformation and was unenforceable. *Id.* at 249-51.

Mann Frankfort appealed as to Fielding’s covenant not to compete, and the Texas Supreme Court reversed entirely to find in favor of Mann Frankfort. The Court analyzed the situation under the non-compete standard enunciated in *Light*, and noted that there were two initial inquiries that must be made in determining whether an enforceable non-compete had been created under Section 15.50: (1) is there an otherwise enforceable agreement, and (2) was the covenant not to compete ancillary to or part of that agreement at the time the otherwise enforceable agreement was made. *Mann Frankfort*, 289 S.W.3d at 849.

Although Fielding promised not to disclose any confidential information, Mann Frankfort did not promise to provide the employee access to confidential information in return as consideration, nor did Fielding acknowledge that he had received or would receive confidential information. However, the Court held that “[w]hen the nature of the work the employee is hired to perform requires confidential information to be provided for the work to be performed by the employee, the employer impliedly promises confidential information will be provided.” *Id.* at 850.

In its analysis, the Court noted that “if one party makes an express promise that cannot reasonably be performed absent some type of performance by the other party, courts may imply a return promise so the dealings of the parties can be construed to mean something rather than nothing at all.” *Id.* at 850. The Court explained that “when it is clear that

performance expressly promised by one party is such that it cannot be accomplished until a second party has first performed, the law will deem the second party to have impliedly promised to perform the necessary action.” *Id.* at 851.

In *Mann Frankfort*, Fielding expressly promised in his employment agreement to “not disclose or use at any time . . . any secret or confidential information or knowledge obtained by [Fielding] while employed. . . .” The Court found that this promise meant nothing without a correlative commitment by Mann Frankfort. *See id.* Neither party disputed that performing the function of a certified public accountant required accessing and using confidential information and that Mann Frankfort actually provided Fielding with confidential information during his employment with the firm. *Id.* Since Fielding’s employment “necessarily involved the provision of confidential information by [defendant],” the Court found the summary judgment evidence conclusively established that Mann Frankfort impliedly promised to supply confidential information to Fielding when the parties entered into the 1995 agreement. *Id.* Although including an express promise of confidential information in a noncompetition agreement is probably still the best practice, based on the *Mann Frankfort* holding, employers can now rely upon implied promises to provide confidential information to create an otherwise enforceable agreement.

Thus, with *Sheshunoff* and *Mann Frankfort*, it was clear that (a) the employer did not have to provide the consideration giving rise to the noncompete at the inception of employment; and (b) so long as the employee promised not to disclose information and the nature of the employee’s duties were such that the employer would be expected to provide confidential information, a promise that the employer would provide confidential information would be implied.

2. *Marsh* Turns Out the Final Part of *Light*

Sheshunoff and *Mann Frankfort* purported to leave undisturbed the two-part ancillary test set forth in *Light*. As noted above, the test requires that the consideration given by the employer give rise to the employer’s interest in restraining competition. Justice Wainwright, in a specially concurring opinion in *Sheshunoff*, suggested the end of the ancillary test. 209 S.W.3d at 665-66. His concurring opinion became the majority opinion in *Marsh*.

In *Marsh*, employee Rex Cook had gone to work for Marsh USA Inc. (“Marsh”) in 1983 and rose to become a district manager. In 1996, Cook was offered stock options through Marsh’s parent company, Marsh & McLennan Companies, Inc. (“MMC”), that would vest over the next four years. In 2005, Cook exercised the options. The stock option agreement provided that if Cook left the company

within three years after exercising the options, then for a period of two years after termination, Cook would not:

(a) solicit or accept business of the type offered by [MMC] during [Cook’s] term of employment with [MMC], or perform or supervise the performance of any services related to such type of business, from or for (I) clients or prospects or [MMC] or its affiliates who [Cook] solicited or serviced directly . . . or where [Cook] supervised, directly, indirectly, in whole or in part, the solicitation or servicing activities related to such clients or prospects; or (II) any former client of [MMC] or its affiliates who was such within two (2) years prior to [Cook’s] termination of employment and who was solicited or serviced directly by [Cook] or where [Cook] supervised directly or indirectly, in whole or in part, the solicitation or servicing activities related [to] such former clients; or

(b) solicit any employee of [MMC] who reported to [Cook] directly or indirectly to terminate his employment with [MMC] for the purpose of competing with [MMC].

Marsh, 2011 WL 2517019, at *1.

Both the trial court and the Court of Appeals had held the covenant invalid as a matter of law because, in their view (correct under the case law at the time), the granting of the options did not give rise to Marsh’s interest in restraining competition. *Marsh USA Inc. v. Cook*, 287 S.W.3d 378, 381-82 (Tex. App.—Dallas 2009, pet. granted). The Dallas Court of Appeals acknowledged that MMC was trying to protect its goodwill by offering the stock options to certain valued employees. However, the Court of Appeals held that “the fact that a company’s business goodwill benefits when an employee accepts the offered incentive and continues his employment does not mean that the incentive *gives rise* to an employer’s interest in restraining the employee from competing.” *Id.* at 381-82 (italics original).

The Supreme Court, however, rejected the appellate court’s holding and explicitly abrogated the two part ancillary test from *Light*. The Court first acknowledged that non-solicitation provisions are treated like covenants not to compete. *Marsh*, 2011 WL 2517019, at *2. But Mr. Cook probably realized that things were not going his way when the Court next observed, “The Texas Constitution protects the freedom to contract.” *Id.* at *3. The Court observed, “[V]alid noncompetes constitute reasonable restraints on commerce agreed to by the parties and may

increase efficiency in industry by encouraging employers to entrust confidential information and important client relationships to key employees.” *Id.* The Court then went on to note that the purpose of the Covenant Not to Compete Act was to restore the common law and to reject *Hill*. *Id.* at *5-6. The Court noted that, with the stock option, there was clearly an otherwise enforceable agreement: “There is offer, acceptance and consideration for the mutual promises, and the non-solicitation and nondisclosure agreements are ‘otherwise enforceable agreements.’” *Id.* at *6.

The Court then turned to the “give rise” requirement in the *Light* ancillary test. The Court held that the requirement of *Light* that the consideration give rise to the employer’s interest was too strict:

Rather than requiring that the otherwise enforceable agreement give rise to “an interest worthy of protection,” *Light* imposed a stricter requirement: that the consideration give rise to “the employer’s interest in restraining the employee from competing.” *Light*, 883 S.W.2d at 647 (emphasis added). *Light*’s “give rise” condition on the enforceability of noncompetes was more restrictive than the common law rule the Legislature intended to resurrect. Although we have recognized on multiple occasions that goodwill, along with trade secrets and other confidential or proprietary information, is a protectable business interest, *Light*’s “give rise” language narrowed the interests the Act would protect, excluding much of goodwill as a protectable business interest.

Id. at *9. Thus, the Court held, the question is not whether the *consideration* gives rise to the employer’s interest but instead whether the covenant not to compete supplements or is otherwise part of an otherwise enforceable agreement:

Consideration for a noncompete that is reasonably related to an interest worthy of protection, such as trade secrets, confidential information or goodwill, satisfies the statutory nexus; and there is no textual basis for excluding the protection of much of goodwill from the business interests that a noncompete may protect. *Light*’s requirement is contrary to the language of the Act; thwarts the purpose of the Act, which was to expand rather than restrict the enforceability of such covenants; and contradicts the Act’s intent to return Texas

law on the enforceability of noncompete agreements to the common law prior to *Hill*.

Id.

The Court then turned to its articulation of the test: whether “the relationship between the otherwise enforceable agreement and the legitimate interest being protected is reasonable.” *Id.* at *12. The Court noted that the stock option was given to promote Marsh’s goodwill and to provide an incentive for employees like Cook to promote that goodwill on Marsh’s behalf. The Court concluded:

[T]he covenant not to compete is “ancillary to or part of” an otherwise enforceable agreement because the business interest being protected (goodwill) is reasonably related to the consideration given (stock options). Section 15.50 requires that there be a nexus between the covenant not to compete and the interest being protected. TEX. BUS. & COMM. CODE § 15.50(a). This requirement is satisfied by the relationship that exists here.

Id. at *14.

In a specially concurring opinion, Justice Willett emphasized that he joined the judgment to give the trial court the first crack at assessing whether the noncompetition agreement was reasonable. Justice Willett also noted that Marsh’s argument that the noncompete agreement was necessary to prevent employees from using goodwill to attract the customer to a competitor “seems just another way of saying the noncompete’s purpose is to stifle competition.” *Id.* Justice Willett further noted that while “goodwill” is a legitimate interest under the Act, “it is not enough to merely utter the word.” Then Justice Willett hit upon the conundrum of the majority’s divorce of consideration from the requirement of the employer’s legitimate interest:

A court cannot uphold a noncompete on goodwill grounds absent a record that demonstrates the limitations are reasonable and as nonburdensome as possible. Every company has customer relationships and attendant goodwill it wants to cultivate by incentivizing employees to stay, but merely *asserting* goodwill is not enough. Marsh contends “Cook could take the customer relationships grown as a result of the stock incentive and use them to compete with Marsh,” but that unadorned assertion is insufficient. And even assuming the incentive spurred Cook to grow Marsh’s goodwill (which strikes me as a curious and

slippery proposition), does that prove too much, lest any workplace benefit—a bonus, a raise, a promotion, a better parking space—suffice to justify a noncompete because it theoretically motivates an employee to strengthen client relationships? The evidentiary record must demonstrate special circumstances beyond the bruises of ordinary competition such that, absent the covenant, Cook would possess a grossly unfair competitive advantage. And even then the restrictions imposed must be as light as possible and not restrict Cook's mobility to an extent greater than Marsh's legitimate need.

Id. at *16.

Likewise, the dissent pointed to the slippery slope created by the majority's holding. "The Act mentions nothing about stock options, and equating stock options with goodwill creates a rule by which any financial incentive given to an employee could justify a covenant not to compete." *Id.* at *19. The dissent noted that the *Light* test assured that the covenant was "ancillary to an exchange of valuable consideration that justifies or necessitates a restraint of trade." *Id.* Pointedly, the dissent noted that a mere employment relationship was not enough. The dissent echoed Justice Willett's concern:

Any financial incentive given to an employee can arguably motivate the employee to increase his employer's goodwill, and every employee, if he performs his job as expected, creates goodwill for his employer. If any financial incentive that can encourage an employee to create more goodwill can satisfy the consideration prong of the Act, then we might as well ignore the consideration requirement all together. Under the Court's reasoning, a raise, a bonus, or even a salary could support an enforceable covenant.

Id. at *20.

The decision in *Marsh* leaves open questions of reasonableness. Is it enough that the employee has some confidential information (as most employees in any position of sales or supervision will) or relationships with customers (again, as any sales or supervisory employee will typically have)? If so, is it a reasonable covenant if the consideration is only a salary or, as Justice Willett suggested, a better parking place? Does a covenant become less "reasonable" if the consideration is less (e.g., a parking space or a \$5 raise)? Does the reasonableness of the covenant mean that the employee resigned or was laid off in a

reduction-in-force? While the emphasis of the Court is clearly upon the reasonableness of the restriction, any restriction may cause an employee to avoid the question altogether and thus lessen employee mobility and competition for wages among employees. *Id.* at 18 (Willett, J., concurring) (noting potential *in terrorem* effects of noncompetes).

II. TIME, GEOGRAPHY AND SCOPE OF ACTIVITY

Section 15.50(a) provides that for a covenant not to compete to be valid and enforceable, it must contain "limitations as to time, geographical area, and 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 promisee." See TEX. BUS. & COM. CODE § 15.50. As the cases from *Sheshunoff* to *Marsh* have emphasized, the reasonableness of the covenant is the "core inquiry" in most cases.

The importance of drafting reasonable restrictions into a noncompetition agreement cannot be stressed enough because, although reformation is an option should the enforcing party request it, even if the covenant is subsequently reformed, the employer loses any claim for damages prior to reformation. TEX. BUS. & COM. CODE § 15.51; *Juliette Fowler Homes, Inc. v. Welch Associates, Inc.*, 793 S.W.2d 660, 662 (Tex. 1990). Also, even if the employee is enjoined after reformation of the covenant, the employee may recover attorney's fees if the employer sought to enforce the covenant to a greater extent than necessary to protect the goodwill or other business interest of the employer. TEX. BUS. & COM. CODE § 15.51(c). For instance, in one case, the Court of Appeals reversed a trial court holding that the covenant was unenforceable, but affirmed the trial court's award of attorney's fees because the court agreed that the covenant was overbroad. *Evan's World Travel, Inc. v. Adams*, 978 S.W.2d 225 (Tex. App. — Texarkana 1998, no pet.).⁶

1. Time

Texas courts have enforced covenants for one to five year periods, and, under unique circumstances, even longer. *Stone v. Griffin Communications and Security Systems, Inc.*, 53 S.W. 3d 687 (Tex. App.—Tyler 2001, no pet.). As they have in the past, courts will consider whether the time period is required to protect the interests of the employer without being

⁶ In *Butler v. Arrow Mirror & Glass, Inc.*, 51 S.W.3d 787, 794 (Tex. App. — Houston [1st Dist.] 2001), however, the Houston Court of Appeals held that an employer was entitled to attorney's fees under the Civil Practice and Remedies Code, even though the trial court had reformed the covenant.

unnecessarily oppressive on the employee. See *French v. Community Broadcasting*, 766 S.W.2d 330 (Tex. App. – Corpus Christi 1989). Thus, it is important that the drafter consider what time period is necessary to protect the employer's interest. For instance, an employee who has the company's most important trade secrets that the employer will use indefinitely may be enjoined from competing for a longer period. On the other hand, the salesperson whose customers, prices, and product preferences change rapidly should have a relatively shorter period in the non-competition agreement.

2. Geography and Scope of Activity

As Yogi Berra might say, geography is not what it used to be. Computer companies may argue, with great force, that even a nationwide ban is not broad enough because, with computers and a telephone line, anyone can set up shop anywhere. On the other hand, courts generally agree that the non-competition covenant should be tied to the geographic area that was the subject of the employee's services for the employer. *Butler v. Arrow Mirror & Glass, Inc.*, 51 S.W.3d 787, 793-94 (Tex. App.—Houston [1st Dist] 2001, no pet.). For instance, a salesperson should be prohibited from competing only in the area that the employee served for the employer. *Weatherford Oil Tool*, 340 S.W.2d at 952. Generally, what constitutes a reasonable area is the territory in which the employee worked while in the employment of his employer. *Zep Manufacturing Co. v. Harthcock*, 824 S.W.2d 654, 661 (Tex. App.—Dallas 1992, no writ); *Evan's World Travel*, 978 S.W.2d at 231. However, the employer's operations may be a proper basis in some circumstances. *Webb v. Hartman Newspapers, Inc.*, 793 S.W.2d 302 (Tex. App.—Houston [14th Dist.] 1990, no writ). In cases involving the sale of a business, courts tend to be more liberal in enforcing broad geographic restrictions, particularly when it is apparent that the parties intended the scope of the covenant to be national. *Vais Arms, Inc. v. Vais*, 383 F.3d 287, 295 (5th Cir. 2004).

Courts recognize that restricting the employee from soliciting former clients of the employer can substitute for the geographic restriction. *Investors Diversified Services, Inc. v. McElroy*, 645 S.W. 2d 338, 339 (Tex. App. — Corpus Christi 1982, no writ); *American Express Financial Advisors, Inc. v. Scott*, 955 F. Supp. 688, 692 (N.D. Tex. 1996). Moreover, these restrictions are often more palatable to judges and therefore easier to enforce because the employee is not precluded from working in his or her chosen occupation entirely. However, covenants with no geographic or customer restriction are invalid. *Juliette Fowler Homes, Inc.*, 793 S.W. 2d at 663; *Goodin v. Joliff*, 257 S.W.3d 341 (Tex. App.—Fort

Worth 2008, no pet.); *Zep Mfg. Co.*, 824 S.W. 2d at 661.

One case, while vacated by the court upon the motion of the parties, shows one way in which a covenant may be overly broad. In *Staples, Inc. v. Sandler*, No. 3:07-CV-0928-K, 2008 WL 4107656 (N.D. Tex. Aug. 29, 2008), the court found the covenant enforceable but held it was overly broad with respect to customers that the employee had provided services to before employment with the plaintiff. In so finding, the Court stated:

Here, it is apparent that the restraint on competition is not justified to the extent contemplated in the covenant not to compete given Sandler's relatively short employment, the minimal amount of confidential information he received, and Staples' legitimate interest in protecting the confidential information it provided him during his tenure. Thus, the Court finds that Staples' legitimate interest in confidentiality gives rise only to a restraint on Sandler that prevents him from competing by doing business with customers he gained during his eleven-month tenure with the company. A restraint that prevents him from continuing long-standing relationships that he brought with him to Staples is overbroad, unrelated to Staples' legitimate interest in confidentiality, and would further unreasonably burden these third-party customers.

Id. at *5.

Other courts have reaffirmed that the covenant must generally be limited to the area for which the employee had responsibility. *TransPerfect Translations, Inc. v. Leslie*, 594 F. Supp.2d 742 (S.D. Tex. 2009) (covenant that prohibited competition in geographic areas where employee did not even attempt to make sales was overly broad); *Safeworks, LLC v. Max Access*, C.A. H-08-2860, 2009 WL 959969 (S.D. Tex. April 8, 2009) (non-solicitation provision not limited to customers or clients with whom the defendants did business during their employment was overly broad; covenant could not be reformed because it had expired); *Courtroom Sciences, Inc. v. Andrews*, C.A. No. 3:09-CV-251-O, 2009 WL 1313274 (N.D. Tex. May 11, 2009) (nationwide covenant on trial consulting services reformed to prohibiting work for clients of former employer, disclosing certain information unique to former employer, and soliciting employees of CSI).

A covenant not to compete may include only reasonable limits on the scope of activity to protect the goodwill or other legitimate business interest of the

employer. The Supreme Court has held that, in some cases, the employer has no legitimate interest in enforcing the covenant, and any restriction would be unreasonable. *DeSantis, supra*; see also *Diesel Injection Sales & Service, Inc. v. Renfro*, 656 S.W.2d 568 (Tex. App.—Corpus Christi 1983, writ ref'd n.r.e.). Also, the covenant must describe some sort of restriction on the scope of activity or the covenant may be held void, as was the case in *Juliette Fowler Homes, Inc., supra*. In that case, a fundraising company, Welch Associates, sued a charity, Juliette Fowler Homes, for tortious interference with a noncompetition clause in a contract with a second fundraising company, the Butler Companies. Welch Associates also sued the Butler Companies and its principal, John Butler, for breach of the noncompetition clause and for tortious interference with the contract between Welch Associates and Juliette Fowler Homes.

Juliette Fowler Homes (“Fowler”) had entered into a contract with Welch Associates (“Welch”) for fundraising services. Welch then entered into a contract with the Butler Companies for help in executing the Fowler fundraising campaign. The noncompetition clause at issue was contained in the agreement between Welch and the Butler Companies and bound the latter to not “enter into any form of contract for services” with any of Welch’s clients for a period of two years after the conclusion of the Butler Companies-Welch contract. Eventually, Fowler terminated the agreement with Welch, and the Butler Companies terminated its contract with Welch. *Juliette Fowler Homes, Inc.*, 793 S.W.2d at 661. Subsequently, John Butler was hired by the National Benevolent Association, one of whose agencies was Fowler. Butler was assigned to work directly with Fowler and supervise Fowler’s fundraising campaign. Welch then filed its claims against Fowler, the Butler Companies and Butler.

The jury found that Butler had violated the noncompetition clause with Welch, Butler and the Butler Companies had tortiously interfered with Welch’s agreement with Fowler, and that Fowler had tortiously interfered with Welch’s agreement with the Butler Companies. The Supreme Court overturned the decision, finding that the noncompetition clause in the Butler Companies-Welch agreement was unreasonable as it contained no limitations concerning geographical area or scope of activity. Essentially, the noncompete prohibited Butler from entering into any form of contract for services or employment in any capacity or position, directly or indirectly, with any past or present clients of Welch wherever they may be located. The Court stated, “This prohibition is absolute, unequivocal and unreasonable.” *Id.* at 663. The Court found that since the noncompetition clause was unenforceable as written, Welch could not

recover monetary damages for breach of an unenforceable clause. *Id.*

The Court went on to hold that Welch could also not recover on its tortious interference claim against Fowler:

We now hold that covenants not to compete which are unreasonable restraints on trade and unenforceable on grounds of public policy cannot form the basis of an action for tortious interference . . . We hold, therefore, that the unenforceability of the noncompetition clause in the Butler Companies-Welch contract is a valid defense to Welch’s tortious interference claim against Fowler.

Id. at 664. As such, *Fowler* not only stands for the proposition that noncompetition clauses that lack any reasonable limitation as to scope of activity will be held unreasonable and unenforceable, but also provides for a defense to tortious interference claims in situations in which the restrictive covenant is found unenforceable.⁷

III. ACCOMPANYING PROVISIONS TO THE COVENANT NOT TO COMPETE

The covenant not to compete should not stand alone but should be accompanied by related provisions strengthen the enforceability of the noncompete and may provide relief that wins the litigation.

A. Non-disclosure/Confidentiality Agreements

Assuming that the employer wishes to protect confidential information, the contract should contain a clause that prohibits the employee from using or disclosing confidential information or trade secrets. In doing so, practitioners often insert a litany of items that are commonly trade secrets or confidential information, but do not consider the particular client or the employee. Instead, the better approach is to consider what a trade secret is for the client and what trade secrets or confidential information the employee will receive. Another common mistake is labeling everything in the company to be “confidential.” Describing marketing literature as a “trade secret” is

⁷ The Covenant Not to Compete Act provides that its criteria are exclusive to the former common law requirements. TEX. BUS. & COM. CODE § 15.52. However, some courts still cling to some of the equitable requirements. *Stone v. Griffin Communications and Security Systems, Inc.*, 53 S.W.3d 687, 693 (Tex. App.—Tyler 2001, no pet.)(court should consider hardship on employee and impact upon the public in determining whether covenant enforceable).

ridiculous when the company gives it to any person who asks for it. (On the other hand, marketing strategies as to future marketing literature may be very confidential.)⁸

Also, the company should ensure that it takes steps necessary to show that the information is truly kept confidential. For example, (i) stamp confidential documents “confidential”; (ii) have confirmation of receipt forms where the employee receiving the company document acknowledges receipt of “confidential information”; (iii) use locked cabinets with limited access; (iv) use computer passwords; (v) use a log in and out system for files, prospect cards, customer lists, and similar items; (vi) provide employees with a brief training session or instructional packet regarding their obligation to protect trade secret information as confidential both during and after employment; (vii) create a termination check list of trade secret items that must be returned and/or accounted for prior to an employee’s departure. The more a company is able to establish the secret or confidential nature of the information, the more likely that the courts will enforce its non-disclosure/confidentiality agreement.

B. Non-Piracy Provisions

Employers should also include a provision restricting the employee from soliciting customers. Such a provision is subject to the Section 15.50 analysis, which remains untouched by *Sheshunoff* and *Marsh* in this respect, even though the employer may argue that it is less restrictive than a total prohibition on competing. *Miller Paper Co. v. Roberts Paper Co.*, 901 S.W.2d 593, 599-600 (Tex. App.—Amarillo 1995, no writ)(invalidating customer restriction clause

when there was no otherwise enforceable agreement under *Light*).

Therefore, as with other non-competition provisions, the covenant must be reasonable and limited to those customers that the employee had contact with while working for the employer. See *Peat Marwick Main & Co. v. Haass, supra* (covenant prohibiting former partner from soliciting or doing business for any clients was overbroad when not limited to those customers with whom the partner had contact). The Court held that there must be “a connection between the personal involvement of the former firm member [and] the client.” *Id.* at 387.

In the case, *Poole v. U.S. Money Reserve, Inc.*, No. 09-08-137 CV, 2008 WL 4735602 (Tex. App.—Beaumont Oct. 31, 2008), an employer filed suit against two of its ex-employees for, *inter alia*, violating their non-solicitation agreements. The agreements at issue prohibited the former employees from soliciting or attempting to take away “any existing or potential clients, customers, suppliers, businesses, and/or accounts of [the employer]”

The trial court enjoined the defendants from soliciting any of the plaintiff’s customers. The defendants then filed an interlocutory appeal, seeking a ruling that the injunction was overly broad.

The court of appeals held that the temporary injunction was void because the injunction order failed to state why injunctive relief was necessary. Under Texas law, a temporary injunction must state why irreparable harm would occur absent injunctive relief. Because the injunction in this case did not do so, the injunction was void.

In addition, the court of appeals held that the temporary injunction was overly broad. Specifically, the court held that a “restrictive covenant is unreasonable unless it bears some relation to the activities of the employee.” Because the non-solicitation provision prohibited the former employees from soliciting all of their former employer’s customers, it was too broad. The injunction should have been limited to the customers with which the defendants themselves did business.

Moreover, the court of appeals held that the restriction on solicitation of *potential* clients was overly broad. The plaintiff argued that the defendants had access to its marketing and advertising materials, and that these materials informed the defendants of the identities of plaintiff’s potential customers. But the court held that the totality of evidence showed that the defendants, who were salespersons, were not in fact knowledgeable about the plaintiff’s marketing information. Thus, the restrictions pertaining to potential customers was overly broad.

In addition to customer non-solicitation provisions, a clause prohibiting solicitation of employees should be included to prevent a former

⁸ To determine whether a trade secret exists, the Texas Supreme Court adopted the following non-exclusive, six-factor test from §757 of the Restatement of Torts: (1) the extent to which the information is known outside of his business; (2) the extent to which it is known by employees and others involved in his business; (3) the extent of the measures taken by him to guard the secrecy of the information; (4) the value of the information to him and to his competitors; (5) the amount of effort or money expended by him in developing the information; (6) the ease or difficulty with which the information could be properly acquired or duplicated by others. *In Re Bass*, 113 S.W.3d 735, 739 (Tex. 2003) (citing RESTATEMENT OF TORTS, § 757 cmt. B. (1939); RESTATEMENT (THIRD) OF UNFAIR COMPETITION § 39 reporter’s n. cmt. d (1995)); see generally, *Hyde Corp. v. Huffines*, 314 S.W.2d 763, 776 (adopting RESTATEMENT OF TORTS, § 757 (1939)), *cert. denied*, 358 U.S. 898 (1958). The Court further recognized that the six factors were not dispositive, but rather should be weighed in the “context of the surrounding circumstances.” *In Re Bass*, 113 S.W.3d at 740.

employee from “raiding” or “cherry picking” the company’s employees. In at least one case, the Texas Supreme Court indicated that such a provision was enforceable in the context of a settlement. *Justin Belt Co. v. Yost*, 502 S.W.2d 681 (Tex. 1973).⁹ A number of other courts, without much analysis, have concluded that the Act applies to a provision requiring an employee not to solicit customers and employees from the former employer without noting a significant distinction between the two. *Oxford Global Resources, Inc. v. Weekley-Cessnun*, 2005 WL 350580 (N.D. Tex., Feb. 8, 2005)(unpublished); *Miller Paper Co. v. Roberts Paper Co.*, 901 S.W.2d at 599; *Olander v. Compass Bank*, 172 F. Supp. 2d 846, 851 (S.D. Tex. 2001)(on denial of preliminary injunction), *aff’d*, *Olander v. Compass Bank*, No. 01-21151 (5th Cir. June 3, 2002) (unpublished).¹⁰

C. Stock and Stock Options

As demonstrated by *Marsh*, employers often include a non-competition provision in conjunction with a stock option or grant. When drafting such an agreement for the employer, the attorney should include a “claw back” provision. In *Olander v. Compass Bank*, 363 F.3d 560, 565 (5th Cir. 2004), the Court invalidated the covenant not to compete on pre-*Marsh* grounds. However, as the court noted, this was very much a pyrrhic victory for the employee. The contract also contained a “claw back” provision¹¹ that required the employee to pay back all of the profits

⁹ But this may not be true outside the context of a settlement agreement. The Court in *Yost* referred to *Pontiac Fire Ins. Co. v. State*, 18 S.W. 2d 929 (Tex. Civ. App. 1929, writ ref’d), in which the Court held that an agreement between two insurance companies not to hire the other’s agents violated the antitrust laws.

¹⁰ The citation is to the District Court opinion on the motion for a preliminary injunction. The opinion of the Fifth Circuit on the appeal from the final judgment is discussed *infra* at I.I.C.

¹¹ The stock option clause provided:

Employee specifically recognizes and affirms that [the aforementioned covenants are] material and important term[s] of this Agreement[,] and Employee further agrees that should all or any part or application of subdivisions (b) or (c) of Section 8 of this Agreement be held or found invalid or unenforceable for any reason whatsoever by a court of competent jurisdiction in an action between Employee and the Company, [Compass] shall be entitled to receive . . . from Employee all Common Stock held by Employee. . . . If Employee has sold, transferred, or otherwise disposed of Common Stock obtained under this Agreement[, Compass] shall be entitled to receive from Employee the difference between the Option Price paid by Employee and the fair market value of the Common Stock . . . on the date of sale, transfer, or other disposition.

earned under the stock options if the covenant not to compete was determined to be *unenforceable*. The court determined that the claw back provision was enforceable and even affirmed a partial award of attorney’s fees to Compass Bank. 363 F.3d at 567-68.

D. Liquidated Damages and Forfeiture Provisions

A liquidated damages provision is enforceable when the harm caused by the breach is incapable or difficult of estimation and the amount of liquidated damages called for is a reasonable forecast of just compensation. *Phillips v. Phillips*, 820 S.W.2d 785, 788 (Tex. 1991). In the context of non-competition covenants, the Supreme Court of Texas has upheld liquidated damages clauses as a remedy for the breach of an enforceable covenant. In *Henshaw v. Kroenecke*, 656 S.W.2d 416, 419 (Tex. 1983), the Court stated that such a provision must “be a reasonable forecast of just compensation for the harm that is caused by the breach.” In *Henshaw*, the parties provided that the liquidated damages clause would be tied to the average monthly billings for any clients that the former employee did business with.

In *Peat Marwick v. Haass*, *supra*, however, the Court distinguished *Henshaw* and noted that the promisee (i.e., the employer) retained the obligation to show that the covenant met the criteria for the enforceability of the non-competition agreement. The Court rejected the notion that the covenant did not have to meet the criteria and held that the covenant’s purpose and effect were to restrict competition. The Court also rejected Peat Marwick’s request to reform the covenant. The Court noted that Peat Marwick sought only damages and not injunctive relief. The Court held that reformation of the agreement was limited to providing injunctive relief and did not allow the employer to recover damages for any acts that occurred prior to reformation.

Thus, if a liquidated damages clause is used, the drafter should not limit the employer’s remedy to liquidated damages. Moreover, the damages clause, if used, should be tailored to be a reasonable forecast of the employer’s damages in the event of a breach.

E. Severance and Settlement Agreements

Often employers desire to couple a severance package with a covenant not to compete. The typical consideration, of course, is some cash payment, along with a mutual release and a reaffirmation of any prior non-disclosure and non-competition agreement. In a normal severance agreement, there is no reciprocal promise from the employee that the covenant is designed to protect. The employee would simply release all claims he or she might have in exchange for a monetary payment. Under the law prior to *Sheshunoff*, the fact that confidential information may

have been given to the employee in the past, and the fact that the employee may have promised at one time not to disclose the confidential information would not necessarily create a protectable interest since these events already occurred and could be viewed as past consideration. *CRC-Evans Pipeline International, Inc. v. Myers*, 927 S.W.2d 259, 262 (Tex.App.—Houston [1st Dist.] 1996, no writ) (covenant unenforceable when employer did not disclose new confidential information upon re-employment of former employee).¹²

In *Sheshunoff*, the Court appeared to reject the argument that *past* confidential information could never form part of the justification for a non-competition covenant. Early in the opinion, the Court made it clear that a non-competition covenant cannot be a stand alone promise lacking any new consideration. But later the Court indicated that concerns that had driven disputes over whether a covenant is “ancillary” or not – like the time period over which confidential information is received – are “better addressed in determining whether and to what extent a restraint on competition is justified.” On this justification issue, Johnson argued that his agreement was unenforceable because he got no *new* confidential information. The Court disagreed and said: “Although ASM had given Johnson access to the same marketing information without a covenant not to

¹²An argument can be made that a severance agreement is like a settlement agreement that is a separate form of ancillary agreement that has been found to be adequate to support a covenant not to compete. See *Justin Belt Co. v. Yost*, *supra*. In *Yost*, the Texas Supreme Court enforced a covenant not to compete that was part of a settlement agreement concerning an employer’s lawsuit for disclosure of trade secrets. The Texas Supreme Court noted the traditional rule that a covenant not to compete must be ancillary to an otherwise enforceable agreement or valid relationship in order to be enforceable, but it did not go into what kind of contract was required. Obviously, the settlement contract at issue was considered adequate, and the Court emphasized the public policy behind enforcing settlement agreements. 502 S.W.2d at 684.

There are some problems with relying upon the *Yost* analysis, however. Obviously, it is dependent upon a Texas Supreme Court opinion that preceded the statute. The statute expressly preempts all common law standards in this area (although, again, the Supreme Court in *Marsh* stated that the purpose was to restore the common law). To the extent the Texas Supreme Court now interprets the language of the statute in a manner different from the common law ancillary agreement test identified in *Yost*, the *Yost* opinion would no longer be applicable. Further, the dissent in *Yost* argued that a non-competition agreement entered into by an employee who did not have one during his employment was unenforceable. *Yost*, 502 S.W.2d at 687 (Johnson, J., dissenting).

compete, nothing precluded ASM from seeking the greater protection of a covenant when it did [i.e. mid-way through employment].” It is unclear at this time whether the same reasoning would be extended to agreements at the end of employment, but there is certainly room for argument either way, particularly since *Marsh* emphasizes that the consideration given in the otherwise enforceable agreement does not have to give rise to the employer’s interest in restraining competition.¹³

The Tyler Court of Appeals considered a release and severance agreement in *American Fracmaster, Ltd. v. Richardson*, *supra*, and generally agreed with this analysis. Using the analysis under *Light* prior to *Marsh*, the Court held that the severance payment (over \$180,000) did not support the non-competition provision under *Light* because the payment of money did not give rise to the employer’s interest in restraining the employee from competing. 71 S.W.3d at 387. Likewise, the Court held, the employee’s reaffirmation of the non-disclosure provisions did not support the non-competition agreement because the employer had not provided any confidential information prior to severance. *Id.* at n.5.

However, the Court held that, in the mutual release between the parties, the employee had agreed not to sue the employer and had agreed not to challenge the non-competition provisions of the Agreement. The Court held that this was an enforceable waiver, notwithstanding that the covenant was unenforceable under *Light*. *Id.* at 389. While *Fracmaster* was vacated pursuant to a settlement agreement, any employer drafting a release agreement should include a specific waiver that the employee will not challenge the enforceability of the non-competition agreement.¹⁴

Thus, even with the *Fracmaster* reasoning and *Marsh*, the employer should take steps that would make the covenant more likely to be enforced. While

¹³ Even subsequent to *Sheshunoff*, however, at least some courts still require new consideration for the enforcement of a noncompetition clause. See *Powerhouse Productions v. Scott*, 260 S.W.3d 693 (Tex. App.-Dallas 2008, no pet.) (agreement concerning “rocket pack pilot” was unenforceable because the evidence did not show the employer provided the employee with additional training or confidential information because he signed the agreement).

¹⁴ In a case involving a covenant not to compete arising out of a partnership agreement, the Waco Court of Appeals reversed a summary judgment and held that a fact issue arose from the estoppel defense asserted by the promisee. The Court cited *Fracmaster* for the proposition that the question of unenforceability could be waived by a valid settlement agreement. *National Café Services v. Podaras*, 148 S.W.3d 194, 199 (Tex. App.—Waco 2004, pet. denied).

no opinion has yet addressed these ideas, the severance agreement should include a provision that, in exchange for the severance payment, the employee releases any claim that he may have to the employer's confidential information and goodwill. Likewise, the severance agreement should provide that the employee will not disclose the confidential information or interfere with the employer's goodwill. If there is a prior non-disclosure and non-competition agreement, the severance agreement should state that it is considered an extension of the original agreement and is reasonable and necessary for the continuing protection of the promises the parties made in the original agreement. Finally, the employer should consider including a reciprocal clause where the employee agrees to remain available for occasional consultation with employees on employment related matters (including matters related to protected interests, confidential information, specialized training, etc.) during the life of the restrictive covenant. This provides an argument that there is a continuing principal purpose for the agreement which the covenant not to compete is designed to protect and also allows the employer to argue that the employee has a continuing fiduciary duty to his or her employer that could be enforced through common law. Finally, delaying payments until the end of the covenant period—or at least paying installments during the covenant period—may offer the most practical means of obtaining compliance with the non-competition provisions.

F. Arbitration Clauses

Coupling the non-competition covenant with an arbitration clause can create some unintended consequences. For instance, an employer generally wishes to obtain emergency relief through a temporary restraining order. Pursuing that action through a temporary injunction, however, may defeat the purpose of an arbitration clause in saving expense and limiting the cost of litigation. Courts have upheld contractual provisions allowing the employer to seek a preliminary injunction pending arbitration.¹⁵

¹⁵ See *RGI, Inc. v. Tucker & Associates, Inc.*, 858 F.2d 227, 228-30 (5th Cir. 1988); *Merrill, Lynch, Pierce, Fenner & Smith, Inc. v. Chapman*, 1998 WL 792501 (N.D. Tex. 1998).

The Beaumont Court of Appeals granted a writ of mandamus where the employer sought to stay an arbitration over severance during the pendency of the employer's suit for violation of the covenant not to compete. The clause exempted proceedings concerning the violation of the non-competition clause from arbitration. The trial court granted a stay of the employee's suit, but the Court of Appeals granted the writ, holding that there was no showing of irreparable harm from allowing the arbitration proceeding

The recent case *Gray Wireline Service, Inc. v. Cavanna*, No. 10-11-00058-CV, 2011 WL 4837727 (Tex. App. – Waco, Oct. 12, 2011) addresses some of the issues that can arise from a mandatory arbitration provision in an employment agreement. In the case, Gray Wireline Service, Inc. (“GWSI”) filed a lawsuit against former employees seeking a temporary restraining order for a variety of violations of the employment agreement. The judge issued the TRO, and shortly thereafter, the employees filed a demand for arbitration. GWSI withdrew its request for temporary injunction the day before the scheduled hearing, and the three employees filed a motion to reform the non-compete clause or for a determination that they were in full compliance with the employment agreements. GWSI then filed its own demand for arbitration. The trial court denied the motion to compel arbitration relating to the motion to reform and by separate order granted the motion to reform and reformed the employment agreements of the three employees. The court then granted the motion to compel arbitration but denied the motion to stay the trial court's proceedings pending the arbitration as to all defendants except the three employees who had sought reformation as well as a CGN Leasing, a company named in the suit.

GWSI argued that the reformation of the non-compete agreements was not allowed within the categories of relief allowed by the arbitration clause, but that the issue of reformation should be determined by the arbitrator because reformation, pursuant to Section 15.50, is an issue to be determined at a final hearing on the merits. Because of this, GWSI contended the trial court could not permanently and finally reform the agreements prior to a determination on the merits at a final hearing, which should have been before the arbitrator.

The Court of Appeals found that the arbitration clause only allowed for temporary relief from the trial court, and reformation of the non-compete agreements could only be construed as a permanent reformation, which was not within the exception to the arbitration clause in the agreements. The appellate court further held that the trial court should have found that the issue of reformation was to be determined by the arbitrators. Accordingly, practitioners should use caution in crafting an arbitration clause as it relates to both the enforcement and reformation of any restrictive covenants to ensure the goal of the arbitration clause is accomplished and does not restrict the enforcement of the noncompetition clauses.

to continue. *Murray v. Epic Energy Resources*, 300 S.W.3d 461 (Tex. App.—Beaumont 2009, no pet.).

G. Tolling Provision

The non-competition covenant should contain a provision stating that the period of the agreement is tolled during any violation of the covenant. Otherwise, the covenant's time period may expire during appeal and render moot any request for injunctive relief. *See Rimes v. Club Corp. of America*, 542 S.W.2d 909, 912 (Tex. Civ. App.—Dallas 1976, writ ref'd n.r.e.)(injunctive relief request moot when term of covenant had expired). However, one Court of Appeals case suggests that even without a tolling provision, proof of continuous and persistent violations of the covenant not to compete may be sufficient to support the equitable extension of a covenant not to compete. *Farmer v. Holley*, 237 S.W.3d 758, 761 (Tex. App. – Waco 2007, pet. denied) (“We do not hold that a covenant not to compete cannot be equitably extended, but hold that the record does not support Holley’s argument that the violations of the covenant, if any, were ‘continuous and persistent.’”).

Additionally, some courts have been willing to equitably extend the length of the non-compete beyond its normal expiration date due to litigation delays. *See e.g. Guy Carpenter & Co. v. Provenzale*, 334 F.3d 459, 464 (5th Cir. 2003) (equitable extension of injunction beyond the expiration of the non-solicitation covenant because of litigation delay); *Premier Indus. Corp. v. Tex. Indus. Fastener Co.*, 450 F.2d 444, 448 (5th Cir. 1971) (equitable extension due to expiration of relief within a few months).

H. No Violation Clause

The employment agreement should also contain a provision stating that any violation or breach by the employer will not constitute a defense to injunctive relief. At least one Texas court has upheld such a provision. *French v. Community Broadcasting*, 766 S.W.2d at 331. On the other hand, courts have denied injunctive relief under the “unclean hands” doctrine when the employee can show that the employer has failed to fulfill all of its promises under the agreement. *Chapman Air Conditioning, Inc. v. Franks*, 732 S.W.2d 737 (Tex. App.—Dallas 1987, no writ)(covenant not enforced when employer cut employee’s vacation time without employee’s consent). *But see Central Texas Orthopedic Products, Inc. v. Espinoza*, 2009 WL 4670446 (Tex. App.—San Antonio, Dec. 9, 2009)(unpublished opinion) (unclean hands doctrine applies only when breach of contract goes to same subject matter of agreement and breach of customer non-solicitation was not same subject matter as breach of action for commissions).¹⁶

Including a “no violation clause” in the agreement provides an argument to distinguish *Chapman Air* if the departing employee argues that the covenant should not be enforced due to some alleged breach by the employer.

I. The Sale of a Business

Covenants not to compete are relatively easy to enforce in the context of a sale of a business. Not only are courts more receptive to such covenants, but also the Covenant Not to Compete Act provides that the promisor must bear the burden of proof that the covenant fails to meet the statutory criteria. Even here, however, it is important for the drafter to consider how the covenant will serve the buyer’s legitimate business interest in preserving the goodwill of the purchased company. Even in the context of the sale of a business, courts have held that a restrictive covenant not to compete must be reasonably necessary, must not be oppressive, and must not be broader than the business sold. *Pitts v. Ashcraft*, 586 S.W.2d 685, 692-93 (Tex. Civ. App.—Corpus Christi 1979, writ ref’d n.r.e.).

Often, the sale of a business will involve the seller continuing as an employee of the new company. If so, the drafter should tie the non-competition covenant to the sale of the business so that it will be easier to enforce. Otherwise, the breaching seller/former employee may argue that the covenant should be construed according to the cases considering employee non-competition covenants.

A 2009 case reminds that enforcement of covenants not to compete in the sale of a business is not automatic. In *Bandera Drilling Co. v. Sledge Drilling Co.*, 293 S.W.3d 867 (Tex. App.—Eastland Aug. 6, 2009, no pet. h.), the seller, Bandera, sold

failed to pay him over \$12,000 in commissions. The Court refused to apply the “unclean hands” doctrine. The Court also stated that, because Espinoza had met with his prospective employer and had shared information about customers and sales, there was a material issue of fact with regard to CTOP’s defense on the wage claim that Espinoza had breached fiduciary duties owed to it.

In a recent federal court case, the Court also rejected the former employees’ argument that the covenant was not enforceable due to the alleged constructive discharge by the former employer. *Drummond American, LLC v. Share Corp.*, 692 F. Supp.2d 650 (E.D. Tex. 2010)(Schell, J.) (“[t]ermination of at will employment does not invalidate a restrictive covenant and it does not give rise to a claim for constructive discharge). The Court also stated that the alleged intolerable working conditions did not invalidate the covenant. *Compare Norris of Houston, Inc. v. Gafas*, 562 S.W.2d 894 (Tex. Civ. App.—Houston [1st Dist.] 1978, writ ref’d n.r.e.)(suggesting that intolerable working conditions might give rise to defense but holding that former employee failed to show such conditions).

¹⁶ In this case, the employee Espinoza alleged that the employer, Central Texas Orthopedic Products, Inc., had

drilling rigs to the buyer, Sledge. Following the sale, Bandera took various steps to transfer the business to Sledge, including transfer of employee files and introduction to Bandera's customers. Bandera also derived tax benefits from treating the sale of the drilling rigs as a sale of a business, rather than the sale of individual drilling rigs. The Eastland Court of Appeals noted that "Texas common law has traditionally been hostile to restraints of trade such as covenants not to compete," but noted that the Texas statute had provided for their enforceability. *Id.* at 871. The Court noted that, from the post-contractual activities, it appeared that the parties had contemplated the sale of the business, including Sledge's goodwill in the drilling business. The Court noted, however, that nothing in the written agreement (which the parties appeared to have drafted without the assistance of counsel) obliged Sledge to transfer the goodwill. The Court recognized that such obligations could be inferred under *Mann Frankfort*, but rejected the application of the "inferred promise" doctrine in this case because, unlike *Mann Frankfort*, it was possible that the drilling rigs could have been transferred without the transfer of the goodwill:

The purchase agreement in this case supports no similar inference [to that of the non-disclosure provision in *Mann Frankfort*]. The extrinsic evidence makes clear that Sledge Drilling intended to operate in West Texas and that it effectively acquired a West Texas going concern, but the contract's written terms would have been equally satisfied if Sledge Drilling had taken the rigs and equipment overseas or if Bandera Drilling had refused to make any introductions or provide any personnel information.

Id. at 874. The Court concluded, "If Bandera Drilling and [its owner] Brazzel were required to do nothing beyond the express terms of the contract, the covenant is a naked restraint of trade and is, therefore, unenforceable." *Id.*

J. Choice of Law and Forum Selection Clauses, and *AutoNation*

In *DeSantis v. Wackenhut*, the Texas Supreme Court held that Texas courts will apply Texas law to a case involving a non-competition covenant where the employee performs the majority of services in Texas, even when the parties stipulated the law of a different forum, because of the important public policy concerns regarding non-competition covenants. 793 S.W.2d at 676-79.

Despite this holding, several Texas courts enforced a forum selection clause where the parties

agreed to litigate the question of a non-competition provision in another state. *Holeman v. National Business Institute, Inc.*, 94 S.W.3d 91 (Tex. App.—Houston [14th Dist.] 2000, pet. denied) (affirming dismissal of case based on forum selection clause requiring Texas employee to go to Georgia); *In re Tyco Electronics Power System, Inc.*, 2005 WL 237232 (Tex. App.—Dallas Feb. 2, 2005, orig. proceeding).

The Houston Court of Appeals disagreed with these cases and, following the reasoning in *DeSantis*, upheld an injunction that prevented an employer from further pursuing the enforcement of a non-competition covenant in Florida, even though there was a clearly otherwise enforceable forum selection clause in the employment agreement that said that Florida law would apply to disputes. *AutoNation v. Hatfield*, 186 S.W.3d 576, 579-580 (Tex.App.—Houston [14th Dist.] 2005, pet. granted). Although the Florida case was filed first, the Court of Appeals found that the public policy interests of Texas merited enjoining the Florida proceedings.

Following the grant of a petition for review, the Supreme Court held that the forum selection clause, at least under the facts presented in *AutoNation*, should be enforced through mandamus. The Court noted that, even where Texas law specified the application of Texas law, "these provisions are irrelevant to the enforceability of a forum-selection clause where no statute 'requires suit to be brought or maintained in Texas.'" *Id.* The Court went on to note, "Along similar lines, even if *DeSantis* requires Texas courts to apply Texas law to certain employment disputes, it does not require suit to be brought in Texas when a forum selection clause mandates venue elsewhere." *Id.* The Court also noted that, under principles of comity it should not interfere with actions filed in other states. The Court concluded:

Here, comity is not pitted against fundamental Texas policy, which does not require that every non-compete case involving a Texas resident be litigated in our courts . . . Accordingly, and without offending *DeSantis*, we will not presume to tell the forty-nine other states that they cannot hear a non-compete case involving a Texas resident-employee and decide what law applies, particularly where the parties voluntarily agreed to litigate enforceability disputes there and not here. Our holding today rests squarely on the parties' contractual commitment, but it carries the concomitant benefit of extending comity to Florida courts.

Id. at 670.

In *Rimkus Consulting Group, Inc. v. Cammarata*, 255 F.R.D. 417 (S.D. Tex. 2008), the court held that because Texas had a substantial relationship to the parties and their employment agreement, the parties' contractual choice that Texas law should govern disputes arising under the agreement was enforceable under the Texas choice-of-law rules. However, the court declined to resolve the issue whether, under the Full Faith and Credit Clause, a Louisiana court's ruling that Louisiana law applied (despite the choice of Texas law in the parties' employment agreement) invalidated the choice-of-law, noncompetition and non-solicitation provisions in all states.

Cammarata resigned from Rimkus on November 15, 2006 and, along with 2 other former Rimkus employees, created and began working for U.S. Forensic in competition with Rimkus. The majority of U.S. Forensic's clients were in Louisiana, and the majority of the company's work was performed in the state. Cammarata filed suit against Rimkus in Louisiana seeking declaratory judgment that the noncompetition and nonsolicitation provisions in the employment agreement were invalid. Rimkus then filed suit in federal court in Texas to enforce the noncompetition and nonsolicitation covenants. Although the agreement specified that Texas law applied, the Louisiana state court found that Louisiana law applied and, therefore, the non-compete clause and non-solicit clauses were unenforceable. The Louisiana court based this decision on public policy that prohibits or restricts noncompetition provisions in employment agreements which curtail an employee's right to earn a livelihood.

Cammarata argued to the U.S. Southern District Court of Texas that because the elements of *res judicata* were met under Louisiana law, the issue of the enforceability of the noncompetition and nonsolicitation clauses was barred. Rimkus responded that the preclusive effect of the Louisiana state court judgment was limited to the enforceability of the restrictive covenants under Louisiana law because the Louisiana court did not reach a decision as to Rimkus's claims that Cammarata breached his promises under Texas law. Essentially, Rimkus argued that since the Louisiana court did not decide whether the provisions of the employment agreement were enforceable under Texas law, the Southern District Court could consider whether the parties' choice of Texas law was enforceable and whether the restrictive covenants were enforceable under Texas law.

The court ultimately declined to resolve the issue of whether, under Full Faith and Credit, the Louisiana court's ruling that Louisiana law applied invalidated the choice-of-law, noncompetition and nonsolicitation provisions in all states. The court noted that at a minimum, the Louisiana court determined that in

Louisiana, the contractual forum-selection, choice-of-law, noncompetition, and nonsolicitation provisions were unenforceable – a ruling which the court found was entitled to preclusive effect in the federal court. The court went on to find that even assuming that it was free to analyze whether the noncompetition and nonsolicitation provisions were enforceable under Texas law, Rimkus was still not entitled to the preliminary injunction it sought.

In its analysis, the court found that Texas had a substantial relationship with the parties and the transaction (i.e. the parties signed the employment agreement in Texas, Rimkus is headquartered in Texas, both Rimkus and U.S. Forensic advertise and do business in Texas, and during his employment, Cammarata received work assignments from Texas and traveled to Texas for training and other employment-related purposes). Therefore, the parties' contractual choice of Texas law was enforceable under the Texas choice-of-law rules.

The court found that the noncompetition and nonsolicitation clauses were ancillary or part of an otherwise enforceable agreement. The court next considered the reasonableness of the restrictions. The court found the geographic restriction of the noncompetition clause unreasonable and unenforceable because it covered an area where Cammarata did not actually work. The court reformed the geographic restriction to be limited to Mississippi and Florida. The court found that while the 18 month time restriction of the non-compete might be reasonable, Rimkus had delayed 1 year before seeking a preliminary injunction against Cammarata and had not shown an entitlement to extending the clause for an additional 18 months.

The court found the nonsolicitation agreement to be unenforceable because it covered all Rimkus customers, not just the clients with whom Cammarata had contact. Since Cammarata's work for Rimkus primarily involved Louisiana clients, and the nonsolicitation provision was found unenforceable in Louisiana, the court refused to reform the clause. Ultimately, Rimkus's request for preliminary injunction was denied.

K. Other Clauses

The contract should also include provisions that (1) the employee has read and understood the agreement; (2) the employer may seek injunctive relief (and, if an arbitration clause is used in the contract, such relief should be excluded from the scope of the arbitration clause); (3) in the event that the covenant is overbroad, the court may reform it; (4) no oral statements are part of the contract; (5) the contract may be modified only in writing signed by a high officer of the company; and (6) the employee will

return all books and records containing confidential information to the company on departure.

Finally, non-competition agreements involving physicians must comply with the specific provisions set forth in TEX. BUS. & COM. CODE § 15.50(b). The Legislature has clarified that the provisions only apply to physicians who enter into a covenant not to compete “relating to the practice of medicine” and specifically provided that the section regarding physician non-competition agreements “does not apply to a physician’s business ownership interest in a licensed hospital or licensed ambulatory surgical center.”¹⁷

IV. CONCLUSION

There is little doubt that *Sheshunoff* through *Marsh* makes the law surrounding covenants not to compete more reasonable than under *Light* by moving away from the highly technical restrictions of *Light*.

These cases, along with *AutoNation* and others, indicate a new direction in which courts will be encouraged to enforce the parties’ promises as written (or implied) and focus on the reasonableness of the covenant’s restrictions, rather than being caught up in public policy concerns that limit the enforceability and scope of the written agreement. At the same time, reducing covenants not to compete to a mere “reasonableness” test leaves much to the discretion of the trial court and, thus, leads to a lack of predictability of the breadth and scope of the covenant’s enforcement.

¹⁷ As amended, the statute now reads:

(b) A covenant not to compete relating to the practice of medicine is enforceable against a person licensed as a physician by the Texas Medical Board [State Board of Medical Examiners] if such covenant complies with the following requirements:

(1) the covenant must:

(A) not deny the physician access to a list of his patients whom he had seen or treated within one year of termination of the contract or employment;

(B) provide access to medical records of the physician's patients upon authorization of the patient and any copies of medical records for a reasonable fee as established by the Texas Medical Board [State Board of Medical Examiners] under Section 159.008, Occupations Code; and

(C) provide that any access to a list of patients or to patients' medical records after termination of the contract or employment shall not require such list or records to be provided in a format different than that by which such records are maintained except by mutual consent of the parties to the contract;

(2) the covenant must provide for a buy out of the covenant by the physician at a reasonable price or, at the option of either party, as determined by a mutually agreed upon arbitrator or, in the case of an inability to agree, an arbitrator of the court whose decision shall be binding on the parties; and

(3) the covenant must provide that the physician will not be prohibited from providing continuing care and treatment to a specific patient or patients during the course of an acute illness even after the contract or employment has been terminated.

(c) Subsection (b) does not apply to a physician's business ownership interest in a licensed hospital or licensed ambulatory surgical center.

