

# Management Alert

## Texas Non-Competes: The Tables Have Turned

Until now, most non-competition agreements in Texas were considered unenforceable because they required a contemporaneous exchange of confidential information from the employer at the exact time the agreement was made, which almost never happened. On October 20, 2006, after considering the issue for almost three years, the Texas Supreme Court changed direction by holding that an at-will employee's non-competition agreement becomes enforceable if the employer imparts confidential information to the employee at some point during employment. *Sheshunoff Mgmt. Servs., L.P. v. Johnson*; No. 03-1050, slip op. at 1 (Tex. 2006). As a result of this opinion, the Texas Supreme Court has resurrected the enforceability of non-competes in Texas.<sup>1</sup>

### The Statute

Section 15.50 of the Texas Business and Commerce Code has created remarkable confusion regarding the consideration necessary to support a non-competition agreement. TEX. BUS. & COM. CODE. §15.50 (Vernon 2002). Specifically, Section 15.50 requires that a non-competition covenant: (1) be "ancillary to or part of an otherwise enforceable agreement at the time the agreement is made;" (2) impose "limitations as to the time, geographical area, and scope of activity to be restrained that are reasonable;" and (3) not "impose a

greater restraint than is necessary to protect the goodwill or other business interest" of the former employer. *Id.*

### The Prior Law: Footnote 6 of *Light*

Prior to last week, *Light v. Centel Cellular Co.*, was the Texas Supreme Court's foremost case interpreting Section 15.50. 883 S.W.2d 642, 643 (Tex. 1994).<sup>2</sup> In particular, footnote 6 became the focus of courts' and employers' attention and was also the source of much confusion on the timing question – that is, when an employer was required to impart confidential information to the employee. Footnote 6 provided as follows:

If only one promise is illusory, a unilateral contract can still be formed; the non-illusory promise can serve as an offer, which the promisor who made the illusory promise can accept by performance. For example, suppose an employee promises not to disclose an employer's trade secrets and other proprietary information, if the employer gives the employee such specialized training and information during the employee's employment. If the employee merely sought a promise to perform from the employer, such a promise would be illusory because the employer could fire the employee and escape the obligation to perform. If, however, the

<sup>1</sup> The Texas Supreme Court has also previously defined the term "ancillary to or part of" to require that (1) the consideration given by the employer in the otherwise enforceable agreement give rise to the employer's interest in restraining the employee from competing; and (2) the covenant be designed to enforce the employee's consideration or return promise in the otherwise enforceable agreement. *Light v. Centel Cellular Co.*, 883 S.W.2d 642, 643 (Tex. 1994).

<sup>2</sup> Footnote 14 of *Light* still provides the primary methodology for creating an enforceable non-competition covenant, *i.e.*, an employer's promise to provide confidential information in exchange for an employee's promise not to disclose the information: *Id.* at 647 n.14.

employer accepts the employee's offer by performing, in other words by providing the training, a unilateral contract is created in which the employee is now bound by the employee's promise. The fact that the employer was not bound to perform because he could have fired the employee is irrelevant; if he has performed, he has accepted the employee's offer and created a binding unilateral contract. . . . Such a unilateral contract existed between Light and United as to Light's compensation. But such unilateral contract, since it could be accepted only by future performance, could not support a covenant not to compete inasmuch as it was not an "otherwise enforceable agreement at the time the agreement is made" as required by § 15.50.

*Light* at 644-45 n.6 (emphasis added). Most courts interpreted footnote 6 to mean that when employment was "at will," a promise dependent on a period of continued employment was illusory because it failed to bind the promisor. Thus, they held, a non-competition covenant was unenforceable absent a near-contemporaneous exchange of the promises and confidential information.<sup>3</sup> A minority of courts did take a more expansive view of the timing issue, which, while not literally correct under *Light*,

had common sense appeal.<sup>4</sup> But the opinions from these courts were generally disfavored.

### The Departure from *Light*

In *Sheshunoff*, the employer, Sheshunoff, presented the employee, Johnson, with a non-competition agreement a few months following his promotion, and sometime later, Johnson received confidential information that he did not previously possess. *Sheshunoff*, slip op. at 2. Sheshunoff sued Johnson for breach of the non-competition agreement when he went to work for a competitor. *Id.* at 3. Johnson (and his new employer, who had intervened) moved for summary judgment arguing that under footnote 6 of *Light*, Sheshunoff's promise to provide confidential information was illusory at the time the agreement was made because there was not a contemporaneous exchange of confidential information. *Id.* The district court granted summary judgment and the Austin Court of Appeals affirmed. *Id.*

The Texas Supreme Court reversed, holding that the agreement was enforceable despite Sheshunoff's delay in providing confidential information to Johnson. In departing from footnote 6 of *Light*, the court re-interpreted the part

<sup>3</sup> See, e.g., *TMC Worldwide v. Gray*, 178 S.W.3d 29 (Tex. App.—Houston [1st Dist.] 2005, no pet.) ("There must be a contemporaneous exchange of consideration between the parties at the time the 'otherwise enforceable agreement' is executed for the promise not to be illusory. Under Section 15.50, the time relevant to this determination is the moment the agreement is made; the issue is whether, 'at the time the agreement is made,' there exists other mutually binding promises to which the covenant not to compete is ancillary or part and parcel."); *31-W Insulation Co. v. Dickey*, 144 S.W.3d 153, 158 (Tex. App.—Fort Worth 2004, pet. withdrawn); *Tom James of Dallas, Inc. v. Cobb*, 2003 WL 21564415 (Tex. App.—Dallas 2003, no pet.) (employer's promise to provide trade secrets to employee in the future was illusory because employment relationship was at-will); *Strickland v. Medtronic, Inc.*, 97 S.W.3d 835, 839 (Tex. App.—Dallas 2003, pet. filed); *American Fracmaster, Ltd. v. Richardson*, 71 S.W.3d 381 (Tex. App.—Tyler 2001, pet. dismissed) ("even if [the employer] had stated . . . that it had provided [the employee] with confidential information, this would not have been adequate consideration for the non-competition agreement, since past consideration will not support a subsequent promise not to disclose."); *Anderson Chem. Co. v. Green*, 66 S.W.3d 434, 438 (Tex. App.—Amarillo 2001, no pet.); *Terminex International Company v. Denton*, 2000 WL 84888 (Tex. App.—San Antonio, 2000 no pet.) (not designated for publication); *Miller Paper Co. v. Roberts Paper Co.*, 901 S.W.2d 593 (Tex. App.—Amarillo 1995, no writ).

<sup>4</sup> See, e.g., *Wright v. Sport Supply Group, Inc.*, 137 S.W.3d 289, 294 (Tex. App.—Beaumont 2004, no pet.) (holding that intermittent flow of alleged confidential information to employee, though after execution of employment agreement, sufficed); *Evan's World Travel, Inc. v. Adams*, 978 S.W.2d 225 (Tex. App.—Texarkana 1998, no pet.); *Beasley v. Hub City Texas, L.P.*, No. 01-03-00287-CV, 2003 WL 22254692, \*5 (Tex. App.—Houston [1st Dist.], Sept. 29, 2003, no pet.) (not designated for publication). Coincidentally, the Fifth Circuit even decided that the Texas Supreme Court could not have meant what it said in *Light* and that Texas intermediate appellate courts that interpreted *Light* in a manner that required the near-contemporaneous exchange of consideration incorrectly stated Texas law. *Guy Carpenter & Co., Inc. v. Provenzale*, 334 F.3d 459 (5th Cir. 2003)

of Section 15.50 that states “a covenant not to compete is enforceable if it is ancillary to or part of an otherwise enforceable agreement at the time the agreement is made . . . .” *Id.* at 7-8. *Light* had concluded that “at the time the agreement is made” modifies “otherwise enforceable agreement,” thereby requiring the contemporaneous exchange of confidential information. *Id.* The court now concludes, contrary to *Light*, that the clause “at the time the agreement was made” was actually intended to modify “ancillary to or part of.” *Id.* Thus, under this interpretation, “a unilateral contract formed when the employer performs a promise that was illusory when made can satisfy the requirements of [Section 15.50].” *Id.* at 8.

The court further analyzed the legislative history of the phrase “at the time the agreement was made” and determined the language “was not intended to impose a new requirement that the agreement containing the covenant must be enforceable the instant it is made.” *Id.* at 12. Otherwise, the court noted, most non-competition agreements executed by at-will employees would be unenforceable. *Id.*

Importantly, the court further noted that Section 15.50 does not ground the enforceability of non-competition covenants on “overly technical disputes . . . , 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.” *Id.* at 13. Rather, courts should focus on whether the terms of the covenant are reasonable and do not impose a greater restraint than is necessary to protect the goodwill or other business interest of the promisee. *Id.*

## The Concurrences

Four of the nine justices concurred with the result in *Sheshunoff*, but not the reasoning. Chief Justice Jefferson and Justices O’Neill and Medina held that the employer’s exchange of confidential information should occur within a reasonable time after the agreement is made. They agree that “at the time the agreement is made” does not require an instantaneous exchange of confidential information, but they disagree that the employer’s promise may hang in the air, indefinitely, until it becomes enforceable by performance. The majority addresses this concern by holding that an employer may not withhold confidential information until it learns that an employee is resigning and then impart the information to make the non-competition agreement enforceable. *Id.* at n.8. Such a stunt would not reasonably protect an employers’ business interest under Section 15.50. *Id.* Justice Wainwright, in his lone concurrence, seems to indicate that he would consider money or continued employment satisfactory consideration to support a non-competition agreement.

## Conclusion

Until last week, Texas law regarding non-competition covenants was notoriously confused and difficult to predict. Most recent cases held non-competition covenants unenforceable, frustrating employers attempting to protect their business interests. With *Sheshunoff*, the Texas Supreme Court has ruled in favor of Texas employers and harmonized inconsistencies in its prior rulings.

*If you have any questions or wish to discuss these changes, please contact the Seyfarth Shaw LLP attorney with whom you regularly work or any attorney in the Trade Secrets Group at [www.seyfarth.com](http://www.seyfarth.com).*

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