Texas Employment Lawyer Association

Strategies for Defeating Non-Compete Agreements

October 28, 2011

Robert W. Schmidt
Crews Law Firm
701 Brazos, Suite 900
Austin, TX 78701
schmidt@crewsfirm.com
(512) 346-7077

Strategies for Defeating Non-Compete Agreements

Robert W. Schmidt

"Every contract, combination, or conspiracy in restraint of trade or commerce is unlawful." Section 15.05(a), Texas Business and Commerce Code.

In spite of this blunt prohibition against restraints on trade or commerce and a long common law history that has been generally hostile towards non-compete agreements, several Texas Supreme Court decisions beginning in 2006 appear to makes it easier than ever to prevent a person from making a living and working in a field of one's choosing. In light of this string of anti-competition decisions – *Alex Sheshunoff Mgmt. Servs., L.P. v. Johnson,* 209 S.W.3d 644, 660 (Tex. 2006), *Mann Frankfort Stein & Lipp Advisors, Inc. v. Fielding,* 289 S.W.3d 844, 849 (Tex. 2009), and *Marsh USA Inc. v. Marsh & McClennan Cos., Inc.,* 2011 Tex. LEXIS 465; 54 Tex. Sup. J. 1234, (June 24, 2011) – how can a non-compete agreement be defeated?

I. The Basic Statutory Framework for Non-Competes:

As an exception to the broad prohibition against restraints on trade, in 1989 the Texas Legislature passed the "Covenants Not to Compete Act," section 15.50 of the Texas Business and Commerce Code. The Act provides:

> § 15.50. Criteria for Enforceability of Covenants Not to Compete
>
> (a) Notwithstanding Section 15.05 of this code, and subject to any applicable provision of Subsection (b), 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 to the extent that it 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.

The statute in essence sets out two specific elements for a non-compete to be enforceable:

(1) the non-compete must be ancillary to or part of an otherwise enforceable agreement at the time that the agreement is made; and

(2) contain limitations of time, geographic area, and scope of activity that are reasonable and that do not impose greater restraint than necessary to protect the company's goodwill or other business interests.

The first significant decision to interpret this statute was *Light v. Centel Cellular Co.*, 883 S.W.2d 642 (Tex. 1994) (opinion by John Cornyn). In this decision, the court noted that while the statute was enacted in response to some of court's decisions striking down non-compete agreements, the

statute essentially codified the common law that was in existence at the time.[1]

With regard to the first specific element of the statute – the requirement the noncompete be "ancillary to an otherwise enforceable agreement at the time the [non-compete] agreement is made" – the *Light* court elaborated on the "ancillary" requirement (drawing from common law) and how an enforceable non-compete agreement could be achieved. Specifically, the court explained that a covenant not to compete is "ancillary to or part of" an otherwise enforceable agreement at the time it was made if: (a) the consideration given by the employer in that agreement "gives rise to" the employer's interest in restraining the employee from competing; and (b) the covenant is designed to enforce the employee's consideration or return promise in that agreement. *Light*, 883 S.W.2d at

---

[1]As set forth in DeSantis v. Wackenhut Corp., 793 S.W.2d 670, 681-82 (Tex. 1990) (and reiterated by the dissent in *Marsh USA Inc. v. Marsh & McClennan Cos., Inc., 2011 Tex. LEXIS 465*; *54 Tex. Sup. J. 1234*, (June 24, 2011) "The fundamental common law principles which govern the enforceability of covenants not to RESTATEMENT (SECOND) OF CONTRACTS § 186 (1981). 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. *Justin Belt Co. v. Yost*, 502 S.W.2d 681, 683-684 (Tex. 1973); Potomac Fire Ins. Co. v. State, 18 S.W.2d 929, 934-935 (Tex. Civ. App.--Austin 1929, writ ref'd); RESTATEMENT (SECOND) OF CONTRACTS § 187 (1981). 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. RESTATEMENT (SECOND) OF CONTRACTS § 187 comment b (1981). Such transactions or relationships include the purchase and sale of a business, and employment relationships. Restatement (Second) of Contracts § 188(2) (1981). Second, the restraint created by the agreement not to compete must not be greater than necessary to protect the promisee's legitimate interest. *Henshaw v. Kroenecke*, 656 S.W.2d 416, 418 (Tex. 1983); *Weatherford*, , 340 S.W.2d at 951; RESTATEMENT (SECOND) OF CONTRACTS § 188(1)(a) (1981). Examples of legitimate, protectable interests include business goodwill, trade secrets, and other confidential or proprietary information. Restatement (Second) of Contracts § 188 comments b, g (1981). The extent of the agreement not to compete must accordingly be limited appropriately as to time, territory, and type of activity. RESTATEMENT (SECOND) OF CONTRACTS § 188 comment d (1981); see *Frankiewicz,* 633 S.W.2d at 507; *Justin Belt*, 502 S.W.2d at 685; *Weatherford*, 340 S.W.2d at 951. An agreement not to compete which is not appropriately limited may be modified and enforced by a court of equity to the extent necessary to protect the promisee's legitimate interest, but may not be enforced by a court of law. *Weatherford*, 340 S.W.2d at 952-953. 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. RESTATEMENT (SECOND) OF CONTRACTS § 188(1)(b) (1981); see *Henshaw*, 656 S.W.2d at 418 (citing *Weatherford*, 340 S.W.2d at 951 (agreement may not impose undue hardship on promisor)). Before an agreement not to compete will be enforced, its benefits must be balanced against its burdens, both to the promisor and the public. Thus, such an agreement may, in a particular case, accomplish the salutary purpose of encouraging an employer to share confidential, proprietary information with an employee in furtherance of their common purpose, but must not also take unfair advantage of the disparity of bargaining power between them or too severely impair the employee's personal freedom and economic mobility. See RESTATEMENT (SECOND) OF CONTRACTS § 188 comments c, g (1981). Whether an agreement not to compete is a reasonable restraint of trade is a question of law for the court. Henshaw, 656 S.W.2d at 418.

647; *see also Alex Sheshunoff Mgmt Servs., L.P. v. Johnson*, 209 S.W.3d 644, 648-51 (Tex. 2006).

Although the actual agreement in *Light* did not satisfy these requirements, the court essentially gave a blueprint on how to create an enforceable non-compete: (1) a promise by an employer to give confidential information to an employee, (2) the employer actually giving confidential information to the employee at the time the agreement is made, (3) in exchange for a promise by the employee to keep the information confidential, and (4) at the time the confidentiality agreement is executed, a non-compete agreement is also executed that contained reasonable restrictions as to time and geographic scope.

These elements were certainly possible to achieve, and *were* achieved if an employer really had *confidential information* and *really provided* the confidential information to the employee *at the time the agreement was made*. However, many non-compete agreements were ultimately held unenforceable following *Light,* because the employer simply failed to comply with these requirements. Attacking these deficits became a standard practice for defeating a non-compete agreement until *Sheshunoff, Mann Frankfort,* and most recently, *Marsh* reinterpreted the Covenants Not to Compete Act. In light of these decisions, several strategies that used to defeat a non-compete are likely no longer effective, while other strategies, both old and new, may still work to strike a non-compete or at least have the non-compete reformed to make it more "reasonable."

II. Arguments That Will Likely *Not* Defeat a Non-Compete Agreement:

A. At-Will Employment Alone Will Likely *Not* Defeat a Non-Compete Agreement.

Light made clear that even in an at-will employment relationship, it was possible for an employer to execute a valid non-compete agreement as long as the elements of the section 15.50 were met.

> Although Light was an employee-at-will, and by definition, she and her employer could not have an "otherwise enforceable agreement" between them pertaining to, for example, the duration of her employment, at-will employment does *not* preclude the formation of other contracts between employer and employee. At-will employees may contract with their employers on any matter except those which would limit the ability of either employer or employee to terminate the employment at will. Consideration for a promise, by either the employee or the employer in an at-will employment, cannot be dependent on a period of continued employment. Such a promise would be illusory because it fails to bind the promisor who always retains the option of discontinuing employment in lieu of performance. *East Line & Red River R. Co. v. Scott, 72 Tex. 70, 10 S.W. 99, 102 (Tex. 1888)* (noting that in at-will employment, "it is no breach of contract to refuse to receive further services"). When illusory promises are all that support a purported bilateral contract, there is no contract. In short, we hold that "otherwise enforceable agreements" can emanate from at-will employment so long as the consideration for any promise is not illusory.

Light, 883 S.W.2d at 644-45 (footnotes omitted). Other cases since *Light* have also held that the fact that an employee is in an at-will alone will not defeat a non-compete agreement. *See e.g. Jon Scott Salon, Inc. v. Garcia,* 343 S.W.3d 532 (Tex. App. – 5th Circuit Dallas, 2011) (no pet.) (reversing summary judgment for a former hair salon employee in non-compete case solely because the non-compete was part of an at-will employment agreement).

B. The Employer's Failure to Provide Consideration (Such as Confidential Information) *at the Time the Agreement Was Made* Will Likely *Not* Defeat a Non-Compete Agreement.

After *Light*, covenants not to compete in Texas have been almost always been based on ("ancillary to") a promise by the employer to provide "confidential" information in exchange for a promise by the employee to not disclose the information. Unless the employer actually gave the confidential information to the employee at (or very near) the time the agreement was made, the agreement was often found not enforceable. This was because the employer's promise to give the confidential information was "illusory" because the employer could terminate the employee before any confidential information is shared. Therefore, one way to challenge a non-compete agreement that depended on a promise to disclose confidential information was by arguing that the employer failed to provide the employee with the confidential information at the time the non-compete/confidentiality agreement was made. *See e.g. CRC-Evans Pipeline Int'l, Inc. v. Myers*, 927 S.W.2d 259, 263 (Tex. App.--Houston [1st Dist.] 1996, no writ).

In *Sheshunoff*, the supreme court held that although the Covenant Not to Compete Act specifically requires the covenant to be "ancillary to or part of an otherwise enforceable agreement *at the time the agreement is made*," the Act did not mean what it actually said: the agreement did not need to be enforceable at the time it is made. *Sheshunoff*, 209 S.W.3d at 651-656. Instead, relying primarily on "legislative history," the court held that even if the agreement was not enforceable *at the time it was made* (because a promise by an at-will employer to perform a future act is "illusory" because the employer could simply terminate the employee) the agreement could *later* become enforceable based on performance and, at that point, the covenant not to compete became enforceable.

The court held that "if the agreement becomes enforceable after the agreement is made because the employer performs his promise under the agreement and a unilateral contract is formed, the covenant [not to compete] is enforceable if all other requirements under the Act are met." *Id.* at 655.

Although *Sheshunoff* essentially did away with the statutory requirement that the "ancillary agreement" be enforceable at the time it was made, as discussed in part III of this paper, the court left some room for challenging a non-compete where the confidential information is given significantly later or under suspicious circumstances.

C. The Employer's *Failure to Actually Promise to Provide Confidential Information* Will Likely *Not* Defeat a Non-Compete Agreement.

Another way non-compete agreements have been challenged and found to be unenforceable is by actually looking at whether the employer actually made any sort of promise (providing consideration) in the "ancillary" agreement that supported the non-compete agreement. In the case of an ancillary agreement based on the provision of confidential information, a fundamental requirement would seem to be that the employer *actually promised to provide the employee with confidential information.* If no such promise was made, there was no mutuality of consideration and no "otherwise enforceable agreement."

In *Mann Frankfort Stein & Lipp Advisors, Inc. v. Fielding*, 289 S.W.3d 844 (Tex. 2009) the supreme court dispensed with this fundamental requirement that the employer actually promise something of value – *i.e.* consideration – in the "otherwise enforceable agreement," but rather found that an "implied promise" is sufficient. The Court concluded that a non-compete agreement is enforceable even if the employer does not actually promise or state that it will provide the employee with any confidential information in the non-competition agreement. Although not stated anywhere in the actual confidentiality/non-compete agreement, the court found that the non-compete was nonetheless enforceable because the employer ultimately provided the employees with access to its client database, containing clients' names, billing information, and tax and financial information, which constitute confidential information. The found that the employer had made an "implied promise" to provide the employee with confidential information, based on the fact that the employee in the agreement had promised not to disclose or use the employer's confidential information and the nature of the contemplated employment would reasonably require the employer to furnish the employee with confidential information.

Following *Mann Frankfort*, several courts have enforced non-compete agreements where an employer simply made an implied promise to provide an employee with trade secrets or confidential information. *See, e.g., Gallagher Healthcare Ins. Services*, 312 S.W.3d at 650-51 (decision enforcing non-compete agreement under *Mann Frankfort* standard); *York v. Hair Club for Men, L.L.C.*, No. 01-09-00024-CV, 2009 WL 1840813 (Tex. App.– Houston [1st Dist.] June 25, 2009, no pet.)

D. The Fact That a Non-Compete Is *Not Ancillary to an Agreement to Provide Confidential Information* May *Not* Defeat a Non-Compete Agreement.

Neither *Light* nor any other binding precedent specifically require that a non-compete be "ancillary to" a contract involving the exchange of confidential information. Nonetheless, perhaps because *Light* gave a "blueprint" for enforcing non-competes by using an ancillary confidentiality agreement, or because "revealing" confidential information to an employee in exchange for a promise to not disclose was the most inexpensive and easily available means of creating a non-compete, almost all employee non-competes in Texas have been based on such an agreement. *Light* explained that a confidentiality agreement was ancillary to and could support a non-compete because the

consideration given by the employer in the confidentiality agreement – the disclosure of confidential information – *"gives rise to"* the need for the non-compete. The logic went that if an employer shares confidential information with an employee, then the disclosure of that information "gives rise to" the need to restrict that employee from later competing against the employer with the benefit of the disclosed confidential information.

In *Marsh,* the Texas Supreme Court significantly expanded the potential realm of "ancillary agreements" that can be used to support a non-compete by doing away with the "gives rise" to requirement found in *Light* and the common law. Specifically, the court held that an agreement giving an employee stock options had a sufficient "nexus" and was "ancillary" to a non-compete agreement. The *Marsh* decision held that the proper test is not whether the "consideration" in the ancillary agreement "gives rise" to the need for the non-compete, but rather whether the "ancillary agreement" is "reasonably related to" an "interest worthy of protection." Under this test, the court found that a stock option agreement was sufficient because the agreement made the employee an "owner" of the company and linked his interests with the company's long-term business interests, including the development of customer and employee relationships. The court reasoned that the stock options furthered the company's goodwill, which is expressly an "interest worthy of protection." Based on the conclusion that the stock option agreement was reasonably related to the company's goodwill, the court held that the stock option agreement had a sufficient "nexus" with the non-compete agreement and that therefore, the non-compete was valid.

The opinion in *Marsh* foreshadows the ruling by beginning its legal analysis with the statement that "The Texas Constitution protects the freedom to contract. *See TEX. CONST. art. I,* Entering a noncompete is a matter of consent; it is a voluntary act for both parties." The reference to "freedom to contract" and the naive assumption that entering into a noncompete is a "voluntary act" harkens back to the notorious case of *Lochner v. New York*, 198 U.S. 45 (1905) that used of the "freedom to contract" doctrine as a justification to invalidate maximum hours labor laws. The court's apparent obliviousness to the unequal bargaining power of most employees who sign non-competes is reflected in its own statement in *Marsh* that "[w]e are somewhat befuddled by the continued antipathy to reliance on consensual and reasonable noncompetes as one means 'to encourage greater investment in the development' of business goodwill." Thus, the court readily acknowledges it's own cluelessness as to the impact of their decisions that keep regular people from making a living in the profession of their choosing. Their decisions not only make it even harder for "regular people"[2] to find a job in a difficult economic climate, but also hurt the broader economy by discouraging competition that typically leads to competitive pricing, better customer services and

[2]In my own practice, I've encountered numerous low wage workers – carpenters, hair salon workers, a pest control/exterminator, and a cook who were forced to sign non-compete agreements to be hired or to keep their jobs. Because of the court's decisions, I was forced to explain that the non-compete they signed were likely valid. These individuals were then forced to either find a new line of work or live under the threat of a lawsuit they could not afford to defend. The "chilling effect" is significant and causes real pain for Texas workers, as well as the loss of valuable knowledge, skill and talent.

innovation.

III. Arguments That *May* Defeat a Non-Compete Agreement.

While the Texas Supreme Court's reshaping of non-compete law appears to have made it significantly easier to enforce covenants not to compete, there are still means for challenging these agreements. In *Marsh, Sheshunoff,* and *Mann*, the court emphasized that the focus of review for such agreements should be the "reasonableness" of the restrictions imposed. Additionally, while the court has bent its interpretation of the statute and common law in favor of enforcement, some basic contractual principles still appear to have meaning in the area of non-competes. As noted by the concurrence in *Mann:*

> [I]n cases involving the enforceability of covenants not to compete, a shift in focus away from the reasonableness of the covenant's time, territory, and conduct restrictions toward issues of contract formation increases the risk that achieving what must in the end be an equitable result will cause a court to distort, confuse, or misstate contract law. Texas law has long been that unreasonable restrictions do not void a covenant not to compete but limit its enforcement. [15] *Section 15.51(c)* specifically requires a trial court to reform unreasonable restrictions. [16] In determining whether and how to enforce a covenant not to compete, a court must seek equity in reformation, not in the statement and application of general contract principles.

Mann 289 S.W.3d at 856. While the statement is intended to support the emphasis on "reasonableness," it also stands for the proposition that basic contract principles still matter. For example, "for a covenant not to compete to be enforceable, it must still be supported by consideration." *Gorman v. CCS Midstream Servs., L.L.C.*, 2011 Tex. App. LEXIS 3262 (Tex. App. Tyler Apr. 29, 2011) (no pet.) (citing *Powerhouse Prods., Inc. v. Scott*, 260 S.W.3d 693, 696 (Tex. App.—Dallas 2008) (no pet.) and *Sheshunoff*, 209 S.W.3d at 651). Following are some strategies and points that may be useful in challenging and defeating non-compete agreements:

A. Consideration (Confidential Information) Given By the Employer *Before* the Non-compete Was Signed May Defeat A Non-Compete Agreement.

In non-compete agreements that are ancillary to a confidentiality agreement, if the agreement was signed *after* the employee has already been working for the employer for a period of time, and *after* the employee has already had access to the confidential information, the non-compete may be invalid for lack of consideration. Such was the case in *Gorman v. CCS Midstream Servs., L.L.C.*, 2011 Tex. App. LEXIS 3262 (Tex. App. Tyler Apr. 29, 2011) (no pet.) The employee admitted that he received confidential and proprietary financial information about the employer's operation, and his knowledge of the employer's financial statements and the disclosure of that information would have given a competitive edge to his new employer. Nonetheless, the court found that a question of fact was raised about whether the alleged confidential information was already known to the employee

through his work at the company before the non-compete was executed. "[F]or a covenant not to compete to be enforceable, it must still be supported by consideration. *Powerhouse Prods., Inc. v. Scott*, 260 S.W.3d 693, 696 (Tex. App.—Dallas 2008, no pet.) (citing *Sheshunoff*, 209 S.W.3d at 651). Past consideration is insufficient. Id. at 697 (citing *Trilogy Software, Inc. v. Callidus Software, Inc.*, 143 S.W.3d 452, 463 (Tex. App.—Austin 2004, pet. denied)). 'The covenant cannot be a stand-alone promise from the employee lacking any new consideration from the employer.' *Id.* (quoting *Sheshunoff*, 209 S.W.3d at 651)." Thus, the court of appeals reversed the trial court's ruling in favor of the employer, and remanded.

B. Consideration (Confidential Information) Given Significantly *After* the Non-Compete Was Signed May Defeat A Non-Compete Agreement.

Although the majority in *Sheshunoff* did not explicitly require performance of the unilateral contract within a "reasonable" time, language in footnote 8 of the decision (responding to the dissent) suggests that a covenant to not compete would be unenforceable if an employer unduly delayed providing confidential information. The *Sheshunoff* court observed that in such a case, a trial court could determine that the employer's belated performance was "'unreasonable' and unnecessary to protect the employer's business interests," thereby defeating Section 15.50(a)'s requirement that a covenant be "ancillary to or a part of" an enforceable agreement, or 2) "conclude that the employer's unclean hands renders it ineligible for injunctive relief, "a remedy permitted under Section 15.51 of the Act. *Sheshunoff* 209 S.W.3d at 656.

C. Other Challenges to the Validity of Consideration (Confidential Information) May Defeat A Non–Compete Agreement.

While a wide variety of "confidential information" can be used as consideration in an "ancillary agreement" to support a non-compete[3], what if the information at issue is not actually confidential? In a case where a confidentiality agreement is the basis for the non-compete, the employer should be asked what steps the employer took to protect the "confidential information." Did the employer require *everyone* who viewed or used the information to sign a confidentiality agreement? Did the employer require everyone who

[3]Knowledge of a unique customer base and knowledge of the equipment or products used by each of the employer's customers are protectable interests. *See Stone v. Griffin Comm. & Security Systems, Inc.*, 53 S.W.3d 687, 694 (Tex. App.–Tyler 2001, no pet.). Information concerning acquisition strategies, compensation and benefits formulas, and payment rates may be considered confidential information that may support a non-compete. *See TransPerfect Translations, Inc. v. Leslie*, 594 F. Supp. 2d 742, 754 (S.D. Tex. 2009); *Teel v. Hospital Partners of America, Inc.*, No. H- 06-cv-3991, 2008 WL 346377, *7 (S.D. Tex. Feb. 6, 2008). The information need not be a trade secret: "Moreover, a covenant not to compete is enforceable not only to protect trade secrets but also to protect proprietary and confidential information." *Gallagher Healthcare Ins. Services v. Vogelsang*, 312 S.W.3d 640, 652 (Tex. App.–Houston [1st Dist.] Aug 21, 2009, pet. filed) (citing *Light*, 883 S.W.2d at 647 n. 14). "Customer information is a legitimate interest which may be protected in an otherwise enforceable covenant not to compete." *Id.* (citations omitted).

viewed or use the information to sign a non-compete agreement? Was the information available to other employees on the company's computer system without any steps taken to ensure its confidentiality? If it were determined that the employer only treated the information as "confidential" for the limited purpose of keeping its employees from competing, a reasonable argument could be made that no valid "consideration" was provided, or potentially that the employee was fraudulently induced into signing the agreement. *See also Staples, Inc. v. Sandler*, 2008 U.S. Dist. LEXIS 68589 (N.D. Tex. August 29, 2008) (noting the "minimal amount of confidential information" provided to the employee.)

D. Challenging the "Reasonableness" of A Non-Compete May Defeat or Limit the Agreement.

In *Sheshunoff, Mann* and *Marsh*, the Texas Supreme Court repeatedly emphasized that future analysis of the enforceability of non-compete agreements should focus less on "overly technical disputes" relating to the application of section 15.50, and more on whether the restraints imposed by the non-compete agreement are reasonable. Given the court's questionable credibility and its own inconsistencies in the interpretation of the statute, the deflection to "reasonableness" is arguably disingenuous. Nonetheless, a reasonable strategy for defeating non-competes will include fully embracing the court's directive to scrutinize non-competes to ensure that they are "reasonable."[4]

1. Non-Competes Run Counter to Capitalism and a Long Tradition in Texas Embracing the Virtues of Competition.

The concurrence written by Justice Don Willett in *Marsh* is a veritable "gold mine" of language lauding the virtues of competition and the dangers of non-compete agreements. Challenging the reasonableness of a non-compete is one notable area where extolling the virtues of capitalism work in favor of "the little guy." As Justice Willett stated:

> Restrictions on employee mobility that exist only to squelch competition are per se illegal in Texas, and for good reason. Economic dynamism in the 21st century requires speed, knowledge, and innovation--imperatives that must inform judicial review of efforts to sideline skilled talent. . . .
>
> Courts must critically examine noncompetes in light of our contemporary, knowledge-based economy that prizes ingenuity and intellectual talent. This much is clear: Courts cannot countenance covenants too contemptuous of competition.
> . . .
>
> But uttering the word goodwill is not enough; magic words do not boast auto-

[4]In determining the reasonableness of a noncompetition agreement's restraints, the court is to consider the restraints "in combination one another, rather than as stand alone requirements. *M-I LLC v. Stelly,* Civil Action No. 4:09-cv-1552, 2010 WL 3257972, at *31 (S.D. Tex. Aug. 17, 2010).

enforceability. Marsh must demonstrate that it is not invoking goodwill to camouflage a less noble interest: escaping future competition from Cook. . . .

There is no significance to the fact that Cook was paid in stock options for the covenant not to compete. Where the goal is restricting competition, the manner of payment is irrelevant. If stock options permit such a covenant because, as the affidavit states, they align the interests of the employee with "the long-term success of the company, which, in turn enhances the goodwill of" the employer, then *any* reward for a job well done--a raise, promotion, bonus, or pension--could justify a noncompete on grounds it aligns employer/employee interests and thus bolsters "goodwill." At bottom, none of these rewards, like "merely promising to pay a sum of money to the employee," can be used to purchase a noncompete whose only purpose is to eliminate competition. Absent some other legitimate reason, such a restraint on trade is unenforceable. . . .

The Act's paramount purpose "is to maintain and promote economic competition in trade and commerce ... and to provide the benefits of that competition to consumers in the state." . . .

The underpinnings of this principle long predate Texas (or America) and draw from the recognition that bustling markets best spur and reward ingenuity. The Lone Star State lauds economic dynamism. And while it is perhaps natural for a profit-maximizing company to bend toward collusive or monopolistic restriction, Texas law is hostile to such noncompetitive impulses. Nor can it be doubted that some companies try to tilt the playing field via dubious noncompete covenants, even facially unenforceable ones, knowing that even the *specter* of enforcement action will chill employees (and their potential employers) into preemptive capitulation. . . .

More to the point, while "goodwill" is a bona fide business interest under the Act, it is not enough merely to mutter the word. You cannot simply buy a covenant not to compete. 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,"[25] 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. . . .

> Summing up: Post-employment restrictions are restraints on trade and, as such, deserve rigorous legal scrutiny, particularly given today's pace of warp-speed economic change. Noncompetes tailored to protectable business interests have their lawful place, but they should be used sparingly and drafted narrowly. And employers must demonstrate special facts that legitimize the noncompete agreement. Squelching competition for its own sake is an interest unworthy of protection. Competition by a former employee may well rile an employer, but companies do not have free rein to, by contract, indenture an employee or dampen everyday competition that benefits Texas and Texans.

(Citations and footnotes omitted.)

2. The Non-Compete Act Provides That the Agreement "Not Impose a Greater Restraint than Is *Necessary*."

The concurrence written by Justice Don Willett in *Marsh* also notes some little noticed language contained within section 15.50:

> Alongside "reasonableness," the statute also requires that the agreement "not impose a greater restraint than is necessary." We have never squarely addressed whether the Act envisions two separate inquiries: (1) that the time/geography/scope limitations be "reasonable," and also (2) that the restraint not reach beyond that which is "necessary" to protect the company's protectable interests. The latter suggests more exacting scrutiny than mere "reasonableness." The Act separates the latter from the former with the conjunction "and," suggesting separateness, while the pre-1993 version of the Act fused the two explicitly. None of our cases declare whether "reasonable" and "necessary" are two separate inquiries or whether the latter is simply blended into the former. Many courts implicitly subsume everything under an overarching banner of reasonableness, while others treat them as separate prongs. [Citing *Am. Express Fin. Advisors, Inc. v. Scott, 955 F. Supp. 688, 691 (N.D. Tex. 1996)*.] Either way, it is not an issue we reach today.

Given the court's professed allegiance to statutory language fidelity in *Marsh*, employees challenging non-competes should accept Justice Willett's invitation to read meaning into this previously unrecognized language in the statute.

3. Prohibiting Solicitation Beyond an Employer's *Actual Clients* May Make a Non-Compete Overly Broad and Unenforceable.

In *EMS USA, Inc v. Shary*, 309 S.W.3d 653 (Tex. App. – Houston [14th Dist.] 2010) (no pet.) the Houston Court of Appeals observed that a "restraint on client solicitation in a personal services contract is overbroad and unenforceable if it extends to clients with whom the employee had no

dealings during his employment." (citation omitted). Similarly, in *Wright v. Sport Supply Group, Inc.*, 137 S.W.3d 289, 292 (Tex. App.–Beaumont 2004) (no pet.) the court held that "a covenant not to compete that extends to clients with whom a salesman had no dealings during his employment is unenforceable." In *John R. Ray & Sons, Inc. v. Stroman*, 923 S.W.2d 80, 85 (Tex. App.–Houston [14th Dist.] 1996, writ denied) the court held "[i]n the case of covenants applied to a personal services occupation, such as that of a salesman, a restraint on client solicitation is overbroad and unreasonable when it extends to clients with whom the employee had no dealings during his [or her] employment."

See also Safeworks, LLC v. Max Access, Inc., No. H-08-2860, 2009 WL 959969, at *5 (S.D. Tex. Apr. 8, 2009), (holding overbroad an unenforceable as a matter of law a noncompete restricting salespersons from soliciting potential clients with whom the sales person had not worked), *York v. Hair Club For Men, L.L.C.*, 2009 Tex. App. LEXIS 4866 (Tex. App. Houston 1st Dist. June 25, 2009) (no pet.) (upholding injunction that only prohibited employees from soliciting former clients of the employer)*; Poole v. U.S. Money Reserve, Inc.*, No. 09-08-137CV, 2008 WL 4735602, at *8 (Tex. App.– Beaumont Oct. 30, 2008); *McNeilus Companies, Inc. v. Sams*, 971 S.W.2d 507, 511 (Tex. App.–Dallas 1997) (no writ) (holding noncompete was overbroad in scope that prohibited former employee from working "in any capacity" for competitor of former employer); *Recon Exploration, Inc. v. Hodges*, 798 S.W.2d 848, 853 (Tex. App.–Dallas 1990) (no writ) (non-competition agreement prohibiting employment in any business of type and character engaged in and competitive with former employer presented question of reasonableness); *Daytona Group of Tex., Inc. v. Smith*, 800 S.W.2d 285, 288 (Tex. App.–Corpus Christi 1990) (writ denied).

Additionally, *Sheshunoff* upheld a covenant prohibiting an employee from soliciting or providing services to the employer's clients for a period of one year following termination. In *Gallagher Healthcare Ins. Servs. v. Vogelsang*, 312 S.W.3d 640 (Tex. App. – Houston [1st Dist] 2009) (no pet.) the court found that restraints tied to the employee's own work at the prior employer were reasonable. In *Drummond American, LLC v. Share Corp.*, 693 F. Supp. 2d 650 (E.D. Tex. 2010), the Court enforced a restriction prohibiting calling on any customer of the employer from whom the employee solicited orders or to whom the employee sold competitive products on behalf of the company during the last year of employment. *But see M-I LLC v. Stelly*, 733 F. Supp. 2d 759 (S.D. Tex. 2010) (holding that the general rule that a covenant not to compete must not extend to clients with whom a salesperson had no dealings during his employment does not apply where the employee at issue is not merely a salesperson).

Finally, in *Staples, Inc. v. Sandler*, 2008 U.S. Dist. LEXIS 68589 (N.D. Tex. August 29, 2008), the Court held that a non-compete agreement was overbroad which prohibited a former employee from doing business with customers the employee had provided services to before employment with the company. "[T]he 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.

4. The Rank of an Employee May Be a Factor in Whether the Agreement Is Reasonable or Enforceable.

In *Marsh* the court repeatedly emphasized that the employee who was restricted by the non-compete was a "key," "valued" and "valuable" "managing director" of the employer. *Similarly,* in *M-I LLC v. Stelly*, 733 F. Supp. 2d 759 (S.D. Tex. 2010), the court placed special emphasis on the fact that the employee held an "upper management position." As the court noted, "M-I has submitted evidence showing that Knobloch was much more than a manager and salesman for his former employer. He oversaw SPS/GCS's relationships with major international clients. … An engineer by training, Knobloch participated in the design of the SPS/GCS's tools and in facilitating wellbore compeletions. He delivered technical presentations internationally, formulated company growth strategies, and discussed product development with engineers. … Given Knobloch's high level of involvement in the company's growth and development, the Court believes that restricting him from contacting SPS/GCS's customer base was reasonable."

5. The Non-Compete May Be Unreasonable as to Time.

Although section 15.50 requires that a non-compete agreement must be reasonable as to time, Texas courts have generally upheld agreements with restrictions of one year, two years or even longer. See, *e.g.*, *Stone*, 53 S.W.3d at 696 (upholding a five year restraint and stating that "two to five years has repeatedly been held a reasonable time restriction in a noncompetition agreement.") (citing *AMF Tuboscope v. McBryde*, 618 S.W.2d 105, 108 (Tex. Civ. App.–Corpus Christi 1981, writ ref'd n.r.e.), citing *Arevalo v. Velvet Door, Inc*., 508 S.W.2d 184 (Tex. Civ. App.–El Paso 1974, writ ref'd n.r.e.); *Electronic Data Systems Corp. v. Powell*, 508 S.W.2d 137 (Tex. Civ. App.–Dallas 1974, writ ref'd n.r.e.); *Weber v. Hesse Envelope Co.*, 342 S.W.2d 652 (Tex. Civ. App.–Dallas 1960, no writ)).

Nonetheless, shorter time periods may be more reasonable. *See M-I LLC v. Stelly*, 733 F. Supp. 2d 759 (S.D. Tex. 2010) (upholding a six month non-compete). Factors that should be considered in assessing whether the length of time is reasonable include the length of time the employee worked for the employer, and the value and nature of the consideration provided by the employer in exchange for the agreement. If the non-compete was based on the provision of confidential information, the "shelf life" of the confidential information (*i.e.* how long will the confidential information really be useful) is a valid consideration. An additional factor might include the length of time it takes to develop customer relationships or sales.

5. The Non-Compete May Be Unreasonable as to Geographic Scope.

Section 15.50 and most Texas courts require some geographic limitation in a valid covenant

not to compete. *Goodin v. Jolliff*, 257 S.W.3d 341, 352 (Tex. App.–Fort Worth 2008) (no pet.) reviews cases in this area and notes that covenants with no geographic or customer restrictions are invalid. *Zep Mfg. Co. v. Harthcock*, 824 S.W.2d 654, 660-61 (Tex. App.–Dallas 1992, no pet.). "A reasonable geographic scope is generally considered to be the territory in which the employee worked for the employer." *TransPerfect Translations, Inc.*, 594 F. Supp. 2d at 754 (citing *Harthcock*, 824 S.W.2d at 660). Overly broad restraints are unenforceable. *See Weatherford Oil Tool Co. v. Campbell*, 340 S.W.2d 950, 951-52 (Tex. 1960) (geographic scope described as "any area where Weatherford Oil Tool Company, Inc., may be operating or carrying on business" held overbroad).

In *Cobb v. Caye Publ. Group, Inc.*, 322 S.W.3d 780 (Tex. App. Fort Worth 2010) (no pet), the court found that a non-compete agreement which contained no limitation as to geographical area, was overbroad and unenforceable under Tex. Bus. & Com. Code Ann. § 15.50(a) (2002 & Supp. 2009). Further, the trial court abused its discretion in determining for purposes of the temporary injunction that the publisher had a probable right to recover for breach of a covenant not to compete in a geographical area in the neighboring county. The publisher had nothing more than a potential business interest in the neighboring county. The publisher never actually distributed any publications in the neighboring county.

Some cases appear to suggest that a reasonable restriction on the scope of activity can substitute for a geographic restriction, even without a geographic restriction. *See, e.g.*, *Sheshunoff*, 209 S.W.3d at 657 (holding covenant prohibiting employee from soliciting or providing services to employer's clients for period of one year following termination reasonable); *Gallagher Healthcare Ins. Services*, 312 S.W.3d at 654-55 (restraints tied to employee's own work at the prior employer are reasonable); *Drummond American, LLC v. Share Corp.*, 693 F. Supp. 2d 650 (E.D. Tex. 2010) (enforcing restriction prohibiting employees from calling on any customer of theirs from whom they solicited orders or to whom they sold competitive products on behalf of the company during the last year of their employment for a period of two years following termination of their employment).

6. Other "Common Sense" Factors Should Be Used for Challenging the Reasonableness of a Non-Compete.

In looking at the "reasonableness" of a non-compete, numerous factors should be considered to determine if the agreement is *really* reasonable. Did the employee have any real choice in signing the non-compete? What were the employee's circumstances in signing the agreement. Did all employees of the company have to sign such an agreement? If not, who did not and why? How long did the employee worked at the company? Are non-competes standard or even necessary in that line of work. What did the owners of the company do before *they* became employed with the company? The nature of our economy is that most businesses are started by an employee leaving a business and starting his or her own, competing business. How much profit did employee bring to employer? Finally, think "outside the box" in raising factors relating to "equity" and

"reasonableness." For example, in the legal profession, non-competes are rare and attorneys regularly leave law firms and take clients with them, moving to competitors or starting up their own competing practice. If a group of lawyers leaves Fulbright & Jaworski to start up their own "boutique" firm, the move, while it can be painful to Fullbright, is a part of the normal course of business. In the end, it forces attorneys in both firms to work to provide better client services and to stay competitive on rates charged to clients. Judges can relate to such scenarios (the judge him or herself likely changed employers during his or her career) and attorneys challenging a non-compete may raise these ideas and others in their arguments.