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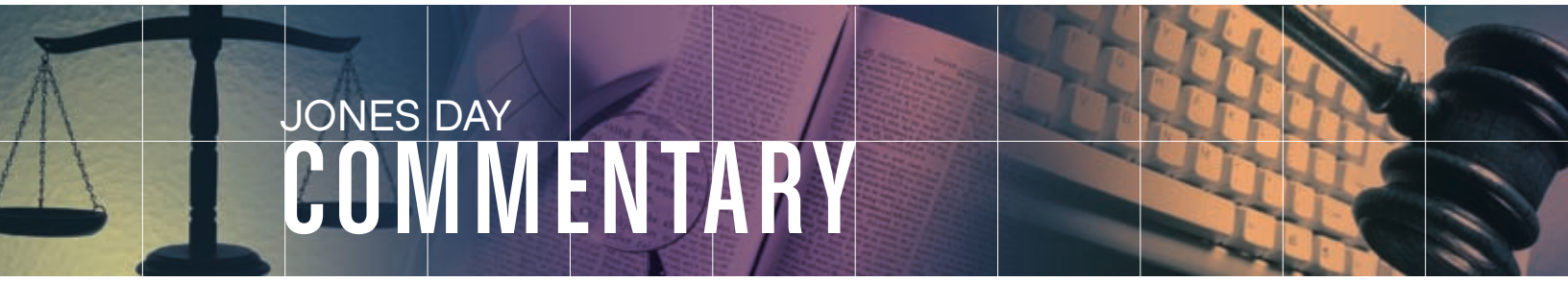

TEXAS SUPREME COURT CLARIFIES CONFUSION OVER ENFORCEMENT OF NONCOMPETE AGREEMENTS FOR AT-WILL EMPLOYERS

On October 20, 2006, the Texas Supreme Court held that an at-will employee's noncompete covenant becomes enforceable when the employer performs the promises it made in exchange for the covenant. *See Alex Sheshunoff Mgmt. Servs., L.P. v. Kenneth Johnson and Strunk & Assocs., L.P.,* No. 03-1050, 2006 WL 2997287, at *1 (Tex. October 20, 2003). Thus, noncompete agreements can be enforceable *even if the employer* does not *provide confidential information contemporaneously with the execution of the agreement*. According to the court, this modifies the holding of the court's 1994 decision in *Light v. Centel Cellular Co. Id.* It also clarifies confusion caused by competing lines of authority interpreting the Texas Covenants Not to Compete Act ("the Act").

Under the Act, a noncompete agreement is enforceable only if: (1) "it is ancillary to or part of an otherwise enforceable agreement at the time the agreement is made," and (2) "it contains reasonable limitations on time, geographical area, and scope of activity that do not impose a greater restraint than necessary to protect the goodwill or other business interest of the promisee." Tex. Bus. & Com. Code Ann. § 15.50. The limited allowable consideration and the need for multiple agreements make Texas noncompete law unique from that of many other states. In 1994, the Texas Supreme Court grappled with this language in *Light v. Centel Cellular Co. of Texas*, 883 S.W.3d 642 (Tex. 1994). In footnote 6 of that opinion, the court stated that a unilateral contract is formed if an employer promises to provide an at-will employee specialized training and information during the employee's employment—and eventually does provide such training and information—in exchange for the employee's promise not to disclose the employer's trade secrets. *Id.* at 645 n. 6. However, according to the court, such a unilateral contract could not support a covenant not to compete since it could be accepted only by future performance. *Id.* As a result, "it was not an 'otherwise

enforceable agreement at the time the agreement is made' as required by Tex. Bus. & Com. Code Ann. § 15.50." *Id.*

After *Light*, many intermediate courts of appeals, including the Austin Court of Appeals in *Alex Sheshunoff Mgmt. Servs. v. Johnson*, embraced the view that the agreement containing the covenant not to compete had to be enforceable the moment it was made. Otherwise, the "ancillary to or part of" prong of the statutory noncompete test was not met. *See, e.g., 31-W Insulation Co. v. Dickey*, 144 S.W.3d 153, 158-59 (Tex. App.—Fort Worth 2004, no pet.); *Sheshunoff Mgmt. Servs. v. Johnson*, 124 S.W.3d 678, 686-87 (Tex. App.—Austin 2003, pet. granted); *Strickland v. Medtronic, Inc.*, 97 S.W.3d 835, 839 (Tex. App.—Dallas 2003, pet. dism'd w.o.j.); *CRC-Evans Pipeline Int'l, Inc. v. Myers*, 927 S.W.2d 259, 263 (Tex. App.—Houston [1st Dist.] 1996, no writ). What this meant for employers under these opinions was that the consideration provided to support the covenant not to compete had to be given at the time the agreement was entered.

Some courts, however, did not take such a restrictive approach. These courts held that a promise to provide confidential information in exchange for a promise not to disclose such information was sufficient to support a noncompete covenant as long as the employer later provided such confidential information. *See, e.g., Wright v. Sport Supply Group, Inc.*, 137 S.W.3d 289, 297 (Tex. App.—Beaumont 2004, no pet.); *Ireland v. Franklin*, 950 S.W.2d 155, 158 (Tex. App.—San Antonio 1997, no writ). Indeed, in 2003, the issue received heightened attention when the Fifth Circuit held that a customer nonsolicitation agreement, which is commonly viewed as being subject to the same analysis as a noncompete agreement, can be supported by a unilateral contract:

> To hold otherwise would pin the enforceability of nonsolicitation agreements on whether an employer discloses confidential information at the time the employee signs an employment contract. This is not what *Light* or § 15.50 intends or requires.

Guy Carpenter & Co. v. Provenzale, 334 F.3d 459, 466 (5th Cir. 2003).

In *Sheshunoff*, the Texas Supreme Court clarified the issue by holding that an at-will employee's noncompete covenant becomes enforceable when the employer performs the promises it made in exchange for the covenant. *Sheshunoff*, 2006 WL 2997287, at *1. Thus, the underlying exchange of consideration does not have to be instantaneous; rather, a unilateral contract will suffice. *Id.* at*1, 9.

In arriving at its holding, the court analyzed the phrase "at the time the agreement is made" from the Act. *Id.* at *6-9. Finding that the language was "indefinite," the court examined the legislative history of the entire Act. *Id.* In so doing, the court revealed that the legislature's intent was to expand the enforceability of noncompete agreements in Texas in order to promote legitimate business interests. *Id.* at *8. This analysis also showed that the insertion of the phrase "at the time the agreement is made" into the statute was done to retain "the notion that a covenant not to compete could be signed after the employment relationship began so long as the covenant is supported by new consideration in an enforceable contract." *Id.* at *8. As a result, the court determined that this phrase was meant to modify the "ancillary to or part of" language in the statute, as opposed to the "otherwise enforceable agreement" language. *Id.* at *8-9. It thus held that "a unilateral contract formed when the employer performs a promise that was illusory when made can satisfy the requirements" of the statute. *Id.* at *5.

Sheshunoff's repercussions are significant. First, noncompete agreements are now easier to enforce in Texas. Second, they will continue to be the subject of litigation. Indeed, *Sheshunoff* does not alter or modify *Light*'s seminal holding that a noncompete agreement must be ancillary to an otherwise enforceable agreement that *gives rise to an interest worthy of protection*. Third, in light of Justice Jefferson's concurring opinion, which was joined by Justice O'Neill and Justice Medina, while the law does not require it, employers may want to consider providing the promised consideration shortly after the execution of the agreement. Justice Jefferson stated that "the employer's exchange of consideration must occur within a reasonable time after the agreement is made." *Id.* at *11 (Jefferson, J., concurring). He would

not let the employer's promise "hang in the air, indefinitely," until it became enforceable by performance. *Id.; see also TMC Worldwide, L.P. v. Gray*, 178 S.W.3d 29, 38-39 (Tex. App.—Houston [1st Dist.] 2005, no pet.) (holding covenant not to compete unenforceable because at-will marketing consultant received customer lists one year after signing employment agreement).

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