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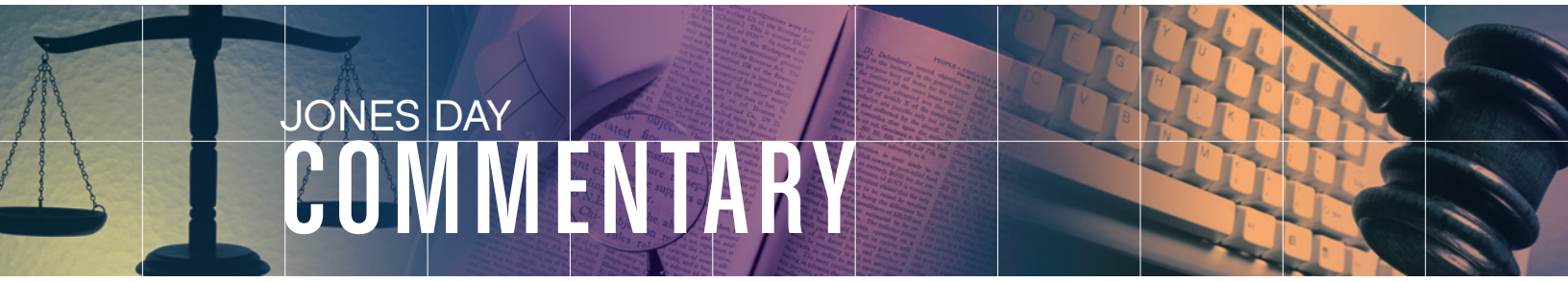

STOCK OPTIONS NOW VALID CONSIDERATION FOR NONCOMPETE AGREEMENTS IN TEXAS

On June 24, 2011, the Texas Supreme Court in *Marsh USA, Inc. v. Cook* further restricted the ability of employees seeking to dodge noncompete restrictions in agreements with their employers by allowing stock options to serve as the consideration supporting the agreement. No. 09-0558, 2011 WL 2517019, at *11 (Tex. June 24, 2011). The Court also opened the door for the potential for other types of financial consideration to be used in noncompete agreements and furthered its expansive view on the enforceability of such provisions.

Rex Cook, a managing director at Marsh USA, Inc. ("Marsh"), a risk management and insurance business, claimed that the noncompete agreement he entered into during his employment was unenforceable. Cook's theory was that Marsh did not provide him adequate consideration at the time he signed his noncompete agreement because all he received was stock options instead of some other type of consideration often provided as a part of such agreements (*e.g.*, confidential information). The basis for this claim was that stock options did not "give rise" to the interest Marsh was seeking to protect by entering into a noncompete agreement with him, a common law, but not statutory, requirement for enforceability.

In response, Marsh contended the stock options given to Cook were adequate consideration because they sought to align his personal financial interests with the interests of the company to develop and maintain customer goodwill. The Court agreed with Marsh that the options "enhance[d] the relationships between Marsh and its customers by helping the company retain highly motivated employees with an interest in the long-term success of the company, which, in turn enhances the goodwill of Marsh." *Id.* at *10.

Under the Texas Covenants Not to Compete Act, a noncompete 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. & Comm. Code § 15.50.

In the seminal case interpreting the Texas statute, *Light v. Centel Cellular Company*, the Texas Supreme Court held that for a noncompete agreement to be "ancillary to or part of" an "otherwise enforceable agreement" under the first prong, the consideration given by the employer in the other agreement must "give rise to the employer's interest in restraining the employee from competing." 883 S.W.2d 642, 647 (Tex. 1994). As noted by the Court in *Cook*, this requirement generally limited the consideration that could support a noncompete to the employer's provision of trade secrets, confidential information, or some type of special training. *Cook*, 2011 WL 2517019, at *7.

In recognizing that customer goodwill is also a protectable interest that an employer must be free to share with employees without fear that it will be unfairly exploited, the Court in *Cook* rejected the restrictive "gives rise to" requirement and held that Texas law requires an employer to show only that the otherwise enforceable agreement be "reasonably related" to a protectable interest, such as goodwill, trade secrets, or confidential information. *Id.* at *9. The Court held that *Light's* requirement that the consideration in the otherwise enforceable agreement "give rise to the employer's interest in restraining the employee" was "contrary to the language of the Act" and "thwarts the purpose of the Act." *Id.*

Analyzing the stock options received by Cook and Marsh's rationale for providing the stock options, the Court in *Cook* agreed with Marsh that when Cook exercised his stock options, he added to the goodwill of Marsh because he was incentivized to build a long-term relationship and contact with the company's customers. *Id.* at *10. The Court further concluded that the enhancement of Marsh's goodwill through the stock options was reasonably related to the noncompete that sought to protect that goodwill, and therefore protectable. *Id.*

The *Cook* decision marks an expansion of the type of consideration that can support noncompete agreements in Texas and continues the Court's departure from its holdings in *Light v. Centel Cellular Company*. Employers may now provide stock options, and possibly other financial incentives, that generate goodwill when entering into noncompete agreements with employees. The Court's decision, however, leaves several open questions for courts faced with noncompete challenges over the coming years, such as (1) the types of financial compensation, incentives, or consideration that adequately enhance a company's goodwill and justify a noncompete protecting that goodwill; (2) whether there will be any limitations on the types of employees that can be restricted by financially based noncompetes; and (3) whether the scope of goodwill-protecting noncompete agreements will be limited to customer nonsolicitation agreements (*i.e.*, the specific goodwill generated by the employees as a result of the financial incentive).

LAWYER CONTACTS

If you desire further information on this topic, please contact one of the following Jones Day lawyers who regularly practice in this area of the law, or your regular Jones Day lawyer contact. General email messages may be sent using our "Contact Us" form, which can be found at www.jonesday.com.

Houston
Mark D. Temple
+1.1.832.239.3741
mdtemple@jonesday.com

Joseph M. Beauchamp
+1.1.832.239.3835
jbeauchamp@jonesday.com

Dallas
Matthew W. Ray
+1.1.214.969.5179
mwray@jonesday.com

Brian M. Jorgensen
+1.1.214.969.3741
bmjorgensen@jonesday.com