

TEXAS COVENANTS NOT TO COMPETE ACT

WILLIAM A. SHERWOOD
GORDON ARATA McCOLLAM
DUPLANTIS & EAGAN, LLC
1980 Post Oak Boulevard, Suite 1800
Houston, Texas 77056
<http://www.gordonarata.com>
bsherwood@gordonarata.com
(713) 333-5500 Main
(713) 333-5501 Facsimile

September 2012

© All Rights Reserved

I. General

There has been a series of recent Texas Supreme Court opinions concerning enforceability of employer/employee non competition agreements. The cases principally concern whether an agreement satisfies the statutory requirement that, for a non compete to be enforceable, the covenant must be “part of or ancillary to” an “otherwise enforceable agreement.”

The evolution in Supreme Court precedent has—by the court’s acknowledgement—represented a retreat from its 1994 precedent and a move toward greater enforceability of employer-employee non-compete covenants to the benefit of employers.

With its 2011 decision in *Marsh USA, Inc. v. Cook*,¹ the Texas Supreme Court made its fourth, and its most recent, effort at evaluating the Covenants Not to Compete Act (the “Act”).²

The statutory criteria (see below) for enforceability of an employee’s covenant not to compete are “exclusive and preempt any other criteria for enforceability.”³ Note, however, that the Act does not control enforceability of an employee’s promise not to disclose trade secrets and confidential information.

Four guiding principles are:

- There must be consideration by the employer to support an enforceable non-compete covenant.
- There must be a nexus between the covenant and the underlying contract.
- The heart of enforceability analysis is the reasonableness of limitations. The Act permits judicial reformation of limitations as to duration, geography and scope of activity.
- The enforceability of a non-compete covenant is a matter of law.

Application of the first and second principles has proven nettlesome.

II. The Covenants Not to Compete Act

The Act, originally passed in 1989, forms an exception to the general rule that “[e]very contract, combination, or conspiracy in restraint of trade or commerce is unlawful” and legitimizes covenants not to compete, provided the covenants satisfy certain conditions. The Act requires that an enforceable covenant must be “part of or ancillary to” an “otherwise enforceable agreement.” Limitations as to time, geographical area, and scope of activity restrained must be (1) reasonable and (2) no greater than is necessary to protect the goodwill or other business interest sought to be protected by the agreement.

¹ *Marsh USA, Inc. v. Cook*, 354 S.W.3d 764 (Tex. 2011).

² Tex. Bus. & Com. Code §§15.50 *et seq.* (2009).

³ *Id.*

A. Section 15.50(a). Criteria for Enforceability of Covenants Not to Compete

(a) ... 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.

Salient points are:

- An otherwise enforceable agreement must exist; and such an agreement pre-supposes legal consideration.
- Non-compete covenant is “ancillary” to same.
- Limitations (duration, geography, scope) are permissible if reasonable and not an unnecessary restraint of trade.
- Goodwill is a legitimate interest that can be protected by a non-compete.
- The required nexus between the non-compete covenant and the “otherwise enforceable agreement” is not statutorily defined. This point is significant in evaluating the competing “give rise” standard and the “reasonably related” standard, as discussed below.⁴

B. Section 15.51. Procedures and Remedies in Actions to Enforce Covenants Not to Compete

(a) Except as provided in Subsection (c) of this section [which addresses judicial reformation of the covenant], a court may award the promisee under a covenant not to compete damages, injunctive relief, or both damages and injunctive relief for a breach by the promisor of the covenant.

The salient point is:

- Injunctive relief and damages are available remedies.
- (b) If the primary purpose of the agreement to which the covenant is ancillary is to obligate the promisor [employee] to render personal services, for a term or at will, the promisee [employer] has the burden of establishing that the covenant meets the criteria specified by Section 15.50 of this code. If the agreement has a different primary purpose, the promisor [employee] has the burden of establishing that the covenant

⁴ See Section VII below.

does not meet those criteria. For the purposes of this subsection, the “burden of establishing” a fact means the burden of persuading the triers of fact that the existence of the fact is more probable than its nonexistence.

Salient points are:

- The Act is limited to “personal services” covenant. This can include non-solicitation promises by the employee.
- The burden of proof is on the employer to prove the contract meets the criteria if the primary purpose of the contract is the employee’s personal services.
- The burden of proof is on the employee to prove the contract does not meet the criteria if the contract’s primary purpose is other than the employee’s personal service (*e.g.*, sale of business).

(c) If the covenant is found to be ancillary to or part of an otherwise enforceable agreement but contains limitations as to time, geographical area, or scope of activity to be restrained that are not reasonable and impose a greater restraint than is necessary to protect the goodwill or other business interest of the promisee, the court shall reform the covenant to the extent necessary to cause the limitations contained in the covenant as to time, geographical area, and scope of activity to be restrained to be reasonable and to impose a restraint that is not greater than necessary to protect the goodwill or other business interest of the promisee [employer] and enforce the covenant as reformed, except that the court may not award the promisee [employer] damages for a breach of the covenant before its reformation and the relief granted to the promisee [employer] shall be limited to injunctive relief. ...

Salient points are:

- Court can reform limitations (duration, geography, scope of activity) to make them reasonable and not greater than necessary.
- If limitations are reformed and then enforced, prevailing employer can only get injunctive relief, not damages.
- See discussion at section VIII for attorney fee availability to an employee who successfully defends against his employer’s suit.

C. Section 15.52. Preemption of Other Law

... criteria for enforceability of a covenant not to compete provided by [the Act] ... are exclusive and preempt any other criteria for enforceability of a covenant not to compete or procedures and remedies in an action to enforce a covenant not to compete under common law or otherwise.

Salient points are:

- The Act's remedies are exclusive for a contract within the Act.
- An employee's agreement not to disclose trade secrets and confidential information are not expressly governed by the Act, nor is an agreement for other than "personal services."

III. General Principles

Marsh offers these general formulations, which I have either quoted or paraphrased.

A. Freedom of Contract

- The Texas Constitution protects the freedom to contract.
- Entering a non-compete is a matter of consent; it is a voluntary act for both parties. However, the Legislature may impose reasonable restrictions on the freedom to contract consistent with public policy.
- "Robust competition and reasonable covenants not to compete can co-exist."
- "A person's right to use his own labor in any lawful employment is ... one of the first and highest of civil rights."

B. Restraint of Trade

- Covenants that place limits on former employees' professional mobility or restrict their solicitation of the former employers' customers and employees are restraints on trade and are governed by the Act.
- Non-solicitation covenants prevent the employee from soliciting customers of the employer and effectively restrict competition.
- Non-solicitation covenants restrain trade and competition and are governed by the Act.
- A "non-solicitation covenant is also a restraint on trade and competition and must meet the criteria of [the Act] to be enforceable."

- Valid non-competes 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.
- Legitimate covenants not to compete also incentivize employers to develop goodwill by making them less reluctant to invest significant resources in developing goodwill that an employee could otherwise immediately take and use against them in business.
- Valid covenants not to compete ensure that the costs incurred to develop human capital are protected against competitors who, having not made such expenditures, might appropriate the employer's investment

C. Historical Texas Law

- At one time the common law generally prohibited all restraints on trade ... and Texas jurisprudence once held covenants not to compete to be unenforceable because they were in restraint of trade and contrary to public policy.
- But “people and the courts” came to recognize that “it was in the interest of trade that certain covenants in restraint of trade should be enforced.”
- And the rule became well-established in Texas that reasonable non-compete clauses in contracts pertaining to employment are not considered to be contrary to public policy as constituting an invalid restraint of trade.
- Texas courts have enforced reasonable covenants not to compete dating back at least to 1899.
- “The courts of this State have in numerous cases enforced negative restrictive covenants not to compete when ancillary to employment involving trade or professions although such covenants may be in limited restraint of trade, provided they are reasonably limited as to duration and area.”

D. The Act

- In 1973, [the Supreme Court] articulated for the first time the common law requirement recognized by courts of appeals in Texas and other states that a covenant not to compete must be “ancillary” to another contract, transaction or relationship.
- The purpose of [the Act] is “to maintain and promote economic competition in trade and commerce” occurring in Texas. Unreasonable limitations on employees' abilities to change employers or solicit clients or former co-employees, i.e., compete against their former employers, could hinder

legitimate competition between businesses and the mobility of skilled employees.

- The Legislature, presumably recognizing these [competition and restraint of trade] interests could conflict, crafted the Act to prohibit naked restrictions on employee mobility that impede competition while allowing employers and employees to agree to reasonable restrictions on mobility that are ancillary to or part of a valid contract having a primary purpose that is unrelated to restraining competition between the parties.
- By doing so, the Legislature facilitated its stated objective of promoting economic competition in commerce.
- The Legislature also recognized that, even though it may restrain trade to a limited degree, a valid covenant not to compete facilitates economic competition and is not a naked restraint on trade.
- The Act was 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 ... and to "restore over 30 years of common law developed by Texas Courts and remove an impairment to economic development in the state."
- Quite simply, "[t]he purpose of the act was to return Texas' law generally to the common law as it existed prior to Hill v. Mobile Auto Trim." *Peat Marwick Main & Co. v. Haass*, 818 S.W.2d 381, 388 (Tex.1991) ... Under the common law prior to Hill, the "rule [was] well established in Texas that non-competition clauses in contracts pertaining to employment [were] not normally considered to be contrary to public policy as constituting an invalid restraint of trade."
- In addition to legislatively overruling Hill's "common calling" requirement, the Act also made explicit that a court could reform covenants that contained unreasonable restrictions on time, geographical area, or scope of activity or restrictions that were greater than necessary to make them reasonable and no greater than necessary, and could provide money damages for a violation occurring after reformation
- "The hallmark of enforcement is whether or not the covenant is reasonable."
- "The enforceability of the covenant should not be decided on 'overly technical disputes' of defining whether the covenant is ancillary to an 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.'"

E. “Goodwill”

- Goodwill is defined as:

“The advantage or benefits which is acquired by an establishment beyond the mere value of the capital stock, funds or property employed therein, in consequence of the general public patronage and encouragement which it receives from constant and habitual customers on account of its local position, or common celebrity, or reputation for skill, or influence, or punctuality, or from other accidental circumstances or necessities, or even from ancient partialities or prejudices.”

F. **Agreements not to disclose trade secrets and confidential information are not expressly governed by the Act.**

- Agreements not to disclose trade secrets and confidential information are not expressly governed by the Act.

IV. *Light v. Centel Cellular Co. of Texas*⁵

The Texas Supreme Court interpreted the Act for the first time in *Light*. Note, at the outset, that *Light* has been substantially abrogated by *Marsh*. Also, the enforceability of a non-compete covenant is a matter of law.⁶

An at-will employee was required to sign a covenant not to compete two years into her employment. Eventually, the employee resigned and her employer refused voluntarily to release her from the covenant. The employee sued seeking a declaration that the non-compete was not enforceable.

The Texas Supreme Court held:

Although [the employee] 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.⁷

The court found that otherwise enforceable agreements could arise from at-will employment provided the consideration for the employee’s non competition promise is not “illusory.” The court identified three non-illusory promises providing consideration:

- (1) the employer’s promise to provide “initial ... specialized training” to the employee.

⁵ *Light v. Centel Cellular Co. of Texas*, 883 S.W.2d 642 (Tex. 1994).

⁶ *Id.* at 644.

⁷ *Id.* (emphasis by the court.).

- (2) the employee's promise to provide 14 days notice to the employer of the employee's intent to terminate employment.
- (3) the employee's promise to provide an inventory of all employer property upon termination.

Even if [the employee] had resigned or been fired after this agreement was executed, [the employer] would still have been required to provide the initial training. Similarly, the fact that [the employee] could terminate the employment at her will in no way renders her two promises illusory. Thus, an otherwise enforceable agreement for [the employer] to train [the employee] in exchange for [the employee's] giving 14 days' notice to terminate employment and [the employee's] providing an inventory upon termination, existed ...⁸

Nevertheless, the court found the non-compete covenant unenforceable because it was not "ancillary to" the agreement between the employee and her employer. The court held that a covenant is "ancillary to" an employment agreement when:

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

Note the operative "give rise" phrase in (1) and compare it with the "reasonably related" nexus articulated in *Marsh*. Comparison of these competing standards, as articulated by *Marsh*, is discussed below.⁹ Compare: "gives rise to the employer's interest in restraining the employee from competing" with "reasonably related to an interest worthy of protection," e.g., good will.

The court concluded the covenant did not meet the second condition and therefore was not ancillary to the agreement, and therefore not enforceable. The covenant forced on the employee was "not designed to enforce any of [employee's] return promises in the otherwise enforceable agreement."¹⁰

The covenant not to compete between [the employee] and [the employer] is not ancillary to or a part of the otherwise enforceable agreement between them. While [the employer's] consideration (the promise to train) might involve confidential or proprietary information, the covenant not to compete is not designed to enforce any of [the employee's] return promises in the otherwise enforceable agreement.

⁸ *Id.* at 646.

⁹ See *Marsh* discussion below at Section VII.

¹⁰ 883 S.W.2d at 647-648.

[The employee] did not promise in the otherwise enforceable agreement to not disclose any of the confidential or proprietary information given to [the employee] by [the employer].

At footnote 15, the court stated:

In the otherwise enforceable agreement, [the employee's] promises were to give 14 days' notice and provide an inventory upon termination. The covenant not to compete is not designed to enforce either of those promises. The covenant would have enforced an agreement by [the employee], for example, not to disclose confidential proprietary information after her termination. She did not have this agreement with [the employer].

V. *Alex Sheshunoff Mgmt. Servs., L.P. v. Johnson*¹¹

Twelve years later, the Texas Supreme Court reconsidered covenants not to compete.

The at-will employee was constrained to sign a non-compete five years after he had been working at the company and shortly after his promotion to a position, which focused on client maintenance and development. The agreement obligated the employer to provide the employee with specialized training and access to confidential and proprietary information. Several years later, the employee quit and began working for a direct competitor. The employer sought injunctive relief.

The trial and appellate courts, relying on *Light*, refused to enforce the covenant. They found that the employer's promises of training and access to confidential information were "illusory" at the time the contract was formed because the employer was free to terminate the employee before the employer honored its promises.

The Texas Supreme Court granted review to consider the question of "whether an at-will employee who signs a non-compete covenant is bound by that agreement if, at the time the agreement is made, the employer has no corresponding enforceable obligation." The answer under *Light* had always been "no." In footnote 6 of *Light*, the Court had decided that a unilateral contract that could be accepted only by an employer's 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." In its first departure from *Light*, the *Sheshunoff* court held that "[t]here is no sound reason why a unilateral contract made enforceable by performance should fail under the Act." The Court therefore concluded that "if ... the employer's consideration is provided by performance and becomes

¹¹ *Alex Sheshunoff Mgmt. Servs., L.P. v. Johnson*, 209 S.W.3d 644 (Tex. 2006).

non-illusory at that point, and the agreement in issue is otherwise enforceable under the Act, ..." then the covenant is enforceable.¹²

The court, enforcing the contract, departed from *Light*, and held that confidential information does not have to be exchanged contemporaneously with the employee if the employee receives the information before leaving employment but after execution of the non-compete covenant.

VI. *Mann Frankfort Stein & Lipp Advisors, Inc. v. Fielding*¹³

In *Mann Frankfort*, the court considered whether an employer's promise to provide confidential information--a promise which would be adequate to anchor an enforceable non-compete--must be explicit, or can it be implied? It can be implied. The court considered:

whether a covenant not to compete in an at-will employment agreement is enforceable when the employee expressly promises not to disclose confidential information, but the employer makes no express return promise to provide confidential information.¹⁴

The employee was an accountant who resigned from his employer but was rehired two years later. As a condition of his reemployment, he signed an at-will employment agreement, which included a covenant not to compete. The covenant prohibited the employee from disclosing or using any confidential information or knowledge he obtained while employed. However, there was no provision in the agreement by which the employer promised to provide the employee access to such confidential information. The trial and appellate courts found the covenant unenforceable.

The Texas Supreme Court upheld the non-compete even though the employer did not expressly promise to provide the employee with access to confidential information. The court reasoned:

[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.¹⁵

...

... 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.¹⁶

¹² Harrell, Alex, "Light Fades Further – The Texas Supreme Court Changes Direction on Covenants Not to Compete." Texas Bar Journal (June 2012): 438-443.

¹³ *Mann Frankfort Stein & Lipp Advisors, Inc. v. Fielding*, 289 S.W.3d 844 (Tex. 2009).

¹⁴ *Id.* at 849.

¹⁵ *Id.* at 850.

¹⁶ *Id.*

VII. *Marsh USA, Inc. v. Cook*¹⁷

The court acknowledges that it is “abrogating” *Light*, even though it does not purport expressly to overrule *Light*, a point made by the dissent in this 5-3 opinion.

The employee had been rewarded for his 13 years of service with stock options as part of an employee incentive plan. Nine years later, the employee exercised his options, and pursuant to the incentive plan, he was required to execute a non-solicitation agreement, which included a covenant not to compete. The employee exercised the options. Three years later, the employee resigned to work for a direct competitor.

The former employer sued, claiming breach of contract and breach of fiduciary duty. Citing *Light*, the employee claimed the agreement was unenforceable because it was not part of or ancillary to an otherwise enforceable agreement. The trial and appellate courts agreed. The Supreme Court reversed.

The court reaffirmed the longstanding two-step threshold inquiry to determine if a covenant is enforceable. First, the court determined there was an “otherwise enforceable agreement,” an issue not in dispute. The employee’s agreement that he would not solicit his employer’s clients, recruit its employees or disclose confidential information—all in exchange for the stock option—was a contract falling with the Act. The court next considered whether the covenant was “ancillary to or part of” the otherwise enforceable agreement, using the two-pronged test first announced in *Light*.

In *Light v. Centel Cellular Co. of Texas*, we first considered a two-pronged approach to determine whether the covenant is “ancillary to or part of” the otherwise enforceable agreement, requiring that:

(1) the consideration given by the employer in the otherwise enforceable agreement must **give rise** (emphasis supplied) to the employer's interest in restraining the employee from competing; and (2) the covenant must be designed to enforce the employee's consideration or return promise in the otherwise enforceable agreement.¹⁸

The court disagreed with *Light*'s “give rise” judicial formulation of the nexus—required for covenant enforceability—between the non-compete covenant and the “otherwise enforceable contract.” The court found this “give rise” standard to be restrictive, meaning it was too burdensome a standard for covenant enforceability. The court concluded there is no reason that “consideration for the otherwise enforceable agreement [must] give ... rise to the interest in restraining the employee from competing.” The court undertook a semantic analysis and developed a “reasonably related” standard, which it said corresponded to the historical common law standard.

¹⁷ *Marsh USA, Inc. v. Cook*, 354 S.W.3d 764 (Tex. 2011).

¹⁸ *Id.* at 773.

In its criticism of *Light*, the court stated:

...the Act itself does not include a “give rise” requirement, nor does it define “ancillary.”¹⁹

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*’s “give rise” condition on the enforceability of non-competes was more restrictive than the common law rule the Legislature intended to resurrect.²⁰

Light’s “give rise” language narrowed the interests the Act would protect, excluding much of goodwill as a protectable business interest.²¹

[T]he focus in applying section 15.50 should be on the reasonableness of the covenant.²²

We took another step away from *Light*’s restrictiveness and toward greater enforceability of non-compete agreements.²³

[T]he Legislature did not include a requirement in the Act that the *consideration* for the non-compete must give rise to the interest *in restraining competition with the employer.*²⁴

[T]here is no compelling logic in *Light*’s conclusion that consideration for the otherwise enforceable agreement gives rise to the interest in restraining the employee from competing. ... Consideration for a non-compete 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 the excluding the protection of much of goodwill from the business interests that a non-compete may protect. ... [T]he purpose of the Act, ... was to expand rather than restrict the enforceability of such covenants;²⁵ ...

The stock options are reasonably related to the protection of this business goodwill.²⁶

¹⁹ 354 S.W.3d 764 at 773.

²⁰ *Id.* at 773-774.

²¹ *Id.* at 774.

²² *Id.*

²³ *Id.* at 774-775.

²⁴ *Id.* at 775 (emphasis by the court).

²⁵ *Id.*

²⁶ *Id.* at 777.

There is no requirement under Texas law that the employee receives consideration for the non-compete agreement prior to the time the employer's interest in protecting its goodwill arises.²⁷

[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).²⁸

The *Marsh* dissent is instructive. The principal analysis is whether: (1) the “give rise” standard or the “reasonably related” standard is more faithful to the Act; and (2) whether purely economic enhancements and benefits to an employee constitute consideration necessary to support the covenant.

The Court today decides that a non-solicitation agreement extracted from an employee in exchange for stock options can be enforceable solely because the employer's goodwill, which purportedly benefits from the gift of stock options, is an interest worthy of protection. ... This decision is directly at odds with our holding in *Light*, ... which required that an employer's consideration for a covenant not to compete must give rise to an interest in restraining trade. Yet the Court refuses to say that it is overruling *Light*.²⁹

[Note the comparison: gives rise to an interest in restraining trade; and reasonably related to an interest worthy of protection.]

...

[Enforceability] hinges upon *consideration*—whether stock options given to an employee can justify a restraint of trade. 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. ... covenants not to compete must be ancillary to an exchange of valuable consideration that justifies or necessitates a restraint of trade.”³⁰

The Court's main problem with the “give rise” standard appears to be this: Stock options do not give rise to an interest in restraining

²⁷ *Id.* at 778.

²⁸ *Id.* at 780.

²⁹ *Id.* at 788.

³⁰ *Id.* (emphasis by the court).

trade, and therefore, the give rise standard cannot accompany the enforcement of a covenant based on stock options.³¹

Goodwill is not the dispute in this case. The dispute is whether the *consideration* given to allegedly protect the employer's goodwill gives rise to an interest in restraining competition.³²

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.³³

The Court cannot rely on the second prong of § 15.50(a) to ensure that covenants which are "unreasonable" will not be enforced. Under the express language of the statute, only the first prong—the consideration prong—determines whether covenants are enforceable, while reasonableness defines only *the extent* to which they are enforceable.³⁴

Whether stock options constitute valid consideration is an essential inquiry under the prong of the statute requiring that the agreement be "ancillary to or part of an otherwise enforceable agreement." The fact that the Court now holds stock options satisfy this prong ignores the consensus amongst Texas courts that mere financial compensation as consideration will not support an enforceable restraint of trade.³⁵

[T]he relevant question under this Court's precedent is whether the consideration given by the employer for the covenant not to compete—not the employer's motivation or some other characteristic of the agreement or events leading up to the transaction—gives rise to an interest in restraining competition. ... *Why* consideration was given has never mattered so much as *what* was given.³⁶

...

³¹ *Id.* at 789.

³² *Id.* at 789-90 (emphasis by the court).

³³ *Id.* at 790.

³⁴ *Id.* at 791 (emphasis by the court).

³⁵ *Id.* at 793.

³⁶ *Id.* at 793-94 (emphasis by the court).

Allowing employers to obtain covenants not to compete by providing such financial incentives without actually giving the employee anything that gives rise to an interest in restraining trade is bad policy for Texas, and will make covenants not to compete much more commonplace in instances where there is little risk of unfair competition.³⁷

VIII. Attorneys' Fees

A. Chapter 38, Texas Civil Practice and Remedies Code

Chapter 38 provides for recovery of attorneys' fees by a party which proves a contractual breach.³⁸

B. Section 15.51(c) of the Act

In limited circumstances, an employee (promisor) may recover his attorney's fees if he successfully **defends** a claim brought by his employer who seeks to enforce limitations as to geography, time and scope of activity, which limitations the employer "knew at the time of the execution of the agreement" were excessive and unreasonable. Section 15.51(c) of the Act states:

If the primary purpose of the agreement to which the covenant is ancillary is to obligate the promisor [employee] to render personal services, [if] the promisor [employee] establishes that the promisee [employer] **knew at the time of the execution of the agreement** that the covenant did not contain limitations as to time, geographical area, and scope of activity to be restrained that were reasonable and [if] the **limitations imposed a greater restraint than necessary to protect the goodwill or other business interest of the promisee [employer], and [if] the promisee [employer] sought to enforce the covenant to a greater extent than was necessary** to protect the goodwill or other business interest of the promisee [employer], the court may award the promisor [employee] the costs, including reasonable attorney's fees, actually and reasonably incurred by the promisor [employee] in **defending** the action to enforce the covenant.

³⁷ *Id.* at 794.

³⁸ In appropriate cases, Texas courts utilize the "Lodestar" method for proof of attorneys' fees. This methodology employs hours worked by prevailing hourly rates to which a multiplier can be applied if that mathematical exercise does not reflect a reasonable fee. *See generally*, Rule 42(i)(1), Texas Rules of Civil Procedure, and Section 26.003, Texas Civil Practice and Remedies Code. In *El Apple I, Ltd. v. Olivas*, ___ S.W.3d ___, 2012 WL 2361722 (Tex. 2012), the Texas Supreme Court held that an application for an award of attorney's fees based on the "Lodestar" method must be supported by evidence ordinarily in the form of contemporaneous billing records, which reflect the nature and date of the work, the identity of the professional performing the work, and the number of hours worked. The court may be moving toward this requirement for proof of attorneys' fees in any setting.

IX. Questions and Comments

- Can cash alone buy an enforceable non-compete?
- There must always be consideration for a non-compete.
- If there is consideration, the court will evaluate whether the non-compete is reasonable.
- To promote enforceability, the employer should have its employee sign the covenant before the employer provides (bona fide) confidential information.
- If the covenant prevents the employee from making a living, it will not be enforced.
- If the covenant does not have any geographic restriction, the court might still enforce the covenant by enjoining contact by the departing employee with his customers for a period of time.
- Trade secrets and fiduciary duties create rights and obligations, which can be enforced outside of the Act and its exclusive remedies.