Guarding the Goods:
Non-Competition Agreements, Non-Solicitation Agreements, and Non-Disclosure Agreements

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Andrew D. Weisblatt earned his J.D. from **South Texas College of Law** in Houston, Texas. His initial practice was with Alvin M. Rosenthal, one of the great lawyers in Houston's history. After several years of practicing together, Alvin retired and Mr. Weisblatt grew the firm from a two lawyer shop to a nearly twenty person shop. In 2005, Mr. Weisblatt sold his firm and became General Counsel and Chief Operating Officer of a multi-national steel flange and fitting corporation with operations in multiple locations in the USA and Canada. In 2009, Mr. Weisblatt opened The Weisblatt Law Firm, L.L.C. a boutique business and litigation firm.

Mr. Weisblatt has practiced continuously since becoming licensed in 1992 and has represented businesses ranging in size from one person start-up ventures to multi-national corporations employing hundreds of people in multiple countries. From 2005 through 2009 Mr. Weisblatt was in-house counsel and chief operating officer of a multi-national corporation in the steel products industry. That in-house position provided valuable insight into how businesses work and what they actually need from their lawyers – both in-house and outside counsel. In 2009 Mr. Weisblatt started the The Weisblatt Law Firm, L.L.C. with the goal of creating a special law firm which could cater to a few select business clients and provide them the best legal services coupled with the best customer service. It is a matter of great pride to Mr. Weisblatt that the very first customer who hired him when he started in 1992 was also the first customer of The Weisblatt Law Firm, L.L.C. continuing a many decade long relationship. Mr. Weisblatt represents businesses typically in the role of outside general counsel and as litigation counsel. Mr. Weisblatt litigates numerous matters ranging from routine collection matters to complex commercial disputes.

Mr. Weisblatt is proudly a member of the State Bar of Texas including the business, creditor-debtor, litigation, commercial law, real estate, and law office management practice groups. He has spoken at the new licensee institute in Houston, Texas instructing new lawyers. He also is an avid reader, an exercise buff, enjoys woodworking and participates each year in the MS150 bicycle ride from Houston to Austin to raise money to fight multiple sclerosis.

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1. INTRODUCTION

Those of us who practice business law have received "the call" many times: "My ex-employee has defected to the competition and is using all of the information about my business to bury me! You have to do something!" This paper is designed as a go-to quick reference (with some history and analysis) to assist the practitioner in how to triage that situation and help to establish a strategy to best assist the client in dealing with a business threatening situation.

2. GATHERING FACTS

The very first step in helping this client is to figure out what tools you have at your disposal. The most common documents which your client might have had their employees sign are:

a. Non-Compete Agreement
b. Non-Solicitation Agreement
c. Non-Disclosure Agreement

Once you determine what you have to work with, you can then go about figuring out which of these documents is enforceable and how they can be used to stop the employee from harming his or her ex-employer.

3. NON-COMPETITION AGREEMENTS

The History

Section 15.50 of the Texas Civil Practice and Remedies Code is entitled "Criteria for Enforceability of Covenants Not to Compete" and is the starting point for the enforceability analysis. 15.50(a)[1] provides:

"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 interests of the promise." §15.50(a) Texas Business and Commerce Code.

We will examine this seemingly simple paragraph through the lens of the twenty seven years of case law interpreting it. If you're not interested in the "how did we get here" and really just need to know "where are we now" then skip to the section entitled "**Current Law of Non-Compete Agreements**."

Ancillary to or a part of...

The first major case to interpret §15.50 of the Texas Civil Practice and Remedies Code was *Light v. Centel Cellular Co. of Texas*, 883 S.W.2d 642 (Tex. 1994). In *Light* the Texas Supreme court stated that a covenant not to compete is "ancillary to or part of" an otherwise enforceable agreement 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 647. These words added burden to employers trying to enforce noncompetition agreements, and in fact, the agreement at issue in the *Light* case was found not to be enforceable. The employer

[1] §15.50(b) provides the statutory guidelines for covenants not to compete applicable to physicians. §15.50(b) is beyond the scope of this paper, but it is important to note that it is radically different from the typical employer-employee situation and most of this paper does not apply to that situation.

was now required to show that the consideration the employer provided in exchange for the employee's non-competition obligations "gave rise" to the employer's interest in restraining the employee from competing. The easiest example is an employer providing confidential or proprietary information to the employee which one can easily understand would "give rise" to the employer not wanting the employee to compete. The problem, from the employer's perspective, was that it was hard to imagine any other consideration which would meet that burden. *Light* at 648.

Additionally, the *Light* court interpreted the words "at the time it was made" to modify the words "an otherwise enforceable agreement." This interpretation required that the consideration provided by the employer be provided contemporaneously with the signing of the contract, and not at a future time. The Court's conclusion was that unless the consideration was provided by the employer contemporaneously, then the contract was illusory. The court reasoned, an illusory contract is not an "otherwise enforceable contract" and therefore the covenant not to compete would fail under that prong. These common law requirements remained the law until the Court began chipping away at them starting with the *Sheshunoff* case.

At the time it was made…

The decision in *Light* was very confusing for businesses, courts and practitioners. A large part of the confusion stemmed from the *Light* Court's decision that the words in the statute "at the time it was made" modified "an otherwise enforceable agreement." They concluded from this interpretation that the consideration the employer was to provide must be provided at the time the non-competition agreement was signed. Applying this legal logic to the business world proved difficult. The Texas Supreme Court revisited this issue when it decided *Alex Sheshunoff Management Services, L.P. v. Johnson*, 209 S.W.3d 644 (Tex. 2006). In *Sheshunoff* the court decided that the words "at the time it was made" did NOT modify the words "an otherwise enforceable agreement" but instead modified the words "ancillary to or part of." The impact of this change was that the employer no longer had to provide the consideration simultaneously with execution of the contract. The consideration only had to be provided by the employer before the agreement could be enforced. This change made it much easier for covenants not to compete to be enforced and took employers partially out of the morass of confusion created by the *Light* decision. The decision also foreshadowed the Supreme Court's tilt towards making covenants not to compete much more enforceable. The next major case easing the enforceability of covenants not to compete was published in 2009.

Consideration may be implied….

In 2009, the Texas Supreme Court decided *Mann Frankfort Stein & Lipp Advisors, Inc. v. Fielding*; 289 S.W.3d 844 (Tex. 2009) ruling that even if the consideration provided by the employer was not explicitly stated, it could be implied from the contract using the general rules of contract construction. This decision was a substantial deviation from *Light* where the consideration had to be given contemporaneously with the execution of the document. In *Mann Frankfort* the employer did not explicitly promise to provide confidential information, but because of the nature of the position (an accountant) the court concluded that it was implied from the facts that confidential information would be provided. This notion was bolstered by obligations on the part of the accountant not to provide accounting services to the employer's customers for at least one year without paying a fee for doing so.

Court has continued to rule in accordance with this philosophy.

Marsh virtually extinguishes *Light*

The *Light* decision was further eroded in 2011 when the Supreme Court ruled that there is no requirement that the "consideration for the otherwise enforceable agreement gives rise to the interest in restraining the employee from competing." *Marsh USA Inc. v. Cook*; 354 S.W.3d 764 (Tex. 2011)[2]. This decision continued the pattern started in *Sheshunoff* of relaxing the requirements that employers must meet in order to enforce a covenant not to compete. The *Marsh* case evaluated the situation where a manager signed a stock option agreement which included a provision that he would not solicit Marsh customers for two years after the termination of his employment. The Court found that this was an "otherwise enforceable agreement" and went on to say that "Consideration for a noncompete 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 excluding the protection of much of goodwill from the business interests that a noncompete may protect." *Marsh* at 775. This sentence removed the obligation that the consideration by the employer "give rise to the employer's interest" found in *Light*. The *Marsh* Court also said "And the rule became well-established in Texas that reasonable noncompete clauses in contracts pertaining to employment are not considered to be contrary to public policy as constituting an invalid restraint of trade. *DeSantis*, 793 S.W.2d at 681; *Chenault*, 423 S.W.2d at 381. *Marsh USA Inc. v. Cook*, 354 S.W.3d 764, 771 (Tex. 2011). The

Current Law of Noncompete Agreements

There can be no doubt after the *Marsh* case that the Texas Supreme Court is comfortable with the notion that reasonable covenants not to compete should be enforced. The painful progression from the time that such covenants were considered against public policy to their current status as a necessary tool for conducting business is complete.

The Act

The Court, when evaluating the enforceability of a covenant not to compete will apply §15.50 of the Texas Business and Commerce Code which states:

(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.

Tex. Bus. & Com. Code Ann. § 15.50 (West)

Determining the enforceability is a multi-step process. (See generally Marsh USA Inc. v. Cook, 354 S.W.3d 764, 773 (Tex. 2011)).

[2] The *Marsh* case contains a terrific recitation of the history of the enforcements of noncompetition agreements in the State of Texas and I have therefore included it as an appendix to this paper. I recommend it to anyone trying to understand the current state of the enforcement of noncompetition agreements in Texas in 2016.

Step 1. Is there an "otherwise enforceable agreement?"

The "otherwise enforceable agreement" requirement is satisfied when the covenant is "part of an agreement that contained mutual non-illusory promises." *Sheshunoff*, 209 S.W.3d at 648–49 (quoting *Light*, 883 S.W.2d at 646); see also DeSantis, 793 S.W.2d at 681 (noting that "the agreement not to compete must be ancillary to an otherwise valid transaction or relationship," including purchase and sale of a business and employment relationships (citations omitted)) *Marsh USA Inc. v. Cook*, 354 S.W.3d 764, 773 (Tex. 2011). If the agreement being examined includes mutual non-illusory promises it should pass the first threshold.

Step 2: Is the agreement "ancillary to or part of" the "otherwise enforceable agreement."

This requirement is present to prevent enforcement of agreements which are naked restraints of trade. (Requiring that a covenant not to compete be ancillary to an otherwise enforceable agreement or relationship ensures that noncompete agreements that are naked restraints of trade will not be enforceable under the Act. *Marsh USA Inc. v. Cook*, 354 S.W.3d 764, 775-76 (Tex. 2011)

In order to ensure the "otherwise enforceable agreement" is not a naked restraint of trade, the Court reads the statute to require that there be a nexus between the consideration provided by the employer and an interest of the employer that is worthy of protection saying: "Consideration for a noncompete that is reasonably related to an interest worthy of protection, such as trade secrets, confidential information or goodwill, satisfies the statutory nexus" *Marsh USA Inc. v. Cook*, 354 S.W.3d 764, 775 (Tex. 2011).

In the *Marsh* case, Marsh provided stock options to Cook in exchange for Cook signing a noncompetition agreement. The *Marsh* court ruled that "Awarding to Cook stock options to purchase MMC stock at a discounted price provided the required statutory nexus between the noncompete and the company's interest in protecting its goodwill." Marsh USA Inc. v. Cook, 354 S.W.3d 764, 777 (Tex. 2011). The Court is saying that the consideration of the stock options are reasonably related to the company's goodwill – which is an interest worthy of protection. This consideration would not have worked for the *Light* court because giving stock options does not "give rise" to an interest worthy of protection but that is now no longer the law. So long as the consideration is "reasonably related" to the interest worthy of protection, that is enough.

We know from *Light*, and *Mann Frankfort* that an employer providing confidential information, or even promising to provide confidential information in the future (if it is eventually provided) will satisfy the requirement that the consideration be reasonably related to the interest worthy of protection. We know from *Marsh* that providing stock options is reasonably related to goodwill – an interest worthy of protection – such that the "ancillary to or part of" threshold is crossed. Unfortunately, we do not know much more than that. Since *Marsh* there has been only one significant Supreme Court case which tangentially touched this issue and it really related to what agreements constitute "non-competition" agreements and did not further address the nexus between consideration and the interest worthy of protection.

The practical application of these cases is therefore fairly straightforward when the consideration is the provision by the employer of confidential information and the promise to provide confidential information. This consideration is adequate. The same holds true for stock options. The court has stated that

one cannot simply "buy" a non-competition agreement (see for instance the dicta in *Sheshunoff* which is quoted by the dissent in *Marsh* "To hold otherwise would mean that an employer could enforce a covenant merely by promising to pay a sum of money to the employee in the agreement, a result inconsistent with *Light's* requirements that the covenant must give rise to the employer's interest in restraining the employee from competing and the covenant must be designed to enforce the employee's consideration or return promise. *Alex Sheshunoff Mgmt. Servs., L.P. v. Johnson*, 209 S.W.3d 644, 650 (Tex. 2006.))

Step 3. Introduction to is the agreement "reasonable?"

The *Marsh* court, quoting the *Sheshunoff* court focuses the analysis on the reasonableness of the agreement, stating "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. *Marsh USA Inc. v. Coo*k, 354 S.W.3d 764, 777 (Tex. 2011). This opinion aligns well with the statute which states that "the agreement **will be enforced** to the extent to the extent that it contains limitations as to time, geographical area, and scope of activity to be restrained that are reasonable…" §15.50 Texas Business and Commerce Code (emphasis added.) There are three basic factors that the court considers when determining if the agreement is reasonable: time, scope and geography.

Step 3 – A. Reasonable as to Time.

Texas courts have held that that noncompete agreements as long as five years are enforceable (see *Stone v. Griffin Commc'ns & Sec. Sys., Inc.*, 53 S.W.3d 687, 689 (Tex. App. 2001) overruled on other grounds by *Am. Fracmaster, Ltd. v. Richardson*, 71 S.W.3d 381 (Tex. App. 2001). In *Stone* the plaintiff was able to convince the court that the information possessed by the employee they were attempting to enjoin would be useful to a competitor for as much as five years. The court was persuaded. The *Stone* case is useful because it shows us how the court wants the reasonableness of the time issue to be analyzed. The courts ask the question (or size of geography for that matter) "whether it [the time or geography] imposes upon the employee any greater restraint than is reasonably necessary to protect the business and good will of the employer ... a restraint of trade is unreasonable ... if it is greater than is required for the protection of the person for whose benefit the restraint is imposed or imposes undue hardship upon the person restricted." *AMF Tuboscope v. McBryde*, 618 S.W.2d 105, 108 (Tex. Civ. App. 1981), writ refused NRE.

Two to five years has repeatedly been held a reasonable time in a noncompetition agreement. *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) quoted in *AMF Tuboscope v. McBryde*, 618 S.W.2d 105, 108 (Tex. Civ. App. 1981), writ refused NRE.

Step 3 – B. Reasonable as to Geography.

The agreement must be reasonable as to the geography in which the employee is not permitted to compete. Texas Business and Commerce Code 15.50(a). "Generally, a reasonable area for purposes of a covenant not to compete is considered to be the territory in which the employee worked while in the employment of his employer." *Cobb v. Caye*

Publ'g Grp., Inc., 322 S.W.3d 780, 784 (Tex. App. 2010). This has proven to be true even when the area is very large. "Even a worldwide non-competition agreement may be upheld under circumstances where determining the scope of the geographical area of former employment was difficult." *Daily Instruments Corp. v. Heidt*, 998 F. Supp. 2d 553, 567 (S.D. Tex. 2014), appeal dismissed (Sept. 11, 2014). In *Heidt* the employee was a very high level employee in the very narrow field of thermometry. He had sales responsibilities for large portions of the United States, Canada, all of Europe, and all of Russia. The court was convinced because of his large territory and his very high ranking position (and commensurate access to highly sensitive information) that the non-competition agreement would be enforceable.

Step 3 – C. Reasonable as to Scope.

The final aspect which is mentioned in the Act is that the scope of the activity restrained must also be reasonable. Texas Business and Commerce Code §15.50. In order to be "reasonable" the restraint must not impose a greater restraint than is necessary to protect the goodwill or other business interest of the promisee. Texas Business and Commerce Code §15.50. The court will find it easier to find that the scope of activity restrained is reasonable if it can be shown that there are other activities which are not restrained. For instance, in *Butler v. Arrow Mirror & Glass, Inc.*, 51 S.W.3d 787, 794 (Tex. App. 2001), the Court reasoned that restraining an ex-employee from installing *residential* glass did not impose a greater restraint than necessary in part because it left open the possibility of installing glass in *commercial* buildings. The *Butler* court stated, "Restraints are "easier to justify if ... limited to one field of activity among many that are available to the employee." restatement (Second) of ContractsSSSS [*sic*] § 188 cmt. g (1979). *Butler v. Arrow Mirror & Glass, Inc.*, 51 S.W.3d 787, 794 (Tex. App. 2001).

Who makes these decisions anyway?

All of the issues described above are questions of law for the Court to decide. "The enforceability of a covenant not to compete is a question of law." *Light v. Centel Cellular Co. of Tex.*, 883 S.W.2d 642, 644 (Tex.1994), quoted in *Mann Frankfort Stein & Lipp Advisors, Inc. v. Fielding*, 289 S.W.3d 844, 848 (Tex. 2009). There is no right to have a jury decide what is "reasonable" in these cases – all of the issues in steps 1 – 3 are questions of law.

Finally, what happens if it's not reasonable?

If a provision of a non-competition agreement is *present* but *found to be unreasonable* the court will typically reform the agreement so that it is reasonable and find that it is enforceable. This reasoning pre-dates the Act. In 1973 the Texas Supreme Court opined, "Indeed, this Court approved the opinion in *Spinks v. Riebold*, 310 S.W.2d 668 (Tex.Civ.App.1958, writ ref'd) wherein it was written that contracts of employment containing restrictive covenants **will not be declared void** because they are unreasonable as to time, or as to the extent of territory covered, or unreasonable as to both time and territory. The contract is unenforceable in either instance, whether either or both, in the absence of reformation; **and the result in each instance is the enforcement of restraints found by the Court upon evidence to be reasonable**. *Justin Belt Co. v. Yost*, 502 S.W.2d 681, 685-86 (Tex. 1973) (emphasis added).

4. NON-SOLICITATION AGREEMENTS

There are two principal types of non-solicitation agreements. One is an agreement

not to steal an employer's customers and the second is an agreement not to steal an employer's employees. There are not a great number of reported cases on these agreements. Historically, Texas Courts did not consider these agreements restraints of trade and did not subject them to the same analysis as required under §15.50 of the Texas Business and Commerce Code. In 1998 the 1st Court of Appeals in Houston said (in what was apparently a case of first impression as the court could find no prior cases in Texas), "here, the nonrecruitment covenants do not significantly restrain the individual appellants' trade or commerce…" *Totino v. Alexander & Associates, Inc., No*. 01-97-01204-CV, 1998 WL 552818, at *8 (Tex. App. Aug. 20, 1998) (not designated for publication). *Totino* was followed in 2005 by a Federal District Court the *Nova Consulting* case, in which the "Court concludes that Texas courts specifically considering the issue would find the covenants not to solicit Nova employees do not bar competition and are not restraints on trade or commerce in violation of § 15.05." *Nova Consulting Grp., Inc. v. Eng'g Consulting Servs., Ltd.*, No. CIV. SA03CA305FB, 2005 WL 2708811, at *18 (W.D. Tex. June 3, 2005)

However, in 2011, the Texas Supreme Court in *Marsh* stated "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. *Marsh USA Inc. v. Cook*, 354 S.W.3d 764, 768 (Tex. 2011)(emphasis added). There have been very few cases which examine non-solicitation agreements since *Marsh* and we will have to watch closely to see how other Courts react to this statement by the Supreme Court.

5. CONFIDENTIALITY/NON-DISCLOSURE AGREEMENTS

"Nondisclosure covenants, on the other hand, are not restraints on trade." *Zep Mfg. Co. v. Harthcock*, 824 S.W.2d 654, 663 (Tex. App. 1992). The impact of this statement is that nondisclosure covenants – agreements which require an employee to keep his or her employer's secrets secret – are subject to standard contract formation analysis. The *Zep Mfg. Co.* court goes on to say "We find no Texas case requiring that enforceable nondisclosure covenants contain time, geographical, or scope-of-activity limitations. Employers have an interest in protecting trade secrets and confidential information disclosed to employees during the course of the employment relationship, especially when, as here, the former employee had signed an employment agreement containing a nondisclosure covenant. *Zep Mfg. Co. v. Harthcock*, 824 S.W.2d 654, 663 (Tex. App. 1992).

The fact that an employee is an at-will employee does not automatically render a non-disclosure agreement unenforceable. Provided that there is actual consideration, the agreement not to disclose trade secrets is enforceable. The employee in *Zep Mfg. Co.* case was an at-will employee.

6. SUMMARY

The clear trend is that covenants not to compete are becoming easier to enforce. The resistance against them as a restraint of trade or as a tool which interferes with a person's right to ply his or her trade has weakened and provided the agreement is carefully drafted, it will likely be enforced. The law of non-solicitation agreements is in flux. If the dicta in *Marsh* is followed, these agreements will become more difficult to enforce than in the past as they will become subject to the complex analysis required by §15.05(a) as amplified by

the case law interpreting it. Confidentiality agreements remain a relatively simple applications of standard, black letter, contract formation law.