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Non-Compete Agreements: Where Have We Come From and Where We Go From Here

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I. OVERVIEW OF COVENANTS NOT TO COMPETE

A. The Statute.

Covenants not to compete are governed in Texas by statute. Section 15.05 of the TEXAS BUSINESS & COMMERCE CODE generally declares restraints on competition unlawful. However, the Covenants Not to Compete Act, enacted in 1989, carves out an exception for non-compete agreements and provides the framework for litigating the enforceability of non-competes. *See* TEX. BUS. & COM. CODE ANN. § 15.50 – 15.52.

B. Basic Requirements

15.50(a) of the TEX. BUS. & COM. CODE states,

> Notwithstanding Section 15.05 of this code, and subject to any applicable provision of Subsection (b) [dealing with non-competes for physicians], 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 boils down to two basic requirements:

- the covenant must be "ancillary to or part of an otherwise enforceable agreement at the time the agreement is made"; and

- the covenant must contain "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.

C. Is the Covenant "Ancillary to an Otherwise Enforceable Agreement at the time the agreement is made?"

The first issue that must be addressed by the employer is whether or not a non-competition covenant is "ancillary to or part of an otherwise enforceable agreement at the time the agreement is made." TEX. BUS. & COM. CODE ANN. § 15.50.

1. Non-competition Covenants Contained in an Agreement for the Sale of a Business.

Covenants not to compete set forth in an agreement for the sale of a business or a settlement agreement almost always satisfy the ancillary requirement. *See, e.g., Hill v. Mobile Auto Trim, Inc.,* 725 S.W.2d 168 (Tex. 1987) (sale of business); *Heritage Operating, L.P. v. Rhine Bros., LLC*, 2012 Tex. App. LEXIS 2065, *17 (Tex. App. -- Fort Worth Mar. 15, 2012, no pet. history); *Justin Belt Co. v. Yost*, 502 S.W.2d 681 (Tex. 1973) (settlement agreement). The focus of this paper, however, is the enforceability of non-competes that arise out of the employment relationship.[1]

2. Non-competition Covenants Arising out of an Employment Relationship.

Covenants not to compete that arise out of an employment relationship are more difficult to enforce than those arising out of a sale of a business. To determine whether a covenant not to compete is "ancillary to or part of an otherwise enforceable agreement at the time the agreement is made," a court must make two inquiries: (i) is there an enforceable agreement; and, if so, (ii) is the covenant not to compete "ancillary to or part of" the agreement at the time the agreement is made? The answer to both questions must be "yes," or the non-compete is unlawful. *Mann Frankfort Stein & Lipp Advisors, Inc. v. Fielding*, 289 S.W.3d 844, 849 (Tex. 2009); *Ray Mart, Inc. v. Stock Building Supply of Texas LP,* 2008 U.S. App. LEXIS 22882 [**6] (5th Cir. 2008).

At this point we pause to consider the evolution in the law over the last 18 years. In that time the Texas Supreme Court has changed meaning of the statutory term "ancillary" and the meaning of the statutory phrase "otherwise enforceable agreement at the time the agreement is made." This has caused a significant shift in non-compete law that makes it difficult to rely on some prior caselaw for some purposes. By way of example, pre-2006 cases seeming to require a simultaneous signing and exchange of confidential information are now obsolete. Also by way of example, in many situations an employer may not even be required to provide confidential information at all.

II. The Evolution of the Phrase "Ancillary to or Part of an Otherwise Enforceable Agreement at the Time the Agreement is Made: *Light* (1994) to *Sheshunoff* (2006), to *Mann Frankfort* (2009) to *Marsh* (2011).

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

Before the *Sheshunoff* opinion in October 2006, the Texas Supreme Court and virtually every appeals court required that the non-compete be ancillary to an agreement that was enforceable at the time the agreement was made. Neither an at-will employment relationship, nor any other promise that was conditioned upon a continued period of at-will employment, was deemed to be enforceable when made, since the person making the promise could avoid having to perform by simply terminating employment, which it could do at-will. *Light v. Centel Cellular Co. of Texas,* 883 S.W.2d 642, 644-45 (Tex. 1994).

For example, promising to give a raise to an at-will employee after thirty days is an illusory promise because its performance is conditioned upon some period of continued at-will employment; so such a promise would not have satisfied the requirement articulated in *Light v. Centel* that the underlying agreement be enforceable at the time the agreement is made. *Light v. Centel* at 645. An employer's promise to give an at-will employee access to confidential information during the course of the employment is likewise illusory because the promise

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[1] In *Traders International, Ltd. v. Scheuermann*, 2006 U.S. Dist. LEXIS 61995 *25 (S.D. Tex. 2006), the court found that the fact that the defendant was an independent contractor rather than an employee did not in that case impact the enforceability of the non-compete. In 2002, the Amarillo Court of Appeals held that §15.50 of the TEXAS BUSINESS & COMMERCE CODE does not govern the rights and liabilities of owners of real property who sell or buy land subject to restrictive covenants on the use of the land. *Ehler v. B.T. Suppenas Ltd.*, 74 S.W.3d 515, 520 (Tex.App.—Amarillo 2002, writ denied). In conducting its analysis, the court said, "Section 15.50 of the TEXAS BUSINESS & COMMERCE CODE specifies criteria for enforceability of covenants not to compete almost exclusively in the context of employment contracts." *Id*

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