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Non-Competes and Trade Secrets: It's Not Just Tech Anymore

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INTRODUCTION

As a labor market tightens, employment-based covenants not to compete and covenants not to solicit take on increasing importance. In Texas, Section 15.50 *et seq.* of the Texas Business & Commerce Code ("Section 15.50") governs the enforceability of covenants not to compete and is central to understanding how and to what extent such agreements are enforceable.

Of course, the existence of Section 15.50 leads to the question of which agreements are "covenants not to compete" subject to its requirements. As discussed below, it is generally accepted that true covenants not to compete (those purporting to prevent an employee from working) and covenants not to solicit customers are subject to Section 15.50 (because they restrain trade), while covenants against the disclosure of confidential or trade secret information are not (because they do not restrain trade).

This leaves the question of whether covenants against the solicitation of employees are restraints of trade subject to Section 15.50. Prior to the Texas Supreme Court's 2011 decision in *Marsh USA, Inc. v. Cook*, the common understanding was that such agreements were not subject to Section 15.50 because they did not restrain trade. Following the *Marsh* opinion, however, more and more Texas courts have begun analyzing employee non-solicitation covenants under Section 15.50, even though the Texas Supreme Court has confirmed its opinion in *Marsh* did not establish what was and was not a covenant not to compete.

Past the question of enforceability, there is the further question of whether a covenant will be enforced by injunction or whether the plaintiff will instead be limited to monetary recovery. This question is often effectively decided at the temporary or preliminary injunction stage: if the covenant is enforced by injunction pending final trial, the case is effectively decided in favor of the covenant; if the covenant is not enforced (or not meaningfully enforced) by injunction pending final trial, the case is effectively decided against the covenant. Once this temporary outcome is decided, very rarely do the parties proceed to final trial on the covenant itself (although the author has done so).

This paper will analyze the requirements of Section 15.50, discuss the treatment of employee non-solicitation covenants under Section 15.50, and examine the standard for enforcing agreements subject to Section 15.50 at the temporary or preliminary injunction phase. This paper also discusses the Texas Uniform Trade Secret Act ("TUTSA").

I. COVENANT ANALYSIS: FROM LIGHT TO MARSH

A. The Statute

Section 15.50(a) provides a covenant not to compete is enforceable, if it:

> (1) is ancillary to or part of an otherwise enforceable agreement at the time the agreement is made; and
>
> (2) 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. & COMM. CODE § 15.50(a).[1]

Pursuant to Section 15.51 of the Texas Business and Commerce Code ("Section 15.51"), a court is obligated to reform an overbroad covenant not to compete if the covenant is first found to be "ancillary to or part of" an otherwise enforceable agreement when made. TEX. BUS. & COMM. CODE § 15.50(c). In other words, if a covenant is *not* "ancillary to or part of" an otherwise enforceable agreement when made, it is fatally flawed and cannot be reformed or enforced. *See id.* If it is "ancillary to or part of" an otherwise enforceable agreement when made, it is enforceable and the only remaining question is to what extent. *See id*.

B. *Light v. Centel Cellular* (1994)

On June 2, 1994, the Texas Supreme Court issued its decision in *Light v. Centel Cellular Co.*, 883 S.W.2d 642 (Tex. 1994), construing the Section 15.50(a) requirement that a covenant not to compete be "ancillary to or part of an otherwise enforceable agreement at the time the agreement is made." *See Light*, 883 S.W.2d at 644-48. Among other things, *Light* held the phrase "at the time the agreement is made" modified both the requirement that the covenant not to compete be ancillary to or part of the underlying agreement (at the time made) *and* the requirement that the underlying agreement be enforceable (at the time made). *See id.* at 645-46. In other words, under *Light*'s reading of Section 15.50(a), the covenant had to be ancillary to or part of that agreement when the agreement was made *and* the agreement had to be enforceable when it was made to be capable of supporting a covenant not to compete. *Id.*

1. The Challenge for At-Will

Light's construction of Section 15.50(a) presented a challenge for covenants entered into with at-will employees. Any promise by an employer to an at-will employee that is dependent on any period of continued employment is not enforceable "when made," because the employer retains the right to terminate the employee at-will and thereby avoid performance of the promise.[2] *Light*,

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[1] Section 15.50(b) imposes additional requirements for the enforcement of a covenant not to compete against a physician. *See* TEX. BUS. & COMM. CODE § 15.50(b).

[2] For example, if an employer promises to provide an at-will employee confidential information in connection with the employee's employment, the employer may avoid the promise by terminating the employee. *Light*, 883 S.W.2d at 645 n.5. However, if the employee promises not to disclose the employer's confidential information, a binding unilateral contract will be formed *if* the employer does in fact provide the confidential information. *Id.* at n.6.

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