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A Primer on Covenants Not to Compete in Texas

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Article 15 of the Texas Business and Commerce Code is generally referred to as the Covenants Not to Compete Act. The Act has governed covenants not to compete in Texas for over 20 years now. However, a few opinions issued by the Texas Supreme Court over the last eight years have provided greater clarity for employers seeking to bind employees to enforceable non-compete agreements. Section 15.05 of the Act specifies that a restraint on trade or commerce created by a covenant not to compete is unenforceable in the State. The Act then creates an exception, providing that a covenant not to compete is enforceable if two requirements are satisfied. First, it must be "ancillary to or part of an otherwise enforceable agreement at the time the agreement is made." Second, to the extent it contains any limitations to time, geographical area or the scope of activity restrained, those limitations must be reasonable and not impose a greater restraint than necessary to protect the employer's goodwill or other business interests.

Regarding the first of these requirements, a covenant not to compete that an employer requires an *existing* employee to sign is not enforceable, by itself, because it is a stand-alone agreement unsupported by any consideration at the time the employee signs it. This is why employers should include restrictive covenants in written employment offers or employment agreements before an employee commences work for the company or at the very start of employment. The offer letter or employment agreement constitutes the requisite "otherwise enforceable agreement." It will then provide that the employer agrees to provide specialized training and confidential information in exchange for the covenant not to compete (and, perhaps, additional covenants, such as not to solicit other employees or any of the employer's customers on behalf of a subsequent employer).

In the seminal case of *Alex Sheshunoff Management Services, L.P. v. Johnson*, the Texas Supreme Court held that an employer's promise to provide training and access to confidential information in the future could form the otherwise enforceable agreement (even though the employer could terminate the employee the very next day). The Court was, therefore, careful to explain that the employer had to actually make good on its promise. This point is rarely challenged because the employer almost always does provide some training and access to confidential information. If the employer fails to make good on that promise, however, an employee who jumped shop for a competitor may be able to avoid enforcement of the covenant.

Many employers that do not provide unique services or products in the marketplace nonetheless require their employees to sign these agreements, creating a chilling effect and achieving the restraint on trade the Act is intended to prohibit. This suggests several guidelines for management, two of which we will address briefly here. First, specify restrictions as to time, geographical area and scope that are reasonable. Broader restraints are appropriate for a sales representative given access to customer lists or a researcher working with unique patentable technologies than an administrative assistant! Second, if the employer works in a competitive market in which everyone knows what everyone else is doing, the employer's mere references to its training as unique and its records as "confidential" do not automatically render them as such. For example, an employer whose personnel have published the company's methods or techniques, or presented them to industry organizations, may create distinct challenges when later arguing that it provided unique know-how to a now-former employee.

What other counsel can you provide for management?