A BRAVE NEW WORLD: NON-COMPETE AGREEMENTS AFTER THE DEMISE OF *LIGHT*

JASON S. BOULETTE
MICHAEL J. GOLDEN
TANYA DEMENT

BOULETTE & GOLDEN L.L.P.
1221 S. MOPAC EXPRESSWAY, SUITE 300
AUSTIN, TEXAS 78746

(512) 732-8900 | WWW.BOULETTEGOLDEN.COM

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INTRODUCTION

Section 15.50(a) of the Texas Business & Commerce Code ("Section 15.50(a)") imposes two requirements for the enforceability of a covenant not to compete in Texas.[1] The first is a technical requirement: the covenant must be ancillary to or part of an otherwise enforceable agreement. The second relates to reasonableness: the covenant must not impose a greater restraint than is necessary to protect the goodwill or other business interest of the party seeking the protection of the covenant.

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 requirements of Section 15.50(a). As is explained below, *Light's* analysis focused on Section 15.50(a)'s technical requirements and made the enforceability of a covenant not to compete (particularly one executed by an at-will employee) more a question of draftsmanship than legitimate business need.

On October 20, 2006, the Texas Supreme Court revisited the technical requirements of Section 15.50(a) in its *Alex Sheshunoff Management Services, L.P. v. Kenneth Johnson and Strunk & Associates, L.P.*, 209 S.W.3d 644 (Tex. 2006) decision. This time, the court pulled back from *Light* and advised courts not to become mired in technical analysis but instead to focus on the reasonableness of the covenant.[2]

On April 17, 2009, the Texas Supreme Court further clarified its retreat from *Light's* technical analysis in *Mann Frankfort Stein & Lipp Advisors, Inc. v. Fielding*, 2009 WL 1028051 (Tex. Apr. 17, 2009). Building on the holding in *Sheshunoff*, the court held in *Mann Frankfort* that even an implied promise could support a covenant.

Section I of this paper explains *Light's* technical analysis and the modification of that analysis by *Sheshunoff* and *Mann Frankfort*. Section II analyzes Texas decisions addressing the reasonableness of time, geographic, and scope of activity restrictions in covenants not to compete.

I. TECHNICAL COVENANT ANALYSIS: FROM *LIGHT* TO *SHESHUNOFF* & *MANN FRANKFORT*

A. The Statute

Section 15.50(a) provides that 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 promise.

TEX. BUS. & COMM. CODE § 15.50(a).

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, but only 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.*

B. The *Light* Construction

In *Light*, the Texas Supreme Court focused its attention on 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" to be enforceable. *See Light*, 883 S.W.2d at 644-48. Among other things, *Light* held that the phrase "at the time the agreement is made" modified both the requirement that the underlying agreement be enforceable (at the time made) and the requirement that the covenant not to compete be ancillary to or part of the underlying agreement (at the time made). *See id.* at 645-46. In other words, under *Light*'s reading of Section 15.50(a), an agreement had to be enforceable when it was made to be capable of supporting a covenant not to compete *and* the covenant had to be ancillary to or part of that agreement when the agreement was made for the covenant to be enforceable. *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

[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 convenience, this paper frequently uses the term "covenant" as short-hand for "covenant not to compete."

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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.[3] *Light*, 883 S.W.2d at 645 n.5. Such promises are thus "illusory" and, under *Light*, incapable of supporting a covenant not to compete, because they are not enforceable when made. *Id.* Accordingly, under *Light*, an at-will employment relationship could not support a covenant not to compete, unless the employer made a promise to the employee that was not dependent upon continued at-will employment. *Id.* at 645-46.

Under *Light*, even if the employer did make a non-illusory promise to the employee that was enforceable when made (*i.e.*, one that was not dependent on continued at-will employment), the covenant would still not be enforceable unless it was "ancillary to or part of" the underlying agreement containing the non-illusory promise. *Id.* at 646-47. According to *Light*, a covenant could be "ancillary to" to such an agreement only if: (1) the otherwise enforceable agreement between the employer and the employee gave rise to the employer's interest in restraining the employee from competing; and (2) the covenant was designed to enforce one or more of the employee's promises to the employer in the otherwise enforceable agreement.[4] *Id.* at 647.

With respect to Section 15.50(a)'s alternate requirement that a covenant need only be "part of" an otherwise enforceable agreement, the *Light* court engaged in a footnote analysis that effectively read the phrase out of the statute. *See id.* at 647 n.12 ("We interpret the phrase 'or a part of' to mean more than merely in the same instrument because such a literal reading renders the phrase 'at the time the agreement is made' redundant."). The court never explained what it thought "part of" in fact meant (if not what it literally means), and modern courts rarely reference the phrase in analyzing covenants in Texas.[5] *See id.*

2. The *Light* Test

The net result of the *Light* decision was that a covenant not to compete was enforceable against an at-will employee only if:

(1) There was an agreement between the employer and the employee that was otherwise enforceable when made (*i.e.*, contained promises that were not dependent on continued at-will employment);

(2) The consideration given by the employer in the otherwise enforceable agreement gave rise to the employer's interest in restraining the employee from competing; and

(3) The covenant not to compete was designed to enforce the employee's consideration or one of the employee's return promises in the otherwise enforceable agreement.

Id. at 647-48.

3. The *Light* Test Applied in *Light*

Applying its newly created standard to the case before it, the court found that the agreement between Debbie Light and her employer, United TeleSpectrum, Inc. ("United"), was an otherwise enforceable agreement when made, because it contained three promises that were not contingent on Light's continued at-will employment with United: (1) United's promise to provide "initial … specialized training" to Light; (2) Light's promise to provide 14 days' notice to United before terminating employment; and (3) Light's promise to provide an inventory of all United property upon termination. *Id.* at 646.

With respect to United's promise to provide training, the court held that it was otherwise enforceable when made, because "[e]ven if Light had resigned or been fired after this agreement was executed, United would still have been required to provide the initial training." *Id.* The court further acknowledged that this otherwise enforceable promise might very well have

[3] 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. According to *Light*, such a unilateral agreement is not sufficient for purposes of Section 15.50(a), because the agreement between the employer and the employee is not enforceable "when made" but instead only becomes enforceable when the employer later provides the employee with the confidential information. *Id.*

[4] This paper frequently uses the terms "employer" and "employee"—rather than "promisee" and "promisor"—for convenience and clarity.

[5] One appellate court made a reference to the phrase, before going on to conduct a cursory *Light*-based "ancillary to" analysis. *See Curtis v. Ziff Energy Group, Ltd.*, 12 S.W.3d 114, (Tex. App.—Houston [14th Dist.] 2000, no pet.) ("Next we must determine whether the covenant was ancillary to or part of the otherwise enforceable agreement. We find that it is part of the contract.").

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given rise to United's interest in restraining Light from competing, because United's promise to train "might involve confidential or proprietary information. …" *Id.* at 647. Nevertheless, the court concluded that the covenant was not "ancillary to" the agreement between Light and United, because it was not designed to enforce either of Light's return promises to United. *Id.* As the court explained:

> While United's consideration (the promise to train) might involve confidential or proprietary information, the covenant not to compete is not designed to enforce any of Light's return promises in the otherwise enforceable agreement. Light did not promise in the otherwise enforceable agreement to not disclose any of the confidential or proprietary information given to her by United.

Id.

C. The Progeny of *Light*

In response to the *Light* decision, lower courts analyzing covenants entered into by at-will employees began focusing almost exclusively on the question of whether the agreement between the employer and the employee contained any promises by the employer that (1) were enforceable when made (*i.e.*, not dependent on continued employment); and (2) gave rise to the employer's interest in restraining the employee's competition. *See, e.g., Trilogy Software, Inc. v. Callidus Software, Inc.*, 143 S.W.3d 452, 462 (Tex. App.—Austin 2004, pet. denied) (promise to provide confidential information was not enforceable at the time made because employer did not provide confidential information until later in the day that employee signed the agreement); *Strickland v. Medtronic, Inc.*, 97 S.W.3d 835, 839 (Tex. App.—Dallas 2003, pet. dismissed w.o.j.) (contractual language stating "this agreement is intended to recognize that Medtronic provides the Employee with [confidential] information" did not constitute an implied promise to provide such information and, even if it did, such a promise would be dependent on continued employment and thus illusory); *but see Guy Carpenter & Co. Inc. v. Provenzale*, 334 F.3d 459, 466 (5th Cir. 2003) (rejecting an overly technical reading of *Light*); *Wright v. Sport Supply Group, Inc.*, 137 S.W.3d 289, (Tex. App.—Beaumont 2004, no pet.) (same). The net result of *Light* was to make it exceedingly difficult, if not impossible, to enforce a covenant not to compete against an at-will employee, regardless of how reasonable the covenant was.

D. The Austin Court's Decision in *Sheshunoff*

On October 2, 2003, the technical analysis spawned by *Light* reached its apex in the Austin Court of Appeals' decision in *Alex Sheshunoff Management Company v. Johnson*, 124 S.W.3d 678 (Tex. App.—Austin 2003), *rev'd in part and aff'd in part*, 209 S.W.3d 644 (Tex. 2006). Ignoring *Light*'s holding that a promise to provide confidential information *could* support a covenant not to compete (provided it was not dependent on continued at-will employment), the Austin court held that a covenant not to compete was not enforceable against an at-will employee unless the employer *actually provided* the employee with confidential information *contemporaneously* with the execution of the agreement containing the covenant. *Id.* at 686-87 ("Under *Light*, a *promise* to give confidential information is not sufficient. The employer must actually give the confidential information in return for the employee's promise to not to disclose it.") (emphasis in original); *see also TMC Worldwide, L.P. v. Gray*, 178 S.W.3d 29, 38 (Tex. App.—Houston [1st Dist.] 2005, no pet.) (same).

The fact that the Alex Sheshunoff Management Company ("ASM") provided Kenneth Johnson with confidential information *after* he signed the employment agreement containing the covenant could not save ASM, because there was no evidence that ASM provided such confidential information "at the time of signing. …" *Sheshunoff*, 124 S.W.3d at 687. Finally, although the employment agreement did contain a non-illusory promise by ASM to provide Johnson with two weeks' notice of termination, that promise did not give rise to ASM's interest in restraining Johnson's competition. *Id.* at 688. Accordingly, ASM's non-compete was not "ancillary to" Johnson's employment agreement and, as a result, could not be reformed or enforced as a matter of law. *See id.*

E. The Supreme Court's *Sheshunoff* Decision

On September 10, 2004, the Texas Supreme Court agreed to review the Austin court's decision in *Sheshunoff*. On November 10, 2004, the court heard oral argument in the matter. On October 20, 2006, the Texas Supreme Court finally issued its *Sheshunoff* decision.

1. <u>"At the Time Made" Revisited</u>

Based largely on the legislative history of Section 15.50(a), the Texas Supreme Court in *Sheshunoff* held that an agreement did *not* have to be enforceable "at the time made" to support a covenant

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not to compete. *Sheshunoff*, 209 S.W.3d at 651. Rather, the covenant need only be "ancillary to or part of" the agreement at the time the agreement is made.[6] *Id.* As long as the employer ultimately performs its otherwise illusory promise under the agreement (*e.g.*, ultimately provides the employee with confidential information), the agreement is capable of supporting a covenant not to compete. *Id.* In other words, the fact that the underlying promise by the employer was technically unenforceable when it was made is no longer fatal to a covenant not to compete, provided the employer ultimately performs the promise. *Id.*

Applying the newly modified *Light* test, the *Sheshunoff* high court found the covenant at issue was "ancillary to" Johnson's employment agreement:

> [W]e hold that a covenant not to compete is not unenforceable under the Covenants Not to Compete Act solely because the employer's promise is executory when made. If the agreement becomes enforceable after the agreement is made because the employer performs his promise under the agreement and a unilateral contract is formed, the covenant is enforceable if all other requirements of the Act are met. In the pending case, these other requirements were met and, by the time Johnson left ASM, the agreement had become an enforceable unilateral contract because ASM had provided confidential information and specialized training as promised to Johnson, and Johnson had promised in return to preserve the confidences of his employer.

Id. at 655.

2. Promises to Support a Covenant

Sheshunoff did not specifically disturb *Light*'s "ancillary to" test, nor did it restore the phrase "or part of" to Section 15.50(a). *See Sheshunoff*, 209 S.W.3d at 649. As a result, the employer's promise (or other consideration) in the underlying agreement must still give rise to the employer's interest in restraining competition, and the covenant must still be designed to enforce the employee's consideration or return promise. *See id.* at 651.

In pre-*Sheshunoff* cases, courts generally recognized that "legitimate, protectable interests include business goodwill, trade secrets, and other confidential or proprietary information." *DeSantis v. Wackenhut Corp.*, 793 S.W.2d 670, 682 (Tex.1990) citing RESTATEMENT (SECOND) OF CONTRACTS § 188 cmts. b, g (1981); *see also Henshaw v. Kroenecke*, 656 S.W.2d 416, 418 (Tex. 1983) (recognizing a protectable business interest in preventing former employee from misusing rapport with clients). Accordingly, promises related to these items have typically satisfied *Light's* requirement that the employer's promise give rise to its interest in restraining the employee's competition, as well as *Light's* requirement that the covenant be designed to enforce the employee's return promise. *See, e.g., Guy Carpenter & Co. v. Provenzale*, 334 F.3d 459, 465-66 (5th Cir.2003) (promise to provide confidential information in return for promise not to disclose information); *Sheshunoff*, 209 S.W.3d at 649 (promise to disclose confidential information and provide specialized training in return for promise not to disclose confidential information); *Light*, 883 S.W.2d at 645-46, 647, n.14 (promise to provide "initial . . . specialized training" or "confidential and proprietary information or trade secrets" would have been sufficient, if the agreement had included a return promise by the employee not to disclose that information); *Pearson v. Visual Innovations Co.*, 2006 WL 903736, *4 (Tex. App.—Austin 2006, pet. denied) (not for publication) (promise to provide confidential information and specialized training in return for promise not to disclose information); *Wright v. Sport Supply Group*, 137 S.W.3d 289, 297 (Tex. App.—Beaumont 2004, no pet.) (promise to provide confidential information and training in return for promise not to disclose or use information); *Flake v. EGL Eagle Global Logistics, L.P.*, 2002 WL 31008136, *2 (Tex. App.—Houston [14th Dist.] 2002, no pet.) (not for publication) (promise to provide confidential information and trade secrets in return for promise not to use or disclose confidential information or trade secrets); *Curtis v. Ziff Energy Group Ltd.*, 12 S.W.3d 114, 118 (Tex. App.—Houston [14th Dist.]

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[6] Ironically, *Light* itself actually supports this result. First, in describing the issue before it, the *Light* court used a grammatical structure that suggested that "at the time made" only modified the requirement that the covenant be a part of the agreement (at the time made). *See Light*, 883 S.W.2d at 645 ("Section 15.50 requires us to make two initial inquiries as to formation of the covenant not to compete: (1) is there an otherwise enforceable agreement, to which (2) the covenant not to compete is ancillary to or a part of at the time the agreement is made."). Second, the *Light* court defended its decision to read "part of" out of Section 15.50(a) by noting that a literal reading of "part of" would render "at the time the agreement is made" redundant (because any covenant that was literally "part of" the underlying agreement would obviously be part of the agreement "at the time the agreement was made"). *See id.* at 647 n.12.

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2000, no pet.) (promise to provide confidential information and trade secrets in return for promise not to disclose or use information or trade secrets); *Evan's World Travel, Inc. v. Adams*, 978 S.W.2d 225, 232 (Tex. App.—Texarkana 1998, no pet.) (promise to provide confidential customer information in return for promise not to disclose information or take documents upon termination); *Ireland v. Franklin*, 950 S.W.2d 155, 158 (Tex. App.—San Antonio 1997, no writ) (promise to share listed trade secrets in return for promise not to disclose or use information); *cf. American Express Fin. Advisors v. Scott*, 955 F. Supp. 688, 692 (N.D. Tex. 1996) (covenant was ancillary to business relationship agreement where provision of goodwill and confidential information were "part and parcel" of the agreement and the promisor promised not to use or disclose confidential information); *Sheshunoff*, 209 S.W.3d at 665 (Wainwright, J., concurring) (an employer places confidence in its employees, and employees are under a duty not to misuse that confidence, so continued employment should be sufficient consideration for a covenant not to compete); *Martin v. Credit Protection Ass'n*, 793 S.W.2d 667, 670 n.2 (Tex. 1990), cited by *Sheshunoff*, 209 S.W.3d at 651 (noting that specialized training and knowledge are *not* the only promises that will support a covenant not to compete);[7] *O'Brien v. Rattikin Title Co.*, 2006 WL 417237, *5 (Tex. App.—Ft. Worth 2006, pet. dism'd w.o.j.) (not for publication) (noting that the trial considered that one purpose of the covenant was to retain the employee and to prevent employer's competitors from getting an unfair advantage by hiring an employee similar to the former employee at issue); *Totino v. Alexander & Associates, Inc.*, 1998 WL 552818, *6-7 (Tex. App.—Houston [1st Dist.] 1998, no writ) (not for publication) (covenant was "ancillary to" stock option award designed to encourage loyalty and retention); *but cf. Olander v. Compass Bank*, 363 F.3d 560, 565-66 (5th Cir. 2004) (finding that promises in stock option agreement were illusory without examining whether those promises would give rise to an interest in restraining competition).

By way of contrast, pre-*Sheshunoff* cases have routinely held that promises that are strictly financial in nature or relate to the circumstances surrounding the employee's termination generally do *not* give rise to an interest in restraining competition. *See, e.g., 31-W Insulation Co., Inc. v. Dickey*, 144 S.W.3d 153, 159 (Tex. App.—Fort Worth 2004, pet. withdrawn) (promise to give two weeks' notice of termination); *McAnelly v. Brady Medical Clinic, P.A.*, 2004 WL 2556634, *3 (Tex. App.—Austin 2004 no pet.) (not for publication) (agreement to repurchase medical supplies); *Trilogy Software, Inc. v. Callidus Software, Inc.*, 143 S.W.3d 452, 462 (Tex. App.—Austin 2004, pet. denied) (promise to pay one month salary); *C.S.C.S., Inc. v. Carter*, 129 S.W.3d 584, 591 (Tex. App.—Dallas 2003, no pet.) (promise not to terminate except for gross misconduct); *Sheshunoff*, 124 S.W.3d at 688 (promise to give two weeks' notice before terminating employee); *Strickland v. Medtronic, Inc.*, 97 S.W.3d 835, 839 (Tex. App.—Dallas 2003, pet. dismissed w.o.j.) (promise to give 90 days' notice before terminating employee); *American Fracmaster, Ltd. v. Richardson*, 71 S.W.3d 381, 387 (Tex. App.—Tyler 2001) (opinion withdrawn) (promise to provide 12 months' notice of termination); *Anderson Chemical Co., Inc. v. Green*, 66 S.W.3d 434, 439 (Tex. App.—Amarillo 2001, no pet.) (promise to give 10 days' notice of termination); *Houston Solvents and Chemicals Co., Inc. v. Montealegre*, 1999 WL 219366, *4 (Tex. App.—Houston [14th Dist.] 1999, no pet.) (not for publication) (promise to give 45 days' notice of termination without cause); *Donahue v. Bowles, Troy, Donahue, Johnson, Inc.*, 949 S.W.2d 746, 752 (Tex. App.—Dallas 1997, writ denied) (promise to give 30 days' notice of termination).

3. <u>New Consideration is Required</u>

It is important to note that whatever consideration is provided by the employer must be *new* consideration, if it is going to support a covenant not to compete:

> We understand why the Legislature and the courts would not allow an employer to spring a non-compete covenant on an existing employee and enforce such a covenant absent new consideration from the employer. "[A]n agreement not to compete, like any other contract, must be supported by consideration. The Act, as we now read it, addresses this concern. The covenant cannot be a stand-alone promise from the

[7] Strangely, the *Martin* court held that customer information does not constitute "independent valuable consideration" capable of supporting a non-competition agreement but then went on to state that customer information *was* a legitimate interest that could be protected by a covenant not to compete. *Martin*, 793 S.W.2d at 670 n.3. Martin was decided prior to the enactment of Section 15.50. Moreover, given that *Light* and *Sheshunoff* now test the employer's promise under Section 15.50(a) by examining whether the promise gives rise to an interest in restraining competition (effectively collapsing the question of consideration into the question of a legitimate interest worthy of protection), *Martin*'s distinction with respect to customer information appears to have been effectively overruled.

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> employee lacking any new consideration from the employer.

Sheshunoff, 209 S.W.3d at 651 (citations omitted).

4. <u>*Sheshunoff's* Call for a Return to Reason</u>

Notwithstanding *Sheshunoff's* statement that it did not disturb *Light*'s "ancillary to" test, the Texas Supreme Court did note that the "core" question for covenants not to compete should be whether the covenant's restrictions are reasonable and specifically warned courts not to become consumed in the technical analysis that had grown out of *Light*:

> We also take this opportunity to observe that section 15.50(a) does not ground the enforceability of a covenant not to compete on the overly technical disputes that our opinion in *Light* seems to have engendered over whether a covenant is ancillary to an otherwise enforceable 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 promise." Concerns that have driven disputes over whether a covenant is ancillary to an otherwise enforceable agreement—such as the amount of information an employee has received, its importance, its true degree of confidentiality, and the time period over which it is received—are better addressed in determining whether and to what extent a restraint on competition is justified. We did not intend in *Light* to divert attention from the central focus of section 15.50(a). To the extent our opinion caused such a diversion, we correct it today.

Sheshunoff, 209 S.W.3d at 655.

5. <u>Post-*Sheshunoff* Cases Prior to *Mann Frankfort*</u>

As of September 2008, several Texas and federal courts had applied the reasoning of *Sheshunoff* to a covenant not to compete case. They reached very different results.

In *Hardy v. Mann Frankfort Stein & Lipp Advisors, Inc.*, the Houston Court of Appeals, First District, held that a covenant not to compete was not enforceable, because the employer did not explicitly promise to provide the employee with confidential information. *Hardy v. Mann Frankfort Stein & Lipp Advisors, Inc.*, 2007 WL 1299661, *9 (Tex. App.—Houston [1st Dist.] 2007, pet. filed). The agreement did state that the employee would not disclose "any secret or confidential information or knowledge obtained … while employed," but the court held that this was not the same as a promise to provide such information and did not create an implied promise to provide such information. *Id.* at *8. Notably, it was undisputed that the employer in fact provided the employee with confidential information. *Id.* at *9.

By contrast, in *Wood v. Reserve First Partners, Ltd.*, the Beaumont Court of Appeals found that the absence of a promise to provide confidential information was not fatal to a covenant, where the underlying employment agreement was a "for cause" agreement (i.e., not at will) and the employer in fact provided the employee with confidential information. *Wood v. Reserve First Partners, Ltd.*, 2007 WL 2199901, *3 (Tex. App.—Beaumont 2007, n.p.h.). The court first found that the employment agreement was "otherwise enforceable," because it was a for cause contract. *Id.* The court then noted that the employer actually provided the employee with confidential information, which gave rise to the employer's interest in restraining the employee from competing. *Id.* Implicitly, then, the court found that *Sheshunoff* modified *Light* such that the promise that makes the agreement "otherwise enforceable" need not be the "consideration" that gives rise to the employer's interest in restraining competition. *See id.*

Likewise, in *Shoreline Gas, Inc. v. McGaughey,* the Corpus Christi Court of Appeals found the absence of a promise to provide confidential information by the employer was not fatal to a covenant, even where the employee was an at-will employee, because the employer in fact provided the employee with confidential information. *Shoreline Gas, Inc. v. McGaughey,* 2008 WL 1747624, *4-8 (Tex.App.—Corpus Christi, April 17, 2008, no pet.) (unpublished). The court found that the employer's acceptance—by supplying the confidential information—of the employee's offer for a unilateral contract not to disclose the employer's confidential information "constitutes an 'otherwise enforceable agreement' sufficient to support an accompanying non-compete covenant." *Id.* at *6.

In a footnote, the court addressed the employee's attempt to distinguish his case from *Sheshunoff* because the *Sheshunoff* contract required the employer to provide the confidential information. *Id.* at 8, n. 5. The court reasoned that the employer's promise to

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provide confidential information in *Sheshunoff* did not constitute the "otherwise enforceable agreement" in that case, because the promise was illusory and it was not an offer for a unilateral contract. *Id.; see also, In re Electro-Motor, Inc.,* 390 B.R. 859 (Bankr. E.D. Tex. 2008) (finding an otherwise enforceable agreement based on the employee's promise not to disclose confidential information, despite that there was "no express provision by which [the employer] directly promised to provide confidential information to [the employee]").

Even in the aftermath of *Sheshunoff,* the timing of transmitting confidential information is not completely irrelevant. In *Powerhouse Productions, Inc. v. Scott,* the employee worked under an employment agreement containing a non-compete for seven years. *Powerhouse Productions, Inc. v. Scott,* __ S.W.3d __, 2008 WL 3196174 (Tex.App.—Dallas, Aug. 8, 2008, no pet. h.). The employee learned everything about the operation, maintenance, techniques, and performance of the employer's business—flight using a personal rocket pack called the Rocketbelt. *Id.* at *1. After the employment agreement expired, the parties continued their relationship under the terms of the expired agreement. *Id.* Four years after the original agreement expired, *i.e.,* eleven years after the employee began working for the employer, the employer required the employee to sign a new non-compete agreement containing a promise by the employee not to disclose confidential information. *Id.* The Dallas Court of Appeals held that the new non-compete agreement was unenforceable for lack of consideration, because "the training and confidential information [the employer] provided [the employee] before he signed the non-compete agreement cannot form the consideration for the agreement because past consideration is not competent consideration for contract formation" and because there was no evidence that the employer provided confidential information and training after the employee signed the agreement. *Id.* at *4.

6. <u>The Supreme Court's *Mann Frankfort* Opinion</u>

In *Mann Frankfort*, the Texas Supreme Court resolved the lower courts' disagreement about whether an explicit promise by the employer is required. Specifically, the court answered this question by engaging in an implied promise analysis and holding, "When 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." *Mann Frankfort,* -- S.W.3d --, 2009 WL 1028051, *5 (Tex. Apr. 17, 2009). In other words, a promise to provide confidential interest or other consideration giving rise to an interest in restraining competition is required, but a court may imply such a promise based on the nature of the employee's work. *See id.*

It should be noted that the covenant at issue in *Mann Frankfort* contained an express promise on the part of the employee not to disclose confidential information. Not only is such a promise required under *Sheshunoff*, the *Mann Frankfort* court used the explicit promise not to disclose confidential information as support for finding an implied promise to provide confidential information. *See Mann Frankfort*, -- S.W.3d --, 2009 WL 1028051, *6 ("[I]f 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.").

II. RENEWED ATTENTION TO REASONABLENESS

Given the Texas Supreme Court's directive in both *Sheshunoff* and *Mann Frankfort* to focus on reasonableness rather than technicalities, practitioners are well advised to re-familiarize themselves with the long-ignored body of Texas law addressing what terms are and are not considered reasonable in a covenant not to compete.

A. Reasonableness and Reformation Under the Statute

Under Section 15.50(a), a covenant not to compete is enforceable only "to the extent 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 promise." TEX. BUS. & COMM. CODE § 15.50(a). If a covenant is ancillary to or part of an otherwise enforceable agreement but is overbroad in its terms, a court must reform the agreement so as to make it reasonable and enforceable. TEX. BUS. & COMM. CODE § 15.51(c); *Wright v. Sport Supply Group, Inc.*, 137 S.W.3d 289, 299 (Tex. App.—Beaumont 2004, no pet.) (reformation of overbroad covenant is mandatory and no request for reformation need be made).

1. <u>Reformation Precludes Damages for Pre-Reformation Breaches</u>

Reformation comes at a cost. First, although a court may typically award damages, injunctive relief, or both for a breach of a covenant not to compete, if the

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covenant is overbroad, a court "may not award the promise damages for a breach of the covenant before its reformation and the relief granted to the promisee shall be limited to injunctive relief."[8] TEX. BUS. & COMM. CODE § 15.51(c).

2. Reformation Precludes Tortious Interference Pre-Reformation

Second, until the covenant is reformed, it cannot support a claim for tortious interference against an individual or entity who uses the services of the individual bound by the covenant. *See Juliette Fowler Homes, Inc. v. Welch Associates, Inc.*, 793 S.W.2d 660, 665 (Tex. 1990) ("We now hold that covenants not to compete which are unreasonable restraints of trade and unenforceable on grounds of public policy cannot form the basis of an action for tortious interference.").

3. Reformation Opens the Door to a Claim for Attorney's Fees

Third, if the primary purpose of the agreement to which the covenant is ancillary is to obligate the promisor to render personal services, and the promisor establishes that the promisee knew that the covenant was overbroad at the time it was made and that the promisee attempted to enforce the covenant to a greater extent than necessary to protect the promisee's goodwill or other business interests, then a court may award the promisor costs, including reasonable attorney's fees, actually and reasonably incurred in defending the action to enforce the covenant. TEX. BUS. & COMM. CODE § 15.51(c); *see also Evan's World Travel,* 978 S.W.2d at 233-34 (analyzing right to attorney's fees under Section 15.51(c) and affirming trial court finding that employer knew geographical scope of covenant was overbroad at the time the covenant was made).

B. *Sheshunoff's* Reasonableness Analysis

After determining that Kenneth Johnson's covenant was ancillary to his employment agreement with ASM, the *Sheshunoff* high court turned to the issue of its reasonableness. In the covenant, Johnson agreed not to (1) directly or indirectly provide consulting services to banks, savings and loans, or other financial institutions where he had provided fee based services in excess of 40 hours within the last year of his employment or with which he had conducted "significant" sales activity; (2) solicit or aid any other party in soliciting any affiliation member or previously identified prospective client or affiliation member; or (3) solicit or aid any other party in soliciting for employment any then-current employee of ASM. *Sheshunoff*, 209 S.W.3d at 656.

1. Reasonableness Analysis Considers All Confidential Information Given

Johnson signed the employment agreement containing the covenant in connection with a promotion, roughly four years after he started with ASM. Attempting to leverage this fact to his full advantage, Johnson argued that the reasonableness of ASM's covenant should be judged against the information ASM provided him *after* he executed the employment agreement and not with reference to any information ASM provided him *before* he executed the employment agreement. *Id.* at 657. More specifically, Johnson argued that the covenant was overbroad because (1) the restriction on solicitation of certain prospective clients and affiliation members was unrelated to any training or confidential information ASM provided him *after* he signed the employment agreement; (2) ASM's protection of its goodwill was unrelated to any such information; and (3) he was aware of some of ASM's clients before he signed the employment agreement. *Id.*

[8] The language of the statute is somewhat conflicted on whether the promisee may be awarded damages for a breach of the covenant that occurs *after* reformation. On the one hand, the statute's statement that the court may not award damages "for a breach of the covenant *before* reformation" suggests that the court may award damages for a breach that occurs after reformation. *See* TEX. BUS. & COMM. CODE § 15.51(c) (emphasis supplied). On the other hand, the statute's statement that "the relief granted to the promisee shall be limited to injunctive relief" could be read to suggest that the court may be limited to injunctive relief even following reformation. *Id.* Unfortunately, there is little to no law on the subject, in part because *Light* defeated most covenants on technical grounds such that reformation was not available and in part because a trial court's reformation of a covenant is typically accompanied by an injunction ordering the promisor to comply with the reformed covenant, thus preventing (in most cases) any breach following reformation. All of this said, the language of Section 15.51(c) largely codified the common law as it existed prior to the statute's enactment, and decisions from that time suggest that damages following reformation may be available. *Cf. Juliette Fowler Homes, Inc. v. Welch Associates, Inc.*, 793 S.W.2d 660, 663 (Tex. 1990) ("If the agreement is not enforceable in accordance with its terms because either the time or the area stipulated therein is unreasonable, the employer may obtain injunctive relief but will not be awarded a money recovery for anything the employee may have done *prior to* a judicial declaration of the rights and obligations arising from the contract.") (emphasis supplied).

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The court dismissed Johnson's arguments almost out of hand:

> With Johnson's help as Director of Affiliation, ASM continued to develop clients for four years after the employment agreement was signed. Johnson helped develop ASM's goodwill and could have tried to capitalize on it unfairly after going to Strunk. Johnson was even privy to ASM's development of a product to compete with Strunk. Although ASM had given Johnson access to the same marketing information without a covenant not to compete, nothing precluded ASM from seeking the greater protection of a covenant when it did.

Id.[9]

2. The Employee's Agreement That the Covenant Is Reasonable Counts

The court also noted that Johnson had agreed in the employment agreement that the covenant was reasonable and had testified that the broader covenant he had signed with his new employer was also reasonable:

> The summary judgment record shows that Johnson's covenant would have precluded him from calling on 821 ASM clients for one year. When Johnson began work with Strunk, he agreed he would not sell an overdraft protection production, not just to Strunk's customers, but to anyone in the industry, and not for one year, but for two years after leaving Strunk's employment. Johnson testified that his covenant with Strunk was reasonable, just as he admitted in his employment agreement that his covenant with ASM was reasonable.

Id.; cf. Wright, 137 S.W.3d at 293-94 (noting that the parties had contractually agreed that the employer would have no adequate remedy at law in deciding that the employer in fact had no adequate remedy at law).

C. Reasonableness Cases

As noted above, the overly technical analysis of *Light* produced twelve years of jurisprudence in which courts rarely reached the issue of whether the employer's covenant was reasonable. Nevertheless, there are a handful post-*Light* cases that did reach the issue of reasonableness, as well as many pre-*Light* cases on the subject. Given *Sheshunoff's* instruction to lower courts to focus on the "core" inquiry of reasonableness in covenant analysis, these cases are likely to take on new importance in the coming years. In addition, several courts have engaged in a reasonableness analysis since *Sheshunoff* was decided.

1. Geographic Area

In 1960, the Texas Supreme Court set the standard for a reasonable geographic area in a covenant not to compete:

> [T]he restrictive covenant must bear some relation to the activities of the employee. It must not restrain his activities in a territory into which his former work has not taken him or given him the opportunity to enjoy undue advantages in later competition with his employer.

Weatherford Oil Tool Co. v. Campbell, 340 S.W.2d 950, 952 (Tex. 1960).

a. The area in which the employee worked

As a general matter, a reasonable geographic restriction will almost always include the area in which the employee performed services for the employer. *See, e.g., Webb v. Hartman Newspapers, Inc.*, 793 S.W.2d 302, 305 (Tex. App.—Houston [14th Dist.] 1990, no writ) (covenant that covered any area within 50-miles of any of the employer's papers reduced to the actual distribution area of the paper for which the employee worked); *Property Tax Associates, Inc. v. Staffeldt*, 800 S.W.2d 349, 351 (Tex. App.—El Paso 1990, writ denied) (multi-county restriction reformed to county in which lawyer serviced clients); *Diversified Human Resources Group, Inc. v. Levinson-Polakoff*, 752 S.W.2d 8, 12 (Tex. App.—Dallas 1988, no writ) (covenant that applied to 50-mile radius of any profit center of the

[9] Interestingly, although the *Sheshunoff* court confirmed that an employer *must* provide new consideration following the execution of the covenant, the *Sheshunoff* court judged the reasonableness of the covenant against what the ASM *actually* provided Johnson, both before and after execution of the covenant. *Compare Sheshunoff*, 209 S.W.3d at 651 (explaining that covenant must be supported by new consideration to be enforceable) *with Sheshunoff*, 209 S.W.3d at 657 (analyzing reasonableness of covenant in light of all confidential information and goodwill given to employee both before and after execution of the covenant).

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company was unreasonable, where the employee only worked for the employer in the Dallas metroplex area); *Cross v. Chem-Air South, Inc.*, 648 S.W.2d 754, 757 (Tex. App.—Beaumont 1983, no writ) (covenant restraining herbicide helicopter pilot from competing in counties and parishes in which he had worked for the employer was reasonable); *American Speedreading Academy, Inc. v. Holst*, 496 S.W.2d 133, (Tex. App.—Beaumont 1973, no writ) (area reduced from 1,000 miles of any class conducted by the former employer to Dallas county, the only county in which the teacher worked for the former employer).

b. <u>The nature of the employer's business and the employee's involvement</u>

In some instances, a court will look beyond the mere physical area in which the employee worked to "the nature and extent of the employer's business and the degree of the employee's involvement." *See, e.g., Allan J. Richardson & Associates, Inc. v. Andrews*, 718 S.W.2d 833, 835 (Tex. App.—Houston [14th Dist.] 1986, no writ); *see also Butler v. Arrow Mirror & Glass, Inc.*, 51 S.W.3d 787, 793 (Tex. App.—Houston [1st Dist.] 2001, no pet.) (same).

In *Allan J. Richardson*, for example, the court noted that the nature of the employer's business (structuring settlements in personal injury cases) was such that it could be conducted nationwide from a single physical location via telephone. *Allan J. Richardson*, 718 S.W.2d at 834 ("Much of the services performed by the company can be done by telephone so that it is possible that a nationwide operation could be conducted from corporate headquarters.") Upon examining the extent of the employees' actual involvement in conducting nationwide sales, however, the appellate court affirmed the trial court's decision to enforce a multi-state prohibition rather than a nationwide prohibition:

> [T]he trial court could reasonably have concluded that although the appellees had solicited customers on a nationwide basis, the overwhelming majority of actual sales accomplished by salesmen in the Houston office were to clients in Texas, Oklahoma, New Mexico, Kansas and California. Contacts with potential customers in other states had resulted in only four sales outside the five state area by Ricklin; there was no evidence of sales outside the five state area made by Newton or Andrews. Richardson, Inc., failed to prove the requisite probable injury to the corporation to justify a nationwide injunction. The trial court did not abuse its discretion in restraining appellees from competing with appellant in the states of Texas, Oklahoma, New Mexico, Kansas and California only.

Allan J. Richardson, 718 S.W.2d at 834.

Of course, if the employee's involvement in the employer's operations is substantial, a court employing this analysis may conclude that a prohibition matching the employer's scope of operations is appropriate. In *Curtis*, for example:

> Curtis was the Vice President of Pipelines and Energy Marketing, hired to "head and build up the U.S. practice in the areas of consulting regarding pipeline/transportation issues, and energy marketing." The covenant did not allow Curtis to engage in competitive business in Canada or the United States. … Based on Curtis' job description and responsibilities, it was reasonable to restrict Curtis from working in other oil and gas consulting firms in North America for a six month period, and it did not impose an unnecessary restraint.

Curtis, 12 S.W.3d at 119; *see also French v. Community Broadcasting of Coastal Bend, Inc.*, 766 S.W.2d 330, 333-34 (Tex. App.—Corpus Christi 1989, writ dism'd w.o.j.) (noting the breadth of the employee's involvement in the employer's television broadcast operations in upholding a prohibition on competition throughout the whole of the employer's broadcast market); *Teel v. Hospital Partners of America Inc.,* 2008 WL 346377, *7 (S.D. Tex., Feb. 6, 2008) (covenant that applied to competing hospitals located within a 25-mile radius of a facility of the employer or a facility the employer was pursuing was reasonable "[g]iven the senior position [employee] occupied and the proprietary information he received during his employment").

c. <u>Dynamic descriptions v. fixed descriptions</u>

Practitioners should exercise caution when drafting agreements that describe the geographic area to be covered in dynamic terms rather than in fixed geographical measurements. First, if the description is too indefinite, it will be deemed overbroad as a matter of law. *Gomez v. Zamora*, 814 S.W.2d 114, 117-18 (Tex. App.—Corpus Christi 1991, no writ) ("existing marketing area" and "future marketing area" were indefinite and thus overbroad); *see also Butts Retail, Inc. v. Diversifoods, Inc.*, 840 S.W.2d 770, 774 (Tex. App.—Beaumont 1992, writ denied) ("metropolitan

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area" was indefinite and thus overbroad); *but see Wright*, 137 S.W.3d at 298 n.5 (construing prohibition on doing business with customers with whom former employee had "dealings" to mean customers the employee called on and any customers in the employee's territory whose purchases were used to determine the employee's compensation); *French*, 766 S.W.2d at 333-34 (taking no issue with covenant that barred competition in the "area of dominant influence, as defined by Arbitron [the station owner], of KAVU-TV, including, but not limited to, Victoria and such other counties as may be included in the area of dominant influence at the date of termination," where the promisor only included Victoria county in the area of dominant influence at the time of termination).

Second, logical descriptions sometimes result in unintended, theoretical consequences that may render the covenant overbroad. In *Weatherford Oil*, for example, the employer's covenant purported to bar competition in any area in which Weatherford Oil might be operating during the one-year post-employment term of the covenant. *Weatherford Oil*, 340 S.W.2d at 312. Although this language may appear reasonable at first glance, it is in fact plainly unreasonable:

> The size of the included area will depend upon the extent of the petitioner's operations, and under the terms of the agreement respondents are free to engage in a similar business in any other territory they might select. There is no assurance, however, that they would be permitted to sell their products there throughout the period of restraint. If petitioner should extend its business operations into such territory, respondents are obligated by their contract to discontinue selling competing merchandise therein for the remainder of the year.

Id. at 313.

d. A customer restriction as a substitute for a geographic restriction

Although the complete lack of a geographic restriction will render a non-competition agreement overbroad as a matter of law, *Juliette Fowler Homes*, 793 S.W.2d at 663, the Texas Supreme Court has acknowledged that a customer restriction may substitute for a geographic restriction in an appropriate case. *Peat Marwick Main & Co. v. Haass*, 818 S.W.2d 381, 387-88 (Tex. 1991). A customer-based restriction must still bear a direct relationship to the interest in being protected, however. *See id.* Usually, this interest will be the goodwill that exists between the employer and its clients that might otherwise be diverted by the employee. *See id.* In such a case, a reasonable restriction would only prohibit the former employee from calling on those customers with whom the employee actually dealt.[10] *Id.* (customer restriction that extended to customers with whom employee had no contact was overbroad); *John Ray & Sons, Inc. v. Stroman*, 923 S.W.2d 80, 85 (Tex. App—Houston [14th Dist.], writ denied) (same); *see also American Express*, 955 F. Supp. at 692-93 (covenant was reasonable in restricting former financial advisor from contacting customers he served while affiliated with the promisee, where customers included current customers, potential customers to whom a presentation was made, and the members of their household); *Wright*, 137 S.W.3d at 298 n.5 (construing prohibition on doing business with customers with whom former employee had "dealings" to mean customers the employee called on and any customers in the employee's territory whose purchases were used to determine the employee's compensation); *but see Martin v. Linen Systems for Hospitals, Inc.*, 671 S.W.2d 706, 708 (Tex. App.—Houston [1st Dist.], no writ) (geographic scope of covenant reduced from a 10-mile radius of any customer to a 10-mile radius of the former employer's home office, where the employee worked within the 10-mile radius but solicited customer accounts outside of the 10-mile radius); *Goodin v. Jolliff,* 257 S.W.3d 341, 351-52 (Tex.App.—Ft. Worth 2008, no pet.) (prohibition on starting a "competing business" without any geographic limitation whatsoever would not be construed as limited to the employer's then-current customers and was unreasonable given that the employer's business was not limited to any one particular area).

e. Reformation and the burden of proof

Even if a covenant is limited neither geographically nor by reference to customers, a court must reform it under Section 15.51(c), if it is ancillary to or part of an otherwise enforceable agreement. *See* TEX. BUS. & COMM. CODE § 15.51(c); *Zep Mfg. Co. v. Harthcock*, 824 S.W.2d 654, 661 (Tex. App.—Dallas 1992, no writ) (trial court must reform overbroad covenant, even if it contains no geographic limitations whatsoever). That being said, if the primary purpose

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[10] If the covenant was actually designed to protect the employer's confidential information regarding its customers, then the restriction could presumably extend to those customers about whom the employee had confidential information, regardless of whether the employee actually had contact with those customers.

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of the underlying agreement is to obligate the promisor to render personal services, the promisee has the burden of establishing reasonableness. TEX. BUS. & COMM. CODE § 15.51(c); *Stroman*, 923 S.W.2d at 85. Building off of this notion, at least one court has held that no reformation is possible if the promisee of such a covenant fails to prove what reformation, if any, is reasonable and necessary to protect its goodwill or other business interests. *Stroman*, 923 S.W.2d at 85.

2. Scope of Activity

A flat prohibition on engaging in any form of competition is overbroad as a matter of law. *Juliette Fowler Homes*, 793 S.W.2d at 663; *McNeilus Companies, Inc. v. Sams*, 971 S.W.2d 507, 511 (Tex. App.—Dallas 1997, no pet.) (trial court would not abuse discretion in finding prohibition on working "in any capacity … whatsoever … in any business activities … competitive with those of [the company]" was overbroad); *but see Property Tax Associates*, 800 S.W.2d at 351 (prohibition against engaging "in any business that is in competition in any manner whatsoever" with the employer was reasonable, because the employer was in only one area of business – tax preparation). Likewise, an industry-wide prohibition on competition is overbroad as a matter of law. *Wright*, 137 S.W.3d at 298; *Stroman*, 923 S.W.2d at 85.

a. Tailoring the scope of the restriction to the former employee's duties

The *Diversified Human Resources* decision illustrates the analysis often used to tailor a scope of activity restriction. Diversified Human Resource Group ("Diversified") was in the personnel placement business. *Diversified Human Resources*, 752 S.W.2d at 10. Lauren Levinson-Polakoff worked for Diversified in its Dallas office recruiting prospective employees for placement with Diversified's data processing clients. *Id.* After Diversified terminated her in May 1986, Levinson-Polakoff took a position with Danbrook Group ("Danbrook") recruiting and placing employees for insurance underwriting positions with insurance companies. *Id.* Danbrook's office was only a few miles away from Diversified's Dallas office. *Id.*

Diversified sued Levinson-Polakoff to enforce her non-competition agreement, which purported to prohibit her from recruiting or placing any kind of personnel within a 50-mile radius of any Diversified "profit center." In addition to holding that the geographic scope of the agreement was overbroad, *see supra*, the court held that the scope of activity to be restrained under the agreement was unreasonable:

> Stringer [a Diversified manager] claims that he did not train Levinson-Polakoff to work exclusively in the data processing placement business, although he admits her job with Diversified was to recruit data processors. Both Stringer and Tobolka [another Diversified manager] suggest that she would not be able to recruit underwriting professionals for Danbrook if it were not for her training at Diversified, and because Diversified also recruits insurance underwriting professionals, Levinson-Polakoff is necessarily in competition with them. …
>
> We recognize that Diversified may have had a legitimate interest in restricting Levinson-Polakoff from recruiting data processors in the Dallas area for six months. However, we are not persuaded that a covenant that restrains her from placing personnel in any other field is reasonable. Levinson-Polakoff may have acquired useful skills through her employment with Diversified, but it appears from the record that her true ability to compete with Diversified derives from her data processing related contacts.

Diversified Human Resources, 752 S.W.2d at 11.

Obviously, the more involvement an employee has in an employer's business, the broader a restriction a court is likely to tolerate. In *French v. Community Broadcasting of Coastal Bend*, for example, the appellate court affirmed the trial court's enforcement of a covenant barring the former chief operating officer of a television station from competing with his former employer in the general business of television broadcasting in the market area of his former employer, in light of the chief operating officer's extensive involvement in the employer's business:

> In balancing the interest of the employer and the employee, we find it significant that French was the general manager of the television station and was responsible for and directed all activities at the station-promotions, sales, programming, hiring, firing, etc. He set policies and determined marketing strategy. French knew all of the strengths and weaknesses of the station that would be influenced directly by the actions he took as general manager or by the

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> policies he adopted. He was not an ordinary employee but was the chief operation officer of the station.

French, 766 S.W.2d at 334.

b. <u>Tailoring the scope of the restriction to the employer's business</u>

In *Webb v. Hartman Newspapers*, the court carefully examined the nature of the former employer's newspaper and the nature of the former employee's newspaper, as well as the nature of competition for advertising dollars, before reforming the covenant at issue:

> Regarding the scope of activity which the covenant prohibits, Webb contends that Hartman's interest in seeing *The Fort Bend Mirror* and the *Mirror* succeed as general interest newspapers would not be unduly threatened by Webb disseminating information, although in newspaper format, which is narrowly targeted at a different audience, Fort Bend County's business and legal communities. Hartman, however, contends that because Webb's position with the *Mirror* newspapers acquainted him with their advertising customers, allowing him to engage in any newspaper venture competing for advertising dollars in Fort Bend County would give him an unfair competitive advantage that was gained at Hartman's expense. Finding merit in both perspectives, we limit the furtherance of Webb's vocation by restraining him for the time specified in the covenant from soliciting advertising from those concerns which advertised in either *Mirror* newspaper during his tenure as a Hartman employee.

Webb, 793 S.W.2d at 304-05.

c. <u>Weighing options and balancing hardships</u>

In addition to the foregoing considerations, the number of career options available to the employee under the covenant often plays a role in a court's reasonableness analysis:

> French was not forbidden from employment in a radio station, which made up the bulk of his past work experience. He was not prohibited from making a livelihood or to engage in television business outside the Victoria area.

French, 766 S.W.2d at 334; *cf. Curtis*, 12 S.W.3d at 119 (noting that the employer limited its competitor to 20 companies and that not "all oil and gas companies were included" when upholding six month restriction against competition in all of North America).

Although *French* was decided under the "balancing of hardships" common-law standard that preceded Section 15.50(a), the scope of activity "balancing" analysis found in *French* is intuitive, likely to be used at some level by most trial judges, and continues to find its way into appellate decisions applying Section 15.50(a). *See, e.g., DeSantis v. Wackenhut Corp.*, 793 S.W.2d 670, 682 (Tex. 1990) ("[T]he promisee's need for the protection afforded by the agreement not to compete must not be outweighed by either the hardship to the promisor or any injury likely to the public."); *Deaton v. United Mobile Networks, L.P.*, 926 S.W.2d 756, 762 (Tex.App.—Texarkana 1996), *rev'd in part on other ground and aff'd in part*, 939 S.W.2d 146 (Tex. 1997), *citing DeSantis*, 793 S.W.2d at 682 ("[T]he need for protection afforded by the agreement not to compete must not be outweighed by either the hardship to the promisor or any injury likely to the public."); *Butts Retail*, 840 S.W.2d at 773, *quoting DeSantis*, 793 S.W.2d at 683 ("We have been instructed by our Supreme Court in adjudicating the reasonableness of a non-competition agreement to 'focus on the need to protect a legitimate interest of the promisee and the hardship of such protection on the promisor and the public.'"); *but see* TEX. BUS. & COMM. CODE § 15.50(a) (covenant is enforceable if, among other things, its restrictions "are reasonable and do not impose a greater restraint than is necessary to protect the goodwill or other business interests of the promisee"); *Property Tax Associates*, 800 S.W.2d at 352 (opining that Section 15.50(a) replaced the balancing of benefits and burdens to the employer and the employee with the question of whether the covenant imposes a greater restraint than is necessary to protect the goodwill or other business interest of the promisee).

Indeed, the court in *Butler v. Arrow Mirror & Glass, Inc.*, a case decided under Section 15.50(a), engaged in an analysis very similar to the analysis found in *French* in deciding to uphold the covenant at issue in that case:

> The covenant as reformed enjoins Butler and ReGlaze from "installing mirrors and glass products in *new residential construction*" (emphasis added); Butler and ReGlaze were not enjoined from doing business in commercial construction. Restraints are "easier to justify if … limited to one field of

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> activity among many that are available to the employee."

Butler, 51 S.W.3d at 794, citing RESTATEMENT (SECOND) OF CONTRACTS § 188 cmt. g (1979) (emphasis added in original).[11]

Likewise, the court in *Stone v. Griffin Commc'n and Security Systems, Inc.*, another case decided under Section 15.50(a), engaged in an analysis of the alternatives available to the employee in determining that the covenant at issue in that case was reasonable:

> Contrary to Appellants contentions, the covenant does not impose industry-wide restrictions as it does not prevent them from performing installation or maintenance of systems, so long as they do not sell or lease such systems. Moreover, the non-solicitation clause does not prevent Griffin customers from contacting Appellants for services, so long as Appellants do not solicit business from such customers. Further, the non-solicitation portion of the agreement properly relates only to such customers with whom appellants had contact while they were employed by Griffin.

Stone v. Griffin Commc'n and Security Systems, Inc., 53 S.W.3d 687, 694 (Tex. App.—Tyler 2001, no pet.).

3. Time

a. The rule of thumb

With respect to time limitations, it is frequently noted that Texas courts have upheld restrictions ranging from two to five years. *Stone*, 53 S.W.3d at 687 (collecting cases) (upholding a five year restriction after noting that Texas courts uphold restrictions ranging from two to five years in length); *Property Tax Associates*, 800 S.W.2d at 350-51 (collecting cases) (upholding a two year restriction after noting that Texas courts uphold restrictions ranging from two to five years in length); *Teel v. Hospital Partners of America Inc.,* 2008 WL 346377, *7 (S.D. Tex., Feb. 6, 2008) (collecting cases) (upholding a one year restriction because "Texas courts have enforced covenants with similar or greater restrictions"); *see also Sheshunoff*, 209 S.W.3d at 657 (two years reasonable); *Butler*, 51 S.W.3d at 793 (two years reasonable); *Cross*, 648 S.W.2d at 757 (two years reasonable); *but see Martin*, 671 S.W.2d at 708 (restriction reformed from 18 months to one year).

b. The why behind the rule of thumb?

This general rule of thumb has become so commonplace, that many appellate courts do not engage in any analysis of *why* Texas courts uphold restrictions ranging from two to five years. In theory, the reasonableness of a temporal restriction depends upon the interest being protected. For example, if the interest being protected is confidential information, a reasonable restriction would presumably reflect the period of time that must pass before such information becomes "stale" or otherwise of limited use to the employer's competitors. *See Stone*, 53 S.W.3d at 696 ("Although no evidence was introduced specifically stating that five years was a reasonable time period of restraint, there is ample evidence in the record showing that it would take five years for the information received by Appellants while there were employed by Griffin to become outdated.").

c. Indefinite duration

As with the indefinite geographic restriction struck down in *Weatherford Oil*, a time limitation that is effectively indefinite (and thus potentially unlimited) is overbroad as a matter of law. *See General Devices, Inc. v. Bacon*, 888 S.W.2d 497, 503 (Tex. App.—Dallas 1994, writ denied). In *General Devices, Inc. v. Bacon*, the covenant stated that the former employee would not accept employment with any client of the former employer "for a period of thirty (30) days beyond the period of association between COMPANY and CLIENT or any firm of aforesaid." *Id.* The court had little difficulty concluding that the restriction was unreasonable, if for no other reason than the simple fact that "[t]he relationship between GDI and its clients could exist indefinitely." *Id.*

d. Reformation and the burden of proof

As is the case with covenants with no geographic restriction, a court must reform a covenant, even if it contains no temporal limitation, provided it is ancillary to or part of an otherwise enforceable agreement. *Stroman*, 923 S.W.2d at 85. That being said, when the primary purpose of the underlying agreement is to obligate the promisor to render

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[11] Interestingly, the *Butler* court concluded that it was proper to restrain ReGlaze, the company Butler formed, even though ReGlaze never signed a non-competition agreement, because Butler's non-competition agreement stated that Butler would not, directly or indirectly, "'either as an employee, officer, director, consultant, agent, principal, *owner or in any other individual or representative capacity* engage in a business that is in competition with [Arrow].'" *Butler*, 51 S.W.3d at 795 (emphasis in original).

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personal services, the promisee has the burden of establishing reasonableness. TEX. BUS. & COMM. CODE § 15.51(c); *Stroman*, 923 S.W.2d at 85. As noted earlier, at least one court has held that no reformation is possible if the promisee of such a covenant fails to prove what reformation, if any, is reasonable and necessary to protect its goodwill or other business interests. *Stroman*, 923 S.W.2d at 85.

CONCLUSION

Although certain aspects of *Light's* technical analysis may have survived *Sheshunoff*, the Texas Supreme Court has specifically directed lower courts to focus on the reasonableness of a covenant not to compete in deciding whether the covenant is enforceable. As lower courts begin digesting *Sheshunoff* and its full meaning, pre-*Sheshunoff* cases addressing the reasonableness of covenants not to compete in Texas will likely take on new significance in determining the outcome of covenant not to compete litigation. As more courts move to reasonableness-based analysis, a new focus on reformation is likely to emerge, and previously ignored issues, such as the availability of damages following reformation, are likely to come to the forefront of covenant not to compete jurisprudence. In addition to understanding the remaining technical vagaries of *Light*, practitioners are well advised to re-familiarize themselves with Texas' reasonableness jurisprudence and to craft non-competition agreements that "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 interests of [their clients]."

This paper is not intended to serve as a substitute for legal advice. For advice specific to a given situation, please consult with an attorney.

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