

Texas Supreme Court Adopts New Approach to Covenants Not To Compete

Sheshunoff Mgmt. Serv's v. Johnson, Tex. Supreme Ct Case No. 03-1050 (October 20, 2006)
<http://www.supreme.courts.state.tx.us/opinions/HTMLopinion.asp?OpinionID=2000844>

On October 20, 2006, the Texas Supreme Court issued its opinion in *Sheshunoff Managemen. Services, L.P. v. Johnson*, which should make some covenants not to compete easier to enforce in employment situations. In the opinion, the Court considered whether a covenant not to compete is enforceable when, at the time it is made, the at-will employee agrees to execute the covenant not to compete in exchange only for the employer's promise to provide confidential information or specialized training *at some time in the future*.

The Covenants Not to Compete Act sets forth the general rule regarding covenants not to compete and provides that “[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.” While this general rule may seem simple at first glance, it has been the source considerable confusion among Texas appellate courts.

In *Sheshunoff*, the Court addressed the “at the time the agreement is made” portion of the statute. Specifically, the Court addressed situations in which an at-will employee agrees to the terms of a covenant not to compete, and the employer merely agrees to provide confidential information to the at-will employee *at sometime in the future*. Prior to *Sheshunoff*, such an agreement stood the risk of being found unenforceable, as certain courts required a simultaneous or contemporaneous exchange of confidential information in exchange for the agreement not to compete – *i.e.* an “otherwise enforceable agreement” could not depend on future performance.

In *Sheshunoff*, the Court adopted a more flexible approach and held that even if the employer promises to disclose confidential information to the employee *at sometime in the future*, the covenant not to compete will constitute an “otherwise enforceable agreement” at the time the employer performs its promise to disclose confidential information to the at-will employee. Upon performance by the employer before the employee's employment is terminated, the covenant not to compete becomes enforceable against the at-will employee. This decision was based on the Court's reading of the Covenants Not to Compete Act and desire to avoid “overly technical disputes.”

In sum, it now appears as though an enforceable covenant not to compete should satisfy the following: (1) it must be part of, or ancillary to, an agreement that contains a promise giving rise to the employer's interest in restraining the employee from competing, such as the employee's promise not to disclose the employer's confidential information; (2) the employer should promise and make good on its promise to deliver confidential information, specialized training, or the like to the employee; and (3) the covenant should be reasonable in scope as to time, geographical area, and activity to be restrained.

Although an employer's ability to rely on future performance to support a non-compete agreement may help its enforcement of the agreement, there are still many concerns employers should address to assure enforceability. Covenants not to compete still must be carefully drafted to comply with the requirements of the Covenants Not to Compete Act and case law and to avoid being overly broad.