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national employment PERSPECTIVE

MAY 7, 2009

A PUBLICATION OF SHOOK, HARDY & BACON L.L.P

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COVENANTS NOT TO COMPETE: TEXAS SUPREME COURT DECISION FAVORABLE TO EMPLOYERS

Mann Frankfort Stein & Lipp, Inc., MFSL GP, L.L.C., And MFSL Employee Investments, Ltd. v. Brendan J. Fielding, No. 07-0490, 2009 Tex. LEXIS 124 (Tex. Apr. 17, 2009).

The Texas Supreme Court has held that a client-purchase provision in an at-will employment agreement was an enforceable covenant not to compete under section 15.50(a) of the Texas Business & Commerce Code, even though the employer's promise to provide confidential information to the employee in support of the covenant not to compete was an implied promise, not an express one.

Under *Mann Frankfort,* when an employee's job is such that it will "reasonably require" the employee to use confidential information and the employee expressly promises not to disclose the information, the law deems the employer to have impliedly promised to produce the confidential information to the employee. As long as the employer actually fulfills its implied promise, the law considers the parties to have made "an otherwise enforceable agreement" that supports the covenant not to compete under section 15.50(a) of the Texas Business & Commerce Code.

Under section 15.50(a) of the Texas Business & Commerce Code, a covenant not to compete is enforceable if, in addition to having reasonable limitations as to time, geographical area and scope of activity, it is "ancillary to or part of an otherwise enforceable agreement at the time the agreement is made."

A nondisclosure agreement—where the employer promises to give the employee confidential information or trade secrets and the employee promises not to disclose that information—may constitute the "otherwise enforceable agreement" required under section 15.50(a). *See Alex Sheshunoff Mgmt. Servs., L.P. v. Johnson*, 209 S.W.3d 644 (Tex. 2006).

Under earlier case law, covenants not to compete in at-will employment relationships often failed because the confidential information addressed in the nondisclosure agreement was not exchanged at the *exact time* the agreement was executed, and, therefore, the agreement was not an "otherwise enforceable agreement" under section 15.50(a).

In *Sheshunoff,* the Texas Supreme Court modified this harsh rule and held

This Newsletter is prepared by Shook, Hardy & Bacon's National Employment Litigation & Policy Practice. Contributor to this issue: Marlene C. Williams.

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that an employer is not required to exchange confidential information the moment the agreement is executed. As long as the employer actually provides the confidential information at some time during employment, the covenant is supported by the nondisclosure agreement and can be enforced. *Sheshunoff,* 209 S.W.3d at 647.

In *Mann Frankfort*, Fielding was a senior manager in Mann Frankfort's tax department. At the start of his employment, Fielding signed a client-purchase agreement indicating that he would purchase certain Mann Frankfort clients if he performed services for those clients within one year of his employment's termination. After resigning his position, Fielding brought a declaratory judgment action seeking to have the client-purchase provision in his employment agreement declared unenforceable under §15.50(a) of the Texas Business & Commerce Code. Mann Frankfort filed a counterclaim for breach of contract.

The appellate court affirmed summary judgment in Fielding's favor, finding that the client-purchase provision was an unenforceable covenant not to compete because it was not ancillary to or part of an otherwise enforceable agreement as required by section 15.50(a). The appellate court based its ruling in part on the fact that the client-purchase provision reflected Fielding's express promise not to disclose Mann Frankfort's confidential information but did not reflect Mann Frankfort's promise to actually provide the confidential information.

The Texas Supreme Court disagreed and reversed, holding that "if the nature of the employment for which the employee is hired will reasonably require the employer to provide confidential information to the employee for the employee to accomplish the contemplated job duties, then the employer *impliedly promises* to provide confidential information" and the covenant can be enforced. (emphasis added) Thus, because Fielding's job required the use of confidential information and Fielding promised not to disclose that information, the law deemed Mann Frankfort to have impliedly promised to provide the confidential information. Because Mann Frankfort fulfilled its implied promise and actually provided the information, the covenant was supported by "an otherwise enforceable agreement" and was, therefore, enforceable.

Mann Frankfort eases the burden on employers when it comes to enforcing covenants not to compete. Still, strict requirements must be met before a covenant can be enforced: a covenant must still contain reasonable restrictions as to time, location and scope of activity, and it cannot be a stand-alone agreement. Employers must therefore, continue to treat covenants not to compete with care to ensure continued protection.

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COVENANTS NOT TO COMPETE: PENDING STATE LEGISLATION WOULD MAKE RESOLUTION OF COVENANT DISPUTES MORE EFFICIENT

On March 13, 2009, Texas State Senator Carlos Uresti proposed changes to the Texas Business & Commerce Code relating to covenants not to compete. The legislation (S.B. 2441) is currently pending before the Business and Commerce committee.

Generally, the changes do not reflect a radical shift in the law of covenants not to compete. But, they do reflect a few practical changes to align the statute with recent case law and to make the resolution of covenant disputes more efficient. Here are some of the proposed changes:

(1) revise §15.53(a) by replacing the phrase "ancillary to or part of an otherwise enforceable agreement at the time the agreement is made to the extent that it contains" with the phrase "part of or

supported by an otherwise enforceable agreement only to the extent that it contains" reasonable limitations as to time, location and scope of activity. Among other things, this change would align the statute with *Alex Sheshunoff Management, Inc. v. Johnson,* 209 S.W.3d 644 (Tex. 2006), which held that a covenant not to compete is enforceable even if confidential information is not exchanged contemporaneously with the execution of the agreement, as long as the employer fulfills its promise to provide confidential information to the employee.

(2) revise §15.54(c) by allowing employers to unilaterally modify a covenant to make the time, location and scope of activity limitations reasonable and then allowing employers to seek enforcement of the covenant as modified. The employer, however, must make this election before it sues to enforce the covenant. If a court enforces a covenant as unilaterally modified by the employer before suit, the court can award the employer damages and injunctive relief. Courts would retain the ability to reform a covenant as necessary to make the time, location and scope of activity restrictions reasonable. Courts would be authorized to award damages and injunctive relief for any breach after the reformation, but not for breaches occurring before the reformation.

(3) revise §15.54(d) to expedite trials involving the enforceability of covenants not to compete. Cases involving covenants not to compete "shall take precedence over" all cases except family and criminal cases. An employer seeking to enforce a covenant would also be entitled to temporary injunctive relief without having to show "irreparable harm" or "an inadequate remedy at law," and the employer would be entitled to temporary injunctive relief during the pendency of the case if the trial is not held within six months of the date the suit was filed.

(4) revise §15.54(e) to allow for an extension of the restricted period equal to the period of breach. Thus, if an employee breaches a covenant for six months, the restriction will be extended for a six-month period.

(5) revise §15.54(f) to allow the prevailing party to recover attorney's fees and court costs. This is a significant change. Previously, the employee could recover attorney's fees under the statute if the covenant related to the provision of personal services and the employee demonstrated that the employer knew, when the agreement was entered, that the limitations were not reasonable and the limitations imposed on the employee were greater than necessary. Under the proposed changes, however, an employer would not be entitled to attorney's fees and costs if the covenant was reformed.

(6) add §15.55(b), which provides that when the "otherwise enforceable agreement" is primarily intended as a personal services agreement and the covenant restricts activities in Texas, the agreement cannot select another state's law to govern in a suit regarding the covenant's enforceability. This change aligns the statute with *DeSantis v. Wackenhut*, 793 S.W.2d 670 (Tex.1990).

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