



ASAPs

Unfair Competition

Another Step Forward in the Enforcement of Noncompetes

April 2009

By:

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The Texas Supreme Court in *Frankfort Mann Stein & Lipp Advisors, Inc. v. Fielding* has further clarified the circumstances in which noncompete contracts with at-will employees will be enforced that was first announced by the same court in *Sheshunoff Management Services, L.P. v. Johnson*.¹ In *Sheshunoff*, the court announced that the focus should be shifted back from overly strict technical requirements to the reasonableness of the restrictions used in the contract. In addition to agreeing with decision in *Sheshunoff*, the court in *Frankfort Mann* also eliminated yet another technical argument against the enforcement of noncompete agreements. Although Texas law still adheres to certain special requirements for noncompete contracts, the enforcement of such agreements has become one step easier.

Although the Texas Supreme Court's ruling in *Sheshunoff* was a welcome clarification of the law for employers, it left unanswered one important question — whether a noncompete contract would fail if the agreement contained neither an explicit promise by the employer to provide confidential information to the employee nor an acknowledgment by the employee of receipt of such information. It is now clear that if the performance of the employee's position would necessarily involve the provision of confidential information, the law will deem the employer to have impliedly promised to provide such confidential information.

Texas Non-Compete Law – A Refresher

The Texas Covenants Not to Compete Act (the "Act"), as amended in 1993, reads:

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 interests of the promisee.²

Under the Act, a threshold issue is whether a covenant not to compete is ancillary to an otherwise enforceable agreement. In the 1994 decision, *Light v. Centel Cellular*, the Texas Supreme Court created a two-part test to address whether an agreement not to compete was "ancillary to an otherwise enforceable agreement" as required by the Act, stating:

- a. the consideration given by the employer in the otherwise enforceable agreement must give rise to the employer's interests in restraining the employee from competing; and
- b. the covenant must be designed to enforce the employee's consideration or return promise in the otherwise enforceable agreement.³

The above test created a new requirement that the "ancillary agreement" and the covenant not to compete be linked in order to be adequate. In other words, the covenant must be designed to enforce the ancillary agreement. What this meant in actual application was cloudy. This murkiness was exacerbated by footnote 6 of the *Light* decision, which indicates that the "ancillary agreement" referred to in the Act could not be a unilateral agreement contingent upon continued at-will employment.

Thus, not surprisingly, following *Light*, two competing lines of authority developed. Under one line of authority, the contract had to contain a promise by the employer to provide something that gives rise to the need for the noncompete (such as a promise to provide confidential information) and receive a complimentary promise in return (such as the employee's nondisclosure promise). Under these cases, once the employer's promise was performed (at or near the time of the contract), the ancillary agreement test was met. This promise-for-a-promise format satisfied the ancillary agreement test as long as the employer carried out its promise (by providing the employee with confidential information, etc.). Under a second line of authority, the ancillary agreement could not be formed through mutually dependent promises, but had to instead be in the form of an *immediately binding* agreement — either through an instantaneous exchange or through the modification of the at-will termination rights in a term agreement.

The split in lower court opinions created uncertainty. And, a practical problem was created because it was difficult for an employer to make an instantly enforceable promise to provide confidential information, customer goodwill, or some other protectable interest at the time the noncompete contract was made (as opposed to disseminating confidential information, goodwill, and training over the normal course of time to the employee).

In 2006, the *Sheshunoff* decision, made clear that the contract formation issues emphasized in *Light* were not a proper focus. The *Sheshunoff* decision allows for the formation of the ancillary agreement to be unilateral in nature so that the contract becomes binding when the executory (future performance) promise by the employer in the agreement is performed. It now makes no difference whether or not the employer's promises are contingent upon continued at-will employment. What is important is that the employer perform its promise.

However, in *Sheshunoff*, the court retained the part of the ancillary agreement test in *Light* that requires the existence of: (1) a set of promises between the employer and employee separate from the noncompete provisions (*i.e.*, the noncompete agreement cannot be a stand-alone agreement); and (2) that give rise to the need for, or justify, the noncompete restriction. Stated another way, the ancillary agreement between the employer and employee must be an exchange of consideration in the form of promises that involve a protectable interest like goodwill, specialized training, or confidential information and trade secrets.

What then of noncompete agreements that contain no agreement by the employer to provide confidential information? This question leads us to the Texas Supreme Court's decision in *Mann Frankfort*.

Factual and Procedural Background of *Mann Frankfort*

Brendan Fielding was a Certified Public Accountant and Senior Manager in Mann Frankfort Stein & Lipp Advisors, Inc.'s Tax Department. As a condition of becoming (re)employed by the Company in 1995, Fielding signed an employment agreement containing a "client purchase provision." Under this provision, Fielding agreed to immediately purchase that portion of his employer's business associated with a particular client if, within one year following termination, he performed accounting services for such client. The employment agreement did not contain a promise by Mann Frankfort to give Fielding access to customer information. Nor did Fielding acknowledge in the agreement that he had received or would receive such confidential information.

Fielding resigned from Mann Frankfort in 2004 and shortly thereafter opened his own accounting firm. He then filed a declaratory judgment suit to have the client purchase provision declared unenforceable under the Act. Mann Frankfort answered and filed a counterclaim asserting, among other things, breach of contract. Fielding prevailed in his declaratory judgment action, but was denied recovery of his attorneys' fees. Fielding appealed the trial court's denial of attorneys' fees and Mann Frankfort cross-appealed on the enforceability of the client purchase provision.

The Houston Court of Appeals (First District) affirmed the trial court's order holding that the client purchase provision was unenforceable for lack of a promise by Mann Frankfort that gave rise to an interest justifying the restriction. In so doing, the Texas Court of Appeals rejected Mann Frankfort's argument that the agreement contained an "implied promise" to disclose confidential information.

The Texas Supreme Court's *Mann Frankfort* Decision

The Texas Supreme Court disagreed and reversed the court of appeal's decision. The court stated that "[w]hen it is clear that performance expressly promised by one party is such that it cannot be accomplished until a second party has first performed, the law will deem the second party to have impliedly promised to perform the necessary action." In examining the summary judgment evidence provided by the parties, the court concluded that Mann Frankfort provided Fielding confidential information early on in Fielding's employment. The court further concluded that as a Certified Public Accountant, Fielder necessarily used confidential information belonging to Mann Frankfort and its clients and that it would be impossible for Fielding to do his job without this information. Citing *Sheshunoff*, the court found that Mann Frankfort made an illusory (implied) promise to provide confidential information when it hired Fielding that became enforceable when Mann Frankfort performed its illusory promise by actually providing confidential information. For this reason, the court held the client purchase provision to be enforceable.

The Resulting Focus on the Employee's Job Responsibilities

The *Mann Frankfort* opinion creates greater focus on an employee's job responsibilities as they relate to the employer's legitimate concern in protecting its confidential information. The decision highlights the interplay between the confidential information provided to the employee and the employee's ability to do his or her job.

***Mann Frankfort Stein & Lipp Advisors, Inc., v. Fielding* is an Important Case to Employers Because It:**

- o Eliminates a technical argument against enforcement of noncompete contracts with at-will employees and, to this extent, makes noncompete contracts easier to enforce in Texas.

- Increases the focus on the necessity of the confidential information at issue to the performance of the employee's job responsibilities.
- Eliminates an important question that remained after the Texas Supreme Court's *Sheshunoff* decision.

¹ For an in-depth look at the Texas Supreme Court's decision in *Sheshunoff*, see the Littler ASAP, [Texas Supreme Court Provides New Focus for Noncompete Contract Enforcement](#).

² 63 Tex. Bus. & Comm. Code § 15.52.

³ 883 S.W.2d 642 (1994).

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