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LEGAL ALERT

New Texas Non-Compete Decision Marks Further Shift Towards Enforceable Non-Compete Agreements

In its latest foray into non-compete jurisprudence, the Texas Supreme Court this week made it easier for employers seeking to restrict key employees from competing post-employment. In *Marsh USA Inc. v. Cook,* the Court held that a non-compete covenant contained in a stock option purchase plan was enforceable.

Prior to the Supreme Court's decision in *Marsh*, Texas courts have required that the promise not to compete be made in connection with some other agreement between the employee and employer – an agreement which involved the very interests the employer wanted to protect with the restrictive covenant. In practice, this usually meant that the non-compete was enforceable when the employer agreed to provide confidential information or trade secrets, and in exchange the employee promised to keep such material confidential. Under the Supreme Court's recent cases, that was enough to support a non-compete/non-solicitation agreement (as long as the material was really confidential and was actually given to the employee after the non-compete was signed). But now, other employee-employer agreements will support enforceable restrictive covenants.

In *Marsh*, the non-compete promise was made in connection with a stock option purchase plan provided to "valuable" and "select" employees. In order to exercise the stock option, the Marsh employees had to sign a non-solicitation agreement preventing them from seeking business from Marsh customers with whom the employee worked for a period of two years after termination (if the termination was within three years of exercising the options). Rex Cook signed such an agreement when he exercised options in 2005. He later resigned within the three-year period, triggering the restrictive covenant. Marsh sued to enforce the non-solicitation agreement.

The trial court determined that the agreement was unenforceable because the transfer of stock did not "give rise" to Marsh's interest in restraining Cook from competing, and the appeals court agreed. In so holding, the courts relied on a Texas Supreme Court case from the mid-1990s, *Light v. Centel Cellular Co. of Texas*, its most important case interpreting the Texas Covenants Not to Compete Act. That statute requires, among other things, that the restrictive covenants be ancillary to or part of an "otherwise enforceable agreement."

In *Light,* the Supreme Court held that the consideration given by an employer in that "otherwise enforceable agreement" must "give rise" to the employer's interest in restraining the employee from competing. That

odd phrase – "give rise" – has been the subject of much litigation in Texas since *Light*, but a consensus has developed among Texas courts that the "otherwise enforceable agreement" to which the non-compete attached had to be something more than an out-and-out "purchase" of the restrictive covenant. Rather, there had to be an agreement that sought to protect the very interest that the non-compete agreement was supposed to protect.

In this week's decision, the Supreme Court tossed out the "give rise" language. It noted that the phrase appears nowhere in the statute and does not comport with the Texas Legislature's intent when passing the Act – to undo a Court ruling disfavoring restrictive covenants and to return to earlier Texas law governing non-competes. There was no "give rise" requirement in that earlier Texas case law, reasoned the Court in *Marsh*, and by adding it in *Light*, it had mistakenly made it harder to enforce restrictive covenants than the Legislature had intended.

Instead of requiring that the consideration "give rise" to the interest in restraining competition, the Court held in *Marsh* that the "otherwise enforceable agreement" merely has to be "reasonably related" to the interest worthy of protection. Applying this new standard to the agreement in *Marsh*, the Supreme Court held that the employer had "linked the interests of a key employee with the company's long-term business interests" when it provided Cook the stock options. It noted that by owning stock, Cook was an "owner" of the business, and owners are

interested in protecting the goodwill between the employer and its clients. Ultimately, the Court concluded that the stock options were "reasonably related to the protection of this business goodwill."

So what does this all mean for Texas employers? Besides eliminating a confusing phrase, the Supreme Court's decided shift means, as a practical matter, that non-competes will no longer have to be based solely on the exchange of confidential information and the promise to keep it secret. Employers relying on such language in their agreements usually have to face numerous challenges to enforceability – that the information was not really confidential; the information did not actually provide any competitive advantage; or that nothing "new" was provided to the employee after signing the agreement.

Without question, the kind of consideration provided to employees in connection to the agreement that the non-compete language "attaches to" has been broadened substantially. Certainly, stock option purchase plans like the one in *Marsh* will work. The real question facing employers now is whether cash, or some other form of consideration, will cause the ancillary agreement to be sufficiently related to the protection of an employer's goodwill to satisfy the statute's requirements. For example, would the payment of cash in exchange for a release be an agreement that is "reasonably related" to the employer's business interests? Until *Marsh*, such agreements almost always fell short in Texas. Now, it is entirely possible that a restrictive covenant made part of such an agreement is enforceable.

But caution is warranted. The Supreme Court went to great lengths to emphasize the importance of Cook's status as an "owner" once he purchased the stock, and that it gave him a "greater stake" in the company's performance. This suggests that cash alone might not be enough. It is possible, though, that incentive pay plans could be carefully tailored to mimic the connection between the employee's and employer's interests found in the Marsh stock option plan (at least enough to serve as the basis for a valid non-compete).

Given that *Marsh* is the latest in a series of cases making restrictive covenants easier to enforce in Texas, district courts deciding these issues have been given clear direction: avoid legalistic technicalities, and decide whether a restrictive covenant is necessary to protect an employer's goodwill and investment in its employees. Unfortunately, more litigation is sure to follow, as employers' revised agreements are tested in the Courts.

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