Just When You Thought Covenants Were Enforceable

Recent decisions by the Texas Supreme Court have resulted in a "pro-enforcement" trend for covenants not to compete, and have eroded the holding in *Light v. Centel Cellular Co. of Tex.*, 883 S.W.2d 642, 647 (Tex. 1994) requiring contemporaneous consideration to enforce a covenant not to compete against an at-will employee. Beginning with *Alex Sheshunoff Mgmt. Serv., LP v. Johnson,* 209 S.W.3d 644 (Tex. 2006), the Texas Supreme Court clarified *Light*'s requirement of "an otherwise enforceable agreement" under the Texas Covenants Not To Compete Act, Tex. Bus. & Comm. Code §15.50 *et. seq.,* by recognizing that a unilateral contract consisting of an employer's promise to give the employee confidential information would provide adequate consideration to support the covenant not to compete even if the promise was contingent on continued at-will employment. The trend continued with the decision in *Mann Frankfort Stein & Lipp Advisors, Inc. v. Fielding,* 289 S.W.3d 844 (Tex. 2009), where the Court upheld a covenant without *any* explicit promise of the employer to give the employee confidential information. The "pro-enforcement" trilogy became complete with the decision in *Marsh USA Inc. v. Cook,* 354 S.W.3d 764 (Tex. 2011), in which the Court held that the grant of stock options was adequate consideration to support a covenant in order to protect the company's goodwill.

The decision in *Drennen v. Exxon Mobil Corp.,* No. 14-10-01099-CV (Tex.App.-Houston [14th Dist.] Feb. 14, 2012) serves as a reminder that forfeiture agreements, treated as a covenant not to compete, must meet reasonable standards to be enforceable under Texas law. Drennen was a retired senior VP for ExxonMobil responsible for its exploration activities in the Western Hemisphere. Over the years, Drennen was awarded incentive compensation, including restricted stock and "earnings-bonus units." The incentive compensation program was created to reward high performing employees and to dissuade executive level employees from going to work for competitors by a provision that allowed ExxonMobil to cancel the incentive awards of employees who engage in "detrimental activity," creating a conflict of interest by becoming employed by a competitor of ExxonMobil. After Drennen announced his retirement but before he actually retired, he received a letter from ExxonMobil's counsel reminding him of his obligations to protect its confidential information and requesting he not, for a period of two years after his retirement, take a position with or provide services for another organization in the petroleum or petrochemical industry. After Dennen interviewed and accepted a position with Hess Corporation, a competitor, ExxonMobil informed him it was canceling all his incentive awards.

Drennen filed suit to prevent enforcement of the "detrimental activity" clause, which he argued was an unenforceable covenant not to compete because it did not contain any reasonable restrictions but was a drastic forfeiture clause. ExxonMobil responded by urging that the provision was not a covenant not to compete, but if it was, it was enforceable under New York law, which was specified as the choice of law in the agreement.

Although the Court of Appeals found such a clause would be enforceable under New York law, relying on a pre-*Light* decision, *Peat Marwick Main & Co. v. Haass,* 818 S.W.2d 381, 388 (Tex. 1991), the Court found the clause to function as a covenant not to compete by imposing a severe economic penalty on the departing employee if he engages in competition, and was unenforceable under Texas law because the detrimental activity provisions met none of the

Act's requirements in §15.50(a) that the covenant contain reasonable limitations as to time, geographic area and scope of activity to be restrained.

The Court found that the choice of law provision inapplicable because the issue whether the non-competition agreement is enforceable is one which the parties could not resolve by an explicit contract provision. Since the gist of the agreement was personal services in Texas, and the issue of enforceability was a fundamental Texas public policy for employees working in the state, the Court found applying New York law would be contrary to that fundamental policy. See, *DeSantis v. Wackenhut Corp.,* 793 S.W.2d 670,682 (Tex. 1990). Because the detrimental activity provisions were unenforceable under Texas law, they could not support ExxonMobil's action canceling the incentive compensation awards to Drennan. See, *Frankiewicz v. Nat'l Comp Assocs.,* 633 S.W.2d 505, 507-08 (Tex. 1982) (holding that for purpose of money damages, a restrictive covenant must stand or fall as it is written).

Drennen serves as an important reminder that non-compete and forfeiture provisions in employment agreements must meet the Act's requirement of having reasonable restrictions, or risk being struck down as unenforceable under Texas law. *Drennen* further reminds drafters that insertion of an out of state choice of law provision will not salvage an otherwise unenforceable agreement. McDole Kennedy & Williams can review and assess the reasonableness of these and other provisions in company employment agreements and provide representation in litigation arising from breach of such agreements. For further information, contact sclark@mkwpc.com.