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NON-COMPETE AGREEMENTS NOW EASIER TO ENFORCE IN TEXAS

The Texas Supreme Court recently relaxed the burden to enforce a non-compete agreement under Texas law in Marsh USA Inc. v. Cook, 2011 Tex. LEXIS 465 (Tex. S. Ct. June 24, 2011). In a 6-3 decision, the Court found that a restrictive covenant that is reasonable in time, scope and geography is valid, where it is "'ancillary to or part of' an otherwise enforceable agreement [and] the business interest being protected (goodwill) is reasonably related to the consideration given (stock options)." Id. at *41.

The Texas Supreme Court's decision in Marsh is significant because it is now easier for employers in Texas to contractually restrict employees from competing once they depart. Prior to the Court's recent decision, a non-compete agreement was only enforceable when the consideration given by the employer "g[a]ve rise to the employer's interest in restraining the employee from competing." Light v. Centel Cellular Co. of Texas, 883 S.W. 2d 642, 647 (Tex. S. Ct. 1994). Light created a demanding nexus between the consideration provided and the protectable interest. As a practical matter, goodwill was excluded as a protectable business interest in Texas and non-compete agreements were typically only enforceable when an employer agreed to provide confidential information or trade secrets in exchange for an employee's promise to keep such information confidential. However, in Marsh, the Court rejected the prior ruling in Light and stated that "[t]he enforceability of the covenant should not be decided on 'overly technical disputes' of defining whether the covenant is ancillary to an agreement," but rather on the reasonableness of the limitations as to time, geographical area and scope of activity. Marsh, 2011 Tex. LEXIS 465 at *34.

Key Facts and Points of Law

The defendant, Rex Cook, had been employed by Marsh since 1983. In 1996, Cook was granted the option to purchase shares of common stock in Marsh as part of an incentive program for valuable, select employees which he exercised in 2005. As a pre-condition for executing the stock options – after 22 years of continuous employment, Cook was required to sign a Non-Solicitation Agreement, prohibiting him from soliciting Marsh clients and employees for two years after the termination of his employment. Cook later resigned and began soliciting Marsh clients in alleged violation of his agreement.

Marsh filed suit against Cook in Texas state court for breach of contract and breach of fiduciary duty, claiming that Cook had solicited business from clients and prospects of Marsh in violation of the Non-Solicitation Agreement. The trial court granted Cook's motion for partial summary judgment on the breach of contract claim, concluding that the Non-Solicitation Agreement was not enforceable as a matter of law under Texas' non-compete statute. The Texas Court of Appeals affirmed, holding that under Light the transfer of stock did not give rise to Marsh's interest in restraining Cook from competing.

The Texas Supreme Court reversed and remanded, holding that so long as the restrictions in the Non-Solicitation Agreement are reasonable as to time, geographical area and scope of activity, the restrictive covenant is valid, because "[t]he stock options are reasonably related to the protection of [the employer's] business goodwill." Id. at *33. As a stockholder, Cook was an owner of Marsh, who benefitted from the company's growth and development, and he had an interest that was furthered by the development of the company's goodwill with its clients. Thus, the stock options were reasonably related to the protection of the company's goodwill and the Non-Solicitation Agreement was valid since it was ancillary to an enforceable agreement, i.e., the stock option agreement.

Implications for Employers

- The decision in Marsh follows other recent Texas Supreme Court decisions moving away from the restrictive principles of Light, making it easier to enforce restrictive covenants under Texas law. See, Alex Sheshunoff Mgmt. Servs., L.P. v. Johnson, 209 S.W.3d 644, 651 (Tex. S. Ct. 2006) (finding that "at the time the agreement is made" as defined in Light was overly restrictive); Mann Frankfort Stein & Lipp Advisors, Inc. v. Fielding, 289 S.W.3d 844, 850 (Tex. S. Ct. 2009) ("the employer impliedly promises confidential information will be provided," thereby providing adequate consideration, where the work an employee is hired to perform requires confidential information). This clear line of decisions from the Texas Supreme Court strongly trend towards greater enforcement of restrictive covenants under Texas law.

- The Court's ruling broadens the range of consideration that may potentially support a valid restrictive covenant so long as it is reasonably related to the business interest that is being protected. Moreover, the Court confirmed that prior access to confidential information does not destroy the consideration provided by employers for a midstream restrictive covenant so long as the employer continues to provide confidential information after the restrictive covenant is executed and the restrictions are reasonable.

- Importantly, the Court's ruling shifts the focus away from analyzing the drafting of the non-compete agreement and towards the "hallmark of enforcement," i.e., whether or not the covenant is reasonable. Employers in Texas now have the opportunity to focus on implementation of non-compete agreements based on desired results, as opposed to drafting technicalities.

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