

## CLIENT ALERT

### The Evolving Texas Law of Non-Compete Agreements

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The Texas Supreme Court has enhanced the ability of Texas employers to enforce non-compete agreements, issuing a significant ruling in *Marsh USA Inc. v. Cook* on June 24.

In this case, Marsh awarded stock options to a key employee. In order to exercise the options, the employee – a managing director – was required to sign an agreement that, if he left the company within 3 years after he exercised his stock options, he would not compete with the company. The non-compete covenant prohibited him from performing services related to the type of business offered by the company for its clients or prospects, for 2 years thereafter.

When the employee went to work for a direct competitor less than 3 years later, Marsh sued the employee and his employer. The trial court held that the covenant was unenforceable under Texas law, and the court of appeals affirmed the decision.

The trial court's decision was consistent with previous opinions of the Texas Supreme Court, which generally held that an employer could not "buy" a non-compete, through awarding options or paying severance pay. The Texas Business and Commerce Code requires that a non-compete covenant be "ancillary to or part of an otherwise enforceable agreement," or else it is unenforceable. The Texas Supreme Court has interpreted this to mean that the proper consideration for a binding non-compete is for the employer to provide employees access to confidential information under a confidentiality agreement. The Court has required that the ancillary agreement – here, the agreement to provide confidential information - must give rise to the need to restrain the employee from competing. The non-compete covenant is necessary to ensure confidentiality of that information, and so it is ancillary to the confidentiality agreement and enforceable.

In the *Marsh* decision, the court significantly moves toward making non-compete covenants easier to enforce. The court held that, as long as the scope of Marsh's non-compete covenant was reasonable as to time, scope and geography, then it was enforceable. The employee's receipt of stock in the company gave rise to the company's interest in protecting its goodwill and its long-term interests. The non-compete in this way was ancillary to an otherwise enforceable agreement – the agreement for the employee to acquire stock in the company. The employer had a valid interest to protect its "human capital," its investment in its key employees and its goodwill. The court found this to be a legitimate economic interest to employers -- providing them with an incentive to train their employees and give them access to key clients. The non-

compete protects employers from the risk that the employees would take this goodwill to a competitor.

*Comments:*

- It will be interesting to see how the lower courts will apply the Texas Supreme Court's guidelines in future cases. What if the employee is not a "key employee"? How much stock will be sufficient consideration?
- The consideration for the non-compete will continue to be the focus of these cases. It seems clear that merely paying severance to a departing employee is not sufficient consideration for an enforceable non-compete covenant. A severance agreement and release do not give rise to an interest entitled to the protection of a non-compete agreement.
- Employers will want to review their procedures for awarding stock to key employees. Requiring employees to sign non-solicitation, confidentiality and non-compete agreements as part of the award is a routine practice by many large employers. *Marsh* indicates that these non-compete agreements are enforceable.

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