

*Covenants Not to Compete*

October 23, 2006

To Our Clients and Friends:

On October 20, 2006, the Texas Supreme Court handed down a long-awaited decision in *Alex Sheshunoff Mgmt. Servs., L.P. v. Johnson* in which it addressed the enforceability of a covenant not to compete in an at-will employment context. I write to make you aware of this because it constitutes a significant departure from prior law in this area and may impact how and when you choose to seek protection from existing and future employees competing with your business who have had or will have access to the confidential or proprietary information of your business.

Covenants not to compete are governed by chapter 15 of the Texas Business & Commerce Code. In *Sheshunoff*, the Texas Supreme Court re-affirmed that an enforceable covenant not to compete must meet two requirements: "(1) the consideration given by the employer in the otherwise enforceable agreement must give rise to the employer's interest in restraining the employee from competing, and (2) the covenant must be designed to enforce the employee's consideration or return promise in the otherwise enforceable agreement." In the typical case, this simply means that an employee's agreement not to compete in the future must be founded on the fact that the employee will be given valuable company secrets, such as certain processes of a business, customer lists, etc., that give a business a competitive advantage over other businesses.

Previously, the Texas Supreme Court and lower courts have interpreted chapter 15 of the Texas Business & Commerce Code to require that any covenant not to compete be coupled with a certain term of employment; otherwise, the agreement was said to be "illusory" in the sense that an employer could make an agreement with a new employee and then immediately terminate the employment without having provided the basis for the covenant not to compete, *i.e.*, without providing the company secrets that give rise to the basis for the covenant not to compete. The Court's opinion in *Sheshunoff* departs from prior court decisions in this regard and now holds that an at-will employment agreement can form the basis of an enforceable covenant not to compete as long as the employer fulfills the agreement to share the confidential information that forms the basis of the covenant not to compete.

This is a significant development in Texas law. Previously, businesses were faced with a dilemma. They could seek protection of their proprietary information with the use of term employment contracts, but had to accept all of the attendant consequences of having to guarantee employment of key employees for months or years in order to make the agreement enforceable, or they could maintain the at-will status of their employees and try to protect confidential information with non-disclosure agreements, which have proven difficult, at best, to effectively enforce. *Sheshunoff* has expanded the opportunity in properly worded agreements for your business to have both at-will employment arrangements and enforceable covenants not to compete.

If you have any questions or would like additional information about the topic of this update, please contact John D. Jacks at [john.jacks@graybecker.com](mailto:john.jacks@graybecker.com) or Bradley B. Clark at [bradley.clark@graybecker.com](mailto:bradley.clark@graybecker.com) or 512.482.0061.