

NON-COMPETES, CONFIDENTIALITY AGREEMENTS, AND TRADE SECRETS

**R. Doak Bishop
Sashe D. Dimitroff
Kevin D. Mohr
King & Spalding
1100 Louisiana, Suite 3300
Houston, Texas 77002
(713) 751-3200**

24TH ANNUAL ADVANCED CIVIL TRIAL COURSE

August 29-31, 2001
Dallas

October 3-5, 2001
Houston

November 14-16, 2001
San Antonio

CHAPTER 21

TABLE OF CONTENTS

I. INTRODUCTION 2

II. COVENANTS NOT TO COMPETE 3

A. COVENANTS NOT TO COMPETE AT COMMON LAW 3

B. THE COVENANTS NOT TO COMPETE ACT 3

 1. *Section 15.50*..... 4

 2. *Section 15.51*..... 4

 3. *Section 15.53*..... 5

B. *LIGHT V. CENTEL CELLULAR COMPANY OF TEXAS* 5

C. ENFORCEABILITY OF COVENANTS NOT TO COMPETE AFTER *LIGHT* 7

 1. *Applicability of the Light Test*..... 7

 2. *Existence of an Otherwise Enforceable Agreement* 8

 3. *Ancillary to or Part of the Otherwise Enforceable Agreement*..... 10

 4. *At the time the Agreement is Made* 11

 5. *Reasonableness of the Scope of Covenants Not to Compete*..... 12

D. PROCEDURE IN ACTIONS TO ENFORCE COVENANTS NOT TO COMPETE..... 15

 1. *Injunctive Relief*..... 15

 2. *Reformation* 15

 3. *Attorney Fees* 15

III. CONFIDENTIALITY AGREEMENTS AND TRADE SECRETS 16

A. CONFIDENTIALITY AGREEMENTS 16

B. TRADE SECRETS 17

IV. CONCLUSION 18

NON-COMPETES, CONFIDENTIALITY AGREEMENTS, AND TRADE SECRETS*

R. Doak Bishop**
Sashe D. Dimitroff***
Kevin D. Mohr****

I. INTRODUCTION

Employers have a substantial interest in protecting their confidential information from disclosure to third parties, particularly their competitors. Information ranging from the secret formula for Coca Cola to the customer list of the small town insurance agency in many instances is among the most valuable assets that a business has. For the lawyer who represents employers and established businesses, covenants not to compete often are the primary weapons in the arsenal to protect clients from the harm they can suffer when their employees (and other non-employee contractors)¹ come into contact with sensitive information that the employer has cultivated, and which is critically important to the employer's competitive position in the marketplace. To be sure, other bodies of law and forms of agreement can bear on a former employee's use of sensitive information. For example, copyright and patent law—which lie outside the scope of this article—may in some instances limit a former employee's use of information that literally *belonged* to his former employer. The law of trade secrets may limit an

employee's use of information that is not publicly known, and that the former employer endeavored to protect. Confidentiality agreements may limit an employee's disclosure of even broader categories of information to third parties.

Yet, to many employers and the lawyers who represent them, these alternatives to covenants not to compete are inadequate. Sensitive information may not qualify for protection by copyright or patent law. Trade secrets require significant endeavors to maintain and protect. An unlawful disclosure of trade secrets or information subject to a confidentiality agreement may be difficult to discover and prove. And, perhaps more to the point, confidentiality agreements only prohibit the *disclosure* of sensitive information, not the unfair *use* of sensitive information. Covenants not to compete, on the other hand, strike at the heart of what the employer often hopes to obtain: protection from *competition* with former employees whose ability to compete was largely created by access to the employer's own customer lists, specialized business processes, training procedures, or other investments by the employer in the employee.

The reality, however, is that covenants not to compete are substantially less powerful than many employers and attorneys believe—and this is especially so in Texas. The most common misconception is that any covenant not to compete will be enforceable so long as it is reasonably limited in time, geography, and scope. But their actual enforceability is substantially more limited, for a variety of reasons. First, even at common law, covenants not to compete were only enforceable to serve a legitimate business interest of an employer. Accordingly, a covenant would be enforceable to protect an employer's confidential information, but not simply to discourage employees in whom employers had made some investment from departing to establish competing businesses. Second, the enforceability of covenants not to compete is now a creature of statute in Texas. Although the legislature intended to broaden the enforceability of covenants not to compete in employment

* Copyright 2001 by R. Doak Bishop, Sashe D. Dimitroff, and Kevin D. Mohr.

** B.A., Southern Methodist University; J.D., University of Texas; Partner; King & Spalding, Houston.

*** B.B.A., University of Texas; J.D./M.B.A. University of Houston; Partner; King & Spalding, Houston.

**** B.A., Ohio University; J.D., Harvard Law School; Associate; King & Spalding, Houston.

¹ Although covenants not to compete, confidentiality agreements, and the law of trade secrets can apply in many contexts outside the employment context, by far the most common context in which these issues arise (and are litigated) is the employment context. Accordingly, although this article discusses these issues in nonemployment contexts when relevant, this article generally focuses on the employment context.

relationships, as a result of poorly chosen statutory language, and an extremely limiting interpretation by the Texas Supreme Court, the enforceability of covenants not to compete is more limited than ever.

For historical perspective, this article begins with a short description of the enforceability of covenants not to compete at common law. Because the common law in this area largely has been preempted by statute, however, this article quickly turns to the much richer, and certainly more relevant, topics of the Covenants Not to Compete Act and the watershed Texas Supreme Court decision in *Light v. Centel Cellular Company of Texas*.² The bulk of the article then discusses the requirements for enforceability of covenants not to compete under that Act, and some procedural issues that may be of interest to practitioners in this area. Finally, this article concludes with a brief discussion of confidentiality agreements and trade secrets as alternatives to covenants not to compete.

II. COVENANTS NOT TO COMPETE

A. Covenants Not To Compete at Common law

As the Texas Supreme Court explained in *Hill v. Mobile Auto Trim, Inc.*, at common law, an agreement not to compete was a restraint of trade, and therefore was unenforceable unless it was reasonable.³ An agreement not to compete would not be deemed reasonable unless it met each of four criteria.⁴ First, the covenant had to be necessary for the protection of the promisee.⁵ Legitimate interests worthy of such protection included business goodwill and trade secrets.⁶ Second, the restraint could not be oppressive to the promisor, and thus had to be appropriate in

² TEX. BUS. & COM. CODE § 15.50 *et seq.*; *Light v. Centel Cellular Company of Texas*, 883 S.W.2d 642 (Tex. 1994).

³ *Hill v. Mobile Auto Trim, Inc.*, 725 S.W.2d 168, 170 (Tex. 1987).

⁴ *Id.*

⁵ *Hill*, 725 S.W.2d at 170-71.

⁶ *Id.*

terms of time, territory, and type of activity.⁷ Third, the covenant could not be injurious to the public.⁸ Finally, as with any contract, the promisee had to give valuable consideration for the promisor's covenant not to compete.⁹

In *Hill*, the defendant purchased an auto trim franchise from the plaintiff.¹⁰ In the franchise agreement, the franchisee agreed not to compete with the franchisor or contact the franchise's customers for three years following termination of the franchise.¹¹ After two and a half years, the franchise terminated, because defendant failed to pay the franchise fees.¹² Thereafter, the defendant began contacting the franchise's customers independently, and the franchisor sought an injunction to enforce the covenant not to compete.¹³ The franchisor argued that the covenant was enforceable to protect the substantial goodwill of the franchise, but the court disagreed.¹⁴ Applying the test set out above, the court held that it would not enforce a covenant which is "primarily designed to limit competition or restrain the right to engage in a common calling."¹⁵

B. The Covenants Not To Compete Act

The Texas Supreme Court's decision in *Hill* extremely restricted the enforceability of covenants not to compete, and was not very popular with many business interests.¹⁶ In response to *Hill*, the Texas legislature enacted the Covenants Not to Compete Act.¹⁷ The purpose of the Act was to broaden the enforceability of covenants not to compete.¹⁸

⁷ *Hill*, 725 S.W.2d at 171.

⁸ *Id.*

⁹ *Id.*

¹⁰ *Hill*, 725 S.W.2d at 169.

¹¹ *Hill*, 725 S.W.2d at 170.

¹² *Id.*

¹³ *Id.*

¹⁴ *Hill*, 725 S.W.2d at 171.

¹⁵ *Hill*, 725 S.W.2d at 172.

¹⁶ See Jeffrey W. Tayon, "Covenants Not to Compete in Texas: Shifting Sands from Hill to Light," 3 Tex. Intell. Prop. L. J. 143 (1995).

¹⁷ *Id.*; see also *Donahue v. Bowles, Troy, Donahue, Johnson, Inc.*, 949 S.W.2d 746, 755 (Tex. App.—Dallas 1997, writ denied) (Mosely, J., concurring).

¹⁸ See *Light*, 883 S.W.2d at 643 n. 2.

Section 15.50 of the Act establishes statutory criteria for the enforceability of covenants not to compete,¹⁹ Section 15.51 establishes procedures and remedies for actions to enforce covenants not to compete,²⁰ and Section 15.52 establishes the Act's scope. The Act was amended in 1993,²¹ and was amended again into its present form in 1999.²²

1. Section 15.50

a. General provision

Section 15.50(a) provides the following statutory criteria for the general enforceability of covenants not to compete:

[n]otwithstanding Section 15.05 of this code,²³ and subject to any applicable provision of Subsection (b), a covenant not to compete is enforceable if it is ancillary to or part of an otherwise enforceable agreement at the time the agreement is made to the extent that it contains limitations as to time, geographical area, and scope of activity to be restrained that are reasonable and do not impose a greater restraint than is necessary to protect the goodwill or other business interest of the promisee.²⁴

b. Provision for covenants enforceable against physicians

Section 15.50(b) provides specialized criteria for the enforceability of covenants not to compete against licensed physicians, which protect the physician's access to lists of his

¹⁹ TEX. BUS. & COM. CODE § 15.50.

²⁰ TEX. BUS. & COM. CODE § 15.51.

²¹ Acts 1993, 73rd Leg. ch 965, §§ 1-3, eff. Sept. 1, 1993.

²² Acts 1999, 76th Leg. ch 1574, § 1, eff. Sept. 1, 1999.

²³ TEX. BUS. & COM. CODE § 15.05 is the Texas "baby antitrust" statute, which provides in relevant part that "[e]very contract, combination, or conspiracy in restraint of trade or commerce is unlawful."

²⁴ TEX. BUS. & COM. CODE § 15.50(a).

recent patients and their medical records as well as the physician's ability to continue to treat patients with an acute illness, and which require the covenant to contain a provision allowing buy-out at a reasonable price.²⁵ Section 15.50(b) apparently has not been litigated in any reported decisions, and accordingly is not discussed further in this article.

2. Section 15.51

a. Remedies

Section 15.51(a) provides that a court may award damages, injunctive relief, or both to a promisee for a breach by a promisor (except as provided in Section 15.51(c), discussed below).²⁶

b. Standard and Burden of Proof

Section 15.51(b) provides that the standard of proof in an action to enforce a covenant not to compete is preponderance of the evidence.²⁷ Section 15.51(b) also imposes the burden of proof on the parties differently according to the nature of the contract to which the covenant is ancillary.²⁸ If the primary purpose of the agreement to which the covenant is ancillary is to obligate the promisor to render personal services, the promisee has the burden to establish that the covenant meets the Section 15.50 criteria.²⁹ But if the agreement has a different primary purpose, the promisor has the burden to establish that the covenant does not meet those criteria.³⁰

c. Reformation

Section 1551(c) contains a reformation provision that provides (in essence) as follows:

- if a covenant is ancillary to or part of an otherwise enforceable agreement; but

²⁵ TEX. BUS. & COM. CODE § 15.50(b).

²⁶ TEX. BUS. & COM. CODE § 15.51(a).

²⁷ TEX. BUS. & COM. CODE § 15.51(b).

²⁸ *Id.*

²⁹ *Id.*

³⁰ *Id.*

- the covenant contains limitations as to time, geographical area, and scope of activity to be restrained that are not reasonable and impose a greater restraint than is necessary to protect the goodwill or other business interest of the promisee; then
- the court shall reform the covenant to the extent necessary to cause the limitations contained in the covenant as to time, geographical area, and scope of activity to be restrained to be reasonable and to impose a restraint that is not greater than necessary to protect the goodwill or other business interest of the promisee.³¹

Under Section 1551(c), following reformation the court shall enforce the covenant as reformed through injunctive relief, but the court may not award the promisee damages for a breach of the covenant prior to its reformation.³²

d. Attorney fees

Section 1551(c) also contains a limited attorney fees provision in favor of promisors. A promisor *may* recover the costs, including reasonable attorney fees, actually and reasonably incurred by the promisor in defending an action to enforce the covenant, but only under the following circumstances:

- if the primary purpose of the agreement to which the covenant is ancillary is to obligate the promisor to render personal services; and
- the promisor establishes that the promisee knew at the time of the execution of the agreement that the covenant did not contain limitations as to time, geographical area, and scope of activity to be restrained that were reasonable and the limitations imposed a greater restraint than necessary to

protect the goodwill or other business interest of the promisee; and

- the promisee sought to enforce the covenant to a greater extent than was necessary to protect the goodwill or other business interest of the promisee.³³

3. Section 15.53

Section 15.53 provides that “[t]he criteria for enforceability of a covenant not to compete provided by Section 15.50 of this code and the procedures and remedies in an action to enforce a covenant not to compete provided by Section 15.51 of this code are exclusive and preempt any other criteria for enforceability of a covenant not to compete or procedures and remedies in an action to enforce a covenant not to compete under common law or otherwise.”³⁴ Interestingly, as discussed below, the Texas legislature apparently added Section 15.53 in 1993 in response to several decisions of the Texas Supreme Court that continued to analyze covenants not to compete under common law standards despite the enactment of the Covenants Not to Compete Act.

B. *Light v. Centel Cellular Company of Texas*

The Texas Supreme Court avoided addressing the provisions of the Covenants Not to Compete Act for several years after it was enacted in 1989. In *DeSantis v. Wackenhut Corp.* and *Martin v. Credit Protection Ass’n, Inc.*, the court acknowledged the Act but continued to apply its common law standards on the unexplored basis that the result would not differ under the statute.³⁵ Subsequently, the court decided *Travel Masters, Inc. v. Star Tours, Inc.* solely on the basis of *DeSantis* and *Martin*, without even referring to the Act.³⁶ Even *after*

³³ *Id.*

³⁴ TEX. BUS. & COM. CODE § 15.53.

³⁵ *DeSantis v. Wackenhut Corp.*, 793 S.W.2d 670, 684-85 (Tex. 1990); *Martin v. Credit Protection Ass’n, Inc.*, 793 S.W.2d 667, 669 n. 1 (Tex. 1990).

³⁶ *Travel Masters, Inc. v. Star Tours, Inc.*, 827 S.W.2d 830, 832-33 (Tex. 1991).

³¹ TEX. BUS. & COM. CODE § 15.51(c).

³² *Id.*

the legislature added Section 15.53 of the Act to clarify that its provisions preempt the common law, the Texas Supreme Court continued to apply its own common law test when it first considered *Light v. Centel Cellular Company of Texas* in 1993.³⁷ Not until 1994, when the Texas Supreme Court withdrew and superseded its original opinion in *Light*, did the court finally construe the provisions of Section 15.50.³⁸

In *Light*, the plaintiff Debbie Light brought an action to declare that the covenant not to compete into which she had entered with United Telespectrum, Inc. (“United”) was unenforceable.³⁹ United had hired Light in 1985 to sell pagers. In 1987, United obtained a license to sell cellular products.⁴⁰ But before United would permit Light to sell cellular products, and in fact, if Light wanted to retain her job at all, United required Light to sign an employment agreement that included a covenant not to compete.⁴¹ In addition to the covenant not to compete, the agreement contained provisions that stated, among other things: (1) that United would employ Light at will; (2) that United would pay Light a salary and commission; (3) that United would provide “initial and on-going specialized training to Light;” (4) that Light would provide 14 days notice before terminating employment; and (5) that Light would provide an inventory of United property upon termination.⁴²

Analyzing the enforceability of the covenant not to compete under Section 15.50, the Texas Supreme Court first inquired whether the covenant was “ancillary to or part of an otherwise enforceable agreement” at the time the agreement was made. The court noted that, although the Texas legislature apparently intended to broaden the enforceability of covenants not to compete when it enacted and amended Section 15.50, the statutory language

requires the covenant to be ancillary to or part of an otherwise enforceable *agreement*, as opposed to an otherwise valid transaction or relationship.⁴³ Accordingly, the court framed this inquiry into two questions: “(1) is there an otherwise enforceable agreement, to which (2) the covenant not to compete is ancillary to or a part of at the time the agreement is made.”⁴⁴

Applying this test, the court first had to consider whether there was an enforceable agreement between Light and United. Although Light was an at-will employee, and at-will employees by definition do not have enforceable agreements regarding the duration of their employment, the court concluded that at-will employment does not necessarily preclude the formation of other contracts between employer and employee.⁴⁵ An “otherwise enforceable agreement” can emanate from at-will employment so long as the consideration for any promise is not illusory.⁴⁶ Consideration is illusory when the party to be bound can avoid performance by discontinuing employment.⁴⁷ Accordingly, most of United’s promises in the employment agreement—such as its promises to provide salary, commissions, benefits, and ongoing training—were illusory because United could avoid those obligations simply by terminating Light.⁴⁸ United’s obligation to provide *initial* training to Light was not illusory, however, because under the court’s interpretation of the agreement, that obligation would have been binding even if United had terminated Light prior to giving her the training.⁴⁹ Similarly, Light could not, by terminating the agreement, avoid her obligation to give United 14 days notice before, and an inventory after, termination.⁵⁰ Accordingly, “an otherwise enforceable agreement for United to train Light in exchange for Light’s giving 14 days’ notice to terminate employment and Light’s providing an inventory upon termination

³⁷ See *Light v. Centel Cellular Co. of Texas*, 1993 WESTLAW 392211, *2 n. 2 (Tex. 1993), superseded by *Light*, 883 S.W.2d 642 (Tex. 1994).

³⁸ *Light*, 883 S.W.2d at 643.

³⁹ *Id.*

⁴⁰ *Id.*

⁴¹ *Id.*

⁴² *Light*, 883 S.W.2d at 646, n. 8.

⁴³ *Light*, 883 S.W.2d at 644, n. 4.

⁴⁴ *Light*, 883 S.W.2d at 644.

⁴⁵ *Id.*

⁴⁶ *Light*, 883 S.W.2d at 645.

⁴⁷ *Id.*

⁴⁸ *Light*, 883 S.W.2d at 646, n. 9.

⁴⁹ *Id.*

⁵⁰ *Id.*

existed between Light and United.”⁵¹

The court next considered whether the covenant not to compete was “ancillary to or part of the otherwise enforceable agreement.” The court rejected the argument that the covenant could be “part of” the agreement merely by being included in the same instrument, because that interpretation would render the phrase “at the time the agreement is made” redundant.⁵² Instead, the court focused on the “ancillary to” language. Relying upon the U.S. Supreme Court’s decision in *Business Electronics v. Sharp Electronics*,⁵³ the court concluded that a covenant is ancillary to an agreement if “it is designed to enforce a contractual obligation of one of the parties.”⁵⁴ In the court’s view, the “designed-to-enforce-a-contractual-obligation standard” was consistent with the court’s previous decisions holding that a covenant not to compete is only enforceable if the otherwise enforceable agreement gives rise to an “interest worthy of protection” by the covenant.⁵⁵ The court then restated this rule as follows:

in order for a covenant not to compete to be ancillary to an otherwise enforceable agreement between employer and employee:

- (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.⁵⁶

As an example of what might meet this test, the court suggested a covenant not to compete that

is ancillary to an agreement in which “an employer gives an employee confidential and proprietary information or trade secrets in exchange for the employee’s promise not to disclose them.”⁵⁷

Ultimately, the covenant not to compete in *Light* failed this test. Although United’s consideration—its promise to train Light—might have involved confidential or proprietary information, the covenant not to compete was not designed to enforce any of Light’s return promises.⁵⁸ Light merely promised to give notice and an inventory; she did not promise not to disclose the information she obtained from United in training.⁵⁹ Accordingly, the court found the covenant not to compete unenforceable, and did not reach any of the other requirements under Section 15.50.

Light has not passed without criticism in the years since its announcement. Most notably, one judge has criticized *Light* for its conflation of the “ancillary to” and “or part of” requirements into a single test. In a thoughtful concurrence in *Donahue v. Bowles, Troy, Donahue, Johnson, Inc.*, Justice Mosely argues that a covenant not to compete may be “part of” an otherwise enforceable agreement merely by being in the same instrument.⁶⁰ In his view, the “at the time the agreement is made” requirement has independent significance in that it requires the covenant not to compete to be included in the *original* agreement, and not added subsequently by modification.⁶¹ As Justice Mosely himself recognized, however, Texas courts are bound by the Texas Supreme Court’s view unless and until that court revisits its decision in *Light*.⁶²

C. Enforceability of Covenants Not to Compete After *Light*

1. Applicability of the *Light* Test

⁵¹ *Id.*

⁵² *Light*, 883 S.W.2d at 647.

⁵³ *Business Electronics v. Sharp Electronics*, 485 U.S. 717, 108 S. Ct. 1515, 99 L.E.2d 808 (1988).

⁵⁴ *Light*, 883 S.W.2d at 647.

⁵⁵ *Id.*

⁵⁶ *Id.*

⁵⁷ *Light*, 883 S.W.2d at 647, n. 14.

⁵⁸ *Id.*

⁵⁹ *Id.*

⁶⁰ *Donahue*, 949 S.W.2d at 755.

⁶¹ *Donahue*, 949 S.W.2d at 757.

⁶² *Donahue*, 949 S.W.2d at 755

An initial question, before turning to the cases that have applied the two-prong test announced in *Light*, is when that test is applicable. One court, in *Stone v. Griffin Communications & Security Systems*, has held that *Light* only addressed the enforceability of covenants not to compete in at-will employment relationships, and that the two-prong test set out in *Light* has no application to term employment agreements.⁶³ In *Evan's World Travel, Inc. v. Adams*, however, the court found that the two-prong *Light* test applies to all, not only at-will, agreements.⁶⁴ *Evan's World* seems to have the better of this argument. The Texas Supreme Court in *Light* purported to construe, for the first time, statutory language creating a new standard for the enforceability of a covenant not to compete. The court concluded that the new statutory standard had two requirements: (1) that there be an otherwise enforceable agreement; and (2) that the covenant not to compete be ancillary to or part of the agreement at the time it is made.⁶⁵ The court did not even begin to discuss the at-will nature of the plaintiff's employment until it began to address whether an otherwise enforceable agreement existed,⁶⁶ and nothing in the decision suggests that the two prongs of the test are in the alternative. Accordingly, although there is authority to the contrary, the better interpretation is that the *Light* framework applies to determine the enforceability of all covenants not to compete.

A related question is the extent to which decisions predating the enactment of Section 15.50, and the *Light* decision interpreting it, remain valid now. At least two decisions of

intermediate Texas appellate courts have suggested that Section 15.50 merely codifies the common law. In *John R. Ray & Sons, Inc. v. Stroman*, the court stated that section 15.50 "adopted the common law in many respects" and thus "[w]e may therefore look to cases prior to the statute's enactment for guidance."⁶⁷ That court then completely ignored the Texas Supreme Court's watershed decision in *Light*, and decided the enforceability of a covenant not to compete under the standards set forth in *Martin*, *DeSantis*, and other common law cases.⁶⁸ Similarly, in *Oliver v. Rogers*, the court held that the purpose of Section 15.50 was simply to return the law to its state prior to the Texas Supreme Court's decision in *Hill*, in which the court held that covenants not to compete involving common callings were void as a matter of law.⁶⁹ That court also ignored *Light*, and decided the enforceability of a covenant not to compete under the common law as it existed before *Hill*. These decisions are hard to defend in light of the Texas legislature's express preemption of the common law in Section 15.52, and the Texas Supreme Court's recognition in *Light* that the legislature "has generally sought to occupy the field with this statute."⁷⁰ Nevertheless, these decisions provide some basis for the continued vitality of decisions that predate the enactment of the Covenants Not to Compete Act.

2. Existence of an Otherwise Enforceable Agreement

As the Texas Supreme Court emphasized in *Light*, the threshold question when analyzing the enforceability of a covenant not to compete is whether there is some otherwise enforceable agreement between the parties. Because employment agreements almost always impose numerous nonillusory obligations on employees, such as obligations to give notice before termination, obligations to return employer

⁶³ *Stone v. Griffin Communications & Security Systems*, ___ S.W.3d ___, 2001 WESTLAW 839352, *4 n. 5 (Tex. App.—Tyler July 25, 2001, n.p.h.).

⁶⁴ *Evan's World Travel, Inc. v. Adams*, 978 S.W.2d 225, 230-31 (Tex. App.—Texarkana, 1998, n.p.h.) (although employment agreement was not terminable at will, "[u]nless both elements of the [*Light*] test are satisfied, the covenant cannot be ancillary to or part of an otherwise enforceable agreement and is therefore a naked restraint of trade and unenforceable").

⁶⁵ *Light*, 883 S.W.2d at 644.

⁶⁶ *Id.*

⁶⁷ *John R. Ray & Sons, Inc. v. Stroman*, 923 S.W.2d 80, 84-85 (Tex. App.—Hous.[14th Dist.] 1996, writ denied).

⁶⁸ *Id.*

⁶⁹ *Oliver v. Rogers*, 976 S.W.2d 792, 800 (Tex. App.—Hous.[1st Dist.] 1998, pet. denied).

⁷⁰ *Light*, 883 S.W.2d at 647.

property upon termination, and—most important in this context—obligations not to disclose confidential information after termination—this question almost invariably turns on whether the consideration given by the employer is illusory.

An employer's consideration is illusory when the obligation to perform can be avoided simply by terminating the employee. At least one court has invalidated a covenant not to compete at this step in the analysis, simply because all of the employer's promises in the employment agreement were contingent on continued performance. In *Miller Paper Co. v. Roberts Paper Co.*, the court invalidated a covenant not to compete in an agreement in which the employer promised to pay commissions to its salespersons, to reconcile commissions and accounts, to record sales and gross profits, and to foster relationships between the salespersons and customers.⁷¹ Each of those promises was dependant upon the salespersons' commencement and continuation of employment, and the employer's consideration was illusory.

When the employer promises to give something to the employee immediately or upon termination, however, the cases are clear that an otherwise enforceable agreement exists. Thus, when an employer promises to give an employee notice before termination, courts have found an otherwise enforceable agreement to exist.⁷² Likewise, when a termination agreement obligated the employer to provide severance and health benefits after termination, a court found an otherwise enforceable agreement to exist.⁷³ Similarly, a promise to give an employee stock options upon execution of the employment

agreement has been found to support the existence of an otherwise enforceable agreement.⁷⁴ The important question in these cases usually was not whether an otherwise enforceable agreement existed, but—as is discussed below—whether the employer's nonillusory promise gave rise to the interest worthy of protection by the covenant not to compete.

By far, however, the most important but puzzling question litigated in the cases that follow *Light* is what constitutes a nonillusory promise by the employer to give the employee confidential information or trade secrets. In *CRC-Evans Pipeline International, Inc. v. Myers*, the employer promised to give its employees trade secrets and proprietary information necessary to perform their duties.⁷⁵ The employee plaintiffs, however, signed the agreement when they returned to the employer for *re-employment* after departing several years earlier.⁷⁶ Relying on the Texas Supreme Court's distinction in *Light* between initial and ongoing training, and the fact that returning employees did not require initial training, the court in *CRC-Evans* concluded that the employer at most promised to provide trade secrets and proprietary information "sometime during their employment if and when needed."⁷⁷ Because the obligation to provide such information would depend on continued employment, the court found that the promise was illusory and the covenant not to compete was unenforceable.⁷⁸

Other courts have reached the same conclusion, outside of the peculiar facts of the *CRC-Evans* case. In *Bandit Messenger of Austin, Inc. v. Contreras*, although the court acknowledged that a promise by an employer to give an employee trade secrets can provide the consideration for an otherwise enforceable agreement, the court held that an agreement stating that an employee would have *access* to

⁷¹ *Miller Paper Co. v. Roberts Paper Co.*, 901 S.W.2d 593, 599 (Tex. App.—Amarillo 1995, n.w.h.).

⁷² See *Houston Solvents & Chemicals Co. v. Montealegre*, 1999 WESTLAW 219366, *3 (Tex. App.—Hous.[14th Dist.] Apr. 15, 1999, n.p.h.); *Totino v. Alexander & Associates, Inc.*, 1998 WESTLAW 552818, *5 (Tex. App.—Hous.[1st Dist.] Aug. 20, 1998, n.p.h.).

⁷³ *Leon's Fine Foods, Inc. v. McClearin*, 2000 WESTLAW 277135, *2 (Tex. App.—Dallas Mar. 15, 2000, pet. denied).

⁷⁴ *Totino*, 1998 WESTLAW 552818 at *5.

⁷⁵ *CRC-Evans Pipeline International, Inc. v. Myers*, 927 S.W.2d 259, 263 (Tex. App.—Hous.[1st Dist.] 1996, n.w.h.).

⁷⁶ *CRC-Evans*, 927 S.W.2d at 265.

⁷⁷ *CRC-Evans*, 927 S.W.2d at 265-66.

⁷⁸ *Id.*

trade secrets does not affirmatively obligate the employer to provide anything to the employee.⁷⁹ Similarly, in *Ad Com, Inc. v. Helms*, the court found no nonillusory duty to provide confidential information in an agreement which stated that the employee's nondisclosure obligation was necessary "[b]ecause [employee's] unique position requires that she acquire confidential information in order to properly perform her" duties.⁸⁰

Several apparently indistinguishable cases, however, have reached the opposite result. In *Rimkus Consulting Group. v. Budinger*, the court found an otherwise enforceable agreement to exist where the employee's promise not to disclose confidential information was in exchange for the employer's "agreement to engage Employee [at will] to perform personal services and the resulting access by Employee to" confidential information.⁸¹ Similarly, in *Curtis v. Ziff Energy Group, Ltd.*, the court found that a simple promise to "provide" confidential information to an at-will employee in exchange for a nondisclosure obligation was sufficient consideration to create an otherwise enforceable agreement.⁸² Likewise, in *Ireland v. Franklin*, an agreement that conditioned "disclosure" of trade secrets on an at-will employee's promise not to disclose them created an otherwise enforceable agreement.⁸³ These cases, however, neither distinguish *Light* nor explain how these promises to provide confidential information to at-will employees satisfy *Light's* requirement that the promise not be conditioned on the continuation of employment.

⁷⁹ *Bandit Messenger of Austin, Inc. v. Contreras*, 2000 WESTLAW 1587664, *2 (Tex. App.—Austin Oct. 26, 2000, n.p.h.).

⁸⁰ *Ad Com, Inc. v. Helms*, 2000 WESTLAW 45880, *3 (Tex. App.—Dallas, Jan. 21, 2000, pet. denied).

⁸¹ *Rimkus Consulting Group. v. Budinger*, 2001 WESTLAW 619067, *1-*2 (Tex. App.—Hous. [14th Dist.] June 7, 2001, n.p.h.).

⁸² *Curtis v. Ziff Energy Group, Ltd.*, 12 S.W.3d 114, 118 (Tex. App.—Hous.[14th Dist.] 1999, n.p.h.).

⁸³ *Ireland v. Franklin*, 950 S.W.2d 155, 157 (Tex. App.—San Antonio 1997, n.w.h.).

3. Ancillary to or Part of the Otherwise Enforceable Agreement

Assuming that an otherwise enforceable agreement exists, the *Light* test next requires a court to determine whether the covenant not to compete is ancillary to that agreement. *Light* further refined this requirement into a two-part test: (1) does the consideration paid by the employer give rise to the interest worthy of protection by the covenant not to compete; and (2) is the covenant not to compete designed to enforce the employee's consideration in the otherwise enforceable agreement?

- a. *The consideration paid by the employer gives rise to the interest worthy of protection by the covenant not to compete*

More often than not, courts have found the existence of valid consideration to support an otherwise enforceable agreement. As noted in Section II.C.2 above, an employer need only offer some unconditional promise to support an otherwise enforceable agreement, such as a promise to give notice before termination. The employer's consideration, however, must also *give rise* to the interest worthy of protection by the covenant not to compete. Thus when the employer's consideration is only a promise to give advanced notice of termination, courts have held that the employer's consideration did not give rise to an interest worthy of protection by a covenant not to compete.⁸⁴

Simple monetary consideration, on the other hand, has been found to support the enforceability of a covenant not to compete. In *Totino v. Alexander Associates, Inc.*, the court held that a covenant not to compete was ancillary to an employment agreement in which the employer's only consideration was stock options.⁸⁵ Likewise, in *Leon's Fine Foods v. McClearin*, the court found that a covenant not to compete was ancillary to a termination agreement in which the employer promised to

⁸⁴ See *Houston Solvents*, 1999 WESTLAW 219366 at *4; *Totino*, 1998 WESTLAW 552818 at *7.

⁸⁵ *Totino*, 1998 WESTLAW 552818 at *7.

give \$12,000 in severance and health benefits after termination.⁸⁶ Although neither of these cases expressly discusses whether these promises give rise to the interest worthy of protection by a covenant not to compete, both cases clearly apply the *Light* test, and thus, implicitly hold that this requirement is satisfied.

It is not exactly clear why monetary consideration gives rise to an interest worthy of protection by a covenant not to compete, but a promise of advanced notice does not. It is clear, however, that a promise to give an employee trade secrets or confidential information does satisfy this requirement. The Texas Supreme Court made this clear in *Light*, stating in no uncertain terms that an employer has an “interest in restraining [an] employee with knowledge of [the] employer’s trade secrets from competing....”⁸⁷ Indeed, the vast majority of cases finding covenants not to compete enforceable have involved promises of this kind.

b. The covenant not to compete is designed to enforce the employee’s consideration in the otherwise enforceable agreement

Neither the Texas Supreme Court in *Light*, nor any Texas court since, has explained how a covenant not to compete can “enforce” a promise given by an employee. If one considers the Texas Supreme Court’s example of an enforceable covenant not to compete in *Light*—one that is ancillary to an agreement in which the employer promises to provide trade secrets in exchange for the employee’s promise not to disclose them—the answer to this question becomes no clearer. Because the nondisclosure agreement by definition must be “otherwise enforceable,” a covenant not to compete is not necessary to enforce the employee’s covenant not to disclose. Moreover, as is discussed in more detail below, the clear purpose of a covenant not to compete is to *supplement* a duty not to disclose confidential information with a

duty not to *use* the information. Because the meaning of this requirement is somewhat mysterious, it is not clear from the test itself what promises by an employee can satisfy this requirement. Indeed, it appears that no promise by an employee other than a promise not to disclose confidential information has satisfied this requirement since *Light* was decided in 1994.

4. At the time the Agreement is Made

The final requirement of the first half of Section 15.50’s enforceability test—before turning to the reasonableness of the covenant—is that the covenant not to compete must be ancillary to or part of the otherwise enforceable agreement *at the time the agreement is made*. Under the framework announced by the Texas Supreme Court in *Light*, the primary effect of this requirement seemingly is to render covenants that are ancillary to unilateral contracts unenforceable. The court explained in *Light* that when only one promise in an agreement is illusory, a unilateral contract may be formed.⁸⁸ This occurs, for example, when an employee promises not to disclose confidential information, and the employer promises to provide confidential information as may be necessary during the employment.⁸⁹ This agreement would not form an enforceable bilateral contract because the employer could avoid performance simply by terminating the employment.⁹⁰ It could form an enforceable unilateral contract, however, if the employer subsequently accepted the employee’s “offer” by actually providing the confidential information sometime during the employment.⁹¹ Because such a unilateral contract would not be enforceable unless and until the employer actually accepted the offer by providing the confidential information, however, the covenant not to compete would not be ancillary to or part of an otherwise enforceable agreement at the

⁸⁶ *Leon’s Fine Foods*, 2000 WESTLAW 277135 at *2.

⁸⁷ *Light*, 883 S.W.2d at 647, n. 14.

⁸⁸ *Light*, 883 S.W.2d at 645, n. 6.

⁸⁹ *Id.*

⁹⁰ *Id.*

⁹¹ *Id.*

time the agreement is made.⁹²

5. Reasonableness of the Scope of Covenants Not to Compete

The final requirement in Section 15.50's enforceability test states that a covenant not to compete is enforceable only "to the extent that it contains limitations as to time, geographical area, and scope of activity to be restrained that are reasonable and do not impose a greater restraint than is necessary to protect the goodwill or other business interest of the promisee." Construed literally, this language imposes three requirements in order for a covenant not to compete to be enforceable: (1) the covenant must contain limitations as to time, geographical area, *and* scope of activity; (2) those limitations must be reasonable; and (3) those limitations must not impose a greater restraint on the promisor than is necessary to protect the goodwill or other business interest of the promisee. This literal interpretation is utterly counterintuitive, however, because the *limitations* on a covenant not to compete impose *no* restraint on the promisor; they of course *limit* the restraint placed on the promisor. The most reasonable interpretation of this language is that, in order to be enforceable, a covenant not to compete must contain reasonable limitations as to time, geographical area, *and* scope of activity such that the *covenant* imposes no greater restraint on the promisor than is necessary to protect the goodwill or other business interest of the promisee.

Because the Texas Supreme Court in *Light* found that the covenant not to compete was not ancillary to an otherwise enforceable agreement, the court did not have occasion in that case (or since, for that matter) to address this requirement. As noted above, several Texas intermediate appellate courts have suggested that Section 15.50 merely codifies the common law, so that rules that addressed the scope of enforceable covenants not to compete prior to that statute's enactment remain viable.⁹³

⁹² *Id.*

⁹³ See *Oliver*, 976 S.W.2d at 800; *Ray & Sons*, 923 S.W.2d at 84-85.

Although the validity of those decisions is questionable in light of the express preemption of the common law in Section 15.52, this article will discuss decisions decided after the enactment of Section 15.50 that apply common law standards, to the extent they may have continued vitality under the new statutory scheme.

a. Reasonable Limitations as to Time

One recent decision, applying common law standards, held that absence of a fixed time limitation cannot in and of itself render a covenant unreasonable. In *Oliver v. Rogers*, the seller of an optical business promised in the agreement of sale not to open a similar optical business within three miles of the business so long as the buyers were not in default of the agreement.⁹⁴ In defense of an action to enforce the covenant, the seller argued that the covenant was unreasonable as a matter of law because it contained no express time limitation.⁹⁵ The court disagreed, holding—at least with respect to a covenant not to compete in a sale of a business—that a covenant may be unlimited in duration so long as it is reasonable as to geography and scope of activity.⁹⁶ As noted above, the language of section 15.50 seems to require a covenant not to compete to contain limitations as to time, geography, *and* scope of activity. It is arguable, however, that if an indefinite covenant not to compete is necessary to protect the promisee's legitimate interests, an indefinite covenant is reasonable within the spirit of Section 15.50.

In the employment context, however, courts seem much less willing to accept covenants not to compete that are unlimited as to time. In *General Devices, Inc. v. Bacon*, an agreement between a supplier of temporary personnel and its employees provided that the employees could not accept employment with any of the employers' existing clients until 30 days after the relationship between the employer and that

⁹⁴ *Oliver*, 976 S.W.2d at 795.

⁹⁵ *Oliver*, 976 S.W.2d at 800-801.

⁹⁶ *Id.*

client ended.⁹⁷ Because the employer's relationship with the client could continue indefinitely, the court concluded that the covenant not to compete was unlimited as to time and thus unenforceable.⁹⁸ (The court also concluded that the covenant was unenforceable for lack of a geographical limitation.)⁹⁹ Likewise, in *John R. Ray & Sons, Inc. v. Stroman*, a court invalidated a covenant not to compete between an insurance agency and an agent that precluded the agent from ever soliciting or accepting business from any of the agency's accounts, in part because of the unlimited duration of the agreement.¹⁰⁰

Covenants that do impose some limitation on the duration of restraint will be enforceable—or at least, will not be unenforceable for this reason—so long as the duration of restraint is reasonable. Reasonableness of the duration depends on the circumstances of a particular case, however, and is not amenable to broad generalization. Nevertheless, covenants not to compete for periods of several years often have been found to be reasonable,¹⁰¹ and in at least one case a duration of five years has been found to be reasonable.¹⁰²

b. Reasonable Limitations as to Geography

By far the most commonly litigated issue as to the reasonable scope of covenants not to compete involves the reasonableness of the geographic areas embraced by the covenants. The generally accepted rule is that a covenant not to compete may be no broader

geographically than the area in which the employee operated while working for the employer.¹⁰³ Generally, covenants that contain no geographic restrictions, or very broad geographic restrictions (e.g., “within the United States”) are unreasonably broad.¹⁰⁴ For example, in *Software Systems, Inc. v. Ajuria*, an agreement between a provider of specialized computer programs and its programmers provided that the programmers could not compete with the employer anywhere in the United States for a period of one year after termination.¹⁰⁵ Because the employer had clients only in four cities, and thus the employees “did not actually work in all areas covered by the covenant,” the covenant did not contain a reasonable restriction of geographical area.¹⁰⁶ Even when a covenant is restricted to a much smaller area, such as a few counties, the covenant is overbroad if the employee did not actually work in the entire area. Thus, for example, in *Butler v. Arrow Mirror & Glass*, an employment agreement that prohibited an employee from opening a similar glass repair business in Harris and six surrounding counties had to be reformed to include only Harris and Fort Bend counties, because the majority of the customers with whom the employee interacted

⁹⁷ *General Devices, Inc. v. Bacon*, 888 S.W.2d 497, 503 (Tex. App.—Dallas 1994, writ denied).

⁹⁸ *Bacon*, 888 S.W.2d at 504.

⁹⁹ *Id.*

¹⁰⁰ *Ray & Sons*, 923 S.W.2d at 85.

¹⁰¹ See, e.g., *Butler v. Arrow Mirror & Glass, Inc.*, ___ S.W.3d ___, 2001 WESTLAW 699935, *4 (Tex. App.—Hous. [1st Dist.] June 21, 2001, n.p.h.) (two year covenant reasonable); *Rimkus* at *4 (18 month covenant reasonable); *Curtis*, 12 S.W.3d at 118-19 (six month covenant reasonable); *Property Tax Associates v. Staffeldt*, 800 S.W.2d 349, 350 (Tex. App.—El Paso 1990, writ denied) (two year covenant reasonable).

¹⁰² *Stone*, 2001 WESTLAW 839352 at *7.

¹⁰³ See, e.g., *Stone*, 2001 WESTLAW 839352 at *6; *Evan's World Travel*, 978 S.W.2d at 232-33; *Zep Mfg. Co. v. Harthcock*, 824 S.W.2d 654, 660 (Tex. App.—Dallas, 1992, writ denied).

¹⁰⁴ See, e.g., *Leon's Fine Foods* at *2 (restriction of competition within the United States unreasonably broad); *Zep*, 824 S.W.2d at 660-61 (covenant not to compete with no geographic limitation was unreasonably broad); *Sheline v. Dun & Bradstreet Corp.*, 948 F.2d 174, 176 (5th Cir. 1991) (absence of a geographical area limitation rendered covenant not to compete unenforceable).

¹⁰⁵ *Software Systems, Inc. v. Ajuria*, 2000 WESTLAW 1122917, *4 (Tex. App.—Dallas Aug. 9, 2000, n.p.h.); compare *Curtis*, 12 S.W.3d at 119 (agreement preventing vice-president from working for specific group of competitors anywhere in North America for six months' following termination was reasonable where vice-president was hired to “head and build up the U.S. practice in the areas of consulting regarding pipeline/transportation issues, and energy marketing”).

¹⁰⁶ *Id.*

were in those counties.¹⁰⁷

In addition, a covenant not to compete generally should identify the area in which the competition is prohibited with some specificity. In *Butts Retail, Inc. v. Diversifoods, Inc.*, a covenant that prohibited a franchisee from opening a competing store in a particular mall was enforceable, but a covenant that prohibited the franchisee from opening a competing store in the undefined “metropolitan area” of Beaumont was not.¹⁰⁸ There is one apparent exception to this requirement, however. In *American Express Financial Advisors, Inc. v. Scott*, the covenant prohibited the employee from soliciting the employer’s customers for a period of one year within the “Territory” in which the employee had worked.¹⁰⁹ Although there was no express geographic limitation in the agreement, the court found that it was reasonable because the “substance of the Contract makes clear that Defendant may sell his financial planning services anywhere he chooses...just not to the customers he served while affiliated with Plaintiff...”¹¹⁰ Although a limitation on whom the employee may solicit is more a limitation on scope of activity than geography, apparently such a limitation may in some instances satisfy the geographical requirement as well (presumably because it limits the restriction to the areas in which employee actually worked).

c. Reasonable Limitations as to Scope of Activity

The requirement that a covenant not to compete contain reasonable limitations as to the scope of activity restrained generally imposes one of two requirements, depending on what the covenant seeks to restrain. As a general matter, covenants usually seek to restrain either *what* a former employee may do after termination, or *with whom* the former employee may have contact after termination. Either type of

covenant may be reasonable, so long as its restriction is not overly broad.

Covenants not to compete that seek to limit what an employee can do after termination should not impose “industry-wide exclusions” on an employee’s ability to work. For example, in *John R. Ray & Sons, Inc. v. Stroman*, an agreement between an insurance agency and an agent provided that the agent could not “engage in or have an interest in any business that sold insurance policies or that engaged in the insurance agency business within Harris County and all adjacent counties for a period of five years....”¹¹¹ This restriction was overly broad, because it precluded the employee from working in the insurance agency business in any capacity.¹¹² In contrast, the agreement between a residential glass installation company and an employee in *Butler v. Arrow Mirror & Glass, Inc.*, only limited the employee from installing glass in new residential construction.¹¹³ Because the employee was not restrained from installing glass in commercial construction, the covenant not to compete was appropriately limited.¹¹⁴ Likewise, in *Stone v. Griffin Communications & Security Systems*, a covenant that prohibited a former employee from installing or maintaining security systems, but not from selling or leasing security systems, was reasonable.¹¹⁵

Covenants not to compete that seek to limit with whom an employee can do business after termination may be found unreasonable if they extend to customers with whom the employee had no contact while working for the employer. Thus in *John R. Ray & Sons, Inc. v. Stroman*, a separate agreement that obligated a former employee not to solicit business from any of the employer’s customers was overbroad.¹¹⁶ In

¹⁰⁷ *Butler*, 2001 WESTLAW 699935 at *4.

¹⁰⁸ *Butts Retail, Inc. v. Diversifoods, Inc.*, 840 S.W.2d 770, 773-74 (Tex. App.—Beaumont 1992, writ denied).

¹⁰⁹ *American Express Financial Advisors, Inc. v. Scott*, 955 F. Supp. 688, 692 (N.D. Tex. 1996).

¹¹⁰ *Id.*

¹¹¹ *John R. Ray & Sons*, 923 S.W.2d at 83.

¹¹² *John R. Ray & Sons*, 923 S.W.2d at 85.

¹¹³ *Butler*, 2001 WESTLAW 699935 at *5.

¹¹⁴ *Id.*

¹¹⁵ *Stone*, 2001 WESTLAW 839352 at *5.

¹¹⁶ *John R. Ray & Sons*, 923 S.W.2d at 85; *but see*, *American Express*, 955 F. Supp. at 692-93 (covenant prohibiting employee from soliciting any customer or potential customer to whom an American Express sales presentation had been made, apparently by anyone at American Express, was enforceable).

contrast, in *Stone v. Griffin Communications & Security Systems*, a covenant that only prohibited a former employee from soliciting business from customers with whom the employee had contact during employment was reasonable.¹¹⁷

D. Procedure in Actions to Enforce Covenants Not to Compete

1. Injunctive Relief

In an action to enforce a covenant not to compete in Texas, the availability of injunctive relief is governed by Section 15.51 of the Covenants Not to Compete Act. Because that Act expressly provides for injunctive relief, it is not necessary also to prove an irreparable injury for which no adequate remedy at law exists.¹¹⁸

The most important unresolved question with respect to the availability of injunctive relief is whether injunctive relief is proper after—because of the delay inherent in litigation—a covenant not to compete has expired. In both *Leon's Fine Foods, Inc. v. McClearin* and *John R. Ray & Sons, Inc. v. Stroman*, the courts held that reformation (and implicitly, injunctive relief) is moot after a covenant not to compete has expired by its own terms.¹¹⁹ But in *Rimkus Consulting Group, Inc. v. Budinger*, the appellate court granted injunctive relief to enforce a covenant not to compete that had expired of its own terms.¹²⁰ None of these cases fully explores the policy arguments that lie on both sides of this issue: on the one hand, it would be inequitable to allow litigation to deprive an employer of injunctive relief, while on the other, the public policies that require reasonable time limitations would be frustrated if litigation could substantially extend those limits.

2. Reformation

¹¹⁷ *Stone*, 2001 WESTLAW 839352 at *5.

¹¹⁸ *Butler*, 2001 WESTLAW 699935 at *5.

¹¹⁹ *Leon's Fine Foods, Inc. v. McClearin*, 2000 WESTLAW 277135 at *3; *Ray & Sons*, 923 S.W.2d at 85.

¹²⁰ *Rimkus*, 2001 WESTLAW 619067 at *4.

Under Section 15.51(c), when a covenant is ancillary to or part of an otherwise enforceable agreement, but contains unreasonable limitations that impose a greater restraint than is necessary to protect the goodwill or other business interest of the promisee, the court *shall* reform the covenant to the extent necessary to cause the limitations to be reasonable and to impose a restraint that is not greater than necessary to protect the goodwill or other business interest of the promisee. Several courts have interpreted this language to make reformation mandatory whenever a covenant is ancillary to or part of an otherwise enforceable agreement but contains unreasonable restrictions.¹²¹ In *John R. Ray & Sons, Inc. v. Stroman*, however, the court declined to reform a covenant that was ancillary to an otherwise enforceable agreement but contained unreasonable restrictions, because the employer was unable to show what reformation, if any, would be necessary and reasonable to protect its goodwill or other business interests.¹²²

3. Attorney Fees

Under Section 15.51(c), attorney fees are available in an action to enforce a covenant not to compete only in one narrow situation. They are available only to promisors in agreements the primary purpose of which are to obligate the promisors to render personal services (e.g., employees), and they are available only when the promisee knew when the agreement was executed that the covenant did not contain reasonable limitations and imposed a greater restraint than necessary to protect the goodwill or other business interest of the promisee. By virtue of the broad preemption clause in Section 15.52, attorney fees should not be available under any other circumstances in an action to enforce a covenant not to compete.

Attorney fees may be awarded under the Declaratory Judgment Act,¹²³ however, to promisors who obtain declaratory judgments that

¹²¹ *Rimkus*, 2001 WESTLAW 619067 at *3; *Evan's World Travel*, 978 S.W.2d at 233; *Zep*, 824 S.W.2d at 661.

¹²² *Ray & Sons*, 923 S.W.2d at 85.

¹²³ TEX. CIV. PRAC. & REM. CODE § 37.001 *et seq.*

covenants not to compete are unenforceable. In *Gage Van Horn & Associates, Inc. v. Tatom*, an employee sought and obtained a declaratory judgment that a covenant not to compete was unenforceable, and the trial court awarded attorney fees.¹²⁴ On appeal, the employer argued that Section 15.52 preempted the attorney fee provision in the Declaratory Judgment Act,¹²⁵ and that the employee had failed to show that the employer had the knowledge required to obtain attorney fees under Section 15.51(c) of the Covenant Not to Compete Act. The court found that the attorney fees provision of the Declaratory Judgment Act was not preempted, because an action for declaratory judgment that a covenant not to compete is unenforceable is not an action to enforce a covenant.¹²⁶ (The Texas Supreme Court granted a petition for review in *Gage Van Horn* on April 26, 2001.)¹²⁷

III. CONFIDENTIALITY AGREEMENTS AND TRADE SECRETS

To be sure, covenants not to compete are one means by which an employer can protect its sensitive information from disclosure to third parties. But as can be seen above, covenants not to compete are not the panacea that they may seem to be at first blush. When an employer's primary goal is to protect the confidentiality of its sensitive information, covenants not to compete are both too broad and too narrow. They are too broad because they severely limit a former employee's freedom beyond the mere disclosure of confidential information, and as a result, may be more costly to obtain than is necessary to protect the employer's interests. Perhaps more significantly, they are too narrow because they must be limited as to time, geography, and scope of activity. Their utility is complicated further by the need to ensure that they are ancillary to or part of an otherwise enforceable agreement. Put simply, although the Texas Supreme Court's decision in *Light*

inextricably ties covenants not to compete and covenants not to disclose, noncompetition and nondisclosure are very different things.

The two primary alternatives to covenants not to compete are confidentiality agreements (covenants not to disclose) and the law of trade secrets. Confidentiality agreements simply obligate an employee not to disclose certain information to third parties. Because they do not implicate the public policy concerns with unrestrained competition to the same degree as covenants not to compete, they are much easier to create and enforce. The law of trade secrets, on the other hand, limits an employee's ability to use or disclose certain information without the necessity of an agreement at all. The most significant concerns in the area of trade secrets are the requirements that an employer must satisfy to ensure that information qualifies for trade secret protection.

A. Confidentiality Agreements

A confidentiality agreement is nothing more than a contract in which an employee makes a covenant not to disclose, e.g., a promise not to disclose certain information acquired during employment.¹²⁸ Because nondisclosure covenants are not a restraint on trade, they are not against public policy, are not subject to the reasonable time, geographic, and scope-of-activity limitations that apply to covenants not to compete, and are generally more readily enforced than covenants not to compete.¹²⁹ In fact, their enforceability should be subject to the general requirements of contract law, and presumably their subject matter could extend to any information on which the parties agree.

Some caselaw, however, suggests that confidentiality agreements are only enforceable to the extent they prohibit the disclosure of trade secrets. In *CRC-Evans Pipeline International, Inc. v. Myers*, two employees signed employment agreements in which they promised not to disclose "trade secrets or confidential information" that they had learned in a previous stint of employment, in exchange for the

¹²⁴ *Gage Van Horn & Associates, Inc. v. Tatom*, 26 S.W.3d 730, 731 (Tex. App.—Eastland 2000, pet. granted).

¹²⁵ TEX. CIV. PRAC. & REM. CODE § 37.009.

¹²⁶ *Gage Van Horn*, 26 S.W.3d at 732-33.

¹²⁷ *Id.*

¹²⁸ *Zep Mfg.*, 824 S.W.2d at 663.

¹²⁹ *Id.*; see also *CRC-Evans*, 927 S.W.2d at 265.

employer's promise of renewed employment.¹³⁰ The court assumed without deciding that the employer gave nonillusory consideration sufficient to create a binding contract, but nonetheless found the agreement unenforceable because what the employees promised not to disclose were not trade secrets.¹³¹ Because there was evidence that the employer had not taken sufficient steps to protect the confidentiality of the information, the information had lost its trade secret status.¹³² The court apparently ignores the employees' agreements not to disclose "confidential information" as well as trade secrets, holding that "[a]n agreement not to disclose what was once 'trade secret' information, which has lost its trade secret status with the consent of the employer, is not enforceable."¹³³ Moreover, in one of the cases the *CRC-Evans* court cites for this holding, *Rimes v. Club Corp. of America*, the court denied enforcement of a confidentiality agreement that defined the information not to be disclosed by specific reference, on the grounds that the information was not a trade secret.¹³⁴ Similarly, the other case on which *CRC-Evans* relies, *Numed, Inc. v. McNutt*, does not involve a confidentiality agreement at all, further suggesting that *CRC-Evans* conflates the requirements for an enforceable confidentiality agreement with the law of trade secrets.¹³⁵

Apart from the proper scope of an enforceable confidentiality agreement, the biggest potential pitfall in the enforceability of confidentiality agreements is whether the employer gives nonillusory consideration sufficient to make the employee's nondisclosure covenant binding. The Texas Supreme Court's discussion in *Light* of at-will employment and illusory consideration is as applicable to covenants not to disclose as it is to covenants not to compete. If an employer merely promises to give an at-will employee confidential

information sometime during the course of employment, an enforceable confidentiality agreement does not yet exist for lack of consideration; the employer may avoid the obligation to perform merely by terminating employment.¹³⁶ Similarly, an employee's promise not to disclose confidential information that she already has received will not create a binding contract because past consideration will not support a subsequent promise.¹³⁷ Of course, if the employer actually does follow through on a promise to give the employee confidential information in exchange for a nondisclosure covenant, an enforceable unilateral contract will be formed.¹³⁸ And since covenants not to disclose are not subject to the requirement that they be ancillary to an otherwise enforceable agreement at the time the agreement is made, such a unilateral contract may be enforced.¹³⁹

B. Trade Secrets

The law of trade secrets imposes certain duties on an employee regardless of any contractual agreements with the employer. Upon formation of an employment relationship, certain duties arise apart from the existence of any written contract.¹⁴⁰ One of these duties forbids an employee from using confidential or proprietary information acquired during the relationship in a manner adverse to his employer.¹⁴¹ This obligation survives the termination of employment.¹⁴²

The major limitation contained in the law of trade secrets is that only information which qualifies for trade secret status is protected. This rule in turn imposes two limitations. First, trade secret status extends only to information that has a substantial element of secrecy and provides an employer for an opportunity for advantage over competitors.¹⁴³ Common examples include

¹³⁰ *CRC-Evans*, 927 S.W.2d at 265.

¹³¹ *CRC-Evans*, 927 S.W.2d at 265-66.

¹³² *CRC-Evans*, 927 S.W.2d at 266.

¹³³ *Id.*

¹³⁴ *Rimes v. Club Corp. of America*, 542 S.W.2d 909, 913-14 (Tex. App.—Dallas 1976, writ ref'd).

¹³⁵ *Numed, Inc. v. McNutt*, 724 S.W.2d 432 (Tex. App.—Fort Worth 1987, n.w.h.).

¹³⁶ See *Light*, 883 S.W.2d at 644-45, n. 6.

¹³⁷ See *CRC-Evans*, 927 S.W.2d at 265.

¹³⁸ See *Light*, 883 S.W.2d at 644-45, n. 6.

¹³⁹ See *CRC-Evans*, 927 S.W.2d at 265.

¹⁴⁰ See *Miller Paper*, 901 S.W.2d at 600.

¹⁴¹ *Id.*

¹⁴² *Id.*

¹⁴³ See, e.g., *Evan's World Travel*, 978 S.W.2d at 231; *Miller Paper*, 901 S.W.2d at 601.

pricing information, customer lists, customer preferences, buyer contacts, and market strategies.¹⁴⁴ Information that is commonly known in a trade or industry or is readily accessible through private investigation does not qualify for trade secret status.¹⁴⁵

Second, the employer must take significant steps to protect the information from disclosure. For example, in *Bandit Messenger of Austin, Inc. v. Contreras*, an employer argued that despite the unenforceability of a covenant not to compete, a former employee still should be enjoined under the law of trade secrets from operating a competing business using the employer's customer list.¹⁴⁶ The court disagreed, in part because the employer had not taken sufficient steps to protect the information in the customer list.¹⁴⁷ The employee had access to the list before he had been required to sign the confidentiality agreement, and not all employees who had access to the list were required to sign confidentiality agreements.¹⁴⁸ In contrast, the court in *T-N-T Motorsports, Inc. v. Hennessey Motorsports, Inc.*, found that a customer list was a trade secret because the business had kept the list in a locked room apart from most employees, and not all employees were allowed access to the list.¹⁴⁹

Unlike confidentiality agreements, which merely prohibit the disclosure of sensitive information, the law of trade secrets prohibits a former employee from *utilizing* confidential information acquired during employment in a manner adverse to the employer.¹⁵⁰ Thus in *Rugen v. Interactive Business Systems, Inc.*, the court enjoined a former employee from soliciting a former employer's customers and consultants, whose identities she was able to obtain through protected confidential

information.¹⁵¹ Although the trial court in *Rugen* had found a covenant not to compete unenforceable, the appellate court nonetheless held that the court could enjoin the former employee from soliciting customers under the law of trade secrets, because such injunction did not prohibit all competition but merely the unfair use of the employer's confidential information.

Indeed, in light of the breadth of protection afforded by the law of trade secrets, it is worthwhile to inquire what is added by the creation of a covenant not to compete. Arguably, a covenant not to compete could prohibit competition even when the employee did not have access to information that meets the rigorous demands for trade secret protection. Both *Light* and common law cases such as *DeSantis* mention both trade secrets and "confidential information" as the sort of "legitimate interests" that can give rise to enforceable covenants not to compete.¹⁵² Nevertheless, under *Light* a covenant not to compete is only enforceable to the extent it is designed to enforce an employee's covenant not to disclose, and there is some indication in the caselaw that a covenant not to disclose is only enforceable to the extent that the employee received protectable trade secrets.

IV. CONCLUSION

In theory, trade secrets, confidentiality agreements, and covenants not to compete are very different creatures that complement each other very well. The law of trade secrets exists independently of any agreement, and forbids an employee from using or disclosing a very limited set of confidential information that an employer endeavors to keep secret. Confidentiality agreements should permit employers and employees to extend these nondisclosure obligations to a broader set of information, provided they include this covenant not to disclose in an enforceable agreement. Covenants not to compete should permit employers and employees to extend the

¹⁴⁴ *Id.*

¹⁴⁵ *Miller Paper*, 901 S.W.2d at 601.

¹⁴⁶ *Bandit*, 2000 WESTLAW 1587664 at *4.

¹⁴⁷ *Id.*

¹⁴⁸ *Id.*

¹⁴⁹ *T-N-T Motorsports, Inc. v. Hennessey Motorsports, Inc.*, 965 S.W.2d 18, 22-23 (Tex. App.—Hous. [1st Dist.] 1998, pet. dism'd).

¹⁵⁰ See *Miller Paper*, 901 S.W.2d at 601.

¹⁵¹ *Rugen v. Interactive Business Systems, Inc.*, 864 S.W.2d 548, 551 (Tex. App.—Dallas 1993, n.w.h.).

¹⁵² *Light*, 883 S.W.2d at 647 n. 14; *DeSantis*, 793 S.W.2d at 682.

noncompetition obligations beyond the prohibition on use of trade secrets, provided the restraints on competition are reasonable. Texas courts, however, have done much to conflate these three creatures into one, first by limiting the scope of enforceable confidentiality agreements to the nondisclosure of trade secrets, and second by requiring that covenants not to compete be ancillary to otherwise enforceable confidentiality agreements. In light of this conflation, it is worthwhile to question whether the benefit of a covenant not to compete is worth the burden of making it enforceable.

Assuming that a covenant not to compete is the best option for a client, however, several lessons from *Light* and the cases that follow it will assist in ensuring its enforceability. First, the covenant should be created as part of a confidentiality agreement in which the employee promises not to disclose trade secrets in exchange for the employer's *expressly unconditional* promise to provide trade secrets to the employee. Second, the covenant should contain reasonable limitations that only restrict the employee from competing *directly* with the employer, *where* the employee previously worked for the employer, and *in the capacity* in which the employee previously worked for the employer. Finally, the employer should take steps to protect the secrecy of the confidential information that it supplies to the employee, both because trade secret status may enhance the enforceability of the covenant not to compete, and because trade secret status can provide an alternative basis for protection should the covenant not to compete fail.