I. INTRODUCTION

Suppose you represent a company, ABC, which provides consulting services to financial institutions.[1] ABC is very concerned about maintaining its trade secrets and confidential, proprietary information. ABC comes to you and wants you to make sure that its at-will employees are not able to share this information with competitors or use it for their own advantage if the employees are terminated or chose to resign.

You decide the best way to protect your client's interest is to draft an employment agreement. You recall the Texas Supreme Court's decision in *Light v. Centel Cellular Company of Texas*[2] interpreting the Texas Business and Commerce Code's statute regarding covenants not to compete.[3] Thinking you are complying with *Light*, you draft what you believe is an enforceable covenant not to compete.

In this agreement, you provide that the employer, ABC, will agree to provide the employee special training and access to confidential information. You also provide that ABC promises to give the employee at least two-weeks' notice before terminating him for any reason other than misconduct. The employee, in return, agrees to keep the confidential information strictly confidential, to not solicit or aid any other party in soliciting any prospective clients for one year after termination and to give two-weeks' notice before terminating his employment.

You give this agreement to your client and reassure him that it complies with the Texas Supreme Court's ruling and is therefore, an enforceable covenant not to compete. ABC has all of its employees sign this agreement. Thereafter, one employee, Smith, decides to go to work for a competitor.

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[1] This scenario is based on a recent Texas Supreme Court case, *Alex Sheshunoff Mgmt. Servs., L.P. v. Johnson*, No. 03-1050, 2006 Tex. LEXIS 1039 (Tex. Oct. 20, 2006).

[2] 883 S.W.2d 642 (Tex. 1994).

[3] TEX. BUS. & COM. CODE ANN. § 15.50(a) (Vernon 2004). This section states:

Notwithstanding Section 15.05 of this code, 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.

Your client calls you and wants to know what it can do about this. "Not to worry," you reassure your client. You explain that you have drafted an enforceable covenant not to compete preventing Smith from doing such things.

You find out later that Smith has filed for declaratory judgment asking the court to find the covenant not to compete unenforceable. Smith files a motion for summary judgment and the district court grants it. You cannot comprehend how this could happen, after all, you followed the Texas Supreme Court's opinion in *Light*. . .or so you thought.

This was the scenario many employers were finding themselves in proper to the Texas Supreme Court's recent ruling in *Alex Sheshunoff Management v. Johnson*. Prior to *Johnson*, employers were relying on *Light* to aid them in drafting employment agreements with covenants not to compete. In doing so, employers believed that a non-compete agreement would be enforceable in an employment at-will situation so long as the agreement contained a promise by the employee not to disclose confidential or proprietary information in return for a promise by the employer to provide training and confidential information. This was perfectly understandable since the Texas Supreme Court gave this specific practice as an example in *Light*. The Court stated in Footnote 14:

Thus if an employer gives an employee confidential and proprietary information or trade secrets in exchange for the employee's promise not to disclose them, and the parties enter into a covenant not to compete, the covenant is ancillary to an otherwise enforceable agreement because (1) the consideration given by the employer [confidential and proprietary information or trade secrets] in the otherwise enforceable agreement [exchange of trade secrets and confidential proprietary information for promise not to disclose] must give rise to the employer's interest in restraining the employee from competing [employer has interest in restraining employee with knowledge of employer's trade secrets from competing] and (2) the covenant must be designed to enforce the employee's consideration or return promise [the promise not to disclose the trade secrets] in the otherwise enforceable agreement.[4]

With this in mind, employers became alarmed when many Texas courts of appeals started striking down covenants not to compete even when the employment agreement contained a promise to provide confidential information and/or training in return for the employee's promise not to

[4] *Id*. at 647 n.14.

disclose confidential information. This shocked employers and employers began believing that it was virtually impossible to draft an employment agreement with an enforceable covenant not to compete. Then, the Texas Supreme Court addressed these lower court opinions and gave employers a glimmer of hope. The purpose of this article is to examine the Texas Supreme Court's recent opinion in *Johnson* and to address issues that still may not be settled by the *Johnson* opinion.

A. Light vs. Centel Cellular Company of Texas

In order to understand the Texas courts of appeals decisions and the distinction made in *Johnson*, it is necessary to first discuss the Texas Supreme Court's opinion in *Light*.[5] In *Light*, Centel hired Light to sell pagers.[6] Pursuant to her becoming employed, she was required to sign an employment agreement.[7] The agreement had numerous provisions including the following: both parties agreed that Light was an employee at-will, she would be paid a salary plus commissions, her employer would provide her a package of employee benefits, her employer would provide her initial and on-going specialized training, she would agree to give her employer fourteen-days' notice before terminating her employment, she would provide her employer with an inventory after giving notice of termination, and most importantly, the agreement also had a provision prohibiting Light from competing with her employer in the area she serviced while employed with her employer for a period of one year.[8] After working for three years, Light resigned but Centel refused to voluntarily release Light from the covenant not to compete.[9] Light sued Centel claiming the covenant not to compete was not enforceable.[10]

1. The Standard Used To Determine Whether a Covenant Not To Compete Is Enforceable

In analyzing whether the covenant not to compete was enforceable, the Texas Supreme Court cited to section 15.50 of the Texas Business and Commerce Code stating:

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[5] *Light*, 883 S.W.2d at 642.
[6] *Id.* at 643.
[7] *Id.*
[8] *Id.*
[9] *Id.*
[10] *Id.*

Section 15.50 provides two criteria for the enforceability of a covenant not to compete: the covenant must (1) be ancillary to or part of an otherwise enforceable agreement at the time the agreement is made and (2) contain 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. The enforceability of a covenant not to compete, including the question of whether a covenant not to compete is a reasonable restraint of trade, is a question of law for the court.[11]

The court then focused on the first requirement regarding formation and broke it down into two main inquiries.[12] First, courts must determine whether there is an otherwise enforceable agreement.[13] Then, courts must ask whether the covenant not to compete is ancillary to or part of the otherwise enforceable agreement at the time the agreement is made.[14]

2. Is There An Otherwise Enforceable Agreement?

The court's first step in the analysis was to determine whether there was an otherwise enforceable agreement.[15] In order to do this, the court disregarded the covenant not to compete and then looked at the remaining promises.[16] Once the covenant not to compete was disregarded, the following promises were remaining: both parties agreed that Light was an employee at-will, both parties agreed Light would be paid a salary plus commissions, Centel agreed it would provide her a package of employee benefits, Centel agreed it would provide her initial and on-going specialized training, Light agreed to give Centel fourteen-days' notice before terminating her employment and after giving notice of termination, Light would provide Centel with an inventory.[17]

a) Illusory Promises

In conducting the analysis of whether there was an otherwise enforceable agreement, the court pointed out that many of the remaining

[11] *Id.* at 644.
[12] *Id.*
[13] *Id.*
[14] *Id.*
[15] *Id.*
[16] *Id.*
[17] *Id.*

promises were illusory.[18] The court stated that there could not be an otherwise enforceable agreement between the employer and employee if that promise is dependent upon continued employment.[19] If a promise is dependent upon an additional period of employment, it is illusory because it is exclusively within the control of the promisor.[20] The court explained, "Consideration for a promise, by either the employee or the employer in an at-will employment, cannot be dependent on a period of continued employment. Such a promise would be illusory because it fails to bind the promisor who always retains the option of discontinuing employment in lieu of performance."[21] With that being said, the court held the following promises were illusory: the at-will employment agreement, the promise to pay salary and commissions and the promise to a provide benefits package.[22]

b. Non-Illusory Promises

While the court stated that there could not be an otherwise enforceable agreement between an employer and employee that was dependent upon continued employment, the court held that at-will employment does not preclude the formation of other contracts between the employer and employee.[23] The court stated, "At will employees may contract with their employers on any matter except those which would limit the ability of either the employer or employee to terminate the employment at will."[24] The court found the following promises to be non-illusory: the employer's promise to provide initial, specialized training; the employee's promise to provide fourteen-days' notice to the employer before terminating employment and the employee's promise to provide an inventory.[25] In holding that these promises were non-illusory, the court stated that an otherwise enforceable agreement existed.[26]

3. Is the Covenant Not to Compete Ancillary to an Otherwise

[18] *Id.* at 644-45.
[19] *Id.*
[20] *Id.*
[21] *Id.*
[22] *Id.* at 645.
[23] *Id.* at 645-46.
[24] *Id.* at 644.
[25] *Id.* at 646.
[26] *Id.*

Enforceable Agreement?

The next step in the court's analysis was then to determine whether the covenant not to compete was ancillary to an otherwise enforceable agreement.[27] The standard the court used was "a restraint is not ancillary to a contract unless it is designed to enforce a contractual obligation of one of the parties."[28] The court stated in other words, "The otherwise enforceable agreement must give rise to the 'interest worthy of protection' by the covenant not to compete."[29] The court further explained,

[I]n 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.[30]

It is at this point in the court's analysis that it discusses non-disclosure agreements.[31] The court explains in a footnote that if the employer and employee enter into an agreement that provides that the employer will give the employee confidential and proprietary information in exchange for the employee's return promise not to disclose this information and the parties also enter into a covenant not to compete, then the covenant not to compete is ancillary to this agreement.[32] The covenant not to compete is ancillary to this otherwise enforceable agreement because the employer is protecting a worthy interest of keeping the information confidential by having the employee agree to not disclose the information and also by having the employee enter into a covenant not to compete.[33]

The court ruled that the covenant not to compete between Light and Centel was not ancillary to or a part of the otherwise enforceable agreement.[34] The court found that Centel's promise to train Light might have involved confidential or proprietary information but that the covenant

[27] *Id*. at 646-47.
[28] *Id*. at 647.
[29] *Id.*
[30] *Id.*
[31] *Id*. at 647 n.14.
[32] *Id*.
[33] *Id.*
[34] *Id*. at 647.

not to compete was not designed to enforce any of Light's return promises which were to give fourteen-days' notice and to provide an inventory.[35] The court then stated in a footnote, "The covenant would have enforced an agreement by Light, for example, not to disclose confidential proprietary information after her termination."[36] Since Light did not have an agreement not to disclose confidential proprietary information, the court ruled that the covenant not to compete between Light and Centel was unenforceable because it was not ancillary to an otherwise enforceable agreement between them.[37]

B. Appellate Courts' Analysis

After reading the Texas Supreme Court's opinion in *Light*, many employers relied on the example given by the court which stated that a covenant not to compete would be ancillary to an otherwise enforceable agreement if the otherwise enforceable agreement consisted of an agreement between the employer and employee in which the employer promised to trained an employee for a return promise by the employee not to disclose the confidential, proprietary information. A problem developed when the Texas courts of appeals started looking at this example and comparing it to another footnote in the *Light* opinion.

In *Light*, the Texas Supreme Court explained in Footnote 6 the application of unilateral contracts when one promise is illusory.[38] The court gave the following example:

[S]uppose an employee promises not to disclose an employer's trade secrets and other proprietary information, if the employer gives the employee such specialized training and information during the employee's employment. If the employee merely sought a promise to perform from the employer, such a promise would be illusory because the employer could fire the employee and escape the obligation to perform. If, however, the employer accepts the employee's offer by performing, in other words by providing the training, a unilateral contract is created in which the employee is now bound by the employee's promise. . ..The fact that the employer was not bound to perform because he could have fired the employee is irrelevant; if he has performed, he has accepted the employee's offer and

[35] *Id*.
[36] *Id*. at 648 n.15.
[37] *Id*. at 647-48.
[38] *Id*. at 645 n.6.

created a binding unilateral contract. To form such a unilateral contract, however, (1) the performance must be bargained-for so that it is not rendered past consideration. . . and (2) acceptance must be by performance and not by a promise to perform. Such a unilateral contract existed between Light and [Centel] as to Light's compensation. But such unilateral contract, since it could be accepted only by future performance, could not support a covenant not to compete inasmuch as it was not an "otherwise enforceable agreement at the time the agreement is made" as required by § 15.50.[39]

The court's analysis of unilateral contracts in this footnote was heavily relied upon by the appellate courts' decisions.[40]

1. Trilogy Software, Inc. v. Callidus Software Inc.[41] – Austin Court of Appeals

A case that illustrates this hypertechnical analysis in *Light's* footnote 6 is *Trilogy Software, Inc. v. Callidus Software Inc.* In this case, the Austin Court of Appeals struck down a covenant not to compete holding that the employer's promise to provide the employee with training and confidential information is illusory due to the employee's at-will status.[42] In *Trilogy*, Liu, the employee was hired to be a computer programmer.[43] On Liu's first day of work, he signed an agreement that contained a nondisclosure agreement and a covenant not to compete.[44] He also agreed to return all property belonging to his employer upon termination.[45] While Liu was working for Trilogy, a competitor contacted Liu and offered him a position.[46] The employee declined the position stating that he was not interested in leaving Trilogy.[47] A few months later, Trilogy notified Liu he would be laid off due to lack of work.[48]

Trilogy prepared an Employment Separation Agreement detailing the

[39] *Id.*

[40] *Id.*

[41] *Trilogy Software, Inc. v. Callidus Software, Inc.*, 143 S.W.3d 452 (Tex. App.—Austin 2004, no pet.).

[42] *Id.* at 463.

[43] *Id.* at 455.

[44] *Id.* at 455-56.

[45] *Id.* at 456.

[46] *Id.*

[47] *Id.*

[48] *Id.*

terms of Liu's termination.[49] Trilogy agreed to provide Liu with one-month's salary and allowed him to remain on the payroll for that month so that Liu could preserve his immigration status.[50] In addition, the agreement also reiterated that Liu agreed to comply with the nondisclosure and non-competition agreements.[51]

After Liu was notified that he would be laid-off, Liu sent out his resume to a number of companies including the competitor that had contacted him previously.[52] The competitor hired Liu.[53] Thereafter, Trilogy filed suit claiming Liu breached his nondisclosure and non-competition agreements along with various other claims.[54] Both Liu and the competitor filed a motion for summary judgment, which was granted, by the trial court.[55] Trilogy appealed.[56]

In conducting its analysis of whether the covenant not to compete was enforceable, the Austin Court of Appeals clearly connected *Light's* Footnote 14 to *Light's* Footnote 6 and further ruled that Trilogy misunderstood Footnote 14. Trilogy argued that Footnote 14 in *Light* supported its proposition that its promise to give Liu access to confidential information and training in the future was sufficient consideration to support the nondisclosure agreement.[57] The court stated,

Trilogy misreads footnote 14. The footnote states in pertinent part: "If an employer *gives* an employee confidential and proprietary information or trade secrets in exchange for the employee's promise not to disclose them, and the parties enter into a covenant not to compete, the covenant is ancillary to an otherwise enforceable agreement." Footnote 14 thus contemplates not a bilateral contract, but a unilateral contract in which the employer's provision of confidential information comprises consideration for the employee's nondisclosure obligations.[58]

After stating this, the court immediately cited to *Light's* Footnote 6,

[49] *Id.* at 456-57.
[50] *Id.*
[51] *Id.* at 457.
[52] *Id.*
[53] *Id.*
[54] *Id.*
[55] *Id.* at 458.
[56] *Id.*
[57] *Id.* at 461.
[58] *Id.*

which discussed unilateral contracts.[59] After the court made Trilogy aware of its misapplication of *Light's* Footnote 14, Trilogy argued that even if the agreement was a unilateral contract, it met the requisites of an otherwise enforceable agreement.[60] The court disagreed with this argument.[61]

In doing so, the court held that while the employer's agreement to provide training and information is ancillary to an otherwise enforceable agreement, it is not made at the time of the covenant not to compete.[62] This is because the court ruled that an agreement to provide training in the future is illusory because it is conditioned on continued employment.[63] Therefore, the court ruled, the only way to have a binding contract is if a unilateral contract is entered.[64] Pursuant to the unilateral contract, the employee promises not to disclose confidential, proprietary information. This is a unilateral contract because the employer is never bound since he could fire the employee at any time. However, the employer can accept the employee's offer not to disclose the confidential information by actually performing or, in other words, by actually training and giving access to confidential information.

The court explained that even though the employer and employee can enter into a binding, unilateral contract, the contract fails under the covenant not to compete analysis because this otherwise enforceable agreement is not made at the time of the covenant not to compete.[65] This is because the employer and employee only enter into a binding contract when the employer actually begins to provide training and access to confidential information.[66] The employer only begins to provide training and access to confidential information after the employment agreement is signed which contains the covenant not to compete.[67] Therefore, the binding contract not to disclose confidential and proprietary information in return for training is not entered into at the time the covenant not to compete is entered and hence, violates section 15.50 of the Texas Business and Commerce Code.[68]

[59] *Id.*
[60] *Id.*
[61] *Id.*
[62] *Id.* at 461.
[63] *Id.*
[64] *Id.*
[65] *Id.*
[66] *Id.* at 460-61.
[67] *Id.*
[68] *Id.*

The court noted in a footnote that this analysis causes practical problems.[69] The court stated, "even a momentary pause between [the employee's] signature and [the employer's] provision of information and training could conceivably preclude enforcement of the non-compete agreement."[70] Therefore, under this analysis, it will be rare that a covenant not to compete will be upheld when the otherwise enforceable agreement is to provide training and access to confidential information in return for a promise to not disclose confidential, proprietary information if training and access is conditioned upon continued employment.

The analysis in *Trilogy* was complicated even more due to the fact that Liu, the employee, had not only signed a nondisclosure and non-competition agreement on his first day of work but also signed the Employment Separation Agreement (ESA) when he was laid off.[71] After the court considered the agreement signed on the first day of work, the court then analyzed the effect of the ESA.[72]

The court first found that the nondisclosure agreement in the ESA was an otherwise enforceable agreement because at the time Liu signed the ESA, Trilogy had already performed.[73] Under the unilateral contract analysis outlined in *Light's* Footnote 6, the employer had accepted the employee's offer to not disclose confidential information once Trilogy provided training and information.[74] Therefore, the ESA was a binding agreement made at the time the non-compete agreement was made.[75]

Next, the court considered whether the non-compete agreement was ancillary to the employer's promise to pay the employee one month of salary at the time the agreement was made.[76] The court held that the employer's agreement to pay one month of salary was not ancillary because it was not an interest worthy of protection by the covenant not to compete.[77] The rationale is that an employer does not promise to pay an employee one month of salary to ensure that the employee will not compete for a specified period of time.

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[69] *Id.* at 461 n.6.
[70] *Id.*
[71] *Id.* at 462.
[72] *Id.*
[73] *Id.*
[74] *Id.*
[75] *Id.*
[76] *Id.*
[77] *Id.*

Finally, the court analyzed the nondisclosure agreement and held that it was an otherwise enforceable agreement made at the point in time the employee reaffirmed the non-competition covenant within the ESA.[78] The court also found that the interest of preserving the confidentiality of information was an interest worthy of protection by a covenant not to compete.[79] Just when it seemed this nondisclosure agreement and covenant not to compete were going to be held valid, the court struck down the covenant not to compete holding that the problem was consideration.[80] The court held that the employer's promise to provide confidential, proprietary information and specialized training was past consideration.[81] Therefore, there was no binding contract for an otherwise enforceable agreement and hence, the covenant not to compete failed.[82]

2. 31-W Insulation Co., Inc. v. Dickey[83] – Fort Worth Court of Appeals

The Fort Worth Court of Appeals followed the same analysis as the Austin Court of Appeals in *31-W Insulation Co., Inc. v. Dickey*.[84] In this case, Dickey, the employee, was hired by 31-W as an insulation salesman.[85] On the day he was hired, Dickey executed a Salesman Employment Agreement.[86] The promises made by the employer were to pay Dickey a commission on his sales, to reimburse his work-related expenses, to pay him a monthly automobile allowance and to give him access to 31-W's confidential information.[87] Dickey in returned promised not to disclose or use confidential information and promised not to compete with 31-W in an area within a hundred-mile radius of 31-W for six months following termination of his employment with 31-W.[88] Dickey eventually resigned due to a dispute over commission payments.[89] Dickey immediately went to

[78] *Id*. at 462.
[79] *Id*. at 462-63. This also complies with *Light's* Footnote 14.
[80] *Id*. at 463. The court cited to *Sheshunoff*, 124 S.W.3d at 687.
[81] *Id*.
[82] *Id*.
[83] 144 S.W.3d 153 (Tex. App.—Fort Worth 2004, no pet.).
[84] *Id*.
[85] *Id*. at 155.
[86] *Id*.
[87] *Id*.
[88] *Id*.
[89] *Id*. at 156.

work for a competitor within the hundred-mile radius of 31-W.[90] Dickey filed a declaratory judgment action asking the court to declare the agreement he signed unenforceable.[91] The trial court found the non-compete covenant to be invalid and 31-W appealed to the Fort Worth Court of Appeals. [92]

The Fort Worth Court of Appeals began its analysis of the covenant not to compete by setting out its three-step process.[93] First, the court stated that it would consider whether there was an agreement existing apart from the covenant not to compete.[94] Once the court excluded the covenant not to compete, the court stated its next step was to examine the remaining promises to ensure the Agreement was enforceable.[95] Finally, once the court determined there was an otherwise enforceable agreement, the court would then determine whether the non-compete agreement was ancillary to the otherwise enforceable agreement.[96]

In conducting this analysis, the court first found that there was an agreement that existed apart from the covenant not to compete.[97] After excluding the covenant not to compete, the court found that there were other promises remaining to bind the parties under the agreement the employee signed.[98]

Next, the court examined those remaining promises that existed apart from the covenant not to compete.[99] The court found the agreement that the employee would be an at-will employee was illusory because it failed "to bind the promisor who always retain[ed] the option of discontinuing employment in lieu of performance."[100]

Just like the court in *Trilogy*, the Fort Worth Court of Appeals also found that the employer's promise to provide the employee with access to its confidential information in return for the employee' nondisclosure

[90] *Id.*
[91] *Id.*
[92] *Id.*
[93] *Id.* at 157.
[94] *Id.*
[95] *Id.*
[96] *Id.*
[97] *Id.*
[98] *Id.*
[99] *Id.* at 157-58.
[100] *Id.* at 158.

promise was illusory.[101] The court held the promise was illusory because the employer could terminate the employee immediately after signing the agreement and never be obligated to provide him with any confidential information at all.[102]

While some of the remaining promises were considered illusory, there were other promises the court found non-illusory.[103] These promises included the promise by the employer to provide the employee with two-weeks' notice of termination and the employer's promise to compensate the employee during the two-week period.[104] Therefore, the court ruled there was an otherwise enforceable agreement.[105]

The third and final step was to determine whether the covenant not to compete was ancillary to the otherwise enforceable agreement.[106] The court held that the employer's promise to give the employee two-weeks' notice of termination and to compensate him during that period did not give rise to an interest worthy of protection by a covenant not to compete.[107] Therefore, the covenant not to compete was held to be invalid.[108]

3. *Strickland v. Medtronic, Inc*.[109] – Dallas Court of Appeals

Another court of appeals engaging in the same analysis as the Austin and Fort Worth Court of Appeals is the Dallas Court of Appeals in *Strickland v. Medtronic, Inc*.[110] In this case, Medtronic hired Strickland to sale cardiac rhythm management devices.[111] When she was hired, she signed an employment agreement that contained provisions preventing her from selling competitive products in the same sales territory for a period of up to 360 days following her resignation or termination.[112] Thereafter, Strickland resigned and immediately went to work for a competitor.[113]

[101] *Id*.
[102] *Id*.
[103] *Id*.
[104] *Id*.
[105] *Id*. at 159.
[106] *Id*.
[107] *Id*.
[108] *Id*.
[109] 97 S.W.3d 835 (Tex. App.—Dallas 2003, no pet.).
[110] *Id*.
[111] *Id*.
[112] *Id*.
[113] *Id*.

Strickland sued Medtronic seeking a declaratory judgment that the non-compete agreement was not enforceable.[114] The trial court granted Medtronic's temporary injunction enjoining Strickland from competing.[115] Strickland appealed.[116]

The court first considered whether the parties entered into an otherwise enforceable agreement.[117] The court noted that at-will employment would not be considered an otherwise enforceable agreement because neither the employer nor the employee is bound to perform.[118] Medtronic argued that Strickland's employment status was not at-will because Medtronic guaranteed Strickland a three-month term of employment because the agreement provided that Medtronic would give Strickland ninety-days' notice prior to terminating her without cause and because the agreement also provided that the non-compete provision would not be enforced if Strickland was discharged without cause.[119]

In deciding whether this was enough to alter the presumption of at-will employment status, the court stated that, "In order to alter the presumption of at-will employment, there must be an agreement that limits the employer's right to terminate the employee in a meaningful and special way."[120] The court found that the agreement made by Medtronic not to terminate Strickland on less than ninety days' notice did not purport to set a term of employment or limit its rights to terminate Strickland without cause.[121] The court stated that the agreement clearly indicated that Medtronic could terminate Strickland even if she was doing a good job.[122] The court also ruled that Medtronic's agreement not to enforce the covenant not to compete if Strickland was terminated without cause did not limit Medtronic's ability to terminate Strickland in any meaningful way. Therefore, the court ruled that Strickland was an at-will employee.[123]

Since at-will employment is not an otherwise enforceable agreement, the court next considered the other promises that were made in conjunction

[114] *Id*.
[115] *Id*.
[116] *Id*.
[117] *Id*. at 838.
[118] *Id*.
[119] *Id*.
[120] *Id*.
[121] *Id*.
[122] *Id*.
[123] *Id*.

with the covenant not to compete.[124] The following promises were remaining:

(1) Medtronic's promise to provide ninetydays notice of termination if Strickland was terminated without cause; (2) Medtronic's promise to compensate Strickland in the event of economic hardship resulting from the non-compete provision; (3) Strickland's promise not to use or disclose confidential information; (4) Strickland's promise to return documents and tangible items upon termination.[125]

The court first held that Medtronic's promise to provide confidential information to Strickland was illusory because it was dependent upon a period of employment, which is not possible when the employee is an at-will employee. [126] Just as the Austin and Fort Worth courts ruled, the Dallas Court of Appeals held that the agreement was illusory because "Medtronic could avoid this obligation by simply firing Strickland on the date the employment agreement was executed." [127]

Medtronic also argued that its promise to provide Strickland with "immediate training" was additional consideration.[128] The court ruled that providing Strickland with pre-study materials before she was required to execute the agreement and promising to give her training in the initial months of her employment were not enough to make a binding contract.[129] The court stated, "The relevant inquiry under section 15.50, however, is whether, at the time the agreement is made, there exists a binding promise to train."[130] The court held there was no such binding promise that existed.[131] In concluding the covenant not to compete was unenforceable, the court ruled that Medtronic's consideration which consisted of its promise to give Strickland ninety-days' notice prior to termination without cause and the promise to compensate Strickland in the event of economic hardship due to the covenant not to compete did not give rise to an interest worthy of protection by a covenant not to compete.[132]

[124] *Id*.
[125] *Id*. at 839.
[126] *Id*.
[127] *Id*.
[128] *Id*.
[129] *Id*.
[130] *Id*.
[131] *Id*.
[132] *Id*.

4. *Alex Sheshunoff Management Services, L.P. v. Johnson* – Austin Court of Appeals[133] and Texas Supreme Court[134]

In *Alex Sheshunoff Management Services, L.P. v. Johnson*, the Austin Court of Appeals again followed this same rational in ruling that a covenant not to compete was unenforceable.[135] Thereafter, the Texas Supreme Court granted petition for review and heard oral arguments on November 10, 2004.[136] On October 20, 2006, the Texas Supreme Court issued its ruling clarify the standard used in determining whether a covenant not to compete is enforceable.[137]

In *Johnson*, the employee, Johnson, was employed by Alex Sheshunoff Management Services, L.P. ("ASM").[138] ASM provided consulting services to financial institutions.[139] Johnson worked for three years when the director of human resources asked him to sign an employment agreement that contained a covenant not to compete.[140] Johnson told the director of human resources he would not sign the agreement.[141] Later, Johnson was promoted to Director of Affiliation and his responsibilities were to oversee a program in order to develop and maintain relationships with financial institutions.[142] After working at this position for a few months, Johnson was told that as a member of senior management he had no choice but to sign the agreement.[143] Johnson complied.[144]

The agreement contained a promise by ASM to provide training and access to confidential information.[145] ASM also agreed to give Johnson two-weeks' notice before terminating him as long as his termination was not due to misconduct.[146] In return, Johnson agreed that while he was employed by ASM and for one year after, he would not "solicit or aid any

[133] 124 S.W.3d 678 (Tex. App.—Austin 2003, pet. granted).
[134] *Johnson*, No. 03-1050, 2006 Tex. LEXIS 1039 (Tex. Oct. 20, 2006).
[135] *Id*.
[136] No. 03-1050, 2004 Tex. LEXIS 885 (Tex. September 10, 2004).
[137] *Johnson*, 2006 Tex. LEXIS 1039.
[138] *Johnson*, 124 S.W.3d at 681.
[139] *Id*.
[140] *Id*.
[141] *Id*.
[142] *Id*.
[143] *Id*.
[144] *Id*.
[145] *Id*. at 685.
[146] *Id*.

other party in soliciting any affiliation member or previously identified prospective client or affiliated member."[147]

Four years later, Johnson resigned.[148] Johnson told ASM that he was leaving the company to work for a competitor, Strunk.[149] ASM informed Strunk of Johnson's covenant not to compete.[150] Strunk informed ASM that Johnson considered the covenant not to compete unenforceable.[151] Eventually, Strunk filed a declaratory judgment action asking the court to find the covenant not to compete unenforceable.[152] Both Strunk and Johnson filed motions for summary judgment and the district court granted the motions on the grounds that the covenant not to compete was unenforceable.[153] ASM appealed this judgment.[154]

The appellate court started its analysis by stating that "A covenant not to compete is a disfavored contract in restraint of trade and is unenforceable unless it meets certain statutory requirements."[155] The court then explained that when a covenant not to compete is contained in an employment agreement in which the primary purpose is to render personal services, the employer has the burden to prove that the covenant not to compete meets the statutory criteria.[156]

In conducting the analysis outlined by section 15.50 of the Texas Business and Commerce Code, the appellate court broke its analysis into two main inquires: (1) whether there was an otherwise enforceable agreement and (2) whether the covenant not to compete was ancillary to the otherwise enforceable agreement.[157] In analyzing the first requirement, the court first cited to basic contract law and stated, "The 'otherwise enforceable agreement' must, like any contract, be supported by

[147] *Id*.
[148] *Id*. at 681.
[149] *Id*.
[150] *Id*.
[151] *Id*. at 682.
[152] *Id*.
[153] *Id*.
[154] *Id*.
[155] *Id*. at 684 (citing to Tex. Bus. & Com. Code Ann. §§ 15.05, 15.50 (West 2002); *Travel Masters, Inc. v. Star Tours, Inc*., 827 S.W.2d 830, 832 (Tex. 1991); *Miller Paper Co. v. Roberts Paper Co*., 901 S.W.2d 593, 599 (Tex. App.—Amarillo 1995, no writ).
[156] *Id*. (citing to Tex. Bus. & Com. Code § 15.51(b) (West 2002).
[157] *Id*.

consideration."[158] Since the parties were in agreement that the employee's status was at-will, the court cited to well-established law by stating, "Standing alone, an at-will employment relationship does not constitute an otherwise enforceable agreement because it is 'illusory,' meaning not binding on either the employer or the employee."[159] While the at-will employment status could not be an otherwise enforceable agreement, the court stated that other promises not conditioned upon continued employment could satisfy this requirement.[160]

The court looked at the parties' promises in the employment agreement.[161] ASM agreed to provide Johnson special training and access to confidential information and also promised to give him at least two-weeks' notice before terminating him for any reason other than misconduct.[162] Johnson in return promised to keep the confidential information strictly confidential, to not solicit or aid any other party in soliciting any prospective clients for one year after termination and to give two-weeks' notice before terminating his employment.[163]

The main argument between the parties was whether ASM's promise to provide special training and access to confidential information was illusory.[164] The court stated that the relevant inquiry was "whether ASM's promise was binding at the time the agreement was made."[165] ASM argued that Johnson was continually provided with confidential information because their confidential databases changed daily.[166] Therefore, ASM argued, that since the database changed daily, the information Johnson received after signing the employment agreement was different than the information he had access to before signing the agreement.[167] ASM asserted that this was therefore valid consideration.[168] ASM also argued that its agreement to give Johnson at least two-weeks' notice prior to

[158] *Id*.

[159] *Id*. (citing to *Light*, 883 S.W.2d at 645; *Martin v. Credit Prot. Ass'n*, 793 S.W.2d 667, 669 (Tex. 1990)).

[160] *Id*.

[161] *Id*. at 685.

[162] *Id*.

[163] *Id*.

[164] *Id*.

[165] *Id*.

[166] *Id*.

[167] *Id*.

[168] *Id*.

terminating him would give Johnson the right to receive confidential information during the notice period.[169]

Strunk countered ASM's argument by stating that Johnson already had access to the confidential information on the databases before signing the employment agreement.[170] Strunk argues that Johnson received nothing new at the time of signing the agreement, therefore rendering the consideration past consideration.[171] In addition, Strunk argued that the promise to train and give confidential information was illusory because ASM could have fired Johnson at any time after the parties signed the agreement which would mean that ASM was never legally bound to perform.[172]

In considering both parties' arguments, the Austin Court of Appeals stated that in order to determine whether a covenant not to compete is enforceable, the court must disregard the covenant not to compete and focus on the remaining promises.[173] In doing so, the court stated that in evaluating the remaining promises it must look at the time the agreement was made and determine whether there exists mutually binding promises to which the covenant not to compete is ancillary.[174] The court held, "The fact that ASM gave new confidential information and training to Johnson some time *after* entering into the agreement will not suffice; we must evaluate the consideration given at the time the agreement was made."[175] In addition, the court also ruled that information and training Johnson received *before* signing the agreement would also not support its promises in the agreement.[176] "Consideration is a present exchange bargained for in return for a promise."[177]

In arguing that ASM's promise to give Johnson access to confidential information and training was sufficient consideration for the otherwise enforceable agreement, ASM cited and relied heavily on *Light's* Footnote

[169] *Id*.
[170] *Id*.
[171] *Id*.
[172] *Id*. at 685-86.
[173] *Id*. at 686.
[174] *Id*.
[175] *Id*. (emphasis added).
[176] *Id*.
[177] *Id*.

14.[178] The court ruled that ASM misunderstood *Light's* Footnote 14.[179] The court stated, "Under *Light*, a *promise* to give confidential information is not sufficient. The employer must actually give the confidential information in return for the employee's promise not to disclose it."[180] In so holding, the court ruled that there was no evidence of new confidential information or training given to Johnson at the time he entered into the employment agreement.[181]

The court also stated that ASM's promise to give Johnson access to training and confidential information in the future was illusory because "ASM could have fired Johnson immediately after he signed the agreement and escaped its obligation to perform."[182] ASM argued that this promise was not illusory due to the two-week notice period it promised to give Johnson.[183] The court held that this argument was without merit and stated,

It is difficult to believe that ASM would have given Johnson access to new confidential information in the interim, in light of the fact that Johnson's access to confidential information was conditioned on assisting him in the performance of his duties and Johnson was sent home with pay after ASM learned he was leaving the company to work for Strunk. There is simply no support in the record for this bald assertion.[184]

Switching back to contract law, the court then stated that the agreement to provide training and access to confidential information in return for Johnson's promise to not disclose the confidential information was really a unilateral contract because ASM's promise was an illusory promise since it was conditioned upon continued performance.[185] It is here that the court cites to Footnote 6 in the *Light* opinion.[186] In citing to Footnote 6 of the

[178] *Id.* ASM also relied on another case that stated that an employer's promise to provide confidential information in return for the employee's promise of nondisclosure was non-illusory and sufficient consideration. The court noted, however, that these opinions do not show that the employee challenged this but in stead the employee only challenged the geographic restrictions. *See Curtis v. Ziff Energy Group Ltd*., 12 S.W.3d 114, 116 (Tex. App.—Houston [14th Dist.] 1999, no pet.).

[179] *Id*. at 686-87.

[180] *Id*. at 687.

[181] *Id*.

[182] *Id*.

[183] *Id*.

[184] *Id*.

[185] *Id*.

[186] *Id*.

Light opinion, the Austin Court of Appeals ruled that the unilateral contract was not sufficient to support the covenant not to compete because the unilateral contract was not entered at the same time the covenant not to compete was entered.[187]

Under basic contract law, a unilateral contract is only made binding when the promisee begins to perform.[188] Here Johnson was the promisor and he promised he would not disclose confidential information if ASM would promise to provide training.[189] ASM could only accept this unilateral contract by first performing, or giving Johnson training and access to information.[190] Since ASM could only possibly give access to information and training at some point in the future, the contract was not actually binding until after the covenant not to compete was entered which, thus violated section 15.50 of the Texas Business and Commerce Code. [191]

After disregarding the agreement not to disclose confidential, proprietary information in return for ASM's promise to give access to confidential information and training, the court then focused on the remaining promise.[192] The remaining promise was ASM's promise to give Johnson two-weeks' notice before terminating him for anything other than misconduct.[193] The court ruled that this was an otherwise enforceable agreement.[194]

Since the court determined that an otherwise enforceable agreement existed, the court next had to decide whether the covenant not to compete was ancillary to this promise.[195] The court stated that ASM's promise to give at least two-weeks' notice before terminating Johnson did not give rise to ASM's interest in restraining Johnson from competing.[196] Therefore, the

[187] *Id*.

[188] *Id*.

[189] *Id*.

[190] *Id*.

[191] *Id*. The Texas Business and Commerce Code states "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*." TEX. BUS. & COM. CODE ANN. § 15.50(a) (Vernon 2004).

[192] *Id*. at 688.

[193] *Id*.

[194] *Id*.

[195] *Id*.

[196] *Id*. (citing to *Light*, 883 S.W.2d at 647; *Strickland v. Medtronic, Inc.*, 97 S.W.3d 835, 839 (Tex. App.—Dallas 2003, no pet.); *Donahue v. Bowles, Troy,*

appellate court ruled the covenant not to compete was unenforceable.[197]

ASM appealed and approximately two years after hearing oral arguments, the Texas Supreme Court issued its opinion.[198] The court specifically stated that it was not disturbing its holding in *Light* because in *Light*, the employee never promised not to disclose confidential information but instead the employee only promised to give an inventory and provide fourteen days notice prior to termination.[199] The court stated that *Light's* covenant was not enforceable because it was "not designed to enforce any of Light's return promises in the otherwise enforceable agreement."[200]

This was not the case in *Johnson* because the employee actually promised not to disclose confidential information in return for a promise by the employer to train and provide confidential information.[201] Therefore, the court found that the covenant not to compete was ancillary.[202] However, the court then stated that under *Light*, the otherwise enforceable agreement was not enforceable at the time the Agreement was signed.[203] The court stated that the Austin Court of Appeals was correct in finding that the otherwise enforceable agreement to provide training and confidential information in return for the employee's promise not to disclose confidential information illusory.[204] ASM could very well fire Johnson immediately after the agreement was signed and before providing any confidential information or specialized training.[205] Therefore, the otherwise enforceable agreement between ASM and Johnson was a unilateral contract.[206]

This is the point in the analysis that the Texas Supreme Court deviates from it previous opinion in *Light*. The court states that it agrees with *Light's* analysis of unilateral contracts in that if one promise is illusory, a

Donahue, Johnson, Inc., 949 S.W.2d 746, 752 (Tex. App.—Dallas 1997, pet. denied).

[197] *Id*.

[198] *Johnson*, No. 03-1050, 2006 Tex. LEXIS 1039 (Tex. Oct. 20, 2006).

[199] *Id*. at *8, 12.

[200] *Id*. at *10.

[201] *Id*. at *11.

[202] *Id.*

[203] *Id.*

[204] *Id.* at *13.

[205] *Id.*

[206] *Id.*

unilateral contract can still be formed.[207] The non-illusory promise, the employee's promise not to disclose confidential information, can serve as an offer which the promisor, the employer, can accept by performance or by actually giving training or confidential information.[208] However, the court then provides its new stance on covenants not to compete by stating, "[W]e disagree with footnote six [of *Light*] insofar as it precludes a unilateral contract made enforceable by performance from ever complying with the Act because it was not made at the time [the Agreement] was made."[209]

The court reviewed the language in section 15.50 and analyzed the words "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."[210] The court found that the clause "at the time the agreement is made" can modify either "otherwise enforceable agreement" or ancillary to or part of."[211] *Light's* analysis assumes that the clause "at the time the agreement is made" modifies "otherwise enforceable agreement."[212] The court disagrees with this interpretation and now holds, "We now conclude, contrary to *Light*, that the covenant need only be 'ancillary to or part of' the agreement at the time the agreement is made. Accordingly, a unilateral contract formed when the employer performs a promise that was illusory when made can satisfy the requirements of the Act."[213]

In stating this new stance on the reading of section 15.50, the court found that there is no reason why a unilateral contract made enforceable by performance should fail under the Covenant Not to Compete Act.[214] The

[207] *Id.* at *15.

[208] *Id.*

[209] *Id.* The court further states that this part of the *Light* opinion was not essential to its holding and was mere dicta. *Id.* at *15. In *Light*, the contract was not a unilateral contract but instead was an enforceable bilateral contract because the employer made a promise to provide initial training regardless of whether the employee remained employed in the future. *Id.* The court found that the employer would have been bound by its promise to provide the initial training even if the employer fired the employee immediately after signing the agreement. *Id.* The covenant in *Light* did not fail because the otherwise enforceable agreement was not made at the time of the covenant not to compete but instead because the otherwise enforceable agreement was not ancillary. *Id.*

[210] *Id.* at *16 (citing TEX. BUS. & COM. CODE ANN. § 15.50(a) (Vernon 2004)).

[211] *Id.*

[212] *Id.*

[213] *Id.* at *17.

[214] *Id.*

court stated that it understood that a covenant not to compete cannot be supported by a standalone promise by the employee not to disclose information without sufficient consideration by the employer.[215] However, if the employer actually performs under the unilateral contract by providing the training and confidential information, the otherwise enforceable agreement becomes binding and non-illusory at that instance.[216]

The legislative history for the Covenant Not to Compete Act provides that there was an amendment to the original version of the bill.[217] The amendment was meant to address situations whereby a covenant not to compete is executed after the date the underlying employment agreement is executed.[218] The amendment stated, "if the covenant not to compete is executed on a date other than a date on which the underlying agreement is executed, such covenant must be supported by independent valuable consideration."[219] Further, other amendments of the Act indicate that the legislature wanted to make clear that covenants not to compete are applicable to at-will employment situations and that the statute prevails over contrary common law.[220] Therefore, there is nothing in the legislative history that prohibits unilateral contracts offered to support a covenant not to compete.[221]

C. How To Make an Enforceable Covenant Not to Compete under Light and Johnson

Johnson is a huge relief for current employers seeking to draft employment agreements with enforceable covenants not to compete. Prior to *Johnson*, the only true way to ensure a covenant not to compete was enforceable was either to provide a term of employment or for the employer to promise to provide initial training regardless of whether the employee

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[215] *Id.*

[216] *Id.*

[217] *Id.* at *20. The original version of the bill only stated that the covenant had to be (1) ancillary to an otherwise enforceable agreement and (2) contain reasonable limitations as to time, geographical area, and scope of activity to be restrained. Tex. S.B. 946, 71st Leg., R.S. (1989)(original version of bill).

[218] *Id.*

[219] *Id.* (citing Act of May 23, 1989, 71st Leg., R.S., ch. 1193, § 1, 1989 Tex. Gen. Laws 4852).

[220] *Id.* at *22 (citing HOUSE COMM. ON BUS. & INDS., BILL ANALYSIS, Tex. H.B. 7, 73d Leg., C.S. (1993)).

[221] *Id.*

resigned or was fired after the agreement was executed.[222] Under a pre-*Johnson* analysis, if the employer did not want to offer a term of employment, the employer and the employee would have to enter into an "otherwise enforceable agreement" to provide specialized training that would give the employee confidential and proprietary information. This special training, however, could not be conditioned upon continued employment. Instead, the employer would have to specify that the employee could participate in the specialized training regardless of his employment status. So long as the specialized training is not conditioned upon continued employment, the promise made by the employer to give this specialized training will not be considered illusory.

For example, under the pre-*Johnson* analysis, the employer would have to state in the agreement that specialized training will take place on a specific date and state in the agreement that the employee can receive this training regardless of whether the employee is still employed or not. The specialized training can take place in a seminar setting on a specific date or over the course of a few days. Second, the employee's return promise must be to not disclose the confidential, proprietary information given by his employer. If the agreement specifies that the employee agrees to not disclose confidential, proprietary information in return for the employer's promise to provide specialized training that is not conditioned upon continued employment, the agreement is enforceable when the court then asks whether the covenant not to compete is ancillary to the otherwise enforceable agreement. This is true even today under the *Johnson* analysis.[223]

Post-*Johnson*, all the employer has to do is ensure that its employment agreements contain the covenant not to compete and the otherwise enforceable agreement, which is (1) a promise by the employer to provide training and/or confidential, proprietary information to the employee and (2) a promise by the employee not to disclose the company's confidential information. The otherwise enforceable agreement is a unilateral contract consisting of a promise by the employee not to disclose confidential information. Once the employer performs by giving the employee confidential information and/or training, a binding otherwise enforceable agreement is made supporting the covenant not to compete.

[222] *Light v. Centel Cellular Co. of Tex*., 883 S.W.2d 642, 646 (Tex. 1994).

[223] *See Johnson*, 2006 Tex. LEXIS 1039 at *13 (noting the difference between *Light* and *Johnson* in that in *Light* the employer actually made a binding, bilateral promise because it did not condition the training on continued employment).

D. Other Issues Not Specifically Addressed by the Johnson Opinion

The *Johnson* opinion only specifically addresses issues regarding unilateral contracts as otherwise enforceable agreements. While the opinion helps to clear some uncertainty, unanswered questions still remain. For example, can a party to an agreement containing a covenant not to compete come before the court and raise affirmative defenses such as promissory estoppel or unclean hands? Another question is whether an employer can argue that the otherwise enforceable agreement is supported by an implied promise to provide confidential information. Finally, there is also a doubt as to whether the otherwise enforceable agreement can consist of promises other than a promise to provide training or confidential information. These issues are briefly addressed below.

1. Can a party to an agreement containing a covenant not to compete come before the court and raise affirmative defenses such as promissory estoppel or unclean hands?

The *Johnson* opinion briefly raises an issue that has been a pending question on many practitioners' minds – whether the employer can assert affirmative defenses when the employee argues that the covenant not to compete is unenforceable. Prior to *Johnson,* Texas became known as one of the most difficult states for employers to establish enforceable covenants not to compete. This notion became so widely known, that employees would know at the time of signing employment agreements containing covenants not to compete that the covenants would not be enforce by the courts. Therefore, the common practice after an employee was terminated and after receiving all the benefits under the employment contract, was that the employee would then go to the court and file a declaratory judgment action seeking to have the court declare that his or her covenant not to compete was unenforceable. The common response by the employer is always "but had we known that the employee was not going to abide by his promise, we never would have given him access to confidential information and we never would have given him the benefits he received under the agreement."

The issue of whether the employer can assert affirmative defenses such as promissory estoppel and unclean hands arises as a result of section 15.52 of the Texas Business and Commerce Code which states:

The 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.

TEX. BUS. & COM. CODE § 15.52 (Vernon Supp. 1994) (emphasis added). The statute provides that the Covenant Not to Compete Act preempts all other procedures and remedies under common law but does not specifically address common law affirmative defenses such as estoppel and unclean hands.

In *Light*, the court addressed section 15.52 by stating, "Section 15.52 makes clear that the Legislature intended the Covenants Not to Compete Act to largely supplant the Texas common law relating to enforcement of covenants not to compete. Thus, we apply the Covenants Not to Compete Act to the facts of this case, in lieu of '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.'"[224] Again, the court never specifically addresses common law affirmative defenses.

Since *Light*, other courts have briefly addressed section 15.52 in determining whether a party can sue for breach of a fiduciary duty and in determining the standard for preliminary injunctions.[225] For example, in *RenewData Corp. v. Strickler*, an employer sued a former employee after the employee started working for a competitor for violating his covenant not to compete and nondisclosure agreements and for breaching a fiduciary duty.[226] The employee argued that section 15.52 provides that if there is a noncompetition agreement, an action for breach of fiduciary duty is

[224] *Light*, 883 S.W.2d at 644.

[225] *See Cardinal Health Staffing Network, Inc. v. Bowen*, 106 S.W.3d 230, 239 (Tex. App.—Houston [1st Dist.] 2003, no pet.) (holding the Legislature intended *section 15.51(a)* govern only final remedies and therefore, the standard for preliminary injunction for violations of covenants not to compete are applicable); *NMTC Corp v. Conarroe*, 99 S.W.3d 865, 868 (Tex. App.—Beaumont 2003, no pet.) (holding the same); *Butler v. Arrow Mirror & Glass, Inc*., 51 S.W.3d 787, 795 (Tex. App.—Houston [1st Dist.] 2001, no pet.) (holding that a showing by the promisee of an irreparable injury for which he has no adequate legal remedy is not a prerequisite for obtaining injunctive relief under the Covenants Not to Compete Act).

[226] No. 03-05-002 73-CV, 2006 Tex. App. LEXIS 1689, at *1 (Tex. March 3, 2006).

preempted by the Covenants Not to Compete Act.[227] Without really addressing the issue, the court apparently accepted the employer's argument that it is well-settled law that a claim based on an employee's use of a former employer's information is not governed or preempted by the Covenants Not to Compete Act.[228] The court cited to *Rugen v. Interactive Bus. Sys., Inc.* that held:

[A]s a general rule, in the absence of an enforceable agreement not to compete, an employer is not entitled to an injunction preventing a former employee from soliciting the employer's clients. But it is well established that even without an enforceable contractual restriction "a former employee is precluded from using for his own advantage, and to the detriment of his former employer, confidential information or trade secrets acquired by or imparted to him in the course of his employment."[229]

The only case that comes close to addressing the affirmative defense issue is *National Café Services, Ltd. v. Podaras*.[230] In this case, Podaras signed an operating agreement with a company to run a café in the lobby of a downtown Houston theater.[231] In order to secure financing pursuant to the operating agreement, Podaras formed a limited partnership called National Café with Podaras acting as general partner.[232] The partnership agreement contained a covenant not to compete for a period of one year after Podaras' employment terminated unless otherwise expressly agreed in writing by the limited partner.[233]

Podaras' café did not succeed and Podaras was unable to satisfy his financial obligation under the partnership agreement.[234] Thereafter, Podaras signed an agreement with a different company that did three things: (1) assigned Podaras' interest in National Café to a new company, (2) released him from further liability under the partnership agreement and (3) released the new company and National Café from any claim which Podaras may have had as of the date of the agreement.[235] The agreement also expressly stated that all of the provisions of the partnership agreement were in full

[227] *Id.* at *31.
[228] *Id.* at *33.
[229] 864 S.W.2d 548, 551 (Tex. App.--Dallas 1993, no writ).
[230] 148 S.W.3d 194 (Tex. App.—Waco 2004).
[231] *Id.* at 195.
[232] *Id.* at 196.
[233] *Id.*
[234] *Id.*
[235] *Id.*

force and effect.[236]

Podaras then sought to open a bar nearby and National Café sent the new bar's potential investors letters advising them of Podaras' covenant not to compete.[237] The investors backed out of the deal and Podaras sued National Café alleging that the covenant not to compete was unenforceable and sought summary judgment on this issue.[238] National Café responded by asserting the affirmative defense of release.[239]

Podaras argued at the summary judgment stage that section 15.52 preempts common law affirmative defenses.[240] In response to that argument, the court stated that section 15.52 preempts the common law in two respects: "(1) it provides that the criteria of section 15.50 are the exclusive criteria for determining the enforceability of a covenant not to compete; and (2) it provides the exclusive "procedures and remedies in an action *to enforce* a covenant not to compete."[241]

The court stated that section 15.52 did not preempt National Café's affirmative defense of release because Podaras did not file suit to *enforce* the covenant not to compete and because National Café does not contend that the release makes the covenant enforceable.[242] Instead, National Café was asserting the affirmative defense of release to prevent Podaras from contesting enforceability at all.[243]

Again, *Podaras* does not directly address the issue of whether affirmative defenses are available to an employer when the employee files a declaratory judgment action. Like *Podaras*, the employer is not the party bringing the action – instead it is the employee. Additionally, unclean hands and estoppel are not procedures and/or remedies but instead are affirmative defenses. Therefore, it could be argued that section 15.52 does not preclude an employer from asserting affirmative defenses like estoppel and unclean hands in response to a declaratory judgment action. With both unclean hands and estoppel, the employer appears before the court and

[236] *Id.* at 196.

[237] *Id.*

[238] *Id.*

[239] *Id.* at 197.

[240] *Id.*

[241] *Id.* at 200 (emphasis in original); *see also Gage Van Horn & Assocs., Inc. v. Tatom*, 26 S.W.3d 730, 733 (Tex. App.--Eastland 2000 pet. denied).

[242] *Id.*

[243] *Id.*

pleads that even if the court finds that the covenant not to compete is unenforceable, the court should still hold the employee to his promise because he received consideration for a promise he is now seeking to break. This situation is not the same as a scenario where the employer goes to the court seeking to enforce a covenant not to compete. As a result, it is entirely possible for an employer to assert affirmative defenses like unclean hands and estoppel and prevail.

This argument is supported by the majority opinion in *Johnson*.[244] In footnote 8 of *Johnson*, the court addresses a concern by Chief Justice Jefferson.[245] Chief Justice Jefferson argues in his concurrence that the court's unlimited ruling would allow an employer to wait months or even years after the employee signs the employment agreement to comply with its promise to provide specialized training or confidential information.[246] Further, Chief Justice Jefferson argues that under the majority's ruling, an employer could "easily refrain from sharing trade secrets or other specialized technical knowledge with an employee for a substantial period of time after the covenant is signed, only to quickly perform once the employee indicates an intention to leave his current job for the employer's competitor."[247] To ensure this does not occur, Chief Justice Jefferson would hold that "at the time" requires both that "the employer's promise be tied to the covenant as part of the same transaction, and that the employer tender consideration within a reasonable time after the covenant is signed."[248]

The majority opinion addresses this concern by stating that such "one-sided gamesmanship" should not be tolerated by the courts.[249] In doing so, the court states that when the employer comes to the court seeking an injunction, the court can use its equitable principles to prevent the employer from prevailing.[250] Specifically, the court states, "the court could easily conclude that the employer's unclean hands in such circumstances renders it ineligible for injunctive relief."[251]

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[244] *Alex Sheshunoff Mgmt. Servs., L.P. v. Johnson*, No. 03-1050, 2006 Tex. LEXIS 1039, at *31 n.8 (Tex. Oct. 20, 2006).

[245] *Id.*

[246] *Id.* at *36 (Jefferson, J. concurring).

[247] *Id.* at *50.

[248] *Id.* at *51.

[249] *Id.* at *31 n.8.

[250] *Id.*

[251] *Id.*

Chief Justice Jefferson disagrees with the majority's argument in his concurrence.[252] Citing to Texas Business and Commerce Code section 15.50(a), he states:

Moreover, the circumstances behind the covenant's formation are not, as the Court suggests, subject to equitable review. Nor should they be if, as the Court holds, the contract is enforceable as a covenant the moment it is signed. By statute a court in equity reviews not the covenant's formation, but its reasonableness in respect to time, geographical area, and scope of activity.[253]

Relying on the majority's argument, however, it is possible for an employer to assert the affirmative defenses of estoppel and unclean hands and prevail after being sued by the employee for declaratory relief. The Texas Supreme Court has stated that an action under a statute providing for declaratory judgment is equitable in nature.[254] While it is more likely classified as neither legal nor equitable, but *sui generis*, due to the equitable nature of a declaratory judgment, it could be argued that the doctrines of unclean hands and estoppel should apply just as the Texas Supreme Court says they apply to actions for an injunction.[255]

2. Can the otherwise enforceable agreement be supported by an implied promise to provide confidential information?

Johnson provides a clear formula for crafting an enforceable covenant not to compete. However, what happens when you have an existing employment agreement that does not comply with *Johnson*? The employer has a few options: (1) find additional, new consideration which can take the form of new, specialized training or new confidential, proprietary information; (2) offer the employee employment for a specified term or (3) find a way to make the existing agreement work.

Under option (3), some employer have reviewed their current employment agreements and have realized that while the employment agreement may have a promise by the employee not to disclose confidential information, the employer never expressly states in the agreement that it is going to provide the employee confidential information or specialized

[252] *Id.* at *52-53.
[253] *Id.*
[254] *Cobb v. Harrington*, 144 Tex. 360, 190 S.W.2d 709 (1945).
[255] *Id.*

training. This is especially true in situations where it is a matter of necessity that the employee receives confidential information.

For example, suppose a company is seeking to hire a CEO. The company finds the perfect match and has the new CEO enter into an employment agreement containing a covenant not to compete. Unfortunately, this all occurs before *Johnson* and therefore, the company does not have the easy to follow blueprint given by the Texas Supreme Court. The employment agreement has numerous provisions defining confidential information and providing that the CEO is never to disclose confidential information. However, the agreement never expressly provides a promise by the employer to provide the CEO with confidential information or specialized training. Is this detrimental to the covenant not to compete? Not necessarily.

Johnson stands for the proposition that an employer's promise to provide confidential information or specialized training at the time of contracting with an at-will employee is invalid as illusory because the employer could fire the employee immediately after signing the agreement. Therefore, the only true promise is the employee's promise to not disclose confidential information. *Johnson* says this is perfectly acceptable provided that the employer eventually accepts the employee's offer not to disclose confidential information by eventually performing – by providing the confidential information or training. This same analysis could apply for an implied promise to give confidential information or training.

For example, in *CRC-Evans Pipeline Int'l, Inc. v. Myers*, the court recognized that some positions require initial, specialized training or confidential information in order for the employee to be able to perform new duties.[256] In those instances, the employee would be unable to function without the new training or new information and as such, an implied promise to provide confidential information or specialized training could satisfy the employer's promise for the otherwise enforceable agreement.[257]

In *Myers*, the court addressed a situation in which an employee worked for the employer in the past and came back to the employer after a number of years for re-employment at the same position.[258] When the employee returned, the employer required the employee to sign an employment

[256] 927 S.W.2d 259, 264 (Tex. App.—Houston [1st Dist.] 1996, no writ).
[257] *Id*.
[258] *Id.*

agreement containing the covenant not to compete.[259] The employee was in the same position as he had previously been in and was not provided with any new information or specialized training after signing the employment agreement.[260] The court found that there was no express or implied promise to provide the employee with new training or information since the employee had already worked in the same position for the same company in years past.[261] As a result, the covenant not to compete was unenforceable.[262]

However, the court recognized that this will not always be the case.[263] When an employee takes a position that would necessarily require access to new information and/or training, the court can find that the employer made an implied promise.[264] This practical approach allows the court to look realistically at the situation to determine whether the employee was given confidential information or specialized training. The court is able to look at the facts of the case to determine whether the employee must have immediate access to confidential information and/or training to perform the duties of his or her job.[265] Therefore, it can be argued that an implied promise by the employer may be used to establish the otherwise enforceable agreement that is ancillary to the covenant not to compete.

3. Can the otherwise enforceable agreement consist of promises other than a promise to provide training or confidential information?

Light's Footnote 14 provides that an employer's promise to provide confidential information or specialized training in return for the employee's promise not to disclose the confidential information is a promise that is ancillary to the covenant not to compete because it gives rise to the employer's interest in restraining the employee's ability to compete. When employers are unable to establish such a promise, they advance many different arguments in an effort to establish a valid, non-illusory promise that is ancillary to the covenant not to compete. However, most of the time,

[259] *Id.*
[260] *Id.*
[261] *Id.*
[262] *Id.* at 265.
[263] *Id*.
[264] *Id*.
[265] *Id*.

the employers fail.

One commentator correctly noted, "given the constraints imposed by the court's interpretation of Section 15.50, it is difficult to think of any other agreement between an employer and an at-will employee that would qualify as an 'otherwise enforceable agreement' to which a covenant not to compete could be ancillary."[266] In fact, Texas courts have rejected most arguments by the employer that anything but a promise to train and provide confidential information is ancillary to the covenant not to compete.

Some employers have promised to pay the employee money or give the employee notice prior to terminating the employee in return for the employee's promise not to compete. However, many courts have held that "a pecuniary interest or promises by an employer to give notice before termination are not interests worthy of a non-competition covenant.[267] In

[266] Ernest C. Garcia and Fred A. Helms, *Legal Article: The State of the Law in Texas: Covenants Not to Compete & Not to Disclose*, 64 Tex. B.J. 32, 34 (January 2001).

[267] *Trilogy Software, Inc. v. Callidus Software, Inc.*, 143 S.W.3d 452, 462-63 (Tex. App.—Austin 2004, pet. filed) (citing *Strickland v. Meditronic, Inc.*, 97 S.W.3d 835, 839 (Tex. App.—Dallas 2003, pet. dis'd w.o.j.)); *see also 31-W Insulation Co. v. Dickey*, 144 S.W.3d 153, 158 (Tex. App.—Fort Worth 2004, pet withdrawn) (holding that an employer's promise to compensate the employee for two-weeks after termination did not give rise to the employer's interest in restraining the employee from competing); *Alex Sheshunoff Mgmt. Servs., L.P. v. Johnson*, 124 S.W.3d 678, 687-88 (Tex. App.—Austin 2003, pet. granted) (holding that a two-week notice was not sufficient consideration and stating, "It is difficult to believe that [the employer] would have given [the employee] access to new confidential information in the interim, in light of the fact that [the employee's] access to new confidential information was conditioned on assisting him in the performance of his duties and [the employee] was sent home with pay after [the employer] learned he was leaving the company to work for [a competitor]; *Strickland v. Medtronic, Inc*., 97 S.W.3d 835, 839-40 (Tex. App.—Dallas 2003, pet. dism'd w.o.j.)(holding that the employer promise to provide 90-days notice of termination if the employee was terminated without cause and to compensate the employee in the event of economic hardship resulting from the non-compete provision do not give rise to an interest worthy of protection by a covenant not to compete); *Anderson Chem. Co. v. Green*, 66 S.W.3d 434, 439 (Tex. App.—Amarillo 2001, no pet.) (holding that the employer's promise to give 10-days' notice prior to a termination of the employee's employment is not sufficient to give rise to any interest it might have in restraining the employee from competition); *Am. Fracmaster, Ltd. v. Richardson*, 71 S.W.3d 381, 389-89 (Tex. App.—Tyler 2001, pet. granted, judgm't vacated w.r.m.) (holding that the employer's promise to

doing so, court have rejected employers promises to give anywhere from two weeks notice to twelve weeks notice of termination.[268]

However, some courts have ruled otherwise. For example, in *Rimkus Consulting Group, Inc. v. Phillips*,[269] the court found that an employer's promise of three-weeks severance pay was not illusory because it was a promise to which the employee could have bound the employer. Instead of the employer having the exclusive control over whether the employee received additional compensation, the court found that the severance pay was a promise the employee could use to bind the employer at the employee's option, thus making the consideration non-illusory.[270]

Additionally, in *Totino v. Alexander & Associates, Inc*.,[271] at-will employees argued that their covenants not to compete were not enforceable because they were not supported by non-illusory consideration. In addition to finding that the employee's promise not to disclose confidential information was non-illusory consideration supporting the covenant not to compete, the court also held that a company's stock option plan was sufficient non-illusory consideration ancillary to the covenant not to compete.[272] In doing so, the court found that stock option plans that are based on the employee's performance, designed to encourage continued

give 12-months notice of termination and pay him $182,083 in the event of termination does not give rise to the employer's interest in restraining the employee from competition); *Totino v. Alexander & Associates, Inc*., No. 01-97-01204-CV, 1998 Tex. App. LEXIS 5295, at *8-27 (Tex. App.—Houston [1st Dist.] 1998, no pet.) (unpublished opinion) (holding that that the 14-day notice of termination was not designed to enforce the noncompetition covenant and that the promise to pay the employee $7,500 after termination did not give rise to the employer's interest in restraining the employee from competing); *Donahue v. Bowles, Troy, Donahue, Johnson, Inc*., 949 S.W.2d 746, 751-52 (Tex. App.—Dallas 1997, pet. denied) (holding that the employer's promise to give thirty days' notice does not give rise to its stated interest in restraining the employee from competing).

[268] *Id.*

[269] No. 10-00-220-CV, 2003 Tex. App. LEXIS 149, at *18 (Tex. App.—Waco Jan. 8, 2003, no pet.) (unpublished opinion) (opinion withdrawn).

[270] *Id*.; *but see Richardson*, 71 S.W.3d at 389-89 (holding that the employer's promise to give 12-months notice of termination and pay him $182,083 in the event of termination does not give rise to the employer's interest in restraining the employee from competition).

[271] No. 01-97-01204-CV, 1998 Tex. App. LEXIS 5295, at *17 (Tex. App.—Houston [1st Dist.] Aug. 20, 1998, no pet.) (unpublished opinion)

[272] *Id.* at *25.

employment and influence future performance and made dependent on the employee's agreement to a covenant not to compete, are ancillary to the covenant not to compete and can be sufficient consideration for the covenant not to compete.[273]

While it is best for employers to rely on the blueprint provided by *Johnson* to draft an enforceable covenant not to compete, it is possible that promises other than a promise by the employer to provide confidential information or training can support a covenant not to compete. Understanding that most courts believe that a pecuniary interest or financial incentives are not interests worthy of a non-competition covenant, what if the promise by the employer is to pay the employee one year's worth of his salary and the period for the covenant not to compete is one year. Isn't that just the same as saying the employee is guaranteed employment for at least one year? If the answer is yes, then the analysis under *Light* and *Johnson* no longer applies and the covenant not to compete is enforceable unless it fails the reasonableness test.

II. CONCLUSION

The opinion in *Johnson* definitely gives employers a glimmer of hope after many of the Texas courts of appeals seemed to be making it impossible for an employer to ever have an enforceable covenant not to compete. Luckily, employers now have a clear blueprint to follow when drafting new employment agreements and can stand by what appears to be a fairly straight-forward opinion. Going forward, not only do employers need to go back and review their current employees' contracts but additionally, employer will also want to think about adding additional hiring rules and procedures to ensure that it will not be caught in the cross-fires of a former employer suing the employer's brand new employee. Overall, the *Johnson* opinion is very favorable to employers who are seeking to protect their confidential information and therefore, more employers may want to consider adding covenants not to compete in future contracts.

[273] *Id.* at *24-25.