Noncompetes Become Even Easier to Enforce in Texas

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Continuing to chip away at one of its prior decisions, the Texas Supreme Court just made it a bit easier to enforce restrictive covenants in Texas. In Marsh USA, Inc. v. Rex Cook, the Court rejected prior precedent as it considered whether an employer could enforce a non-compete signed by an employee in exchange for stock options. The answer in Texas is now a clear "Yes." And there is room to conclude that cash may suffice as consideration to support a non-compete.

For years, Texas courts (including the Texas Supreme Court) have struggled to consistently define when a restrictive covenant is enforceable under the Texas Covenants Not to Compete Act. Various court opinions have stated that the Act says non-competes must be ancillary to an otherwise enforceable agreement at the time the agreement is made, and the otherwise enforceable agreement must "give rise" to the need for protection. What does that mean? It seems a lot of courts and lawyers have been asking the same question.

For example, suppose an employer promises to provide an employee with confidential customer information, but requires the employee to agree not to solicit clients. It has long been settled in Texas that this satisfies applicable statutory requirements -- the employer has made "an otherwise enforceable agreement" – an agreement in which it promises to provide the employee with confidential information – and at the time the agreement is made, the employee executes a restrictive covenant that is ancillary to the "otherwise enforceable agreement" which "gives rise" to the need for protection.

The phrase "gives rise" is the subject of the Court's most recent decision. Over the years, many Texas courts have construed prior holdings to mean that the consideration underlying a restrictive covenant must “give rise” to the need for protection. Invoking this authority, the employee in Marsh argued that providing stock options did not qualify because it did not “give rise” to a need for a restrictive covenant. In response, Marsh argued that by providing the employee with stock options, Marsh linked the interests of the employee with the company’s long-term business interests. According to Marsh, because stockholders are owners, and owners’ interests are furthered by fostering goodwill between the employer and its clients, the stock options "give rise" to Marsh's need for protection. Under the Texas Covenants Not to Compete Act, goodwill is a recognized interest that employers may protect through restrictive covenants. The Court ruled in favor of Marsh, but not because the stock options "give rise" to a protectible interest. Rather, it seems that the Texas Supreme Court is looking to simplify matters for future litigants by focusing the inquiry on whether the non-compete is reasonably related to an interest worthy of protection.

All of this is a long way of saying that the Texas Supreme Court has retreated from its prior holding that the consideration underlying a non-compete must give rise to the employer’s need for protection. In the words of the Court, “[C]onsideration for a noncompete that is reasonably related to an interest worthy of protection, such as trade secrets, confidential information or goodwill, satisfies the [statute].”

A copy of the Texas Supreme Court's decision is available in pdf format below.

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