IN THE SUPREME COURT OF TEXAS

NO. 03-1050

ALEX SHESHUNOFF MANAGEMENT SERVICES, L.P., PETITIONER,

v.

KENNETH JOHNSON AND STRUNK & ASSOCIATES, L.P., RESPONDENTS

ON PETITION FOR REVIEW FROM THE
COURT OF APPEALS FOR THE THIRD DISTRICT OF TEXAS

Argued November 10, 2004

CHIEF JUSTICE JEFFERSON, joined by JUSTICE O'NEILL and JUSTICE MEDINA, concurring.

The Court's holding permits an employer to enforce a non-compete covenant months or even years after the employee signed it, as long as the employer eventually fulfills its side of the bargain. That sort of delay is inconsistent with clear statutory language that the covenant must be enforceable "at the time the agreement is made." While I agree with the Court that "at the time" does not require an instantaneous exchange of consideration, neither does the statute permit the employer's promise to hang in the air, indefinitely, until it "becomes enforceable" by performance. Rather, consistent with *Light* and with the statute, I would hold that the employer's exchange of consideration must occur within a reasonable time after the agreement is made. Because that condition was satisfied on this record, I concur in the judgment.

I
The Covenants Not to Compete Act

At common law, courts used four criteria to evaluate the reasonableness of a covenant not to compete. *Hill v. Mobile Auto Trim, Inc.*, 725 S.W.2d 168, 170-71 (Tex. 1987). The covenant had to be (a) necessary to protect a legitimate business interest of the promisee, (b) supported by consideration, (c) reasonable as to its time, territory, and activity limitations, and (d) not injurious to the public. *Id.* In *Hill*, we adopted the additional restriction that "covenants not to compete which are primarily designed to limit competition or restrain the right to engage in a common calling are not enforceable." *Id.* at 172 (citations and quotations omitted). Our "common calling" rule proved difficult to define and apply. *See DeSantis v. Wackenhut Corp.*, 793 S.W.2d 670, 682-83 (Tex. 1990) (discussing cases). In 1989, the Legislature enacted the Covenants Not to Compete Act, which essentially codified the four criteria applied at common law. *See* Act of June 16, 1989, 71st Leg., R.S., ch. 1193, § 1, 1989 Tex. Gen. Laws 4852, 4852; *Peat Marwick Main & Co. v. Haass*, 818 S.W.2d 381, 388 (Tex. 1991) (noting that "the purpose of the Act was to return Texas' law generally to the common-law as it existed prior to *Hill*"). As amended, the Act states that a covenant 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.

TEX. BUS. & COM. CODE § 15.50(a).

The central issue in this case concerns the meaning and application of "ancillary to or part of an otherwise enforceable agreement at the time the agreement is made." *Id.* Consistent with our

interpretation in *Light*, it is helpful to view this text as incorporating the first two criteria from the common law. First, the covenant must protect a legitimate business interest that originates in the enforceable agreement. Second, the covenant must be supported by the consideration in the enforceable agreement.

A
The "Ancillary" Relationship

Because a covenant not to compete is a restraint of trade, at common law the covenant was unenforceable as against public policy unless it arose from a "valid transaction or relationship," such as "the purchase and sale of a business, and employment relationships." *Light v. Centel Cellular Co. of Tex.*, 883 S.W.2d 642, 644 n.4 (Tex. 1994) (citing *DeSantis*, 793 S.W.2d at 681-82). The transaction or relationship had to create a legitimate interest worthy of protection, such as "business goodwill, trade secrets, and other confidential or proprietary information." *DeSantis*, 793 S.W.2d at 682. Thus, for example, an agreement between two strangers in which a covenant not to compete was supported merely by a payment of money was unenforceable. *See, e.g.*, RESTATEMENT (SECOND) OF CONTRACTS § 187 cmt. b.

Following the common law, section 15.50(a) does not permit the covenant to stand alone. Hence, the covenant must be "ancillary to or part of" an enforceable agreement. TEX. BUS. & COM. CODE § 15.50(a). In *Light*, we dissected the ancillary relationship with a two-part test.[1] The relationship is satisfied if the covenant arises within or alongside an agreement to transfer and

[1] We stated that (1) the consideration given by the employer in the enforceable agreement must give rise to its interest in restraining the employee from competing, and (2) the covenant must be designed to enforce the consideration given by the employee in the enforceable agreement. *Light*, 883 S.W.2d at 647.

safeguard a legitimate business interest. A confidentiality agreement is a model because its purpose is to provide the employee with confidential information in return for his promise not to disclose it.[2] If the covenant is ancillary to such an agreement, it is not a direct restraint of trade in violation of public policy because it protects a legitimate business interest. The agreement must, however, be supported by consideration.

B
Consideration

A promise not to compete, by itself, is not a contract. Like any other promise, it must be supported by consideration to be enforceable.[3] Consideration for a promise may be either a performance or a return promise bargained for in a present exchange. *Roark v. Stallworth Oil & Gas, Inc.*, 813 S.W.2d 492, 496 (Tex. 1991); RESTATEMENT (SECOND) OF CONTRACTS § 71(1) (1981). Each party's promise or performance serves as a reciprocal inducement to enter the agreement. *Roark*, 813 S.W.2d at 496; OLIVER WENDELL HOLMES, JR., THE COMMON LAW 293-94 (Little, Brown & Co. 1881); *cf. Connell v. Provident Life & Accident Ins. Co.*, 224 S.W.2d 194, 196 (Tex. 1949) (discussing "the elemental principle of contract law that 'nothing is a consideration that is not regarded as such by both parties'") (quoting *Fire Ins. Ass'n v. Wickham*, 141 U.S. 564, 579 (1891)); RESTATEMENT (SECOND) OF CONTRACTS § 71(2) (a performance or return promise is

[2] As we explained in *Light*, the provision of confidential information gives rise to the employer's interest in restraining the employee from competing, and a covenant not to compete is designed to enforce the employee's promise not to disclose the information. *Light*, 883 S.W.2d at 647 n.14.

[3] There are, of course, traditional exceptions to this general rule. *See, e.g.*, *1464-Eight, Ltd. v. Joppich*, 154 S.W.3d 101, 109-10 (Tex. 2004) (failure to pay recited nominal consideration does not preclude enforcement of option contract); RESTATEMENT (SECOND) OF CONTRACTS §§ 82-94 (1981) (discussing promissory estoppel, promises to pay debts discharged in bankruptcy, and other examples).

bargained for if it is "sought by the promisor in exchange for his promise and is given by the promisee in exchange for that promise"). It follows that "past consideration" is not consideration. *See Light*, 883 S.W.2d at 645 n.6; *Roark*, 813 S.W.2d at 496.

So that the covenant complies with these principles and is enforceable as a matter of contract law, section 15.50(a) requires the covenant to be supported by consideration in the "otherwise enforceable agreement." The common law was familiar with this system of supplying consideration to the covenant:

> An enforceable covenant not to compete must be ancillary to an otherwise valid contract whose primary purpose is unrelated to the suppression of competition between the parties. A covenant not to compete must be supported by valuable consideration. However, as long as there is an exchange of consideration to support the primary purpose of the agreement, the covenant not to compete is supported by that consideration.

Martin v. Credit Prot. Ass'n, Inc., 793 S.W.2d 667, 669 (Tex. 1990) (citations omitted); *see also Justin Belt Co. v. Yost*, 502 S.W.2d 681, 683-84 (Tex. 1973). Thus, if the "otherwise enforceable agreement" is a confidentiality agreement, the promise (or performance) to provide confidential information must serve as consideration for the promise not to compete.[4] Because "past consideration" is not consideration, the statute requires the covenant to be "ancillary to or part of an otherwise enforceable agreement *at the time the agreement is made* . . . ." TEX. BUS. & COM. CODE

[4] The employer's promise or performance in the "otherwise enforceable agreement" can furnish consideration for promises given by the employee in both the agreement and the covenant. *See Birdwell v. Birdwell*, 819 S.W.2d 223, 228 (Tex. App.—Fort Worth 1991, writ denied) ("A single consideration is sufficient to support multiple promises bargained for in an agreement."); *Mitchell v. Lawson*, 444 S.W.2d 192, 196 (Tex. Civ. App.—San Antonio 1969, no writ) (where two instruments are executed as part of the same transaction, the consideration given in one may support collateral promises made in the other); *see also* RESTATEMENT (SECOND) OF CONTRACTS § 80 cmt. a (a single performance or return promise may furnish consideration for multiple promises).

§ 15.50(a) (emphasis added). Accordingly, the covenant and the enforceable agreement must be formed together as part of one transaction.

In sum, section 15.50(a) seeks to enforce reasonable covenants that protect legitimate business interests and are supported by valid consideration. These two criteria are interlaced because, for purposes of the statute, valid consideration is a promise (or performance) to transfer or share the legitimate business interest, be it trade secrets, specialized training, goodwill, or other confidential and proprietary information. A covenant satisfying the statute is part of a transaction that benefits both parties. In the employment setting, these benefits include, for example, more efficient operations through freedom of communication within an organization, and greater investment in the improvement of business methods and technologies. Harlan M. Blake, *Employee Agreements Not to Compete*, 73 HARV. L. REV. 625, 627 (1960). In addition, the special knowledge and skills acquired by the employee increase his value and compensation. *Hill v. Mobile Auto Trim, Inc.*, 725 S.W.2d 168, 171 (Tex. 1987); *see also* Jeffrey T. Rickman, *Noncompete Clauses in Georgia: An Economic Analysis*, 21 GA. ST. U. L. REV. 1107, 1120-21 (2005). The covenant, in turn, ensures that the costs incurred to develop human capital are protected against competitors who, having not made such expenditures, might offer higher salaries to employees and thereby appropriate the employer's investment. Greg T. Lembrich, *Garden Leave: A Possible Solution to the Uncertain Enforceability of Restrictive Employment Covenants*, 102 COLUM. L. REV. 2291, 2296 (2002).

C
At-Will Employment

The covenant's dependency on the consideration in an "otherwise enforceable agreement" presents problems in the at-will employment context because any promise whose performance requires continued employment is illusory. *Light*, 883 S.W.2d at 645; *see also J.M. Davidson, Inc. v. Webster*, 128 S.W.3d 223, 228 (Tex. 2003). Generally, a promise is illusory if it does not commit the promisor to perform. *See* RESTATEMENT (SECOND) OF CONTRACTS § 77 cmt. a; 3 SAMUEL WILLISTON & RICHARD A. LORD, A TREATISE ON THE LAW OF CONTRACTS § 7.7 (4th ed. 1992). At-will employment renders many promises illusory because the promisor effectively "retains the option of discontinuing employment in lieu of performance." *Light*, 883 S.W.2d at 645 & n.5 (discussing the example of an employer's promise to raise wages). Because an illusory promise does not constitute consideration, an agreement based on an illusory promise is not an "otherwise enforceable agreement." *See id.*, 883 S.W.2d at 645 n.6; RESTATEMENT (SECOND) OF CONTRACTS § 77 cmt. a; 3 WILLISTON ON CONTRACTS § 7.7.

I agree with the Court that an agreement based on an illusory promise may become enforceable as a unilateral contract when the promisor performs. *Light*, 883 S.W.2d at 645 n.6 (explaining that the employee's promise is treated as an offer, which the employer accepts by performance, creating a binding unilateral contract); *United Concrete Pipe Corp. v. Spin-Line Co.*, 430 S.W.2d 360, 364 (Tex. 1968) (assignee of pipeline construction contract performed terms of assignment agreement, rendering promissory note enforceable); 3 WILLISTON ON CONTRACTS § 7:15. Part performance is sufficient to render the entire agreement enforceable. *Hutchings v. Slemons*, 174 S.W.2d 487, 489 (Tex. 1943); *see also O'Farrill Avila v. Gonzalez*, 974 S.W.2d 237, 244 (Tex. App.—San Antonio 1998, pet. denied); *Sunshine v. Manos*, 496 S.W.2d 195, 198 (Tex. Civ.

App.—Tyler 1973, writ ref'd n.r.e.); RESTATEMENT (SECOND) OF CONTRACTS §§ 32, 50, 62. However, while a unilateral contract is an "otherwise enforceable agreement," the performance that creates it does not supply consideration to a covenant, nor satisfy section 15.50(a), unless the unilateral contract and the covenant are formed together as part of one transaction. *See* TEX. BUS. & COM. CODE § 15.50(a). For example, in a confidentiality agreement, the employer must provide the confidential information in exchange for the employee's promises not to disclose and not to compete. *Light*, 883 S.W.2d at 645 n.6. While this exchange need not be contemporaneous, it must occur within a reasonable time so that the employer's performance and the employee's promises are bargained for and constitute reciprocal inducements. *Cf. Montgomery County Hosp. Dist. v. Brown*, 965 S.W.2d 501, 504 (Tex. 1998) (Gonzalez, J., concurring) ("When the parties omit an express stipulation as to time, it is in accord with human experience and accepted standards of law for us to assume they meant whatever term . . . might be reasonable in the light of the circumstances before them at the date of the contract.") (quoting *Hall v. Hall*, 308 S.W.2d 12, 16 (1957)); *Gulf Oil Corp. v. Reid*, 337 S.W.2d 267, 275 (Tex. 1960) ("Where no time is fixed for performance of any phase of a contract, the law necessarily will imply that it is to be performed within a reasonable time. That which is implied in a written contract is as much a part of it as though it were expressed therein."); *see also* U.C.C. § 2-309(1) (2003); RESTATEMENT (SECOND) OF CONTRACTS § 231 cmt. b. If the employer's performance is not part of the same transaction, but instead comes months or years later, the resulting unilateral contract does not satisfy the statute because it was not an "otherwise enforceable agreement" when the parties formed the covenant. *Light*, 883 S.W.2d at 645 n.6.; TEX. BUS. & COM. CODE § 15.50(a); *see, e.g.*, *TMC Worldwide, L.P. v. Gray*, 178 S.W.3d 29, 38-39 (Tex.

App.—Houston [1st Dist.] 2005, no pet.) (holding covenant not to compete unenforceable because at-will marketing consultant received customer lists one year after signing employment agreement).

II
Response to the Court

Undeterred by a contrary pronouncement in *Light*, the Court holds that the phrase "at the time the agreement is made" modifies not "otherwise enforceable agreement," which directly precedes it, but "ancillary to or part of." A plain reading of the statute, however, establishes that the phrase "at the time the agreement is made" either refers solely to "otherwise enforceable agreement" or to both "otherwise enforceable agreement" and "ancillary to or part of" — but in no event to "ancillary to or part of" alone. Under the Court's reasoning, however, an employer's illusory promise satisfies the Act's requirements as long as the employer opts to perform at some indefinite time in the future. There are two problems with this approach: First, it is contradicted by the Act's grammatical structure. *See Spradlin v. Jim Walter Homes, Inc.*, 34 S.W.3d 578, 580-81 (Tex. 2000) (stating that, under the doctrine of last antecedent, "a qualifying phrase in a statute or the Constitution must be confined to the words and phrases immediately preceding it to which it may, without impairing the meaning of the sentence, be applied"). Second, and more importantly, it would permit an employer's illusory promise to bind its employee to the covenant even if, at the time the covenant is signed, the employer never intended to perform, and even when the employer's performance is deferred so long that one cannot say the enforceable agreement and covenant are part of the same transaction.

After today, an employer may 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. *See Light*, 883 S.W.2d at 645 & n.5 (discussing the example of an employer's promise to raise wages). Thus, an employer may now legitimately restrain trade merely by performing a previously illusory promise, thereby converting an unenforceable unilateral contract into a binding commitment at the last minute. We should not encourage such one-sided gamesmanship. If the employer's performance is not part of the same transaction but instead comes much later in time, the resulting unilateral contract does not satisfy the Act's requirements because it was not "an otherwise enforceable agreement" when the parties formed the covenant. TEX. BUS. & COM. CODE § 15.50(a); *Light*, 883 S.W.2d at 645 n. 6; *see*, *e.g.*, *TMC Worldwide, L.P. v. Gray*, 178 S.W.3d 29, 38-39 (Tex. App.—Houston [1st Dist.] 2005, no pet.)(holding covenant not to compete unenforceable because at-will marketing consultant received customer lists one year after signing employment agreement). I 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.

In a footnote, the Court says that only an irrational employer would trigger the covenant as a means of subverting an employee's subsequent mobility in the marketplace. ___ S.W.3d ___. The Court underestimates the competitive nature of business. But the point is larger than that. Under the Court's interpretation, the employer need not even intend to perform its side of the bargain when it compels the employee to sign covenant. If the employer has no incentive to perform, these

covenants—once viewed as impermissible restraints on trade—will become not only ubiquitous in at-will employment contracts, but enforceable at the employer's whim. Because the Court would not require the employer to prove an intent to fulfill its side of the bargain (an intent that would be implicit if the employer had to perform within a reasonable time), the employee is potentially left with none of the benefits typically conferred by an exchange of consideration. *See DeSantis* 793 S.W.2d at 682 (holding that covenant can permissibly accomplish a "salutary purpose" that encourages "an employer to share confidential, proprietary information with an employee in furtherance of their common purpose," but may not "take unfair advantage" of its employee, thereby impairing the "employee's personal freedom and economic mobility"). 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. TEX. BUS. & COM. CODE § 15.50(a).

III
Johnson's Covenant Not to Compete

In January 1998, the parties signed an employment agreement containing a confidentiality agreement and a covenant not to compete. In the confidentiality agreement, ASM promised "special training regarding [its] business methods and access to certain confidential and proprietary information" in exchange for Johnson's promise "to keep the Confidential Information, and all documentation, access and information relating thereto, strictly confidential." Johnson's covenant satisfies section 15.50(a)'s ancillary relationship requirement because it reinforces the parties'

agreement to share and protect ASM's confidential and proprietary information. *See Light*, 883 S.W.2d at 647 & n.14.

Johnson's covenant also satisfies the statute's consideration requirement. In September 1997, four months before signing the employment agreement, Johnson was promoted to Director of ASM's Affiliation Program. In this position, ASM provided Johnson with daily access to confidential information about the company's finances, strategies, client lists, marketing assessments, product development, pricing, sales projections, and client feedback. Much of this information was made available on an electronic database, which continuously updated the information. When Johnson signed the covenant, and during the next four years, ASM provided such access on a daily basis.[5] Although ASM's promise to provide the access was initially illusory, ASM's contemporaneous performance created an enforceable unilateral contract. For example, Johnson became a member of ASM's senior management team, affording him the opportunity to interact directly with numerous chief executive officers and senior bank executives the moment he signed the agreement. ASM's performance thus supplied valid consideration for Johnson's covenant not to compete. *Light*, 883 S.W.2d at 645 n.6; *United Concrete*, 430 S.W.2d at 364. Johnson's covenant was therefore ancillary to an otherwise enforceable agreement at the time the agreement was made, as section 15.50(a) requires.

[5] Both Johnson and ASM's CEO, Gabrielle Sheshunoff, testified that he experienced "no change" in his access to confidential information as a result of signing the covenant. Johnson's briefs to this Court confirm that the covenant "resulted in absolutely no change in his job duties, responsibilities, or access to information—confidential or otherwise—within ASM."

IV
Conclusion

Based on the record in this case, I agree with the Court's judgment that Johnson's employment agreement is enforceable. I disagree with the Court's analysis, however, and thus concur only in the judgment.

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Wallace B. Jefferson
Chief Justice

OPINION DELIVERED: October 20, 2006