COMMENT

TEXAS, COVENANTS NOT TO COMPETE, AND THE TWENTY-FIRST CENTURY: CAN THE PIECES FIT TOGETHER IN A DOT.COM BUSINESS WORLD?*

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I. INTRODUCTION

This Comment focuses on the Texas Supreme Court's continuing trend of limiting the feasibility of covenants not to

* This paper was selected as the recipient of the Andrews & Kurth, L.L.P. 2002 Writing Award for Distinguished Paper in General Business.

compete in the business employment context. In the near future, the court will likely hear a case considering how the Internet expansion and resultant increase in business technology has affected the enforceability of covenants not to compete. Specifically, the supreme court will likely emphasize why it is in the best interests of employers, employees, and the general public if these covenants are narrowly drawn to account for changes brought about by this new age of technology.

Part I of this Comment presents a brief overview of covenants not to compete, their utilization, and the motivations behind their usage. Part II discusses modifications in the law on covenants not to compete over time in Texas and the Texas Supreme Court's role in shaping that change. Part III contemplates the future of Texas law regarding these covenants and details numerous decisions from other jurisdictions, focusing primarily on which policy-based approaches regarding the enforceability of covenants not to compete may be superior to others. Additionally, Part III summarizes a hypothesis regarding an alleged nexus between the enforceability of these covenants in a particular jurisdiction and that region's corresponding economic growth. Part III also anticipates the result of a future Texas Supreme Court decision addressing the viability of enforcing covenants not to compete in a rapidly evolving business world. Finally, Part IV offers a brief conclusion and summarizes the reasons why the Texas Supreme Court is likely to further restrict the applicability of covenants not to compete.

II. GENERAL OVERVIEW OF COVENANTS NOT TO COMPETE

A corollary to the common law principle of freedom of enterprise in the employment context is the more specific policy that, absent agreement to the contrary, an employee whose term of service has ended is entitled to compete with his former employer.[1] As a result of this public policy against undue restraints of trade, employers typically insert provisions in their standard employment contracts that prohibit employees from competing with the employer once the employee's duration of service is complete.[2] These provisions are commonly referred to

1. Mark W. Freel & Matthew T. Oliverio, *When Commercial Freedoms Collide: Trade Secrets, Covenants Not to Compete and Free Enterprise*, 47 R.I. B.J. 9, 9 (1999); C.T. Drechsler, Annotation, *Enforceability of Restrictive Covenant, Ancillary to Employment Contract, as Affected by Territorial Extent of Restriction*, 43 A.L.R. 2D 94, 105 (1955).

2. Drechsler, *supra* note 1, at 105.

as covenants not to compete,[3] noncompete agreements,[4] or restrictive covenants.[5]

A covenant not to compete (hereinafter "CNC") is "[a]n agreement, generally part of a contract of employment or a contract to sell a business, in which the covenantor agrees for a specific period of time and within a particular area to refrain from competition with the covenantee."[6] Although courts have validated several types of CNCs,[7] this Comment focuses strictly on post-employment CNCs. This specific type of CNC forbids an employee from competing with his employer after the employment relationship has been terminated.[8] At common law,[9] contracts restricting an employee's post-employment mobility were generally deemed void and unenforceable as a matter of public policy.[10] This settled policy was founded on the basic assumptions that restrictive covenants undermined the free flow of human capital in the marketplace and were the product of unequal bargaining power between employer and employee.[11] In addition, the American market has a time-honored tradition of promoting free enterprise and entrepreneurial spirit.[12]

Due to these settled expectations in the employment field, the common law established certain substantive criteria a CNC

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3. *Id.*

4. Frank J. Cavico, *"Extraordinary or Specialized Training" as a "Legitimate Business Interest" in Restrictive Covenant Employment Law: Florida and National Perspectives*, 14 ST. THOMAS L. REV. 53, 54 (2001); Ronald B. Coolley, *Definitions, Duties, Covenants Not to Compete, Assignment After Termination and Severability*, 14 AM. INTELL. PROP. L. ASS'N Q.J. 20, 24 (1986).

5. BLACK'S LAW DICTIONARY 1316 (7th ed. 1999).

6. BLACK'S LAW DICTIONARY 364 (6th ed. 1990).

7. *See infra* text accompanying notes 36–40.

8. *See* Coolley, *supra* note 4, at 25 (stating that "employment agreements frequently contain express provisions restricting the right of the employee, after termination of employment, to engage in a business similar to or competitive with that of the employer").

9. Harlan M. Blake, *Employee Agreements Not to Compete*, 73 HARV. L. REV. 625, 626–27 (noting that a CNC is a common-law mechanism to restrain trade, and the treatment of which by courts "has reflected the evolution of industrial technology and business methods, as well as the ebb and flow of such social values as freedom of contract, personal economic freedom, and business ethics").

10. Gillian Lester, *Restrictive Covenants, Employee Training, and the Limits of Transaction-Cost Analysis*, 76 IND. L.J. 49, 54 (2001).

11. *Id.*; *see also* Rachel S. Arnow-Richman, *Bargaining for Loyalty in the Information Age: A Reconsideration of the Role of Substantive Fairness in Enforcing Employee Noncompetes*, 80 OR. L. REV. 1163, 1166 (2001) (observing that "[d]ue to historical concerns about employees' lack of bargaining power, courts have treated [CNCs] as narrow remedial tools, designed to prevent damage to cognizable business interests, rather than as bargained-for alterations of the default rules of the employment relationship").

12. Freel & Oliverio, *supra* note 1, at 9.

had to meet to be valid and enforceable.[13] First, a CNC must always be reasonably limited in time, geographical extent, and scope of activity restrained.[14] In addition, most courts also require CNCs to be supported by consideration and to not be unreasonably detrimental to either the employee or the general public.[15] Finally, because CNCs curtail free enterprise in the market and mobility in society, all restrictions in the CNC must be narrowly drawn to safeguard some legally protectable interest of the employer, not simply the employer's competitive position.[16]

Most jurisdictions today adhere to some variation of the common law tri-partite test set forth in the Restatement (Second) of Contracts to determine the "reasonableness" of all restrictions contained in a CNC.[17] Section 188 provides that a CNC is unreasonable if: (i) the restraint is greater than necessary to protect the employer's legitimate business interest; (ii) the burden imposed on the employee outweighs the employer's right to protect its business interest; or (iii) the employer's interests in enforcing the CNC is outweighed by the likely injury to the public.[18] In 1991, the Texas Supreme Court formally accepted this approach in *Peat Marwick Main & Co. v. Haass*.[19]

Because CNCs help safeguard an employer's proprietary information,[20] businesses are increasingly utilizing them today.[21] CNCs have long been recognized as powerful instruments that employers can use to protect their business.[22] More specifically,

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13. Cyndi M. Benedict et al., *Employment and Labor Law, Annual Survey of Texas Law*, 50 SMU L. REV. 1101, 1163–65 (1997).

14. Larry Carlson, *Enforcing a Non-Compete*, 4 TEX. INTELL. PROP. L.J. 149, 150–51 (1996).

15. JOHN D. CALAMARI & JOSEPH M. PERILLO, CONTRACTS § 16.19(b) (4th ed. 1998).

16. *See id.* at § 16.19; Freel & Oliverio, *supra* note 1, at 10 (recognizing the inherent tension between the freedom to contract and the free enterprise system).

17. *See* RESTATEMENT (SECOND) OF CONTRACTS § 188 (1979); Katherine V.W. Stone, *The New Psychological Contract: Implications of the Changing Workplace for Labor and Employment Law*, 48 UCLA L. REV. 519, 579–80 (2001) (discussing this approach).

18. RESTATEMENT (SECOND) OF CONTRACTS § 188 cmt. a (1979).

19. 818 S.W.2d 381, 386 (Tex. 1991) (also holding that CNCs must be "ancillary to an otherwise valid contract, transaction or relationship").

20. *See* Freel & Oliverio, *supra* note 1, at 9 (stating that there are "instances in which employers have a valid and compelling interest in the protection of intellectual property interests, customer relationships and sensitive technological and business-related information"); Lester, *supra* note 10, at 51 (referring to a company's business secrets and client information as a "specific investment").

21. *See* Arnow-Richman, *supra* note 11, at 1164–65 (observing that the increased usage of noncompete agreements has coincided with increased mobility in the workforce); Lester, *supra* note 10, at 49 (noting that CNCs "are an increasingly common feature of employment . . .").

22. *See* Cavico, *supra* note 4, at 54–55 (stating that noncompetes have increasingly emerged in employment contracts in computer and technology fields).

CNCs enable employers to protect several types of legitimate business interests when former employees are either hired by competitors or establish a new business.[23] These legitimate interests include: (i) customer contact lists, (ii) trade secrets[24] and other confidential information possessed by the employee, and (iii) any special skills acquired by the employee during the particular employment.[25] The employer's ability to safeguard these interests once the employee leaves is critical to the employer's business surviving in a competitive market.[26] Hence, employers often require employees to sign a CNC contained in the employment contract before beginning work.[27]

III. COVENANTS NOT TO COMPETE IN TEXAS

A. *From Common Law to Primitive Standards*

In Texas, common law initially governed the contours of covenants not to compete.[28] Although lower courts consistently

23. Carey A. DeWitt, *Enforcing Non-Competes: Ten Lessons from the Litigator*, 80 MICH. BAR. J. 48, 48–49 (2001) (explaining the advantages of CNCs and suggesting procedures employers should implement to demonstrate to courts that confidential information is at risk).

24. The 1985 Uniform Trade Secrets Act, which has been adopted by a majority of states, defines a "trade secret" as "information . . . that: (i) derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use, and (ii) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy." UNIF. TRADE SECRETS ACT § 1(4) (amended 1985), 14 U.L.A. 437, 438 (1990); *see also* Ernest C. Garcia & Fred A. Helms, *Covenants Not to Compete & Not to Disclose*, 64 TEX. B.J. 32, 38 (2001) (pointing out that "[i]tems such as customer lists, pricing information, client information, customer preferences, buyer contracts, market strategies, blueprints, and drawings have been shown to be trade secrets").

25. Kurt H. Decker, *Refining Pennsylvania's Standard for Invalidating a Non-Competition Restrictive Covenant When an Employee's Termination is Unrelated to the Employer's Protectible Business Interest*, 104 DICK. L. REV. 619, 619–21 (2000) (justifying employers' use of CNCs by recognizing the growth of employee rights and the erosion of at-will employment relationships). These legitimate interests of the employer are important factors that courts take into account when determining the reasonableness of a particular restrictive covenant. *See, e.g.*, Peat Marwick Main & Co. v. Haass, 818 S.W.2d 381, 386 (Tex. 1991) (holding that for a CNC to be reasonable, "the restraint created must not be greater than necessary to protect the [employer's] legitimate interests such as business goodwill, trade secrets, or other confidential or proprietary information").

26. *See* Cavico, *supra* note 4, at 55–56 (recognizing that an employee's potential to disclose is an "edge" that threatens a company's existence).

27. *See* Philip J. Closius & Henry M. Schaffer, *Involuntary Nonservitude: The Current Judicial Enforcement of Employee Covenants Not to Compete—A Proposal for Reform*, 57 S. CAL. L. REV. 531, 532 (1984) ("Because of the increasing emphasis in the American economy on technically skilled employees and service oriented businesses, the covenant not to compete has become a standard addition to employment contracts.").

28. *See* Steven R. Borgman, *The New Covenant Not to Compete Statute*, 2 TEX.

addressed the enforceability of these covenants in decisions throughout the first half of the twentieth century,[29] the matter did not reach the Texas Supreme Court until 1960, when the court delivered its seminal opinion in *Weatherford Oil Tool Co. v. Campbell*.[30] Relying heavily on certain rules propounded in the Restatement of the Law, the court sketched a "reasonableness" test to guide lower courts in determining the enforceability of CNCs:

> An agreement on the part of an employee not to compete with his employer after termination of the employment is in restraint of trade and will not be enforced in accordance with its terms unless the same are reasonable. Where the public interest is not directly involved, the test usually stated for determining the validity of the covenant as written is whether it imposes upon the employee any greater restraint than is reasonably necessary to protect the business and good will of the employer. . . . The period of time during which the restraint is to last and the territory that is included are important factors to be considered in determining the reasonableness of the agreement.[31]

With these broad guidelines in place, lower courts attempted to distinguish between enforceable CNCs and those broader than reasonably necessary to protect the employer's business interests.[32] Subsequently, in *Justin Belt Co. v. Yost*, the Texas Supreme Court adopted the requirement that CNCs must also be

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INTELL. PROP. L.J. 19, 19–22 (1993) (recounting the view of Texas courts toward CNCs before 1987). Prior to 1987, the Texas Supreme Court had only sparingly addressed the enforceability of CNCs, and public policy concerns largely shaped this area of the law. Jason S. Wood, *A Comparison of the Enforceability of Covenants Not to Compete and Recent Economic Histories of Four High Technology Regions*, 5 VA. J.L. & TECH. 14, ¶ 29 (2000), *at* http://www.vjolt.net/vol5/issue3/v5i3a14-Wood.html.

29. *See, e.g.*, Comer v. Burton-Lingo Co., 24 Tex. Civ. App. 251, 58 S.W. 969 (1900); Parisian Live Dyers & Cleaners v. Springfield, 275 S.W. 1098 (Tex. Civ. App.—Galveston 1925, writ ref'd); Blaser v. Linen Serv. Corp. of Tex., 135 S.W.2d 509 (Tex. Civ. App.—Dallas 1939, writ dism'd judgm't cor.); Ofsowitz v. Askin Stores, Inc., 306 S.W.2d 923 (Tex. Civ. App.—Eastland 1957, writ ref'd); Spinks v. Riebold, 310 S.W.2d 668 (Tex. Civ. App.—El Paso 1958, writ ref'd).

30. 340 S.W.2d 950 (Tex. 1960).

31. *Id.* at 951.

32. *See, e.g.*, Traweek v. Shields, 380 S.W.2d 131, 133 (Tex. Civ. App.—Tyler 1964, no writ); Vaughan v. Kizer, 400 S.W. 2d 586, 589 (Tex. Civ. App.—Waco 1966, writ ref'd n.r.e.); Cardinal Pers., Inc. v. Schneider, 544 S.W.2d 845, 848 (Tex. Civ. App.—Houston [14th Dist.] 1976, no writ).

"ancillary to and in support of another contract."[33] Thus, to be enforceable in the employment context, a CNC must be ancillary to a separate, valid employment contract.[34] Consequently, a CNC entered into independently of an employment contract or agreed to by the employee only after termination of employment is not considered ancillary to another contract and, therefore, is unenforceable in Texas.[35] Through the years, the supreme court determined CNCs to be ancillary to a variety of contractual relationships, including employment contracts,[36] settlement agreements,[37] leasing arrangements,[38] contracts for the sale of a business,[39] and partnership agreements.[40]

In addition, Texas courts have consistently maintained the view that they are empowered to reform CNCs deemed unreasonable.[41] Thus, a CNC unreasonably broad in scope, duration, or geographical extent is not necessarily void in Texas because its courts are vested with an equitable power to modify it to make the restrictions reasonable.[42] This reformatory power seems to have had its genesis in *Weatherford Oil Tool Co.*, in which the supreme court opined that, "although the territory or period stipulated by the parties may be unreasonable, a court of equity will nevertheless enforce the contract by granting an injunction restraining the defendant from competing for a time and within an area that [is] reasonable under the circumstances."[43] Over the years, Texas courts have evidenced a willingness to use their equitable powers to the fullest, even to the extent of adding time and geographical limitations when none were present in the original covenant.[44]

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33. Justin Belt Co. v. Yost, 502 S.W.2d 681, 683–84 (Tex. 1973).

34. *Id.*

35. *See id.*; P. Jerome Richey & Margaret J. Bosik, *Trade Secrets and Restrictive Covenants*, 4 LAB. LAW. 21, 28 (1988) (discussing this requirement).

36. *See Weatherford Oil Tool Co.*, 340 S.W.2d at 951–53.

37. *See Justin Belt Co.*, 502 S.W.2d at 684.

38. *See* City Prods Corp. v. Berman, 610 S.W.2d 446, 450 (Tex. 1980).

39. *See* Hanks v. GAB Bus. Servs Inc., 644 S.W.2d 707, 708 (Tex. 1982).

40. *See* Henshaw v. Kroenecke, 656 S.W.2d 416, 418 (Tex. 1983).

41. *See, e.g.*, *Weatherford Oil Tool Co.*, 340 S.W.2d at 952–53; Butler v. Arrow Mirror & Glass, Inc., 51 S.W.3d 787, 794 (Tex. App.—Houston [1st Dist.] 2001, no pet.) (affirming the trial court's reformation of the geographical restriction contained in the CNC).

42. *See Butler*, 51 S.W.3d at 794 (commenting on the statutory duty of Texas courts to reform CNCs); Evan's World Travel, Inc. v. Adams, 978 S.W.2d 225, 233 (Tex. App.—Texarkana 1998, no pet.) (viewing this power of reformation as a commandment by law).

43. *Weatherford Oil Tool Co.*, 340 S.W.2d at 952.

44. Borgman, *supra* note 28, at 20; *see also* Justin Belt Co. v. Yost, 502 S.W.2d 681, 681 (Tex. 1973) (affirming the trial court's reformation of a noncompete agreement that contained no limitation as to time or duration).

In 1987, the Texas Supreme Court modified its baseline "rule of reason" test.[45] In *Hill v. Mobile Auto Trim Inc.*, a franchisor had sought to prevent its former franchisee from competing in a seven-county area for three years after termination of employment, based on the terms of a CNC contained in the franchise agreement.[46] After reviewing past judicial decisions concerning noncompete agreements, the *Hill* court formulated a new, more specific test to determine the validity of a CNC.[47] The court set forth four requirements that had to be satisfied for a CNC to be deemed enforceable.[48] The first criterion required the promisee to have a legitimate business interest justifying the protection of goodwill or trade secrets.[49] Second, all limitations imposed with regard to time, territory, and scope of activity had to be reasonable.[50] Third, the CNC could not injure the public by denying accessibility to needed goods or services.[51] Finally, the covenant was enforceable only if the promisee imparted consideration for something of value to the promisor.[52]

After articulating these requirements, however, the *Hill* court carved out a broad exception that effectively limited the clarity of the new test.[53] Referred to later as the "common calling" exception, the supreme court held that CNCs designed to limit the right to engage in a common calling were per se unenforceable.[54] This broad exception created ambiguity among lower courts that had to adjudicate the enforceability of certain noncompete agreements.[55] The *Hill* decision, specifically the "common calling" exception, received immediate disapproval.[56] Predicting the difficulties that would accompany the new test, Justice Gonzalez pointedly stated:

> The court implicitly holds that a former franchisee or employee who is engaged in a "common calling"

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45. *See* Hill v. Mobile Auto Trim, Inc., 725 S.W.2d 168, 170–71 (Tex. 1987), *superseded by* TEX. BUS. & COM. CODE ANN. § 15.50 (Vernon Supp. 2001).

46. *Hill*, 725 S.W.2d at 169–70.

47. *See id.* at 170–71.

48. *Id.* at 170.

49. *Id.* at 170–71.

50. *Id.* at 171.

51. *Id.*

52. *Id.*

53. *Id.* at 172.

54. *Id.*

55. *See* Jeffrey W. Tayon, *Covenants Not to Compete in Texas: Shifting Sands from* Hill *to* Light, 3 TEX. INTELL. PROP. L.J. 143, 154–57 (discussing the ambiguity created by the *Hill* decision and the lower courts' ensuing reactions).

56. Borgman, *supra* note 28, at 21–22.

> is free to divert the customers of a former franchisor or employer in disregard of a prior contractual agreement not to do so. If this is what the court means, the practical effect of this is to void most, if not all, covenants not to compete in franchise agreements and/or to generate extensive and costly litigation until the court adopts a definition of "common calling" and/or litigants test the limits of this opinion. What about employees engaged in a "common calling" that also have knowledge of the employer's trade secrets? Are they free to divulge the trade secrets in violation of an agreement to the contrary?[57]

Subsequent to its decision in *Hill*, the Texas Supreme Court issued three more opinions in an attempt to clarify the limits on enforcing CNCs.[58] Notably, in each decision, the supreme court found the particular CNC unreasonable as originally written and, thus, unenforceable.[59] In addition, after the court handed down *Hill*, a number of appellate courts considered the scope of the "common calling" exception.[60] Although most of these courts construed the exception narrowly, dissatisfaction with the *Hill* test and its noticeable exception had increased dramatically by the late 1980s.[61]

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57. *Hill*, 725 S.W.2d at 176 (Gonzalez, J., dissenting).

58. *See* Bergman v. Norris of Houston, 734 S.W.2d 673, 674 (Tex. 1987), *superseded by* TEX. BUS. & COM. CODE ANN. § 15.50 (Vernon Supp. 2001); DeSantis v. Wackenhut Corp. ("DeSantis I"), 793 S.W.2d 670, 681–82 (Tex. 1990); Martin v. Credit Prot. Ass'n ("Martin I"), 793 S.W.2d 667, 669 (Tex. 1990).

59. *See Bergman*, 734 S.W.2d at 674; *DeSantis I*, 793 S.W.2d at 684; *Martin I*, 793 S.W.2d at 670.

60. *See, e.g.*, B. Cantrell Oil Co. v. Hino Gas Sales, Inc., 756 S.W.2d 781, 783 (Tex. App.—Corpus Christi 1988, no writ), *superseded by* TEX. BUS. & COM. CODE ANN. § 15.50 (Vernon Supp. 2001) (defining a person in a common calling as "one who performs a generic task for a living, one that changes little no matter for whom or where" that person works); Hoddeson v. Conroe Ear, Nose and Throat Assocs, 751 S.W.2d 289, 289–90 (Tex. App.—Beaumont 1988, no writ), *superseded by* TEX. BUS. & COM. CODE ANN. § 15.50 (Vernon Supp. 2001) (holding that a medical doctor certified as an ear, nose and throat specialist was engaged in a common calling); Spicer v. Tacito & Assocs, Inc., 783 S.W.2d 220, 221–22 (Tex. App.—Dallas 1989, no writ) (determining that a job that entailed selling promotional material was a common calling).

61. Borgman, *supra* note 28, at 21–22. For instance, one court even stated, "[I]t seems clear that the opinions in *Hill*, *Bergman*, *DeSantis*, and *Martin* have effectively repudiated long-honored, common-law principles relating to consideration as applied to the law of contracts involving post-employment covenants not to compete. . . .We disagree with the Supreme Court's abolition of these sound common-law principles. . . ." Bland v. Henry & Peters, P.C., 763 S.W.2d 5, 8 (Tex. App.—Tyler 1988, writ denied).

B. *The 1989 Texas Covenants Not to Compete Act and the Texas Supreme Court's Ensuing Reaction*

In 1989, the Texas Legislature decided the supreme court had gone too far in curtailing the effectiveness of valid CNCs and promptly took action.[62] Responding to criticism expressed by the Texas bar as well as lobbying from the commercial industry, the legislature enacted a new Subchapter E to the Texas Business and Commerce Code.[63] This piece of legislation, termed the

62. Tayon, *supra* note 55, at 178–80.

63. Act of Aug. 28, 1989, 71st Leg., R.S., ch. 1193, 1989 Tex. Gen. Laws 4852, *amended by* Act of Sept. 1, 1993, 73d Leg., R.S., ch. 965, 1993 Tex. Gen. Laws 4201 (codified at TEX. BUS. & COM. CODE ANN. §§ 15.50–.52). The Act provided as follows:

> SECTION 1. Chapter 15, Business & Commerce Code, is amended by adding Subchapter E to read as follows:
>
> SUBCHAPTER E. COVENANTS NOT TO COMPETE
>
> Section 15.50. CRITERIA FOR ENFORCEABILITY OF COVENANTS NOT TO COMPETE.
> Notwithstanding Section 15.05 of this code, a covenant not to compete is enforceable to the extent that it:
>
> (1) is ancillary to an otherwise enforceable agreement but, if the covenant not to compete is executed on a date other than the date on which the underlying agreement is executed, such covenant must be supported by independent valuable consideration; and
>
> (2) contains reasonable limitations as to time, geographical area, and scope of activity to be restrained that do not impose a greater restraint than is necessary to protect the goodwill or other business interest of the promisee.
>
> Section 15.51. PROCEDURES AND REMEDIES IN ACTIONS TO ENFORCE COVENANTS NOT TO COMPETE.
>
> (a) Except as provided in Subsection (c) of this section, a court may award the promisee under a covenant not to compete damages, injunctive relief, or both damages and injunctive relief for a breach by the promisor of the covenant.
>
> (b) If the primary purpose of the agreement to which the covenant is ancillary is to obligate the promisor to render personal services, the promisee has the burden of establishing that the covenant meets the criteria specified by Subdivision (2) of Section 15.50 of this code. If the agreement has a different primary purpose, the promisor has the burden of establishing that the covenant does not meet those criteria. For the purposes of this subsection, the "burden of establishing" a fact means the burden of persuading the triers of fact that the existence of the fact is more probable than its nonexistence.

Covenants Not to Compete Act, was the first set of substantive guidelines in Texas that directly addressed CNCs.[64] Senator John Whitmire, who introduced the bill that would later become the Covenants Not to Compete Act, gave his reasons for favoring its passage:

> It is generally held that these covenants, in appropriate circumstances, encourage greater investment in the development of trade secrets and goodwill employee training, provide contracting parties with a means to effectively and efficiently allocate various risks, allow the freer transfer of property interests, and in certain circumstances, provide the only effective remedy for the protection of trade secrets and goodwill.[65]

Immediately after passage of the 1989 legislation, the Texas Supreme Court responded by handing down three cases, all decided in 1990, which reinforced the court's reluctance to enforce CNCs: *Juliette Fowler Homes, Inc. v. Welch Associates, Inc.*,[66] *Martin v. Credit Protection Ass'n* ("*Martin II*"),[67] and

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> (c) If the covenant meets the criteria specified by Subdivision (1) of Section 15.50 of this code but does not meet the criteria specified by Subdivision (2) of Section 15.50, the court, at the request of the promisee, shall reform the covenant to the extent necessary to cause the covenant to meet the criteria specified by Subdivision (2) of Section 15.50 and enforce the covenant as reformed, except that the court may not award the promisee damages for a breach of the covenant before its reformation and the relief granted to the promisee shall be limited to injunctive relief. If the primary purpose of the agreement to which the covenant is ancillary is to obligate the promisor to render personal services, the promisor establishes that the promisee knew at the time of the execution of the agreement that the covenant did not meet the criteria specified by Subdivision (2) of Section 15.50 and the promisee sought to enforce the covenant to a greater extent than was necessary to protect the goodwill or other business interest of the promisee, the court may award the promisor the costs, including reasonable attorney's fees, actually and reasonably incurred by the promisor in defending the action to enforce the covenant.
>
> SECTION 2. This Act applies to a covenant entered into before, on, or after the effective date of this Act.

Id.

64. Tayon, *supra* note 55, at 147.

65. Senator John Whitmire, SEN. COMM. ON ECONOMIC DEVELOPMENT, BILL ANALYSIS, Tex. S.B. 946, 71st Leg., R.S. (1989).

66. 793 S.W.2d 660, 663 (Tex. 1990).

DeSantis v. Wackenhut Corp. ("*DeSantis II*").[68] A fourth opinion, *Travel Masters, Inc. v. Star Tours, Inc.*,[69] was issued one year later.

In *Martin II*, the supreme court narrowed the reach of the Act by holding that CNCs ancillary to an at-will employment agreement were unenforceable.[70] Generally, at-will employment contracts are those where no definite length exists for the term of the relationship or where standards have not been specified for employee termination.[71] In this common type of employment relationship, either the employee or employer may, without incurring liability, terminate the agreement at any time, without reason.[72] The *Martin II* court first held that an at-will agreement was not "an otherwise enforceable agreement" as the new Act required in order for an accompanying CNC to be enforceable.[73] After establishing this point, the court examined the particular employee contract at issue.[74] Scrutinizing the agreement, the court noted the absence of certain terms, such as title, position, duration of employment, compensation, duties, and responsibilities that would have indicated it was a separate, otherwise enforceable contract to which the CNC could be ancillary.[75] As such, the court determined the contract created an at-will relationship and held, accordingly, that it could not be an otherwise enforceable agreement.[76]

Additionally in *Martin II*, the Texas Supreme Court raised the bar by devising another requirement for CNCs to be valid and enforceable.[77] The court held that a CNC entered into on a date other than when the original employment began was presumed unenforceable as a matter of law, unless the employer could prove "independent valuable consideration" accompanied the CNC.[78] It then rejected the employer's argument that the

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67. 793 S.W.2d 667, 670 (Tex. 1990).

68. 793 S.W.2d 670, 684 (Tex. 1990).

69. 827 S.W.2d 830 (Tex. 1991).

70. *Martin II*, 793 S.W.2d at 669–70.

71. 33 TEX. JUR. 3D *Employer* § 18 (2002) (describing the contours of an at-will employment relationship).

72. Deborah A. Ballam, *Employment-At-Will: The Impending Death of a Doctrine*, 37 AM. BUS. L.J. 653, 653 (2000) (defining at-will employment as a relationship wherein the employer or employee may terminate the relationship without consequences of legal liability); Borgman, *supra* note 28, at 23.

73. *Martin II*, 793 S.W.2d at 669.

74. *See id.* at 669–70.

75. *Id.* at 669.

76. *Id.* at 669–70.

77. *See id.* at 670.

78. *Id.*; *see also* TEX. BUS. & COM. CODE § 15.50 (providing, "[I]f the covenant not to

employee's continued period of employment constituted "independent valuable consideration" sufficient to sustain the CNC.[79]

The Texas Supreme Court continued to scrutinize restrictive covenants the same year in *DeSantis v. Wackenhut Corp.* ("*DeSantis II*").[80] In *DeSantis II*, the court formally overruled the *Hill* "common calling" exception, noting that it proved to be a confusing and impractical method for deciding whether to enforce a particular CNC.[81] The court referenced the actions of the Texas Legislature to bolster its decision, explicitly noting that the Covenants Not to Compete Act did not encompass the "common calling" test to determine the reasonableness of a particular CNC.[82] The court emphasized, however, that the nature of the employee's position, specifically whether the job was considered a common calling, could potentially factor into a determination of the restriction's reasonableness.[83]

Analyzing the CNC at issue, the *DeSantis II* court first established that the covenant was ancillary to an otherwise enforceable agreement.[84] Employing the next step of the new *Hill* test, the court then inquired as to whether the covenant was necessary to protect a legitimate interest of the employer.[85] The employer, Wackenhut, claimed the covenant was necessary to protect its business goodwill that DeSantis had wrongfully appropriated.[86] The court disagreed with Wackenhut for a number of reasons.[87] Specifically, it found DeSantis had developed only minimal business goodwill for Wackenhut,[88] had

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compete is executed on a date other than the date on which the underlying agreement is executed, such covenant must be supported by independent valuable consideration.").

79. *Martin II*, 793 S.W.2d at 670. The court did acknowledge, however, that an employee's special training or knowledge gained during employment could comprise "independent valuable consideration" sufficient to support a CNC. *Id.*

80. 793 S.W.2d 670 (Tex. 1990).

81. *Id.* at 682–83.

82. *Id.* at 683 (implying that omission of the "common calling" exception from the language of the Covenants Not to Compete Act was equivalent to congressional rejection of the test).

83. *See id.* (stating, in dicta, "The nature of the promisor's job—whether it is a common calling—may sometimes factor into the determination of reasonableness, but it is not the primary focus of the inquiry.")

84. *Id.*

85. *Id.*

86. *Id.*

87. *See id.* at 683–84.

88. *Id.* at 683 (stating further that Wackenhut failed to prove the necessity of protecting such business goodwill outweighed the hardship placed upon DeSantis by the agreement).

not appropriated for his own use any of that goodwill,[89] and had also not taken advantage of any confidential or secret information during his employment.[90] Thus, the court found that Wackenhut, as the former employer, had not carried its burden of showing the CNC was necessary to protect a legitimate business interest.[91] After making this final determination, the court held that the CNC was unreasonable and, therefore, unenforceable as written.[92]

One year later, the supreme court reaffirmed its decision from *Martin II* and once again refused to enforce a CNC that was ancillary to an at-will employment agreement.[93] In *Travel Masters, Inc. v. Star Tours, Inc.*, the court deemed the CNC unenforceable because the at-will agreement containing the covenant could have been terminated at any time by either side and, thus, was not an "otherwise enforceable agreement."[94]

C. *The 1993 Amendment to the Covenants Not to Compete Act and Subsequent Case Law*

By late 1993, almost seven years had elapsed since the *Hill* decision and the Texas Supreme Court had still not enforced a single covenant not to compete brought before it.[95] Noting the supreme court's obvious hostility toward CNCs in general, one commentator even posited that the court "created the at-will employment exception to enforcement of covenants not to compete in *Martin* (1990) and *Travel Masters* as a substitute for the 'common calling' analysis expressly rejected by the Texas Legislature."[96] In response to the court's adamant resistance toward enforcing CNCs, the legislature amended the Covenants Not to Compete Act in an attempt to overcome the court's line of decisions.[97] This legislation exemplified the ongoing conflict of views concerning the viability of CNCs between the legislature, which favored their enforcement, and the supreme court, which

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89. *Id.* at 683–84.

90. *Id.* at 684 (noting that Wackenhut failed to prove its customers could not be easily identified by outside parties or that the protection of this information procured an advantage for Wackenhut over its competitors).

91. *Id.*

92. *Id.*

93. *See* Travel Masters, Inc. v. Star Tours, Inc., 827 S.W.2d 830, 833 (Tex. 1991).

94. *Id.* at 832–33.

95. Borgman, *supra* note 28, at 26.

96. Tayon, *supra* note 55, at 220.

97. Act of Sept. 1, 1993, 73d Leg., R.S., ch. 965 § 1, 1993 Tex. Gen. Laws 4201–02 (codified at TEX. BUS. & COMM. CODE ANN. §§ 15.50–.52 (Vernon Supp. 2002)).

generally disliked their usage.[98] Viewing the Texas Supreme Court's litany of opinions as an attempt to dilute the effectiveness of the Covenants Not to Compete Act,[99] the legislature reworded sections 15.50 and 15.51.[100]

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98. *See* Tayon, *supra* note 55, at 148 (referring to the impasse between the legislature and the supreme court as a "pitched battle"); Garcia & Helms, *supra* note 24, at 33 (describing the situation as a "struggle of wills").

99. *See* Tayon, *supra* note 55, at 220 (suggesting that the supreme court's creation of the "at-will employment exception," as well as its continued application of the common law in lieu of the explicit language of the statute created "obstacles to enforcement of non - competition agreements. . ."); Garcia & Helms, *supra* note 24, at 33 (noting there were "complaints that the court emphasized 'form over substance[]' or demonstrated a lack of intellectual vigor in its analysis").

100. *See* TEX. BUS. & COM. CODE ANN. §§ 15.50–.51 (Vernon Supp. 2002). The amended statute reads as follows (italics denote amended provisions):

> Notwithstanding Section 15.05 of this code, . . . 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.

Id. § 15.50. The legislature also made critical changes to sections 15.51(b) and (c), which now read (italics denote amended provisions):

> (b) If the primary purpose of the agreement to which the covenant is ancillary is to obligate the promisor to render personal services, *for a term or at will*, the promisee has the burden of establishing that the covenant meets the criteria specified by Section 15.50 of this code. If the agreement has a different primary purpose, the promisor has the burden of establishing that the covenant does not meet those criteria. For the purposes of this subsection, the "burden of establishing" a fact means the burden of persuading the triers of fact that the existence of the fact is more probable than its nonexistence.
>
> (c) *If the covenant is found to be ancillary to or part of an otherwise enforceable agreement but contains limitations as to time, geographical area, or scope of activity to be restrained that are not reasonable and impose a greater restraint than is necessary to protect the goodwill or other business interest of the promisee, the court shall reform the covenant to the extent necessary to cause the limitations contained in the covenant as to time, geographical area, and scope of activity to be restrained to be reasonable and to impose a restraint that is not greater than necessary to protect the goodwill or other business interest of the promisee* and enforce the covenant as reformed, except that the court may not award the promisee damages for a breach of the covenant before its reformation and the relief granted to the promisee shall be limited to injunctive relief. If the primary purpose of the agreement to which the covenant is ancillary is to obligate the promisor to render personal services, the promisor establishes that the promisee knew at the time of the execution of the agreement that the covenant did not *contain*

Importantly, the amended version of the Act no longer requires courts to consider either the interests of the employee or the general public, important components of the preempted three-part common law test.[101] Further, the amended Act incorporated a new provision, the substance of which clearly evidenced the legislature's intent that the supreme court defer to the Act's explicit terms.[102] Specifically, section 15.52 provided that sections 15.50 and 15.51 were "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."[103]

Notwithstanding the legislature's clear directive, confusion arose after the Texas Supreme Court's 1994 decision in *Light v. Centel Cellular Co. of Texas*, in which the court once again invalidated a CNC that was arguably reasonable under the Act.[104] Notably, the supreme court for the first time acknowledged it was required to follow the legislature's mandate set forth in the Act.[105] Nevertheless, the court then construed the amended Act in such a narrow and convoluted fashion that it is now extremely difficult for Texas practitioners to be confident they are drafting an enforceable CNC.[106]

> *limitations as to time, geographical area, and scope of activity to be restrained that were reasonable and the limitations imposed a greater restraint than necessary to protect the goodwill or other business interest of the promisee,* and the promisee sought to enforce the covenant to a greater extent than was necessary to protect the goodwill or other business interest of the promisee, the court may award the promisor the costs, including reasonable attorney's fees, actually and reasonably incurred by the promisor in defending the action to enforce the covenant.

Id. § 15.51.

101. *See* Tayon, *supra* note 55, at 234–35 (calling these changes a "fundamental shift in thinking"). The Act now only requires a court to make sure the CNC's restrictions are reasonable in comparison to the *employer's* need to protect its business interests. *Id.* at 234.

102. *See* TEX. BUS. & COMM. CODE ANN. § 15.52 (Vernon Supp. 2002).

103. *Id.*

104. *See* Light v. Centel Cellular Co. of Tex., 883 S.W.2d 642, 643 (Tex. 1994).

105. *See id.* at 644 ("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.").

106. *See* Tayon, *supra* note 55, at 244–45 ("[T]he analysis in Light (1994) raises as many questions as it answers. . . .How at-will employment agreements must be drafted to enforce a covenant not to compete is still an open question."); L.M. Sixel, *Noncompete Pacts: Are they Fair?/Workers Say Rights Violated; Firms Cite Need for Protection*, HOUS. CHRON., March 17, 1998, at A1 (citing the frustrations of employers with the inconsistent rulings of Texas courts).

The *Light* court first stated that the new section 15.50 required courts to determine that there exists (1) "an otherwise enforceable agreement, to which (2) the covenant not to compete is ancillary to or a part of at the time the agreement is made."[107] In its analysis of the first prong, the court reasoned that, although an at-will employment relationship alone could not constitute an "otherwise enforceable agreement," this type of agreement *could* be derived from at-will employment if the consideration for any promise in the agreement was not illusory.[108] An example the court provided of an illusory promise was one that, in an at-will relationship, depended upon an additional period of employment.[109] Thus, in the context of at-will employment, there now must be at least one non-illusory promise that can serve as consideration for an agreement between the parties.[110] After analyzing the terms of the agreement between Light and her employer, the court identified three non-illusory promises between the parties.[111] Consequently, the court held an "otherwise enforceable agreement" existed between Light and her employer and the first prong was satisfied.[112]

The court next stated that, because there was an "otherwise enforceable agreement at the time the agreement was made," it had to determine whether the CNC was ancillary to or part of that agreement.[113] The court's analysis closely followed the language of the newly amended Act and was a noticeable change from the common law standard, which had required simply that the covenant be ancillary to "a valid transaction or relationship."[114] After noting this difference, the court adopted the reasoning of the United States Supreme Court that "a restraint is not ancillary to a contract unless it is designed to enforce a contractual obligation of one of the parties."[115]

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107. *Light*, 883 S.W.2d at 644.

108. *Id.* at 644–45.

109. *Id.* at 644. The court explained such a promise was illusory because the promisor could avoid its obligation simply by severing the employment relationship. *Id.* at 645.

110. Garcia & Helms, *supra* note 24, at 36.

111. *Light*, 883 S.W.2d at 645–46 (listing these promises as "(1) [The employer's] promise to provide 'initial . . . specialized training' to Light; (2) Light's promise to provide 14 days' notice to [the employer] to terminate employment; (3) Light's promise to provide an inventory of all [the employer's] property upon termination").

112. *Id.* at 646.

113. *Id.* at 646–47.

114. *See id.* at 644 n.4. The court noted that the broader common law standard, which had been set forth in a prior decision, *DeSantis II*, was superseded by the narrower concept contained in the 1993 amendatory version of the Covenants Not to Compete Act. *Id.*

115. *Id.* at 647 (quoting Bus. Elecs v. Sharp Elecs, 485 U.S. 717, 729–30 n.3 (1988)

Specifically, the Texas Supreme Court held that for a CNC to be ancillary to an otherwise enforceable agreement: (1) consideration furnished by the employer in the otherwise enforceable agreement has to give rise to its interest in restraining the employee's ability to compete; and (2) the covenant must be specifically tailored to enforce the employee's consideration in the otherwise enforceable agreement.[116] Unless both elements are met, the CNC is not considered "ancillary to or part of an otherwise enforceable agreement," and is therefore unenforceable.[117]

After setting forth its new standard, the *Light* court determined that the particular CNC at issue was not ancillary to or a part of the otherwise enforceable agreement.[118] Specifically, the CNC was not drafted in such a way as to enforce any of Light's return promises to her employer.[119] Therefore, despite applying the terms of the new Act, the supreme court once again invalidated a CNC brought before it.[120]

IV. THE FUTURE OF COVENANTS NOT TO COMPETE IN TEXAS – WHERE IS THE LAW HEADING?

An evolving business environment presents new obstacles to the enforcement of CNCs. A competitive economy, fueled by exponential growth in high-tech industries, should force Texas courts to reconsider the practicality of enforcing traditional restrictions in CNCs.[121] Most importantly, these changes will likely afford the Texas Supreme Court yet another opportunity to dilute the authority commanded by the Covenants Not to

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(Stevens, J., dissenting)). The Texas Supreme Court termed this the "designed-to-enforce-a-contractual-obligation standard." *Id.*

116. *Id.*

117. *Id.*

118. *Id.*

119. *Id.* at 647–48 (explaining further that no specific promise existed in the agreement that Light would refrain from disclosing confidential information the employer furnished her).

120. *Id.* at 648.

121. *See* John D. Shyer & Blair G. Connelly, *Dot-Com Noncompete Agreements Enforceable?: Internet Context May Require Different Outcomes Than in Past Cases*, N.Y. L.J., Sept. 18, 2000, at S5 (describing the problems courts will face when attempting to enforce CNCs in the context of Internet businesses' employment agreements); Beth Donovan, *New Economy Shifts Contract Balance: Spate of Decisions Shows that Noncompetes Must Reflect Pace of Technology*, NAT'L L.J., Sept. 25, 2000, at M2 (discussing how various courts have handled the problem of enforcing CNCs in the technology-intensive "new economy"); Richard A. Mann & Barry S. Roberts, *Cyberlaw: A Brave New World*, 106 DICK. L. REV. 305, 339–40 (2001) (suggesting the evolution of business technology will require noncompete agreements in high-technology industries to be governed by specialized rules).

Compete Act and reposition Texas as a jurisdiction that disfavors CNCs.

The supreme court will likely be forced by external realities to take on, in the near future, the issue of how to enforce CNCs in a dot.com-driven business culture. The rapid expansion of technology, especially the Internet, is making it increasingly difficult for courts to effectively enforce traditional time and geographical restrictions within a CNC that were once considered reasonable.[122] Several reasons account for this particular difficulty courts are facing.

One explanation is that the Internet has given businesses the opportunity to establish a nationwide or even global customer base.[123] Such a customer base expansion either severely limits or renders futile conventional geographical restrictions.[124] Traditionally, a reasonable geographical restriction encompassed the general territory in which the former employee conducted business for the employer.[125] In practice, courts have usually found the territorial scope of a restriction to be reasonable only "if the area of the restraint is no broader than the territory throughout which the employee was able to establish contact with his employer's customers during the term of his employment."[126] However, a traditional brick-and-mortar business that decides to advertise its products nationwide or worldwide utilizing the Internet will be able to contact a

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122. John Siegal, *Noncompetes: Geographical Limits*, NAT'L L.J., Aug. 28, 2000, at B9 ("Time will tell whether geographic-scope requirements give way to the forces of national commerce and globalization."); Shyer & Connelly, *supra* note 121, at S5 ("[H]ow does one determine an appropriate time period for the restriction in an industry where technology often becomes obsolete in a matter of months?").

123. *See* Xuan-Thao N. Nguyen, *Shifting the Paradigm in E-Commerce: Move Over Inherently Distinctive Trademarks—The E-Brand, I-Brand and Generic Domain Names Ascending to Power?*, 50 AM. U. L. REV. 937, 949–50 (2001) (commenting that in the last ten years, "[m]any traditional brick-and-mortar companies rapidly expanded their businesses to the Internet to take advantage of Internet-based technology"); RAYMOND T. NIMMER, THE LAW OF COMPUTER TECHNOLOGY § 3:42 (2002) ("Many companies in the computer industry are nationwide in character and worldwide in scope.").

124. *See* W.R. Grace & Co. v. Mouyal, 982 F.2d 480, 481 (11th Cir. 1993) (holding that traditional geographical restrictions are no longer viable in light of the evolving nature of contemporary commercial activity); Gaylen L. Knack & Ann K. Bloodhart, *Do Franchisors Need to Rechart the Course to Internet Success?*, 20 FRANCHISE L.J. 101, 144 (2001) (opining, in the context of CNCs found in franchise agreements, that "court[s] will find it difficult to apply a geographical limit in any Internet case").

125. *See* Diversified Human Res. Group, Inc. v. Levinson-Polakoff, 752 S.W.2d 8, 12 (Tex. App.—Dallas 1988, no pet.); Butler v. Arrow Mirror & Glass, Inc., 51 S.W.3d 787, 793 (Tex. App.—Houston [1st Dist] 2001, no pet.).

126. *See, e.g.*, Curtis v. Ziff Energy Group, Ltd., 12 S.W.3d 114, 119 (Tex. App.—Houston [14th Dist.] 2000, no pet.); Evan's World Travel, Inc. v. Adams, 978 S.W.2d 225, 232–33 (Tex. App.—Texarkana 1998, no pet.).

potentially infinite number of customers.[127] In this situation, the Texas Supreme Court likely would not enforce a CNC containing a geographical restriction that prevented an employee from contacting such a dispersed clientele. This probable reaction would occur because (i) as a matter of established law, a nexus must exist between the employee's actual contact with customers and the geographical restraint in order for the restriction to be "reasonable";[128] (ii) an employer, while complying with this established rule of law, could insert a correspondingly limitless territorial restriction into the CNC because the former employee had "access" to its worldwide or nationwide client base; and (iii) an enormous and unjustified burden would be placed on both the former employee and the public in general[129] and, consequently, create a legal mechanism causing inefficient capital flow in the market.[130] Further, the Texas Supreme Court's existing disfavor of CNCs should give the court an added incentive to invalidate a CNC used in this type of situation.

A second major problem Texas courts will face when enforcing CNCs in the context of high-tech businesses is the extremely rapid pace at which Internet technology is evolving.[131] Traditional time restraints of one year or longer, at one time feasible, are now becoming unduly burdensome for employees who work at high-tech business enterprises or companies relying heavily on the Internet to market their products or services.[132]

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127. *See* Thompson v. Hande-Lopez, Inc., 998 F. Supp. 738, 742–43 (W.D. Tex. 1998) (discussing the problem of exercising personal jurisdiction over a company that relies on the Internet, when such usage "makes it possible to conduct business throughout the world entirely from a desktop"); Carroll E. Dubuc, *Cyberspace: The Advertising Super Highway—Some Bumps Need Repair*, 790 PLI/COMM 165, 169–70 (PLI Commercial Law & Practice Course, Handbook Series No. A0-002V, 1999) (commenting on the dramatic rise of business advertising over the Internet).

128. *See* Peat Marwick Main & Co. v. Haass, 818 S.W.2d 381, 387 (Tex. 1991) (holding there must be a "connection between the personal involvement of the former firm member with the client acquired for reasonableness"); Weatherford Oil Tool Co. v. Campbell, 340 S.W.2d 950, 952 (Tex. 1960) (alluding to the legal rule that the restriction must relate to the employee's activities).

129. *See* Gerald T. Husch & John Kluksdal, *Employers' Attorney Must be Careful in Drafting Covenants Not to Compete*, 44 ADVOC. 17, 17 (2001) (stating that the effects of enforcing restrictive covenants must be measured against the cost to society of losing the services of trained employees with valuable skills). *But see* Tayon, *supra* note 55, at 234–35 (noting that, in contrast to the common law standard, the amended Covenants Not to Compete Act does not require Texas courts to consider the interests of the employee or the public anymore).

130. *See* discussion *infra* Part III.B.

131. Shyer & Connelly, *supra* note 121, at S5 (noting that courts should consider "events unfold very quickly in the world of e-commerce").

132. *See* discussion *infra* Part III.A.2. (describing two New York decisions, in which the respective courts noted the difficulty in attempting to enforce traditional time restraints in the context of high-tech business companies); Mann & Roberts, *supra* note

Traditional restrictions are also becoming increasingly difficult for employers to justify in light of the primary purpose served by CNCs: preventing an employee from directly competing with his former employer only for the period of time absolutely necessary to ensure the employee poses no real danger to that employer. As technology continues to expand, information an employee acquires on the job will be rendered obsolete in a shorter period of time. Thus, Texas courts will increasingly be faced with the problem of balancing an employer's interest in protecting its proprietary information, trade secrets, customer lists, and business goodwill with an employee's freedom to choose a career as well as earn a living.

A. *Other States' Views on the Effect Increased Technology Has on CNCs*

Although Texas courts appear to lag behind in recognizing the practical difficulties of enforcing traditional CNCs in today's "digital age," other jurisdictions have taken the initiative and formulated various solutions. Chief among these are Georgia, New York, and California. Conversely, Pennsylvania, similar to Texas, has failed to rethink its judicial perspective on CNCs in light of modern realities. An analysis of cases derived from each of these jurisdictions allows for a comparison of competing policies on CNCs.

1. Georgia

In *W.R. Grace & Co. v. Mouyal*, the Eleventh Circuit recognized the inherent problem of enforcing a "traditional" restriction in the context of a high-tech industry.[133] In disposing of the issue certified to it by the Georgia Supreme Court, the Eleventh Circuit commented:

> An employer's ability to restrict the competitive activities of former employees without slavish adherence to geographical boundaries reflects the nature of contemporary commercial activity. In an age of commerce where technology enables business to be conducted across continents and oceans by electronic impulse and jet propulsion, it is not surprising that the law must be redefined to

121, at 399 (reporting that some lawyers are being told to shorten CNCs used in the Internet industry from the usual one year to three to six months).

133. *See* W.R. Grace & Co. v. Mouyal, 982 F.2d 480 (11th Cir. 1993).

> maintain its currency and usefulness. It appears that the Georgia Supreme Court, in its certified opinion, has moved the Georgia restrictive covenant law into the twentieth century, with a weather-eye towards the twenty-first, and thereby has enhanced the competitiveness of Georgia's business citizens while accommodating the individual worker's need to fairly earn a living.[134]

In this case, the Eleventh Circuit also approved the Georgia Supreme Court's position of allowing employers to eliminate geographical restrictions in nonsolicitation covenants[135] of employment contracts.[136] These types of covenants would be enforceable, the court held, if they (i) were explicit, (ii) did not overreach, and (iii) sufficiently clarified the limits of the restriction.[137] More specifically, instead of being constrained by a specific geographical boundary, the restriction would be deemed reasonable if it was limited to all customers the former employee had contact with during the employment relationship.[138] The court reasoned that the substitution of a customer list restriction for the traditional geographical limitation would provide employers with the flexibility they needed in the modern business environment, while still respecting the rights of individual employees.[139] Other courts have agreed that customer-based restrictions are acceptable substitutes for geographical constraints in the appropriate situation.[140] These courts often believe customer-based restrictions are a more viable alternative because they are less rigid than geographical limitations.[141] Some

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134. *Id.* at 481.

135. Non-solicitation clauses only prohibit an employee from soliciting a former employer's clients, and do not prevent the employee from working for a competitor, as does a covenant not to compete. Kenneth J. Vanko, *"You're Fired! And Don't Forget Your Non-Compete. . .": The Enforceability of Restrictive Covenants in Involuntary Discharge Cases*, 1 DEP. BUS. & COMM. L.J. 1, 6–7 (2002).

136. *See Mouyal*, 982 F.2d at 481.

137. *Id.*

138. *Id.*

139. *See id.*

140. *See, e.g.*, Farm Credit Servs of N. Cent. Wis., ACA v. Wysocki, 627 N.W.2d 444, 448–49 (Wis. 2001) (holding that a customer-based restriction, limited to customers whom the former employee had contact with one year prior to the employee leaving the company, was valid as a matter of law); Pinnacle Performance, Inc. v. Hessing, 17 P.3d 308, 312 (Idaho Ct. App. 2001) (holding that an otherwise overly broad geographical limitation in a CNC may be considered reasonable if the class of persons with whom contact is prohibited is sufficiently limited); Schott v. Beussink, 950 S.W.2d 621, 627 (Mo. Ct. App. 1997) (same).

141. *See, e.g.*, *Farm Credit Servs of N. Cent. Wis., ACA*, 627 N.W.2d at 449; Rollins

courts have gone even further and implemented an employee-favorable "actual contact" test.[142] This test provides that a CNC can only restrict a former employee from contacting those customers who the former employee *actually* did business with while working for the employer.[143]

2. New York

In *EarthWeb, Inc. v. Schlack*, a New York federal district court heard an action brought against the former vice president of an Internet information technology company, in which the claims were for breach of contract and misappropriation of trade secrets.[144] Mark Schlack, defendant in the suit, was responsible for the "content" of EarthWeb's websites while employed as a divisional vice president of the company.[145] Although Schlack's input and analysis were essential to the websites' success, the court found his access to highly confidential information was limited because he was not privy to the company's "advertiser list, source codes or configuration files" and because he did not have direct contact with the company's high-level executive officers.[146]

The suit originated as a result of Schlack's acceptance of a position with ITworld.com, a subsidiary of IDG.[147] At the time, IDG was considered the world's leading provider of information technology in print-based form.[148] The court agreed with Schlack's contention that ITworld.com was fundamentally

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Burdick Hunter of Wis., Inc. v. Hamilton, 304 N.W.2d 752, 755 (Wis. 1981) (recognizing the validity of CNCs that use customer list restrictions as a substitute for geographical restrictions because this type of limitation approximates the area in which the employer is susceptible to unfair competition while concurrently entitling the former employee to engage in competitive opportunities); Thompson, Breeding, Dunn, Creswell & Sparks v. Bowlin, 765 S.W.2d 743, 745–46 (Tenn. Ct. App. 1987) (noting that the CNC, which contained a client-based restriction in lieu of a territorial restriction, gave the employee "great freedom to practice his profession in the same area as [his former employer]").

142. *See, e.g.*, Hulcher Servs Inc., v. R.J. Corman R.R. Co., 543 S.E.2d 461, 466–67 (Ga. Ct. App. 2000) (holding a restriction to be overbroad because it sought to prohibit a former employee from "doing business with any actual or potential customers of the employer located in a specific geographic area in which the employee had not actually done business"); Sanford v. RDA Consultants, Ltd., 535 S.E.2d 321, 324 (Ga. Ct. App. 2000) (same).

143. *See Hulcher Servs Inc.*, 543 S.E.2d at 467–68.

144. *See* EarthWeb, Inc. v. Schlack, 71 F. Supp. 2d 299, 302 (S.D.N.Y. 1999).

145. *Id.* (describing EarthWeb's business operations, which relied heavily on the use of Internet websites to communicate with IT professionals).

146. *Id.* at 305.

147. *Id.* at 303.

148. *Id.* (observing that IDG generated over $1 billion in revenue annually and published more than 280 monthly periodicals).

different in nature than EarthWeb in various ways.[149] For instance, one significant difference was in business strategies: EarthWeb obtained the products and services of third parties through acquisitions and licensing agreements and made them available on its website, while ITworld.com's philosophy was to use original material for over 70 percent of its website.[150] Additionally, Schlack maintained the two companies were distinguishable because each targeted different audiences.[151]

After bringing suit, EarthWeb filed a temporary restraining order seeking to preclude Schlack from working for IDG and from disclosing any trade secrets, as they were defined by Schlack's employment contract with EarthWeb.[152] EarthWeb based its suit on three contentions.[153] First, it alleged the CNC in the employment contract precluded Schlack from accepting employment with ITworld.com because ITworld.com would be in direct competition with EarthWeb.[154] Second, EarthWeb argued that, under the doctrine of inevitable disclosure, a preliminary injunction was necessary to prevent Schlack from exposing its trade secrets while he was employed with ITworld.com.[155] Finally, EarthWeb maintained that the doctrine of inevitable disclosure provided an independent basis to enjoin Schlack from working for ITworld.com.[156]

In response, Schlack contended that the non-compete provision did not apply to his employment with ITworld.com because the company's "primary business" would not provide the same services as those offered by EarthWeb.[157] Further, Schlack denied having any knowledge of EarthWeb's trade secrets and rejected the notion that his services to EarthWeb were "unique

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149. *See id.* at 306, 312–13 (contrasting EarthWeb's emphasis on obtaining the products and services of third parties with ITworld.com's allegation that it relied on original content for the majority of its websites' material).

150. *Id.* The original material ITworld.com utilized, such as product reviews, technical research, and editorial opinions, was derived from ITworld.com's own staff employees. *Id.*

151. *Id.* (contending that the products and services EarthWeb offered were aimed at programmers and technicians, while those of ITworld.com were directed mainly at upper-level executives, such as technology managers and chief information officers).

152. *Id.* at 302.

153. *See id.* at 307–08.

154. *Id.* at 307 (claiming enforcement of the CNC was necessary not only to prevent disclosure of EarthWeb's trade secrets, but because the services Schlack provided to EarthWeb were "unique and extraordinary").

155. *Id.*

156. *Id.* at 308.

157. *Id.* Specifically, Schlack argued that ITworld.com's main business would not "involve offering 'a directory of third party technology,' an 'online reference library' or an 'online store.'" *Id.*

and extraordinary."[158] Schlack also argued that the inevitable disclosure doctrine did not apply because any trade secrets he might have actually remembered from his time at EarthWeb were of no value to ITworld.com due to the fundamental differences between the two companies.[159]

The district court first discussed the doctrine of inevitable disclosure and decided that the factual circumstances dictated against its application.[160] Taking a suspicious view of the doctrine, the court emphasized that it would not "re-write the parties' employment agreement under the rubric of inevitable disclosure and thereby permit EarthWeb to broaden the sweep of its restrictive covenant [because] such retroactive alterations distort the terms of the employment relationship and upset the balance which courts have attempted to achieve in construing non-compete agreements."[161]

The court next analyzed whether the actual language of the CNC restricted Schlack from working for ITworld.com.[162] The pertinent provision of the agreement, entitled "Limited Agreement Not to Compete," provided in part:

> For a period of twelve (12) months after the termination of Schlack's employment with EarthWeb, Schlack shall not, directly or indirectly: (1) work as an employee, employer, consultant, agent, principal, partner, manager, officer, director, or in any other individual or representative capacity for any person or entity that directly competes with EarthWeb. For the purpose of this section, the term "directly competing" is defined as a person or entity or division on an entity that is (i) an on-line service for Information Professionals whose primary business is to provide Information Technology

158. *Id.*

159. *Id.*

160. *See id.* at 308–12. Factors a court may consider in determining whether to apply the inevitable disclosure doctrine include "whether (1) the employers are direct competitors providing the same or very similar goods or services; (2) the employee's new position is nearly identical to the old so that he could not reasonably be expected to fulfill his duties without using the secrets of his former employer; and (3) the trade secrets at issue are highly valuable to both employers." Victoria A. Cundiff, *Untangling* EarthWeb*: A Fresh Look at Non-Competes and the Inevitability Doctrine*, *in* CORPORATE RAIDING 2000, 1166 PLI/CORP 187, 193 (PLI Corp. Law and Practicing Course, Handbook Series No. B0-00HA, 2000).

161. *EarthWeb*, 71 F. Supp. 2d at 311.

162. *See id.* at 312.

> Professionals with a directory of third party technology, software, and/or developer resources; and/or an online reference library, and or (ii) an on-line store, the primary purpose of which is to sell or distribute third party software or products used for Internet site or software development[.][163]

The court agreed with Schlack that the description of ITworld.com's "primary business" did not fall within the express language of the CNC.[164] In addition, the court held that EarthWeb had failed to carry its burden of proving the terms of the covenant comported with New York's understanding of what constituted a reasonable and necessary restraint on trade.[165] Noting the competing policy considerations involved with enforcing CNCs,[166] the court rendered the provision in the employment contract unenforceable as written.[167]

Analyzing the CNC, the *EarthWeb* court first assessed the one-year time restriction and held it was unreasonable due to the dynamic character of the technology industry as well as the nature of Schlack's position at EarthWeb, where advancement depended on keeping abreast of changes in the Internet.[168] The court contrasted the one-year limitation with a time restriction upheld in an earlier New York opinion.[169] In that case, *DoubleClick v. Henderson*, a New York trial court enjoined the defendants for only a six-month period, reasoning that the application of a longer limitation would be futile in a high-tech business atmosphere.[170] Specifically, the court in *DoubleClick*

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163. *Id.* at 307.

164. *Id.* at 312 (finding EarthWeb had no probative basis to refute the testimony of William Reinstein, president and CEO of ITworld.com, detailing the intentions of ITworld.com).

165. *See id.* at 313. New York deems a CNC valid only if it is "reasonably limited in scope and duration, and only 'to the extent necessary (1) to prevent an employee's solicitation or disclosure of trade secrets, (2) to prevent an employee's release of confidential information regarding the employer's customers, or (3) in those cases where the employee's services to the employer are deemed special or unique.'" *Id.* at 312 (quoting Ticor Title Ins. Co. v. Cohen, 173 F. 3d 63, 70 (2d Cir. 1999)).

166. *See EarthWeb*, 71 F. Supp. 2d at 313 (stating that, while New York's policy underlying its strict approach towards restrictive covenants is based on free enterprise, employee mobility, and ensuring employee livelihood, employers are still entitled to protection from unfair or illegal conduct that would result in economic harm to their business).

167. *Id.*

168. *Id.*

169. *Id.*

170. *See* DoubleClick, Inc. v. Henderson, No. 97-116914, 1997 WL 731413, at *8 (N.Y. Sup. Ct. Nov. 7, 1997).

determined that, because Internet technology was changing at such a rapid pace, the likelihood a former employee could harm the employer through the use or disclosure of specific knowledge about the employer was remote.[171] After comparing the two CNCs, however, the *EarthWeb* court declined to reform the temporal restriction because the CNC as a whole was invalid due to overreaching.[172]

The court also rejected EarthWeb's contention that Schlack's services were of such value that enforcing the CNC was necessary to protect the company.[173] Specifically, the court determined the services Schlack provided were not "unique and extraordinary" and that Schlack was not privy to any of the company's trade secrets during his employment.[174] Moreover, the court found Schlack would have been disproportionately burdened if the CNC was enforced because "a one-year hiatus from the workforce" in the IT industry is considered to be "several generations, if not an eternity."[175] As a result, the court denied EarthWeb's motion for a preliminary injunction and dissolved the existing temporary restraining order.[176]

A similar case from New York concerning the feasibility of enforcing CNCs in the modern business environment was *DoubleClick, Inc. v. Henderson*, briefly noted above.[177] Decided two years before *EarthWeb*, this opinion was important because it showed that New York courts were willing to take into account the changing nature of business technology in establishing new standards for CNC time restrictions in the Internet industry.[178] DoubleClick specialized in selling advertising space on Internet websites, and its clients included advertisers and a network of websites on which advertising space was purchased.[179]

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171. *Id.*

172. *EarthWeb*, 71 F. Supp. 2d at 313 (reiterating that "in order to justify an enforcement of a restrictive covenant, '[m]ore must . . . be shown to establish such a quality than that the employee excels at his work or that his performance is of high value to his employer. It must also appear that his services are of such character as to make his replacement impossible or that the loss of such services would cause the employer irreparable injury.'" (quoting Am. Inst. of Chem. Eng'rs v. Reber-Friel Co., 682 F.2d 382, 390 n.9 (2d Cir. 1982))).

173. *See id.*

174. *Id.* at 313, 315–16 (stating that it did "not appear that [Schlack's] editorial responsibilities placed him in the requisite proximity" to possess any of EarthWeb's trade secrets).

175. *Id.* at 316.

176. *Id.* at 317.

177. *See* DoubleClick, Inc. v. Henderson, No. 97-116914, 1997 WL 731413 (N.Y. Sup. Ct. Nov. 7, 1997).

178. *See id.* at *8.

179. *Id.* at *1.

Defendants Dickey and Henderson had previously held the positions of Vice President of Business Development and Vice President of North American Advertising Sales at DoubleClick, respectively.[180] Their positions at DoubleClick entitled both Dickey and Henderson to access the company's confidential information.[181] Dickey had originally entered into an agreement with DoubleClick's parent company, Bozell, to maintain the confidentiality of client information, in addition to a CNC that restricted his ability to compete for Bozell's clients for one year after leaving the company.[182] Henderson, unlike Dickey, only entered into a confidentiality agreement with Bozell and not a CNC.[183]

After leaving DoubleClick, the defendants started their own Internet advertising business, Alliance Interactive Network.[184] Soon after, DoubleClick moved for a preliminary injunction, seeking to preclude Dickey and Henderson from competing with it for future business opportunities.[185] The company based its action on three claims: misappropriation of trade secrets, unfair competition, and breach of its employees' duty of loyalty.[186] After noting the likelihood of success on all three claims,[187] presuming irreparable harm to DoubleClick, and balancing the equities in favor of DoubleClick, the court granted the preliminary injunction.[188]

After granting the injunction, the court described its specific terms.[189] DoubleClick had sought to prevent the defendants from starting a business in competition with it or from working for one of DoubleClick's direct competitors for a period of one year.[190] The court denied this request for two reasons.[191] First, the CNC's scope of activity restriction was not adequately tailored to the situation.[192] The restriction was overbroad, the court held,

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180. *Id.* at *2.

181. *See id.* (stating that Dickey had access to DoubleClick's "[b]usiness [p]lan, its revenue projections, plans for future projects, pricing and product strategies, and its various databases with information concerning DoubleClick's clients" and that Henderson had contact with this information as well as other "confidential information" given to him at executive meetings).

182. *Id.*

183. *Id.*

184. *Id.* at *3.

185. *Id.* at *1.

186. *Id.*

187. *Id.* at *3–*7.

188. *See id.* at *7–*8.

189. *See id.* at *8.

190. *Id.*

191. *See id.*

192. *Id.*

because it sought to prevent the defendants from working in fields they had not operated in while at DoubleClick.[193] Thus, the covenant could only viably restrict the defendants from taking employment where their new responsibilities primarily entailed Internet advertising.[194] Further, the CNC's time restriction was unreasonable.[195] The court stated that the rapid rate at which information in the Internet advertising industry changed would render the defendants' knowledge insignificant or even obsolete in less than one year.[196] The court then reformed the durational period of the injunction to provide for a more reasonable six-month limitation.[197]

These two decisions indicate that New York courts are willing to address the difficulties increased business technology imposes on the enforcement of CNCs. With rapid technology growth and companies relying on the Internet to expand their client base, it is becoming increasingly problematic for courts to abide by traditional notions of what constitutes a reasonable restriction in a CNC.[198] New York courts apparently realize the term "reasonable" has evolved over time as a consequence of technology and an increasingly mobile employee workforce. Applying more flexible standards to determine the "reasonableness" of a restriction, these courts have assessed the plight of modern employees while concurrently affording sufficient protection to employers.[199] Although the courts concluded that traditional time restrictions were ineffective in the context of Internet-related businesses, it is prudent to not read these two cases as creating a per se rule that invalidates all time restrictions longer than 6 months in this particular industry.[200] Instead, courts must still scrutinize the facts of each case, particularly the type of information at issue, the degree to which the employee has access to such information, and the extent this information will remain current as the industry changes.[201]

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193. *See id.* The restriction provided that Dickey and Henderson could work for companies engaging in Internet advertising as part of its business, as long as the two defendants did not participate in the Internet advertisement department. *Id.*

194. *See id.*

195. *See id.*

196. *Id.*

197. *Id.*

198. *See* Arnow-Richman, *supra* note 11, at 1165, 1198–1202 (commenting that existing doctrines do not fulfill the needs of the modern workplace and have created confusion in the case law).

199. *See, e.g.*, *EarthWeb*, 71 F. Supp. 2d at 313; *DoubleClick*, 1997 WL 731413 at *8.

200. *See* Cundiff, *supra* note 160, at 194 (stating that *EarthWeb* "should not be read to hold that a one-year restrictive covenant is never enforceable in an Internet-related business").

201. *See* Jack E. Karns & Roger P. McIntyre, *Are Intellectual Property Rights*

To provide a complete illustration of New York's policy toward CNCs, the two aforementioned cases should be contrasted with an earlier New York opinion, *Business Intelligence Services, Inc. v. Hudson*, which is representative of how New York courts viewed CNCs before the recent technology revolution.[202] In that case, Business Intelligence Services, Inc. ("BIS") brought suit seeking to enjoin Carole Hudson, a former employee, from working for Management Technologies, Inc. ("MTI"), a direct competitor of BIS.[203] BIS specialized in the development, production, and licensing of computer software.[204] Before leaving BIS, Hudson had been employed as a senior consultant with the company and her duties included implementing computer software programs and acting as a liaison between the company and its clients.[205] Both BIS and MTI specialized in a similar type of packaged software and marketed software programs in direct competition with one another.[206] The covenant not to compete BIS sought to enforce mandated that Hudson was not to work for "[any] company which is carried on in competition with any part of the business of the Company wherever located," for a duration of twelve months.[207]

After first indicating that BIS would suffer irreparable harm if Hudson went to work with MTI, the New York district court analyzed whether the CNC was enforceable as written.[208] Evaluating the one-year time restriction, the court held it was reasonable in light of the particular factual circumstances.[209] The court heavily favored the interests of the former employer, BIS, despite acknowledging that the confidential information Hudson

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Protected in Employment Contract Covenants Not to Compete Given the Rapid Rate of New Product Development?, 26 OKLA. CITY U. L. REV. 631, 647 (2001) (concluding that *EarthWeb* should not be read as rendering unenforceable all CNCs in high-technology industries, and asserting that "companies must be extremely specific and selective with regard to each incoming employee and the information to which that employee will have access . . .").

202. Bus. Intelligence Servs, Inc. v. Hudson, 580 F. Supp. 1068, 1071–72 (S.D.N.Y. 1984).

203. *Id.* at 1069.

204. *Id.*

205. *Id.*

206. *Id.* at 1071. The court noted the two companies were "vigorous competitors in the rapidly developing market for computer software where design and program are paramount." *Id.*

207. *Id.* at 1070.

208. *See id.* at 1072.

209. *Id.* The court based its decision on the fact that Hudson had considerable knowledge of the software programs, source codes, and modules of BIS, as well as relevant information concerning the development and design of its new programs. *Id.* at 1072–73.

possessed would be outdated and useless within a year.[210] Thus, in the court's view, protecting BIS from irreparable harm was a higher priority than allowing Hudson to accept employment with a competitor.[211]

Satisfied with the time restriction, the court proceeded with caution in scrutinizing the unlimited geographical scope of the CNC.[212] In its brief analysis, the court considered prior cases in which extensive geographical restrictions had been enforced.[213] The court found the global nature of BIS determinative in holding that the worldwide restriction was necessary for BIS to continue to run a successful business."[214] The court then granted a temporary injunction that prevented Hudson from working for MTI for one year.[215]

3. California

California, home to a large percentage of America's technology-intensive businesses, is unique in that it absolutely prohibits the enforcement of CNCs except in certain narrow circumstances.[216] California's statute pertaining to CNCs states: "Except as provided in this chapter, every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void."[217] The only statutory exceptions to this default rule are provided for in the following situations: (1) sale of business goodwill and (2) in anticipation of the dissolution of a partnership.[218] Some

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210. *See id.* at 1073.

211. *See id.*

212. *See id.*

213. *See id.* (discussing Cont'l Group, Inc. v. Kinsley, 422 F. Supp. 838, 843 (D. Conn. 1976); Mixing Equip. Co., Inc. v. Phila. Gear, Inc., 436 F.2d 1308, 1314 (3d Cir. 1971)).

214. *Id.*

215. *Id.*

216. *See* CAL. BUS. & PROF. CODE §§ 16600–602 (West 1997 & Supp. 2003); *see generally* Ronald J. Gilson, *The Legal Infrastructure of High Technology Industrial Districts: Silicon Valley, Route 128, and Covenants Not to Compete*, 74 N.Y.U. L. REV. 575, 607–08 (1999) (discussing California law and policy on covenants not to compete); Richard R. Mainland, *Contracts Limiting Competition by Former Employees: A California Law Perspective*, *in* TRADE SECRET PROTECTION & LITIGATION: PROTECTING CONFIDENTIAL BUSINESS & TECHNICAL INFORMATION 1992, 340 PLI/PAT 119 (PLI Patents, Copyrights, Trademarks, and Literary Property Course, Handbook Series No. G4-3884, 1992) (detailing California's unique perspective on CNCs). In addition to California, several other states place heavy statutory limits on the usage of CNCs. *See, e.g.*, ALA. CODE § 8-1-1 (2002); MONT. CODE ANN. § 28-2-703 (2001); N.D. CENT. CODE § 9-08-06 (1987 & SUPP. 2001); OKLA. STAT. ANN. tit. 15, § 217 (West 1993 & Supp. 2003).

217. CAL. BUS. & PROF. CODE § 16600.

218. *See id.* at §§ 16601–602; Kolani v. Gluska, 75 Cal. Rptr. 2d 257, 260 (Cal. Ct. App. 1998) (pointing out that these two exceptions are construed narrowly).

California courts have also created additional exceptions, enforcing the CNC if it only partially restrains the employee, although this is not common.[219] Such enforceable partial restraints have included "clauses prohibiting the solicitation of the former employer's customers, . . . limiting certain post-employment activities (but not an entire business), and . . . covenants protecting an employer's trade secrets."[220] However, even in the special situation where an exception is applicable, the covenant must still relate to a specific purpose and be narrowly tailored in order to pass muster in California.[221]

The strong public policy underlying California's statute is the promotion of its residents' right to choose and pursue lawful employment in any industry.[222] California deems "[t]he interests of the employee in his own mobility and betterment [to be] paramount to the competitive business interests of the employers,"[223] a view that conflicts with those held by an overwhelming majority of other states.[224] California courts have generally reasoned that CNCs attempting to restrain activities outside the two specified exceptions are not in conformity with this public policy and are, therefore, void.[225] In addition to its policy of ardently disfavoring the usage of CNCs, California's choice-of-law provisions[226] also fail to afford its employers any relief.[227] Specifically, in a conflict of law scenario, the law of a

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219. *See* Larry C. Drapkin & Samantha C. Grant, *Strategies for Dealing with Departing Employees: Why Wait Until Then? Let's Think About It Now*, 1233 PLI/CORP 261, 266–78 (PLI Corp. Law & Practice Course, Handbook Series No. B0-00VS, 2001) (discussing a variety of methods California employers utilize to partially restrain their former employees).

220. Wood, *supra* note 28, ¶ 19; *see also Kolani*, 75 Cal. Rptr. 2d at 259; Int'l Bus. Machs Corp. v. Bajorek, 191 F.3d 1033 (9th Cir. 1999); Boughton v. Socony Mobil Oil Co., 41 Cal. Rptr. 714 (Cal. Ct. App. 1964).

221. Wood, *supra* note 28, ¶¶ 19–20.

222. Metro Traffic Control, Inc. v. Shadow Traffic Network, 27 Cal. Rptr. 2d 573, 577 (Cal. Ct. App. 1994).

223. Diodes, Inc. v. Franzen, 67 Cal. Rptr. 19, 26 (Cal. Ct. App. 1968).

224. Mainland, *supra* note 216, at 123.

225. *See, e.g.*, *Kolani*, 75 Cal. Rptr. 2d at 260; *see also* Mainland, *supra* note 216, at 125–29 (explaining the two statutory exceptions).

226. *See* Nedlloyd Lines B.V. v. Superior Court, 11 Cal. Rptr. 2d 330, 332–34 (Cal. 1992) (discussing California's current approach toward choice-of-law provisions).

227. *See, e.g.*, Scott v. Snelling and Snelling, Inc., 732 F. Supp. 1034, 1039–40 (N.D. Cal. 1990) ("California Business and Professions Code Section 16600 . . . has been held by the California courts to represent a strong public policy which would override the choice of law provision in the contract at least with regard to the restrictive covenant."); Application Group, Inc. v. Hunter Group, Inc., 72 Cal. Rptr. 2d 73, 81–88 (Cal. Ct. App. 1998) (declining to enforce a contractual conflict-of-law provision when doing so would have violated California's fundamental policy on CNCs); Frame v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 97 Cal. Rptr. 811, 814 (Cal. Ct. App. 1971) (declining to apply New York law in a profit-sharing agreement because doing so would have violated California's

foreign jurisdiction that permits the usage of CNCs will not be allowed to preempt California law.[228]

4. Pennsylvania

Contrary to New York and Georgia, which permit flexibility in restructuring CNCs, and California, which generally precludes their usage, Pennsylvania has yet to reformulate its policy[229] on enforcing CNCs in light of the changing business environment. A clear example of this can be seen in a recent Pennsylvania decision in which the court enforced a CNC containing traditional restrictions in the context of an Internet-based business.[230] In *National Business Services, Inc. v. Wright*, a United States District Court for the Eastern District of Pennsylvania enforced a CNC against an employee who changed jobs in the promotional products industry.[231] The employer, National Business Services d/b/a Advertising Specialty Institute ("ASI"), had hired Wright to launch an Internet product to various distributors.[232] During Wright's employment with ASI, her primary duties included overseeing Internet sales to distributors, gathering product feedback from customers, and attending management meetings regarding Internet products.[233] Wright had specialized knowledge concerning the company that included ASI's future plans for its products as well as confidential information relating to manufacturing, research, product development, marketing strategies, advertising plans, pricing, and customers.[234] She was considered "an expert on Internet information products in the advertising specialty

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"strong public policy").

228. *See Scott*, 732 F. Supp. at 1039–40; *Application Group, Inc.*, 72 Cal. Rptr. 2d at 81–88; *Frame*, 97 Cal. Rptr. at 814. For a discussion of additional cases regarding how California's choice-of-law policy affects the enforceability of CNCs, see Carla Feldman & Jill Westmoreland, *Noncompetes Aren't Guaranteed: Sometimes the Law of One State Will Override an Employment Agreement Made Elsewhere*, NAT'L L.J., Sept. 24, 2001, at B18.

229. For a brief overview on the law of restrictive covenants in Pennsylvania, see Hess v. Gebhard & Co., 808 A.2d 912, 917–18 (Pa. 2002). In Pennsylvania, CNCs "are enforceable if they are incident to an employment relationship between the parties; the restrictions imposed by the covenant are reasonably necessary for the protection of the employer; and the restrictions imposed are reasonably limited in duration and geographic extent." *Id.* at 917.

230. *See* Nat'l Bus. Servs, Inc. v. Wright, 2 F. Supp. 2d 701, 702–03 (E.D. Pa. 1998).

231. *See id.* at 702–03.

232. *Id.* at 703. ASI, along with Wright's new employer, Impact, were the "[t]wo principal companies provid[ing] sales, marketing, and information services to suppliers and distributors in the advertising specialty industry. . . ." *Id.*

233. *Id.* at 705.

234. *Id.*

industry."[235] Less than three years after joining ASI, Wright resigned and subsequently entered into an employment agreement with Impact, a direct competitor of ASI, thereby disregarding the CNC she had previously signed.[236]

After determining the CNC was ancillary to Wright's employment contract with ASI, the court found the CNC's one-year time restraint to be reasonable.[237] Refusing to take into account the realities of a changing business environment, the court simply stated, "Pennsylvania courts routinely uphold one year restrictive covenants."[238] Balancing the competing interests of both parties in a simplistic, summary manner, the court weighed in favor of ASI because the one-year restriction "seemed necessary to protect [its] confidential information."[239]

The court also held that the geographical restriction, which encompassed the entire United States, was reasonable.[240] Despite acknowledging that nationwide limitations were rarely enforced, the court held the factual circumstances of the case, including ASI's and Impact's national reach and Wright's extent of customer contact, dictated such a broad-reaching restriction be permitted.[241] The court reaffirmed a position it had taken in an earlier case, in which it held that an employee working for a company conducting business in all fifty states had no recourse when the CNC contained a nationwide restriction.[242]

Unfortunately, the court failed to fully appreciate the difficulties posed by enforcing traditional restrictions in today's evolved business environment. The court would have done well to take the same thoughtful approach as the courts in *Mouyal*, *EarthWeb*, and *DoubleClick*. Further, the court's rationale was deficient because it failed to take into account other important considerations, such as foreseeable injury to the public at large and the nature of the burden imposed on the employee, which should have factored into the enforceability of the CNC.[243]

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235. *Id.*

236. *Id.* at 703, 706.

237. *Id.* at 707–08.

238. *Id.* at 708.

239. *See id.* Interestingly, the court also recognized that "[m]uch of the information about ASI that Wright possesses is only valuable for a limited time because of rapid changes in the industry, particularly in the Internet sphere." *Id.* at 705.

240. *Id.* at 708.

241. *Id.* (stating that "[t]ransactions involving the Internet unlike traditional 'sales territory' cases, are not limited by state boundaries").

242. *See* Kramer v. Robec, Inc., 824 F. Supp. 508, 512 (E.D. Pa. 1992) (upholding a nationwide restriction because the product was marketed in all fifty states).

243. *See, e.g.*, Thermo-Guard, Inc. v. Cochran, 596 A.2d 188, 194 (Pa. Super. Ct. 1991) (holding that Pennsylvania law requires its courts to "balance the interest the

Unfortunately, the court's decision offers little hope to employees working at Internet-related businesses in Pennsylvania who desire to transfer jobs or begin a start-up company within the industry.

B. *Speculation on the Effect a Jurisdiction's CNC Policy Has on the Region's Technological Growth*

In the last decade, the Internet and technology-based industries have been at the forefront of an amazing information revolution that has powerfully affected the economy.[244] Despite the recent downturn in the economy, we have seen a drastic and continual economic growth that surpasses any other time period in history.[245] With this backdrop in place, several commentators have expressed intriguing opinions as to why certain regions of the United States have experienced rapid technological, informational, and economic growth, while others have noticeably lagged behind.[246] One of these commentators, Professor Ronald Gilson, hypothesized that high-growth regions are a product of their legal infrastructure and, more specifically, the particular jurisdiction's law and public policy concerning the enforceability of CNCs.[247] A study Gilson conducted comparing Silicon Valley to Boston and its surrounding Route 128 corridor revealed that California almost always prohibits the usage of CNCs, while Massachusetts courts tend to favor their enforcement.[248] Gilson believes Silicon Valley in California

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employer seeks to protect against the important interest of the employee in being able to earn a living in his chosen profession"); Cliff v. R.R.S., Inc., 620 N.Y.S.2d 190, 192 (N.Y. App. Div. 1994) (pointing out that, to be enforceable in New York, a covenant not to compete must not be "harmful to the general public") (citations omitted).

244. Wood, *supra* note 28, ¶ 1; *see also* Peter G. Gosselin & Jube Shiver, Jr., *After the Attack the Financial Fallout: 'New Economy' is a Thing of the Past*, L.A. TIMES, Sept. 23, 2001, at A20 ("Economists have treated the combination of the Internet, cell phones and fiber-optic networks as the 'x' factor that prodded the country into operating more productively after decades of stubbornly refusing to do so.").

245. *See* Steve Bickerstaff, *Shackles on the Giant: How the Federal Government Created Microsoft, Personal Computers, and the Internet*, 78 TEX. L. REV. 1, 2–3 (1999) (stating, "The unparalleled success of the U.S. economy [in the 1990s] has been fueled in large part by the growing revenues and soaring stock values generated by information technology (IT) companies, as well as increased productivity in other industries attributable to the use of information technology.").

246. *See* ANNALEE SAXENIAN, REGIONAL ADVANTAGE: CULTURE AND COMPETITION IN SILICON VALLEY AND ROUTE 128 at 29–37 (Harvard University Press 1994) (focusing on a particular region's business culture and social customs as the main factor in the region's comparative economic growth). *But cf.* Gilson, *supra* note 216, at 577–78 (expanding on Saxenian's theory by concentrating on the legal rules applicable to CNCs in the jurisdiction that the particular "industrial district" is located in).

247. Gilson, *supra* note 216, at 578.

248. *Id.* at 603.

experienced such rapid growth in the early 1990s, in contrast to Route 128's stunted development,[249] because it had a "much more collaborative culture, with employees continually job-hopping and carrying knowledge with them from company to company, [which] resulted from the fact that covenants not to compete in employment agreements are unenforceable by law in California."[250] AnnaLee Saxenian, who had conducted a prior study comparing the two regions, offered a somewhat different explanation for Silicon Valley's success, one that had its basis in socio-economic theory rather than any legal rationalizations.[251] Saxenian posited that Silicon Valley's growth resulted from the way its "business culture" facilitated an extremely high level of mobility among workers with technical and technological expertise, and caused corresponding knowledge spillovers between firms.[252]

In contrast to Silicon Valley's exponential development, Gilson hypothesized that Massachusetts's policy of favoring enforcement of CNCs in employment contracts inhibited Route 128's growth by preventing the free flow of human capital between businesses.[253] He believed the limitations Massachusetts courts artificially imposed on employee mobility prevented valuable knowledge spillovers between Route 128 firms[254] and, consequently, stunted informational and technological growth in the region.[255]

Similar to other technologically advanced regions, Austin, Texas is widely considered to be a hub of innovation and technology.[256] Austin is already home to four hundred software companies and several billion-dollar semiconductor plants.[257]

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249. In the fifteen years between 1975 and 1990, "Silicon Valley created three times the number of new technology-related jobs as Route 128." *Id.* at 587.

250. *Id.* at 607–09.

251. *See* Saxenian, *supra* note 246, at 34–37.

252. *Id.*

253. *See* Gilson, *supra* note 216, at 603–07. In his study, Gilson contrasted Route 128 firms, which possessed the traditional, vertically integrated structure of large mass-production companies, with companies in Silicon Valley, which actively encouraged horizontal movement by employees between firms in a "high velocity labor market." *Id.* at 591–92 (citations omitted).

254. Gilson explained that "[k]nowledge, especially tacit knowledge, 'spills over' between firms through the movement of employees between employers and start-ups." *Id.* at 579.

255. *See id.* at 603.

256. *See* Elizabeth Smith, *Austin's Evolution: University Town to High Tech Center* 1, *at* http://www.austinchamber.org/Do_Business/Business_Resources/Reports/AustinHigh TechEvolution.doc; Dan Morales, *Rainmakers for the Harvest of Technology*, 2 TEX. INTELL. PROP. L.J. 1 (1993).

257. Wood, *supra* note 28, ¶ 42. For current statistics and a detailed analysis of

Over two thousand technology-based businesses reside in the city, including Dell Computers, Motorola, and IBM.[258] Recently, a study found that Austin had a higher rate of patents issued than Silicon Valley, the region considered by most to be the leader in technological entrepreneurship.[259]

Under Gilson's theory, one could argue that the growth Austin experienced in the 1990s was directly related to the Texas Supreme Court's strong disfavor of CNCs. Texas employers, the argument would go, were hesitant to use CNCs out of fear they would waste time and resources in a losing battle defending the noncompetes in court. This argument is appealing on its face and likely does possess some degree of truth. However, there are some fundamental problems with the analysis. For instance, why did Austin attract such a high number of tech businesses during this period while Houston, Dallas, and San Antonio failed to enjoy parallel success in the sector? Addressing this very issue, another commentator remarked that if Gilson's theory proved sound, then regions whose jurisdictions prohibit or disfavor the enforcement of CNCs would generally have the most economic growth.[260] Testing this hypothesis, he concluded that a particular jurisdiction's legal rules and policies concerning CNCs could not be the sole determinant of that region's growth.[261] Instead, he posited alternative reasons to explain the discrepancies in Gilson's theory, including:

1. Unprecedented national economic growth during the time Gilson's study was conducted obscured the alleged advantage procured by regions disfavoring CNCs;

2. Low unemployment rates allowed employees to change jobs more easily, thus providing the imperative knowledge spillovers needed for regional growth; and

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technology industries in Austin, Texas, visit the Greater Austin Chamber of Congress, *at* http://www.austinchamber.org/Do_Business.

258. Smith, *supra* note 256, at 1–3. Currently, Texas ranks second in the nation for number of individuals employed in the computer industry. Greater Austin Chamber of Congress, *at* http://www.austinchamber.org/Do_Business/What_s_Hot_Here/Key_Industries/Computers_Peripherals.

259. *See* Neil Orman, *Austin Tops in Patent Growth*, AUSTIN BUS. J., Nov. 29, 1996, at 1, 32 (reporting that patents issued to Austin-based inventors rose by a 29.4 percent average annual rate).

260. *See* Wood, *supra* note 28, ¶ 36.

261. *See id.* ¶ 58 (observing that relevant statistical data did not substantiate Gilson's hypothesis).

3. State and local leaders made concerted efforts to reproduce the network effects and knowledge spillovers seen in Silicon Valley on a smaller scale.[262]

C. *Predicting the Texas Supreme Court's Resolution of a Case Concerning the Enforceability of CNCs in a Dot.com Business World*

It waits to be seen what kind of solution the Texas Supreme Court will formulate when it is presented with a case directly addressing the validity of enforcing CNCs in today's Internet-based society.[263] An educated guess is that the court will decide the case in a manner similar to that of *EarthWeb*. In other words, the Texas Supreme Court will recognize, as did the court in *EarthWeb*, that applying outdated legal rules in the context of an evolved and modernized business environment is not viable because of an unavoidable conflict of paradigms.[264] In this hypothetical case, the court will likely gloss over the first part of the statutory test (proving the CNC was ancillary to or part of an otherwise enforceable agreement at the time the agreement was made)[265] and speak directly to the substantive reasonableness of the particular restrictions.

Although the supreme court may not revert back to common law notions of what constitutes a valid and enforceable CNC,[266] it nonetheless has full discretion under the Covenants Not to Compete Act to determine the "reasonableness" of any restrictions.[267] This statutorily-mandated discretion is an extremely powerful tool the supreme court can wield to shape public policy.[268] In essence, it gives the court power to insert its

262. *Id.* ¶¶ 59–64. The last of these three explanations, as applied to Austin, is supported by research. *See infra* note 273.

263. *See* William H. Horton & Michael R. Turco, *Business Law: Some Observations on Restrictive Employment Agreements in the Information Age*, 79 MICH. B.J. 1520, 1520 (2000) (remarking that the law responds to, rather than drives, changes in American society and the economy).

264. *See* EarthWeb v. Schlack, 71 F. Supp. 2d 299, 313 (S.D.N.Y. 1999); Mann & Roberts, *supra* note 121, at 339 (stating that, in general, application of traditional legal principles to the Internet will not function and new rules should be developed by courts).

265. The supreme court analyzed this part of the test, in detail, in its last decision concerning CNCs, *Light v. Centel Cellular Co. of Texas*, 883 S.W.2d 642, 644–48, and therefore will likely be disinclined to spend much time discussing it in this case.

266. *See Light*, 883 S.W.2d at 644 ("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.").

267. *See* TEX. BUS. & COM. CODE ANN. § 15.51(c) (Vernon Supp. 2002).

268. *See* NIMMER, *supra* note 123, § 3:41 ("[A] court's . . . general willingness to

own biases into the opinion. Hence, the court should enthusiastically take into account the effect of the technological revolution when formulating an evolved standard of "reasonable" restrictions.

One course of action the supreme court could take is to significantly narrow the scope of what is considered a "reasonable" time restriction. For example, the court could emulate the reasoning used in *DoubleClick* and find the confidential or proprietary information at issue has such a brief shelf life that, in effect, the employer would not suffer irreparable damage from its former employee divulging the information to a competitor.[269] It is also possible, with an appropriate fact pattern, that the court could reform the particular CNC's time restriction to be even shorter than the six-month period held reasonable in *DoubleClick*.

As worldwide markets expand quickly in this age of globalization, the court should also realize that the traditional geographical scope of an employer's business interests entitled to protection has correspondingly been modified. Continuing the application of traditional geographical restrictions today would inevitably injure employees' monetary interests and reasonable expectations without any form of just compensation.[270] If recent history repeats itself, the Texas Supreme Court should use these changes in technology as yet another justification to avoid enforcing the CNC due to an overbroad geographic restriction.

Finally, acting under the public policy presumption that CNCs are unreasonable restraints of trade unless narrowly tailored, the court will likely find that voiding the CNC and affording employers and the general public access to a pool of well-trained employees better serves society.[271] The supreme court could possibly utilize the same reasoning used by California

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superimpose judicially determined reasonableness standards stems from a paternalism fitted into contract law to protect employees.").

269. *See* DoubleClick v. Henderson, No. 97-116914, 1997 WL 731413, at *8 (N.Y. Sup. Ct. Nov. 7, 1997).

270. A worldwide or nationwide geographical restriction would almost always unreasonably harm the employee because he would have to locate a job in a completely different industry to make a living. *See* Russo Assocs, Inc. v. Cachina, No. 276910, 1995 WL 43683, at *4 (Conn. Super. Feb. 28, 1995) (stating that "the computer field changes rapidly and [] a two year hiatus from working in the [computer assisted design] field would exclude Cachina from the developments in the field. If the covenant was enforced, Cachina would be extremely disadvantaged when he reentered the [market].").

271. *See* Singer v. Habif, Arogeti & Wynne, P.C., 297 S.E.2d 473, 475 (Ga. 1982) (holding a CNC to be an unenforceable restraint of trade where it unreasonably impacted on the accountant's capacity to render professional services and the public's ability to choose a well-qualified accountant).

courts when making this determination.[272] However, the supreme court should be wary not to subvert employer interests, as oftentimes they are entirely legitimate as well as socially and economically important.

As a final thought, if Professor Gilson's theory is indeed correct, this should provide the Texas Supreme Court with yet another incentive to curb the enforcement of CNCs. Stated differently, if there were a proven correlation between the non-enforceability of CNCs and regional economic growth, this could factor into the court's decision to narrow the enforceability of CNCs in high-tech industries.[273]

V. CONCLUSION

The traditional usage of covenants not to compete in Texas should soon come to a crossroads, as it is inevitable the Texas Supreme Court will hear a case concerning the enforceability of CNCs in the context of an evolving, dot.com business world. A combination of factors points to the conclusion that the supreme court will again significantly reduce the effectiveness of CNCs when the opportunity presents itself. First, the court has already made clear, through numerous opinions, its strong disfavor of CNCs because of the undue restraints they put on employee mobility. There is no reason to believe this sentiment will not carry forward into a new generation of cases, especially as the political composition of the court has remained virtually static over the years. Second, other jurisdictions whose opinions have traditionally held sway, including New York and California, have been at the forefront of advocating change in the legal principles and policy aspects of enforcing CNCs in an evolved business world. The Texas Supreme Court is a natural candidate to further the change espoused by these jurisdictions when the opportunity presents itself. Finally, the supreme court could

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272. *See, e.g.*, Application Group, Inc. v. Hunter Group, Inc., 72 Cal. Rptr. 2d 73, 85 (Cal. Ct. App. 1998) ("California employers in [high-tech] sectors of the economy have a strong and legitimate interest in having broad freedom to choose from a much larger, indeed a 'national,' applicant pool in order to maximize the quality of the product or services they provide, as well as the reach of their 'market.'").

273. At least one commentator, however, has emphasized that Austin's exponential growth in tech companies during the latter half of the twentieth century was mainly the result of a planned "partnership between government, business and the University of Texas at Austin." Smith, *supra* note 256, at 2. She pointed out that "[s]tate and local leaders realized how critical research and technology were to future prosperity." *Id.* at 3. Thus, it could very well be that it was the conscious effort and determination of this "Austin partnership" to attract tech businesses, and not the Texas Supreme Court's refusal to enforce CNCs, that transformed Austin into "one of the leading centers of the high technology industry." *Id.* at 1.

maintain that a substantial reason Texas, particularly Austin, experienced such technological and economic growth in the 1990s was because the court consistently limited the enforceability of CNCs in the business employment context. In particular, an argument could be raised that the litany of opinions the supreme court handed down restricting CNCs discouraged employers in high-tech enterprises from placing restrictions in their employment agreements, and thus facilitated knowledge spillovers in these industries. In conclusion, gleaning from its record of past decisions, it seems probable that the Texas Supreme Court will attempt to further restrict the usage of covenants not to compete in Texas in order to promote the free flow of information and human capital in the business market.

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