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03-1050
ALEX SHESHUNOFF MGMT SVCS V. JOHNSON & STRUNK

MCKETTA: This case comes here on summary judgment and tests the inforceability of a noncompeting agreement. And brings several very important things for which we are grateful that the court has accepted review and will give guidance. One, is the importance of predictability. Ten years ago this court gave an excellent exposition about a statute and gave the guidance both of the statute and of what some courts and commentators have called a blueprint setting out what does and what does not comport with a sufficient agreement in order to have enforceable non-compete. Predictability is extremely important. Lawyers drafting, parties negotiating, and parties seeking to hire and parties seeking to enforce should not have to guess from judge to judge what will happen.

O'NEILL: Let's say you are at a company and you have access to a certain body of confidential information. The company decides whoops, we really better get this protected. Then comes the employer and says now we want you to sign - because we've given you this in the past, you now need to sign it. Now presume with me that the confidential information doesn't change. I understand in this case you claim it does, because client lists and data bases that are constantly changing. So everyday it's newly confidential. But presume that it wasn't newly confidential. Presume that it was the formula for something. And you've had access to it for 20 years with no agreement. The company says now we want you to sign it because this is confidential, and consideration of us having given this to you in the past, we want you to sign this agreement. And you sign it. What then?

MCKETTA: There is a decision out of Beaumont that addresses exactly that situation. It's the Wright case, and it has two pieces. The piece that has been discussed in the briefing is the piece where it says like the SC in the Light case and like every CA except Austin, it says a promise to give confidential information is sufficient.

O'NEILL: There is no new consideration there.

MCKETTA: The other piece says, we now have to reach the question of reasonableness of the restraint for the circumstances presented. And this record is not clear enough for us to know the quality of the protectable information and whether it is different information. Then you put that in the remedy of would it be right to protect things that were not different?

O'NEILL: But presume it's a formula that you've had access to forever. It hasn't changed. They come to you and say, now we want you to sign the agreement. You sign the agreement. There's no new consideration there. But do you need new consideration?

MCKETTA: I would actually say there is new consideration. I would say that unless that some record showed that it was memorized information, that there is a benefit to having a contractual

right to re-access that information, get that new training, and the facts of this case get the new information. But in your hypothetical, to re-access the Coca Cola formula, to re-access the information that will somehow help me in my job, and after my post-employment constraints may have benefits to me in my general learning though I still have to keep confidences. There is a contractual right to see information which my employer says I won't give you access to anymore if you don't sign this. I would say that now having a contractual promise is better than having an employer who has never promised me that I will get any continuing access to that. So I would call it new consideration.

But to answer the second part of your question: does it matter if it's new and different consideration? It is an enforceable contract. It's an enforceable promise. And for the purpose of the statute, and for the purpose of the analysis under Light, I think the testing is whether there is now two enforceable contracts. And every case has said, except the Austin court, if there is a promise by the employer to furnish confidential information and or training, and if there is a promise by the employee to keep confidential or otherwise give the _____ of the agreement that supports noncompete. If they are promised by each, that will support the noncompete. And that's the analysis whether or not we would test that new consideration or not. But I would say it's new consideration. If I now have a power to insist on something that yesterday I didn't have the power to assist on that's consideration.

WAINWRIGHT: Footnote 14 in Light says that, thus if an employer gives an employee confidential and proprietary information, then consequences follow. Doesn't that suggest that more than a promise is necessary, that the training and confidential information have to be actually provided?

MCKETTA: You thought it exactly what mislead the Austin CA. If you look at footnote 15, and if you look at the promise in Light to give training, the SC squarely held on page 645-46, it squarely held that the promise to give training, it wasn't received yet, it wasn't given, it was a promise to receive, said it is a non-illusory promise. Footnote 15 says, that if there had been here the employee promise in return, these circumstances would have enforced for non-compete. And, therefore, when the Austin court focused on the word "gives" it gave a meaning that I think this court and J. Cornyn did not intend. I think that footnote 14 gave that as an instance, but did not say it must be only by giving. Because the clear language that the promise to give training, a promise that I will do something is enough and is not illusory. And footnote 15 emphasis that that was so...

WAINWRIGHT: I hear what you're saying. I think you're looking for a way to reconcile the statements in footnote 14, 15 in the holding that you mentioned. I don't hear you suggesting we should ignore footnote 14. You're trying to reconcile them. Let's think about that conceptually. In a contract that's not a non-compete, and I understand the statute is a bit different and it was the result of some back and forth between the legislature and the court, but in a contract generally if I make a promise to do something and you make a return promise, and that I never perform my promise, do we have an enforceable contract?

MCKETTA: Oh, you bet you do. And that's the importance of the DeSantis v. Wackenhut decision. We were so disappointed we couldn't get the Austin court to focus on.

WAINWRIGHT: And you have a breach of contract damages?

MCKETTA: That's right. And what is enforcement other than to have a remedy when somebody fails to perform their promise. In Wackenhut and the cases of Langdon and _____, the cases that are never mentioned by the Austin court, though we have urged them to look at that. I think the proving point that you raise, how can somebody say that a promise is illusory when it gives valuable, substantial and powerful rights so that if the employer did not perform, if in Light, if Centel did not not give that training. If Sheshunoff did not give access to the six specifically named data bases and the training, the record makes clear it did give, what a powerful remedy Mr. Johnson would then have because it was an enforceable contract with legal consequences and he would be excused from all the post-termination powers against the Wackenhut case.

WAINWRIGHT: And I make the promise to provide trade secrets. And five minutes later I fire him.

MCKETTA: It would be illusory if I said I will give you trade secrets if you keep the job. Rather than I promise you come to me as an employee. I will give you trade secrets. If it's unconditional and then five minutes later you fire him.

WAINWRIGHT: Which I have the right to do in Texas.

MCKETTA: Not under our contract, but under the Light contract, under the at-will contract in Light. Then the employee would say where are those trade secrets you promised me and for which I gave a non-compete. You never gave them. That's what the Light case was saying. If the reason that the promise to give training was enforceable is because there were consequences if the employer failed to meet its promise. It was not illusory. The employer could say if I feel like it, I will give you training. If you keep your job for longer than a second, I will give you training. It was an unconditional promise, which if it was not given, the employee has a complete power to say because of the inforceability of contracts, I am excused from my obligations post-termination because a promise made to me was breached. That's very important. I think that's the importance of footnote 14, footnote 15 and the discussion of the promise to train that is given.

BRISTER: People only do non-competes when they don't want employees to steal clients and business when they leave. What business with clients and accounts wouldn't give training and wouldn't have some trade secrets in the sense of customers and what they bought for them before?

MCKETTA: I think many do. Many don't. There are many instances of businesses where the _____ things are not secret and are not...

BRISTER: But there are plenty of businesses that do non-competes that don't give any

training or any access to trade secrets. Like what?

MCKETTA: They see them all the time in the trucking company, where a trucking company tells its $20,000 a year trucker here, I'm going to show you how to run your rig and then if you go somewhere else you can't work for 1 year, or 5 years. And the court said no, there is nothing confidential, there was no training, there was nothing that was actually given that supports. But as in the Wright case, the testing is, is the constraint on competition reasonable for these circumstances, and where there was nothing to be protected then the benefits in favor of the constraint are vastly outweighed by the constraints.

BRISTER: So it's not a promise of training. It's a promise of a secret trade.

MCKETTA: I know what the Light case says. I know what the statute says. And yet, you're asking helpful and proper questions. The question in my reading of the Light case and the statute, is it's the trade - it does not have to be secret. But there then has to be some reciprocal promise by the employee corresponding to that trade. Typically it would be confidentiality. It could be good will or relationships, but typically it would be confidentiality. If there was no training given, if there is a promise I'm going to give you confidential information, all I gave you was the phonebook, then that's a breach of a promise or it was a false statement of some promise.

As in the Wright case, I think that's dealt with very appropriately in narrowing the constraint and here the remarkably narrow constraint was that Mr. Johnson couldn't solicit(?) about 821 banks, but could continue against 19,000 banks. Hardly any constraint at all.

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RESPONDENT

LAWYER: It's remarkable in this case that Mr. McKetta and I agree on a lot of legal principles. I think the crux of our disagreement has to do with how they are applied here. Light is this court's most recent pronouncement in this area and it construes the legislature's effort to preempt the law in this area. Light remains good law. There's been no intervening legislation, and there's no reason to disturb in our view the sound legal analysis outlined by J. Cornyn in his application of what are basically Horn book principles.

BRISTER: The world's changed since then. Right? When Light was written there was no internet. Now if I want to buy shoes, used shoes from somebody in Massachusetts I can do it on E-Bay like that.

LAWYER: There's a law review article that I've read recently on this issue that suggests that the second prong of Light and the reasonableness of the scope of how one should enforce or what kind of enforcement _____ is warranted may be affected by the internet. But I think this case...

BRISTER: And of course the first prong arose from a fight between this court and the legislature where they thought these things were good, and this court thought they were bad.

LAWYER: You're exactly right. And I think it started in 1987...

BRISTER: And this court is in the position of saying people who promise I won't go to work in the area for 1 year can actually go to work, can break that promise and go to work in the area for 1 year.

LAWYER: I'm not sure how this court can disregard the statutory language about requiring that the agreement be enforceable when made. And the concept of illusory promises, which is a Horn book principle, and change the result as it applies to this case. This case is a contract construction case. And unless this court somehow finds that these patently illusory promises to provide Mr. Johnson with confidential information are not illusory, then I don't think you get to the next step about trying to adapt it to a changing environment.

There are three different reasons why these promises supposedly made by - and that's where Mr. McKetta and I depart so fundamentally. We agree on the law, but the false premise that makes this case fall apart is that there is no way that one can read this contract and find the promise to provide Mr. Johnson with confidential information to be non illusory.

The entire agreement on its face says it's terminable at will.

OWEN: Well it's not actually because if the company terminates him, they have to pay him for a period of time no matter what. So isn't that a separately enforceable agreement to which the covenant not to compete is ancillary?

LAWYER: The way the contract is constructed is, that whole section of the agreement says this whole agreement could be terminated at will. And then it's got a bunch of subsections below it. The subsection that you are referring to J. Owen talks about a classic notice or pay in lieu of notice optional performance just like a take or pay. And the question that the court needs to ask in determining whether that termination clause is operative here and extends and could have an impact on obligations in other parts of the contract is, what would Mr. Johnson's rights be if the company said we're going to fire you and we are going to give you pay in lieu. What other rights would he still have under the contract? We submit since the contract on its face is terminable at will, and since he agreed to accept pay in lieu of notice in that self contained subsection, that under contract construction principles, he would have no remedies anywhere else in the contract.

Then there is the separate reason why the promise is illusory because it's too vague to be a meaningful contract. So I think that the problem that Mr. McKetta has seized upon is in J. Patterson's opinion. She made a statement that a promise is not sufficient, that there must actually be an exchange of confidential information.

J. Wainwright you hit on this. I think the way that that statement has to be read for it to be reconciled with Wright, we agree that enforceable promises can provide a basis for consideration for non-competes.

HECHT: So you think the CA was wrong - it sounds like they were wrong then.

LAWYER: I think that needs to be read in context. And I think if J. Patterson was referring to illusory promises, then it can be reconciled. And I think that's the way it has to be read. Because I do think that under contract principles non illusory promises to provide confidential information in the future and this whole concept about if you don't do it at the exact instant it doesn't hold up. I don't think that's the case. I do think that non illusory promise to provide specialized training and confidential information gets you past the first hurdle in Light.

HECHT: Can you have a non illusory promise like that and still have a contract that's terminable at will?

LAWYER: Yes. It won't be non illusory if it's dependent on the on going at will relationship. It has to be a separate promise that clearly, unlike here, clearly would survive the exercise of the rights to terminate the at will relationship.

HECHT: Well it wouldn't survive. If it was breached there would be consequences.

LAWYER: Exactly.

HECHT: If you say I promise to give you confidential information, then the next day you say I've changed my mind. I am going to fire you instead. Well he can do that - fire him instead, but then he can't enforce the non compete because he never got the confidential information.

LAWYER: The statute directs us to look at the inforceability of the promise at the moment of formation. So all this - I think that's where a lot of the CA's have gotten confused. There's 150 cites to Light over the years. And a lot of times the CAs talk about what might have happened or what actually did happen after the fact. The legislature has directed and J. ____ has properly interpreted for the courts to focus on the moment of contract formation. And what happens after that is beside the point. De Santis v. Wackenhut is a redherring. That all talks about remedies for performance. The focus in these cases needs to be on the moment of formation. Is there an enforceable non illusory promise to provide this? If there is, then you get to the next step.

HECHT: I'm not sure how there could ever practically be such a promise in a contract that was terminable at will. Because the next minute you could say I'm terminating the employment, but no employer is going to give a terminated employee confidential information after his employment is terminated.

LAWYER: Then the legislature needs to change that. As a practical matter for trade

secrets _____ another formula to coke, you are going to either hire people for terms and say that you are here for at least 6 months and during that we're going to give you the formula to coke.

HECHT: My question was, can you have a non illusory promise to give confidential information or training in a contract that is otherwise, the contract of employment, that is otherwise terminable at will? And you said yes. But it doesn't sound like it's possible.

LAWYER: The best practical example of that is the illustration in Light itself. I'm sending you to this highly specialized course, and whether you are fired tomorrow or not, you are still going to get to that course. That's a scenario where there could be an enforceable agreement that's not depended on on-going employment. But we're going to give you this specialized training and because of that we are going to impose these compete restrictions that courts need to determine whether they are reasonable given the enforceable agreement.

There's another comment that J. Patterson made that Mr. McKetta has seized upon in the briefing that I want to address. And that is where she talks about speculating about this performance or non-performance. And that I think is addressed by the reply brief filed by Sheshunoff itself on page 18. Where the statement is made that speculation about whether ASM would have breached the _____ is wholly irrelevant to whether the promises are enforceable. I think that's the key point here. What actually happened after the fact begs the question of whether you have what is classified as an enforceable agreement.

This case is not about trade secret misappropriation. There is no suggestion here that Mr. Johnson went out and misappropriated trade secrets. And I think the court needs to remember in analyzing the policy issues here, that promises to keep confidential information secret are independent of and enforceable independently of agreements not to compete. Non-compete is an extra tool available in very limited circumstances to secure enforcement of those promises and you would be in a different posture here if Mr. Johnson actually had been accused of having misused the trust conferred upon him.

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LAWYER: I would endeavor to address in a bullet point like fashion what the dispositive points are with respect to each of the principle issues that are before the court. First, with respect to the merits of the non-compete agreement. There are several dispositive reasons that the consideration that was given to give rise to the non-compete is insufficient. It's agreed. Everybody is on board with the proposition that the scope of the non-compete must be judged from the scope of the consideration given by the employer that gives rise to it. Light is very clear, that that doesn't include anything in the future that could be accepted by way or unilateral contract or anything that is given in the past. Past consideration.

HECHT: Well that doesn't leave anything but the present. The employer has a real problem. He wants to keep the guy. He wants him to keep giving him access to information. He

wants to take him into his confidences, but he doesn't want him to use it against him. As in this case, years on down the road. And if you can't consider confidential information in the future, confidential information in the past, there is nothing left but what you hand him on the daily contract is there?

LAWYER: Not what you hand him, but what you promise him on the day of the contract. And it has to be something that's not illusory, theoretically not illusory, but a real world, not illusory. A contract term that you can construe as a matter of law in the first instance and then apply to that term the statute to see whether the contract is valid and, if so, whether the restraint is reasonable under the circumstances.

HECHT: And your co-counsel gave a good example of a course that you are going to let the employee attend no matter what. But you're not going to give any terminated employee confidential information in order to enforce a non-compete agreement.

LAWYER: I don't disagree. And I wouldn't suggest that the court should struggle to find a way for the business community to be able to enforce these agreements simply because they want to. Because this has been worked out between the court and the legislature and it's been the law for 10 years. The legislature has not seen fit to comment further on how those are resolved. And ultimately you have to meet this test. Failing which, you default to the statute that controls that says an agreement in restraining trade is invalid as a matter of law.

Turning specifically to the consideration that's given here. J. Owen, I would respectfully disagree that there was anything here other than at will employment that could be terminated at will. And I direct your attention specifically to page 379...

OWEN: I'm not saying we characterize it differently. But in the sense that - this reminds me somewhat of the cases we've discussed in employer context, employer/employee in the arbitration agreements. We had an existing employee at will. The employer came and said look, we want to go to an arbitration system and if you don't sign this arbitration agreement I am going to terminate you right here and now. And the employee said, okay, I will sign it. And we held that that was sufficient consideration. And it made the arbitration - you could terminate down the line the agreement to arbitrate but going forward until you did terminate the agreement to arbitrate is binding on both parties even if you got fired two days...

LAWYER: And I don't think that that proposition is anyway inconsistent with the legal issues to be considered in this case here.

OWEN: How is this different because you are saying that this guy - he knew if he didn't sign the covenant not to compete that he is going to get terminated. They weren't going to keep him on at his high level position at least without a covenant not to compete. It seems to be the quid pro quo for keeping this high level position was his agreement, the agreement he would sign the covenant not to compete. And that came with all the bells and whistles.

LAWYER: I think that it is confusing to look at this in terms of simply a regular contract. The question here is what is the consideration that's given that gives rise to an interest in not competing, not what consideration that would generally support a contract. Continued employment would support...

OWEN: Continued employment in this high level position. He would not have otherwise have been able to _____(coughing) had he not signed the non-compete. And plus with the termination rights, that if he were terminated the very next day, then the company was obligated to pay him a number of weeks of...

LAWYER: When the smoke cleared on this business about paying him later, what you have is a negative strain of trade that is compensated for by cash. And you have to look, not at what he was getting, which is a question of fact, but the consideration that's promised. What he is entitled to as a matter of right from the moment that he signs that agreement? And the answer is absolutely nothing except cash. It must be a substantive transaction that complies with the statute.

And if you look at §3 of the contract, which is page 379 in the record, you see clearly that "either party may elect to terminate this agreement at anytime for any reason." And it simply says that if the employer does that, they are going to give him some cash. And that alone is dispositive of that question in the case. The first question: is a non-compete valid? There are other issues but that is dispositive.

WAINWRIGHT: That's not future consideration?

LAWYER: It is, but it's cash. Cash does not give rise to an interest in non-compete. That's the premise that 1505 is based on.

WAINWRIGHT: What if at the time of offering him the non-compete they say we'll give you $100,000. We know you've had access to all these trade secrets for years, but now we're elevating your position and we want to make sure we are protected. So we're going to ask you to sign this non-compete and give you a bonus - $100,000 today when you sign it.

LAWYER: Give him hundred million dollars. It wouldn't make any difference. Cash does not give rise to an interest in non-compete. They may really want it. But that will not support the non-compete. That does not comport with the statute.

WAINWRIGHT: Give us three things that would?

LAWYER: You have to look at the contract and actually construe it and see what that consideration is. In this particular case what's interesting about it, is that the undisputed facts are such that there is this amorphous you can do some training whenever you want to at the Sheshnouff' companies and there is some information that's confidential. Most of that he already has. Some of it he might get in the future. The question is, and this is overlooked in a lot of the cases. Either it's

not addressed or it's skipped over in to reasoning. But it is _____ the requirement that you actually construe the contract as a matter of law which is why all of this is a matter of law, and then apply the statute to it. If you do that exercise, you cannot assign any meaning in a non illusory way, any meets and bounds to this loose reference of trade secrets. You can't determine what that is. And it's not an ambiguity. No one here has contended at any point that it's ambiguous. The question is, you can't really assign any meaning to this. And it's not simply a resuscitation of some buzz words that's get you in to the statute.

You have to actually promise something. A list of trade secrets, something that can actually be construed that is real, that you can actually enforce after the fact. Not theoretically on illusory, but whether it's a special training course, which in Light existed. There wasn't a lot of discussion about that, but apparently everybody understood exactly what course they were talking about. And the premise was, that Ms. Light could actually go to that course, even if she quit, even if she was fired.

WAINWRIGHT: It sounds like you would say that anything that's promised that the employer could preclude from having the obligation to provide by firing the employee 5 minutes later is illusory?

LAWYER: Yes.

WAINWRIGHT: A payment of $100 million dollars at the end of the contract wouldn't be illusory, because if you fire them 5 minutes later, he still has the $100 million dollars. But it sounds like your position there is, there's no nexus between that and the trade secrets.

LAWYER: It's not just that it has to be non illusory, but it has to give rise to the interest in non-competing.

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REBUTTAL

LAWYER: I think a policy choice was needed by the legislature that the construction of that policy choice was made by this court and made very soundly, and that the remedial portion of that statute about fashioning remedies defer enormously to the courts. So I think the State of Texas won, but the State of Texas won only if there is predictability and what is called the blue print and is followed to the letter in this contract and in many contracts written by many law firms and used by many employers, and is then upheld by the Dallas court, by the 14th court, by the San Antonio court, by the Beaumont court, but not by the Austin court. The blue print was this court doing a fine job reluctantly after the common law work that this court had done on the covenant not to compete reluctantly but well.

Second, I hope we do not lose track that this is not the hypothetical that J. O'Neill asked of an unchanging amount of information. The summary judgment record shows that

there was everyday constant changing of the information. And when we're told it's too vague to know what we're discussing neither the Austin court nor either briefed in the petitions or the replies or anywhere mentions what I hope the court in Wilson, Tab C of our brief, is the contract. Page 4 is the promise. The last three lines sets out six data bases which Mr. Johnson has now a contractual instantaneous opportunity and actual use of of a great deal of information promised to him with specificity. The promise in Light that was non illusory to provide training does not go on in that contract to say what the training is. It's a very brief 5 line paragraph quoted in the opinion. The Sheshnouff/Johnson contract and many contracts throughout the State of Texas promise what was in Light and promised much more and includes specific data. And the reason is to avoid some claim that this is illusory or vague or whatever. It is what the SC laid out in Light and more.

O'NEILL: You say it's not trade secret information. So is there no claim that the particular overdraft protection system is somehow a trade secret?

LAWYER: I couldn't agree more. The facts that are shown here of learning and asking to know, asking for the manual of what is the bargaining strategy going to do? how low will we go? Very confidential. But that all applied later at the instant of the contract. Sheshonouff was not yet trying to stake out a market against the market leaders ___ in that area. It had many other things in this data base. And when we say trade secret, there are differences between confidential and trade secret. Trade secret is an important area of law, but there can be confidential information beyond trade secret.

O'NEILL: There are two categories of confidential information we're talking about here. One is the development and in particular this overdraft protection system, and the other one is the client base.

LAWYER: Yes. He was in charge of 821 client relationships. He denies in the briefing, but the record is very clear that one of the principal purposes of that affiliation program that he was appointed to become in charge of, was to market, to get revenue from preferred banks. And in doing that, he knew what they liked, what their weaknesses were, what their strategies were for growth, whether they wanted to sell their bank. He had all this information and everyday when anybody in that organization learned about it, they updated the data base and it was new information. And whoever had brought in the data was now always contractually available to him and he had no contractual power to access it before. And the summary judgment record shows that he never would have gotten that position except they thought he had at the time signed the non-compete. When it was discovered by _____ Sheshonouff, according to the summary judgment record, that he had failed to do so. She demanded that he sign it. He took it home over a weekend not wanting at all to sign it, negotiated changes which the company approved. The signed document was what he included every amendment he asked for. So this was a negotiated contract so that he could keep the job and have a contractual power of access that he used more than 50 times of training that he used. But what about at the moment of contract? I'm glad for the admission, concession agreement by Mr. Burn that the Austin court mistakenly chose the word gives instead of promise. This promise was enforced and he had under paragraph 3, if he was terminated other than for cause, he had the power

to insist for 7 weeks minimum that he continue to have that access or to say you failed to give it to me. Under Wackenhut you can't enforce your post-termination agreement.