LABOR & EMPLOYMENT

NATIONAL FORUM SHOPPING OVER RESTRICTIVE COVENANTS

*By Donald W. Benson**

Counsel wishing to protect the confidential information and customer relationships of their businesses' clients often include restrictive covenants in the company's employment agreements, severance plans, and stock option, shareholder or partnership agreements. Substantial energy in due diligence examinations is devoted to determining whether the target company's restrictive covenants with its employees and officers are enforceable. Because each state's restrictive covenant laws can vary so widely, drafting such restrictions for a large company becomes a matter of selecting the most common denominator or picking a favorable forum and including extensive choice of law provisions in the hopes of avoiding the pitfalls within numerous states. That strategy can now be easily defeated by employees who actively forum shop in states like Georgia and corporate counsel must re-examine their approach to restrictive covenant drafting and enforcement.

There is a new and growing industry of forum shopping where the employee relocates to Georgia and initiates a declaratory judgment action in Georgia against his former employer seeking to have the covenant found to be un-enforceable under Georgia's anti-restrictive covenant case law. Starting with the Eleventh Circuit's April 2005 decision, *Palmer & Cay*,[1] recent cases have accelerated the use of this tactic as the scope of injunctive relief can foreclose parallel state or federal litigation, and the federal courts are deferring to the first to file doctrine, which is often the Georgia federal court sitting in diversity and applying Georgia's choice of law and substantive restrictive covenant precedent.

Restrictive covenants come in three flavors: (1) noncompete agreements that restrict business activities in a territory; (2) non-solicitation of customer restrictions; and (3) confidentiality restrictions for information that falls below the threshold of trade secret protections. Those drafting agreements for maximum enforceability often include choice of law clauses specifying that some favorable, "blue pencil" state's law will apply to interpretations and disputes over the agreement. "Blue pencil" states

---

* Donald W. Benson is a senior litigator in the Atlanta office of Littler Mendelson where he helps employers avoid, resolve and litigate employment disputes. Mr. Benson received his A. B. degree in 1976 from Davidson College in Davidson, N. C., his M. A. degree in 1978 in philosophy from the University of Georgia in Athens, Georgia, his J. D. degree in 1984 from the University of Utah in Salt Lake City, Utah. He can be reached at dbenson@littler.com

1. *Palmer & Cay*, 404 F.3d 1297 (11th Cir. 2005).

will generally either: (1) "blue pencil" by redacting or striking out and ignoring words in the agreement that might make it overbroad; or (2) "blue pencil" in the more liberal sense of taking a "50-mile radius" clause and enforcing to the extent of reasonableness, to say 25-miles. A restrictive covenant with a choice of law provision based on redacting "blue pencil" rules might list several counties as part of a restricted territory, knowing that the court will merely strike through the overbroad counties and enforce the remainder. A liberal "blue pencil' choice of law provision might lead the drafter to include more sweeping territory or time restrictions, hoping that a court would enforce them to the extent necessary.

Georgia is one of the toughest states in which to enforce a restrictive covenant. It will not apply either form of the "blue pencil" rule. If only a twenty-mile radius is reasonable, then a twenty-five mile restriction is wholly unenforceable. If even one in a list of counties or customers who are not to be solicited is overbroad because the employee did not work in that county or with that customer, the entire noncompete or non-solicitation fails. Further, an overbroad noncompete provision will poison an otherwise enforceable "non-solicitation of customers" provision in the same agreement, and *vice versa*. Of particular surprise to many drafters is Georgia's requirement that a non-disclosure provision must have a reasonable time limit. Trade secrets may be protectable for as long as they remain trade secrets; but other confidential information may not be protected indefinitely, and the provision must set forth a reasonable time period or be unenforceable.

Choice of Law Provisions Often Rejected

Even if the agreement includes a choice of law provision allowing the court to "blue pencil" or modify an overbroad restrictive covenant to the extent that it is reasonable, Georgia's choice of law principles require its courts to analyze such choice of law provisions by first determining whether the noncompete agreement is enforceable under Georgia law. The strong Georgia public policy against noncompetes would not allow a Georgia court to enforce a noncompete agreement contrary to that policy, despite a choice of law provision in the agreement. A federal court in Georgia hearing a case based on diversity jurisdiction would also apply Georgia choice of law principles to such a dispute.

The result is that savvy counsel will consider again whether restrictive covenants should be drawn to be enforceable in such a restrictive state as Georgia where a key employee can easily relocate or where a competitor may entice its employees, and whether forum selection clauses or arbitration may increase the likelihood of enforceability.

PALMER & CAY

On April 1, 2005, in *Palmer & Cay*[2], the Eleventh Circuit Court of Appeals revised a ruling of a federal Georgia District Court that an employer's noncompete agreement was unenforceable *only in Georgia.* The employee relocated from the Mid-west and initiated a declaratory judgment action in Georgia in order to take advantage of the pro-employee Georgia law regarding noncompete and non-solicitation covenants (NCAs).

The Eleventh Circuit extended the unenforceability to any other lawsuits regarding the NCA between the same parties, *even if such other lawsuits are filed outside of Georgia.* Most importantly, this ruling may provide an avenue of escape from an otherwise valid NCA to employees who can relocate to Georgia and are willing to preemptively bring a declaratory judgment action in Georgia.

Because so many of these cases would be removable to federal court on the basis of diversity of citizenship, the *Palmer & Cay* decision has attracted significant attention nationwide by confirming that federal courts sitting in diversity in Georgia will issue declaratory judgments in NCA disputes that are as broad in scope as those rendered by Georgia state courts. Although the *Palmer & Cay* case continues because the defendant filed a Notice of Petition for Writ of Certiorari to the United States Supreme Court, the debate it is creating among commentators is likely to focus more and more attention on the importance of winning the race to the courthouse.

THE "FIRST TO FILE RULE"

On November 15, 2005, the Eleventh Circuit Court of Appeals in *Manuel v. Convergys Corp.*[3] further validated the trend of racing to the courthouse over employment-related NCAs. Manuel worked in Florida for an Ohio corporation, signing an NCA with Ohio choice of law and a permissive forum selection provisions stating that any NCA disputes "may" be brought in the state or federal courts of Hamilton County, Ohio.

On April 5, Manuel accepted work in Georgia. On April 8, Manuel resigned from Convergys, but promised to work until the end of the month. He promised that he would not work for a competitor and that he had not yet accepted another job. On April 9, Manuel leased an apartment and obtained a driver's license in Georgia. On April 20, Manuel brought a Georgia declaratory judgment action that the NCA was unenforceable under Georgia law. The district court granted Manuel's motion for summary judgment on the NCA and applied Georgia law in dismissing Convergys's counterclaims for trade secret violations.

---

2. *Id.*

3. *Manuel v. Convergys Corp.*, No. 04-16032, 2005 U.S. App. LEXIS 24549 (11th Cir. November 15, 2005).

Where overlapping actions are pending in two federal courts, the Eleventh Circuit followed the "first filed" rule. Georgia's connections to this action were not "slight or manufactured." The appellate court was particularly sympathetic to the Georgia forum because Georgia civil procedure allows for expedited settings of such competing litigation.

Rushing to the Courthouse Often Decides the Case

Employers are, therefore, faced with a litigation environment where the former employee will almost always be able to control who reaches the courthouse first. If the employee files first in Georgia state court and the case is removed to federal court to compete with parallel federal litigation initiated by the employer in the choice of law forum, then the federal court's respect for "first to file" may result in deferral to the federal court in Georgia applying Georgia's choice of law principles and in effect, Georgia substantive law on restrictive covenants. If the former employee first files in Georgia or is even second filing in Georgia, it is unlikely that a Georgia state court will defer to a first filed case in another state where the substantive law of restrictive covenants would violate Georgia public policy. As seen in the *Hostetler* case, Georgia courts have expedited the setting of the Georgia case in order to be the first to enter a final judgment and then promptly issued permanent injunctive relief against the former employer's effort to enforce the lawsuit elsewhere.

What was not clear prior to *Palmer & Cay* was whether the employee could gain anything by preemptively rushing to court in Georgia for a judgment declaring the NCA unenforceable under Georgia law. Would that protect him only from suit in Georgia? Could he still be sued elsewhere for his prior competition outside of Georgia? *Palmer & Cay* now indicates that, in the Eleventh Circuit, the employee obtaining such a final declaratory judgment would be protected if he were simultaneously or later sued outside of Georgia, whether or not his competitive activities were restricted to Georgia. Rushing to court in Georgia assures that Georgia's substantive restrictions against NCAs will many times find an NCA unenforceable, even if courts in the state in which it was originally signed and drafted would reach a different conclusion.

Responding Within and Outside of Georgia

Employees can more easily relocate if their former territories include states like Georgia, or if their job could be performed primarily by telephone or Internet from any state. An employer with operations near Georgia should consider the likelihood of such relocations and draft its NCA provisions with an eye toward enforceability in Georgia, not just the current location of its employee. Companies often send "cease and desist" letters prior to an enforcement action. Now, prolonged letter writing may no longer be a useful tactic against a former employee willing to rush to the courthouse to obtain a declaratory judgment in a favorable jurisdiction.

Waiving venue and forum selection clauses may decide a case's outcome. Litigants must balance the merits of a forum where jurisdiction is easily obtained and where docket pressures allow for a quick hearing on a temporary restraining order (TRO) to be set against the importance of a forum applying favorable law. Employers may face multiple lawsuits, progressing in different forums. Litigation strategy must recognize that it is not the first court that enters a TRO or preliminary injunction, but the first to enter a final judgment that will have its judgment followed in other jurisdictions. Consequently, employers may be forced to aggressively fight any Georgia litigation until a final judgment can be obtained outside Georgia in a forum willing to apply the NCA's choice of law provisions. Conversely, companies seeking to help a new employee avoid the enforcement of an NCA might pursue a declaratory judgment by rushing to a state or federal court in a state, like Georgia, whose laws disfavor NCAs.

In response to this development, an ounce of prevention may be worth a pound of cure, even for employers in jurisdictions that have not faced the issue yet. Employers should carefully examine their contracts to make sure that they include useful forum selection, consent to jurisdiction, and choice of law provisions. Recognizing that some choice of law provisions may not be enforced in declaratory judgment actions brought in Georgia, could the employer prevent a declaratory judgment preemptive strike by providing in a forum selection clause that all disputes must be brought in a specific forum, with parallel consents to jurisdiction and service?

FORUM SELECTION CLAUSES

The next major battle in Georgia may be over the enforceability of forum selection clauses in employment-related NCA cases. The dicta of two Georgia cases may indicate a willingness to refuse enforcement of forum selection clauses where enforcement would result in application of a choice of law provision contrary to the public policy of Georgia disfavoring restraints on trade.

For example in *Iero v. Mohawk Finishing Products, Inc*,[4] a forum selection clause in a non-competition covenant was enforced by the Georgia Court of Appeals because Iero did not show that the clause was "unreasonable under the circumstances." Unfortunately, Georgia courts have shed little light on what constitutes "unreasonable under the circumstances." Georgia courts consider more than whether the chosen forum would be merely inconvenient for one of the litigants, but also whether there is evidence of "fraud, undue influence or overweening bargaining power."

Although *Iero* enforced a forum selection clause, the court noted that it was leaving open the issue of whether a forum selection clause

4. *Iero v. Mohawk Finishing Products, Inc.*, 534 S.E.2d 136 (Ga. Ct. App. 2000)

would be unenforceable in Georgia as against public policy on a different factual record. The Georgia Court of Appeals pointed out that the United States Supreme Court has noted "certain contractual forum selection clauses may be held unenforceable if such clauses contravene 'a strong public policy of the forum in which the suit is brought, whether declared by statute or by judicial decision.'" Perhaps this indicates that the Georgia courts will someday consider whether a forum selection clause is unenforceable because it damages the litigants by applying unfavorable law contrary to Georgia public policy in the selected forum, which the *Iero* court expressly noted was an argument not raised by Iero.

As parties continue to assess the usefulness of the *Palmer & Cay* decision in avoiding NCAs, two messages are clear: pro-active, aggressive litigation strategies have grown even more important for employers, and the approach of broadly drafting restrictive covenants relying on choice of law provisions specifying "blue pencil' states may have Draconian consequences for the protection of confidential information and restricting competitive activities.