A Timely Analysis of Legal Developments

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In November 2010, the Georgia electorate voted to amend the state's constitution so as to allow for legislation enhancing the enforceability of post-employment restrictive covenants. While the November 2010 vote gave immediate effect to a statute containing flexible enforceability standards for noncompete, nonsolicitation, and nondisclosure covenants, the enabling constitutional amendment did not go into effect until January 1, 2011.

# Georgia's Reenacted Restrictive Covenants Statute – A New Era in Georgia Noncompete Law Has Finally Arrived

**By Eric Smith and Jerry Newsome**

For decades, Georgia law on employee restrictive covenants has been defined exclusively by the decisions of the Georgia Supreme Court and Court of Appeals, which historically have been hostile toward such covenants. Under the court-created common law, noncompete and customer nonsolicitation agreements are subject to a "strict scrutiny" standard, which consists of a maze of highly technical rules under which most covenants are vulnerable to enforceability challenges. As a component of the strict scrutiny standard, the Georgia courts adopted an "all-or-nothing" rule, under which an overbroad noncompete clause automatically invalidates both the noncompete covenant ***and*** any nonsolicitation covenant contained in the same agreement (and *vice versa*). For good reason, Georgia came to be regarded as one of the most undesirable jurisdictions for enforcing post-employment covenants, as well as a favorite "forum shopping" destination for former employees seeking to invalidate their covenants through preemptive declaratory judgment suits.

In 2009, Georgia took a significant step toward abating its longstanding hostility toward restrictive covenants by enacting a statute containing flexible rules that "favor providing reasonable protection to all legitimate business interests."[1] Recognizing that the statutory reform would not pass muster under the Georgia Constitution (as it existed at the time), the Georgia General Assembly passed the statute with the proviso that it would become effective only upon the ratification of an enabling constitutional amendment.[2] The enabling amendment was ratified on November 2, 2010, thus making the statute effective as of November 3, 2010. However, due to a drafting oversight, the enabling constitutional amendment itself did not become effective until January 1, 2011. The mis-matched effective dates arguably rendered the statute unconstitutional and void, and this made relying on the statute an extremely risky proposition.[3] Consequently, many Georgia employers never endeavored to take advantage of the benefits the statute was intended to provide.

In November 2010, attorneys from Littler alerted key members of the Georgia General Assembly to the statute's apparent constitutional defect. We advised that the problem could effectively be resolved by reenacting a substantially identical version of the statute during the 2011 legislative session. And, the General Assembly has done just

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that. The "new" version of the statute was passed on April 14, 2011, and Georgia's Governor signed it into law on May 11, 2011. Like its first incarnation, the reenacted statute ("Statute" or "Act") eschews the "strict scrutiny" standard in favor of more lenient and forgiving enforceability rules. The Statute also eliminates the draconian "all-or-nothing" rule and allows courts to modify covenants that are found to be overly broad. Importantly, however, the new version of the Act applies only to agreements that are entered into on or after May 11, 2011 (the Statute's effective date).

## Highlights of the Statute

The Statute addresses three types of post-employment covenants: (1) covenants that prohibit an array of competitive activities/endeavors ("noncompete covenants"); (2) covenants prohibiting the solicitation of customers ("nonsolicitation covenants"); and (3) covenants not to use/disclose confidential information ("nondisclosure covenants").[4] The statutory provisions regarding each type of covenant are discussed, in turn, below.

On the whole, the Act requires courts to honor the intent of the contracting parties and give appropriate deference to the legitimate business interests that the covenants aim to protect. Indeed, the Statute expressly provides that "[a] court shall construe a restrictive covenant to comport with the reasonable intent and expectations of the parties . . . and in favor of providing reasonable protection to all legitimate business interests established by the person seeking enforcement."[5] This represents a dramatic departure from the preexisting "strict scrutiny" standard, under which the enforceability question often turns on technical "wordsmithing" requirements, and the parties' intent and reasonable expectations are largely ignored. This major policy shift also is exemplified by how the Statute treats overly broad covenants. Specifically, as mentioned above, the Act allows a court to "modify a covenant that is otherwise void and unenforceable" so as to protect the employer's legitimate interests.[6]

### *Noncompete Covenants*

Under the Act, a noncompete covenant is enforceable so long as its restrictions are reasonable in time, geographic area, and scope of prohibited activities.[7] This three-pronged test is identical to the common law test. However, the Act adopts new rules and standards for determining whether a given covenant satisfies the various components of this test. The Statute's most significant features are its flexible and common-sense rules for gauging compliance with the "geographic scope" and "prohibited activities" prongs of the test.

The common law strictly requires the scope of a noncompete to be in line with the employee's actual territory and duties at the time of termination (when the restrictions will go into effect). Further, under the court-created "strict scrutiny" standard, the covenant must describe the territorial scope and prohibited activities with enough specificity to enable the employee to ascertain, *on the front end*, exactly what his/her future obligations will be. Under this "front-end certainty" test, noncompetes containing geographic restrictions such as "the territory where the employee is working at the time of termination" are unenforceable because the precise contours of the restrictions cannot be ascertained until the time of termination. But, any covenant that provides the requisite front-end certainty is vulnerable to a different sort of enforceability challenge in that any subsequent change in the employee's territory or job duties will likely make the covenant overbroad. The Statute eliminates this dilemma by altogether abolishing the front-end certainty requirement.

The Statute expressly endorses phrases such as "the territory where the employee is working at the time of termination" as adequate descriptions of a covenant's geographic scope.[8] The Act also declares that "any good faith estimate of the activities, products, and services, or geographic areas, that may be applicable at the time of termination" is sufficient, even if the estimate "is generalized or could possibly be stated more narrowly to exclude extraneous matters" and even if it "ultimately proves to include extraneous activities, products, and services, or geographic areas."[9] In keeping with its emphasis of honoring the intent of the contracting parties, the Statute deals with such inadvertent over-breadth issues by simply requiring that the covenant "be construed ultimately to cover only so much of such estimate as relates to the activities actually conducted, the products and services actually offered, or the geographic areas actually involved within a reasonable period of time prior to termination."[10]

The Statute also creates an exception to the rule that the territorial restrictions must be confined to the *employee's* territory at the time of termination. Under the common law, restrictions which relate to the territory in which the employer does business, but the

employee did not work, are overbroad and unenforceable, irrespective of whether the restrictions are limited in other respects. Under the Statute, however, a geographic limitation that is defined by "the areas in which the employer does business at any time during the parties' relationship" is reasonable and enforceable, provided that "[t]he agreement contains a list of particular competitors as prohibited employers for a limited period of time after the term of employment."[11]

With respect to the "reasonable timeframe" prong of the enforceability test, the Act adopts a rule-of-thumb under which post-employment restrictions of two years or less are presumptively reasonable.[12] While this rule-of-thumb will insulate most two-year restrictions from over-breadth challenges, it also may be construed as creating a negative inference against post-employment restrictions of more than two years.[13]

Finally, the Statute provides that noncompetes may be enforced against only certain categories of employees, which include: (a) sales personnel; (b) brokers; (c) management personnel; and (d) anyone performing the duties of a "key employee" or "professional."[14] However, in light of the Statute's broad definitions of "key employee" and "professional," this ostensible limitation is not particularly significant.

### *Nonsolicitation Covenants*

The Act also endorses post-employment covenants that prohibit employees from soliciting (or attempting to solicit, directly or by assisting others) customers and prospects for the purpose of providing competitive products or services.[15] Similar to the common law, the Statute limits the permissible scope of such restrictions to those customers and "actively sought prospective customers" with whom the employee had "material contact" during his/her employment.[16] However, the Statute departs from the common law by how it defines "material contact." Under the common law, nonsolicitation restrictions may reach only those customers with whom the employee had actual contact, and such restrictions may not extend to customers about whom the employee "merely" obtained confidential information but had no direct contact.[17] The Act abolishes this limitation by defining "material contact" to include "contact between an employee and each customer or potential customer . . . [a]bout whom the employee obtained confidential information in the ordinary course of business as a result of such employee's association with the employer."[18]

The Act also significantly departs from the common law regarding the language required for a nonsolicitation covenant to be enforceable. Unlike the common law, the Act does not require a nonsolicitation covenant to state expressly that it is limited to actual/prospective customers with whom the employee had material contact, nor does the Act require the covenant to list or describe the products and services that are considered to be competitive.[19] Instead, the Statute provides that any written "prohibition against 'soliciting or attempting to solicit business from customers' or similar language" shall be "narrowly construed to apply only to: (1) such of the employer's customers, including actively sought prospective customers, with whom the employee had material contact; and (2) products and services that are competitive with those provided by the employer's business."[20]

The Act does not require a nonsolicitation covenant to contain a geographic limitation, but it does require that the restrictions be limited to a reasonable time period. The Statute's two-year "rule of thumb" for reasonableness applies to nonsolicitation covenants, as well as noncompetes.

### *Nondisclosure Covenants*

The Statute alters the common law regarding nondisclosure covenants in one significant respect. Under the pre-Statute case law, a nondisclosure covenant will be deemed overly broad and unenforceable if it does not contain an express time limit or if it contains a time limit that goes beyond what is actually needed to protect the employer's confidential information. Under the Act, however, an employee may be prohibited from using/disclosing an employer's confidential information for as long as the information remains confidential, and no express time limit is required.[21]

## Obtaining the Benefits of the Statute

For employers wishing to reap the benefits of the Statute, the first step is to have a restrictive covenant agreement (RCA) that complies

with the Act's requirements. Many Georgia employers have existing RCAs in place, and the covenants contained therein may very well pass muster under the Act. However, as mentioned above, the Statute applies only to agreements that are entered into on or after May 11, 2011. RCAs that were executed prior to November 3, 2010 (the effective date of the predecessor statute) remain subject to the common law "strict scrutiny" and "all-or-nothing" rules. And RCAs that were executed while the predecessor statute was in effect (November 3, 2010 to May 10, 2011) also may be subject to the common law standards, depending on the outcome of future litigation regarding the predecessor statute's constitutionality. Consequently, to ensure coverage under the Act, employers should replace *all* preexisting RCAs with newly executed agreements that conform with the Statute's requirements.

As with any contract, an RCA must be supported by "consideration." For a new hire, this requirement can be easily satisfied by the job offer itself or the simple act of hiring the employee. For incumbent employees, the consideration requirement can be satisfied by continued employment (*i.e.*, refraining from firing the employee), a promotion, a signing bonus, or anything else that has value. However, if not handled properly, the rollout of new or replacement RCAs to incumbent employees may lead to workplace morale problems and even unwanted departures. Therefore, any such rollout should be preceded by careful planning and analysis.

Finally, although the Act's pro-enforcement standards are a welcome departure from the common law, it remains important to carefully draft RCAs so that their restrictions do not exceed what is necessary to protect the employer's legitimate interests. While the Act *allows* courts to modify overly broad covenants, modification is not required. In light of the Georgia courts' longstanding hostility toward restrictive covenants, judges likely will be disinclined to modify an overly broad covenant if it appears that the over-breadth is the product of overreaching.

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[1] O.C.G.A. § 13-8-54.

[2] Ga. L. 2009, p. 231.

[3] For a more detailed discussion of the statute's apparent constitutional infirmities (and the risks associated with relying on it), see Littler's November 2010 ASAP entitled: *The Long Wait for a New Era in Georgia's Law on Post-Employment Covenants May Last A Bit Longer*.

[4] The Statute addresses restrictive covenants found in various types of agreements, including (but not limited to) agreements between employers and employees, contracts relating to the sale of a business, franchise agreements, and agreements between manufacturers and distributors. This article covers only those provisions relating to employee-employer restrictive covenants.

[5] O.C.G.A. § 13-8-54(a).

[6] O.C.G.A. §§ 13-8-53(d) & 13-8-54(b).

[7] O.C.G.A. § 13-8-53(a).

[8] O.C.G.A. §§ 13-8-53(c)(2) & 13-8-56(2).

[9] O.C.G.A. § 13-8-53(c)(1).

[10] *Id.*

[11] O.C.G.A. § 13-8-56(2)(B).

[12] O.C.G.A. § 13-8-57(b).

[13] This two-year rule of thumb does not apply to noncompete covenants that are made in connection with the sale of a business. The Act adopts a five-year rule of thumb for noncompetes that are ancillary to the sale of a business.

[14] O.C.G.A. § 13-8-53(a).

[15] O.C.G.A. § 13-8-53(b).

[16] *Id.*

[17] *Trujillo v. Great Southern Equip. Sales, LLC*, 657 S.E.2d 581, 584 (Ga. Ct. App. 2008).

[18] O.C.G.A. § 13-8-51(10).

[19] O.C.G.A. § 13-8-53(b).

[20] *Id*.

[21] O.C.G.A. § 13-8-53(e).