A Timely Analysis of Legal Developments

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Georgia voters recently ratified an amendment to the State's Constitution, and in doing so, laid the foundation for a dramatic change in Georgia law regarding post-employment restrictive covenants.

The Long Wait for a New Era in Georgia's Law on Post-Employment Covenants May Last a Bit Longer

By Eric Smith, Jerry Newsome and Benson Pope

For good reason, Georgia has come to be regarded as one of the most undesirable jurisdictions for enforcing post-employment restrictive covenants, as well as a favorite "forum shopping" destination for former employees seeking to invalidate their covenants through preemptive "declaratory judgment" suits. Under the case law created by the Georgia Supreme Court and Court of Appeals, employee non-compete and non-solicitation covenants are subject to a "strict scrutiny" standard, which consists of a maze of highly technical rules that are so difficult to follow that even the Georgia Supreme Court has lamented that "ten Philadelphia lawyers could not draft an employer-employee restrictive covenant agreement that would pass muster."[1] The courts compounded the problem by adopting an "all-or-nothing" rule, under which an overbroad non-compete clause automatically invalidates both the non-compete covenant ***and*** any non-solicitation covenant contained in the same agreement (and *vice versa*).

On November 2, 2010, Georgia voters ratified an amendment to the State's Constitution, which was intended to eradicate Georgia's longstanding hostility toward post-employment covenants. With the ratification of the amendment, a new restrictive covenant statute ("Statute" or "Act") went into effect on November 3, 2010.[2] The Statute eschews the "strict scrutiny" standard in favor of pragmatic and flexible rules for determining enforceability. The Act also eliminates the draconian "all-or-nothing" rule, and allows courts to modify covenants that are found to be overbroad. The Statute applies only to agreements that are entered into after November 2, 2010.

Unfortunately, however, the Statute is vulnerable to constitutional attack due to a technical problem with the enabling constitutional amendment. Although we anticipate that this problem will be cured during the next legislative session, employers should be reluctant to rely on the Act for the time being.

Legislative And Judicial History

The Georgia General Assembly made its first attempt at reforming the state's law on restrictive covenants *via* a statutory enactment in 1990.[3] The next year, however,

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the Georgia Supreme Court struck down that statute, holding that the State's Constitution prohibits any legislation that enhances the enforceability of post-employment restrictive covenants.[4] The upshot of that holding was that any future legislative effort to reform this area of the law would have to be accompanied by an enabling amendment to the Georgia Constitution. In 2009, the General Assembly initiated a resolution calling for such an amendment.

During the 2009 legislative session, the General Assembly passed the new restrictive covenant Statute. In an attempt to protect the Statute from a premature constitutional challenge, the legislature provided that: "This Act shall become effective on the day following the ratification at the time of the 2010 general election of an amendment to the Constitution of Georgia providing for the enforcement of covenants in commercial contracts that limit competition and shall apply [only] to contracts entered into on and after such date[.]"[5]

The Georgia electorate ratified the enabling constitutional amendment on November 2, 2010, and thus, the Statute became effective on November 3, 2010.

The Statute's Vulnerability to Constitutional Attack

While the Statute specifies its own effective date, no effective date was provided for the enabling constitutional amendment. With respect to such amendments, the Georgia Constitution states that: "Unless the amendment . . . itself or the resolution proposing the amendment . . . shall provide otherwise, an amendment to this Constitution . . . shall become effective on the first day of January following its ratification."[6] Consequently, whereas the Statute became effective on November 3, 2010, its enabling constitutional amendment will not go into effect until January 1, 2011. If judged under the present (pre-amended) version of the Georgia Constitution, the Act almost certainly will be declared unconstitutional.[7]

Under Georgia law, the constitutionality of a statute "is to be determined by the constitution in effect on the date the law became effective[,]" and "if it is unconstitutional then, it is forever void."[8] Such a statute cannot be revived by a subsequent constitutional amendment because "an unconstitutional statute, though having the form and name of law, is in reality no law, but is wholly void, and in legal contemplation is as inoperative as if it had never been passed."[9] In light of these well settled principles, a strong argument can be made that the Statute is unconstitutional and, thus, "forever void."

The only clear solution to this problem is for the General Assembly to reenact a substantively identical version of the Statute, but with a January 1, 2011 effective date. There is a good possibility that the General Assembly will take this action during its next legislative session, and thereby assure that the Statute's substantive provisions will have binding legal effect in 2011.

The Statute's Substantive Highlights

The Statute addresses three types of post-employment covenants: (1) covenants that prohibit an array of competitive activities/endeavors ("non-compete covenants"); (2) covenants prohibiting the solicitation of customers ("non-solicitation covenants"); and (3) covenants not to use/disclose confidential information ("nondisclosure covenants").[10] 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.[11] As mentioned above, the Statute also abrogates the "all-or-nothing" rule and expressly authorizes courts to "modify a covenant that is otherwise void and unenforceable" so as to protect the employer's legitimate interests.[12]

Non-Compete Covenants

Under the Act, a non-compete covenant is enforceable so long as its restrictions are reasonable in time, geographic area, and scope of prohibited activities.[13] Although this is the same basic enforceability test that was already in effect, the Act adopts new rules and standards for determining whether a given covenant satisfies the various components of this test. Among 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.

Both the preexisting case law and the new Statute require the scope of a non-compete to be in line with the employee's actual territory and duties at the time of termination (*i.e.*, at the time the restrictions go into effect). However, as part of the preexisting "strict scrutiny"

standard, the courts also require that the covenant 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, non-competes 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 problem 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.[14] 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."[15] 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."[16]

Finally, with respect to the "reasonable timeframe" prong of the enforceability test, the Act adopts a new rule-of-thumb under which post-employment restrictions of two years or less are presumptively reasonable.[17] 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.[18]

Non-Solicitation 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.[19] Consistent with the preexisting 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.[20] However, the Statute significantly departs from preexisting law on the question of what language is required for such a covenant to be enforceable.

Unlike the preexisting law, the Act does not require a non-solicitation covenant to expressly state 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.[21] 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."[22]

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

Nondisclosure Covenants

The Statute alters the preexisting law regarding nondisclosure covenants in one significant respect. Under the preexisting law, a nondisclosure covenant will be stricken as overly broad 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.[23]

What Should Employers Do Now?

Taken at face value, the Statute greatly enhances an employer's ability to protect itself through post-employment covenants. However, for the constitutionality reasons stated above, considerable uncertainty exists as to whether the Act is a law that employers can really rely on, or whether it is "wholly void" and "as inoperative as if it had never been passed." While arguments can be made on both sides of this issue, the Statute's viability will remain uncertain until the issue plays itself out in the court system or the problem is remedied via legislative action.

In the meantime, employers are left with two choices: (1) play Russian-roulette regarding what the courts and/or legislature might do; or (2) simply refrain from relying on the Statute, at least until the uncertainty is resolved. The first option is dangerous because an employer who implements new covenants that track the Statute may well be left with no enforceable protections at all if the Statute is declared unconstitutional. This result would be particularly painful for any employer who rolls out new Statute-based covenants in place of covenants that are enforceable under the preexisting law.

We have raised our constitutionality concerns with the Statute's sponsors and other ranking members of the General Assembly. From the feedback received thus far, we anticipate that the General Assembly will cure the problem during its next legislative session (which begins on January 10, 2011) by reenacting the Statute with a January 1, 2011 effective date. Of course, there is no guarantee that this will happen. Therefore, for the time being, employers would be well advised to refrain from relying on the Statute and to assume that the pre-Statute case law still governs the enforceability of all employee restrictive covenants. Assuming the Statute is re-enacted, however, employers most definitely should take advantage of the considerable protections that it offers. In the meantime, Littler will provide further updates as the issues under the Act are addressed.

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[1] *Watson v. Waffle House, Inc.*, 324 S.E.2d 175, 177 (Ga. 1985).

[2] The Statute (O.C.G.A. §§ 13-8-50 et seq.) was enacted on April 29, 2009 with the proviso that it would not become effective unless and until the Georgia Constitution is amended to allow for legislation easing the impediments to enforcing restrictive covenants.

[3] O.C.G.A. § 13-8-2.1.

[4] *Jackson & Coker, Inc. v. Hart*, 405 S.E.2d 253, 254-55 (Ga. 1991); see also *Atlanta Bread Co. Intern'l, Inc. v. Lupton-Smith*, 679 S.E.2d 722, 724-25 (Ga. 2009).

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

[6] Ga. Const., Art. XII, Sec. I, Para. IV.

[7] *See Atlanta Bread Co.*, 679 S.E.2d at 724-25; Jackson & Coker, 405 S.E.2d at 254-55.

[8] *Building Auth. of Fulton County v. Ga.*, 321 S.E.2d 97, 99 (Ga. 1984); In the Interest of R.A.S., 290 S.E.2d 34, 35 (Ga. 1982).

[9] R.A.S., 290 S.E.2d at 35; *Jamison v. Atlanta*, 165 S.E.2d 647, 648 (Ga. 1969); *Comm'rs of Rds. & Revenues v. Davis*, 102 S.E.2d 180, 183 (Ga. 1958).

[10] 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.

[11] O.C.G.A. § 13-8-54(a).

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

[13] O.C.G.A. § 13-8-53(a).

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

[15] O.C.G.A. § 13-8-53(c)(1).

[16] *Id*.

[17] O.C.G.A. § 13-8-57(b).

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

[19] O.C.G.A. § 13-8-53(b).

[20] *Id*.

[21] *Id*.

[22] *Id*.

[23] O.C.G.A. § 13-8-53(e).