Unfair Competition Trade Secrets

A Littler Mendelson **Time Sensitive** Newsletter

in this issue:

MAY 2005

The Eleventh Circuit Court of Appeals encourages a rush to the courthouse as it revised a trial court declaratory judgment ruling that an employer's noncompete agreement was unenforceable only in Georgia. The Court extended the unenforceability to any other lawsuit between the same parties, even if other lawsuits are filed outside of Georgia. (*Palmer & Cay, Inc. v. Marsh & McLennan Companies, Inc.*, No. 03-16248, (11th Cir. Apr. 1, 2005)).

Littler Mendelson is the largest law firm in the United States devoted exclusively to representing management in employment and labor law matters.

New Eleventh Circuit Ruling In *Palmer & Cay* Promotes Racing To The Courthouse In Noncompete Disputes

By: Don Benson and Scott McDonald

Employers with multi-state noncompete contracts may want to lace up their best pair of running shoes and get ready for a race. On April 1, 2005, the 11th Circuit issued an opinion in *Palmer & Cay, Inc. v. Marsh & McLennan Companies, Inc.*, that some commentators are interpreting as an open door to forum shopping. Although the full effect of this case is difficult to predict at this time and recognizing that the defendant filed a Petition for Rehearing En Banc on April 22nd, 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 Eleventh Circuit Court of Appeals revised a trial court ruling that an employer's noncompete agreement was unenforceable **only in Georgia**. The employee initiated the case in Georgia in order to use the pro-employee Georgia law. The Eleventh Circuit extended the unenforceability to any other lawsuit between the same parties, **even if other lawsuits are filed outside of Georgia**. (*Palmer & Cay, Inc. v. Marsh & McLennan Companies, Inc.*, No. 03-16248, (11th Cir. Apr. 1, 2005)). Most importantly, this ruling may provide an avenue of escape from an otherwise valid noncompete to employees who can relocate to Georgia and are willing to rush to the courthouse before they are sued in another state. Employees may soon ask other states with anti-noncompete policies to extend their declaratory judgment protections in the same way.

Factual Background

Marsh & McLennan Companies, Inc. (MMC) bought the brokerage that employed James Meathe in 1997. Mr. Meathe sold his shares in the acquired brokerage and accepted employment with MMC, ultimately becoming Managing Director and Head of the Midwest Region of MMC. Mr. Meathe executed a 1997 stock sales agreement containing noncompete agreements ("NCAs") and a 2002 employment-related NCA. In February of 2003, Mr. Meathe left MMC, relocated to Georgia, and joined Palmer & Cay in direct competition with MMC in both Georgia and his former Midwest territory.

To take advantage of Georgia's anti-NCA precedent, Mr. Meathe and his new employer, Palmer & Cay, filed a declaratory judgment action in the federal district court in Savannah, Georgia, seeking an order that both the 1997 stock sale NCA and his 2002 employment-related NCA are unenforceable.

Declaratory judgment is the vehicle for asking the court to outline the parties' contractual rights, even before one is sued for breach of contract.

Georgia is one of the most difficult states for an employer to obtain enforcement of an employment-related NCA. Georgia will not "blue pencil" an overly-broad, employment-related NCA to enforce it to the extent reasonable. Although Georgia law is quite antagonistic to employment-related NCAs, it will blue pencil an NCA ancillary to the sale of a business. However, if a stock sale occurs at the same time that an employee joins the buying company, Georgia law has its own peculiarities for determining whether the NCA in a stock agreement is entitled to the lower blue-pencil standard or the stricter standards for employment-related NCAs. In *Palmer & Cay*, the employment-related 2002 NCA was found to be unenforceable and Eleventh Circuit declared that Georgia law would determine whether the 1997 stock sale NCA would be judged by the tougher employment-related standard or the less-strict sale-of-a-business standard.

The Effect of Declaratory Judgments Outside of Georgia

NCA agreements often specify the state law to be used for interpreting the agreement. Before *Palmer & Cay*, it was clear that if an employer had a valid NCA in, for example, Iowa, and if it could obtain jurisdiction in Iowa over its former employee who now lived in Georgia, then the NCA would likely be enforced under Iowa law particularly if the agreement includes an Iowa choice of law clause.

It was also clear that if the employee located in Georgia was sued in Georgia, a court applying Georgia law would not enforce the agreement, even if the NCA stated that Iowa law was to apply. Georgia's choice of law principles require its courts to bypass initially such choice of law provisions and first determine whether the NCA is enforceable under Georgia law. The strong Georgia public policy against NCAs would not allow a Georgia court to enforce an NCA contrary to that policy, despite a choice of law provision in the NCA. A federal court in Georgia hearing a case based on diversity jurisdiction would also apply Georgia law to such a contract dispute.

It was not yet clear what the employee could gain 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 11th 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 the state where it was originally signed and drafted would reach a different conclusion.

Responding Within and Outside of Georgia

The *Palmer & Cay* decision provides a blue print for aggressive companies seeking to evade otherwise valid NCAs based on the three R's:

- Raiding a competitor's key employees;
- Relocating the employees to Georgia; and
- Racing to a Georgia courthouse for declaratory relief.

Additional states with strong public policies against NCAs, like California and Texas, may see similar declaratory judgment actions being filed in an attempt to extend protections beyond their state borders to the parties of a declaratory judgment lawsuit. Other courts applying another state's choice of law and declaratory judgment statutes may reach a more limited ruling than the Eleventh Circuit announced in *Palmer & Cay*, and a number of different opinions from other jurisdictions already indicate a reluctance to issue declaratory judgments with such sweeping territorial reach. Nevertheless, the likelihood of this kind of challenge emerging in other jurisdictions is high.

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. Those employers who are not using binding arbitration may want to reconsider its appropriateness for their business. To maximize the usefulness of an arbitration clause, it will be important for the employer to aggressively invoke its arbitration rights ***before*** the employee obtains a final declaratory judgment in Georgia.

Is your company subject to a *Palmer & Cay* pre-emptive strike? 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 in similarly anti-NCA jurisdictions, should consider the likelihood of such relocations and draft its NCA provisions with an eye toward enforceability in neighboring states, 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 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.

Companies seeking to help a new employee avoid the enforcement of an NCA might pursue a declaratory judgment that it is unenforceable by rushing to a state or federal court applying favorable anti-NCA case law.

As parties continue to assess the usefulness of the *Palmer & Cay* decision in avoiding NCAs, one message is clear: pro-active, aggressive litigation strategies have grown even more important for employers.

Donald Benson is a shareholder in Littler Mendelson's Atlanta Office. Scott McDonald is Office Managing Shareholder in Littler Mendelson's Dallas Office. If you would like further information, please contact your Littler attorney at 1.888.Littler, info@littler.com, Mr. Benson at dbenson@littler.com or Mr. McDonald at smcdonald@littler.com.