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LETTER
NONCOMPETE NEWS

Noncompete News: Uncertainty Remains Regarding Georgia Noncompete Laws

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On November 3, 2010, Georgia voters approved a constitutional amendment giving effect to the Georgia Restrictive Covenants Act ("RCA"). What we do know is that the RCA constitutes a monumental change to existing Georgia "noncompete" law. What we do not know is when the RCA will take effect.

Under the Georgia Constitution, Art. X, §1, ¶6, a constitutional amendment becomes effective on the January 1st following its ratification, unless the amendment provides otherwise. The amendment was silent, so the constitutional amendment (and thus the RCA) presumably went into effect January 1, 2011. Nevertheless, many practitioners believed the RCA to be effective as of November 3, 2010. To address this discrepancy (i.e., when the RCA takes effect), the Georgia legislature recently presented House Bill 30. On Tuesday, February 22, 2011, the House of Representatives passed HB 30. The bill is now before the Senate. If HB 30 is passed, however, there may be an argument that the RCA does not become effective until HB 30 goes into effect. Accordingly, some practitioners have adopted a "wait and see" approach to applying the RCA. Because of this uncertainty, many practitioners who draft and litigate Georgia noncompete agreements continue to adhere to the "old" law with an eye toward interpreting and understanding the RCA, if and when it becomes effective.

What is Certain: All agreements entered into before November 3, 2010 subject to old law.

Here is what will not change: Georgia law provides that the RCA "shall not apply in actions determining the enforceability of restrictive covenants entered into before" November 3, 2010. That principle was applied a few weeks ago in Cox v. Altus Healthcare and Hospice, Inc. (Ga. Ct. App. January 24, 2011). While employed, Cox, an Altus employee, signed an agreement that prohibited him from: (a) disclosing confidential information to others; (b) soliciting Altus referral sources; and (c) soliciting any Altus employee. When Cox resigned and acquired a competing hospice provider, Altus sued to enforce the covenants. The trial court issued an injunction in March 2010, enjoining Cox from using any Altus confidential information, soliciting Altus referral sources, and soliciting Altus employees. Cox appealed and also filed a claim under O.C.G.A. § 9-11-65 for wrongful restraint, contending that he had been wrongfully enjoined and was entitled to damages during the period in which he was enjoined: March 2010 – September 2010.

On January 24, 2011, the Court of Appeals issued its decision and reversed the trial court. The court first recognized that prior Georgia law, and not the RCA, would apply to interpret the agreement because, by Georgia statute, the RCA could not apply to agreements entered into before November 3, 2010. Applying pre-existing Georgia law, the court next determined that the provisions failed as a matter of law for several reasons. The nondisclosure provision failed because it contained no temporal restriction. And the nonsolicit of referrals provision failed because it contained no time

limitation and was not limited to the customers/referrals with which Cox had contact. The court reminded the reader of Georgia's unique take on employee-based restrictive covenants: a court cannot "blue pencil" or modify restrictive covenants. They live or die on the face of the agreement. Because the provisions were void on their face, Cox could seek to recover damages for wrongful restraint.

If/When the RCA Becomes Effective

The result in Altus may not have been the same under the RCA.

A. Modification of Overbroad Provisions

Under the RCA, the court is expressly authorized to "modify" an overbroad restrictive covenant provision. Under the RCA, "modification" is defined as "severing or removing" a part of a restrictive covenant that would otherwise make the covenant unenforceable. Accordingly, under the definition, a court arguably is allowed only to strike out or remove language that renders the restrictive covenant otherwise unenforceable, but it cannot rewrite or otherwise add to the language of a noncompete. This constitutes the primary change to pre-existing Georgia law, as Section 13-8-54 of the RCA now provides that a court "may modify" an otherwise unenforceable restrictive covenant.

B. No Temporal Restriction for Nondisclosure Provision

Pursuant to Section 13-8-53(e) of the RCA, a nondisclosure provision relating to confidential information no longer has to have a temporal restriction in order to be enforceable. Further, the RCA defines confidential information. Therefore, the drafter of a restrictive covenant going forward can rely on the definition in the RCA to ensure that the agreement complies with the RCA.

C. Broadening a Nonsolicitation of Customers Provision

Under pre-existing Georgia law, a nonsolicitation of customers provision needs to be narrowly defined to include only those customers with which the employee had actual contact (at least as to those nonsolicitation of customers provisions that do not have a narrowly-defined territorial restriction). Under the RCA, the definition of "material contact" now allows a nonsolicit to include not only those customers with whom the employee had actual contact, but also those customers: 1) whose dealings with the employer the employee coordinated or supervised; 2) about whom the employee obtained confidential information while employed by the employer; or 3) about which the employee received compensation, commissions, or earnings during the two years prior to the employee's termination. In addition to the broader definition of "material contact," the nonsolicitation of customers provision need not expressly define the types of products or services considered to be competitive in order for the nonsolicit of customers to be enforceable.

D. Noncompete Agreements Apply to a More Defined Group of Employees

Under pre-existing Georgia law, an employer can enter into a noncompete agreement with any employee, whether that employee is a janitor, salesman, or CEO. Under the RCA, a noncompete provision may only be enforced against an employee who: 1) customarily and regularly solicits customers or prospective customers; 2) customarily and regularly engages in making sales; 3) has a primary duty of managing a company, or one of its departments or subdivisions, directs the work of two or more employees and has the authority to hire or fire other employees; or 4) performs the duties of a "key employee" or a "professional" as defined by the RCA. As a practical matter, however, true noncompete provisions have, in the past, rarely been enforced against other than the above-identified types of employees. Indeed, restrictive covenant disputes primarily involve sales employees and their employers. Nevertheless, under the RCA, a large subset of Georgia employees cannot be subject to a true post-term noncompete provision.

Bottom Line

Once the RCA becomes effective (assuming it is not effective now), it will represent a sea change in how Georgia restrictive covenants are drafted and enforced. Until there is certainty as to when the RCA is effective, however, practitioners are wise to resort to pre-existing Georgia law to draft any Georgia agreements.

If you have any questions regarding the issues discussed in this Noncompete

Newsletter, please contact the editor, Jeff Mokotoff, jmokotoff@fordharrison.com, or the Ford & Harrison attorney with whom you usually work.