

Restrictive Covenants In Georgia: Avoiding The Choice Of Law Trap

Monday, November 27, 2006 --- Restrictive covenants in employment agreements are an important tool in protecting the customers, clients, business and competitive information of a company from being taken by an employee who leaves.

However, when ancillary to employment, these covenants may not be enforced in Georgia, even if they are enforceable in other states. Many large, sophisticated corporations use agreements that are drafted by counsel in N.Y., Boston, Chicago or elsewhere.

When they use these agreements for employees in Georgia, they are highly susceptible to being struck down and leaving the company exposed to their competitors.

Georgia courts are among the strictest in the country when it comes to enforcement of restrictive covenants in employment agreements. In fact, the Georgia courts are arguably the most hostile in the country to employers when it comes to enforcement of restrictive covenants that are ancillary to employment, even eclipsing California which is well known for its public policy disfavoring these types of agreements.

Importantly, a provision that the law of another state governs the employment agreement will not save a restrictive covenant that is unenforceable under Georgia law. The Georgia courts will disregard the choice of law provision and apply Georgia law. This article will explore what that means from a practical perspective.

In Georgia, the enforceability of restrictive covenants in employment agreements is constitutional in nature. The Georgia Constitution provides that all contracts have the effect of or are intended to defeat or lessen competition or encourage a monopoly are illegal and void.

Restrictive covenants in employment agreements are considered to be in partial restraint of trade and will only be enforced by the courts in Georgia if the restraints are not unreasonable, are given in return for something of value, are reasonably necessary to protect the interest of the employer, and do not unduly prejudice the public interest.

The four types of restrictive covenants most often used are:

--A noncompetition covenant that generally prohibits an employee from engaging in any competition with the employer after termination of

employment.

--A nonsolicitation provision that restricts an employee from soliciting business from certain of the employer's customers after termination of employment.

--A nonrecruitment covenant that restricts an employee from recruiting employees of the employer to a competing business after termination.

--A nondisclosure or confidential information provision that restricts an employee from using or disclosing confidential information (as differentiated from trade secrets) of the employer.

In Georgia, restrictive covenants must be concise, precise, and carefully tailored to the interests of the employer. Georgia courts typically use a three-part test to determine the reasonableness of covenants in employment agreements.

The covenants must be reasonably limited in terms of the time in which they bind the employee, the scope of conduct prohibited, and the geographical territory in which they bind the employee. Each prong of the test merits further explanation.

Duration of the Restrain. No time restriction is unreasonable, per se. Although one and two-year durations are typical, a five year limitation has been upheld. In order to be reasonable, the limitation in time should bear some relation to the amount of time needed by the employer to re-establish and solidify its relationships with its customers, clients, and employees. Unlike many states, even a provision intended to protect confidential information (as differentiated from trade secrets) must contain a time limit.

Scope of Conduct Restricted. The covenants must explain precisely the nature of the business in which the employee is prohibited from engaging, and must relate to that which the employee did for the employer during his employment.

Geographic Limitations. A territorial limitation is ordinarily a necessary element of a covenant against competition. A geographic restriction must specify with particularity the geographic area in which the employee is restricted from competing. The territory must be limited to the area in which the employee worked for or represented the employer. Georgia courts have consistently struck down noncompete covenants that apply wherever the employer is doing business. Territorial restrictions that encompass the entire U.S. or the world are also consistently struck down as overly broad and unenforceable.

Until 1992, all restrictive covenants in Georgia were required to contain a geographical restriction. However, in that year, the Supreme Court of Georgia upheld a nonsolicitation covenant without a geographic limitation because it only related to customers with whom the former employee had

contact while employed by the employer. This represented a significant change in Georgia law concerning restrictive covenants.

In rendering this opinion, the Supreme Court began to recognize that the reality of the modern business world is that today's employees' territories have no geographic boundaries. Employees service customers throughout the country and the world, and demanding a geographic restriction severely limits an employer's ability to protect its interests.

Therefore, a nonsolicitation clause in an employment contract that prohibits the solicitation of the employer's clients or prospective clients who the employee actually contacted for a business purpose while serving the employer will be enforced, notwithstanding the absence of a geographical limitation.

Unfortunately, the Supreme Court's recognition of the realities of the modern business world only went so far. Absent a noncompetition covenant, the employer still cannot prohibit a former employee from merely accepting business from the employer's customers without any solicitation or inducement by the former employee. Moreover, the appellate courts in Georgia still have yet to enforce a nationwide or worldwide noncompetition provision.

Severability. Unlike many other states, Georgia courts will not blue-pencil an overly broad covenant ancillary to an employment agreement, even if the agreement explicitly provides that it can be modified by the courts if it is found to be too broad. In other words, if any portion of the covenant is unenforceable (if any one of the three prongs is unreasonable), the entire covenant is unenforceable.

With the addition of a severability clause to the agreement, different covenants within the same agreement may be severable and enforceable on their own; however, an enforceable nonsolicitation of customers provision cannot be severed from an unenforceable noncompetition provision and the same is true the other way around.

Tolling Provisions. A provision suspending the running of the time period of the covenant during litigation is enforceable. Suspending of the period of limitation while the former employee is in violation of the covenant is invalid in that it potentially extends the duration of the covenant without limit.

Consideration. One area in which Georgia is more liberal than many other states is that the prospect for employment or continued employment is an adequate basis for obtaining restrictive covenants from employees in Georgia. No additional consideration is necessary.

The Choice-of-Law Trap. Most important for employment agreements prepared by counsel outside of Georgia for offices or subsidiaries in Georgia, the law of the state chosen by the parties to govern the contract will not be

applied by Georgia courts where application of the chosen law is contrary to the policy of, or will be prejudicial to the interests of, the state of Georgia.

Therefore, given Georgia's public policy of not restricting trade, the chosen law of another state in an employment agreement will likely not be applied by a Georgia court to uphold the restrictive covenants if they violate Georgia law.

Nevertheless, one tool that can be used to circumvent the harsh consequences of Georgia law is a venue selection provision. The Georgia courts will honor a mandatory venue provision contained in an employment agreement even if that means that litigation of the enforceability of the restrictive covenants will take place in another jurisdiction.

Whether the jurisdiction chosen by the parties will respect the parties' choice of law or apply its own choice of law rules to find that Georgia law should be applied will vary from state to state. In addition, whether an injunction from another state court enforcing restrictive covenants that would not otherwise have been enforceable in Georgia will be afforded full faith and credit by the Georgia courts remains an open question.

* Conclusion *

While this article provides a very general outline of the Georgia law that applies to restrictive covenants in employment agreements, there is much more which must be taken into consideration in drafting and enforcing such agreements.

For employees in Georgia a company may be best served to ensure that its agreements comply with Georgia law, rather than trying to circumvent Georgia law only to find out that the covenants cannot be enforced directly or indirectly in Georgia. Employers should be sure that the attorney who drafts their agreements for use in Georgia, and the one they choose to enforce them, is well-versed in the nuances of Georgia law in this.

For those who rely on counsel outside of Georgia to prepare their agreements, Georgia counsel should be consulted to ensure that the strict scrutiny the Georgia courts apply to such agreements does not cause them to be unenforceable. Using a form prepared by counsel that is not familiar with Georgia law and that is used throughout the country is almost a guarantee that the agreements will not be enforced in Georgia.

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