

# BB REVIEW

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### What's Inside . . .

#### Page 1

*The New Restrictive Covenants Act: Sloppy Draftsmanship May Soon Be Forgiven*

#### Page 2

*McLaughlin & Windham Obtain Preliminary Victory*

#### Page 3

*Businesses Not Required to Accept "Half a Loaf" in Non-Compete Cases*

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THE NEW RESTRICTIVE COVENANTS ACT: SLOPPY DRAFTSMANSHIP MAY SOON BE FORGIVEN

BY J. MATTHEW MAGUIRE, JR. AND GEREMY W. GREGORY

On April 29, 2009, Governor Perdue signed a bill that fundamentally alters the treatment of non-compete, non-solicit and non-disclosure covenants (referred to collectively as restrictive covenants). Assuming the required constitutional amendment is ratified as discussed below, Georgia General Assembly Act 64 will have a dramatic effect on the enforcement of restrictive covenants, which are commonly contained in employment contracts in the healthcare field.

### Background

Because Georgia's Constitution prohibits any contract "which may have the effect of or which is intended to have the effect of defeating or lessening competition, or encouraging a monopoly," Georgia courts are among the most hostile in the nation towards restrictive covenants. Like most states, our courts analyze covenants by looking at whether they are (1) reasonable in scope (in time, territory and restricted activity); (2) supported by consideration; (3) reasonably necessary to protect the employer's interests; and (4) not unduly prejudicial to the public. Unlike most states, however, Georgia courts do not usually modify unreasonable covenants to make them reasonable, but instead, they strike them down in their entirety. This makes it very difficult for well-

meaning employers to gain any measure of protection for their confidential information, customer goodwill and investment in their employees.

### The Act

Act 64 is the state's most recent attempt to protect employers by legislating in this area. The General Assembly passed a similar law in 1990, but the Georgia Supreme Court struck it down because it violated the constitutional provision referenced above. See Jackson & Coker v. Hart, 261 Ga. 371, 405 S.E.2d 253 (1991). To avoid a similar result, Act 64 does not become effective unless and until the Georgia Constitution is amended during the 2010 election cycle.

### Contours of Enforceable Covenants

- The most important provisions of Act 64 are:
- Post-termination non-compete.

Certain employees (managers, professionals, sales staff and key employees) may agree not to compete against their employers following termination if the restrictions are reasonable in time, geographic area and scope of prohibited activities. In what appears to be a legislative oversight, the Act provides no guidance as to the reasonableness of the territory or scope of prohibited activities.

- Post-termination non-solicit. An employee may agree not to solicit

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competing business from customers or prospective customers if the employee had material contact with them while working for the employer.

- Non-compete / Non-solicit during employment period. An employee may agree not to compete or solicit competing business within the geographic area in which the employer does business. The Act goes on to say, however, that any such restriction is not unreasonable if it lacks specific limitations upon scope of activity, duration or geographic area as long as it promotes or protects the purpose of the agreement or deters potential conflicts of interest.
- Restrictions arising from sale of business. A seller may agree to not compete with the buyer or solicit or accept competing business from the buyer's customers and prospective customers within the area in which the business conducted at the time of the sale for as long as is necessary to protect the buyer's investment.
- Non-disclosure covenant. Act 64 also provides that any party may agree not to disclose or use another party's confidential information or trade secrets for so long as the information or material remains confidential or a trade secret.

### **Presumptively Reasonable Time Periods**

Courts must presume a post-employment restrictive covenant is reasonable in duration if it lasts for two years or less in an employment relationship, three years or less in a dealer/distributor/licensee relationship, and five years or less in the sale of a business.

### **Blue Penciling**

The most significant change that Act 64 brings to this area of the law is that it requires courts to modify covenants deemed unreasonable instead of striking them down as has always been done in the past.

### **Conclusion**

If the constitutional amendment is passed, Act 64 will provide employers with significantly more protection from departing employees than they currently have. By requiring courts to redraft unreasonable covenants to make them reasonable, the General Assembly will have shifted the burden of drafting enforceable restrictions from the parties to the courts. This may have the unintended effect of increasing litigation and uncertainty in this area of the law since each covenant will be judged on a case-by-case basis.

### **McLAUGHLIN AND WINDHAM OBTAIN PRELIMINARY VICTORY**

Matthew McLaughlin and Alan Windham of the Jackson Office represent a family-owned closely-held corporation in a petition to judicially dissolve the corporation which also included claims of fraud against one of the corporate officers. The petitioning shareholders also challenged the corporation's title to its primary asset, farm property transferred to the corporation. The petitioning shareholders' ultimate goal was to split the corporation's assets amongst the shareholders, either through dissolution or through challenging the title to the corporate assets. The petitioning shareholders claimed that the transfer of title never occurred because at the time the deeds were signed, a defect existed in the incorporation of the company. After dismissing the claim against the corporate officer for failure to plead sufficient facts to state a claim, the Court affirmed the corporation's title in the farm property. Under Mississippi corporate law, and that of any state which follows the Model Act, the remaining shareholders have the option to purchase the shares of the petitioning shareholders to avoid dissolution of the corporation. Thus, the only issue remaining in the litigation is the determination of the share value and an entry of judgment ordering transfer of the shares.

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BUSINESSES NOT REQUIRED TO ACCEPT "HALF A LOAF" IN NON-COMPETE CASES

**BY WILL HILL TANKERSLEY**

Non-compete agreements are often a source of great frustration by businesses that rely on relationships and confidential information. Businesses dutifully pay large sums to employees and entrust those employees with the "family jewels" for a business (introductions to customers and clients as well as valuable confidential information). Nonetheless, sometimes, businesses end up with unsatisfactory results in the form of courts substituting reduced protections (blue penciling), meaningless injunctions and huge costs with little to show for it. It does not need to be this way.

Here is the short version of how to get the protections that businesses believe they have paid for:

1) Solid Agreements: Make sure that the non-compete agreement is tailored to the business needs, does not overreach, and incorporates the latest legal developments. Every five years, businesses should revisit agreements to make sure they are still a good fit for the company. Such agreements should be kept in a very secure location (usually off-site, like a safety deposit box.)

2) Pay Attention to the Employees: If an employee expresses an interest in leaving, make sure the employee knows that the company will insist on its post-employment rights.

3) Exit Procedures: Attempt to have an exit interview to learn where the employee is going and to remind the employee of her/his post employment obligations. If you believe the (now former) employee is going to a competitor, have the employee's computer forensically examined by a trained professional. Be sure to have privacy policies in place that make this permissible for the company to embark on such forensic examinations. Send a reminder letter to the former employee

with a copy of the Agreement. Bullying in exit interviews only hurts a company. Be professional.

4) Move Quickly: Time is the employer's enemy. Move quickly if a violation is discovered.

5) Decide Litigation Goals: Some violations are worth fighting about and some are not. Make a decision early as to which category this employee fits into.

6) Limit Counter-Punch: Non-Compete and trade secret cases are hard enough to win because of the "David and Goliath" theme that most former employees adopt (even those who were paid hundreds of thousands of dollars). Communication with and about the departed employee must be tightly controlled to keep the former employee from deflecting attention away from his/her wrongful behavior. (Be careful about taping conversations. Some states forbid secret tape recording of conversations.)

A client of B&B followed these steps when a key employee left in the summer of 2009. The result:

1) Non-Compete/Trade Secret Agreement fully enforced (no "blue penciling").

2) Complete injunction entered forbidding the former employee from making or receiving business phone calls or sending and receiving e-mails in the state in which the employee had worked (Alabama).

3) Injunction extended by six months so that the company had a full year of compliance.

4) Full liquidated damages awarded (\$80,000).

5) Over \$120,000 in attorney fees awarded.

The client described above achieved this result by following the steps to successful non-compete agreements and got the protections for which it paid.