

Alabama's New Non- Compete Act

November 3, 2015

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Will Your Non-Competition and Non-Solicitation Contracts Still Be Enforceable After January 1, 2016?

What Do Businesses Need To Know?

Alabama's new statute, the Restrictive Covenants Act,¹ will soon govern non-competition and non-solicitation agreements, and other restrictive covenants. Effective January 1, 2016, the current statute, Alabama Code § 8-1-1 will be repealed and the Restrictive Covenants Act will apply.ⁱⁱ For your convenience, this article includes a chart as an Exhibit comparing the old statute and the new statute. This article highlights changes in the law and describes implications for businesses in drafting and enforcing non-competition and non-solicitation agreements.

The new statute attempts to rectify sometimes inconsistent case law that has developed over many decades. Some things change, others stay the same. The general structure is the same – a general rule prohibiting agreements to restrain trade (i.e. contracts that restrain people from exercising a lawful profession, trade, or business), with exceptions to the general prohibition, followed by related rules.

The General Rule.

"Every contract by which anyone is restrained from exercising a lawful profession, trade, or business of any kind otherwise than is provided by this section is to that extent void."ⁱⁱⁱ Understanding the general rule is important - a prohibition on restrictive covenants with specific exceptions. Such a structure emphasizes a public policy that disfavors restraints of trade and indicates that such restraints will be narrowly interpreted by a court.

What is a Restrictive Covenant?

Under a restrictive covenant, one person agrees with another person to refrain from doing something he or she would otherwise be able to do. For example, a company hiring an employee may not want the employee to work for a competitor if the employee leaves (non-competition restrictions), or may want to prevent a former employee from soliciting clients of the company or hiring away their former co-workers (non-solicitation restrictions). Another common example relates to the sale of a business - where the buyer requires that the seller agree not to compete with the business the buyer just bought.

Restrictive covenants make good business sense. It would be difficult to find a buyer of a business if the seller (who knows all of the customers) could turn around and open a competing company. Similarly, employers' investment in specialized employee training, sharing proprietary information, and development of customer good-will can be protected by restrictive covenants preventing direct competition should an employee depart for a competitor. On the other hand, there is a strong public policy in Alabama favoring a competitive marketplace and disfavoring restrictions that cause otherwise productive workers to sit idly by, unable to work due to a restrictive covenant.

Required Components.

To be enforceable, there must be a signed, written agreement, supported by adequate consideration, which includes both of two threshold items. First, there must exist a protectable interest which is preserved by the restrictive covenant. Second, the agreed-upon restriction must be one of the six types of restraints outlined in Section 1 (b) of the statute.

1. **Protectable Interest.** A “protectable interest” is defined by the new statute as including trade secrets, confidential information, commercial relationships, good will, and specialized training involving substantial business expenditure. Recall that restrictive covenants are disfavored by the law. Therefore, the restrictions contemplated by a restrictive covenant must serve to protect a “protectable interest.” Importantly, merely designating an interest as “protectable” in a form contract is not sufficient. A business must have some interest that is actually preserved by the restrictive covenant. For instance, a restrictive covenant in a form contract may be enforceable in a situation where an employee has access to trade secrets of his or her employer, but unenforceable with respect to another employee without such access because the restriction does not actually preserve a protectable interest.

2. **Permissible Types of Restrictive Covenants.** The six types of permissible restrictive covenants in the new statute are (1) agreements between companies to not hire the other company’s agent, servant, or employee who holds a “uniquely essential” position; (2) agreements to limit commercial dealings to the contracting parties; (3) non-competition and non-solicitation agreements associated with the sale of a business; (4) agreements by an agent, servant, or employee to not compete with a commercial entity; (5) agreements by an agent, servant, or employee to not solicit a commercial entity’s current customers; and (6) agreements upon dissolution of a commercial entity to refrain from carrying on a similar business.

Drafting a Restrictive Covenant.

Components.

In drafting a restrictive covenant, four important components deserve attention - who, what, where, and how long?

1. **Who** is prevented from engaging in an otherwise permissible activity? An employee? A newly hired employee with specialized skills? Were specialized skills acquired during employment? An employee who agreed to work for a 3-year transition period after selling the business to a new owner?
2. **What** is the activity or behavior limited by the restrictive covenant which would not be limited in the absence of a restrictive covenant? This might be competing, working, soliciting customers, hiring, soliciting co-workers to leave their employment, or something else.
3. **Where** is the restriction enforced? Also known as the “geographic scope” - which might be, depending on the circumstances, 1 mile, 5 miles, the southeastern US, east of the Mississippi, or another area.
4. **How long** is the restriction enforceable? Also known

as the “duration” of the restriction, which might be 6 months, 1 year, 2 years, or perhaps longer, or possibly until some particular event takes place.

Why Is Careful, Tailored Drafting So Important?

Three reasons. First, restrictive covenants are disfavored and require observance of certain formalities. Second, timing is key. Third, watch out for the blue pencil!

1. **Writing and Signatures.** Certain formalities are required to create an enforceable restrictive covenant. The contract or agreement must be in writing, signed by all parties, and supported by adequate consideration. The new statute suggests that more than token consideration must be given. Presumably, a judge could invalidate a restrictive covenant if the employee did not receive enough consideration for an agreed-upon restriction. How much is enough in a particular set of circumstances?

2. **Time of Signing – Case Law.** Importantly, restrictive covenants binding employees normally should be entered immediately after employment has begun. If a non-competition agreement is signed before employment begins, a court may declare it unenforceable.^{iv} The practical problem is obvious. If a job is sufficiently important to the business to require restrictive covenants, the terms of employment probably were negotiated in advance of the employee’s start date. Should the employee resign the agreement after employment begins? Is there sufficient consideration to support the restrictions signed after the employee’s start date? Practically, can you “spring” a non-compete on employees after they start? These are important issues to consider.

3. **Blue Pencil.** The component of the new statute likely to have the greatest impact on drafting restrictive covenants is the “blue pencil” rule. The term “blue pencil” references an editing tool used to mark-up a draft copy. In the context of restrictive covenants, it refers to a court’s ability to modify or remove terms of a contract that are illegal or unenforceable while leaving the remainder of the contract intact. Under Alabama’s new Restrictive Covenants Act, a court may void a restrictive covenant in part and reform it to preserve the protectable interest if such restraint is (i) overly broad or (ii) unreasonable in its duration. Further, and even more concerning for employers, if a restraint does not fall within the limited exceptions set out in Section 1(b) of the statute, a court may void the restraint in its entirety.

Many contracts include a provision inviting a court to reform (or re-draft) parts of the contract that are not consistent with the law – essentially the parties agree to permit a court to “blue pencil” any unreasonable restrictions but continue to otherwise enforce the contract. Many states enforce such contracts in accordance with the parties’ intent. This arrangement encourages broad drafting of restrictive covenants. After all, if the court ultimately will reduce any overbroad

provisions, employers and buyers (normally the parties drafting documents with restrictive covenants) should draft the broadest possible restrictions. When a court eventually examines a contract, it will just dial back the restrictive covenant to a reasonable level. Meanwhile, all of the employer's other contracts (which have not been examined by a court) will continue to contain broad restrictions.

In contrast, several states have "all or nothing" blue pencil provisions. Rather than permit courts to re-write or reform an overbroad restrictive covenant, if a court finds that a restrictive covenant is unreasonable, the court will eliminate the provision entirely. The policy at work is to encourage reasonable drafting by employers and buyers. If, the thinking goes, employers know that a court will completely invalidate an overbroad restrictive covenant, then employers will have an incentive to draft only such restrictive covenants that would be defensible if challenged and examined by a court.

Alabama's Restrictive Covenants Act describes a middle approach. Courts appear to be able to exercise the blue pencil to re-write a restrictive covenant, but only in limited circumstances – modifying either (i) the geographic scope, or (ii) the duration of a restriction. In other words, the court can change the answer to two questions – *where* and *how long*. The new statute does not appear to permit a court to change other components of the restrictive covenant. For instance, if a non-solicitation provision in a contract applies to "all customers" of a business, a court may not be able to reduce the restriction to only the top 5 customers of the business.

The language of the new statute provides that Alabama courts may void a restraint entirely (the "all or nothing" response) if the restraint does not fit within one of the limited exceptions outlined in the statute. Precisely what "may" means in this context is unclear – we will have to wait and see how courts interpret this apparently permissive authority. What is clear, however, is that the drafters of the statute intended to discourage overreaching boilerplate restrictive covenants that are not narrowly tailored to a specific situation. Employers and buyers using overbroad restrictions risk losing all protection of the restrictive covenant.

Features of the New Law

1. **Inconsistent Law Repealed.** The previous restrictive covenant statute, Alabama Code § 8-1-1, is repealed along with all laws that conflict with the new Restrictive Covenants Act. All indications are that beginning January 1, 2016, all restrictive covenants, whenever drafted, will be judged under this new statute.
2. **Application to Independent Contractors.** The new statute states that "[a]n agent, servant, or employee of a commercial entity..." may agree to a non-compete

restriction or a non-solicitation restriction. In contrast, the current law states that "one who is employed as an agent, servant or employee may agree with his employer..." to such restrictions. This change in the Restrictive Covenants Act may be interpreted as permitting restrictive covenants to apply in the context of independent contractors. If courts ultimately agree, this will be an important practical change.

3. **Professional Exemption Unchanged.** The "professional exemption" for restrictive covenants, which has been developed through significant litigation over many years, is not eliminated.
4. **Presumptive Periods of Reasonableness.** An often-disputed component of a restrictive covenant is its duration. A feature of the new statute is the introduction of presumptively reasonable time periods for three restrictions.
 - a. **Sale of a Business.** A seller of a business may agree with the buyer to refrain from engaging in a similar business and soliciting customers of the business. Restraints of one year or less are presumed reasonable.
 - b. **Non-Compete.** Second, non-compete agreements that prevent an agent, servant, or employee of a commercial entity from engaging in a similar business, which are two years or less, are presumed reasonable.
 - c. **Non-Solicit.** Third, non-solicitation agreements that prevent an agent, servant, or employee of a commercial entity from soliciting current customers are presumed reasonable for the greater of (i) 18 months, or (ii) "for as long as post-separation consideration is paid for such agreement."

These presumptive periods of reasonableness are an important new feature of the statute. Presumptive periods are not maximums, but enforcing longer restrictions may be an uphill battle. Employers and buyers will need to justify why a particular restriction should extend beyond the presumptively reasonable period.

5. **Undue Hardship – Affirmative Defense.** Under current Alabama law, restrictive covenants not barred by a statutory prohibition are subjected to a 4-part "reasonableness" test to determine if, and to what extent, such restrictions are enforceable. One component of such test is that a restriction may not impose an "undue hardship" on the person against whom it is enforced. The party seeking enforcement of the restriction, normally an employer or buyer of a business, has to show that the restriction imposes no undue hardship on the party against whom enforcement is sought. Under the new Restrictive Covenants Act this burden shifts. "Undue hardship" is an affirmative defense – meaning that the party resisting enforcement (normally an employee or seller of a business) must affirmatively demonstrate that enforcing the restriction will cause an undue hardship.

6. **Remedies – Injunctive Relief + Monetary Damages.** The Restrictive Covenants Act clarifies that injunctive relief and monetary damages are available remedies for breaches of valid restrictive covenants. “Lawful liquidated damages” are permitted if provided in the contract. Note, however, that liquidated damage provisions carry unique risks.

7. **Unanswered Questions.** Many questions remain unanswered. Does the repeal of prior conflicting law impact cases that are merely inconsistent, but not directly in conflict with the new statute? How much consideration is “adequate”? How long can consideration support a non-solicitation restriction? Will courts seek to avoid utilizing the blue pencil? How broadly will courts apply

their power to void restraints entirely? What constitutes a “commercial entity”? What will be the impact of the foreign law provision that appears to prevent selecting a different state’s law to circumvent Alabama’s public policy regarding restrictive covenants? What constitutes a “current” customer? Will a non-solicitation agreement be enforceable with respect to prospective customers? What type of training is “specialized” enough to be a protectable interest?

Next Steps.

Restrictive covenants need to be examined and possibly re-drafted in light of the new statute. Otherwise, employers and buyers risk losing protection after January 1, 2016.

End Notes

ⁱ Alabama Laws Act 2015-465, signed by Governor Bentley on June 11, 2015, and referred to as the “Restrictive Covenants Act”. The Restrictive Covenants Act is codified at Ala. Code § 8-1-190, *et seq.*

ⁱⁱ Restrictive Covenants Act, Sections 9 and 10.

ⁱⁱⁱ *Id.* at Section 1(a), codified at Ala. Code § 8-1-190(a).

^{iv} *Pitney Bowes, Inc. v. Berney Office Solutions*, 823 So. 2d 659 (Ala. 2001). *Dawson v. Ameritox, Ltd.*, 2014 WL 31809 (S.D.Ala., Jan. 6, 2014).

Blue text is new language added by the Restrictive Covenants Act. Red text is language in the current Ala. Code § 8-1-1 which is not part of the Restrictive Covenants Act. Black text is language that appears both in the current Ala. Code § 8-1-1 and the Restrictive Covenants Act.

Section 1(a) is the general rule prohibiting agreements that restrain trade. Section 1(b) lists six (6) types of restrictive covenants that generally would be void by law, but are permissible to preserve a "protectable interest". Sections 2 through 10 provide definitions and rules to apply the permitted restrictive covenants and address other details.

<p>General Structure</p>	<p>Section 1. (a) Every contract by which anyone is restrained from exercising a lawful profession, trade, or business of any kind otherwise than is provided by this section is to that extent void.</p>
<p>Exceptions</p>	<p>(b) Except as otherwise prohibited by law, the following contracts are allowed to preserve a protectable interest:</p>
<p>Non-Hire</p>	<p>(1) A contract between two or more persons or businesses or a person and a business limiting their ability to hire or employ the agent, servant, or employees of a party to the contract is permitted where the agent, servant, or employee holds a position uniquely essential to the management, organization, or service of the business.</p>
<p>Limit Commercial Dealings</p>	<p>(2) An agreement between two or more persons or businesses or a person and a business to limit commercial dealings to each other.</p>
<p>Non-Compete, and Non-Solicit</p>	<p>(b3) One who sells the good will of a business may agree with the buyer and one who is employed as an agent, servant or employee may agree with his employer to refrain from carrying on or engaging in a similar business and from soliciting old customers of such employer business within a specified county, city, or part thereof geographic area so long as the buyer, or any person entity deriving title to the good will from him, or employer that business, carries on a like business therein, subject to reasonable time and place restraints. Restraints of one year or less are presumed to be reasonable.</p>
<p>Non-Compete</p>	<p>(4) An agent, servant, or employee of a commercial entity may agree with such entity to refrain from carrying on or engaging in a similar business within a specified geographic area so long as the commercial entity carries on a like business therein, subject to reasonable restraints of time and place. Restraints of two years or less are presumed to be reasonable.</p>
<p>Non-Solicit</p>	<p>(5) An agent, servant, or employee of a commercial entity may agree with such entity to refrain from soliciting current customers, so long as the commercial entity carries on a like business, subject to reasonable time restraints. Restraints of 18 months or for as long as post-separation consideration is paid for such agreement, whichever is greater, are presumed to be reasonable.</p>
<p>Dissolution of Commercial Entity</p>	<p>(e6) Upon or in anticipation of a dissolution of the partnership a commercial entity, partners, owners, or members, or any combination thereof, may agree that none of them will carry on a similar business within the same county, city or town, or within a specified part thereof, where the partnership business commercial activity in the geographic area where the commercial activity has been transacted.</p>
<p>Protectable Interest</p>	<p>Section 2. (a) A protectable interest includes all of the following:</p>
<p>Trade Secrets</p>	<p>(1) Trade secrets, as defined in Section 8-27-2, Code of Alabama 1975.</p>

Confidential Information	(2) Confidential information, including, but not limited to, pricing information and methodology; compensation; customer lists; customer data and information; mailing lists; prospective customer information; financial and investment information; management and marketing plans; business strategy, technique, and methodology; business models and data; processes and procedures; and company provided files, software, code, reports, documents, manuals, and forms used in the business that may not otherwise qualify as a trade secret but which are treated as confidential to the business entity, in whatever medium provided or preserved, such as in writing or stored electronically.
Relationships and Contracts	(3) Commercial relationships or contacts with specific prospective or existing customers, patients, vendors, or clients.
Good Will	(4) Customer, patient, vendor, or client good will associated with any of the following: <ul style="list-style-type: none"> a. An ongoing business, franchise, commercial, or professional practice, or trade dress. b. A specific marketing or trade area.
Training	(5) Specialized and unique training involving substantial business expenditure specifically directed to a particular agent, servant, or employee; provided that such training is specifically set forth in writing as the consideration for the restraint.
Job Skills	(b) Job skills in and of themselves, without more, are not protectable interests.
Signed Writing, and Consideration	Section 3. In order to be valid, any contract or agreement executed pursuant to this act shall be reduced to writing, signed by all parties, and be supported by adequate consideration.
Blue Pencil	Section 4. If a contractually specified restraint is overly broad or unreasonable in its duration, a court may void the restraint in part and reform it to preserve the protectable interest or interests. If a contractually specified restraint does not fall within the limited exceptions set out in subsection (b) of Section 1, a court may void the restraint in its entirety.
Undue Hardship	Section 5. The party seeking enforcement of the covenant has the burden of proof on every element. The party resisting enforcement of the covenant has the burden of proving the existence of undue hardship, if raised as a defense.
Remedies	Section 6. (a) The remedies available for breach of an agreement subject to this act are:
Injunctive Relief	(1) Such injunctive and other equitable relief as may be appropriate with respect to any actual or threatened breach.
Actual Damages	(2) The actual damages suffered as a result of the breach or lawful liquidated damages if provided in the contract.
Other Remedies	(3) Any remedies available in contract law, including attorneys' fees or costs, if provided for in the contract or otherwise provided for by law.
Defenses	(b) Nothing in this act shall limit the availability of any defense otherwise available in law or equity.
Professional Exemption	Section 7. Nothing in this act shall be construed to eliminate any professional exemption recognized by Alabama law.

Foreign Law	Section 8 It is hereby declared that this act expresses fundamental public policies of the State of Alabama. Therefore, this act shall govern and shall be applied instead of any foreign laws that might otherwise be applicable in those instances when the application of those foreign laws would violate a fundamental public policy expressed in this act.
Repeal Inconsistent Law	Section 9. All laws or parts of laws which conflict with this act are repealed, and specifically, Section 8-1-1, Code of Alabama 1975, is repealed.
January 1, 2016	Section 10. This act shall become effective on January 1, 2016, following its passage and approval by the Governor, or its otherwise becoming law.

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