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LEGAL ALERT

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Georgia Voters Approve Sweeping Overhaul of the State's Restrictive Covenant Law

On November 2, 2010, Georgia voters approved an amendment to the Constitution of Georgia authorizing new legislation that dramatically changes the State's restrictive covenant law. As Georgia business owners are well aware, enforcement of restrictive covenant agreements against employees, franchisees, lessees, or independent contractors has been a moving target because of the Georgia appellate courts' strict approach to such agreements. Despite business owners' and their lawyers' attempts to craft narrowly tailored, enforceable restrictive covenants, Georgia courts' application of strict scrutiny to restrictive covenants often resulted in "gotcha" litigation aimed (often successfully) at unwinding otherwise valid agreements based on minor technicalities or new interpretations of the law. The new statute was drafted with the stated intention of providing guidance to parties entering into such agreements on or after November 3, 2010, and greater certainty as to their enforcement. Most notably, the legislature has reduced the level of scrutiny generally applied to restrictive covenants, authorized courts to "blue-pencil" overly broad covenants, and provided several presumptions to guide courts in their analysis of what time, territory, and activity restrictions are reasonable.

The following discusses the key provisions of the new statute and provides practical tips for Georgia businesses in light of the changes.

Who Is Affected by the New Law?

The new statute recognizes and is intended to protect businesses' legitimate competitive interests reflected in restrictive covenant agreements between employers and employees, distributors and manufacturers, lessors and lessees, partnerships and partners, franchisors and franchisees, and sellers and purchasers of businesses or commercial enterprises. O.C.G.A. §§ 13-8-51(9, 15), 13-8-52(a). Those include interests in trade secrets; confidential information; relationships with existing or prospective customers, patients, vendors, or clients; customer, patient or client goodwill associated with an ongoing business, a geographic location, or a marketing or trade area; and extraordinary or specialized training. O.C.G.A. § 13-8-51(9).

Likely for ease of drafting, the legislature defined "employee" broadly to include traditional employees, independent contractors, franchisees, distributors, lessees, licensees, partners, or other specified agents and employees. O.C.G.A. § 13-8-51(5). "Employee" is not defined to include any person or entity who "lacks selective or specialized skills, learning, or abilities or customer contacts, customer information, or confidential information." *Id.* The term "employer" also is defined broadly to include "any corporation, partnership, proprietorship, or other business organization," any successors to such businesses, or any person or entity that owns an equity or ownership interest accounting for 25% or more of the voting rights or profit interest of the business. *Id.*

What Are the Key Provisions of the New Law?

1. Judicial Construction and Modification.

Consistent with prior Georgia common law, O.C.G.A. § 13-8-53(a) provides that "enforcement of contracts that restrict competition during the term of a restrictive covenant, so long as such restrictions are

reasonable in time, geographic area, and scope of prohibited activities, shall be permitted." *See Atlanta Bread Co. Int'l, Inc. v. Lupton-Smith*, 285 Ga. 587, 589-90, 679 S.E.2d 722, 724 (2009) (recognizing that covenants must be reasonable as to time, territory, and scope). Unlike prior law, however, the new statute requires the court to construe restrictive covenants in favor of providing protection for legitimate business interests. This rule of construction eliminates the strict scrutiny generally applied to covenants in leases and employment, franchise, distributorship, and independent contractor agreements, as well as the middle level of scrutiny applied to covenants in professional partnership agreements. *See, e.g.*, *Atlanta Bread Co. Int'l, Inc.*, 285 Ga. 587, 679 S.E.2d 722 (franchise context); *Jenkins v. Jenkins Irrigation, Inc.*, 244 Ga. 95, 259 S.E.2d 47 (1979) (independent contractor context) *abrogation recognized by Habif, Arogetti & Wynne, PC v. Baggett*, 231 Ga. App. 289, 498 S.E.2d 346 (1998) (professional partnership context); *Advance Tech. Consultants, Inc. v. RoadTrac, LLC*, 250 Ga. App. 317, 551 S.E.2d 735 (2001) (distributorship context); *Herndon v. Waller*, 241 Ga. App. 494, 525 S.E.2d 159 (1999) (lease context).

Significantly, the statute now specifically authorizes, but does not require, the court to modify an otherwise overly broad restrictive covenant to sever the offending provision and enforce the remaining provisions to the extent they are reasonable. *See* O.C.G.A. §§ 13-8-51(11, 12); 13-8-53(d); 13-8-54(b). Although it is unclear how courts will apply this provision, the statute appears to permit modification only if the offending language may be struck from the agreement without rendering the covenant meaningless (*i.e.*, "blue-penciling"). The new statutory language does not, however, indicate that the court is permitted, as in some states, to substitute new language for the parties. For example, if a geographic restriction prohibited the employee from competing in "the Southeast," and that provision was held to be overbroad, it is unclear whether the court could effectively sever the offending language without rendering the restriction meaningless. By contrast, if the covenant listed all of the states intended to comprise the restricted territory, the court could remove the offending provisions and enforce the remainder of the covenant. This also appears to eliminate Georgia's long-standing rule that non-solicitation and non-competition provisions may not be severed from each other. *See, e.g.*, *Ward v. Process Control, Corp.*, 247 Ga. 583, 584 277 S.E.2d 671, 673 (1981) (recognizing that if either a non-solicitation and non-competition covenant is void, the other covenant is also void and unenforceable). The scope of the court's powers in this respect will likely be a topic of litigation.

2. Enforceability of Time, Territory, and Scope of Activity Restrictions in Non-Competition Covenants.

As a preliminary matter, O.C.G.A. § 13-8-53(a) permits post-termination, non-competition restrictions to be enforced only against those employees who (1) solicit customers or prospective customers, (2) regularly make sales, obtain orders or contracts for products or services, (3) manage two or more employees and have the authority to hire or fire other employees, (4) have gained high notoriety or prominence with the employer's customers, or (5) are highly educated professionals. If one of these criteria is met, the new law gives employers substantial flexibility in describing the applicable territorial and scope of activity restrictions. Specifically, O.C.G.A. § 13-8-53(c)(1) provides that whenever a description of:

> activities, products, and services, or geographic areas, is required by this Code section, any description that provides fair notice of the maximum reasonable scope of the restraint shall satisfy such requirement, even if the description is generalized or could possibly be stated more narrowly to exclude extraneous matters.

This provision dramatically alters prior decisional law, which required that the prohibited activities and restricted territory be described with particularity and be determined at the time the covenant was executed. *See, e.g.*, *Wiley v. Royal Cup, Inc.*, 258 Ga. 357, 359, 370 S.E.2d 744, 746 (1988) (holding that restriction must specify with particularity the geographic area in which the employee is restricted); *Howard Schultz Assocs., Inc. v. Broniec*, 239 Ga. 181, 184, 236 S.E.2d 265, 268 (1977) (same as to scope of activity), *superseded by statute as stated in Hart v. Jackson & Coker, Inc.*, Nos. 90-5654-3 & 90-5661-3, 1990 WL 448061 (Ga. Sept. 7, 1990). To provide additional guidance, O.C.G.A. § 13-8-53(c)(2) offers examples of prohibited activities, products, services, and the restricted territory that are specific enough to satisfy the statute.

With respect to time restrictions, O.C.G.A. § 13-8-57 establishes three rebuttable presumptions:

1. In the employment context, restrictions of two years or less are presumed reasonable and restrictions of longer than two years are presumed unreasonable. O.C.G.A. § 13-8-57(b).

2. In the context of covenants to be enforced against distributors, dealers, franchisees, lessees, or licensees, three-year restrictions are presumed reasonable and longer restrictions are presumed unreasonable. O.C.G.A. § 13-8-57(c).

3. In the context of the sale of a business (including partnership interests, limited liability company membership interests, corporate stock, or other equity interests), restrictions equal to five years or the period of time during which payments are made to the seller are presumed reasonable. O.C.G.A. § 13-8-57(d).

It is important to note that employment, franchise, distributorship, lease, independent contractor, and partnership agreements that are "associated with" the sale of a business are subject to the longer presumptions set forth in O.C.G.A. § 13-8-57(d).[1] These presumptions also apply to non-solicitation covenants, which are discussed in the next section.

3. Enforceability of Non-Solicitation Restrictions.

Consistent with prior common law, no geographical restrictions are required in customer non-solicitation provisions. O.C.G.A. § 13-8-53(b). Unlike prior law, however, subject to the presumptions governing time restrictions, the statute permits post-termination restrictions prohibiting the employee from "soliciting, or attempting to solicit, directly or by assisting others, any business from any of such employer's customers, including actively seeking prospective customers, with whom the employee had *material contact* during his or her employment for purposes of providing products or services that are competitive with those provided by the employer's business." *Id.* (emphasis supplied).

The term "material contact," as used in the new non-solicitation provision, could vastly expand the classes of customers with whom contact may be restricted. Previously, non-solicitation provisions were required

[1] Because the statute does not specify what constitutes an agreement "associated with" the sale of a business, courts may continue to look to existing law interpreting whether an agreement is ancillary to such a sale. *See, e.g.*, *Hudgins v. Amerimax Fab. Prods., Inc.*, 250 Ga. App. 283, 551 S.E.2d 393 (2001) (discussing test for covenants "ancillary" to the sale of a business).

to be limited to those customers with whom the employee had a business relationship. *See W.R. Grace & Co. v. Mouyal*, 262 Ga. 464, 467-68, 422 S.E.2d 529, 532-33 (1992), *answer to certified question conformed to W.R. Grace & Co. v. Mouyal*, 982 F.2d 480 (11th Cir. 1993); *Trujillo v. Great S. Equip. Sales, LLC*, 289 Ga. App. 474, 477-78, 657 S.E.2d 581, 584 (2008). Under the new law, an employer may prohibit solicitation of actual or prospective customers:

1. With whom or which the employee dealt on behalf of the employer;

2. Whose dealings with the employer were coordinated or supervised by the employee;

3. About whom the employee obtained confidential information in the ordinary course of business . . . ; or

4. Who received products and services authorized by the employer, the sale or provision of which results or resulted in compensation, commissions, or earnings for the employee within two years prior to the date of the employee's termination.

O.C.G.A. § 13-8-51(10).

4. Enforceability of Non-Disclosure Agreements.

Under prior Georgia common law, non-disclosure and confidentiality restrictions were required to have an express time limitation to be enforceable. *See Howard Schultz Assocs., Inc.*, 239 Ga. at 188, 236 S.E.2d at 270. The new law appears to eliminate the requirement of an express time limitation, but does not eliminate the possibility that the court could conclude that confidential information is no longer subject to protection. O.C.G.A. § 13-8-53(e). This provision appears to bring the law governing confidentiality agreements in line with the Georgia Trade Secrets Act, which provides that "a contractual duty to maintain a trade secret or limit use of a trade secret shall not be deemed void or unenforceable solely for lack of a durational or geographic limitation on the duty." O.C.G.A. § 10-1-767(b)(1). Thus, it appears to be the case that non-disclosure covenants will not be rendered void as a matter of law for lack of an express time restriction. Notwithstanding this change, however, the new law does not alter the burden on the party claiming the protection of such a covenant to demonstrate that the information truly is confidential.[2] The prudent approach, therefore, is to make a reasonable estimate of the time period during which the information would remain confidential.

5. Enforceability of Restrictions During the Course of the Employment or Business Relationship.

The new law also creates several presumptions that apply to limiting competition *during* the course of an employment or business relationship. O.C.G.A. § 13-8-56. First, the statute requires the court to presume that a time period equal to or measured by the term of the parties' business or commercial relationship is reasonable. O.C.G.A. § 13-8-56(1). Second, a geographic limitation defined by the areas in which the employer does business at any time during the relationship, even if not known at the time the

[2] Notably, the new law does not contain provisions applicable to employee non-recruitment or no-hire provisions, which are scrutinized using the same lower level of scrutiny applicable to non-disclosure agreements. As such, prior Georgia law analyzing such restrictions does not appear to be affected by the new statute.

agreement is signed, is reasonable if certain conditions are satisfied. O.C.G.A. § 13-8-56(2). Third, the scope of prohibited activities is measured by the business of the employer, and the employer may enforce partial violations of the restrictive covenant. O.C.G.A. § 13-8-56(3). Finally, any restriction that operates during the term of an employment, agency, independent contractor, partnership, franchise, distributorship, license, ownership, or other ongoing business relationship will not be considered unreasonable due to the lack of specific time, territory, or activity restrictions, "as long as it promotes or protects the purpose or subject matter of the agreement or relationship or deters any potential conflict of interest." O.C.G.A. § 13-8-56(4). These provisions are generally consistent with agency law.

Practical Considerations Under the New Law.

In light of the changes to Georgia law discussed above, businesses should revisit their existing contracts to determine whether there is a significant benefit to amending those agreements or entering into new ones, which would be governed by the new, more covenant-friendly statute. In the employment context, where businesses typically face the stiffest challenges to enforcement, the new law does not appear to alter the rule that continued employment will supply consideration for restrictive covenant agreements. In other words, an employee can be asked to sign a restrictive covenant *during* his employment, not just when he or she is hired. Georgia employers should, therefore, determine whether requiring new restrictive covenant agreements from executive, management, sales, and other key personnel makes business sense.

Businesses that seek new restrictive covenant agreements, regardless of the context, should continue to use caution in drafting these agreements and not assume that the courts will exercise their powers to modify overly broad restrictions. Although much of the prior decisional law may no longer be controlling under the new statute, the courts may continue to look to that body of law in determining whether restrictions are reasonable. Moreover, Georgia employers should be aware that if they try to enforce a post-employment restriction against a former employee, the court still may consider whether enforcement would be an economic hardship to the employee. O.C.G.A. § 13-8-58(d). These circumstances, however, may not be considered in the franchise, lease, distributorship, partnership, or sale of a business. *Id.* Therefore, businesses should work with their counsel to draft agreements that not only comply with the new Georgia statute, but also consider that Georgia courts may be called upon to resolve questions regarding the reasonableness of restraints based on existing Georgia case law, even under the new statute.

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