CARLTON FIELDS

Legislative Changes Give Georgia Employers Cause to Review the Restrictive Covenants in Their Employment Contracts

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Non-competition agreements and other restrictive covenants are valuable tools for employers, allowing companies to protect their business models, customer lists, trade secrets, and other critical information. Until last year, Georgia courts viewed restrictive covenants in the employment context, such as non-compete and non-solicitation agreements, skeptically. The Georgia Constitution prohibited the General Assembly from authorizing "any contract or agreement which may have the effect of or which is intended to have the effect of defeating or lessening competition … ." GA. CONST. Art. III, § VI, ¶ V(c) (1983). Bound by the Constitutional mandate, courts often found such covenants invalid, upholding restrictive covenants only when "the restraint imposed is not unreasonable, is founded on valuable consideration, is reasonably necessary to protect the interest of the party in whose favor it is imposed, and does not unduly prejudice the interests of the public." *W.R. Grace & Co. v. Mouyal*, 262 Ga. 464, 465 (1992). In deciding the question of reasonableness, Georgia courts examined the duration of the restriction, its territorial coverage, and the scope of activity that is restricted. Each of these elements had to be narrowly tailored. Moreover, Georgia was not a "blue-pencil" state, meaning that if a restrictive covenant was unenforceable, a court could not rewrite it; rather, the court would strike it. Also, restrictive covenants often "stood and fell" together, with courts striking all restrictive covenants when only one was found to be overbroad. Examples of overbroad non-compete provisions included ones in which the defined territory was vague or was broader than the territory that the employee had covered. In short, only the most narrowly tailored restrictive covenants that were necessary to protect a legitimate business interest were upheld. In 1990, Georgia lawmakers passed legislation to give restrictive covenants more teeth, but the law was ruled unconstitutional. On November 2, 2010, the path to new legislation in this area was cleared when Georgia voters overwhelmingly approved an amendment to the Constitution that provided an

exception to the general principle quoted above from Article III, Section VI, Paragraph V(c) of the Georgia Constitution. The Constitutional amendment granted the General Assembly the power to pass laws empowering courts to enforce contracts or agreements restricting or regulating competitive activities between or among certain classes of parties, most notably, employees and employers. GA. CONST. Art. III, § VI, ¶ V(c)(2) (1983). The amendment applies to six other types of contracts, including those between or among franchisors and franchisees and those between partnerships and partners. *Id.* The amendment also gave the green light to laws authorizing courts to "blue -pencil" or limit the duration, geographic area, and scope of prohibited activities. GA. CONST. Art. III, § VI, ¶ V(c)(3) (1983). Armed with the constitutional amendment, on May 11, 2011, Georgia Governor Nathan Deal signed into law a statute that significantly changed Georgia law on restrictive covenants, making it easier to enforce noncompetition, non-solicitation, and confidentiality provisions in employment and other contracts. Codified at Georgia Code Sections 13-8-50 through 13-8-58, the new law is designed to create "an environment that is favorable to attracting commercial enterprises to Georgia and keeping existing businesses within the state." O.C.G.A. § 13-8-50. Contracts entered into prior to November 2, 2010 are governed by the old law. *Bunker Hill Int'l, Ltd. v. Nationsbuilder Ins. Serv., Inc.,* 309 Ga. App. 503, 508 n.1 (2011) (noting that the new law does not apply in actions determining the enforceability of restrictive covenants entered into before the ratification of the Constitutional amendment on November 2, 2010). Contracts entered into after May 11, 2011 are governed by the new law. *Murphree v. Yancey Bros. Co.,* 311 Ga. App. 744, n.10 (2011) ("The amended Code only applies to contracts entered on or after May 11, 2011.") For reasons beyond the scope of this article, it is still unclear what law governs contracts entered into between those two dates. *Key provisions of the current Georgia law on restrictive covenants* ***"Blue-Penciling" is now permissible.*** The most significant change is that courts are now authorized to modify a restrictive covenant that otherwise would be invalid to make it enforceable. This can be done, however, only to the extent that it is reasonably necessary to protect the legitimate business interests of the party seeking its enforcement and "to achieve the original intent of the contracting parties." O.C.G.A. § 13-8-54. Additionally, modification cannot render the covenant more restrictive with regard to the employee than as originally drafted by the parties. O.C.G.A. § 13-8-53(d). The word "modification" is defined in the statute as "severing or removing" a part of a restrictive covenant. O.C.G.A. § 13-8-51(11). Although there is no case law interpreting this section yet, it appears that this definition would authorize a court to strike out or remove language that renders the restrictive covenant unenforceable, but it does not authorize the court to otherwise rewrite the provision. Under the new law, such "modification" is not mandatory; rather, it is simply an option available to the courts. ***Key terms are now defined.*** Key terms that are often used in restrictive covenants such as "employee," "confidential information," "material contact," and "legitimate business interest" are now defined, further clarifying their meaning. ***Non-compete agreements during the term of employment.*** Restrictions during employment that lack specific limitations upon scope of activity, duration, or territory, are not deemed unreasonable so long as they promote or protect the purpose or subject matter of the agreement or deter any potential conflict of interest. O.C.G.A. § 13-8-56(4). ***Non-compete agreements after the term of employment.*** Restrictions on competition (as

distinguished from restrictions on solicitation and disclosure of confidential information) after the term of employment may be enforced only against certain employees, those who: 1) customarily and regularly solicit customers or prospective customers; 2) customarily and regularly engage in making sales; 3) have a primary duty of managing a company, or one of its departments or subdivisions, direct the work of two or more employees and have the authority to hire or fire other employees; or 4) perform the duties of a "key employee" or a "professional" as defined by the statute. O.C.G.A. § 13-8-53(a). Importantly, restrictions of two years or less (measured from the date of termination) are presumed reasonable for post-employment non-compete agreements. O.C.G.A. § 13-8-57(b). ***Non-disclosure/confidentiality agreements.*** Agreements to keep information confidential need not be limited in time or geographic area, provided the information meets the statutory definition of "confidential information" or "trade secret." O.C.G.A. § 13-8-53(e). ***Non-solicitation agreements.*** The law now provides guidance by approving certain language. Any reference to a prohibition against "soliciting or attempting to solicit business from customers" is deemed "adequate" to describe the prohibition, but will be "narrowly construed to apply only to: (1) such of the employer's customers, including actively sought prospective customers, with whom the employee had material contact; and (2) products or services that are competitive with those provided by the employer's business." O.C.G.A. § 13-8-53(b). Employees can be restricted from soliciting customers with whom the employee had actual contact, as well as those customers: whose dealings with the employer the employee coordinated or supervised; about whom the employee obtained confidential information while employed by the employer; or about which the employee received compensation, commissions, or earnings during the two years prior to the employee's termination. *Id.* Additionally, non-solicitation agreements need not expressly define the types of products or services considered to be competitive, nor must they be limited geographically. *Id.*. ***Statutorily approved language defining territory.*** The law also approves of the phrase "the territory where the employee is working at the time of termination" as a description of geographic areas if the person or entity bound by the restraint can reasonably determine the maximum reasonable scope of the restraint at the time of termination. O.C.G.A. § 13-8-53(c)(2). ***Court Decisions Interpreting the New Law*** Because the law is still relatively new, and applies to only recently executed contracts, there is little case law interpreting it. In September 2011, however, a federal court in Atlanta applied the new law to a restrictive covenant executed on May 11, 2011, in a case styled *Pointenorth Insurance Group v. Zander*, Civil Action No. 1:11–CV–3262–RWS, 2011 WL 4601028, (N.D. Ga. Sept. 30, 2011). U.S. District Judge Richard W. Story, of the Northern District of Georgia, granted the employer's request for a preliminary injunction to enforce the following provision in an employment agreement: Employee agrees that for a period of 24 months following any termination of this Agreement for any reason by either party, Employee will not . . . solicit, accept, or attempt to solicit or accept, directly or by assisting others, business from any of the Employer's clients which would be in competition with the products or services offered by the Employer, including actively sought prospective clients, with whom Employee had any contact or who were clients of Employer within the three months immediately preceding such termination of this Agreement. *Id.* at *1. The Court found that the restrictions were overbroad in that they extended to any of the Employer's clients – not just those

with whom the employee had previously interacted. *Id.* at *3. The Court then, using the new law, "blue-penciled" the agreement, enjoining the former employee from "soliciting any of PointeNorth's customers with whom Defendant Zander had contact during her employment." Id. at *4. In doing so, the Court also "blue-penciled" the prohibition on "accepting" business from the employer's clients, although the Court did not state that it was limiting the restriction in this way. Notably, the Court, without discussion of its rationale, apparently used case law decided under the old law as guidance for whether to "blue-pencil" under the new law. We will have to wait to see if other courts follow suit.

Who Should Consider Updating Their Employment Contracts? The statue identifies specific contractual language that the Georgia legislature deemed sufficiently well-defined to be enforceable, providing some much-needed clarity to Georgia employers about how courts will view their agreements. To take advantage of the new law, employers (and others whose interests might be served by restrictive covenants) should consider replacing existing agreements with revised versions executed after May 11, 2011 and reflecting the legislature's guidance. Employers using employment contracts containing restrictive covenants should review those contracts with an eye to the following:

- Does the agreement use terms defined in Georgia Code Section 13-8-51 such as "employee," "confidential information," "material contact," and "legitimate business interest"? If so, these terms should be compared to their statutory definitions.

- Does the agreement contain restrictions on competition during the term of employment? It is possible that such restrictions can be broadened under the new law, pursuant to Section 13-8-56(4).

- Does the agreement purport to restrict competition after the term of employment against low-level employees? Care should be taken to ensure that the employees subject to the restriction fall within the specified groups identified in Section 13-8-53(a).

- Is there a post-termination restriction on competition with a duration of less than two years? It may be appropriate to broaden the restriction to two years pursuant to Section 13-8-57(b).

- Are there are any agreements to keep information confidential that are limited in time or geographic area? If so, it may be possible to remove those limitations pursuant to Section 13-8-53(e), provided that the information meets the statutory definition of "confidential information" or "trade secret."

- Are there any non-solicitation agreements? If so, employers may want to consider employing the statutorily approved language described in Section 13-8-53(b).

- Does the agreement purport to impose a non-solicitation restriction on low-level employees? If so, Section 13-8-53(b) should be reviewed to ensure that only the proper categories of employees are subject to the restriction.

- Does the non-solicitation agreement specify the types of products or services considered competitive and/or does it contain a geographic limitation?
- It is possible that the agreement could be broadened to remove such limitations, pursuant to Section 13-8-53(b).

In addition, any employer who may have elected not to include restrictive covenants in its Georgia employment contracts because Georgia law was so hostile in this regard should consider adding such covenants now that Georgia is taking a more permissive position with regard to restrictive covenants.

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