



CARLTON FIELDS

Enforcing Restrictive Covenants and Defending Claims Arising From Such Covenants in Georgia

Presented by:

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What are we talking about?

- Restrictive covenants are most commonly agreed to by parties: (i) to an employment relationship, (ii) involved in the sale of a business, or (iii) entering into professional partnership agreements.
- Today's presentation will focus on restrictive covenants entered into in the context of employment relationships.
- Such covenants usually take three forms: (i) non-disclosure agreements; (ii) non-solicitation agreements; and (iii) non-competition agreements.

Georgia's Historic Hostility to Restrictive Covenants

- In Georgia, non-competition agreements have traditionally been “disfavored [] as a matter of public policy”.
 - *See Atlanta Bread Company v. Lupton-Smith*, 679 S.E.2d 722 (Ga. 2009).

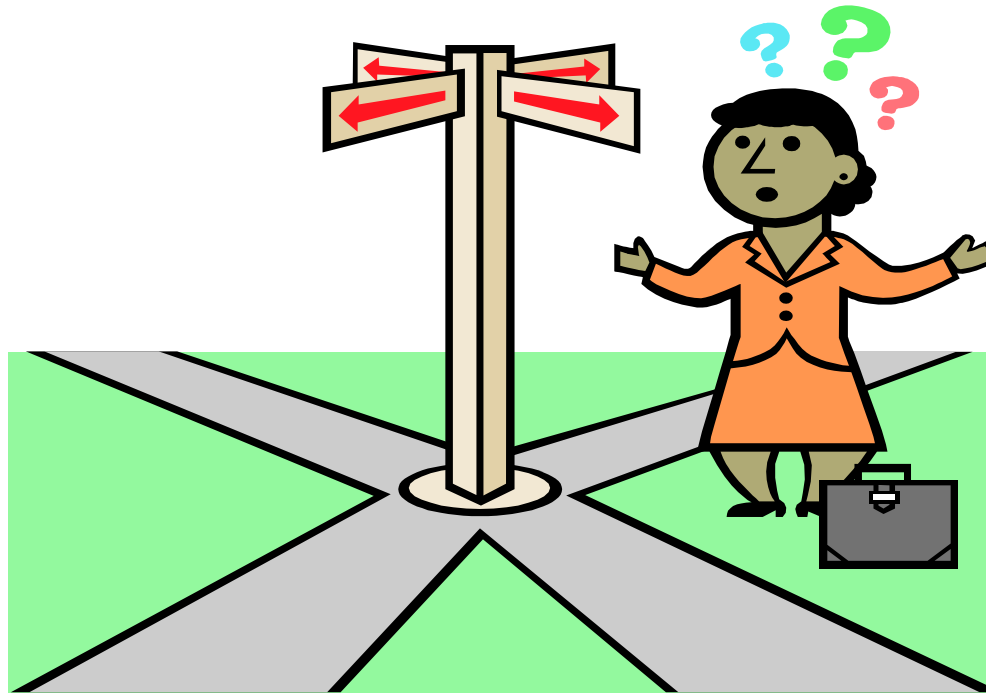
When does the RCA apply?

- The enforceability of restrictive covenants in agreements entered into **before November 3, 2010** is determined under pre-Act common law.
 - See *Boone v. Volt Information Sciences, Inc. v. Corestaff Support Servs, Inc.*, No. 1:11-CV-1175, 2011 U.S. Dist. LEXIS 119297 (N.D. Ga. 2011) (recognizing that the law as the time the non-competition agreement was entered into would be applied) (citing *Bunker Hill Int'l, Ltd. v. Nationsbuilder Ins. Servs., Inc.*, 710 S.E.2d 662 (Ga. App. 2011) (applying law in effect at the time non-competition agreement was entered into)).
- The enforceability of restrictive covenants in agreements entered into **after May 11, 2011** will be determined under the Restrictive Covenants Act.
 - See *Pointenorth Ins. Group v. Zander*, No. 1:11-cv-3262, 2011 U.S. Dist. LEXIS 113413 (N.D. Ga. 2011) (narrowing overbroad non-solicitation provision to cover only those customers with whom the employee had contacted and assisted with insurance while employed).
- What will govern covenants entered into **between November 3, 2010 and May 10, 2011** is still an open question not yet addressed by Georgia courts.

The Law to be Applied to Agreements Entered into Before November 3, 2010

- For more than a hundred years prior to the Act, the standard applied in Georgia, at its root, asked whether restrictive covenants were “reasonable”.
 - *See Rakestraw v. Lanier*, 30 S.E. 735, 737 (Ga. 1898).
- Twenty years after *Rakestraw*, the Georgia Supreme Court set forth the first iteration of the pre-Act modern test applied to such covenants, holding that “the contracts must be limited both as to time and territory, and not otherwise unreasonable.”
 - *See Shirk v. Loftis Bros. & Co.*, 97 S.E. 66, 68 (Ga. 1918).

Application of Pre-Act Law Governing Restrictive Covenants



Varying Levels of Scrutiny

- Covenants contained in contracts for the sale of a business are afforded the lowest level of scrutiny and, even pre-Act, could be blue-penciled if necessary.
 - *See White v. Fletcher/Mayo/Assocs., Inc.*, 303 S.E.2d 746 (Ga. 1983) (recognizing that restrictive covenants entered into as part of the sale of a business are less strictly analyzed and may be blue-penciled).
- Covenants in professional partnership agreements are assessed with moderate scrutiny.
 - *See Martinez v. DaVita, Inc.*, 598 S.E.2d 334 (Ga. App. 2004) (recognizing that the mid-level standard of scrutiny would be applicable to a professional contract).
- Covenants entered into in the context of an employment relationship are afforded the strictest level of scrutiny.
 - *See Martinez*, 598 S.E.2d at 337 (recognizing that the strictest standard of review applies to restrictive covenants entered into as part of an employment agreement).

Common Pre-Act Pitfalls

- Pre-Act non-competition agreements often fail because the defined territory reaches farther than the territory where the employee performed services or the clause attempts to restrict the employee from performing generally competitive services, as opposed to those performed on behalf of the employee's employer.
- Pre-Act non-solicitation clauses often fail because (i) they aren't limited to apply to customers the employee had contact with while employed, i.e. they restrict soliciting all types of business rather than that performed by the employer, (ii) they prohibit the acceptance of business, rather than its active solicitation, or (iii) they exist in an agreement which also contains an unenforceable non-competition agreement.

Enactment of the RCA



Enactment of the RCA; a Constitutional Quandary

- The Georgia Assembly enacted the RCA in 2009, which provided that it would become effective “on the day following” ratification of a constitutional amendment providing for the enforcement of covenants that limit competition.
- On November 2, 2010, Georgia voters approved an amendment to the Georgia Constitution and created an exception to the constitutional prohibition against contracts “defeating or lessening competition” for this purpose. Thus, based upon the language of the RCA, it was to be effective November 3, 2010.
- The problem with this arose from a provision of the Georgia Constitution stating that constitutional amendments do not go into effect until January 1st of the year following their passage. Thus, the 2009 Act went into effect nearly two months before the constitutional amendment that enabled its passage.
- To address this issue, the General Assembly re-enacted the RCA in 2011, making it applicable to contracts entered into on or after May 11, 2011.

The Restrictive Covenants Act: Defining its Purpose

- The purpose of the Act is to create a more favorable environment in Georgia for businesses and to “provide statutory guidance so that all parties to such agreements may be certain of the validity and enforceability of such provisions and may know their rights and duties according to such provisions.”
 - O.C.G.A. § 13-8-50.

Notable Changes Under the RCA

- Perhaps the most important change is that Georgia courts may now “blue pencil” offending provisions. O.C.G.A. §§13-8-51(11)-(12); 12-8-53(d); 13-8-54(b).
- However, in doing so, the RCA provides that a court should try to “achieve the original intent of the contracting parties” and may not make any “covenant more restrictive with regard to the employee than as originally drafted by the parties.” O.C.G.A. §§12-8-53(d), 13-8-54(b).

What does it mean to blue pencil an agreement?

- The “blue pencil” doctrine is defined as a “judicial standard for deciding whether to invalidate the whole contract or only the offending words.”
 - Black’s Law Dictionary 196 (9th ed. 2009).
- Few courts have yet had the opportunity to apply the Act, but at least one Georgia court has used this provision to modify an otherwise unenforceable agreement.
 - *See Pointenorth Ins. Group v. Zander*, No. 1:11-cv-3262, 2011 U.S. Dist. LEXIS 113413 (N.D. Ga. 2011) (narrowing overbroad non-solicitation provision to cover only those customers with whom the employee had contacted and assisted with insurance while employed).

Additional Notable Changes Under the RCA

- With respect to non-solicitation agreements, “[n]o express reference to geographic area or to the types of products or services considered to be competitive shall be required in order for the restraint to be enforceable.”
O.C.G.A. §13-8-53(b)
- With respect to post-employment agreements, a “good faith estimate of the activities, products, and services, or geographic areas, that may be applicable at the time of termination” is acceptable.
O.C.G.A. §13-8-53(c)(1)
- The RCA provides significant definitions which clarify the statute’s scope. For example, it sets out that restrictive covenants may be used to protect “legitimate business interests” including, without limitation, “trade secrets,” “valuable confidential information,” “substantial relationships with specific ...customers,” and “customer ... good will.”
O.C.G.A. §13-8-51(9)

Presumptions Under the RCA

- Restrictive covenants in effect **during the employment relationship** are presumptively reasonable if:
 - (1) their duration is the same as the duration of the parties' relationship;
 - (2) the geographic scope includes those areas in which the employer did business at any time during the parties' relationship, provided the total area is reasonable and/or the covenant contains a list of particular competitors with which employment is prohibited; and
 - (3) the scope of competitive conduct is measured by the business of the employer.
- **Post-termination covenants** are rebuttably presumed reasonable if their durations are:
 - (1) two years or less for former employees;
 - (2) three years or less for former distributors or franchisees; and
 - (3) five years or less for sellers of a business.

Highlights for Non-Disclosure, Non-Solicitation, and Non-Competition Agreements Under the RCA

Non-Disclosure Agreements

- Under Section 13-8-53(e), a non-disclosure agreement relating to confidential information need have no temporal or geographic restriction to be enforceable.
- “Confidential Information” includes, but is not limited to, data and information:
 - Relating to the business of the employer, regardless of whether the data or information constitutes a trade secret as that term is defined in Code Section 10-1-761;
 - Disclosed to the employee or of which the employee became aware of as a consequence of the employee’s relationship with the employer;
 - Having value to the employer;
 - Not generally known to the competitors of the employer; and
 - Which includes trade secrets, methods of operation, names of customers, price lists, financial information and projections, route books, personnel data, and similar information
- Provided, however, that such term shall not mean data or information (A) which has been voluntarily disclosed to the public by the employer, except where such public disclosure has been made by the employee without authorization from the employer; (B) which has been independently developed and disclosed by others; or (C) which has otherwise entered the public domain through lawful means.

O.C.G.A. § 13-8-51(3).

Non-Solicitation Agreements

- The Act broadens allowable non-solicitation provisions by defining “material contact” to allow provisions to include not only those customers with whom the employee had actual contact but also those:
 - (1) whose dealings with the employer were coordinated or supervised by the employee,
 - (2) about whom the employee obtained confidential information during his employment, or
 - (3) from whom the employer received compensation, commissions, or earnings during the two years leading up to the employee’s termination.

Non-Competition Agreements

- Under previous case law, an employer could enter into such agreements with any employee. Now, they are limited to employees who:
 - (1) Customarily and regularly solicit customers and prospective customers for the employer;
 - (2) Customarily and regularly engage in making sales or obtaining orders or contracts for products or services to be performed by others;
 - (3) Perform the following duties:
 - (A) Have a primary duty of managing the enterprise in which the employee is employed or of a customarily recognized department or subdivision thereof;
 - (B) Customarily and regularly direct the work of two or more other employees; and
 - (C) Have the authority to hire or fire other employees or have particular weight given to suggestions and recommendations as to the hiring, firing, advancement, promotion, or any other change of status of other employees; or
 - (4) Perform the duties of a key employee or of a professional.

O.C.G.A. § 13-8-53(a).

Thank You

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