THE NEW RESTRICTIVE COVENANT LAW

by

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In the November 2010 general election, the voters of Georgia approved an amendment to the Georgia constitution that allows the Georgia legislature "to provide by general law for contracts that restrict competition during or after a term of employment or of a commercial relationship so long as such contracts are reasonable in time, geographic area, and line of business." The amendment goes on to state that "in order to achieve the original intent of the contracting parties, a court may modify a contract that restricts competition during or after a term of employment or of a commercial relationship to cure any deficiencies relating to the competitive restrictions where the restrictions would, if left unmodified, contravene any provision of this Constitution or of the United States Constitution or would otherwise render the contract or any restrictive covenant contained in the contract unlawful and unenforceable."

With the passage of the above constitutional amendment, the voters of Georgia have given the authority to determine what kind of restrictive covenants will be enforceable in Georgia to the state legislature and overturned over 50 years of judicial decisions by the Georgia appellate courts that have consistently held that courts do not have the authority to "blue pencil", or modify, restrictive covenants in employment agreements to make them enforceable. In 2009, the Georgia legislature had passed a law exercising the authority given to it by the above constitutional amendment, which law was to become effective if that amendment was approved by the voters in 2010 on the day after such approval. However, due to an apparent oversight by the drafters of the constitutional amendment, the new law governing restrictive covenants in employment, as well as several other types of, agreements will not actually become effective until January 1, 2011.

Any agreements entered into before that date will still be governed by the current judge made law on restrictive covenants. Any agreements entered into on and after January 1, 2011 will be governed by the new statute, O.C.G.A. Section 13-8-50, et. seq.
Although a final answer to this question will have to come from the Georgia appellate courts, it appears that only agreements of the type described in the new statute will be permitted to contain restrictive covenants on and after that date. Those agreements include employment, independent contractor, and sale agreements, as well as several other types of what are essentially business to business agreements.

Enforcement of Restrictive Covenants Under the New Law

Generally speaking the new restrictive covenant law will make it much easier to enforce restrictive covenants in employment and the other types of agreements covered by that law. After a prima facie showing of compliance with the law by the employer, the burden will shift to the employee to prove that the restrictive covenant in question does not actually comply with the applicable provisions of that law or is otherwise "unreasonable." In the context of employment agreements alone, in determining if a particular restrictive covenant is "unreasonable", the new law permits a court to "consider the economic hardship imposed upon an employee by enforcement of the covenant." The new law does not define what constitutes "economic hardship", so it will be up to the Georgia appellate courts to determine what amount of "economic hardship" is necessary to make unenforceable an otherwise enforceable restrictive covenant.

Even if an employee shows to a court's satisfaction that a particular restrictive covenant is "unreasonable", the court still has the discretion to modify the restrictive covenant in question "to render it reasonable in light of the circumstances in which it was made" and then enforce the covenant as modified. The only specific limitation on the court's power in this regard is that the restrictive covenant as modified can not be "more restrictive with regard to the employee than as originally drafted by the parties." Thus, whether such power is limited to dealing with the existing language of such a covenant or extends to crafting new language to make it "reasonable" under the circumstances will have to wait for determination by the Georgia appellate courts.

It is important to note that the new law does not require a court to exercise the power to "modify" a restrictive covenant that is otherwise unenforceable in all cases. Whether to do so is left to the discretion of the trial court in each case, the exercise of which discretion is not reversible by an appellate court unless there was an "abuse" of such discretion. Again, what would constitute an "abuse" of such discretion will have to be determined by the Georgia appellate courts

Type of Employees Covered by the New Law

As noted above, the new law applies to restrictive covenant agreements between employers and employees, but it limits the type of employees who can be subjected to restrictive covenants. Independent contractors are included in the definition of employees, but, as with true employees, they must be an executive employee or "in possession of selective or specialized skills, learning, or abilities or customer contacts, customer information, or confidential information who or that has obtained such skills, learning, abilities, contacts, or information by reason of having worked for an employer." This definition should cover any employee or independent contractor of an insurance agency who could harm the agency if they left its employ and went to work for a competitor.

An additional limitation is imposed on the type of employee who can be subjected to a noncompete covenant. Such covenants can only apply to "key employees", "professional employees", certain management level employees, and employees who "customarily and regularly solicit for the employer customers or prospective customers" or "engage in making sales or obtaining orders or contracts for products or services to be performed by others." Although it is clear that producers fit within the above types of employees who can be subjected to noncompete covenants, whether agency account executives or CSR's can be covered by such covenants is potentially an open question, as it will depend on whether they "customarily and regularly" engage in the above activities.

A potential back door way to include such persons in those who can be covered by noncompete covenants is found in the definition of "key employee". That definition, after describing someone who "has gained a high level of notoriety, fame, reputation, or public persona as the employer's representative or spokesperson or has gained a high level of influence or credibility with the employer's customers, vendors, or other business relationships or is intimately involved in the planning for or direction of the business of the employer", goes on to state that "such term also means an employee in possession of selective or specialized skills, learning, or abilities or customer contacts or customer information who has obtained such skills, learning, abilities, contacts, or information by reason of having worked for the employer." Thus, it appears that a "key employee" can be anyone from a

celebrity spokesperson to the office receptionist. We will have to wait for the Georgia appellate courts to finally determine who such an employee can be.

Nondisclosure Covenants Under the New Law

The new law's definition of what information can be protected by a nondisclosure covenant will present some problems for independent insurance agencies who hire someone who has previously worked in the insurance industry. That is because such information is limited to information "relating to the business of the employer" which has been "disclosed to the employee or of which the employee became aware of as a consequence of the employee's relationship with the employer." Such information must also be "not generally known to competitors of the employer."

Thus, it appears that under the new law any information that an employee or independent contractor has acquired about insurance customers before they became associated with the agency can not be protected from disclosure after that association is terminated. This is a change from the current law which allows for contractual protection of any information about the agency's customers regardless of when that information was first acquired by an employee or independent contractor. This limitation on what information can be protected by a nondisclosure covenant may well have been the trade off for removing any requirement for a time limit on the nondisclosure of such information. Under the new law, "confidential information" covered by it can be protected from disclosure by a former employee or independent contractor for as long as that information remains confidential.

Noncompete Covenants Under the New Law

Under the new law, noncompete covenants no longer have to identify with mathematical precision the types of activities that are prohibited or the territory within which the described activities can not be performed by a former employee or independent contractor. Instead, it is sufficient if a description of such activities or territory "provides fair notice of the maximum reasonable scope of the restraint . . ., even if the description is generalized or could possibly be stated more narrowly to exclude extraneous matters." The new law goes on to state that "any good faith estimate of the activities, products, and services, or geographic areas, that may be applicable at the time of termination shall also satisfy such requirement, even if such estimate is capable of including or ultimately proves to include extraneous activities, products, and services, or geographic areas." Thus, it is no longer necessary that an employee or independent contractor know at the time the employment relationship is entered into the exact activities they will be prohibited from engaging in after the relationship terminates or the territory to which that prohibition will apply.

The new law creates a safe harbor definition for such activities by providing that "activities, products, or services shall be considered sufficiently described if a reference to the activities, products, or services is provided and qualified by the phrase 'of the type conducted, authorized, offered, or provided within two years prior to termination' or similar language containing the same or a lesser time period." For the territory within which such activities can not be engaged in, the new law provides "the phrase 'the territory where the employee is working at the time of termination' or similar language shall be considered sufficient 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." Whether or not such a determination can be made will no doubt be the subject of much

litigation, as the answer to that question will turn on the specific facts and circumstances of each employment relationship.

Nonsolicitation Covenants Under the New Law

The new law's provisions regarding nonsolicitation covenants similarly expand the scope of what activities by a former employee or independent contractor can be prohibited by expanding the definition of what customers can be covered by such covenants. Under the current law, only current customers with whom an employee or independent contractor had "contact" while employed by the employer can be covered by a nonsolicitation covenant. Under the new law, this is expanded to include "customers, including actively seeking prospective customers, with whom the employee had material contact during his or her employment." However, it appears that the current prohibition on requiring former employees to refrain from "accepting" the business of former customers remains in place, as the new law only refers to the conduct of "soliciting, or attempting to solicit, directly or by assisting others" as being the proper subject of a nonsolicitation covenant.

Material contact with a customer or "potential" or "actively sought prospective customer" exists for each such customer "with whom or which the employee dealt on behalf of the employer, whose dealings with the employer were coordinated or supervised by the employee, about whom the employee obtained confidential information in the ordinary course of business as a result of such employee's association with the employer, or who receives products or 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." The Georgia appellate courts will have to determine if an executive officer of an employer whose annual bonus is calculated in whole or in part on the amount of sales made by the sales force has "material contact" with each customer of the employer to whom sales were made during the two year period prior to the termination of their employment. Those courts will also have to determine what constitutes a "potential" or "actively sought prospective" customer, as the new law does not define those terms.

As with noncompete covenants, the new law does provide safe harbor language for nonsolicitation covenants. Such covenants that prohibit "'soliciting or attempting to solicit business from customers' or similar language shall be adequate for such purpose and 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 and services that are competitive with those provided by the employer's business."

Time Limitations on Restrictive Covenants Under the New Law

As far as the permissible time limits on noncompete and nonsolicitation covenants are concerned, the new law establishes a rebuttable presumption that any such covenants that are effective for two years or less after the termination of the employment relationship are reasonable (and thus enforceable) and any such covenants that are effective for a longer period of time are unreasonable (and thus unenforceable). In each instance, the employer or employee can present evidence to the court to try to overcome these presumptions. Where the employment relationship is "associated with the sale or ownership of all or a material part of" a business, the presumptively reasonable time period for which a noncompete or nonsolicitation covenant can be effective rises to "the longer of five years or less in duration

or equal to the period of time during which payments are being made to the owner or seller" of the business in question. What it will take to overcome these statutory presumptions will have to be determined by the Georgia appellate courts.

However, the importance of the above statutory presumptions is considerably lessened by the ability of a court under the new law to modify a restrictive covenant that is otherwise void and unenforceable under that law to make it enforceable. Even if a noncompete or nonsolicitation covenant is effective for more than the presumptively reasonable time period, a court will not be required to invalidate the whole covenant and any similar covenant in the same agreement, as is the case under the current law. Instead, if it determines that the employer has not presented sufficient evidence to overcome the statutory presumption, it can reduce the stated time period to whatever lesser time period it thinks is "reasonably necessary to protect [the employer's legitimate business] interest or interests and to achieve the original intent of the contracting parties to the extent possible."

Conclusion

The new restrictive covenant law offers employers several significant advantages over the existing law, but also includes some disadvantages that may be of significance to certain employers. In determining how to respond to the new restrictive covenant law, an agency owner should consult with their attorney about how that law's provisions may work to the benefit and the detriment of the owner and if the benefit outweighs the detriment, the owner should then consider how best to approach their employees about signing new restrictive covenant agreements. For "at will" employees (that is, those employees whose employment can be terminated with or without cause at any time), it will not be necessary for the employer to pay the employee any extra compensation in exchange for their execution of a new restrictive covenant agreement. Under Georgia law, for such employees the fact that they are allowed to continue to work for the employer is sufficient consideration to support the execution of such an agreement. Even so, there may be legal or practical reasons why an agency owner would want to refrain from making the execution of such an agreement mandatory for all employees covered by the new law.

This article is not intended to provide "legal advice" on the issues discussed in it. It is only for information purposes. The reader should seek advice from an attorney who is knowledgeable in this area of the law about their specific situation before acting. For other articles of interest to insurance agencies and agents, please see the website of Joyner & Burnette, P.C., at www.decatur-law.com.

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