

**HB 173: Georgia's (Potential) New Law on Restrictive Covenants**

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Michael B. Terry  
Sarah M. Shalf  
Bondurant, Mixson & Elmore, LLP  
1201 W. Peachtree Street  
3900 One Atlantic Center  
Atlanta, Georgia 30309  
(404) 881-4100  
[terry@bmelaw.com](mailto:terry@bmelaw.com)  
[shalf@bmelaw.com](mailto:shalf@bmelaw.com)

## I. BACKGROUND AND STATUS OF HB 173.

Georgia's law on restrictive covenants, as it applies to employees (as distinguished from restrictive covenants in connection with the sale of a business), has been among the more restrictive from the employer's perspective. Even Georgia law on restrictive covenants ancillary to the sale of a business is fairly restrictive. This body of law is based on Georgia's constitutional provision (art. VIII, sec. 6, para. V(c)), which states:

The General Assembly shall not have the power to authorize any contract or agreement which may have the effect of or which is intended to have the effect of defeating or lessening competition, or encouraging a monopoly, which are hereby declared to be unlawful and void.

Although **partial** restraints of trade are permissible under the current Constitution, they are carefully reviewed so as to avoid a more complete (and thus unconstitutional) restraint of trade. *Rash v. Toccoa Clinic Medical Assocs.*, 253 Ga. 322, 323 (1984). Generally, a partial restraint has been upheld "if the restraint imposed is not unreasonable, is founded on a valuable consideration, and 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). "A three-element test of duration, territorial coverage, and scope of activity has evolved as a 'helpful tool' in examining the reasonableness of the particular factual setting to which it is applied." *Id.*

Because of lesser differences in bargaining power, the Georgia Supreme Court has viewed restrictive covenants in connection with a sale of a business more permissively than those that apply to employees and franchisees, whose restrictive covenants are assessed under a "strict scrutiny" standard. *See, e.g., Atl Bread Co. Int'l v. Lupton-Smith*, 285 Ga. 587, 590-91 (2009); *Watson v. Waffle House, Inc.*, 253 Ga. 671, 672 (1985). (A middle standard applies to covenants in agreements such as professional partnerships. *Rash*, 253 Ga. at 324.) As a result, employees have often been successful in preventing enforcement of overly restrictive covenants in court. And, in Georgia, when any portion of an employee (or franchisee) restrictive covenant is in violation of the above principles, *all* such covenants are struck from the agreement. *Uni-Worth Enters. v. Wilson*, 244 Ga. 636, 640 (1979). By contrast, restrictive covenants in connection with a sale of a business may be blue-penciled, although in Georgia this appears to mean that an unenforceable provision may be struck in its entirety, independently of the

enforceability of other provisions, and not that individual phrases of a single covenant may be struck, and certainly not that anything may be modified by the court to render it enforceable. *Watson*, 253 Ga. at 671-72.

The Georgia legislature, responding to concerns expressed by employers about their inability to enforce restrictive covenants reliably, attempted in 1990 to change the law by enacting O.C.G.A. § 13-8-2.1. This statute was held unconstitutional in its entirety in the case of *Jackson & Coker, Inc. v. Hart*, 261 Ga. 371 (1991), in particular because it called for courts to enforce restrictive covenants “to the extent reasonable and necessary to protect the interests of the party benefiting from the covenant,” which would “breathe life into contracts otherwise plainly void as being impermissible” under the above constitutional provision. *Id.* at 372; *see Atlanta Bread Co.*, 285 Ga. at 590.

In the most recent legislative session, the General Assembly rewrote and reincarnated the unconstitutional OCGA § 13-8-2.1 as HB 173, which was passed with the stated purpose of protecting “legitimate business interests” as well as improving predictability. The Act passed the House on March 12, 2009, passed the Senate on April 1, 2009, and Governor Perdue signed it into law on April 29, 2009. In light of the holding of the Georgia Supreme Court in the *Jackson & Coker* case, however, the legislature recognized that it would also need to amend the Georgia Constitution in order to render the statute constitutional. Accordingly, HB 173 is not effective unless and until a constitutional amendment allowing for restrictive covenants in commercial contracts is passed in 2010. If such an amendment is not passed in 2010, the Act is automatically repealed. If such an amendment is passed, the statute will only apply to contracts entered into on or after the effective date (which is the day after the election, or Nov. 3, 2010).

## **II. SUMMARY OF MAJOR CHANGES AND POTENTIAL ISSUES.**

### **A. Legislative intent: expressly states a desire to protect businesses, and requires courts to consider protection of business interests in construing and enforcing covenants.**

§ 13-8-50. The General Assembly finds that reasonable restrictive covenants contained in employment and commercial contracts serve the legitimate purpose of protecting legitimate business interests and creating an environment that is favorable to attracting commercial enterprises to Georgia and keeping existing businesses within the state. Further, the General Assembly desires 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.

This express preference of business interests (and specification of certain kinds of agreements, which impliedly protects certain kinds of businesses) may lead employees, in particular, to attempt to argue that this renders the law unfair and/or violative of equal protection or perhaps the special laws/uniformity provisions.

**B. Scope: applies to any restrictive covenants involved in the sale of a business, employment covenants, and covenants in other business agreements (e.g., franchise agreements, leases, etc.).**

**§ 13-8-51**

(15) 'Restrictive covenant' means an agreement between two or more parties that exists to protect the first party's or parties' interest in property, confidential information, customer good will, business relationships, employees, or any other economic advantages that the second party has obtained for the benefit of the first party or parties, to which the second party has gained access in the course of his or her relationship with the first party or parties, or which the first party or parties has acquired from the second party or parties as the result of a sale. Such restrictive covenants may exist within or ancillary to contracts between or among employers and employees, distributors and manufacturers, lessors and lessees, partnerships and partners, employers and independent contractors, franchisors and franchisees, and sellers and purchasers of a business or commercial enterprise and any two or more employers. A restrictive covenant shall not include covenants appurtenant to real property.

**§ 13-8-53**

(a) Notwithstanding any other provision of this chapter, 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. However, enforcement of contracts that restrict competition after the term of employment, as distinguished from a customer nonsolicitation provision, as described in subsection (b) of Code Section § 13-8-53, or a nondisclosure of confidential information provision, as described in subsection (e) of Code Section § 13-8-53, shall not be permitted against any employee who does not, in the course of his or her employment:

(1) Customarily and regularly solicit for the employer customers or prospective customers;

(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.

(b) Notwithstanding any other provision of this chapter, an employee may agree in writing for the benefit of an employer to refrain, for a stated period of time following termination, 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.

No express reference to geographic area or the types of products or services considered to be competitive shall be required in order for the restraint to be enforceable.

Any reference to a prohibition against '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.

...

(d) Any restrictive covenant not in compliance with the provisions of this article is unlawful and is void and unenforceable; provided, however, that a court may modify a covenant that is otherwise void and unenforceable as long as the modification does not render the covenant more restrictive with regard to the employee than as originally drafted by the parties.

The Act only expressly authorizes (1) any kind of noncompete agreement (so long as reasonable) (§ 13-8-53(a)), and (2) post-employment nonsolicitation agreements based on customers with whom the employee had contact (§ 13-8-53(b)), while § 13-8-53(d) states that all restrictive covenants not in compliance with this article are void. Moreover, Georgia appellate authority places limits on many other types of restrictive covenants (e.g., nonsolicit agreements ancillary to the sale of a business must be limited in geographic territory, *Hudgins v. Amerimax Fabricated Prods.*, 250 Ga. App. 283 (2001)), which this Act does not address and therefore may not overrule. Thus, at first blush, the Act appears to only (expressly) authorize these two types of agreements.

However, the term "restrictive covenant," as well as the scope of the Act, is defined far more broadly than that (§ 13-8-51(15), § 13-8-52). The Act establishes presumptions of reasonableness for types of restrictive covenants other than those expressly authorized, (§ 13-8-56). It also exempts nondisclosure agreements from

requirements of having a stated territory or time (other than the length of time that the information remains confidential) (§ 13-8-53(e)). These provisions appear to contemplate a broader scope than just noncompetes and postemployment nonsolicitations. Thus, disputes will likely arise as to what types of restrictive covenants are actually authorized by the law, and how much of the existing precedent has been superseded by statute.

Even if the law as written authorizes the full breadth of restrictive covenants as defined, issues may arise as to whether the agreements are consistent with federal antitrust law. Among the types of restrictive covenants described are agreements between “two employers,” where “employer” is simply defined as a business organization (or its owner, or buyer or seller), and also between distributor and manufacturer, franchisor and franchisee, etc. Indeed, the definition of a restrictive covenant is sufficiently broad to cover many covenants that could appear in business agreements and violate federal antitrust law. Per § 13-8-59, the statute is to be construed so as not to violate federal law, but this is an area where one can certainly anticipate litigation over just how broad the scope of permissible restrictive covenants can be.

**C. Permissible agreements: at least any reasonable noncompete agreement, postemployment nonsolicit agreements limited to customers with whom the employee had material contact, and nondisclosure agreements limited to the period the information is confidential; plus, specified time periods, depending on relationship, are presumed reasonable as to any restrictive covenant.**

Assuming that the law was intended to authorize a universe of restrictive covenants beyond than just those expressly authorized, the basic categories and applicable restrictions are as follows.

1. *Requirements for certain kinds of restrictive covenants:*

Noncompete: Must be “reasonable” in time, territory and scope. § 13-8-53(a).

*Post-employment*: limited to employees who are in sales, management or are supervisors. § 13-8-53(a).

Nonsolicitation:

*Post-employment*: limited to customers with whom the employee had material contact, as to products/services offered by the employer. § 13-8-53(b).

Nondisclosure: Territory need not be restricted; time may be so long as the information is confidential or a trade secret.

§ 13-8-53(e).

(e) Nothing in this article shall be construed to limit the period of time for which a party may agree to maintain information as **confidential or as a trade secret**, or to limit the geographic area within which such information must be kept confidential or as a trade secret, for so long as the information or material remains confidential or a trade secret, as applicable.

\* \* \*

There is a possible drafting error in § 13-8-53(b) regarding nonsolicitation of prospective customers: the first part of the provision states that a restrictive covenant may prohibit an employee from “soliciting ... such employer’s customers, including **actively seeking** prospective customers...” This inartful language perhaps is intended to codify cases that hold unenforceable those nonsolicitation agreements that prohibit accepting business from employer’s customers even where the employee never “actively” solicited the customer. *See Singer v. Habif, Arogeti & Wynne, P.C.*, 250 Ga. 376, 377 (1982).

The last part of the provision (establishing a standard enforceable phrase), however, states that the phrase will be construed to include “such of the employer’s customers, including **actively sought** prospective customers, with whom the employee had material contact.” This suggests the employee is restrained from soliciting the *employer’s* actively sought prospective customers as well as existing customers. The change in tense, between “seeking” and “sought,” is material. Because the definition of “prospective customer” is already malleable, this conflict may result in additional uncertainty (instead of the certainty it was intended to provide).

2. *Presumptively reasonable time periods:*

*During employment or business relationship:* specified time, territory and scope limitations are presumptively reasonable, but no such limitations are required (§ 13-8-56).

In determining the reasonableness of a restrictive covenant that limits or restricts competition during the course of an employment or business relationship, the court shall make the following presumptions:

(1) A time period equal to or measured by duration of the parties’ business or commercial relationship is reasonable;

...

(4) Any restriction that operates during the term of an employment relationship, agency relationship, independent contractor relationship, partnership, franchise, distributorship, license, ownership of a stake in a business entity, or other ongoing business relationship

shall not be considered unreasonable because it lacks any specific limitation upon scope of activity, duration, or geographic area as long as it promotes or protects the purpose or subject matter of the agreement or relationship or deters any potential conflict of interest.

*Postemployment:* two years is presumptively reasonable, more than two years is presumptively unreasonable (§ 13-8-57(b)).

In the case of a restrictive covenant sought to be enforced against a former employee and not associated with the sale or ownership of all or a material part of:

- (1) The assets of a business, professional practice, or other commercial enterprise;
- (2) The shares of a corporation;
- (3) A partnership interest;
- (4) A limited liability company membership; or
- (5) An equity interest or profit participation, of any other type, in a business, professional practice, or other commercial enterprise,

a court shall presume to be reasonable in time any restraint two years or less in duration and shall presume to be unreasonable in time any restraint more than two years in duration, measured from the date of the termination of the business relationship.

*(During or?) after termination of nonemployment business relationship:* three-years is presumptively reasonable, more than three years is presumptively unreasonable. (§ 13-8-57(c)).

In the case of a restrictive covenant sought to be enforced against a current or former distributor, dealer, franchisee, lessee of real or personal property, or licensee of a trademark, trade dress, or service mark and not associated with the sale of all or a part of:

- (1) The assets of a business, professional practice, or other commercial enterprise;
- (2) The shares of a corporation;
- (3) A partnership interest;
- (4) A limited liability company membership; or
- (5) An equity interest or profit participation, of any other type, in a business, professional practice, or other commercial enterprise,

a court shall presume to be reasonable in time any restraint three years or less in duration and shall presume to be unreasonable in time any restraint more than three years in duration, measured from the date of termination of the business relationship.

*In connection with sale of a business:* five years (or less) or during the time the buyer is making payments is presumed reasonable, more is presumptively unreasonable. (§ 13-8-57(d)).

(d) In the case of a restrictive covenant sought to be enforced against the owner or seller

of all or a material part of:

- (1) The assets of a business, professional practice, or other commercial enterprise;
- (2) The shares of a corporation;
- (3) A partnership interest;
- (4) A limited liability company membership; or
- (5) An equity interest or profit participation, of any other type, in a business, professional practice, or other commercial enterprise,

a court shall presume to be reasonable in time any restraint 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 as a result of any sale referred to in this subsection and shall presume to be unreasonable in time any restraint more than the longer of five years in duration or the period of time during which payments are being made to the owner or seller as a result of any sale referred to in this subsection, measured from the date of termination or disposition of such interest.

There is a conflict here between § 13-8-56 and § 13-8-57(c). Both apparently apply to agreements during a business relationship (§ 13-8-57 applies to “**current and former**” distributors, etc.), but § 13-8-56 states that a time equal to the length of the parties’ relationship is reasonable, whereas § 13-8-57(c) states that three years is presumptively reasonable, and more is presumptively unreasonable. However, the date from which three years is to be measured is the “date of termination,” so the inclusion of “current” distributors, etc., in § 13-8-57(c) appears to be a drafting error.

Another conflict occurs between § 13-8-57(b) and § 13-8-57(c). The first applies as to “former employees,” while the second applies as to a “former distributor, dealer, franchisee, lessee,” etc. However, all of the people in the latter category are included in the definition of “employee” in § 13-8-51(5). Thus, it is unclear whether the two-year or the three-year presumption applies to persons in the latter category.

Other than these conflicts, and putting aside the fact that the Georgia courts have not previously employed actual “presumptions” of reasonableness, these time periods are largely consistent with the existing precedents. However, the definition of a post-employment agreement excludes any agreement relating to ownership of another kind of business interest (e.g., partnership), eliminating any argument that a partnership or similar agreement is more akin to employment, and narrowing the category of cases that receives the more restrictive treatment.

**D. Predictability: creates presumptions and creates “safe harbor” provisions to improve predictability of enforcement.**

The Act provides that certain kinds of restrictive covenants are reasonable if they have certain features. This particular provision appears geared toward overriding existing caselaw saying that covenants with those features are *not* permissible. Compare § 13-8-53(c)(1) and § 13-8-56 with *Uni-Worth Enters. v. Wilson*, 244 Ga. 636, 639 (1979); *Nat’l Teen-Ager Co. v. Scarborough*, 254 Ga. 467, 469 (1985); *Koger Props., Inc. v. Adams-Cates Co.*, 247 Ga. 68, 68 (1981).

**§ 13-8-53**

(c)(1) Activities, products, or services that are competitive with the activities, products, or services of an employer shall include activities, products, or services that are the same as or similar to the activities, products, or services of the employer.

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.

In case of a postemployment covenant entered into prior to termination, 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. The postemployment covenant shall be construed ultimately to cover only so much of such estimate as relates to the activities actually conducted, the products and services actually offered, or the geographic areas actually involved within a reasonable period of time prior to termination.

**§ 13-8-56**

In determining the reasonableness of a restrictive covenant that limits or restricts competition during the course of an employment or business relationship, the court shall make the following presumptions:

(1) A time period equal to or measured by duration of the parties' business or commercial relationship is reasonable;

(2) A geographic territory which includes the areas in which the employer does business at any time during the parties' commercial relationship, even if not known at the time of entry into the restrictive covenant, is reasonable provided that:

(A) The total distance encompassed by the provisions of the covenant also is reasonable;

(B) The agreement contains a list of particular competitors as prohibited employers for a limited period of time after the term of employment or a commercial or business relationship; or

(C) Both subparagraphs (A) and (B) of this paragraph;

(3) The scope of competition restricted is measured by the business of the employer or other person or entity in whose favor the restrictive covenant is given; provided, however, that a court shall not refuse to enforce the provisions of a restrictive covenant because the person seeking enforcement establishes evidence that a restrictive covenant has been violated but has not proven that the covenant has been violated as to the entire scope of the prohibited activities of the person seeking enforcement or as to the entire geographic area of the covenant; and

(4) Any restriction that operates during the term of an employment relationship, agency relationship, independent contractor relationship, partnership, franchise, distributorship, license, ownership of a stake in a business entity, or other ongoing business relationship shall not be considered unreasonable because it lacks any specific limitation upon scope of activity, duration, or geographic area as long as it promotes or protects the purpose or subject matter of the agreement or relationship or deters any potential conflict of interest.

But, additionally, the law more generally establishes standard phrases that can be used in restrictive covenants that will be presumed enforceable, and (as described above) establishes presumptions that certain restrictions are reasonable or unreasonable. This latter set of provisions is geared toward the “predictability” goal of the Act.

#### § 13-8-53

(c)(2) 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.

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.

*See also* § 13-8-57, quoted *supra*, pp. 8-9.

The standard phrases appear primarily in the area of defining scope and territory, because several Georgia cases have held such provisions to be too indefinite to be enforced. Thus, the statute provides that a particular phrase will be deemed to mean something enforceable. However, the exact language is not required; “similar language” may also be used, *see* § 13-8-53(c)(2), which will undoubtedly lead to litigation over just how “similar” a phrase in a covenant is to the statutorily prescribed phrase.

**E. Burdens of proof: creates requirement that enforcer show “legitimate business interest,” and establishes burden-shifting procedure.**

**§ 13-8-51**

(9) 'Legitimate business interest' includes, but is not limited to:

- (A) Trade secrets, as defined by Code Section 10-1-761, et seq.;
- (B) Valuable confidential information that otherwise does not qualify as a trade secret;
- (C) Substantial relationships with specific prospective or existing customers, patients, vendors, or clients;
- (D) Customer, patient, or client good will associated with:
  - (i) An ongoing business, commercial, or professional practice, including, but not limited to, by way of trade name, trademark, service mark, or trade dress;
  - (ii) A specific geographic location; or
  - (iii) A specific marketing or trade area; and
- (E) Extraordinary or specialized training.

**§ 13-8-55.**

The person seeking enforcement of a restrictive covenant shall plead and prove the existence of one or more legitimate business interests justifying the restrictive covenant. If a person seeking enforcement of the restrictive covenant establishes by prima-facie evidence that the restraint is in compliance with the provisions of Code Section § 13-8-53, then any person opposing enforcement has the burden of establishing that the contractually specified restraint does not comply with such requirements or that such covenant is unreasonable.

At first glance, the Act appears to require more from employers and businesses in proving their cases, even where it gives more freedom to seek restrictive covenants. That is, the employer must “plead and prove” that the covenant protects at least one “legitimate business interest” in order to make out a cause of action for enforcement of the covenant. But, as a practical matter, “legitimate business interest” is defined (in § 13-8-51(9)) so broadly (e.g., “includes, but is not limited to ... customer ... good will associated with ... an ongoing business”) that the requirement is really more of a pleading (and notice) requirement than a genuine hurdle of proof in most cases.

One issue that likely will arise, then, is whether the failure to plead a “legitimate business interest” can be cured by amendment, or requires dismissal. The latter result would put some teeth in the requirement in its own right. If the failure to plead can be cured by amendment, though, then the pleading requirement

really just requires the plaintiff to announce, at some point, a particular asserted business interest that the court will apply in assessing reasonableness, but it does not place any real burden on the plaintiff in terms of making out its case.

In addition to requiring that the plaintiff “plead and prove” a legitimate business interest, the Act sets out a burden-shifting procedure similar to employment discrimination cases. The plaintiff need not anticipate every possible objection to the covenant, but only make out a prima facie case that the covenant complies with § 13-8-53, at which point the defendant must either prove a violation of § 13-8-53, or more generally prove that the restriction is unreasonable. Of course, § 13-8-53(a) itself requires that a noncompete agreement is “reasonable” as to time, territory and scope, and the statutory presumptions do not necessarily apply in every case, so it is not clear what a “prima facie case” would look like where no presumption applies. It is presumably sufficient to state a plausible argument as to why, for instance, the territory set out in the covenant is reasonable, but would it be sufficient simply to assert that the covenant is reasonable, without providing a basis for that assertion? That will almost certainly become the subject of an appeal from the first case that is dismissed for failure to adequately plead a restrictive covenant violation.

**F. Enforcement and modification (or blue-penciling): permits modification to render a covenant reasonable based on parties’ intent and in view of the proven “legitimate business interests.”**

**§ 13-8-51.**

(11) 'Modification' means the limitation of a restrictive covenant to render it reasonable in light of the circumstances in which it was made. Such term shall include:

(A) Severing or removing that part of a restrictive covenant that would otherwise make the entire restrictive covenant unenforceable; and

(B) Enforcing the provisions of a restrictive covenant to the extent that the provisions are reasonable.

(12) 'Modify' means to make, to cause, or otherwise to bring about a modification.

**§ 13-8-54.**

(a) A court shall construe a restrictive covenant to comport with the reasonable intent and expectations of the parties to the covenant and in favor of providing reasonable protection to all legitimate business interests established by the person seeking enforcement.

(b) In any action concerning enforcement of a restrictive covenant, a court shall not enforce a restrictive covenant unless it is in compliance with the provisions of Code Section § 13-8-53; provided, however, that if a court finds that a contractually specified restraint does not comply with the provisions of Code Section § 13-8-53, then the court

may modify the restraint provision and grant only the relief reasonably necessary to protect such interest or interests and to achieve the original intent of the contracting parties to the extent possible.

### § 13-8-58

(d) In determining the reasonableness of a restrictive covenant between an employer and an employee, as such terms are defined in subparagraphs (A) through (C) of paragraph (5) of Code Section § 13-8-51, a court may consider the economic hardship imposed upon an employee by enforcement of the covenant; provided, however, that this subsection shall not apply to contracts or agreements between or among those persons or entities listed in paragraphs (2) through (7) of subsection (a) of Code Section § 13-8-52.

Whereas Georgia has been adamantly in the “no blue-penciling” category as to employment agreements, and in fact would strike down all restrictive covenants where just one was unreasonable, the proposed new enforcement provisions allow a court to “modify” a covenant to render it reasonable, even in the case of an employment agreement.

Before the court gets to the “modification” of the covenant, it must first “construe” the covenant. In doing so, it is required to consider the intent of the parties as well as to construe the covenant in favor of protecting the plaintiff’s asserted “legitimate business interest.” § 13-8-54(a). The court is also permitted to consider hardship that the covenant would work on an employee in assessing reasonableness of an employee covenant. § 13-8-58(d).

Having construed the covenant, if the court finds that it violates § 13-8-53, then it may “modify” the covenant, again to be consistent with the intent of the parties and “only the relief reasonably necessary to protect” the asserted legitimate business interest. § 13-8-54(b). What is less clear is precisely what a court may do to “modify” the agreement. In some states, and in Georgia with respect to non-employment restrictive covenants, a court may only strike so much of the covenant as is unreasonable and enforce what remains; it cannot add or change provisions to make them enforceable. (For instance, it cannot change “three years” into “two years” in order to make it enforceable.) Technically, “blue-penciling” refers only to this sort of modification. *See, e.g., Hamrick v. Kelley*, 260 Ga. 307, 308 (1990) (“The ‘blue pencil’ marks, but it does not write.”); *H&G Ortho, Inc. v. Neodontics Int’l, Inc.*, 823 N.E.2d 718 (Ind. App. 2005). In other states, a court can essentially fashion an agreement that would be reasonable in view of the intent of the parties, substituting reasonable provisions for unreasonable ones. *See, e.g., Solari Indus., Inc. v. Malady*, 55 N.J. 571, 579 (1970).

Here, “modification” is defined in § 13-8-51(11) as “the **limitation** of a restrictive covenant to render it reasonable in light of the circumstances in which it was made.” That definition “includes, but is not limited to” “severing ...[the] part” that would make the covenant unenforceable **and** enforcing the provisions of a restrictive covenant “to the extent” those provisions are reasonable. It is not clear whether this is intended to be the stricter blue-penciling (allowing only severing the unenforceable part and enforcement of the rest), or any modification of a covenant to make it reasonable, although overall, the language of this provision (“limitation,” “severing”) appears to contemplate only taking away, not adding to, an existing provision. This will likely be the subject of the first cases testing this statute (if it ever actually becomes law).

Moreover, § 13-8-54(b), taken literally, only allows a court to modify a covenant if it violates § 13-8-53,<sup>1</sup> but this modification authority is not triggered if the covenant is otherwise “unreasonable,” *i.e.* for reasons **not** expressly stated in § 13-8-53. While § 13-8-53(a) expressly requires all *noncompete* agreements to be “reasonable,” it does not require any other kinds of restrictive covenants to be reasonable. And yet, § 13-8-55 contemplates covenants that may be unreasonable for reasons other than that they violate § 13-8-53. Indeed, § 13-8-57 establishes presumptions as to time that a court must apply in determining whether a covenant is reasonable, which apply to covenants not covered in § 13-8-53. So, a post-termination nonsolicit covenant contained in a joint venture agreement, for instance, might be unreasonable because it lasts longer than three years, but apparently a court is not authorized to “modify” such a covenant, because it does not violate § 13-8-53 (or any other part of this article, for that matter, since §§ 13-8-57 does not itself prohibit covenants that are unreasonable). Whether the legislature intended this distinction, or it is simply a drafting error, is unclear.

### **G. Equalization of employment and sale covenants.**

Generally, HB 173 appears to be intended to equalize somewhat the treatment of covenants ancillary to the sale of a business with covenants in employment agreements. Rather than subjecting each to a separate level of scrutiny, and not permitting blue-penciling in the employment context, the Act is addressed to all restrictive covenants in the business/employment context, placing employment covenants, all other nonemployment business covenants, and covenants in connection with a sale along a spectrum, from more restrictive (from

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<sup>1</sup> And 13-8-53(d) somewhat redundantly provides for modification if the covenant violates “this article.”

the business's perspective) to less, but applying the same analysis and mode of enforcement to all forms of restrictive covenants. While there is some separate treatment of post-employment covenants (as opposed to other covenants) in the Act, those provisions appear primarily addressed to superseding specific prior caselaw, and do not call for an entirely different mode of analysis. Thus, while employment and other covenants are not placed on **equal** footing by this Act, the Act does eliminate much of the distinction between employment and other kinds of covenants.

Still, while the specific provisions may address most of the specific substantive issues in interpreting restrictive covenants, nothing expressly overrides the different levels of scrutiny the Georgia Supreme Court has applied to employee versus sale covenants, even if the structure of the statute implies an intent to do so. *See, e.g., Rash*, 253 Ga. 322. Accordingly, there may be a question as to whether these standards of review may still apply, even while the specific provisions of this statute are enforced.