Georgia House Bill 173:

Leveling the Playing Field to Make Georgia Businesses More Competitive

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Executive Summary

The pending legislative proposal, House Bill 173, modernizes an area of law important to Georgia business: protection through contractual provisions of competitively sensitive customer relationships, investment in goodwill, and confidential information. Currently, these provisions, or restrictive covenants, are subject to a sometimes antiquated, court decision-driven framework that ignores the realities of Internet commerce and modern business. By requiring that courts uphold the intent of the parties, and setting a baseline of reasonableness for these presumptions, House Bill 173 ensures that more agreements will be enforced, and that Georgia businesses, and their employees, will enjoy more certainty. The threat of increased litigation as a result of the bill is likely misplaced. Instead, the bill's provisions may encourage earlier negotiated resolution between and among businesses, their departing employees, and new prospective employers.

Introduction

With House Bill 173, the Georgia Legislature is taking a very significant and necessary step to level the playing field among Georgia-based businesses and their counterparts in other states, and to make Georgia a more attractive place for all businesses. Currently, the law governing the state of non-competition and other restrictive covenant agreements entered into by employers doing business in Georgia is, charitably speaking, antiquated. From the diverse and often situationally-specific body of case law that governs this area, one consistent theme emerges – employers cannot protect their valuable trade secrets, confidential information and customer relationships through the use of non-competition agreements except in the most limited (and least meaningful) circumstances. Just as Georgia needs to be looking forward into the twenty-first century to attract more jobs and, particularly, more highly skilled jobs, employers are burdened with non-competition laws shaped in the era of the door-to-door encyclopedia salesperson.

The Status Quo

Historically, the Georgia courts, guided not as much by statute as by decisional law, have defined what constitutes a constitutionally enforceable "restraint on trade," and thus, what restrictions can and cannot be placed on competitive action by former employees. Because our courts have been bound by existing legal precedent, this case

law has been very slow to adjust to modern business reality. The existing rules and guiding principles developed before email (much less Facebook, Twitter and the like) became a fundamental part of day-to-day business, and those outdated rules and principles dictate how and when businesses can protect their trade secrets, confidential information and customer relationships in today's modern age.

For example, when restrictive covenants are evaluated for reasonableness by the courts, where the employee physically does business has defined the employee's work territory. Today, though, physical presence has nothing to do with where business is actually accomplished. A simple mouse click can seal a deal between businesses in Atlanta and Hong Kong. But under current case law, unless the employee negotiating this deal actually travels to Hong Kong, and even if all of the employer's revenue is generated from Hong Kong, this trade area is not considered to be a legitimate protectable interest of the employer. Under the current state of Georgia's non-competition law, the following outcomes are also possible:

- A Fortune 500 employer based in Georgia cannot enforce a non-competition agreement entered into by its Chief Executive Officer who does business worldwide for the company, notwithstanding the fact that the agreement was heavily negotiated and the restrictive covenants were provided by the employer in exchange for millions of dollars in compensation. Simply because the CEO does not travel worldwide – as in throughout each corner of each continent – the agreement is unenforceable regardless of the fact that it was the product of equal bargaining power.

- The same Fortune 500 employer could not enter into an enforceable non-competition agreement with an inside salesperson who has accounts in three or four states simply because the employee does not travel to do the job. Yet, that employer could enter into an enforceable non-competition agreement with an outside salesperson with accounts in three or four Georgia counties because the employee actually visits those counties to do business.

The practical dilemma for multi-jurisdictional employers looking to do business in Georgia gets even worse. Take the example of a Massachusetts-based technology company that has entered into a series of restrictive covenant agreements with its highest level executives. All of these agreements are executed in Massachusetts, the place of the company's headquarters, and accordingly, are governed by more business-friendly Massachusetts law. That same company, perhaps tired of the tax climate in Massachusetts, decides to move its corporate headquarters. If the company chooses to relocate to Georgia, those restrictive covenant agreements executed when Georgia was not even on the company's radar screen, would be rendered meaningless if those executives transferred to Georgia. Thus, the company has a disincentive to relocate to Georgia, as opposed to going to Florida, where the agreements likely would be respected.

Irrespective of the fact that the courts are doing their jobs by respecting existing legal precedent, none of this makes any practical sense in today's business and economic climate. Currently, employers have no way of consistently ensuring that they can protect their valuable business interests and considerable investment in talent by reasonable and freely negotiated non-competition agreements.

A Sensible and Practical Legislative Solution

Faced with this reality, Georgia has smartly decided to take action with House Bill 173, which can be found at here. As the fundamental premise for this bill, the Georgia Assembly stated that non-competition and other restrictive covenant agreements "serve the legitimate purpose of protecting legitimate business interests" and "creat[e] an environment that is favorable" to attracting and keeping Georgia businesses. Therefore, the General Assembly proposes to carve out agreements that are consistent with House Bill 173 from the kinds of contracts that are illegal and void against public policy. Freely negotiated employment agreements designed to protect trade secrets, confidential information and customer relationships would no longer be categorized with "contracts tending to corrupt the legislation or the judiciary" or, perhaps more common "wagering contracts."

The bill replaces the rigid "geographic scope" test, thereby modernizing restrictive covenant enforcement. Instead of haphazardly trying to define an employee's territory based on where the employee physically has done business for the employer, the Georgia Assembly permits a court to accommodate not just geography, but the area where activities are actually conducted. House Bill 173 alternatively allows employers to simply list prohibited competitors instead of a prohibited geographic territory. Thus, employers and employees have flexibility in negotiating what kinds of post-employment conduct is prohibited, and the employer does not have to worry about constantly having to update the agreement as the business relationship between the parties changes over time. By giving flexibility at the front end and reducing subsequent transaction costs, House Bill 173 allows employers to focus on the competitiveness of their goods and services instead of the hyper-technical requirements of existing case law. At the same time, the employee is afforded more certainty in the protections negotiated in the event that the agreement has to be enforced.

In virtually every lawsuit over these agreements, the issue arises of bargaining disparity between the corporate employer and the individual employee. It is an important concern. The Georgia Assembly thoughtfully addresses the issue of bargaining power by ensuring that House Bill 173 only applies to employees who truly have access to the kinds of sensitive business information that warrant protection. Indeed, the proposed definition of "employee" extends only to executives, persons with true access to confidential information (such as research and development personnel) and persons with specifically sensitive customer information that is generated from the employee's tenure with the employer. In other words, House Bill 173 is targeted precisely to protect the entrusting of competitively sensitive information by the employer to the

employee in exchange for the compensation and benefits attendant to the job. By not extending to rank and file employees, House Bill 173 appropriately balances the interests of business against the threat of undue influence and coercion.

Moreover, even defined "employees" subject to the new presumptions in favor of restrictive covenant agreements drafted in accordance with House Bill 173 have the legal ability to challenge particular agreements as being overbroad in fact. Unlike the current state of the law where agreements are "good" or "bad" as written and cannot be modified to balance competing interests, House Bill 173 gives the courts the ultimate ability to "blue pencil" or "modify" arguably overbroad agreements. Thus, the courts still serve as a check against an employer who has reached too far in fact, but the courts now have to account for the concerns of business as well in evaluating the scope of the restriction sought to be imposed by the employer. At present, lacking the ability to "blue pencil," courts can only invalidate a restrictive covenant that may reach just beyond what is reasonable.

Businesses drafting restrictive covenants, and the professionals assisting them, will find additional certainty in the bill. For all kinds of prospective restrictive covenants, the Georgia Assembly included presumptions as to the duration of covenants. For covenants provided in the employment context, House Bill 173 states that a period of up to two years is presumptively reasonable. For covenants executed in other situations, the length of the permissible restriction may increase, e.g., for up to three years in a franchise or licensing context and up to five years when covenants are provided in connection with the sale of a business.

Further Analysis and Conclusions

Critics of House Bill 173 have opined that this sea change in Georgia's competition law will lead to more uncertainty. The courts will have the power to enforce and potentially modify the vast majority of restrictive covenant agreements executed under the new law. Hence, these critics argue that the current state of the law is more "certain" because virtually all current non-competition agreements entered into as part of the employment relationship are unenforceable. Under this logic, employers will simply walk away from these agreements regardless of the business needs and legitimate interests involved and regardless of the extent of the breach by the former employee. While this may be "certainty" – if certainty is defined only by predictability – it is not "certainty" when viewed in the realities of day-to-day business. Businesses based on technology have to be able to protect their legitimate business interests just like traditional "door to door" businesses. Businesses must also be able to freely negotiate contract terms with executives and other persons given access to the most sensitive kinds of company information and have some level of confidence that those terms will have meaning if push comes to shove.

Further, it is equally plausible that House Bill 173 will, in some respects, mitigate

litigation over non-competition agreements. Most disputes under the new law will be resolved by prompt negotiations among former employers and new employers. We have to trust that businesses will choose litigation only when the matter is truly essential to them – when the breach in fact will cause irreparable harm. And, remember that House Bill 173 clearly gives the courts the power to modify any attempt at overreaching.

During a time when jobs are on everyone's mind, the Georgia Assembly has focused on providing businesses more certainty as to what kinds of contracts likely would be enforceable going forward. If brought into law by constitutional amendment, House Bill 173 will serve an important function in leveling the playing field for all Georgia businesses. Moreover, businesses looking at Georgia as a potential location will have confidence that their existing agreements can be enforced. In the competition arena, substance finally will be more important than form.

This paper provides an overview of current legislative developments and of their policy implications. It is not intended to, nor does it, constitute legal advice. For any questions about specific application of any legal question, please consult an attorney.