The New Restrictive Covenants Act: Sloppy Draftsmanship May Soon Be Forgiven

On April 29, 2009 Governor Perdue signed a bill that fundamentally alters the treatment of non-compete, non-solicit and non-disclosure covenants (referred to collectively as restrictive covenants). Assuming the required constitutional amendment is ratified as discussed below, Georgia General Assembly Act 64 will have a dramatic effect on the enforcement of restrictive covenants, which are commonly contained in employment contracts in the healthcare field.

Background

Because Georgia's Constitution prohibits any contract "which may have the effect of or which is intended to have the effect of defeating or lessening competition, or encouraging a monopoly," Georgia courts are among the most hostile in the nation towards restrictive covenants. Like most states, our courts analyze covenants by looking at whether they are (1) reasonable in scope (in time, territory and restricted activity); (2) supported by consideration; (3) reasonably necessary to protect the employer's interests; and (4) not unduly prejudicial to the public. Unlike most states, however, Georgia courts do not usually modify unreasonable covenants to make them reasonable, but instead, they strike them down in their entirety. This makes it very difficult for well-meaning employers to gain any measure of protection for their confidential information, customer goodwill and investment in their employees.

BY J. MATTHEW MAGUIRE, JR. AND GEREMY W. GREGORY

The Act

Act 64 is the state's most recent attempt to protect employers by legislating in this area. The General Assembly passed a similar law in 1990, but the Georgia Supreme Court struck it down because it violated the constitutional provision referenced above. See Jackson & Coker v. Hart, 261 Ga. 371, 405 S.E.2d 253 (1991). To avoid a similar result, Act 64 does not become effective unless and until the Georgia Constitution is amended during the 2010 election cycle.

Contours of Enforceable Covenants

The most important provisions are:

- Post-termination non-compete. Certain employees (managers, professionals, sales staff and key employees) may agree not to compete against their employers following termination if the restrictions are reasonable in time, geographic area and scope of prohibited activities. In what appears to be a legislative oversight, the Act provides no guidance as to the reasonableness of the territory or scope of prohibited activities.
- Post-termination non-solicit. An employee may agree not to solicit competing business from customers or prospective customers if the employee had material contact with them while working for the employer.
- Non-compete/Non-solicit during employment period. An employee may agree not to compete or solicit competing business within the geographic area in which the employer does business. The Act goes on to say, however, that any such restriction is not unreasonable if it lacks specific limitations upon scope of activity, duration or geographic area as long as it promotes or protects the purpose of the agreement or deters potential conflicts of interest.
- Restrictions arising from sale of business. A seller may agree to not compete with the buyer or solicit or accept competing business from the buyer's customers and prospective customers within the area in which the business conducted at the time of the sale for as long as is necessary to protect the buyer's investment.
- Non-disclosure covenant. Act 64 also provides that any party may agree not to disclose or use another party's confidential information or trade secrets for so long as the information or material remains confidential or a trade secret.

Presumptively Reasonable Time Periods

Courts must presume a post-employment restrictive covenant is reasonable in duration if it lasts for two years or less in an employment relationship, three years or less in a dealer/distributor/licensee relationship, and five years or less in the sale of a business.

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The most significant change that Act 64 brings to this area of the law is that it requires courts to modify covenants deemed unreasonable instead of striking them down as has always been done in the past.

Conclusion

If the constitutional amendment is passed, Act 64 will provide employers with significantly more protection from departing employees than they currently have. By requiring courts to redraft unreasonable covenants to make them reasonable, the General Assembly will have shifted the burden of drafting enforceable restrictions from the parties to the courts. This may have the unintended effect of increasing litigation and uncertainty in this area of the law since each covenant will be judged on a case-by-case basis.

J. Matthew Maguire, Jr. and Geremy W. Gregory of Balch & Bingham LLP can be reached at mmaguire@balch.com, ggregory@balch.com or (404) 261-6020 or visit www.balch.com.

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