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“Critical Legal Issues” ©

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I. Restrictive Covenants

A. General Points

1. There are different types of restrictive covenants
2. Restrictive covenants, as a general rule, are not favored under the law

B. Covenant Not to Compete

1. Covenant not to compete
 - a. Enforceability may depend on the context – courts are more likely to uphold if the covenant is given pursuant to a sale of the business, rather than in an employment context
 - b. Enforceability may also depend upon applicable state law – is the covenant too restrictive?
2. Are the restrictive covenants enforceable?
 - a. Depends on state law
 - b. Tip: Have the employee acknowledge the reasonableness of the restrictive covenants and their limited scope and that they do not impose an undue hardship on the employee
3. Specify that the company has a right to an injunction and any award of monetary damages does not preclude an injunction.
4. Individual sold his business and personally signed a covenant not to compete. The selling individual then formed another corporation to circumvent the noncompete covenant. The

corporation was disregarded and an injunction was imposed. Rakestraw v. Lanier, 104 Ga. 188, 30 S.E. 735 (1898).

- C. Covenant Not to Solicit Customers
- D. Covenant Not to Solicit Employees
- E. Covenant Not to Disclose
 - 1. Trade Secrets
 - 2. Confidential Information
- F. Restrictive covenants can add value to a business and make it more saleable.

Whimsical Expressions, Inc. v. Brown, 275 Ga. App. 420 (9-8-05).

Facts: Edgar Brown began working for Whimsical, an interior painting company, as a painter. Originally, he worked as an independent contractor and was paid by the day. Later, Brown became an at-will employee. Eventually, Brown became a job foreman for Whimsical and began supervising other workers on his crew. Brown was not involved in the business aspects of Whimsical's operations and did not negotiate contracts with customers. Brown was never the first person from Whimsical to meet a customer and was not familiar with Whimsical's pricing criteria and did not do promotion or advertising for the company. On or about April 27, 2001, Whimsical required Brown to execute "restrictive covenants" as a condition of continuing his employment.

The covenant not to compete stated that "Employee agrees not to work as a painter or salesperson in the decorative or faux painting business within Fulton, Gwinnett, Cobb and Forsyth counties, Georgia for a period of two (2) years following termination of Employee's engagement with the company.

The covenant not to solicit provided that "Employee agrees not to solicit or attempt to solicit any decorative or faux painting business from any clients of the company whose residence or principal place of business is located within Fulton, Gwinnett, Cobb and Forsyth counties, Georgia with whom Employee had material contact during his or her employment with the company, for a period of two (2) years following termination of Employee's engagement with the company. Material contact exists between Employee and a client if the employee dealt with the client or furnished painting service to the client while working as an employee of the company within (1) year prior to the date of Employee's termination of employment with the company.

Whimsical terminated Brown's employment on March 8, 2002.

Procedure: Whimsical filed the lawsuit alleging that Brown violated the non-compete and non-solicitation clauses. The trial court granted summary judgment to Brown and Whimsical appealed.

Issue: Whether the trial court erred in finding the covenants unenforceable?

Decision: No, the Court of Appeals affirmed the trial court's granting of summary judgment. The Court of Appeals noted that as to the non-compete clause, the Court of Appeals concluded that because the clause attempted to preclude Brown from not only from performing painting services for prior clients, but also from acting as a salesman in the decorative or faux painting business. It was overly broad. Citing Ponders, Inc. v. Norman, 246 Ga. 647, 648, 272 S.E.2d 345 (1980); Dent Wizard Intl. Corp. v. Brown, 272 Ga. App. 553, 556-557, 612 S.E.2d 873 (2005); Northside Hospital v. McCord, 245 Ga. App. 245, 247, 537 S.E.2d 697 (2000). The Court of Appeals noted that Whimsical did not employ "salespersons" and there is no evidence produced below that Brown ever acted as a salesperson other than handing out his employer's business cards.

The trial court found that although Brown did work for former clients of Whimsical following his termination of employment, he did not solicit those clients, they came to him. Whimsical failed to show that Brown improperly solicited clients.

Law: Whether the restraint imposed by the employment contract is reasonable is a question of law for determination by the court. W. R. Grace & Co. v. Mouyal, 262 Ga. 464, 465, 422 S.E.2d 529 (1992).

Strict scrutiny is a part in considering whether such restraint in employment contracts is enforceable. Holsapple v. Smith, 267 Ga. App. 17, 19, 599 S.E.2d 28 (2004).

A restrictive covenant contained in an employment contract is considered to be a partial restraint of trade and will be upheld if the restraint imposed is not unreasonable, is founded on a valuable consideration, and is reasonable necessary to protect the interests of the party in whose favor it is imposed, and does not unduly prejudice the interests of the public. Whether the restraint imposed by the employment is reasonable is a question of law by determination by the court, which considers the nature and extent of the trade or business, the situation of the parties, and all other circumstances. 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. W. R. Grace & Co. at 465.

Comments/Key Points/Suggestions:

1. Restrictive covenants are not favored by the law, especially restrictive covenants imposed against an employee.
2. Courts often will review restrictive covenants carefully and will strike them down or hold that they are unenforceable if they believe that the restrictive covenants are overly broad.
3. State law governs the enforceability of restrictive covenants and the applicable state's law should be carefully considered when drafting restrictive covenants.

II. Reviewing a Contract

- A. First question: Who is your client?
 - 1. Who drafted the contract?
- B. What is the other party obligated to do?
 - 1. Note the details: Who, what, when
 - 2. What are the consequences if the opposing party defaults or breaches the contract?
 - a. Specific performance?
 - b. Monetary damages
 - (i) Stipulated amount?
 - c. Interest
- C. Boilerplate provisions
 - 1. Governing law
 - 2. Alternative dispute resolution
 - a. Mediation
 - b. Arbitration
 - (i) Is it binding or not?
 - 3. Jurisdiction and venue
 - 4. Attorney fees
 - a. General rule: Each side pays their own
 - b. Exception: Can provide the losing party pays the prevailing party's attorney fees.
 - 5. Negotiated agreements
 - a. General rule: The agreement will be construed against the drafter.

- b. Exception: If you are the drafter, provide it is **not** to be construed against the drafter.

III. Selecting a Lawyer

- A. Selecting a law firm and/or a particular lawyer is often a significant decision.
 - 1. Is the client an individual or an entity?
 - a. Size of the client?
 - b. Location of the client?
 - c. Type of business?
 - d. Specific legal need vs. ongoing need for representation
 - 2. General full service firm vs. boutique firm
 - 3. Law firm vs. sole practitioner
 - 4. Area of expertise
 - a. Reputation
 - b. Track record that can be verified
 - 5. Billing practices
 - a. Hourly rates for all professionals who are involved
 - b. Padding of hours
 - c. Expense reimbursement policy
 - d. Flat fee?
 - e. Contingency fee?
 - f. Hybrid fee arrangement
 - g. Does the lawyer offer suggestions on how the client can reduce fees?
 - 6. Responsiveness
 - a. Ability to respond quickly?

- b. Ability to work under pressure?
 - 7. Ability to act as a business counselor
 - a. Do they offer practical solutions?
 - b. Compare fees to the “value added”
- B. Clear Communication – The Key to Any Relationship
 - 1. Be specific and detailed
 - a. What work do you want done?
 - b. When should the work be completed?
 - c. Who should do the work? Partner, associate, or paralegal?
 - d. Discuss ASAP any unforeseen circumstances
 - 2. Try to avoid surprises
 - 3. Is everyone acting in good faith?
 - 4. Every relationship requires “give and take”
 - 5. Talk regularly – is every conversation “on the clock”?
 - 6. Try to develop long-term relationships
- C. Balance the need for legal advice and services vs. the cost of such services
 - 1. Don’t be “penny wise but pound foolish.”
 - 2. Remember the old Fram oil filter commercial – “Pay me now, or pay me later.”
 - 3. Don’t hesitate to question a lawyer’s invoice.
 - 4. Consider fee arrangements other than billing by the hour.