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Friday, June 25, 2010

Blue-penciling makes non-compete law bad for Georgia

By Cary Ichter, Special to the Daily Report

Related article:

• Rep. Kevin Levitas' letter: Bill would return power to contracting parties (June 21, 2010)

The purpose of this letter is to respond to Rep. Kevin Levitas' letter, ran in the Daily Report's June 21 edition ("Bill would return power to contracting parties").

The putative purpose of the new statute, O.C.G.A. § 13-8-50, et seq., is to provide "statutory guidance so that all parties to [non-competition covenants] may be certain of the validity and enforceability of such provisions and may know their rights and duties according to such provisions." The problem with the law and with Rep. Levitas' argument is the statute actually disserves the purpose for which it was passed—enhancing certainty in connection with these agreements.

The principal problem with the new law is found in section 13-18-54(b), which provides that "if a court finds that a contractually specified restraint does not comply with the [reasonableness provisions of the law], 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." Section 13-18-53(d) has similar language in it.

For those not versed in this area of the law, this is what is known as "blue-penciling." In short, blue-penciling is the judicial rewriting of the contract so as to render unenforceable provisions enforceable. Typically, in the case of noncompetition covenants, the provision is unenforceable because the employer has over-reached and has not drafted a provision that is in compliance with current law. While the rules that govern noncompetition covenants can be rather inscrutable, the complexity of the law does not justify empowering the courts to rewrite the parties' agreement.

The rule against blue-penciling non-competition covenants in employment agreements was first embraced by the Georgia Supreme Court in *Richard P. Rita Pers. Servs. Int'l Inc. v. Kot*, 229 Ga. 314, 191 S.E.2d 79 (1972). The court explained the basis for its rejection of blue-penciling as follows:

"Courts and writers have engaged in hot debate over whether severance should ever be applied to an employee restraint. The argument against doing so is persuasive. For every covenant that finds its way to court, there are thousands which exercise an in terrorem effect on employees who respect their contractual obligations and on competitors who fear legal complications if they employ a covenantor, or who are anxious to maintain gentlemanly relations with their competitors. Thus, the mobility of untold numbers of employees is restricted by the intimidation of restrictions whose severity no court would sanction. If severance is generally applied, employers can fashion truly ominous covenants with confidence that they will be pared down and enforced when the facts of a particular case are not unreasonable. This smacks of having one's employee's cake, and eating it too." 229 Ga. at 317, 191 S.E.2d at 81 (quoting Hartan M. Blake, *Employee Agreements Not to Compete*, 73 Harv. L. Rev. 625, 682-83 (1960)).

As this passage makes clear, the Georgia Supreme Court eschewed blue-penciling to prevent employers from drafting overreaching covenants designed to intimidate and deter employees from engaging in competitive activities by introducing uncertainty over how far a court would go in rewriting and then enforcing an otherwise unenforceable covenant. Where blue-penciling prevails, no one can know, before the judge rules, what the agreement of the parties will look like when enforced. The court recognized that such uncertainty would intimidate employees and deter them from starting new businesses, which drive competition and create new jobs.

The decisions that have discussed why a restrictive covenant in an employment contract should not be blue-penciled have been unanimous in their concern about over-reaching by employers. See, e.g., *Jenkins v. Jenkins Irrigation Inc.*, 244 Ga. 95, 101, 259 S.E.2d 47 (1979) ("We want to continue to encourage covenant writers to proscribe only such territory as is reasonably necessary to protect the buyer of the business, and to deter them from staking out more territory than is reasonable (e.g., America) in anticipation that the court will pare the territory to that which is reasonable"); *Howard Schultz & Assocs. of the Southeast Inc. v. Broniec*, 239 Ga. 181, 236 S.E.2d 265 (1977) ("Employers covenant for more than is necessary, hope their employees will thereby be deterred from competing, and rely on the courts to rewrite the agreements so as to make them enforceable if their employees do compete. When courts adopt severability of covenants not to compete, employee competition will be deterred even more than it is at present by these overly broad covenants against competition").

Rep. Levitas rejects out of hand the idea that restrictive covenants in employment agreements are "adhesion contracts." He rejects the idea, but offers no explanation. I have been handling non-compete cases for over 20 years, and I know for a fact that the vast majority of non-competition covenants are presented as "take it or leave it" propositions. Last time I checked, that was the operational definition of a contract of adhesion. And in today's economic environment, how many workers enjoy the luxury of walking away from a job to avoid a non-competition covenant?

The new law also substantially increases the potential scope and geographic reach of enforceable non-competition covenants. Under current law, to be enforceable, the territory covered by a non-competition covenant must be coextensive with the territory in which the employee rendered services to his employer. Under the new law, the covenant need only represent a "good faith estimate of the activities, products, and services or geographic areas that may be applicable at the time of termination." See O.C.G.A. § 13-18-53(c)(1). This means that if the employer does business in Georgia only when the agreement is executed, but plans to do business nationally within a few years, it is quite conceivable, if not likely, that a covenant with national scope would be enforceable. And even if it were not, the employer would be encouraged to define the territory as broadly as possible, knowing that overly aggressive

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restrictions would be merely softened, not stricken, by the court. The actual scope of the covenant will only be known following litigation—litigation the employee typically cannot afford. I am struggling to understand how this outcome enhances certainty.

The only way the statute enhances certainty is to make it certain that the employer will win in any effort to enforce a non-compete, but what will be uncertain to everyone—employers and employees alike—is what the victory will look like. Every judge will have to take into account a myriad of variables in deciding what the reasonable scope of any given non-competition covenant. Any judge considering how to rewrite the agreement between the parties—an activity that is ironically supposed to serve the purpose of certainty—would need to consider the employee's work history in and pre-employment knowledge of the industry, the employer's investment in training, the type of work performed by the employee, the employee's access to confidential information, the territory in which the employee has worked, the period of time the employee has worked for the employer, the competitive nature of the market, whether the employee is starting a new business or working for an established competitor, and dozens of other factors that are legitimate considerations.

Were one to take a dozen superior court judges and have each of them rewrite a non-competition covenant based upon all of these considerations—and others some might consider—it would be fair to anticipate that one would wind up with 12 very different contracts at the end of the process. The only certainty this process serves is the certainty that the employee is going to wind up with an agreement that is different, perhaps materially different, than the one he agreed to and that the employer will prevail.

It appears that Rep. Levitas and those who advocate the statute and blue-penciling principally object to the "all or nothing" aspect of the law as it stands. Currently, if the covenant is unenforceable, it is not enforced—as odd as that may sound. Those who favor the new statute apparently prefer that strangers to the agreement—i.e., the courts—adjust the agreements made by the parties and enforce the rewritten instrument. While courts may do that in certain contexts, it is not the typical function of the courts. Indeed, courts more typically adamantly refuse to rewrite the parties' agreement.

Many of the evils that can befall the hapless employers that Rep. Levitas identifies can be addressed by non-disclosure and non-solicitation covenants. Employers do not need non-competition covenants to corral employees who attempt to trade on proprietary training received from the employer or who "misappropriate proprietary information." Nor do they need a non-competition covenant to protect existing relationships with important customers. The goal of protecting those interests can be accomplished with non-disclosure and non-solicitation covenants, and those covenants are infinitely easier to draft and to enforce than are their non-competition counterparts.

It is worth remembering that the constitutional prohibition against agreements in restraint of trade is not designed to protect the parties to the agreements from each other; the prohibition is designed to protect the public's interest in robust competition. While the immediate and most conspicuous loser in any specific controversy regarding a non-competition covenant may be a particular employee, the undetected victim of these covenants and this law will be the public when entrepreneurs are deterred from starting new businesses because they can have no idea of the ultimate breadth of their non-competition covenant until a court tells them what is reasonable. How many will be deterred from risking all when facing that uncertainty?

While there are aspects of the statute that have merit—for example, restricting the use of non-competes to key employees and those with specialized knowledge or training—permitting blue-penciling makes this statute a bad idea for Georgia. When an employer's non-compete is found to be unenforceable, employers can go back to the drawing board and re-draft the covenant. In the meantime, strict and rigorous rules restricting the use of non-competes tend to keep employers honest in drafting such covenants.

The Legislature ought to do the same thing with this statute. Scrap it, start again, and write a law that actually serves the purposes it is advertised as serving—certainty and competition.

Cary Ichter, Special to the Daily Report