

**EMPLOYMENT AND INDEPENDENT
CONTRACTOR AGREEMENTS
FOR TECHNOLOGY COMPANIES**

Presented At the

**17th Annual Technology Law Institute
Georgia Center for Advanced Telecommunications Technology
240 14th Street NW
Atlanta, Georgia**

October 3-4, 2002

By:

**Mari L. Myer
Senior Counsel
Friend, Hudak & Harris, LLP
3 Ravinia Drive, Suite 1450
Atlanta, Georgia 30346
(770) 399-9500
mmyer@fh2.com**

TABLE OF CONTENTS

I.	INTRODUCTION	1
II.	EMPLOYMENT AND INDEPENDENT CONTRACTOR AGREEMENTS.	3
A.	Restrictive Covenants In Employment And Independent Contractor Agreements.	3
1.	Covenants Not to Solicit Customers.	4
a.	Covenant Not to Solicit Customers Must Be Reasonable in Scope.	4
b.	Covenant Not to Solicit Customers Must Be Reasonable in Duration.	5
c.	Former Employee Cannot Be Prohibited From Accepting Unsolicited Business.	7
2.	Covenants Not to Solicit Employees.	7
3.	Covenants Not to Compete.	8
a.	Territorial Restriction Must Be Reasonable.	8
b.	Scope Must be Reasonable.	11
c.	Duration Must be Reasonable.	12
d.	Noncompete in Employment Agreement Executed In Anticipation of Acquisition of Ownership Interest Receives Strict Scrutiny.	13
B.	Nondisclosure Agreements.	13
1.	The Nondisclosure Must Specify a Reasonable Duration.	14
2.	Use of Nondisclosure Agreement in Lieu of, or in Addition to, a Noncompete or Nonsolicitation of Customers.	15
C.	Georgia Trade Secrets Act	16
1.	What is a Trade Secret?	16
2.	What Constitutes Misappropriation?	18
3.	Act Governs Regardless of Existence of Employment Agreement.	20
4.	Inevitable Disclosure.....	20
5.	Production of Trade Secrets in Discovery.	21
D.	Return Of Company Materials	24
E.	Notice Provisions	24
III.	RESTRICTIVE COVENANTS IN PARTNERSHIP AGREEMENTS	24

IV.	RESTRICTIVE COVENANTS ANCILLARY TO SALE OF BUSINESS INTERESTS.....	25
A.	Sale of Even a Small “Business Interest” May Be Sufficient to Trigger The Application of Sale of Business Analysis.....	25
B.	Sale of Business Analysis Not Applicable Where Person Signing Restrictive Covenants Is Not The Person Selling the Business Interest.	27
C.	Even Restrictive Covenants Construed Under the Sale of Business Standard Must Specify Scope, Territory and Duration.	28
D.	Noncompete Ancillary to Sale of Business Is Not Superseded By Noncompete in Separate Employment Agreement Which Was Executed at a Later Date.	29
V.	NON-CIRCUMVENTION AGREEMENTS	29

**EMPLOYMENT AND INDEPENDENT CONTRACTOR
AGREEMENTS FOR TECHNOLOGY COMPANIES**

By

Mari L. Myer, Esq.¹

Friend, Hudak & Harris, LLP

I. INTRODUCTION

In Georgia, employees who enter into oral employment arrangements are “at will”, and may resign or be terminated at any time, for any reason, so long as the reason for the termination is not a discriminatory reason. While this state of the law is often sufficient to protect the needs of employers with respect to lower level employees, both employers and employees often find it useful to confirm the terms of engagement for, and impose post-engagement obligations on, key employees and independent contractors, in a written employment agreement or independent contractor agreement. The restrictive covenants in the employment agreement will be deemed by the courts to be in partial restraint of trade. For this reason, Georgia courts will apply strict scrutiny when evaluating the enforceability of such covenants. See Howard Schultz & Associates v. Broniec, 239 Ga. 181, 183, 236 S.E.2d 265 (1977); see also Ga. Const. 1983, Art. III, VI, V(c). Section I of this paper will focus on such restrictive covenants and related matters in the context of employment and independent contractor agreements.

¹ Mari L. Myer is Senior Counsel with Friend, Hudak & Harris, LLP in Atlanta. She practices in the area of general business litigation, with a focus on intellectual property issues which include interpretation and enforcement of restrictive covenants in employment agreements. She represents both employers and employees in these matters. She earned her A.B. from Wellesley College, *cum laude*, and earned her J.D. from Boston University School of Law.

Entities purchasing business interests often have a need to obligate the seller to refrain from competing with the newly-purchased business, and typically the purchase price for the business will be higher where the seller is willing to execute restrictive covenants agreeing to refrain from such competitive behavior. Because the parties are perceived to have equal bargaining power, and the purchase price includes consideration for the restrictive covenants, restrictive covenants entered into ancillary to a sale of business receive a lower level of scrutiny by Georgia courts than do restrictive covenants in employment and independent contractor agreements. *See* Watson v. Waffle House, 253 Ga. 671, 324 S.E.2d 175 (1985). Section III of this paper will discuss restrictive covenants ancillary to a sale of a business interest.

An emerging “middle level” of scrutiny applies to partnership agreements, with the courts having only decided a handful of cases applying this level of scrutiny. *See, e.g.,* Habif, Arogeti & Wynne, PC v. Baggett, 231 Ga. App. 289, 498 S.E.2d 346 (1998), *cert. denied*; *see also* Physician Specialists in Anesthesia, PC v. MacNeill, 246 Ga. App. 398, 539 S.E.2d 216 (2000). Section II of this paper will address these types of restrictive covenants.

Because the Georgia Supreme Court has applied Georgia law to the interpretation of restrictive covenants binding Georgia employees which are litigated in Georgia, regardless of the choice of law set forth in the employment agreement², the scope of this paper will be limited to Georgia law.

² *See* Nasco, Inc. v. Gimbert, 239 Ga. 675, 676, 238 S.E.2d 368 (1977). Georgia courts will generally follow a forum selection clause in an employment agreement. *See* Iero v. Mohawk Finishing Products, Inc., 243 Ga. App. 670, 534 S.E.2d 136 (2000). The author is unaware of Georgia case law addressing whether Georgia courts will always apply Georgia case law when interpreting restrictive covenants in partnership agreements or agreements ancillary to the sale of business interests. The public policy considerations applicable to employment agreements do not seem to apply to these other types of agreements, suggesting that Georgia courts may be less likely to apply Georgia law when interpreting these other types of agreements.

II. EMPLOYMENT AND INDEPENDENT CONTRACTOR AGREEMENTS.

Typical subjects addressed in employment and independent contractor agreements include: (1) restrictive covenants such as covenants not to compete, covenants not to solicit customers, and covenants not to solicit other employees or independent contractors; (2) nondisclosure agreements; (3) reminders that the employee is subject to the Georgia Trade Secrets Act, O.C.G.A. §§10-1-760 *et seq.*; (4) requirements for the return of company documents and other materials upon termination or when otherwise demanded by the employer; (5) requirements that the employee provide advance notification of resignation; (6) salary and benefits; (7) severance package terms and the criteria for qualification for same; (8) stock option plans; and (9) terms unique to the industry. This paper will discuss the first five of these subjects.

A. Restrictive Covenants In Employment And Independent Contractor Agreements.

Restrictive covenants in an employment or independent contractor agreement must be in writing. Employment, or continued employment, constitutes sufficient consideration for the restrictive covenants. The covenants must be narrowly drawn to protect the employer's business interests, while not preventing the employee from earning a living after termination of the employment. Howard Schultz & Associates of the Southeast, Inc. v. Broniec, 239 Ga. 181, 186, 236 S.E.2d 265 (1977); *see* Sysco Food Services v. Chupp, 225 Ga. App. 584, 586, 484 S.E.2d 323 (1997). Covenants which are overbroad will not be enforceable. Because Georgia does not allow courts to "blue pencil", or modify, covenants in order to render them legal and enforceable, a restrictive covenant which fails to comply with the guidelines in applicable case law will simply be stricken altogether. WAKE Broadcasters, Inc. v. Crawford, 215 Ga. 862, 864, 114

S.E.2d 26 (1960); Howard Schultz, 239 Ga. at 186. Therefore, restrictive covenants should be drafted as narrowly as possible in order to increase the likelihood that the covenants will be enforced by a court.

An unenforceable covenant not to compete will render a nonsolicitation of customers in the same agreement unenforceable, and vice versa. Advance Technology Consultants, Inc. v. Roadtrac, LLC, 250 Ga. App. 317, 320, 551 S.E. 2d 735 (2001) (*en banc*). Therefore, drafting an unenforceable restrictive covenant purely for its *in terrorem* effect is unwise, as its lack of enforceability will taint otherwise enforceable restrictive covenants in the same agreement.

1. Covenants Not to Solicit Customers.

A covenant not to solicit customers, or nonsolicitation of customers, is an agreement in which the employee promises, or covenants, not to solicit business from the employer's customers after termination of the relationship with the employer. The nonsolicitation of customers must be reasonable in scope and duration in order to be enforceable.

Covenant Not to Solicit Customers Must Be Reasonable in Scope.

A nonsolicitation of customers need not specify a geographic territory, so long as it restricts the nonsolicitation of customers to customers or prospective customers with which the employee has had contact on behalf of the employer or in an effort to further the employer's business. See W.R. Grace v. Mouyal, 262 Ga. 464, 467, n.3, 422 S.E.2d 529 (1992); see also Capricorn Systems, Inc. v. Pednekar, 248 Ga. App. 424, 427, 546 S.E.2d 554 (2001); see also American Software USA, Inc. v. Moore, 264 Ga. 480, 484, 448 S.E.2d 206 (1994).

In Wolff v. Protégé, 234 Ga. App. 251, 506 S.E.2d 429 (1998), the Georgia Court of Appeals refused to enforce a covenant not to solicit customers in which the scope was not

sufficiently narrowed, on the ground that under the covenant the employee could have been prohibited from, for example, soliciting business from a neighbor who just happened to also be a customer of the company with whom the employee had never interacted for business purposes, but with whom the employee had become acquainted while employed with the company. Similarly, a nonsolicitation covenant which bars solicitation of business from clients whose names become known to the employee during employment, without specifying how those names must become known to the employee, is overbroad. Morgan Stanley DW, Inc. v. Frisby, 163 F. Supp.2d 1371, 1378 (NDGA 2001)

The Georgia Court of Appeals has also recently reiterated that the covenant must describe the nature of the prohibited solicitation. In Riddle v. Geo-Hydro Engineers, Inc., 254 Ga. App. 119, 561 S.E.2d 456 (2002), the Court of Appeals declined to enforce a covenant not to solicit customers which prohibited solicitation of clients of the company with which the employee had had material contact during the twelve months preceding termination, on the ground that the covenant failed to specify the nature of the prohibited solicitation. Since even solicitation of company customers for business unrelated to the company's business was prohibited, the covenant was overbroad. Riddle, 254 Ga. App. at 120. Importantly, because the nonsolicitation covenant was unenforceable, the noncompete set forth in the same agreement (which might have otherwise been enforceable) was tainted and itself unenforceable. Riddle, 254 Ga. App. at 120; *see* Advance Technology Consultants, Inc. v. Roadtrac, LLC, 250 Ga. App. 317, 320, 551 S.E. 2d 735 (2001) (*en banc*).

Covenant Not to Solicit Customers Must Be Reasonable in Duration.

Although it is not clear that the Georgia appellate courts have ever specified an outer duration for the enforceability of a covenant not to solicit customers, the rule of thumb is that three years or longer is too long. In some instances, depending on the nature of the prohibited conduct, the level of skill required for the position, and characteristics of the industry, only a covenant of a much shorter duration will be deemed reasonable.

Employers who are implementing restrictive covenants should consider the reasons behind the duration they select, as the attorney attempting to enforce the covenants in an injunction hearing will need to demonstrate to the judge that the duration of the covenants is reasonable under the circumstances. Employers should take into consideration the typical period of retention of clients within the industry, as well as the nature of the employee's contacts with clients, in determining the duration necessary to protect the employer from a former employee's potential efforts to divert clients, and be able to articulate these factors if called upon to do so in an injunction hearing. An additional important consideration for the technology industry is the length of time necessary for information to become obsolete. If the industry's technology is developing rapidly, the covenant should have a shorter duration than might be necessary in an industry which remains relatively stable for long periods of time.

The covenant not to solicit customers should also be restricted to those customers with which the employee had business contact within a short period of time prior to termination, such as one or two years. Reaching further back in time is unreasonable and may render the covenant unenforceable. *See Gill v. Poe & Brown of Ga., Inc.*, 241 Ga. App. 580, 524 S.E.2d 328 (1999).

Former Employee Cannot Be Prohibited From Accepting Unsolicited Business.

Although the employer may bar the employee from soliciting business from the employer's customers, the employer may not bar the employee from accepting unsolicited business from those same customers. American Gen. Life & Accident Ins. Co. v. Fisher, 208 Ga. App. 282, 430 S.E.2d 166, 168 (1993), *cert. vacated*; Habif, Arogeti & Wynne v. Baggett, 231 Ga. App. 289, 498 S.E.2d 346 (1998), *cert. denied*. There will, however, likely be a jury question as to who solicited whom, in the event that the matter proceeds to litigation.

2. Covenants Not to Solicit Employees.

Covenants not to solicit employees are often used to prevent a key employee from departing the company and taking his entire team with him. A duration of two years or less will often be enforced if deemed reasonable under the specific circumstances of the case. Generally these covenants are not the subject of much litigation, and as a result, the reams of case law available as to other covenants cannot be located as to these covenants.

The case law has not typically required that the restriction be limited to solicitation of those company employees with which the employee has had some interaction or relationship. But in Hulcher Services, Inc. v. R.J. Corman Railroad Company, LLC, 247 Ga. App. 486, 492, 543 S.E.2d 461 (2000), Judge Eldridge struck down a nonsolicitation of employees because it contained no territorial restriction and there was no evidence that this employee had relationships with other employees located outside his geographic area. The exact language of the covenant is not quoted in the case, so it remains to be seen whether this case signals a change in approach by the Court of Appeals. In view of this case, it may be wise to restrict the scope of any

nonsolicitation of employees to those employees and independent contractors with whom the employee had business contact.

3. Covenants Not to Compete.

For reasons which will be explained herein, covenants not to compete have limited usefulness in a world in which many services can be performed at remote locations. They nevertheless warrant discussion. In a covenant not to compete, or noncompete, the employee covenants, or promises, that he or she will refrain from competing with the employer within a particular line of business, within a particular geographic area, for a particular period of time. The scope, territory and duration must each be reasonable.

Territorial Restriction Must Be Reasonable.

Of particular concern to technology companies may be the fact that Georgia courts require a specification of a geographic territory in a noncompete, and the territory cannot exceed reasonable boundaries. This is often difficult to accomplish in an era of telecommuting.

The noncompete must have a geographic territory which is tailored to the specific responsibilities and skills of the employee executing the covenant. It must balance the employee's right to earn a living against the employer's interest in protecting the customer relationships which the employee is expected to cultivate on the employer's behalf. *See Hulcher Services, Inc. v. R.J. Corman Railroad Company, LLC*, 247 Ga. App. 486, 491, 543 S.E.2d 461 (2000). A noncompete restricting the former employee's activities to the company's territory, without tying the restriction to the territory in which the employee operated on behalf of the company, will be overbroad and unenforceable. *Szomjassy v. OHM Corporation et al*, 132 F.Supp.2d 1041, 1049 (NDGA 2001); *see Hulcher*, 247 Ga. App. at 491.

A territorial restriction encompassing the entire United States, or the entire world, will be overbroad and unenforceable. American Software, 264 Ga. at 484. As a result, it may be impossible in some instances to draft an enforceable noncompete for certain business endeavors which will actually provide the desired protection. For example, a software developer bound by a noncompete could simply move his offices to a point just beyond the geographic boundaries of the noncompete, or telecommute, and continue to compete without a pause. The software developer would be in full compliance with the noncompete, but would continue to harm the employer's business.

The territorial restriction must also be knowable at the time the agreement is executed. For this reason, a covenant which specifies as its geographic territory a particular radius of the employer's principal place of business as of the date the agreement is terminated will be unenforceable because the employee cannot know, at the time the agreement is executed, where the employer's principal place of business will be as of the date of termination. See Koger Properties, Inc. v. Adams-Cates, 247 Ga. 68, 69, 274 S.E.2d 329 (1981)

Where the territorial restriction specifies a radius of the employer's offices in a specific city, but does not specify a street address, the restriction is unknowable at the time the agreement is executed, because the employer's offices within that city can change during the term of the agreement. Thus, the restriction is overbroad and the covenant is not enforceable. For example, in New Atlanta Ear, Nose & Throat Associates, P.C. v. Pratt, 253 Ga. App. 681, 560 S.E.2d 268 (2002), the territorial restriction specified an eight-mile radius of "Medical Quarters/Northside, Roswell, Snellville" for one of the physicians, and similarly worded territorial restrictions applied to the other physicians who were parties to the litigation. Because no street addresses for

the Medical Quarters were specified, and the numbers and locations of the Medical Quarters could change during the terms of the agreements, the territorial restriction was unknowable and unenforceable. New Atlanta Ear, Nose & Throat, 253 Ga. App. at 686. One of the physicians, however, executed an amendment to his restrictive covenants in which specific office locations were listed by their addresses. Because these territorial restrictions were knowable, the noncompete was enforced against him. New Atlanta Ear, Nose & Throat, 253 Ga. App. at 686.

Similarly, where a noncompete specifies a territory which will grow during employment, or which will include territory added as a result of a merger or change in control, the territory will be unknowable when the agreement is signed, and the covenant will be unenforceable. Szomjassy, 132 F.Supp.2d at 1050.

Noncompetes which are not updated after an employee accepts a geographic transfer may no longer be enforceable. In Lighting Galleries, Inc. v. Drummond, 247 Ga. App. 124, 543 S.E.2d 419 (2000), one of the employees against whom the employer sought to enforce a noncompete had accepted a transfer subsequent to executing his employment agreement. The result was that he had not worked in the territory encompassed by the noncompete for a year prior to his resignation from the company. Therefore, the noncompete's territorial restriction as to him was unreasonable, and the noncompete was unenforceable. Lighting Galleries, 247 Ga. App. at 126, 127.

Drafting an unenforceably overbroad noncompete purely for its *in terrorem* effect will backfire on the employer, as the unenforceable noncompete will taint any nonsolicitation of customers in the agreement – rendering both unenforceable. See Advance Technology Consultants, Inc. v. Roadtrac, LLC, 250 Ga. App. 317, 320, 551 S.E. 2d 735 (2001) (*en banc*).

Scope Must be Reasonable.

The noncompete should only restrict activities which mirror those engaged in by the former employee on the employer's behalf. For example, a restriction barring a former salesman from writing software for a competing business would be overbroad, unless the former salesman's duties included software development. Restricting a former mid-level manager from owning a competing business would be overbroad, because the mid-level manager was not an owner or high-ranking officer with the employer. In Ken's Stereo-Video Junction, Inc. v. Plotner, 253 Ga. App. 811, 560 S.E.2d 708 (2002), a car stereo installation manager could not be prohibited from competing with Ken's Stereo as a partner, officer, employee, shareholder, or director of a competing business, because the noncompete sought to prohibit him from engaging in competitive activities which differed from his responsibilities on behalf of Ken's Stereo.³

A common mistake is to restrict competition in "any capacity". Such language is overbroad and will render the noncompete unenforceable. See Wright v. Power Industry Consultants, Inc., 234 Ga. App. 833, 508 S.E.2d 191 (1998)⁴, *overruled on other grounds by* Advance Technology Consultants, Inc. v. Roadtrac, LLC, 250 Ga. App. 317, 320, 551 S.E. 2d 735 (2001) (*en banc*); *see also* Szomjassy, 132 F.Supp.2d at 1050; *see also* Hulcher, 247 Ga. App. at 492, 493.

³ This case had a different procedural posture than most restrictive covenant cases. In most instances, restrictive covenants are before the court because the former employer has sued to enforce restrictive covenants against the former employee. In this instance, the former employee petitioned for a declaratory judgment that the restrictive covenants were unenforceable.

⁴ The author served as lead counsel for the former employees in Wright.

Yet, in Covington v. D.L. Pimper Group, Inc., 248 Ga. App. 265, 267, 546 S.E.2d 37 (2001), the Georgia Court of Appeals enforced a noncompete which at first blush seemed to bar competition in “any capacity”. In Covington, the noncompete barred solicitation of securities transactions or brokerage services, and was found not to be overbroad despite barring such solicitation by the former broker acting in the capacity of an employee, officer, director, or stockholder of a corporation – positions he had not held with his former employer. Covington, 248 Ga. App. at 267, 268. The court’s rationale was that the scope was adequately limited to solicitation of securities transactions or brokerage services, regardless of the title to be held by the former employee at the time he engaged in the restricted competitive behavior.

Courts will occasionally look beyond the four corners of the agreement to examine the factual context in which the parties have operated. In Lighting Galleries, the court looked at the circumstances in order to determine the meaning of the noncompete’s restriction against employment as a “residential lighting sales consultant”, and after doing so held that that phrase was sufficiently specific to render the noncompete enforceable. Lighting Galleries, 247 Ga. App. at 127.

Duration Must be Reasonable.

As with other restrictive covenants, the duration of the noncompete must be defensible. The employer will need to be able to articulate to a court the reasons the specified duration is necessary to protect the employer in the event that the employer ever needs to enforce the noncompete.

Noncompete in Employment Agreement Executed In Anticipation of Acquisition of Ownership Interest Receives Strict Scrutiny.

Even where an employment agreement has been executed in anticipation that the employee will become a shareholder of the employing business, the restrictive covenants in the employment agreement will be subjected to strict scrutiny. In New Atlanta Ear, Nose & Throat Associates, P.C. v. Pratt, 253 Ga. App. 681, 560 S.E.2d 268 (2002), the Georgia Court of Appeals declined to apply a lesser level of scrutiny to restrictive covenants in employment agreements which some physicians had executed in anticipation of their acquisition of shares in a medical practice. In this case, the medical group for which the defendant physicians worked was sold to a newly-formed medical group. These physicians initially executed employment agreements with the newly-formed medical group, only becoming shareholders of the group a couple of months later. Because there was a gap in time between the employment and the acquisition of ownership interests, and the two agreements each stated that they contained obligations separate from those set forth in the other agreement, the court applied strict scrutiny to the analysis of the restrictive covenants in the employment agreements. New Atlanta Ear, Nose & Throat, 253 Ga. App. at 684, 685.

B. Nondisclosure Agreements.

A properly drafted nondisclosure agreement can fulfill the purpose of a nonsolicitation of customers, by prohibiting the employee from using or disclosing the contents of company records for purposes unrelated to the company's business needs. The effect can be to deprive the employee of the ability to use company information to solicit business from the company's customers. In addition, the employee can be prohibited from using any sort of confidential

company information for his own purposes, including the formation and operation of a competing business.

A well-crafted nondisclosure agreement typically encompasses any information, regardless of whether it is in written form, which is important to the operation of the business. Examples include customer and vendor information, marketing information, financial records (including profit margins for various products or services), plans for business and product expansions, business models, and the like. As with the other restrictive covenants addressed above, the nondisclosure agreement must clearly specify what it covers, and should be tailored to the specific needs of the business. Any ambiguity can make it difficult to enforce the nondisclosure in court.

1. The Nondisclosure Must Specify a Reasonable Duration.

A nondisclosure agreement must have a specified duration. Wright v. Power Industry Consultants, Inc., 234 Ga. App. 833, 508 S.E.2d 191 (1998), *overruled on other grounds by Advance Technology Consultants, Inc. v. Roadtrac, LLC*, 250 Ga. App. 317, 320, 551 S.E. 2d 735 (2001) (*en banc*); Howard Schultz & Associates v. Broniec, 239 Ga. 181, 236 S.E.2d 265 (1977); U3S Corporation of America v. Parker, 202 Ga. App. 374, 378, 414 S.E.2d 513 (1991), *cert. denied*. The duration must be reasonable. Courts have often endorsed a two-year duration. But the reasonableness of the stated duration will depend on the nature of the information to be protected, and the length of time needed to protect the employer from disclosure of that information. In an industry in which technological advances render certain types of information obsolete in a matter of months, a two-year duration may be too long; in an industry in which

little changes over several years, an argument could be made that a much longer duration for the protection of certain information may be necessary.

The nondisclosure agreement should be crafted with precision, and the employer should be able to articulate the reasons for the duration selected for the nondisclosure. If a court were to determine that the duration selected was too long, the nondisclosure would be unenforceable. Therefore it is often better to be conservative in determining the necessary duration in order to ensure enforceability of the nondisclosure.

2. Use of Nondisclosure Agreement in Lieu of, or in Addition to, a Noncompete or Nonsolicitation of Customers.

The Georgia Supreme Court has, on at least one occasion, treated a nondisclosure agreement as an enforceable noncompete without a geographic limitation. In Lee v. Environmental Pest & Termite Control, 271 Ga. 371, 516 S.E.2d 76 (1999), the Georgia Supreme Court was confronted with a situation in which a former employee had taken and was using confidential information belonging to his former employer in order to compete with the former employer. Although there was no enforceable noncompete in place, the former employee had executed an enforceable nondisclosure agreement which encompassed information about the employer's customers. The Georgia Supreme Court enforced the nondisclosure so as to bar the former employee from using confidential information belonging to the former employer to compete with the former employer. In other words, the nondisclosure agreement effectively became an enforceable noncompete with no territorial restriction.

C. Georgia Trade Secrets Act

1. What is a Trade Secret?

The Georgia Trade Secrets Act is codified at O.C.G.A. §§10-1-760 *et seq.* A trade secret is defined as:

information, without regard to form, including, but not limited to, technical or nontechnical data, a formula, a pattern, a compilation, a program, a device, a method, a technique, a drawing, a process, financial data, financial plans, product plans, or a list of actual or potential customers or suppliers which is not commonly known by or available to the public and which information:

(A) Derives economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use; and

(B) Is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.

Businesses often regard tangible customer lists, vendor lists, and similar types of information as trade secrets. Whether the information does constitute trade secrets may depend on the characteristics of the particular industry. In Morgan Stanley DW, Inc. v. Frisby, 163 F. Supp.2d 1371 (NDGA 2001), the court refused to treat tangible customer lists and account summaries as trade secrets because securities brokers customarily take their clients with them to new firms. In other words, the industry standard and Morgan Stanley DW's own corporate

practice were not consistent with the treatment of such information as trade secrets, and for this reason the court declined to accord the information the protections available under the Georgia Trade Secrets Act.

The court noted that the relationship between a client and a broker, like the relationship between a client and an attorney, is generally a very personal one, and clients should have the ability to maintain that relationship even if the broker changes firms, thus establishing public policy reasons not to protect such information as trade secrets.

The court also noted that its ruling was based, at least in part, on the fact that Morgan Stanley DW was complaining about tactics in which it had itself engaged when hiring brokers from its competitors. Thus, Morgan Stanley DW was not entitled to the equitable remedy of an injunction to bar the misappropriation of customer lists and account summaries, because it routinely engaged in the very conduct *vis a vis* other brokerage houses which it sought to enjoin in this instance. Morgan Stanley DW, 163 F. Supp. 2d at 1377. In support of this equitable analysis, the court quoted passages from an affidavit filed by Morgan Stanley DW in separate, unrelated litigation.

The importance of this case seems to be twofold: first, the applicable industry standard can have an important impact on an employer's ability to protect information as a trade secret; second, inconsistent positions taken in other contexts, whether in publications or in unrelated litigation, can come back to haunt. For this reason, it is important to take positions *vis a vis* employees and competitors which are at all times consistent and which will withstand judicial scrutiny.

2. What Constitutes Misappropriation?

Trade secret misappropriation is defined at O.C.G.A. §10-1-761(2) as:

(A) Acquisition of a trade secret of another by a person who knows or has reason to know that the trade secret was acquired by improper means;
or

(B) Disclosure or use of a trade secret of another without express or implied consent by a person who:

(i) Used improper means to acquire knowledge of a trade secret;

(ii) At the time of disclosure or use, knew or had reason to know that knowledge of the trade secret was:

(I) Derived from or through a person who had utilized improper means to acquire it;

(II) Acquired under circumstances giving rise to a duty to maintain its secrecy or limit its use; or

(III) Derived from or through a person who owed a duty to the person seeking relief to maintain its secrecy or limit its use; or

(IV) Before a material change of position, knew or had reason to know that it was a trade secret and that knowledge of it had been acquired by accident or mistake.

There is no misappropriation where the evidence establishes that an idea similar to the trade secret at issue was independently conceived and developed. In Penalty Kick Management Ltd. v. The Coca-Cola Company, 164 F. Supp.2d 1376 (NDGA 2001), the Coca-Cola Company was able to establish that a bottle containing hidden writing which it placed into use was a concept which had been independently conceived and developed by a second company after Coca-Cola had seen a presentation of a similar concept by Penalty Kick. Because the evidence established that the idea implemented by Coca-Cola had been independently conceived and developed, there was no trade secret misappropriation.

Another case which stands for the proposition that similarity of appearance is not always enough to establish misappropriation is Tronitec, Inc. v. Shealy, 249 Ga. App. 442, 547 S.E.2d 749 (2001). Former employees were accused of misappropriating trade secrets which allegedly included customer lists. The former employees had formed a competing business and maintained a prospect list which followed the same format as the former employer's prospect list. The employer contended that the two lists were virtually identical. The court decided that this similarity merely meant that the former employees were using a format with which they were familiar from their former employment, but that the names on the list could have been reconstructed from the former employees' memories. Since a former employee's general memory of customer information does not constitute a trade secret under Georgia law, and there was no evidence of misappropriation of any trade secrets pertaining to customers, the court granted summary judgment to the former employees on the trade secret misappropriation allegations as to customer information. (Please see further discussion of Tronitec below regarding inevitable disclosure of other information which was found to be trade secrets.)

3. Act Governs Regardless of Existence of Employment Agreement.

There is no need to have the employee execute any document in order for the company to avail itself of the protections of the Trade Secrets Act. But making reference to the employee's obligations under the Trade Secrets Act in an employment agreement allows the employer to document that it has placed the employee on notice of the employee's obligations under the Trade Secrets Act. A separate nondisclosure agreement will also prevent the employee from asserting the defense used by the former employees in Tronitec which is discussed above: that the allegedly trade secret customer lists were really simply lists reconstructed from memory. Tronitec, 249 Ga. App. at 446.

4. Inevitable Disclosure

In the case of Essex Group, Inc. v. Southwire Company, 269 Ga. 553, 501 S.E.2d 501 (1998), the Georgia Supreme Court adopted a theory known as "inevitable disclosure", to prevent an individual from developing for a competitor from his memory a trade secret logistics system like the one he had developed for his previous employer. Even though there was no evidence that this individual had taken any written materials or computer files with him regarding the development of the logistics system, the evidence established that this person was capable of reconstructing from memory significant portions of the logistics system. The court noted that the former employee likely would be able to create a similar system for his second employer, and almost certainly would be able to do so more efficiently than the first time around. The system was complex and had resulted in significant financial benefit to the first employer; thus the development of a similar system by this former employee for a competitor would have resulted in a financial benefit to the competitor and a diminution in the value of the benefit to the

first employer. Under these circumstances, the court barred the employee from working for the competitor in the capacity in which he had worked for the first employer, developing a logistics system.

Tronitec, Inc. v. Shealy, 249 Ga. App. 442, 547 S.E.2d 749 (2001), seems to follow the Essex analysis. In Tronitec, two former employees were accused of misappropriating trade secrets associated with their former employer's development of a digital test station and a digital station interface box for use in testing and repairing circuit boards. The technology associated with the products was publicly available, and the functionality of the products could be reproduced with commercially available components and reverse engineering. But the system developed by Tronitec was unique, and that uniqueness gave Tronitec a competitive advantage. Even though other systems with similar functionality existed, the one developed by the former employees was virtually identical to that of their former employer. Moreover, the employees had an operational product on the first day their new business opened, despite estimates that approximately 2000 hours of development were needed for this product. For these reasons, the former employees' motion for summary judgment was denied as to the allegations of trade secret misappropriation. Tronitec, 249 Ga. App. at 448-452.

5. Production of Trade Secrets in Discovery.

Parties involved in litigation often are asked to produce trade secret information during discovery. This production is often necessary where the parties are litigating over whether trade secrets have been misappropriated. Although the party producing the information it contends is a trade secret typically does so pursuant to a protective order, there have been some unresolved

questions regarding what effect that production has on the party's ability to protect its trade secrets. We now have answers to some of those questions.

In Chicago Tribune Company et al v. Bridgestone/Firestone, Inc., 263 F.3d 1304 (11th Cir. 2001), the Eleventh Circuit Court of Appeals held that materials produced in discovery in a civil litigation matter pursuant to a protective order, but not filed with the court, did not have to be disclosed to non-party members of the media despite the press' First Amendment and common law rights of access to court proceedings. Chicago Tribune, 263 F.3d at 1310. Additionally, materials filed with the court under seal only in connection with discovery motions, and not in connection with any substantive motions related to the merits of the case, are also not subject to these rights of access to court proceedings. Chicago Tribune, 263 F.3d at 1312-1313. But where the materials which are produced pursuant to the protective order are actually filed with the court, the court must determine whether good cause exists under Fed. R. Civ. P. 26 to allow the materials to remain sealed. Chicago Tribune, 263 F.3d at 1313.

In determining whether good cause exists, the court must first confirm that the information for which protection is sought satisfies the statutory definition of a trade secret. Chicago Tribune, 263 F.3d at 1313. Once satisfied that the information constitutes a trade secret, the court must balance the interests of the owner of the trade secret in keeping it confidential against the public's interest in open access to the information at issue. Chicago Tribune, 263 F.3d at 1314-1315. One factor to consider in making this analysis is which party filed the materials containing the trade secret with the court. If the owner of the trade secret has filed the materials containing the trade secret voluntarily in connection with substantive motions practice, the owner of the trade secret has in essence voluntarily exposed its own trade secrets to the risk

of public scrutiny. Chicago Tribune, 263 F.3d at 1315. If, however, the other party to the litigation has filed the materials with the court, there is a stronger basis for protecting the trade secret from public disclosure, because the party that owns the trade secret took no action to expose the trade secrets to public scrutiny. Chicago Tribune, 263 F.3d at 1315.

Relying on Chicago Tribune for guidance, Senior Judge O’Kelley of the Northern District of Georgia addressed similar issues in Estate of Martin Luther King, Jr., Inc. v. CBS, Inc., 184 F.Supp.2d 1353 (NDGA 2002). In this case, the King Estate asserted that CBS had filed some depositions containing King Estate trade secrets in connection with substantive motions practice, and that the depositions had not been filed under seal despite the existence of a protective order. The King Estate sought a retroactive protective order once this omission was discovered. It was not known whether any third parties had read the depositions during the time between the filing and the parties’ discovery that the depositions had not been sealed. Judge O’Kelley held that the fact that the depositions had been filed without being sealed, and might have been read by members of the public, did not cause the information in the depositions to lose trade secret status, because these disclosures were made through no fault of the owner of the trade secrets. Thus, so long as the King Estate, as the owner of the trade secrets, could satisfy the good cause standard described by the Eleventh Circuit Court of Appeals in Chicago Tribune, the depositions at issue could be retroactively sealed. Estate of Martin Luther King, Jr., Inc., 184 F. Supp.2d at 1364-1365.

It remains to be seen whether Georgia’s state courts will adopt an analysis similar to that adopted by the Eleventh Circuit and Judge O’Kelley. The Georgia Court of Appeals appears to be receptive to Judge O’Kelley’s analysis, having recently held that transmittal to the Court of

Appeals, unsealed, of a record which had been subject to a protective order at the trial level, did not destroy the trade secret status of the information disclosed thereby. Tronitec, 249 Ga. App. at 450.

D. Return Of Company Materials

It is advisable to include in any employment or independent contractor agreement an obligation for the employee or independent contractor to return all company materials upon termination of employment or at any other time requested by management. Such a clause serves to remind the employee that the company owns such materials, and also provides an additional contractual obligation which can be enforced against a former employee who fails to return such materials.

E. Notice Provisions

A notice provision requiring the employee to provide a reasonable amount of notice prior to departure will be enforceable. Capricorn Systems, Inc. v. Pednekar, 248 Ga. App. 424, 425, 546 S.E.2d 554 (2001). The employer will be required to prove the damages arising from breach of the provision. But nominal damages will be available even in the absence of proof of actual damages. *See* Capricorn Systems, Inc. v. Pednekar, 248 Ga. App. 424, 425, 546 S.E.2d 554 (2001).

III. RESTRICTIVE COVENANTS IN PARTNERSHIP AGREEMENTS

In recent years, the Georgia Court of Appeals has carved out a middle level of scrutiny for restrictive covenants in partnership agreements. *See* Habif, Arogeti & Wynne, PC v. Baggett, 231 Ga. App. 289, 498 S.E.2d 346 (1998), *cert. denied*; *see also* Physician Specialists in Anesthesia, PC v. MacNeill, 246 Ga. App. 398, 539 S.E.2d 216 (2000). The rationale for this

change is that partners typically have relatively equal bargaining power, and all typically make the same covenants in favor of one another. Therefore, there is little justification for the assumption that partners must be protected with the strict level of scrutiny appropriate for restrictive covenants in employment agreements.

To date, this middle level of scrutiny has only been applied to accounting practices and medical partnerships. In Russell Daniel Irrigation Company, Ltd., 237 Ga. App. 758, 516 S.E.2d 804 (1999), the Georgia Court of Appeals declined to apply the middle level of scrutiny to restrictive covenants in an employment agreement which an irrigation company employee executed the same day he became a limited partner of the company, on the theory that the employee's bargaining power at the time he executed the employment agreement was no greater than that of any other employee who was vying for a share of the business. Absent the sort of bargaining power an existing partner in the business would be expected to have, the employee's covenants should be subjected to the same strict level of scrutiny as other employment agreements. Russell Daniel, 237 Ga. App. at 759-760.

IV. RESTRICTIVE COVENANTS ANCILLARY TO SALE OF BUSINESS INTERESTS

A. Sale of Even a Small "Business Interest" May Be Sufficient to Trigger The Application of Sale of Business Analysis.

Where a person enters into restrictive covenants in the context of a sale of business, the public policy considerations favoring strict scrutiny of the restrictive covenants do not apply. Unlike where an employee may be forced to execute a "contract of adhesion", because the employee lacks sufficient bargaining power to negotiate more favorable contractual terms, there is perceived to be equal bargaining power between the parties in the context of a sale of a

business. Therefore, Georgia courts will allow greater latitude to the parties, and will “blue pencil”, or edit, an overbroad agreement to render it enforceable. See Watson v. Waffle House, 253 Ga. 671, 324 S.E.2d 175 (1985).

The sale of even a small ownership interest in a business will in some instances be sufficient to trigger the application of the less restrictive standard of review applicable to a sale of a business. In Hudgins v. Amerimax Fabricated Products, Inc., 250 Ga. App. 283, 551 S.E.2d 393 (2001), a seller of a two percent, non-voting interest in a family-owned business was bound by restrictive covenants he executed in connection with that sale, despite his contention that he had opposed the business sale, had been powerless to prevent it, and had had no bargaining power in negotiating the terms of the restrictive covenant agreement he executed. There was also evidence that, although he personally opposed the sale of the business, he agreed to execute the restrictive covenants because his mother, a larger shareholder, wanted him to do so. There was further evidence that his refusal to sign the restrictive covenants (or such a refusal by any other shareholder) would have prevented the sale from closing. He received payment for his shares in the business in an amount equivalent to several years of his average salary. Under these facts, the court determined that Hudgins had had more bargaining power than he contended, and that the sale of business standard of review was properly applied. Hudgins, 250 Ga. App. at 287.

U.S. District Judge Owen Forrester seems to have taken this analysis one step further in Rinks v. Courier Dispatch Group, Inc., 2001 US Dist. LEXIS 4728 (NDGA 2001). Ms. Rinks sold her ownership interest in a business to Courier Dispatch, signing a restrictive covenant agreement as part of the sale. She also joined Courier Dispatch as an executive as part of the

deal. Several years later she departed Courier Dispatch, at which time she executed a release which incorporated by reference the restrictive covenants she had executed when she sold her interest in the business to Courier Dispatch. Judge Forrester concluded that Ms. Rinks' sale of a business interest several years earlier was sufficient to trigger the application of the looser "sale of business" analysis of the restrictive covenants. Rinks, 2001 US Dist. LEXIS 4728 at *10. Judge Forrester noted Ms. Rinks' "business savvy and acumen", suggesting that the analysis of restrictive covenants should depend on the parties' respective levels of sophistication rather than solely on the parties' relative roles as "employee" or "employer".

Recognizing that Georgia case law allows "blue-penciling" in the context of a sale of a business, although the noncompete had an overbroad territorial coverage of sixteen states, Judge Forrester determined that the noncompete was enforceable, and could be "blue-penciled" to render it sufficiently narrow to be enforceable. Rinks, 2001 US Dist. LEXIS 4728 at *11.

B. Sale of Business Analysis Not Applicable Where Person Signing Restrictive Covenants Is Not The Person Selling the Business Interest.

In order for the "sale of business" analysis to apply, the restrictive covenants at issue must have been entered into both contemporaneously with the sale of the business and by the person selling the ownership interest. In Gale Industries, Inc. v. O'Hearn, 2002 Ga. App. LEXIS 1114 (August 29, 2002), Betty O'Hearn sold the assets of her business to Gale, and Troy O'Hearn (not an owner of the assets being sold, but presumably a relative of Betty O'Hearn) executed an employment agreement with Gale in which he agreed to a noncompete with a five-year duration and a territory of a 100-mile radius of the business Ms. O'Hearn was selling. Mr. O'Hearn also agreed not to solicit customers or suppliers of the former business for five years. The asset purchase agreement executed by Ms. O'Hearn, and the employment agreement

executed by Mr. O’Hearn, were executed contemporaneously and cross-referenced one another. Mr. O’Hearn then formed a competing business and Gale sued to enforce the restrictive covenants. The court concluded that, although executed contemporaneously, the employment and asset purchase agreements could not be construed together as part of the same transaction, because they were executed by different people and pertained to different subject matter. Therefore, the employment agreement must be construed under the standard analysis of employment agreements, and not under the less restrictive analysis of agreements entered into in connection with the sale of a business. Gale, 2002 Ga. App. LEXIS 1114, *6-7. Under the more strict analysis of restrictive covenants in employment agreements, the restrictive covenants at issue were overbroad, and could not be “blue-penciled” to render them sufficiently narrow to be enforceable. Gale, 2002 Ga. App. LEXIS 1114, *7, 8.

Where, as in Gale, the person selling the business is in essence a “silent partner”, and the person actually operating the business has no ownership interest in the business, the person operating the business should be asked to execute a restrictive covenant agreement which satisfies the requirements for enforceability of a restrictive covenant executed in the context of employment. This scenario commonly occurs in the context of a family-owned business in which one family member owns the company while another family member operates it.

C. Even Restrictive Covenants Construed Under the Sale of Business Standard Must Specify Scope, Territory and Duration.

An overbroad restrictive covenant executed ancillary to a sale of business will be “blue-penciled” to render it enforceable. But this will only occur where the covenant specifies scope, territory and duration. The court will not add missing terms to the covenant. Thus, in New Atlanta Ear, Nose & Throat Associates, P.C. v. Pratt, 253 Ga. App. 681, 687, 560 S.E.2d 268

(2002), where physicians executed a shareholder agreement containing a noncompete which lacked a territorial restriction, the court refused to enforce the noncompete, and declined to insert its own territorial restriction. The court noted that “blue-penciling” can only be used to edit, or narrow, a restrictive covenant, but cannot write new terms for the covenant. New Atlanta Ear, Nose & Throat, 253 Ga. App. at 687. The court further refused to refer to a previous version of the shareholder agreement to supply terms missing from the restrictive covenants in the shareholder agreement at issue, as the shareholder agreement at issue expressly superseded the previous shareholder agreement.

D. Noncompete Ancillary to Sale of Business Is Not Superseded By Noncompete in Separate Employment Agreement Which Was Executed at a Later Date.

Where someone sells a business and then becomes employed by the purchaser, executing a separate employment agreement related thereto, the restrictive covenants in the two agreements are to be construed separately. Even where the noncompete in the later-signed employment agreement contains a merger clause, the two agreements are separately enforceable, because they address different subject matter. Attaway v. Republic Services of Georgia, LLP, 253 Ga. App. 322, 324, 558 S.E.2d 846 (2002). Thus, in Attaway, the previously-executed, and more extensive, noncompete in the asset purchase agreement was enforceable despite the fact that a later-executed employment agreement containing a more narrowly-worded noncompete contained a merger clause specifying that the employment agreement superseded all prior agreements pertaining to the same subject matter. Attaway, 253 Ga. App. at 324-325.

V. NON-CIRCUMVENTION AGREEMENTS

Companies often enter into non-circumvention agreements with other entities with which they conduct business, particularly in situations in which a company is sharing business “leads”

with another company. In Swartz Investments, LLC v. Vion Pharmaceuticals, Inc., 252 Ga. App. 365, 370, 556 S.E.2d 460 (2001), *cert. denied*, the Georgia Court of Appeals has held that in the absence of separate consideration for such a clause, it will be subject to the same strict scrutiny as is applied to restrictive covenants in employment agreements. Because the clause at issue sought to prevent Vion from entering into any agreement or transaction with the investors which were the subject of the non-circumvention clause, regardless of whether such agreement or transaction might be related to that which was the subject of the arrangement between Swartz and Vion, the non-circumvention clause was deemed to be overbroad and failed under strict scrutiny.

Swartz seems to suggest that non-circumvention clauses must be supported by separate consideration in order to be enforceable. Reciting the existence of separate consideration can help to ensure that such a clause will receive a lower level of scrutiny and will have a stronger chance of being enforced by courts.