

**GEORGIA SUPREME COURT STRIKES DOWN FRANCHISE AGREEMENT
PROHIBITION OF FRANCHISEE COMPETITION DURING AGREEMENT TERM;
GEORGIA LEGISLATURE PASSES NEW BILL THAT WOULD MAKE IT EASIER
TO ENFORCE RESTRICTIVE COVENANTS**

By: Mark VanderBroek, Troutman Sanders LLP; Perry McGuire, Taylor English Duma LLP

A. Supreme Court Strikes Down In-Term Non-Competition Clause

In a June 29, 2009 opinion relevant to all franchise businesses in Georgia, the Georgia Supreme Court held that a covenant in a franchise agreement prohibiting a franchisee from engaging in a competitive business during the term of the agreement is judged under the same standards as a post-termination covenant not to compete, and is unenforceable under Georgia law unless it is reasonably limited in territory and in scope of restricted activities. Atlanta Bread Company International, Inc. v. Lupton-Smith, No. S08G1815 (Ga., June 29, 2009).

The franchise agreement in this case provided that during the term of the agreement neither the franchisee nor its principal shareholders could “engage in, or acquire any financial or beneficial interest in . . . , advise, help, guarantee loans or make loans to, any bakery/deli business whose method of operation is similar to that employed by store units within the [franchise] System.” The Supreme Court affirmed the lower court’s rulings that the covenant was unenforceable because it did not contain a territorial limitation and contained an overbroad activity limitation. As a result, the Court invalidated the franchisor’s reliance on the clause to terminate a franchise agreement after the franchisee allegedly opened a competing business with a similar method of operation.

The Supreme Court’s ruling renders invalid the in-term non-competition covenants of many franchisors with business operations in Georgia. Georgia based franchisors will need to modify their franchise agreements if they want to protect themselves against the divided loyalties and conflicts of interest that can arise if a franchisee becomes involved with a competing business.

B. Georgia Legislature Passes New Restrictive Covenant Bill

On April 2, 2009, the Georgia General Assembly passed a bill (House Bill 173) that reverses Georgia’s long-held legal bias against enforcement of restrictive covenants and would make it far easier to enforce such covenants in Georgia. Governor Purdue has signed the legislation, which becomes effective only if the voters ratify a related state constitutional amendment in the November 2010 general election.

The new law, if enacted, applies to employment relationships and to specified types of agreements including franchise and distribution agreements. The law would effectively reverse the Supreme Court’s Atlanta Bread opinion, by permitting enforcement of in-term restrictive covenants without limitations on scope of activity, duration or territory. Post-termination covenants not to compete still would need to be reasonable in time, geographic area, and scope of prohibited activities. However, the law provides presumptions regarding the reasonableness of time restrictions depending on the type of agreement at issue. For former distributors, dealers, franchisees, or licensees, a post-termination restraint of three years or less from the date of termination of the relationship is deemed to be reasonable. Also, the new law would allow judges to modify or “blue pencil” otherwise unenforceable restrictive covenants by striking through offending language or rewriting clauses to create a reasonable restrictive covenant.