

## Georgia Franchising Update

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A recent decision of the Georgia Supreme Court and recently passed legislation may have a dramatic impact on the ability of a franchisor to restrict the competitive activities of its franchisees in Georgia.

To protect the integrity of its franchise system, franchisors seek to protect their proprietary business methods and information through the confidentiality and noncompetition covenants contained in their franchise agreements. Since the enforceability of noncompetition covenants is typically a matter of state law, a franchisor must deal with differing legal standards of review. The Georgia courts have viewed noncompetition covenants to be in partial restraint of trade, and therefore enforceable only if reasonable as to time, territory and scope. The covenants in franchise agreements are strictly construed and difficult to enforce by the franchisor. A Georgia court will not fix, or "blue pencil," a defective noncompete.

In the case of *Atlanta Bread Co. International, Inc. v. Lupton-Smith*, decided on June 29, 2009, the Georgia Supreme Court ruled that a covenant in a franchise agreement that restricted the competitive activities of a franchisee during the term of the agreement, but which did not contain geographic limitations on those competitive activities was unenforceable, ruling that in-term covenants would be construed in the same manner as post-term covenants.



This decision could greatly impact franchisors with franchised units in Georgia.

According to the amicus brief filed on behalf of the International Franchise Association (IFA) in the Atlanta Bread case, in the franchise agreements of 42 restaurant franchises operating in Georgia, 32 contained in-term covenants without a geographic restriction. According to the IFA, in 2005 there were 32,680 franchised units in Georgia that provided 390,534 franchising jobs. Franchisors must respond by revising their agreements for new franchisees and will be inevitably face challenges to protect their proprietary methods and systems from competition by their current franchisees.

In HB 173 signed by Gov. Perdue on April 29, 2009, the Georgia legislature has made another attempt to address the enforceability of noncompetition covenants. HB 173 would allow a court to "blue-pencil" overly broad restrictive covenants and provides specific guidance as to what provisions in a restrictive covenant would be presumed enforceable, duration, for example. A previous legislative attempt to enact a similar law

was struck down as unconstitutional in 1991. HB 173 will become effective only upon the passage of a Constitutional Amendment in November 2010 permitting the legislature to issue the new law.