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Guide to Drafting Noncompetition Agreements in Georgia

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Research Guides

A Guide to Drafting Noncompetition Agreements in Georgia

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Overview

Covenants not to compete have existed for hundreds of years. Prior to 1711, agreements not to compete were considered against public policy. In 1711, an English court, in *Mitchel v. Reynolds*, overruled that long line of precedent to allow reasonable agreements not to compete, provided they were accompanied by satisfactory consideration. This framework was adopted by most States; covenants not to compete were against public policy and void unless they were deemed reasonable.

Georgia follows this approach, as well, and has devised a three element test to determine the reasonableness of covenants not to compete. First, these agreements cannot impose excessive geographic limitations on a person's ability to seek work. Second, the duration of the covenant must be reasonable. Finally, covenants not to compete cannot prohibit all competitive activity, but must be limited in scope as to the activities prohibited.

Covenants not to compete tend to evolve with business and market conditions. However, the Georgia constitution restricts the manner in which businesses may successfully draft employment agreements containing covenants not to compete and ties the hands of courts in enforcing them. The General Assembly, recognizing this immutability, passed new restrictive covenant laws in 2009, which recently became effective after voters approved the measures as a constitutional referendum in the November 2010 election. The new laws in part codify existing precedent but also enumerate several changes. Among these are presumptions for reasonableness in certain situations and, perhaps most important, courts are now permitted to modify covenant agreements to make them enforceable.

The impact of the new laws has not yet been felt. This Guide provides a look at case precedent prior to the passage of the new laws and examines the likely effect the new laws will have on covenants not to compete in Georgia.

Scope of Research

This Research Guide provides a broad introduction to the current state of Georgia law regarding noncompetition agreements and covenants not to compete. It also provides annotations of several resources—law review articles, form books, encyclopedia articles, etc.—that will instruct a reader in the basic tenants of noncompetition agreements. The world of covenants not to compete is expansive; these covenants appear in many types of agreements and contractual relationships. This Guide is focused on the most common type of noncompetition agreement: covenants not to compete or solicit built into employment contracts.

Disclaimer

This research guide is a broad starting point for research into noncompetition covenants in Georgia. Such agreements must be tailored to individual employer/employee or business needs. This guide should not be considered as legal advice or as a legal opinion on any specific facts or circumstances. If you need further assistance in researching this topic or have specific legal questions, please contact a reference librarian in the Georgia State University College of Law library or consult an attorney.

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About the Author

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Primary Sources

Constitutional Provisions

Ga. Const. art. III, sec. 6, para. 5(c)

"The General Assembly shall not have the power to authorize any contract or agreement which may have the effect of or which is intended to have the effect of defeating or lessening competition, or encouraging monopoly, which are hereby declared to be unlawful and void."

Statutes

Statutory mandates have taken on much greater importance in the drafting of noncompetition agreements since the General Assembly passed HB 173 in 2009 and voters approved its implementation by referendum in 2010. The comprehensive codification of many former common law tenants of restrictive covenants provides additional clarity and guidance for employers and employees, businesses and professional firms that seek to draft noncompetition clauses.

Ga. Code Ann. § 13-8-2: Reinforces the constitutional provision (see "Constitutional Provisions") that prohibits the General Assembly from authorizing contracts or agreements that lessen competition or encourage monopoly. However, the law distinguishes contracts "in partial restraint of trade" which are permitted under the provisions of Article 4 (see below).

New Law: 2010

Pursuant to HB 173, 2009 Ga. Laws 231, Georgia's former restrictive covenant statute, O.C.G.A § 13-8-2.1, was repealed when Amendment 1 of the 2010 General Election passed. A new article, Article 4 of Title 13, Chapter 8 "Restrictive Covenants in Contracts," was created in its place to codify much of the judge-made law concerning restrictive covenants in Georgia. According to O.C.G.A. § 13-8-50, the General Assembly found several policy reasons for codifying the law:

- Reasonable restrictive covenants "serve the legitimate purpose of protecting legitimate busienss interest."
- Restrictive covenants create "an environment that is favorable to attracting commercial enterprises to Georgia and keeping existing businesses within the state."
- Statutory codification provides clarity so that "parties to [noncompetitive agreements] may be certain of the validity and enforceability of such provisions and may know their rights and duties according to such provisions."

The following statutes were added under Article 4 to codify the judge-made law concerning restrictive covenants in Georgia:

O.C.G.A. § 13-8-51: Defines key terms used in Article 4. Some of the definitions provided specific guidance as to the scope of certain meanings.

O.C.G.A. § 13-8-52: Provides that Article 4 will apply only to the following agreements, excluding all others:

- Employers and employees (as defined in O.C.G.A. § 13-8-51)
- Distributors and manufacturers
- Lessors and lessees
- Partnerships and partners
- Franchisors and franchisees
- Sellers and purchasers of a business or commercial enterprise
- Two or more employers

O.C.G.A. § 13-8-53: Lays out the framework for a "reasonable" restrictive covenant. The provisions of a restrictive covenant must be reasonable in three dimensions:

- Time
- Geographic area
- Scope of prohibited activities

Further, contracts that restrict competition after the term of employment (distinguished from customer nonsolicitation agreements and nondisclosure of confidential information agreements) apply only to employees or personnel who:

- Customarily and regularly solicit for the employer customers or prospective customers;
- Customarily and regularly engage in a making sales or obtaining orders or contracts for products or services to be performed by others;

- Perform the duties of a key employee or of a professional; or
- Perform the duties of supervision and hiring/firing as a manager.

Subsection (b) of Code Section 13-8-53 expressly allows customer nonsolicitation agreements without limits on geographic area so long as the agreement pertains only to customers with whom the former employee had "material contact."

Subsection (e) of Code Section 13-8-53 expressly permits nondisclosure of confidential information agreements which are not limited by time or geographic area.

O.C.G.A. § 13-8-54: This Code Section, in conjunction with Subsection (d) of Code Section 13-8-53 seems to invalidate the line of Georgia cases (see "Case Law") refusing to implement the "blue pencil" rule for judicial revisions of restrictive covenants. These provisions permit a court to modify a covenant that is otherwise void and unenforceable as long as the modification does not render the covenant more restrictive with regard to the employee.

O.C.G.A. § 13-8-55: Establishes the burden of proof for enforcement of a restrictive covenant on the person or business seeking its enforcement.

O.C.G.A. § 13-8-56: Outlines reasonableness considerations and judicial presumptions for restrictive covenants that operate during the course of an employment or business relationship.

O.C.G.A. § 13-8-57: This section marks a substantial change to covenant law. The General Assembly imposes rebuttable presumptions for courts when determining the reasonableness in time of a restrictive covenant sought to be enforced after the term of employment:

- Subsection (b) applies to former employees not associated withe sale or ownership of a material part of a business. This limits time restraints to two years.
- Subsection (c) applies to former distributors, dealers, franchisees, lessees, licensees of trademarks, trade dress, or service marks. This limits time restraints to three years.
- Subsection (d) applies to owners or sellers of a material part of a business. This limits time restraints to five years.

O.C.G.A. § 13-8-58: Provides for various remedies for the court to enforce restrictive agreements.

O.C.G.A. § 13-8-59: Restrictive covenants in violation of federal law are not permitted.

Legislative History

House Bill 173, passed in 2009, became effective immediately after the November 2010 general election. This bill provided for comprehensive codification of the law concerning noncompetitive agreements:

2009 Ga. Laws 213

Case Law

DRAFTING CONSIDERATIONS FOR NONCOMPETITION AGREEMENTS

A. Consideration

Often overlooked as part of noncompetition agreements, consideration is still a fundamental element of the bargaining process when binding another party to a contractual covenant. Consideration is satisfied by performance in most cases, however.

Thomas v. Coastal Indus. Servs., 214 Ga. 832, 108 S.E.2d 328, 329 (1959)

The Georgia Supreme Court found that a noncompetition agreement requires consideration. However, consideration in the employment context is satisfied by mere performance. "Even though the agreement does not disclose what salary [the employee] was to be paid or the length of time he was to be employed by [his employer], and despite that fact that the [employee] was already employed by [his employer] at the time the agreement was entered into, mutuality and sufficient consideration to vitalize the ancillary agreement were supplied by performance under the agreement." Therefore, consideration is met by regular performance of the employee's job duties.

Mouldings, Inc. v. Potter, 315 F.Supp. 704, 713 (D.C. Ga. 1970)

The employment agreement in this case was supported by valuable consideration in "namely the promise of the employer to employ or to continue to employ the employee for a definite term and at a specified salary . . . . It has been held that a mere agreement to continue to employee furnishes a sufficient consideration for a non-competition covenant under Georgia law."

B. Blue Pencil Doctrine

Many jurisdictions apply the blue pencil test to contracts that, as written, fail to comply with public policy or contract law. Georgia courts have refused to do so for noncompetition agreements in the past and invalidate the entire agreement if it offends public policy. With the passage of O.C.G.A. §§ 15-8-53 and 15-8-54, the General Assembly authorized courts to "modify" covenant agreements. Whether courts will exercise this new power remains to be seen. Regardless, it is not wise to exceed common notions of reasonability in the context of covenants not to compete because Georgia courts have historically voided the entire agreement rather than rewrite it for enforceability.

Riddle v. Geo-Hydro Engineers, Inc., 254 Ga. App. 119, 561 S.E.2d 456, 458 (2002)

The appellate court refused to rewrite an engineer's employment agreement, which contained a covenant not to solicit prior clients, in order to make it enforceable. "Covenants ancillary to an employment contract . . . cannot be blue penciled . . . as Georgia does not employ the 'blue pencil' doctrine of severability to restrictive covenants in employment contracts."

C. Fiduciary Duty

When drafting covenants not to compete, it is important to consider the responsibilities the parties wish to impose upon each other. An employer must be mindful that employees may begin to compete, or at least make plans to compete, while still employed without breaching their fiduciary duties. A restrictive covenant might be used to close such gaps, and a properly drafted covenant would dissuade employees from doing so because any plans they made would would fail as long as the agreement stood.

Wachovia Ins. Servs, Inc. v. Fallon, 299 Ga. App. 440, 682 S.E.2d 657, 664 (2009)

A corporate officer formed a competing business and hired two other employees of the company after he left. The court found the restrictive covenant overly broad as to the scope of the restraint. It also found that an officer "does not breach fiduciary duties by making plans and arrangements to start a competing company while still employed by the corporation." Therefore, the plans that the officer made while employed were given free reign because the agreement was too broadly drawn.

D. Public Policy Compliance

Recall that the Georgia Constitution, Article III, Section 6, Paragraph 5(c), declares contracts that have the "effect" of "defeating or lessening competition" are unlawful and void. Accordingly, Georgia courts have evolved a system of reasonableness to determine whether covenants not to compete or disclose exceed the prescribed threshold and have the unlawful effect of lessening competition. It is crucial to adhere "strictly" to the limits of reasonableness as described below.

Orkin Exterminating Co., Inc. v. Pelfrey, 237 Ga. 284, 227 S.E.2d 251, 252 (1976)

In finding that an employment contract that allowed an employer to assign an employee to very different areas at will (here, between Georgia and Florida), while having a restrictive covenant as to territory follow the employee regardless, overly broad, the court held as a matter of law and principle, "covenants against competition contained in employment contracts are considered in partial restraint of trade and are to be tolerated only if strictly limited in time and territorial effect and otherwise reasonable considering the business interest of the employer sought to be protected and the effect on the employee."

ENFORCEABILITY

Under O.C.G.A. 13-8-53(a) restrictive covenants must be reasonable as to each of three dimensions: duration, geographic area, and scope of prohibited activities. That statutory provision was written to codify decades of case law requiring the reasonableness of those three elements. The new laws may impact geographic area and scope of prohibited activity. They will certain affect questions concerning duration, as the new laws provide for presumptions for reasonableness in certain situations.

W.R. Grace & Co., Dearborn Div. v. Mouyal, 262 Ga. 464, 422 S.E. 529, 531 (1992)

In construing the reasonableness of a covenant not to compete contained within an employment contract, the courts have evolved "a three-element test of duration, territorial coverage, and scope of activity . . . as a 'helpful tool' in examining the reasonableness of the particular factual setting to which it is applied."

A. Duration

This line of cases is most threatened by the new laws, O.C.G.A. 13-8-50 et seq., because they provide explicit, but rebuttable, presumptions that time limits are reasonable if they are within the specified time limits (e.g. two years for former employees, three years for former franchisees, etc.). See the "Statutes" section for more information.

Johnson v. Lee, 243 Ga. 864, 257 S.E.2d 273, 275 (1979)

An office equipment supplier hired two men under employment contracts to run its service department. A restrictive covenant limited competition for a period of five years. First, the court noted that Georgia law recognized no "set limitations on time restrictions which would, per se, be unreasonable and unenforceable." It then then found that the five year limit was not unreasonable given the nature of the business and the employees' knowledge of the employer's maintenance contracts and the dates associated with them.

Pittman v. Harbin Clinic, 210 Ga. App. 767, 437 S.E.2d 619, 621–22 (1993)

Three neurosurgeons brought an action against their former employer, a clinic, seeking a declaration that the covenants in their respective employment contracts barring them from competing with the clinic were unenforceable. While the court found that the territorial area was overly broad (50 mile radius), it held that a "one-year limitation is patently reasonable . . . . Limitations of one year and greater have been held to be reasonable."

B. Geographic Area

The new laws do not enumerate any new presumptions in favor of the reasonableness of geographic area limitations. Therefore, it is likely that courts will continue to follow precedent set in the following cases.

W.R. Grace & Co. v. Mouyal, 262 Ga. 464, 422 S.E.2d 529, 531–32 (1992)

In determining the reasonableness of a territorial restriction, "the reasonableness of the restriction is more dependent upon the facts and circumstances surrounding the case than on the geographic size of the territory." Other consideration must be given to "the employee's right to earn a living and the employee's ability to determine with certainty the area within which his post-employment actions are restricted." The employer's "protectible interest in the customer relationships its former employee established or nurtured while employed" must also factor into a reasonableness equation because of "the risk that a former employee might appropriate customers by taking unfair advantage of the contacts developed while working for the employer." Also, "as the group which the employer wishes to protect from solicitation by former employees becomes more narrowly defined, the need for a territorial restriction expressed in geographic terms becomes less important." In other words, strict geographic distances may not suffice; rather, naming specific "material" customers may be more precise.

Rollins Protective Servs. Co. v. Palermo, 249 Ga. 138, 287 S.E.2d 546, 548–49 (1982)

A former "manager in training" for a security alarm company left his job with the plaintiff and began working for a competitor. While still employed by plaintiff, the employee had entered into a covenant not to compete that encompassed a 50-mile radius. The court noted that it had upheld 50-mile radii in previous cases where the employer demonstrated a legitimate interest by showing the employee had worked throughout the entire area encompassed by the restriction. In this case, however, the 50-mile radius was held unreasonable because the former manager was not permitted to engage clients throughout the entire area. "Insofar as territorial restrictions are concerned, some of them relate to the territory in which the employee was employed; others relate to the territory in which the employer does business . . . the latter generally are unenforceable absent a showing by the employer of the legitimate business interests sought to be protected." The court

is less likely to accept a territorial restraint that simply protects an employer from competition, rather than protecting the employer against specific competition within an area where the former employee served his employer and met with his employer's customers.

C. Scope of Prohibited Activity

The new laws under O.C.G.A. § 13-5-50 et seq. also do not impose any specific presumptions for the reasonableness of restraints on the scope of activity contained in a covenant not to compete. As a result, case law will continue to define the outer limits of reasonableness on scope of activity restraints. These cases make clear that courts will not enforce agreements that prevent an employee from working for competitors in any capacity; it is essential to narrow the scope of prohibited activity to specific duties or roles rather than broadly prohibit any competition.

National Settlement Associates of Georgia, Inc. v. Creel, 256 Ga. 329, 349 S.E.2d 177, 180 (1986)

A traveling employee who marketed lump sum and structured settlement agreements quit his job to form his own competing business. His former employer sought an injunction under the employee's covenant not to compete. The agreement prevented the employee from being employed "in any capacity by a business or enterprise" engaged in the same business. The court found the language "in any capacity" unreasonable, holding "an employment contract which prohibits the employee, upon leaving such employment, from obtaining employment with a competitor *in any capacity* is unreasonable." Such language would prevent employees from working in capacities that do not threaten the business interest of the former employer, even if that employee was hired by a competitor.

American General Life & Acc. Ins. Co. v. Fisher, 208 Ga. App. 282, 430 S.E.2d 166, 168 (1993)

A covenant not to compete prohibited an employee from assisting, aiding, or abetting others in soliciting any application for insurance or annuities. The court found the language "to assist, aid or abet others" overly broad and unreasonable because it did not reasonably limit the scope of activities. "The covenant is overbroad because a covenant that will not permit [the employee] to 'assist, aid or abet' others, in effect, prohibits [the employee] from working as a supervisor or in other capacities in the insurance business in which he could not unduly influence policyholders directly because of any special trust and confidence he may have built up through his prior employment."

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Secondary Sources

Encyclopedias

Georgia Jurisprudence provides an excellent source for Georgia specific law, annotations, and even trial strategy. The following entries are sound beginning points for the uninitiated in drafting restrictive covenants for noncompetition agreements.

7 Ga. Jur. Contracts § 3

Chapter Three provides a comprehensive look at restrictive covenants in Georgia. Be sure to review the entire chapter, as it contains articles on more specific uses of restrictive covenants (e.g. restrictive covenants pertaining to leases). The following sections are broadly useful:

§ 3:2: Noncompetition covenants in Georgia generally.

§ 3:31: Enforceability of restrictive covenants in contracts.

§ 3:33: Discusses the "no modification" or "blue pencil" rule. Note that this section on the "Blue Pencil" doctrine is no longer valid in light of O.C.G.A. §§ 31-8-53(d) and 13-8-54(b).

§ 3:34: Restrictive Covenants in Employment Contracts.

§ 3:36: Reasonableness of restraints in general.

§ 3:40: Scope of activities permitted to be restrained by restrictive covenants.

§ 3:41, 42: Reasonableness of limitations on geographic area.

6 Ga. Jur. Corporations § 14

§ 14:8: Partnership agreements may contain noncompetition covenants which follow similar reasonableness standards as to duration, geographic areas, and scope of forbidden activity.

17 Ga. Jur. Employment and Labor § 8

To review restrictive covenant law in the specific context of employment contracts, give particular attention to Chapter 8 of the Employment and Labor volume of Georgia Jurisprudence. The sections lay out specific concerns for employers and employees:

§ 8:25–31: Discusses restrictive covenants in employment contracts in general.

For constitutional issues, see § 8:27. Drafting agreements in Georgia takes particular care because covenants not to compete in general are void as against public policy. This section also notes that Georgia courts will frequently disregard choice-of-law provisions and apply Georgia law regardless of the state of origination.

§ 8:32–39: In the context of noncompetition with a former employer, this section discusses the three dimensions in which covenants not to compete must be reasonable or risk being voided: limitations on time, geographic area, and the scope of prohibited activities.

§ 8:40–42: Looks at the reasonableness of prohibitions on the solicitation of a former employer's customers.

§ 8:43–44: Reviews the reasonableness of prohibitions on "poaching" a former employer's employees.

§ 8:45–48: Examines the impact of the Trade Secrets Act on covenants not to disclose trade secrets or confidential information.

Books

Shannon Miehe, How to Create a Noncompete Agreement (NOLO 2002)

Described as "the plain-English legal information and forms" for noncompetition agreements," this book is useful for smaller businesses (who cannot afford expensive legal assistance) to draft generic noncompetition agreements. With guides on how to customize the included boilerplate forms to protect a business's specific interests, this book would be very helpful for smaller businesses when used in conjunction with internet research (see "Internet Sources"). This book can be found online or at many larger bookstores.

Law Review Articles and Periodicals

Shogun J. Khadye, An Uncertain Future: Georgia's Policy on Restrictive Covenants in Employment Contracts, 2 J. Marshall L. J. 208 (2009)

Probably the most comprehensive look at Georgia's policy on restrictive covenants in employment contracts, this article puts Georgia's policies into perspective, tracing their development in both the legislative and judicial arenas. The author describes Georgia's law in the area of non-compete agreements as "greatly cluttered, disorganized and even a 'swampy morass of conflicting interests and policies.'" This article also examines the implications of HB 173, which recently passed and became law. The author argues that by permitting courts to modify agreements (or "blue pencil"), employees will suffer as employers "create more overly broad restrictions with the knowledge that the majority of them will not be challenged" and those that do may be rewritten by courts. For a review of other states' laws in this area and for an analysis of the new laws, this article is a solid read.

Kate O'Neill, 'Should I Stay or Should I Go' - Covenants Not to Compete in a Down Economy: A Proposal for Better Advocacy and Better Judicial Opinions, 6 Hastings Bus. L. J. 83 (2010)

This article looks at the effect of the depressed economy on business behavior in the context of covenants not to compete. The author argues that companies with tightening margins and slower business tend to put the "squeeze" on employees to work harder or relinquish benefits. It is the position of the author that courts should consider this "squeeze" when enforcing covenants not to compete in an effort to "[relieve] some employees at-will of the restraints of covenants they signed voluntarily without resorting to economically and psychologically factitious holdings . . . ." In other words, courts should "deprive the employer of its procedural advantage by denying a presumption of validity to a covenant not to compete simply because its formation satisfied the conventional elements of contract." The author proposes a four-part test where a court considers "the employer's interests, the negotiation between the parties, the employment relationship, and the employer's access to alternative remedies for any injury." For an employee seeking to invalidate a covenant not to compete, this article provides some interesting rhetorical and legal arguments.

Henry F. Luepke, Tortious Interference with Covenants Not To Compete, 66 J. Mo. B. 88 (2010)

Normally, an employer brings suit to enjoin a former employee from working for a competitor when a covenant not to compete exists. The author of this article argues that employers should also file a suit against the competitor who hired the employee. "Given its origins in the employment relationship, this cause of action is particularly well suited to the task of providing a remedy to the employer in whose favor the covenant not to compete was given. By forcing the competitor to pay for the consequences of the employee's breach of his or her covenant, that remedy not only strengthens the legitimate protections afforded by covenants not to compete but also appropriately recognizes the role that the competitor played in that breach." The article lays out the cause of action and the facts that must be pleaded by the employer.

Kenneth F. Antley, The Nuts and Bolts of Ancillary Documents, 27514 NBI-CLE 94 (2005)

The author discusses in brief the requirements for a covenant not to compete in Georgia. The article also discusses other aspects of noncompetition agreements, such as consideration. The focus of the paper, however, is an analysis of, *inter alia*, noncompete agreements in the context of the sale of businesses. Georgia courts apply different standards for noncompete agreements deemed ancillary to the sale of a business and those deemed ancillary to an employment agreement. The author notes that Georgia courts have not been consistent in this area, so employees "retained by the Buyer [of a business] should sign both a noncompete with a time limit based from the time of sale . . . and a more traditional noncompete . . . ."

Internet Sources

American Bar Association: The ABA is a good resource for articles and publications on restrictive covenants. Attorneys will submit from time to time monographs that help illuminate the state of the law concerning restrictive covenants among other topics.

ELinfonet: The Employment Law Information Network is a popular blog that contains articles discussing trends in law that impact businesses and workers. For example, a recent posting discussed "the risks of hiring someone bound by a noncompetition agreement."

FindLaw: Good article on the enforceability of restrictive covenants in employment agreements in Georgia, written prior to the passage of the new laws.

LexisONE: Source for limited but free research into case law at the federal and state levels.

LegalZoom: For profit website that provides "legal services at your specific direction." The website provides non-disclosure forms.

Nolo eForm: An "ebook" that contains a variety of forms for noncompetition agreements, great for per se litigants.

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Interest Groups and Associations

Interest Groups and Associations

Restrictive covenants and covenants not to compete are not a particularly controversial subject, and thus have not spawned significant interest groups. Given the individualized and voluntary nature of covenants not to compete, this is not surprising. However, businesses have powerful lobbies that strive to maintain or expand their ability to enforce covenants not to compete or solicit.

Georgia Chamber of Commerce: The Georgia Chamber of Commerce, which represents the businesses of Georgia, was a major proponent for Amendment One in the 2010 November general election. That amendment implemented the new laws concerning covenants not to compete. Businesses stand to benefit from the legislation's approval of the "blue pencil" doctrine, allowing businesses to draft covenants much more broadly without risking a court striking the entire agreement.

Jobs of Tomorrow: This policy group was the voice of businesses seeking to implement Amendment One. Its website provides policy information, case studies, and a "Q&A" section for citizens. The organization argues that allowing courts to modify covenant agreements is good for both employers and employees.

Workplace Fairness: This non-profit organization works to promote employee rights. It has several sections in which it advises employees how to approach and negotiate covenants not to compete. It also lists lawyers who will represent employees against their former employers.

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