UNIQUE MEDIATION ISSUES IN RESTRICTIVE COVENANT CASES

David N. Schaeffer
Miles Mediation & Arbitration
6 Concourse Parkway
Atlanta GA 30328
678-320-9118
dschaeffer@milesmediation.com

Introduction: There are an extraordinarily large number of moving parts and remedies in restrictive covenant cases and the settlement of such cases. The first issue is always whether injunctive relief is appropriate. That normally depends on whether the covenants are enforceable, which in turn may depend on when they were entered into. If before 2011, they will be subject to the old rules and if after early 2011, they will be subject to the new Restrictive Covenants Act, O.C.G.A § 13-8-1 et seq. ("New Act"), for which there is very little appellate guidance. That first issue is essentially a question of law, but the New Act is anything but clear and leaves open many interpretations. The second issue will always be whether the defendants violated the provisions and whether the defendant competing company induced those violations. That can be a complicated factual issue, especially when it comes to non-solicitation covenants. The third issue will be whether, if violations have occurred, damages can be proved. This is also a complicated issue, as proving lost profits and lost customers can be very difficult unless the customers are willing to participate as witnesses in the case. The mediation may also be quite different depending on whether the restrictive covenants are in conjunction with an individual employee or independent contractor leaving an employer or whether it is in the context of the seller of a business competing in violation of a non-compete provision. Different remedies may be considered depending on the context.

Many of the moving parts depend on when the mediation takes place. Generally, these cases are settled after temporary restraining orders or interlocutory injunctive relief are either granted or denied by the court handling the litigation. If the initial efforts on the part of the plaintiff to obtain injunctive relief fail, generally mediation will focus on

contested enforceability of the covenants and any actual damages incurred because of their alleged violations. The plaintiff will have much less leverage if the court has not entered a TRO or interlocutory injunction. If the court orders an interlocutory injunction, the plaintiff has considerable leverage and will be hard pressed to give that up without a substantial payment, which in turn brings damage calculations into the mix.

It is critical for the neutral mediator to understand both the procedural, equitable, legal, and practical business issues involved and to be familiar with not only the New Act, but for older covenants, the old rules set forth by decades of case law. The mediator must also understand the difficulty in assessing and proving damages and the time and expense that doing so entails.

Injunctive Relief: Injunctive relief is the "hammer" in these types of cases. The Motion for TRO or the Motion for Interlocutory Injunction and the hearings and orders on those motions provide the parties with the first indicator of potential success in pursuing or defending the case. The threshold issue is whether the plaintiff is "reasonably likely to prevail on the merits," which depends on whether the Court thinks the underlying covenants are enforceable. Thus, the granting of a TRO or interlocutory injunction generally indicates (but does not necessarily assure) that the Court is inclined to hold that the covenants are enforceable. Likewise, the denial of a TRO or interlocutory injunction may be based on a decision by the Court that the covenants are not clearly enforceable, or the denial may be based on other unrelated factors such as a delay in seeking injunctive relief, laches, unclean hands, the absence of a showing of immediate harm, or other equitable factors. Deciphering the real reason behind the judge's thinking depends on how thorough the judge explains the basis for his or her decision in the order denying relief. But clearly, if an interlocutory injunction is entered, which most of the time will stay in place for the usual one or two-year duration of the restriction while the lawsuit winds its way through discovery, there will be significant incentive for the defendant(s) to settle the case in order to get back to work.

There are many ways to settle a case even if the Court has entered injunctive relief. The defendant may offer to accept a more limited injunction in return for the defendant not contesting the case. The defendant may agree not to compete if he or she is permitted to return to work for the plaintiff under new restrictive covenants. The defendant may offer some sum of money for the plaintiff to lift or modify the injunction and dismiss the case. The defendant may agree not to solicit a limited, concrete list of the customers the plaintiff may be most concerned about or to not try to recruit specific employees in return for the plaintiff not enforcing a broader injunction. Or the defendant may agree to stay out of his or her primary former territory if allowed to compete in less important territories potentially covered by the injunction. Or the defendant's new competing employer may agree to restrict the ex-employee from competing in certain territories or soliciting or handling specific customers' business.

In short, injunctions are a powerful leveraging agent for the plaintiff, but they can be modified by the parties through negotiation and settlement designed to protect the plaintiff from the most egregious damage while allowing the defendant to continue to

earn a living. Because of the expense of discovery and pursuing the cases all the way to a jury trial on damages, there is almost always some flexibility on the part of the plaintiff even if it has been successful in obtaining injunctive relief.

Enforceability of the Covenants: This is always going to be an issue in the mediation even if the Court has issued an injunction. The defendant always has the threat of an appeal to overturn the injunctive relief or may be successful in convincing the Court to allow it to file a counterclaim for wrongful injunction, thereby exposing the plaintiff to possible damages if it were to lose on appeal. The defendant will almost always argue that it expects to win the case at the summary judgment phase with some combination of the covenants not being enforceable, the covenants not being violated even if enforceable, or there being no provable damages.

The mediator will need to be familiar enough about the New Act to understand the possible open issues that may affect the enforceability of the covenants. Are the covenants reasonable in time, geographic area,a nd scope of prohibited activities as required by O.C.G.A. § 13-8-53? Is the defendant one of the persons to whom post-employment non-competes now apply under O.C.G.A. § 13-8-53, i.e. is the person a sales person, a key employee, a professional, as defined in the statute (See O.C.G.A. § 13-8-51(5),(8) and (14)? Are the definitions too vague to come to any definitive conclusion on that issue? What constitutes "material contact" for purposes of non-solicitation clauses? Are specific geographic restrictions still required for non-solicitation covenants? Are the covenants, if overly broad, able to be blue-penciled or otherwise modified by the Court under O.C.G.A. § 13-8-54 (b)? What about "economic hardship" as a defense to the restrictive covenant under O.C.G.A. § 13-8-58(d)? Should that play a role in the mediation? What evidence would constitute "economic hardship"?

The biggest problem here is that even after seven years, there are almost no appellate decisions to provide guidance on these issues. However, that lack of clarity is a primary motivator for the parties to settle in mediation. With uncertainty comes flexibility and compromise. The experienced mediator will always use uncertainty as an essential tool to move the parties towards each other to reach a solution with which both sides can live.

Disputes Over Whether The Covenants Have Been Violated: Generally, if the restriction is a non-compete covenant with a clear territorial limitation or a specific list of customers with whom the ex-employee may not compete, proof of a violation can be definitively proved by paper discovery, even though actually getting that discovery is often delayed by requests for protective orders and evasive responses or objections to interrogatories and document requests. Sometimes the defendant may do things indirectly and hide the paper trail by paving the way for other persons to deal with the customer in the territory and thus not being the official salesperson on the defendant competing company's records. However, with patience and, if necessary, motions to compel, proof can be obtained.

If the covenant is a non-solicitation clause, proof is much harder. Did the defendant solicit or just accept business from the customer? Who solicited whom? Did the customer leave the plaintiff for other reasons unrelated to the defendant? If the customer's representative or agent who was solicited by the defendant is willing to testify and be involved, then proof is obtainable. However, plaintiffs are usually reluctant to involve the customers for fear that they will just take their business elsewhere. In some instances, the customers may not like being restricted from choosing the salesperson with whom they have placed their trust for many years and may not want to support enforcement of the restrictive covenant.

E-discovery is essential in these cases to nail down what contact information the defendant took on cell phones or other digital platforms, who the defendant called and when, whether there were any prior calls initiated from the customer, etc. Once again, that type of discovery is expensive and time-consuming and may not be available when the parties want to mediate the case.

The mediator will need to be attuned to these issues and the discovery disputes that may arise in order to seek or block this proof. If the negotiations depend on fully knowing the results of this type of discovery, then the mediation may need to be postponed and resumed at a later time following the completion of discovery.

Damages: Once again, the New Act is vague on damages as a remedy. It merely says that: "A court shall enforce a restrictive covenant by any appropriate and effective remedy available at law or at equity, including, but not limited to, temporary and permanent injunctions." O.C.G.A. § 13-8-58(c). Presumably, that would include lost profits from sales or customers taken by the competing conduct. But would it also include disgorgement of revenues or profits received by the violator of the covenants or the company he or she now works for? Disgorgement is a remedy recognized under Georgia law in other contexts such as trade secret misappropriation or usurpation of business by a disloyal servant, so under the broad language of O.C.G.A. § 13-8-58(c), such a remedy would seem to be allowed. But there are no appellate decisions to guide us.

Proof of damages is difficult in these cases. There are many variables which could affect the level of business from a customer or in a geographical area which may not be related to the violation of the restrictive covenants. It is easier to show the business obtained by the defendant for a competitor than it is to show that the plaintiff has lost its business from that customer, especially if the customer has not entirely switched all its business to the competitor who has hired the former employee. If the only covenant is a non-solicitation of customers provision, then in addition to losing the business, the plaintiff has to prove solicitation by the ex-employee caused that loss of business, as opposed to the customer merely switching the business for other reasons or through its own decision without solicitation from the former employee. Effective e-discovery may help with this proof, and, in some cases, I have found direct evidence of solicitation through emails and texts, to bolster the circumstantial evidence based solely on the timing to the switched business.

However, if large sums are demanded in mediation, the plaintiff should be prepared to provide definitive proof of the amount of damages for each customer affected or taken entirely and lost profits as to the ex-employee's specific territory. Otherwise, the damages will be speculative and a persuasive argument for a large recovery or settlement will be missing from the negotiations. In my experience, this is a huge problem where the parties attempt an early mediation shortly after the initial injunction hearings. The discovery necessary to prove the damages has not been done, would be expensive to do if it were to be done, and may or may not provide the evidence sought without taking the risk of involving the actual customers.

Settlement will always be easier if the competing company who has induced the breaches is included in the litigation. Most of the time, unless the individual defendant is a professional with substantial resources, the defendant will plead poverty and inability to pay any significant amount of damages. However, payment plans can sometimes be worked out, usually in combination with some specific restrictions as to specific territories or customers.

Conclusion: Because to the uncertainties regarding enforcement of the restrictive covenants under the New Act and the difficulty in proving damages without a large expenditure of time and e-discovery costs, mediation of these cases frequently defaults to an evaluation of the costs of litigation and the business disruption caused by the litigation and discovery process. If violations are clear, defendant competitors who have hired an ex-employee and placed them in the restricted territory, may essentially buy their peace for a reasonable sum, or agree to keep that employee out of that territory for a certain period in order to settle the suit and avoid litigation costs. Plaintiffs must also factor in the uncertainties of a result, the speculative nature of their damages, the risk of involving customers in the litigation and therefore the risk of losing the customers completely, and then make a business decision as to how far to push the injunctive relief and the damages demands. Sometimes, just the fact that the Plaintiff has filed suit, obtained injunctive relief, and the defendant ex-employee has suffered a restriction on his or her ability to make a living for many months or up to two years, can work as a serious disincentive for other employees to leave and compete in the future. Such a chilling of similar conduct by other employees may be the best remedy of all for the future of the business. A seasoned mediator with knowledge of all these factors can help the parties think through all the possibilities and risks and hopefully come to a solution that both parties can accept.

David Schaeffer, Esq. is a trained mediator and has participated in hundreds of mediations and arbitrations over his career. He is available to mediate any business litigation, personal injury, medical and professional malpractice actions, and employment.

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