IN THE COURT OF APPEALS
STATE OF GEORGIA

WILLIAM T. MULLALLY, COMMUNITY LENDING PARTNERS, LLC, MULLALLY CAPITAL MANAGEMENT, LLC, PEACHTREE LOAN CONSULTANTS, LLC and SOUTHERN COMFORT PARTNERS, LLC,	)	
Appellants,	)	
v.	)	APPEAL NO. A23A0369
CU CAPITAL MARKET SOLUTIONS, LLC, CAPITAL MARKETS MANAGEMENT GROUP, LLC, CU FUNDING COMPANY, LLC, CU FUNDING COMPANY MANAGER, LLC, LEWIS N. LESTER, SR., individually and d/b/a OFFICE OF SUPERVISORY JURISDICTION, ROBERT COLVIN, JEFFERSON FINANCIAL CREDIT UNION, and FREEDOM NORTHWEST CREDIT UNION,	)	
Appellees,	)	

BRIEF OF APPELLANTS

Jerry L. Sims, Esq.
Georgia Bar No. 648400
DAVIS GILLETT MOTTERN & SIMS
545 Dutch Valley Road, SUITE A
Atlanta, Georgia 30324
Phone: (770) 671-1072
Fax: (770) 628-0083
Email: jlsims@investmentlawgroup.com

Attorney for Appellants

Table of Contents

Table of Authorities

Page(s)

CASES:

Table of Authorities - Continued

STATUTES:

BRIEF OF APPELLANTS

The Appellants herein are William T. Mullally ("Mullally"), Community Lending Partners, LLC, and Mullally Capital Management, LLC, the plaintiffs below, and Peachtree Loan Consultants, LLC and Southern Comfort Partners, LLC, third party defendants below. The Appellees herein are CU Capital Market Solutions, LLC ("CMS"), Capital Markets Management Group, LLC, CU Funding Company, LLC, CU Funding Company Manager, LLC, Lewis N. Lester, SR., individually and d/b/a Office Of Supervisory Jurisdiction ("Lester") and Robert Colvin ("Colvin"), the defendants below, and Jefferson Financial Credit Union ("JFCU"), and Freedom Northwest Credit Union ("FNCU"), the intervening counterclaimants below.[1]

This is an appeal from an order of the lower court (i) granting partial summary judgment to the Appellees upholding the validity of restrictive covenants signed by Mullally, CMS, Lester, Colvin and JFCU and finding Mullally in violation of those covenants, and (ii) denying the motion for partial summary judgment of Appellants seeking a judgment declaring the restrictive covenants overly broad in scope and

[1] Capital Markets Management Group, LLC, CU Funding Company, LLC, and CU Funding Company Manager, LLC have no stake in this appeal. FNCU, like JFCU, asserts a claim pursuant to the operating agreement although there is no evidence in the record that they signed a subscription agreement or the operating agreement. For purposes of this appeal, it will be assumed that, FNCU agreed in writing to the terms to be subject to the operating agreement.

indefinite in duration and therefore invalid and unenforceable. The order further denied all other motions for partial summary judgment of Appellants and Appellees.

PART ONE

STATEMENT OF THECASE

A. Introduction.

This appeal involves several legal issues of first impression regarding the applicability of the Georgia Restrictive Covenants Act, O.C.G.A. § 13-8-50 et seq. (the "RCA" or "Act") .

Is an operating agreement between a newly formed limited liability company and its investor members an agreement between "sellers and purchasers of a business or commercial enterprise" so that restrictive covenants in the operating agreement are subject to the RCA?[2]

If the RCA is applicable and the duration of the restrictive covenants satisfies the presumptions established by the RCA[3], are the covenants nevertheless invalid

[2] The RCA only applies to agreements between certain specific types of parties, such as a seller and purchaser of a business and an employer and employees, for example. See, O.C.G.A. § 13-8-51(15) and § 13-8-52. In the case of many closely held businesses all of the investors are also employees, and RCA would apply despite the title of the agreement. That appears to have been the case in *Owens v. Novae*, 357 Ga. App. 240, 850 S.E.2d 457 (2020), but that is not the case here where some investors are not employees.

[3] The presumptions for a reasonable term for covenants between "sellers and purchasers of a business or commercial enterprise" are established by O.C.G.A. § 13-8-56 and § 13-8-57(d).

because the event that triggers the post-separation term of the covenants cannot occur until parties protected by the covenants choose in their sole discretion to allow the event to occur, if ever?

If the RCA is not applicable, are the covenants invalid under Georgia common law because the trigger to the post-separation term of the covenants is under the discretionary control of parties protected by the covenants?

B. The Proceedings Below.

This case was commenced on February 10, 2020, by the filing of a complaint on behalf of the plaintiffs against CMS in the Superior Court of Fulton County, Georgia. The complaint sought a declaratory judgment against CMS invalidating non-competition and non-solicitation covenants contained in the CMS limited liability company operating agreement. (V2–33, 37).[4] *The complaint alleged that the duration of both covenants is indefinite and strictly under the discretionary control of each voting unitholder of CMS other than Mullally.*[5] (V2–35, 38).

[4] Mullally is the restricted party in this case and will be referred to either by his last name or as the "restricted party." Lester, Colvin, JFCU and FNCU own equity interests in CMS (hereinafter "units") and are subject to the operating agreement and its restrictive covenants. CMS, Lester Colvin, JFCU and FNCU will be referred to collectively hereinafter as the "protected parties." (V2-133, 168-169, V7-2109, 2136).

[5] The Class A unitholders of CMS held voting rights. Immediately before Mullally left the company the only unitholders with voting rights were Lester, Colvin, Mullally and FNCU. But under the operating agreement a unitholder disposing of his units did not even have a vote. So, any decision to permit Mullally to dispose of

CMS filed an answer and counterclaims on February 19, 2020. (V2-105). On that same day, JFCU and FNCU filed a motion to intervene in the case and the motion was granted without opposition on March 17, 2020. (V2-193; V3-303). JFCU and FNCU are also bound by the CMS Operating Agreement. (V7-2109, 2136

Next, the plaintiffs filed a motion to add all of the current defendants other than CMS to the case and an order was entered granting the motion on August 7, 2020. (V3-434). Accordingly, an amended and restated complaint including allegations against the newly added defendants was filed on August 7, 2020. (V3-328).

Following a motion of the Appellees to add parties and assert a third-party complaint against Jeremy Gilpin ("Gilpin"), Hardaway Capital Group, LLC, Peachtree Loan Consultants, LLC, and Southern Comfort Partners, LLC[6] and a hearing on March 25, 2021(V15-1), the motion was granted on June 14, 2021, except that Hardaway Capital Group, LLC, was not added as a party. (V 5-1149).

An amended answer, counterclaims and third-party complaint was filed by the Appellants on June 17, 2021.[7] (V5-1161) On September 22, 2021, the Appellants

---

his units was up to Lester, Colvin and FNCU. (V2-161-163, 183, 186).They will be collectively referred to hereinafter as the "controlling unitholders."

[6] Third-party defendants Peachtree Loan and Southern Comfort are both dissolved entities, but remain parties in the case.

[7] The counterclaims and third-party complaint will be referred to hereinafter as the "counterclaims."

filed an answer and affirmative defenses to the counterclaims. (V5-1369). Third-party defendant Gilpin, was represented by separate counsel and filed a separate answer and affirmative defenses to the counterclaims on August 6, 2021. (V5-1334).

On January 14, 2022, a second amended complaint was filed by the plaintiffs. The defendants and intervenors (collectively "Appellees") filed a motion to strike the second amended complaint on January 21, 2022. That motion was denied on July 27, 2022. (V8-2315; V12-3428, 3430).

On July 16, 2021, the Appellees filed a motion for partial summary judgment asking the court to "dismiss" the claims asserted against them in the Plaintiffs complaint. (V5-1265, 1267). After extensions of time to permit the taking of depositions, on October 29, 2021, the Appellants (plaintiffs and third-party defendants Peachtree Loan Consultants and Southern Comfort Partners) responded to the defendants' motion and filed a cross-motion for partial summary judgment against the Appellees as to counts I and II of the amended complaint and counts one and two of the counterclaims.[8] (V6-1520,1524)

[8] Counts I and II of the amended complaint seek a declaratory judgment holding the non-competition and non-solicitation covenants in the CMS operating agreement to be unreasonable and unenforceable. Count One of the counterclaims sought an injunction against Mullally prohibiting him from breaching the restrictive covenants and Count Two sought a money judgment against Mullally for breach of the covenants.

On April 4, 2022, the Appellants filed a second cross-motion for partial summary judgment on counts three through ten of the counterclaims. (V11-3047, 3053, 3092). On the same day, the Appellees filed a pleading entitled "…Redacted Brief in Opposition to Third Party Defendant Jeremy Gilpin's Motions for Summary Judgment and in Support of Renewed Motion for Partial Summary Judgment Against the Mullally Parties." In that brief the Appellees explicitly argue that summary judgment should be granted as to counts two and three of the counterclaims, something the original motion did not request.[9]

On June 21, 2022, Gilpin was dismissed as a third-party defendant. (V12-3416). On July 13 oral argument was held on the motions for partial summary judgment and several other pending motions. The Court below entered an order on July 27, 2022, granting partial summary judgment on count two of the counterclaim finding the restrictive covenants valid as interpreted and modified by the Court's order. All other motions for partial summary judgment were denied. (V12-3428).

The issues raised in the Enumeration of Errors set forth in Part Two of this Brief, were raised by the Appellants in the proceedings below in its briefs in

[9] Apparently, the renewed motion and brief has two purposes. One was to clearly state that the Appellees were seeking summary judgment as to counts two and three of the counterclaims. The other was to make outrageous unsupported allegations against Mullally. As indicated in its title, the renewed motion was filed with portions of its text redacted. An unredacted version was filed later under seal and is part of the record. (Sealed Records, V7-2188-2250).

opposition to the Appellees motion for partial summary judgment and in support of the Appellants cross-motions for partial summary judgment. (V5-1524, 1959; V8-2226, V11-3053, 3092; V12-3377) After the entry of partial summary judgment for the Appellees, the Appellants filed a timely notice of appeal and amendment to notice of appeal on August 8 and August 18, 2022, respectively. (V2-1, 5)

C. THE FACTS.

After working 28 years in the securities industry, Mullally formed his own investment advisory practice in 2012. In February 2014 Mullally joined CNBS, LLC, a credit union service organization. Mullally met Colvin in 2015 when Colvin he joined CNBS. (V5-1385-1386). Lester also joined CNBS in 2015 as CEO. (V6-557; V10-3050). Mullally worked in business development. (V4-556-557;

In May 2015 Mullally reached out to Jeremy Gilpin, an officer at Greater Nevada Credit Union ("GNCU") who had been highlighted in an article about the business of placing USDA and SBA guaranteed loans. After they met, Mullally and Gilpin developed a working relationship. Gilpin and GNCU underwrote USDA and SBA guaranteed loans and Mullally located lenders to participate in the loans. (V10-3049; V5-1385-1386) Mullally often referred to this business as the loan syndication or loan participation business. (V4-696-697).

CNBS was not profitable, and its owners shut the business down in 2016. Lester, Colvin and Mullally decided to continue providing services to credit unions,

so they formed CMS as a Georgia limited liability company on May 5, 2016. (V5-1387). At that time, they acquired limited liability company units ("units") of CMS by separate subscription agreements and executed the CMS operating agreement. (V5-1387-1388, 1420).

The operating agreement designated Lester, Colvin and Mullally as managers, officers and Class A unitholders. Class A units had voting rights but no distribution preferences. Lester, Colvin and Mullally were also employees of CMS from the outset. (V2-133, 183, 185-187). Mullally and Colvin and Lester essentially acquired equal interests in CMS for an aggregate of $1,000 with Mullally and Colvin each investing $333.33 in capital and Lester investing $333.34 capital, respectively for their Class A units in CMS. (V2- 133, 186;V5-`1422, 1427).

CMS was formed to continue the consulting businesses of providing advisory and brokerage services to credit unions previously conducted by CNBS and to implement related additional services. (V14-4071; V7-2120, 2123). CMS acquired the assets of consulting and brokerage businesses of CNBS in June 2016 for a consideration of $100 and the assumption of certain obligations. (V5-1296, 1328). In addition, an offering statement for use in a private placement was prepared by Lester and Colvin to present to potential credit union investors. (V14-4071; V7-2120).

After being presented the CMS offering circular, two credit unions joined CMS as unitholders. In July 2016, JFCU acquired class CU units in exchange for a $1,000,000 investment. (V14-4071, 4084; V7-2109, 2120). In December 2016, Sunstate Federal Credit Union ("SunState") acquired class CU units in exchange for a $250,000 investment.[10] (V14-4084-4086; V7-2136, 2148). The Class CU units had no voting rights but held distribution preferences.[11] (V2-140, 158. 183). JFCU and SunState signed separate subscription agreements and agreed to be bound by the CMS operating agreement. (V7-2109, 2136).

The offering circulars relied on by JFCU and SunState, sought to raise $2,000,000 in equity funding. (V7-2120, 2148). The circulars contained financial projections that anticipated $2,038,759 in revenue and a net profit of $89,187.61 during the first twelve (12) months of business if CMS received no equity funding.(V7-2132, 2160). With $2,000,000 in equity funding, the offering circular projected *revenues of $8,468,759 and net profits of $5,680,314* during the first twelve (12) months of operations. (V7-2132, 2160).

The parties agree that the loan participation business developed by Mullally, and Gilpin was not acquired by CMS from CNBS and was never assigned to CMS

[10] SunState Federal Credit Union did not seek to intervene in this case and is not a party.

[11] It is noteworthy that in the original offering circular, the financial projections contained no mention of a loan participation business. (V7-2132, 2160).

by Mullally or anyone. (V14-4195-4197). Colvin, on behalf of CMS, contends that Mullally did not have a loan participation business at the time CMS was formed, claiming instead that the loan participation business was developed while Mullally worked at CMS. (V11-3235, 3238, 3271-3272).[12] Mullally disputes this contention. (V12-3049-3050, 3371-3372); however, there is no dispute that Mullally directed loan participation fees he generated to CMS during his employment there.

During the short 2016 year when CMS began business, the company raised $1,251,000 in equity funding but only generated revenues of $412,052 and incurred a net loss of $ (869,014) leaving the company with net equity of only $381,986 as of December 31, 2016. (V6-1679-1680).

[12] This dispute is hardly pivotal to the case, except to the extent it speaks to credibility. The claim that Mullally did not have a loan participation business at the time CMS was formed is belied by the claim of Lester and Colvin that rights to the loan participation fees for two related USDA loans, RYZE Reno and RYZE Las Vegas, were orally assigned by Mullally to Capital Markets Management Group, LLC ("CMMG") *before* CMS was formed in 2016. The RYZE loan fees were paid in December 2017 ($1,500,000) and March 2018 ($1,500,000) and were the two largest loan participation fees earned while Mullally was employed by CMS. (V5-1391; V4- 785-786, 1037; V12-3372). The diversion of those fees to CMMG and away from CMS despite the restrictive covenants in the CMS operating agreement was suggested by Lester and was a way for Lester, Colvin and Mullally to keep all of the funds and avoid preferred distributions to JFCU and SunState. (V4-748-749) Mullally disputes the claim that he assigned the right to the Ryze fees to CMMG in 2016. (V5-1394; V14-4057-4058) The point is - if Mullally did not have a loan participation business when CMS was formed, how could he have assigned rights to loan participation fees from specific transactions to CMMG or anyone else before CMS was formed?

During 2017 CMS received another equity investment of $1,000,000 from JFCU. (V6-1660-1661) The company generated $1,902,069 in revenue that year and incurred a net loss of $(370,210) leaving net equity of $1,011,000 at year end. (V6-1679-1780; Cf V5-1296, 1328). Mullally generated revenue for CMS that year from loan participations of $789,373 which comprised 41.5% of the total revenue of the company. (V5-1392, 1437)

During 2018 CMS received a final equity investment of $1,000,000 from JFCU. (V6-1660-1661). The company generated $1,800,424 in revenue and incurred a net loss of $ (1,327,127) that year leaving net equity of $684,649, at year end. (V6-1691-1692; Cf. V5-1296, 1328). Mullally generated revenue for CMS that year from Loan participations of $925,475 which comprised 51.4% of the total revenue of the company. (V5-1392, 1441)

During 2019 CMS raised another equity investment of $200,000, this time from FNCU. (V6-1725, 1692). The company generated $875,389 in revenue and incurred a net loss of $ (1,463,595). (V6-1691-1692 Cf. V5-1296, 1328). Despite having raised $3,451,000 in equity funding since its founding in 2016, the 2019 losses left CMS with negative equity of $ (578,915). (V6-1691-1692). Mullally generated revenue for CMS that year from loan participations of $501,497 which comprised 57.28% of the total revenue of the company. (V5-1392, 1444).

Admittedly, 2019 was a bad year for Mullally and CMS but since Mullally's share of total CMS revenue rose, it is a matter of simple math to understand that 2019 was a worse year for the other revenue generators at CMS. In fact, cash flow was so poor in 2019 that Lester, Colvin and Mullally were forced to delay their paychecks in June and July 2019 until FNCU's investment cleared the bank at the end of July 2019. (V5-1392).[13]

In the fall of 2019, it was clear that additional equity funding was necessary to continue CMS operations and that additional funding would not be forthcoming from credit unions. In late December 2019 Lester and Colvin began discussing raising more equity for CMS by a private placement of the company's units with individual investors. (V5-1392-1393). Mullally had become dissatisfied with the performance of CMS and uncomfortable putting individual investors at financial

[13] In an apparent effort to detract attention from the patently unreasonable duration of the restrictive covenants at issue, the Appellees have claimed that Mullally diverted funds due to CMS to himself and Gilpin through a business he undertook at the request of Gilpin. Gilpin's employer packaged USDA and FHA guaranteed loans and Mullally frequently placed credit unions in those loans as participating lenders thereby earning loan placement fees for CMS. These allegations of the Appellees that Mullally diverted funds owed for participation fees away from CMS are baseless and outrageous. The Appellees argue that the decline in loan participation fees CMS received in 2019 could only have been caused by a diversion of a portion of the fees. Yet, there is no evidence that loan placement fees declined as a percentage of the allocated premiums upon which the fees were based. There is no evidence that loan placements occurred for which CMS was not paid. The allegations are especially ironic in light of the fact that the overall decline in the revenues of CMS in 2019 were greater than the decline in loan placement revenues generated by Mullally.

risk, so he decided to end his relationship with CMS. (V5-1393). At that time, the much of the business conducted by Colvin and Lester for CMS had declined dramatically or ended altogether. (V10-3050).

The restrictive covenants in the operating agreement posed a major problem because they had no discernable term. (V2, 168-169, 161-163). The two-year period for the non-competition covenant and the three-year period for the non-solicitation covenant were both triggered when Mullally disposed of his CMS units. Yet the operating agreement forbade any disposition of units, except upon death, without the unanimous consent of the controlling unitholders of CMS, in their absolute discretion. Moreover, any attempted disposition of units by Mullally could support claims for damages against him by the company and other unitholders. (V2-161-162).

Although restrictions on disposition of equity interests in closely held businesses are common, limitations on the disposition of equity interests like the one in the operating agreement are unusual. Many closely held businesses permit dispositions of equity interests so long as the company or the other members have a first right to purchase on the same terms. Many allow redemptions by the company at a discount based on some fraction of book value, others allow redemption upon payout of the unitholder's capital account, still others allow sales provided the purchaser only receives an economic interest with no right to participate in the

business. This operating agreement contained no such provisions, so the covenants could literally last a lifetime.

In mid-January 2020 Mullally resigned as a Manager, officer and employee of CMS effective as of January 1, 2020. (V5-1393; V2-99). He made no attempt to withdraw as a unitholder because he understood that his withdrawal was absolutely banned. (V5-1393). After he resigned, he engaged in negotiations with CMS regarding the restrictive covenants, but the negotiations were unsuccessful. This lawsuit for declaratory judgment was filed on February 10, 2020. (V2-21). At the time the case was filed, Neither Mullally nor his lawyers had any way of knowing how long the restrictive covenant would last if it was found to be valid.

After Mullally left CMS, he did not send any announcements of his departure and he initiated no contact with CMS clients, and he did not initiate contact with any client of CMS. (V10-3051). However, he was contacted over the next few months by several CMS clients who initiated contact with him and asked if he was willing to continue working with them. Mullally accepted only seven such offers, two from credit union service organizations and five from credit unions. (V10-3051; V3-1393-1394). Mullally's loan participation business is not a consulting or advisory businesses instead he acts as a finder of lenders willing to participate in government guaranteed commercial loans. (V5-1386).

PART TWO
ENUMERATION OF ERRORS

The Court below erred in granting Appellees' motion for summary judgment, in part, finding restrictive covenants in a limited liability company operating agreement valid and enforceable as modified by the Court pursuant to the RCA, and denying Appellants motion for summary judgment seeking a holding that the covenants are unreasonable, invalid and unenforceable.

STATEMENT OF JURISDICTION

This Court, rather than the Supreme Court of Georgia, has jurisdiction of this case on appeal because this is not a case of a type reserved to the Supreme Court.

PART THREE
ARGUMENT AND CITATION OF AUTHORITY

A. The restrictive covenants as modified by the Court below pursuant to the RCA are unreasonable and unenforceable as a matter of law because they have an indefinite duration that is under the discretionary control of some of the protected parties and the covenants cannot be salvaged by permissible modifications.

1. Standard of Review.

This appeal is from an order granting, in part, Appellees' motion for summary judgment holding restrictive covenants in a limited liability company operating agreement enforceable as modified by the court below pursuant to the RCA. At the same time, the Court denied the Appellants' cross-motion for summary judgment seeking a declaration that the covenants are unreasonable and unenforceable due to an indefinite duration.

The Court of Appeals summarized the standard of review on an appeal from a grant of summary judgment in *Belt Power v. Reed*, 354 Ga.App. 289, 290 (2021), as follows:

> Summary judgment is proper when there is no genuine issue of material fact, and the movant is entitled to judgment as a matter of law. A de novo standard of review applies to an appeal from a grant of summary judgment, and we view the evidence, and all reasonable conclusions and inferences drawn from it, in the light most favorable to the nonmovant.

Furthermore, "[t]he enforceability of a restrictive covenant is a question of law that we also review de novo, [citation omitted] *'looking solely to the language of the restrictive covenant[.]'"*(emphasis supplied) *Am. Anesthesiology of Ga., LLC V. Northside Hosp., Inc.*, 362 Ga. App. 350, 354 (2021); *Daneshgari v. Patriot Towing Services, LLC.*, 361 Ga. App. 541, 543 (2021).

2. Even though the restrictive covenants were entered into after the effective date of the RCA, a careful reading of the RCA suggests that the Act is not applicable.

The operating agreement of CMS was signed by its unitholders after the 2011 effective date of the RCA. However, that RCA is only applicable to agreements between "(1) Employers and employees; (2) Distributors and manufacturers; (3) Lessors and lessees; (4) Partnerships and partners; (5) Franchisors and franchisees; (6) Sellers and purchasers of a business or commercial enterprise; and (7) Two or more employers." O.C.G.A. § 13-8-52(a). This list is repeated in the definition of "restrictive covenants" in O.C.G.A. § 13-8-51 (15) with the addition of "employers

and independent contractors." Thus, except for agreements between the parties listed in O.C.G.A. §§ 13-8-51 and 13-8-52, non-competition and non-solicitation covenants are expressly excluded from coverage by the RCA. O.C.G.A. § 13-8-52(b).

The covenants in this case are between CMS and its unitholders consisting of individuals who were employees of CMS and credit unions which were not employees. All of the unitholders subscribed for and purchased units issued by CMS pursuant to separate subscription agreements that contain no restrictive covenants. The unitholders agreed in their respective subscription agreements to be bound by "the Operating Agreement" governing the rights of unitholders and the management and operations of the company and they were all subject to the restrictive covenants.

The question is whether the operating agreement between the CMS and its unitholders, can be fairly characterized as an agreement between the types of parties described O.C.G.A. §§ 13-8-51 (15) and 13-8-52. Although the types of parties to the operating agreement do not neatly match the types required for coverage by the RCA, the operating agreement could possibly be characterized as an agreement among "[s]ellers and purchasers of a business or commercial enterprise…." When the agreement was executed in 2016, it was an agreement between a newly formed business and its investors.

Without explicitly holding that the operating agreement was among any of the necessary types of parties required for coverage, the lower Court concluded that the RCA governs the covenants in this case, reasoning as follows:

> [T]he Court finds the case of Belt Power, LLC v Reed, 354 Ga. App. 289 (2020) to be instructive. In that case, two individuals who were both employees and minority shareholders of Belt Power sold their shares back to Belt Power in a "Confidentiality, Non-Competition and Non-Solicitation Agreement." id at 291. *The employees argued that the agreement was not governed by the 2011 Restrictive Covenants Act because this agreement was not among those enumerated in the Act.* The Court of Appeals disagreed, holding that when the terms of the Act are construed together, the clear and plain language compels a conclusion that "any agreement that meets the Act's definition of restrictive covenant, and is otherwise not excepted from the Act's provisions, is subject to the terms of the Act and must comply with the terms of the Act." id. at 293. (emphasis supplied) (V12-3433).

The italicized language reveals that the lower Court misconstrued the *Belt Power* case. The covenants at issue in *Belt Power* were designed to prevent employee poaching, (i.e., to prevent soliciting and hiring away employees of the former employer) and the case was about alleged violations of those covenants. Id. at 293. The former employees argued that the "main enforcement provision" of the RCA, O.C.G.A. § 13-8-53, contained no mention of employee poaching covenants and therefore the RCA was inapplicable. However, the covenants at issue in *Belt Power* were contained in agreements between Belt Power and two of its

employees,[14] and therefore expressly within the scope of O.C.G.A. §§ 13-8-51(15) and 13-8-52. Id. at 290.

The Appellants are aware of no case holding that the RCA covers restrictive covenants that are not contained in agreements between the types of parties listed in O.C.G.A. §§ 13-8-51(15) and 13-8-52. The law is settled that statutes in derogation of the common law, must be strictly construed.

> … [A]a statute in derogation of the common law … must be limited in strict accordance with the statutory language used therein, and such language "can never be extended beyond its plain and ordinary meaning." Accordingly, the express language of [the Act] must "'be followed literally and no exceptions to the requirements of the Act will be read into the statute by the courts.'"

Killearn Partners, Inc. v. Southeast Properties, Inc., 279 Ga. 144, 146 (Ga. 2005). Accordingly, the Appellants respectfully suggest that the covenants in this case are not governed by the RCA. The only plausible basis for finding the RCA applicable would be to treat the operating agreement as an agreement between Sellers and purchasers of a business or commercial enterprise even though nothing was sold or purchased pursuant to the operating agreement and there was no business or commercial enterprise to sell at the time of formation and initial funding of CMS

[14] In 2014 the former employees of Belt Power sold back small minority interests they owned in their employer pursuant to a "Confidentiality, Non-Competition and Non-Solicitation Agreement" with their employer that contained the employee poaching covenants. One of the employees left the company in 2015 and the other left the company in 2017 and were accused of violating the covenants.

when the operating agreement was executed by Appellant Mullally and Appellees Lester and Colvin.

Nevertheless, as will be shown below, when Mullally left CMS, the restrictive covenants had an indefinite term that could not be triggered without the unanimous, discretionary consent, of the controlling unitholders. Therefore, the covenants (i) were indefinite, unreasonable, and unenforceable and (ii) cannot be salvaged by modification, whether they are governed by the RCA or by principles of common law.

3. The non-competition and non-solicitation covenants are unreasonable and unenforceable whether they are governed RCA or common law because they have a duration of indefinite length that is under the discretionary control of some of the protected parties.

Both restrictive covenants have an indefinite term or duration. Specifically, the term of the non-competition covenant is established by the following language:

> 13.2 Noncompetition. (a) Unless otherwise agreed in writing, except as provided in Section 13.4, while a Unitholder holds any Unit(s) and *for a period of two years after a Unitholder ceases to hold any Unit*, such Unitholder: (i) will not ….”[15] (V2-168).

Similarly, the term of the non-solicitation covenant is expressed as follows:

[15] The caveat for Section 13.4 refers to a provision stating that the covenants become ineffective upon a dissolution of the company. (V2-169). It also refers to as savings clause stating if “any restriction contained in” a covenant “is unenforceable, it is the intention of the [parties hereto] … that [the covenant] … shall not be terminated but shall be deemed amended to the extent required to make it valid and enforceable….”

> "13.3 Nonsolicitation. Unless otherwise agreed in writing, except as provided in Section 12.4 [sic][16], *while a Unitholder holds Units and for a period of three years thereafter*, the Unitholder (i) will not …. (V2-169)

Assuming for purposes of discussion that the restrictive covenants were entered into between a seller and purchasers as part of the sale of a commercial business. In that case, the covenants would be governed by the RCA, and the term of both covenants would be is presumptively reasonable under O.C.G.A. § 13-8-56 and § 13-8-57 (d) which provides in part as follows:

> In determining the reasonableness of a restrictive covenant that limits or restricts competition during or after the term of an employment or business relationship, the court shall make the following *presumptions*:
>
> (1) During the term of the relationship, a time period equal to or measured by duration of the parties' business or commercial relationship is reasonable, provided that the reasonableness of a time period after a term of *employment* shall be as provided for in Code Section 13-8-57….

O.C.G.A. § 13-8-57(d), as applicable here, *presumes* a restraint not longer than 5 years is reasonable id it is measured from the date of termination of the business relationship.

Under the common law "…Georgia courts divide restrictive covenants into covenants ancillary to an employment contract, which receive strict scrutiny and are not blue penciled, and covenants ancillary to a sale of business, which receive much

[16] Section 12.4 relates to the company's obligation to furnish tax information to its unitholders. This reference apparently was intended to refer to Section 13.4, as discussed in footnote 15, above.

less scrutiny and may be blue-penciled. There is also a middle level of scrutiny applicable to covenants found in professional partnership agreements." *Swartz Investments v. Vion Pharmaceuticals*, 252 Ga. App. 365, 368 (2001). So, if the covenants are determined to be ancillary to the sale of a business, they are governed by the RCA and may be blue penciled as authorized by the RCA. If the covenants are not between a seller and a purchaser of a business or commercial enterprise, the common law would apply and they would receive reduced scrutiny, most appropriately mid-level of scrutiny such as partnership agreements, but, in any case, the covenants could not be blue penciled, they would have to stand or fall as written.

It is the Appellants position that the covenants are unreasonable and unenforceable whether they are governed by the RCA or common law. As noted earlier, the reasonableness of restrictive covenants is a question of law for the court. Thus, a presumption established by the RCA that the duration of a covenant is reasonable is a presumption of law and may be rebutted by evidence. O.C.G.A. § 24-14-21. Despite the presumptions of the RCA, the term of the restrictive covenants at issue here is *manifestly unreasonable*. The operating agreement strictly prohibits unitholders from any disposition of their units other than upon death without the unanimous written consent of all of the controlling unitholders, who coincidentally happen to be protected parties.

The ban on the disposition of CMS units is first expressed in Section 8.2 of the operating agreement as follows:

> [E]ach Member hereby covenants and agrees not to … (c) withdraw or attempt to withdraw from the Company, … (e) transfer all or any portion of his interest in the Company except in compliance with this Agreement, … *without the unanimous consent of the Members*. (V2-161).

The ban is then reiterated in Sections 9.1, as follows:

> Restrictions on Transferability. A Unitholder may not sell, assign, pledge, hypothecate, transfer or otherwise dispose of … all or any part of its Units, whether voluntarily or by foreclosure, assignment in lieu thereof or other enforcement of a pledge, hypothecation or collateral assignment, *without obtaining the prior written unanimous consent of the non-transferring Members, which consent in either case may be withheld in a Member's sole discretion*. (Emphasis supplied) (V2-162).

The ban has its final expression in Section 9.3 of the operating agreement, as follows:

> [N]o Member may Transfer all, or any portion of, or any interest or rights in, the Membership Rights or Units owned by the Unitholder, without the written consent of all of the *Members who have a right to vote.* …. The Transfer of any Membership Rights or Units in violation of the prohibition contained in this Section 9.3 *shall be deemed invalid, null and void, and of no force or effect*. (Emphasis supplied) (V2-162).

Among the possible consequences of a breach or attempted breach of the restriction on unitholders disposing of their units, are the following:

> 8.3 Consequences of Violation of Covenants. Notwithstanding anything to the contrary in the Georgia Act, if a Member … withdraws from the Company … or takes any action in breach of Section 8.2 hereof, the Company shall continue, and such Breaching Member shall be subject to this Section 8.3. In such event, any of the following may occur: … (iii) the Breaching Member shall be liable in damages, without requirement of a prior accounting, to the Company for all costs and liabilities that the Company or any Member may incur as a result

> of such breach, (iv) the Company shall have no obligation to pay to the Breaching Member his contributions, capital, or profits, … (vii) the Breaching Member shall have no right to inspect the Company's books or records or obtain other information concerning the Company's operations, (viii) the Breaching Member shall continue to be liable to the Company for any unpaid Capital Contributions required hereunder with respect to such interest…. (V2-161-162).

The ban on disposition of units has potentially serious adverse consequences to any unitholder who attempts to dispose of units without the required consents. While restrictions on the disposition of equity interests in closely held limited liability companies and corporations are common, absolute bars are not. Provisions allowing the sale of an equity interest to a third party provided the other equity owners or the company are first given the opportunity to buy the units on the same terms are common. Provisions are also fairly common that allow the owner of an equity interest to require a purchase of the interest by the company, or in some cases by the other equity owners, for a discounted book value. Some provisions even allow unitholder to surrender their units to the company for nominal consideration. There are many variations of such provisions.

This no-sell provision of the operating agreement renders the stated term of the covenants unreasonable as a matter of law. First, without prior unanimous consent, Mullally had no right whatsoever to dispose of his units no matter how badly he wanted to cut all ties with the company without risking the company asserting damage claims against him. Second, the no-sell provision gives the

controlling unitholders absolute discretionary control over the term of the restrictive covenants with the power (and potentially an incentive) to hold Mullally hostage to the covenants for the rest of his life. *Third, as a practical matter the covenants have no time limit unless the controlling unitholders decide to allow a sale or transfer of the restricted party's units and trigger the post ownership period.*[17] Fourth, when Mullally left CMS, he did not know, and there was no way for him to determine, how long the covenants would remain in force and limit his ability to do business and earn a living.

When Mullally left CMS, the company had a negative book value, and its units were worthless.[18] (V6-1692; V5-1331). He was no longer a manager, officer or employee of the company. He had a single minority vote as a unitholder.

[17] If there was no provision purporting to impose a time limitation on the covenants, CMS would still have had the discretionary right to release Mullally from the covenants at any time it chose. Thus, the covenants in this case are not substantively different from covenants lacking any time limitation. As the Court noted when striking a covenant lacking a time limitation in the case of *Cox v. Altus Healthcare and Hospice, Inc.,* 308 Ga. App. 28, 30 (2011): "'[a]lthough facts may be necessary to show that a questionable restriction, though not void on its face, is, in fact, reasonable, a covenant containing sufficiently indefinite restrictions cannot be saved by additional facts and is void on its face.' (Punctuation omitted.) *Global Link Logistics v. Briles*, 296 Ga. App. 175, 177 (1) (2009)"

[18] On June 8, 2020, approximately four months after this lawsuit for declaratory judgment was filed and the issue on the duration of the covenants was joined, the controlling unitholders elected to redeem Mullally's CMS units for an effective purchase price of $0.00. The purchase price was based on the company's negative equity position. (V5-1328).

Mullally's residual status as a unitholder was compelled by the operating agreement. He resigned to put his involvement with CMS behind him. It is self-evident that Mullally's involuntary ownership of CMS units was not a meaningful "business relationship" and is not a reasonable justification for upholding the covenants in this case. The covenants are unreasonable and invalid on their face.

The case of *Hot Shot Kids Inc. v. Pervis (In re Pervis)*, 512 B.R. 348 (Bankr. N.D. Ga. 2014) is instructive. That case involved the enforceability of a restrictive covenant in a closely analogous fact situation. In *Hot Shot Kids*, Pervis and two other employee-shareholders formed HSK in 2002 and executed a shareholders' agreement containing a noncompetition covenant. In 2007, Pervis assigned her stock in the company to her son and left the employment of the company.

Thereafter, claims were asserted against Pervis for alleged violations of the restrictive covenant. The covenant provided that it was effective throughout the term of the shareholders agreement and for a period of two years thereafter. The agreement provided for its termination in only four circumstances: (i) if all of the shares of the company were owned by one shareholder; (ii) if the company filed for bankruptcy; (iii) if all shareholders agreed to terminate the agreement or (iv) upon an initial public offering of company stock.

After acknowledging that the RCA was not applicable because the covenant

predated the effective date of the RCA , the court declared the covenant invalid, reasoning as follows:

> The agreement and the non-compete do not terminate upon the termination of Pervis' employment. The non-compete provision as written restricts Pervis' activities for open-ended years. She can do nothing to terminate the prohibition. Her partners exercise control over the termination of the Agreement and therefore the trigger of the two-year non-compete. …. The open-ended nature of the duration of the non-compete and the fact the termination of the Agreement is not within Pervis' control make the duration unreasonable and the covenant unenforceable.

Hot Shot Kids, 512 B.R. at 374.

In the case of *Kuehn v. Selton & Associates*, 242 Ga. App. 662 (2000), the Court of Appeals concluded that a restrictive covenant with an analogous, indeterminate duration was unreasonable and therefore unenforceable, :

> It cannot be determined from the contract how long Kuehn's activities would be restricted. The language 'as long as Tenant remains in the building or Project' renders the restriction operable for an indefinite number of years. It does not limit itself to the initial lease term (which, incidentally, might be any number of years) but includes all extensions, expansions and renewals…. The restriction has the potential to be effective for decades. The covenant is therefore unreasonable and unenforceable." *Id*. at 664)

The covenant in *Kuehn v. Selton & Associates* was unreasonable, yet it was not as easily manipulated as the covenants in this case. See, also, *Gynecologic Oncology, P.C. v. Weiser*, 212 Ga. App. 858 (1994) (A tolling provision extended the duration of a two-year covenant during any period the covenant was being violated, "potentially extend[ing] the duration of the covenant without limit and

render[ing] it unreasonable and unenforceable on its face." Id at p. 859.); See, also, *Cox v. Altus Healthcare and Hospice, Inc.,* supra., 308 Ga. App. at pp. 31-32 (Covenants without a time limitation are unenforceable).

In the lower Court, the Defendants did not cite a solitary case in which a restrictive covenant with an indefinite duration or a duration under the control of the protected parties was found to be enforceable. The inalienability provisions of the operating agreement wrested all control of the duration of the business relationship from Mullally, the restricted party, and gave total discretionary control to the protected parties acting through the controlling unitholders. These provisions allowed the protected parties to extend the duration of the restrictive covenants by delaying the trigger date for the post termination period, just as surely as tolling and other provisions were used to impermissibly extend the post-termination periods of restrictive covenants in numerous other cases.[19] No attempt is made in the covenants to achieve mutuality or objectivity, because neither fairness nor the protection of legitimate business interests was the purpose of these provisions. The purpose was to give the protected parties total control over the duration of the restricted activity of Mullally.

[19] Under the inalienability provisions the post-termination periods can only be triggered at the option of the protected parties.

4. Even if the restrictive covenants are governed by the RCA, they cannot be modified to impose a reasonable duration without impermissible substantive changes to the covenants or wholesale rewriting of the nonalienation provisions located in other sections of the operating agreement.

There are a number of cases decided under the RCA where courts have refused to modify or "blue pencil" restrictive covenants that required significant changes to bring them in compliance with the law. For example, the District Court in *LifeBrite Labs., LLC v. Cooksey*, 2016 WL7840217, at pp, 6-8 (N.D. Ga. Dec. 9, 2016) concluded that no provision of the RCA indicates "that the legislature meant to change Georgia's common law approach to blue-penciling other than to allow it in more circumstances." The Court therefore refused to write in a territorial limitation that was missing from a non-competition covenant and declared the covenant unenforceable, stating, "[t]hough courts may strike unreasonable restrictions, and may narrow over-broad territorial designations, courts may not completely reform and rewrite contracts by supplying new and material terms from whole cloth." Id, at p.8. (V8-2262, 2269).

Similarly, in *Wind Logistics Professional v. Universal Truckload*, No. 1:16-cv-00068 (ND Ga Sept 23, 2019), the District Court refused to write in new provisions and declared a non-competition covenant invalid under the RCA that had no territorial limit and prohibited a former employee from accepting unsolicited business from customers of the former employer. (V8-2262, 2268-2269). *In Belt*

Power, 354 Ga. App at 296, the lower court found a restrictive covenant unenforceable after ruling that the RCA did not apply. But the lower court alternatively explained that even if the RCA applied, the covenant should not be modified, and the court's ruling would be the same. The Court of Appeals reversed the lower court's ruling that the RCA did not apply, but upheld its conclusion that the covenant should not be modified and was unenforceable.

The point is, the RCA is not a panacea that gives courts the power to rewrite contracts. If the RCA is applicable, it only permits blue penciling to reduce the term, scope or territory of restrictive covenants. It does not permit courts to insert new provisions or substantive changes to the restrictive covenants. See, *Chef Merito v. Javier Gonzalez*, 2020 U.S. Dist. LEXIS 171934, at p. 17 (N.D. GA 2020) (quoting *Hamrick v. Kelly*, 260 Ga. 307, 308 (1990): "The 'blue pencil' marks, but it does not write. It may limit an area, thus making it reasonable, but it may not rewrite a contract….")

In *Daneshgari v. Patriot Towing*, the Court of Appeals reversed a lower court decision in a contempt proceeding arising from violations of an injunction enforcing a restrictive covenant. The lower court reimposed the injunction even though the restrictive covenant had expired. The Court of Appeals relied on the Supreme Court decision in *Electronic Data Systems Corp. v. Heinemann,* 268 Ga. 755 (1997), and stated as follows: "our Supreme Court expressly reiterated that "[t]he courts should

hesitate to rewrite private contracts," and once again warned that "[j]udicially providing a tolling provision would effect such a rewrite." *Daneshgari v. Patriot Towing*, supra, 361 Ga. App. at 144.

The reality is, there is no way to eliminate the language that renders the duration of the covenants unreasonable. The operating agreement is an agreement among unitholders. The covenants apply to all unitholders, some of whom are *not* employees. The provisions that give the protected parties the unfettered power to trigger post-termination period of the covenant are not part of the covenants but are provisions of general applicability to the operating agreement as a whole. The RCA only permits blue penciling to reduce the term, scope or territory of restrictive covenants. It does not permit inserting new provisions or writing in major changes to the covenants. It certainly does not permit changing provisions of general applicability in an operating agreement that are outside the covenants. It does not permit changing the nature of a covenant from a unitholder covenant into an employee covenant, especially since several unitholders are not employees but are credit unions.

The RCA simply does not permit courts to add provisions, modify contract language outside the covenants or rewrite or reform covenants. Therefore, the restrictive covenants at issue cannot be made reasonable by permissible modifications.

B. CONCLUSION.

The practical reality is that the restrictive covenants in this case have no time limit. Under the express provisions of the restrictive covenants, the covenants last until the controlling unitholders decide, if ever, to permit a disposition of the units of the restricted unitholder plus three years. If a covenant like this is found to be reasonable and enforceable it would provide cleaver way around the requirement that restrictive covenants be limited to a reasonable duration. If a person subject to such a covenant wanted to continue holding units, he would remain subject to the covenant until he wished to sell. Once the unitholder wants out, the relationship of the unitholder to the company is very unlikely to be meaningful.

For the reasons set forth above:

(1) The restrictive covenants in this case are not governed by the RCA; rather they are governed by the principles of Georgia common law;

(2) the covenants are effectively unlimited in duration and therefore unreasonable and unenforceable, whether they are governed by the RCA or common law;

(3) the covenants cannot be modified and rendered reasonable without an impermissible wholesale rewriting the provisions establishing the time limitation of the covenants and the disposition of LLC units; and

(4) this Court should therefore reverse the order of the lower court granting, in part, the Appellees' motion for partial summary judgment upholding the enforceability of the Covenants because the covenants are unreasonable in duration and therefore unenforceable.

Respectfully submitted, this 11th day of October 2022

Certification: This submission does not exceed the word count limit imposed by Rule 24.

/s/ Jerry L. Sims
Jerry L. Sims
Georgia Bar No. 648400
Davis Gillett Mottern & Sims
545 Dutch Valley Road NE, Suite A
Atlanta, GA 30324
Office: (770) 671-1972
Cell: (770) 335-4140
Fax: (770) 628-0083
jlsims@investmentlawgroup.com
Counsel for Plaintiffs

CERTIFICATE OF SERVICE

This will certify that I have this day served the within and foregoing Brief of Appellants upon all Appellees by email and by depositing a copy in the United States Mail properly addressed with sufficient postage affixed thereon.

S. Lawrence Polk
Eversheds Sutherland (US) LLP
999 Peachtree Street NE
Atlanta, GA 30309
E-mail: larrypolk@eversheds-sutherland.com
Telephone: (404) 853-8225
Attorneys for Defendant and Intervening Counterclaimants

This 11th day of October 2022.

/s/ Jerry L. Sims
Jerry L. Sims