Clarifying Georgia's Covenant Law

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Law360, New York (August 14, 2012, 1:09 PM ET) -- As many practitioners in the area are aware, the Georgia General Assembly’s efforts to pass a statute to address the enforceability of restrictive covenants in Georgia have encountered some unanticipated setbacks and continuing uncertainty. A recent opinion from the U.S. Court of Appeals for the Eleventh Circuit is very likely to resolve one of the lingering uncertainties regarding the Georgia covenant statute, but in a way that will require some employers to revisit whether their recently executed covenant agreements remain viable.

The Troubled History of the Georgia Covenant Statute

In 2009, the Georgia General Assembly passed — and then-Gov. Sonny Perdue signed into law — House Bill 173 (HB 173), the original version of a statute intended to displace the collection of complicated and sometimes counterintuitive common law rules regarding the enforceability of restrictive covenants that had developed in the Georgia courts over time.

In recognition of the fact that a previous legislative effort to alter these common law rules had been declared unconstitutional by the Georgia Supreme Court[1], the validity and effective date of HB 173 were made expressly contingent upon the passage of an amendment to the Georgia Constitution to make the new law constitutional.

Specifically, the bill stated that the law would take effect on the day following ratification of the applicable constitutional amendment at the time of the 2010 general election. The bill also stated that it would only apply to contracts entered into on or after the law’s effective date, leaving all previously executed covenant agreements to be analyzed under the old common law regime.

On Nov. 2, 2010, Georgia voters approved the amendment. Following the constitutional amendment’s passage, however, it became apparent that the General Assembly had failed to specify an effective date for the amendment. Therefore, under Art. X, § 1, ¶ 6 of the Georgia Constitution, the amendment took effect on Jan. 1, 2011, nearly two months after the purported Nov. 3, 2010, effective date of HB 173.

The fact that the law purported to take effect nearly two months before the enabling constitutional amendment created significant confusion among lawmakers, attorneys and employers as to when HB 173 actually went into effect, or whether the law was valid at all.

In an effort to eliminate such confusion, the General Assembly passed — and on May 11, 2011, Gov.
Nathan Deal signed — House Bill 30 (HB 30), which substantially reenacted the original statute. The new statute, however, only applied to restrictive covenants signed on or after May 11, 2011, leaving as an open question whether the enforceability of covenants signed between Nov. 3, 2010, and May 10, 2011, would be analyzed under HB 173 or under Georgia’s previous body of rigid common law rules.

Most practitioners felt confident that covenants signed between Nov. 3, 2010, and Dec. 31, 2010 — before the effective date of the enabling constitutional amendment — would continue to be analyzed under the old common law regime.

There was less certainty, however, regarding the treatment of covenants signed between Jan. 1, 2011, and May 10, 2011. Some believed that HB 173 sprang into effect on Jan. 1, 2011, with the effectiveness of the constitutional amendment, and therefore that covenants signed after this date would be analyzed under the original version of the statute (HB 173).

Others, though, were concerned that Georgia courts might find that HB 173 was void ab initio because it was unconstitutional when it went into effect and could not be saved by the subsequent effectiveness of the enabling amendment.

In the face of this uncertainty, some Georgia employers waited until after May 11, 2011, to ask employees to sign new covenant agreements, but others went ahead and obtained new covenant agreements before HB 30 went into effect.

**The Eleventh Circuit’s Becham Opinion**

In a recent unpublished opinion[2], the Eleventh Circuit squarely addressed the constitutionality of HB 173 and the related issue of whether covenants executed between Nov. 3, 2010, and May 10, 2011, should be analyzed under HB 173, or whether they must be examined under the old common law rules.

Relying on previous decisions from the Georgia Supreme Court, the Eleventh Circuit concluded that the constitutionality of the statute must be assessed at the time it went into effect (Nov. 3, 2010), that it was unconstitutional on that date because the enabling amendment did not become effective until Jan. 1, 2011, and that the subsequent effectiveness of the amendment did not alter the unconstitutional status of the statute.

Thus, under Becham, only covenants executed on or after May 11, 2011, are to be analyzed under the new statutory covenant law. All covenants executed before that date must be assessed under Georgia’s common law rules.

While it is theoretically possible that the Georgia Supreme Court or a different panel of the Eleventh Circuit — or the court sitting en banc — could reach a different conclusion if presented with this issue,
unless and until that happens, employers and attorneys should assume that the Eleventh Circuit’s holding in Becham is going to be the controlling word on the issue.

Even though it is an unpublished opinion and therefore not binding precedent, it is very likely that federal district courts will follow the holding, and also likely that state trial court judges will follow it, too.

**Practical Implications of Becham**

As a result of Becham, the enforceability of all covenants signed before May 11, 2011, must be analyzed under Georgia’s common law rules. Thus, any employers who drafted new covenant agreements in reliance on HB 173 and had their employees sign such agreements prior to May 11, 2011, should consult counsel about the most appropriate strategy for having employees sign another round of new agreements in order to get the employer-friendly benefits of the second — and constitutional — version of the Georgia covenant statute.

While some of the court’s comments in Becham suggest that it might be possible to get treatment under the subsequent statute by having employees simply reaffirm in writing previously signed covenants, the much safer and more conservative approach will likely be to have employees sign new agreements rather than only reaffirming earlier agreements.

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