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Taking Stock of Ga. Restrictive Covenant Statute: Part 2

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Law360, New York (August 28, 2013, 11:47 AM ET) -- May 2013 marked the two-year anniversary of the effective date of Georgia's restrictive covenant statute, O.C.G.A. §§ 13-8-50 to -59, legislation aimed at abating the difficulties of drafting and enforcing restrictive covenants.

This article is the second in a two-part series taking stock of the current state of the law under the statute, in which we will examine the case law interpreting the statute since its inception and the issues addressed and resolved through those cases, as well as discuss some of the lingering questions and issues under the statute that will have to be addressed by Georgia's courts as more restrictive covenants are litigated under the new statute.

Issues Addressed by the Courts Since the Statute Took Effect

As with any statute — and particularly one intended to address a topic as broad as the enforceability of restrictive covenants in a number of different contexts — there are many questions that the statute itself leaves unanswered. During the two years since the statute went into effect, the state and federal courts in Georgia have addressed some of these questions, either in whole or in part.

This section examines the judicial interpretations of several important issues under the statute.

The Extent of the Court's Modification Power

The statute's most significant departure from common law is that it allows the court to "modify" a covenant that is otherwise void and unenforceable.[1] To date, only one court has used the modification power in a readily available opinion.[2] The case, PointeNorth Insurance Group v. Zander, involved a restrictive covenant that prohibited a former employee from soliciting "any of the [former] employer's clients."[3]

The agreement in question was executed on May 11, 2011, and was therefore covered by the statute, which the court stated, "allows [the] Court to blue pencil any overbroad or otherwise offensive passages."[4] Based on this authority, the court struck the overbroad language that prevented the former employee from soliciting "any" of the former employer's clients and enforced the remaining language of the covenant, which prevented the former employee from soliciting only those clients with whom she had contact during her employment.[5]

Notably, the PointeNorth court did not discuss the breadth of the modification power granted by the statute, which remains a potentially unsettled issue. In other states that permit judicial modification of overly broad covenants, some allow only for strict blue penciling — that is, the ability to strike through or excise offending provisions but not the ability to add or change provisions.[6]

Other states allow courts the broader ability to reform covenants by changing their terms to make them reasonable.[7] Although the statute's definition of "modification" seems to give Georgia courts the ability both to blue pencil and reform,[8] at least one commentator has suggested that this remain an open question.[9]

In PointeNorth, the court was able to cure the overbreadth of the covenant using strict blue penciling, and, beyond acknowledging that the statute provides for blue penciling, the court did not address whether the statute would permit a broader reformation or otherwise analyze the boundaries of the modification permitted by the statute.[10]

The Law Applied to Covenants Executed between Nov. 3, 2010 and May 10, 2011

As discussed in part 1, HB 173 became effective on Nov. 3, 2010, nearly two months before the Jan. 1, 2011, effective date of the constitutional amendment authorizing the legislation. The General Assembly passed HB 30 to correct this legislative oversight and ensure the constitutionality of the statute going forward. While HB 30 made clear that the new statute took effect May 11, 2011, and only applied to contracts entered into on and after that day, confusion remained as to the effectiveness of HB 173 and what law applied to covenants signed between Nov. 3, 2010, and May 10, 2011.

Although Georgia's appellate courts have not addressed this issue, in a case involving a covenant executed in December 2011, the Eleventh Circuit Court of Appeals held that HB 173 was at all times unconstitutional and void and that the more stringent common law standards established prior to HB 173 were applicable to the covenant's enforcement.[11]

In Becham v. Synthes USA, the Eleventh Circuit relied on prior Georgia precedent, which provides that a statute's constitutionality is tested at the time it was passed.[12] As such, the court found that HB 173 was unconstitutional the moment it went into effect because Georgia's constitution as it existed on Nov. 3, 2010 prohibited the General Assembly from enacting the earlier incarnation of the statute.[13] Moreover, the fact that the constitutional amendment went into effect the following January did not and could not revive HB 173.[14]

Although the Becham decision is not binding authority on Georgia's state courts — and as an unpublished decision is also not binding on district courts in the Eleventh Circuit — it is likely that subsequent courts will follow Becham's sound analysis.

Thus, it appears that the issue of what law applies to covenants executed between Nov. 3, 2010, and May 10, 2011, has effectively been resolved, absent an unlikely contrary holding by Georgia's appellate courts.

Georgia's New Public Policy Regarding Covenant Enforcement Does Not Affect Pre-Statute Covenants

In assessing the enforceability of restrictive covenants in a contract, Georgia courts will normally apply the law selected in the contract's choice-of-law provision unless doing so would lead to a result contrary to Georgia public policy.[15] As a practical matter, under the pre-statute common law regime, this meant that Georgia courts would only honor a choice-of-law provision if the covenant in question would also be enforceable under Georgia law.[16]

Although the statute is clear that it only applies to covenants executed on or after May 11, 2011, when pre-statute covenants are accompanied by a choice-of-law provision for another state, the question has arisen as to at what point in time Georgia courts should look when determining and applying Georgia's public policy.

Employers attempting to enforce pre-statute covenants with favorable, non-Georgia choice-of-law provisions have argued that the court should look to public policy as of the date of the requested enforcement rather than as of the date the covenant was executed. This argument, however, has been uniformly rejected.

Several state court opinions have indirectly rejected this argument by applying, with little or no discussion, pre-statute public policy to the choice-of-law analysis for covenants executed prior to May 2011.[17] Additionally, in Boone v. Corestaff Support Services Inc., a federal district court addressed this issue directly and expressly held that Georgia's public policy as it existed at the time the covenant was executed applies in determining whether a choice-of-law provision is enforceable.[18]

Notably, the covenant at issue in Boone was executed in 2008, prior to both the passage of the new statute and the constitutional amendment. Therefore, the Boone court did not have occasion to comment on whether passage of the amendment in November 2010 (and effective Jan. 1, 2011) altered Georgia's public policy for purposes of the choice-of-law analysis in covenant enforcement.

This issue, however, was addressed by the Eleventh Circuit in Becham. There, the employer argued that Georgia's public policy shifted in November 2010 when Georgia citizens voted to approve the amendment

and support the broad enforcement of restrictive covenants.[19]

The Becham court definitively rejected this contention stating, "Because the amendment addressed only the power of the General Assembly [to legislate], it did not affect Georgia's public policy on restrictive covenants."[20]

Although the Supreme Court of Georgia has not commented on these issues, the several state and federal court decisions applying Georgia's public policy in the context of the choice-of-law analysis are consistent with the General Assembly's decision to permit application of the statute only to agreements executed following the effective date of the statute.

Lingering Questions and Issues

Though the courts have addressed several important questions and issues under the statute, many more unanswered questions remain. Below is a brief summary of some of the most important questions and issues that will need to be resolved by the courts as more covenants that fall within the ambit of the statute become the subject of litigation.

Do Noncompetition and Nonsolicitation Covenants Still Rise and Fall Together?

Under the prior Georgia common law, noncompetition covenants and nonsolicitation covenants contained in the same agreement were deemed to rise and fall together, meaning that the invalidity of one would render the other unenforceable.[21] Although the statute does not directly address the continuing applicability of this rule, one provision of the statute does expressly distinguish noncompetition and nonsolicitation covenants as separate and distinct.[22]

Moreover, given that the original justification for the common law rule was that the two covenants were so inextricably linked that they could not be severed from one another,[23] the judicial modification power permitted under the statute would seem to render the old rule obsolete with respect to agreements covered by the statute.

How Will the Courts Interpret the Statute's Guidance on Geographic Restrictions?

In addition to the general guidance in O.C.G.A. § 13-8-53(c)(1) regarding permissible ways to define the scope of a covenant, two other parts of the statute provide further guidance regarding permissible geographic restraints. One provides that the phrase "'the territory where the employee is working at the time of termination'" shall be a sufficient geographic limitation "if the person or entity bound by the restraint can reasonably determine the maximum reasonable scope of the restraint at the time of termination."[24]

The other states, "A geographic territory which includes the areas in which the employer does business at any time during the parties' relationship … is reasonable provided that … [t]he total distance encompassed … also is reasonable."[25]

The ultimate significance and impact of these provisions will depend in large part on how courts interpret the italicized phrases above, which, standing alone, are extremely vague and susceptible to many different interpretations.

Must All Customer Nonsolicitation Covenants Have Material Contact Qualifiers?

At common law, a customer nonsolicitation covenant was generally enforceable if it had a reasonable geographic limitation or, absent such a limitation, if it only applied to customers with which the employee had contact on behalf of the employer.[26] In contrast to these drafting options, O.C.G.A. § 13-8-53(b) appears to require courts to impose the latter approach on a nonsolicitation covenant, at least in the employment context.

It remains an open question whether courts will allow a geographic restriction to substitute for the material contact limitation that seems to be mandatory under the statute. It is also uncertain whether courts will judicially impose the material contact limitation on nonsolicitation covenants signed in other

contexts, most notably the sale-of-business context, where it is common to have such a covenant apply to all of a business' customers.

How Will Courts Treat Covenants That Fall Outside the Statute's Ambit?

As discussed above, the statute provides that it only applies in certain contexts and within the employment context, only to covenants with certain types of employees.[27] It is unclear whether covenants with employees or in contexts that fall outside the ambit of the statute are to be analyzed under the old common law regime or are simply invalid in their entirety.

Does the Statute Permit No-Hire and No-Acceptance-of-Business Provisions?

Under the prior common law, it was typically permissible — with appropriate limits on scope — to prohibit an employee from soliciting a company's customers or employees. Such covenants could not, however, extend to prohibit passive acceptance of business from customers or to prohibit the bound employee from merely hiring another employee who had not previously been solicited or recruited.[28]

The statute does not address this issue, and no court has yet expressly examined the continuing viability of those rules.[29]

Does Continued Employment Remain Sufficient Consideration?

One of the few employer-friendly aspects of the common law regime was the longstanding rule that continued employment, standing alone, constituted sufficient consideration to support an employee's agreement to be bound by restrictive covenants.[30] The statute does not address the issue.

Because this is a matter of contract formation, rather than an issue relating to covenant enforcement, presumably, the common law rule remains in place, but no court has yet had an opportunity to discuss the issue in the context of the statute.

Do Prior Tolling Provision Requirements Remain in Effect?

Under the old common law regime, Georgia courts invalidated tolling provisions that purported to extend a covenant's period of restriction during the period while an employee was in breach.[31]

Rather, to be enforceable, a tolling provision could only extend the restricted period for the covenant's remaining length following the actual initiation of litigation by the employer.[32] The statute does not address tolling provisions at all, and the continuing viability of the old rule remains unclear.

Conclusion

The statute has ushered in a new era of restrictive covenant drafting and enforcement in Georgia. In addition to changing some of the fundamental rules that apply to covenant enforcement in the state and providing some guidance to employers, courts and others regarding the new covenant landscape, the statute leaves many open questions to be answered by the judicial system.

As a result, Georgia law regarding restrictive covenants will continue to develop and change as more litigation of covenants covered by the statute works through Georgia's state and federal court systems.

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[1] O.C.G.A. §§ 13-8-53(d), -54(b).

[2] Because orders from state trial courts are typically not available, research on judicial interpretations of

the statute is typically limited to decisions from Georgia's appellate courts, plus decisions from federal trial and appellate courts.

[3] PointeNorth Ins. Grp. v. Zander, No. 1:11-CV-3262-RWS (N.D. Ga. Sept. 30, 2011).

[4] Id. at *3.

[5] Id.

[6] See, e.g., Howard v. Nitro-Lift Techs. LLC, 273 P.3d 20, 30 (Okla. 2011), cert. granted and vacated on other grounds, 133 S. Ct. 500 (2012); Dicen v. New Sesco Inc., 839 N.E.2d 684, 687 (Ind. 2005); Fowler v. Printers II Inc., 598 A.2d 794, 802 (Md. 1991).

[7] See, e.g., Estetique Inc. USA v. Xpamed LLC, No. 0:11-CIV-61740 (S.D. Fla. Sept. 15, 2011) (citing Fla. Stat. Ann. § 542.335)); Money & Tax Help Inc. v. Moody, 180 S.W.3d 561, 566 (Tenn. Ct. App. 2005).

[8] See O.C.G.A. § 13-8-51(11).

[9] See Thomas D. Sherman, To Strike or to Rewrite? Judicial Modification Under New Georgia Non-Competition Statute, Locke Lord Quick Study (Nov. 4, 2011), available at: http://www.lockelord.com/qs_201111corp_ganoncompetebluepencil/.

[10] See PointeNorth Ins. Grp.

[11] Becham v. Synthes USA, 482 F. App'x 387, 392 (11th Cir. 2012).

[12] Id. (citing Comm'rs of Roads & Revenues of Fulton Cnty. v. Davis, 213 Ga. 792, 793-94, 102 S.E.2d 180, 182-83 (1958)).

[13] Id. (citing Jackson & Coker, 261 Ga. at 372, 405 S.E.2d at 254-55).

[14] Id.

[15] See Bunker Hill Int'l Ltd. v. Nationsbuilder Ins. Servs. Inc., 309 Ga. App. 503, 506, 710 S.E.2d 662, 665 (2011).

[16] See Gandolfo's Deli Boys LLC v. Holman, 490 F. Supp. 2d 1353, 1357 (N.D. Ga. 2007) ("[B]ecause the covenant is invalid under Georgia law, the Court is not permitted to apply the law of another state in interpreting the covenant."); see also Keener v. Convergys Corp., 342 F.3d 1264, 1268-69 (11th Cir. 2003); Hulcher Servs. Inc. v. R.J. Corman R.R. Co., 247 Ga. App. 486, 543 S.E.2d 461, 465 (2000); Enron Capital & Trade Res. Corp. v. Pokalsky, 227 Ga. App. 727, 730, 490 S.E.2d 136, 139 (1997).

[17] See Carson v. Obor Holding Co., 318 Ga. App. 645, 646 n.1, 734 S.E.2d 477, 480 n.1 (2012); Bunker Hill Int'l Ltd. v. Nationsbuilder Ins. Servs., Inc., 309 Ga. App. 503, 506 n.1, 710 S.E.2d 662, 665 n.1 (2011); Gordon Document Prods. Inc. v. Serv. Techs. Inc., 308 Ga. App. 445, 448 n.5, 708 S.E.2d 48, 52 n.5 (2011); Cox v. Altus Healthcare & Hospice Inc., 308 Ga. App. 28, 30, 706 S.E.2d 660, 664 (2011), cert. denied (Ga. May 31, 2011).

[18] Boone v. Corestaff Support Servs. Inc., 805 F. Supp. 2d 1362, 1369 (N.D. Ga. 2011).

[19] Becham, 482 F. App'x at 391.

[20] Id.

[21] See Advance Tech. Consultants, 250 Ga. App. at 320, 551 S.E.2d at 737.

[22] O.C.G.A. § 13-8-53(a) ("[E]nforcement of contracts that restrict competition after the term of employment, as distinguished from a customer nonsolicitation provision").

[23] See, e.g., Watson v. Waffle House Inc., 253 Ga. 671, 671-72, 324 S.E.2d 175, 177 (1985) ("[T]he court has found covenants not to compete which are part of a contract of employment to be nonseverable and has held that overbreadth of one portion of the covenant so taints the entire covenant as to make it unenforceable.").

[24] O.C.G.A. § 13-8-53(c)(2).

[25] O.C.G.A. § 13-8-56(2).

[26] See W.R. Grace & Co. v. Mouyal, 262 Ga. 464, 466-67, 422 S.E.2d 529, 532-33 (1992).

[27] O.C.G.A. §§ 13-8-51(5), -52.

[28] See Cox, 308 Ga. App. at 32, 706 S.E.2d at 664 ("The nonrecruitment provision is likewise invalid on its face because it bars Cox from even unsolicited contact with Altus employees or affiliates."); Waldeck v. Curtis 1000 Inc., 261 Ga. App. 590, 592, 583 S.E.2d 266, 268 (2003) ("While a prohibition involving some affirmative act on the part of the former employee, such as solicitation, diversion, or contact of clients, may be reasonable, a covenant prohibiting a former employee from merely accepting business, without any solicitation, is not reasonable.").

[29] But see PointeNorth Ins. Grp. (issuing preliminary injunction enjoining only solicitation of certain customers where covenant purported to prohibit solicitation and passive acceptance of business).

[30] See Dixie Homecrafters Inc. v. Homecrafters of Am. LLC, No. 108-CV-0649-JOF (N.D. Ga. Mar. 5, 2009) (citing Breed v. Nat'l. Credit Ass'n., 211 Ga. 629, 631–33, 88 S.E.2d 15 (1955)).

[31] See Gandolfo's Deli Boys LLC v. Holman, 490 F. Supp. 2d 1353, 1359 (N.D. Ga. 2007); Gynecologic Oncology, PC v. Weiser, 212 Ga. App. 858, 859, 443 S.E.2d 526, 528 (1994).

[32] See Paul Robinson Inc. v. Haege, 218 Ga. App. 578, 579, 462 S.E.2d 396, 398 (1995).