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Taking Stock of Ga. Restrictive Covenant Statute: Part 1

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Law360, New York (August 21, 2013, 12:30 PM ET) -- At common law, restrictive covenants have been notoriously difficult to draft and enforce in Georgia. However, 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 those difficulties.

This article is the first of a two-part series taking stock of the current state of the law under the statute. Here, in part 1, we discuss the tortured history of the statute and provide a summary of some of the statute's key provisions.

History of Georgia's Covenant Statute

The history of the statute has been anything but straightforward. Historically, Georgia has been hostile to restrictive covenants, which include noncompetition, customer nonsolicitation, employee nonrecruitment and nondisclosure provisions. Before the Georgia Constitution was amended following the November 2010 election, it specified that contracts restraining trade were illegal and void.[1] Georgia's courts interpreted this provision to place substantial limitations on the ability of employers and others to enforce restrictive covenants.

This meant that Georgia courts would subject these covenants to rigorous (and sometimes unpredictable) review in determining their reasonableness, refusing to enforce a covenant if any part of it was found to be unreasonable. As a result, employers had to be overly cautious in setting the duration, geographic area and scope of prohibited activities contained in the restrictive covenants in their employment agreements.

Over time, a collection of complicated and sometimes counterintuitive "rules" developed, introducing significant uncertainty for employers and making it difficult to create and enforce meaningful employment covenants in Georgia. This difficulty has been exacerbated in recent decades by the modern business environment in which traditional geographic restraints have been broken down by technological developments that allow employers and their employees to conduct business in diverse and far-reaching locations.

The genesis of legislative efforts to address the enforceability of restrictive covenants in Georgia actually dates back to 1990, when the General Assembly adopted O.C.G.A. § 13-8-2.1. The Supreme Court of Georgia, however, struck the statute down, finding that the statute authorized contracts in restraint of trade in violation of the Georgia Constitution.[2]

Following the Supreme Court's decision in Jackson & Coker, issues relating to the enforceability of restrictive covenants in Georgia remained solely the province of the judiciary — always guided by the underlying constitutional prohibition on contracts in restraint of trade — until 2009.

In 2009, the General Assembly passed, and Gov. Perdue signed into law, House Bill 173 (HB 173), an earlier legislative incarnation of the current statute. The bill was codified at O.C.G.A. §§ 13-8-50 to -59.[3] In response to the Supreme Court's ruling in Jackson & Coker, the General Assembly made the statute's validity and effective date expressly contingent upon the passage of an amendment to the Georgia Constitution to make the 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.[4] The bill also made clear that the new statute would only apply to contracts entered into on and after the date the statute went into effect, thus leaving the prior common law regime intact with respect to contracts entered into before that date.[5]

On Nov. 2, 2010, Georgia voters approved the constitutional amendment.[6] Following the amendment's passage, however, it became apparent that the General Assembly had failed to specify an effective date for the amendment. Therefore, under 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.[7] This inconsistency led many to reconsider HB 173's effective date and even led some to question its constitutionality altogether.

In early 2011, in an effort to alleviate the uncertainty surrounding the validity and effective date of the covenant statute passed through HB 173, the General Assembly introduced and passed House Bill 30 (HB 30), which was a substantial re-enactment of HB 173.[8]

Gov. Deal signed HB 30 into law on May 11, 2011. The bill made clear that the new version of the statute only applied to contracts entered into on and after the effective date of the statute,[9] thus leaving unresolved at the time the proper law to be applied to contracts entered into between Nov. 3, 2010 and May 10, 2011.

Key Provisions in the Current Covenant Statute

The statute attempts to resolve the previous uncertainties surrounding the enforcement of restrictive covenants in Georgia by providing guidance to employers and others regarding the permissible parameters of restrictive covenants, as well as guidance to courts on how to interpret and enforce them. Below is a summary of some of the most important aspects of the statute.

Courts Can Now Modify Overly Broad Covenants

Perhaps most importantly, the statute allows for judicial modification of an otherwise overly broad covenant to make it enforceable.[10] Previously, Georgia courts took an "all or nothing" approach, invalidating a restrictive covenant in its entirety if any part of it was found to be unreasonable.[11]

The statute seems to allow courts to uphold and enforce overly broad covenants either by removing unenforceable provisions in their entirety or enforcing provisions only to the extent that they are reasonable.[12] Importantly, use of this modification power is not mandatory but rather is left to the discretion of the trial court.[13]

Types of Parties and Relationships Covered by the Statute

The statute only applies to agreements between employers and employees; distributors and manufacturers; lessors and lessees; partnerships and partners; franchisors and franchisees; sellers and purchasers of a commercial enterprise; and two or more employers.[14]

While most contractual relationships in which restrictive covenants are likely to be included will fall within one of these provisions (particular given the broad statutory definition of "employer" and the statute's coverage of covenants between two or more employers[15]), drafters should remain aware of the statute's limited scope when drafting covenants in nontraditional situations.

Types of Employees Covered by the Statute

The statute only applies to employment covenants with executive employees; research and development employees and others in possession of important confidential information; and employees with specialized skills or knowledge, customer contacts, customer information or confidential information.[16]

Noncompetition covenants — as compared to customer nonsolicitation covenants — may only be enforced against a narrower subset of such employees.[17]

Legitimate Business Interests that May Be Protected

The statute defines the "legitimate business interests" that an employer may protect through restrictive covenants to include, without limitation, trade secrets, other valuable confidential information, substantial

relationships with customers and venders, customer good will and extraordinary or specialized training.[18]

Pleadings Requirements and Burdens of Proof

The statute establishes pleading requirements and shifting burdens of proof. The party seeking enforcement must plead and ultimately prove the existence of one or more legitimate business interests justifying the covenant.

That party must also present prima facie evidence that the covenant complies with the reasonableness requirements of O.C.G.A. § 13-8-53, after which the party opposing enforcement then bears the burden of proving that such requirements have not been met or that the covenant is unreasonable.[19]

Permissible Geographic Scope and Scope of Activities

The statute makes clear that the geographic scope and scope of activities need not be precisely defined in order to be enforceable. Rather, such descriptions may be generalized, as long as they provide fair notice of the maximum reasonable scope of the covenant, and a good faith estimate of the geography or activities at issue is acceptable.[20]

The statute provides some suggested generalized language to aid drafters and courts in working through such definitional issues.[21] Importantly, the scope of the covenant need not be determinable at the time the covenant is executed, which is another significant change from the prior common law.[22]

Ultimately, however, the statute instructs that post-employment covenants shall be construed to cover only the geography or activities that were actually involved within a reasonable period prior to the employee's termination.[23]

Presumptions Regarding Time Limits

The statute provides guidance regarding the permissible time limits of restrictive covenants. Employment covenants of two years or less are presumed reasonable, while covenants of more than two years are presumed unreasonable. There are different presumptive time limits for covenants entered into outside of the employment context.[24]

Required Limitations on Customer Nonsolicitation Covenants

The statute provides that customer nonsolicitation covenants in the employment context are to be construed by courts as only applying to customers with whom the employee had material contact (a defined term under the statute) and to products or services actually competitive with those of the employer. Such construction is required even if the covenant does not expressly contain such limitations.[25]

Issues Regarding Nondisclosure Covenants

The statute defines "confidential information" as data and information relating to the business of the employer, disclosed or known to the employee, having value to the employer and not generally known to competitors of the employer.[26] Additionally, the statute makes clear that confidential information may be protected by a restrictive covenant for as long as the information in question remains confidential.[27]

This is a significant change from the prior common law rule, which required that a nondisclosure covenant contain a reasonable time limit in order to be enforceable with respect to confidential information not rising to the level of a trade secret.[28]

Conclusion of Part 1

This marks the end of part 1 of this article. To follow, in part 2, 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.

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[1] Ga. Const. art. III, § VI, ¶ V(c) (1983) ("The General Assembly shall not have the power to authorize any contract or agreement which may have the effect of or which is intended to have the effect of defeating or lessening competition, or encouraging a monopoly, which are hereby declared to be unlawful and void.").

[2] Jackson & Coker Inc. v. Hart, 261 Ga. 371, 372, 405 S.E.2d 253, 254 (1991) ("We hold that the Act is beyond the power of the General Assembly inasmuch as it is one that authorizes contracts and agreements which may have the effect of or which are intended to have the effect of defeating or lessening competition or encouraging monopoly.").

[3] HB 173 also repealed O.C.G.A. § 13-8-2.1. See 2009 Ga. Laws Act 64, § 2 (HB 173).

[4] 2009 Ga. Laws Act 64, § 4 (HB 173).

[5] Id.

[6] See 2009 Ga. H.R. 178 (proposing amendment to Ga. Const. Art. III, § VI, ¶ V(c)); AJC Election Central, Atlanta J.-Const., Nov. 4, 2010, at A16 (reporting that Georgia voters approved the constitutional amendment by a 67% majority).

[7] Unless an amendment provides otherwise, ratified amendments to Georgia's constitution take effect on the first day of January following ratification. See Ga. Const. art. X, § I, ¶ VI.

[8] The new bill repealed the HB 173 version of the statute as codified at O.C.G.A. §§ 13-8-50 to -59 and replaced it under the same code sections. The HB 30 version of the statute was very similar to the original HB 173 version, with only a few minor substantive changes. The main substantive change was to O.C.G.A. § 13-8-56, which, under the current version of the statute provides that in-term and post-employment geographical limitations that include the area in which the employer does business are presumptively reasonable, provided the distance encompassed is reasonable and/or the restriction is limited to particular competitors. O.C.G.A. § 13-8-56(2). Under the previous version of the statute, the similar guidance regarding the reasonableness of a geographic limitation applied only to covenants restricting competition during the period of employment. See 2009 Ga. Laws Act 64, § 3 (HB 173).

[9] 2011 Ga. Laws Act 99, § 5 (HB 30).

[10] O.C.G.A. §§ 13-8-53(d), -54(b).

[11] See, e.g., Advance Tech. Consultants Inc. v. Roadtrac LLC, 250 Ga. App. 317, 320, 551 S.E.2d 735, 737 (2001) ("Georgia law is clear that if one [covenant] is unenforceable, then they are all unenforceable … Georgia does not employ the 'blue pencil' doctrine of severability.") (citing Ward v. Process Control Corp., 247 Ga. 583, 584, 277 S.E.2d 671 (1981); Uni–Worth Enters., Inc. v. Wilson, 244 Ga. 636, 640, 261 S.E.2d 572 (1979)).

[12] O.C.G.A. §§ 13-8-51(11)-(12), -53(d), -54(b).

[13] O.C.G.A. §§ 13-8-53(d), -54(b) (stating that court "may" modify overbroad covenants).

[14] O.C.G.A. § 13-8-52.

[15] O.C.G.A. §§ 13-8-51(6), -52(a)(7).

[16] O.C.G.A. §§ 13-8-51(5), -52(a)(1).

[17] O.C.G.A. § 13-8-53(a).

[18] O.C.G.A. § 13-8-51(9).

[19] O.C.G.A. § 13-8-55.

[20] O.C.G.A. § 13-8-53(c)(1).

[21] O.C.G.A. § 13-8-53(c)(2).

[22] Compare O.C.G.A. §§ 13-8-53(c)(1), -56(2), with Durham v. Stand-By Labor of Ga., Inc., 230 Ga. 558, 562, 198 S.E.2d 145, 149 (1973) ("[S]uch terms are overly broad and unreasonably in restraint of trade due to the chilling effect that may be had upon post-employment competitive activity because of the employee's inability to forecast with certainty the territorial extent of the duty owing the former employer.").

[23] O.C.G.A. § 13-8-53(c)(1).

[24] O.C.G.A. § 13-8-57.

[25] O.C.G.A. §§ 13-8-53(b), -51(10).

[26] O.C.G.A. § 13-8-51(3).

[27] O.C.G.A. § 13-8-53(e).

[28] See Allen v. Hub Cap Heaven, Inc., 225 Ga. App. 533, 539, 484 S.E.2d 259, 265 (1997) ("A nondisclosure clause with no time limit is unenforceable as to information that is not a trade secret.") (citing U3S Corp., etc. v. Parker, 202 Ga. App. 374, 378, 414 S.E.2d 513 (1991)).