

# State of Alabama



## Alabama Law Institute

### Restrictive Covenants Act

November 2013

#### ALABAMA LAW INSTITUTE

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## **Preface**

The Alabama Law Institute presents to the Bench and Bar of Alabama, for consideration and constructive criticism, the following proposed act.

Section 8-1-1 of the Alabama Code dates back to the Code of 1923 standing for the proposition that contracts in the restraint of trade are void. This statute has resulted in extensive litigation and a great many opinions from the Alabama Supreme Court, which turn on innumerable fact patterns. Often it is difficult, if not impossible, to advise persons on how such a dispute over a restrictive covenants will turn out.

This Act was the result of a great deal of scholarly work over the past two years by a committee of judges, professors, and practitioners with extensive backgrounds in this area of the law. The proposed Act attempts to provide some clarity and statutory structure to this area of the law, while not varying widely from the current blackletter principles in Alabama. The committee was capably chaired by Will Hill Tankersley.

Othni J. Lathram  
Director

November 2013



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## Restrictive Covenants Act

### **Section 1. Contracts restraining profession, trade or business void; exceptions.**

(a) Every contract by which anyone is restrained from exercising a lawful profession, trade, or business of any kind otherwise than is provided by this section is to that extent void.

(b) Except as otherwise prohibited by law, the following contracts are allowed to preserve a protectable interest:

1. A contract between two or more persons or businesses limiting their ability to hire or employ the agent, servant, or employees of a party to the contract is permitted where the agent, servant or employee holds a position uniquely essential to the management, organization, or service of the business.

2. An agreement between two or more persons or businesses to limit commercial dealings to each other.

3. One who sells the good will of a business may agree with the buyer to refrain from carrying on or engaging in a similar

business and from soliciting customers of such business within a specified geographic area so long as the buyer, or any entity deriving title to the good will from that business carries on a like business therein, subject to reasonable time and place restraints. Restraints of one year or less are presumed to be reasonable.

4. As an agent, servant, or employee of a commercial entity may agree with such entity to refrain from carrying on or engaging in a similar business and from soliciting current customers of such entity within a specified geographic area so long as the employer carries on a like business therein, subject to reasonable restraints of time and place. Restraints of one year or less are presumed to be reasonable.

5. Upon or in anticipation of a dissolution of a commercial entity, partners, owners and/or members may agree that none of them will carry on a similar commercial activity in the geographic area where the commercial activity has been transacted.

(c) Courts may refuse to enforce such restraints in whole or in part if the Court finds that enforcement causes an undue hardship.

### **Committee Comment**

Section 1 preserves the current presumption in Alabama Code Section 8-1-1 against contracts in restraint of trade. It also retains, in Sections 1(b)(3) and (5), two exceptions from the previous statute. Because other “partial restraints” have been recognized by the courts as not inconsistent with the general prohibition, this redraft codifies those exceptions. In addition, it makes explicit three limitations to those exceptions which have developed over time. The first is the requirement in Section 1(b) that all exceptions must preserve a protectable interest, defined in Section 2. The second is that two of the limitations, Sections 1(b)(3) and (4), impose a requirement that time and place restraints be reasonable. The third is that courts are given a general power not to enforce, in whole or in part, restraints which cause undue hardship.

The phrase in Section 1(b), “except as otherwise prohibited by law,” recognizes that there may be prohibitions on contracts in restraint of trade found elsewhere in state or federal law.

The term “uniquely essential” in Section 1(b)(1) reflects the [Committee’s] intent to limit use of the exception to circumstances in which the employee in question holds a position which is not only important to the business, but in which the agent, servant or employee’s services would be very difficult to replicate.

### **Section 2. Protectable interest; defined.**

- (a) A “protectable interest” includes:
  - 1. Trade secrets, as defined by Section 8-27-2(1);

2. Confidential information, including pricing methodology, used in the business that does not otherwise qualify as a trade secret;
  3. Substantial relationships or contacts with specific prospective or existing customers, patients, vendors, or clients;
  4. Customer, patient, vendor, or client good will associated with:
    - i. An ongoing business, franchise, commercial, or professional practice, or trade dress; and
    - ii. A specific marketing or trade area.
- (b) Job skills in and of themselves, without more, are not protectable interests.

### **Committee Comment**

This section confirms current Alabama law with regard to the requirement to show the actual protectability of the information or commercial relationship that is the purported subject of the restrictive covenant, including a reference to the definition of "trade secrets" as codified in Ala. Code Section 8-27-2(1). It is the committee's intent that simply referring to information as "confidential" or by some other similar designation alone will not suffice to meet the standard established by this statute. Merely prospective commercial relationships are not be protectable, unless the proponent of the covenant can show substantial investment in the specific prospective commercial relationship. Restrictive covenants related to good will in franchise or other agreements that otherwise satisfy the requirements of this act are enforceable.

### **Section 3. Contact formation and validity.**

In order to be valid, any contract or agreement executed pursuant to this act shall be reduced to writing, signed by all parties, be supported by adequate consideration, and must be mutual in all significant provisions.

### **Committee Comment:**

The language in this section requires mutuality with respect to all significant provisions of a restrictive covenant. By way of example, a restrictive covenant which provides for recovery of attorney's fees and expenses by only the party seeking to enforce the contract or agreement in the event of its breach would fail to satisfy this section. It is the intent of this section that a restraint failing to satisfy all the requirements of this section would be void.

**Section 4. Judicial authority to void in whole or in part.**

If a contractually specified restraint is overly broad, too long in its duration, or otherwise not necessary to preserve a protectable interest or interests, a court may void the restraint in whole or in part.

**Committee Comment:**

It is the intent of this Section to cause parties, especially the drafting party, to draft reasonable restraints, so the Courts will not be burdened with parsing through unreasonable restraints.

**Section 5. Burden of proof.**

(a) Any person seeking enforcement of a restrictive covenant as provided in this act shall plead with specificity the existence of each element required for such a covenant.

(b) The party seeking enforcement of the covenant has the burden of proof on every element. The party resisting enforcement of the covenant has the burden of proving the existence of undue hardship, if raised as a defense.

**Committee Comment**

Section (a) requires the pleader must plead more than generalized or conclusory statements of the elements of an enforceable covenant as provided in Sections 1(b), 2(a), 3 and 4 to

meet their pleading burden. The pleader must allege specific facts with particularity, which, taken as true, would entitle the pleader to relief under this Section. Subsection (b) leaves intact existing case law regarding the allocation of the ultimate burden of proving each element of an enforceable covenant. However, the party seeking enforcement of a restrictive covenant under this section is neither obligated to plead nor prove the absence of an undue hardship on the party against whom enforcement is sought. Rather, undue hardship is an affirmative defense to be raised, if at all, by the party against whom enforcement is sought under this Section.

**Section 6. Remedies and defenses.**

(a) The remedies available for breach of an agreement subject to this act are:

1. Such injunctive and other equitable relief as may be appropriate with respect to any actual or threatened breach;
2. The actual damages suffered as a result of the breach or lawful liquidated damages if provided in the contract; and
3. Any remedies available in contract law, including attorneys' fees or costs, if provided for in the contract or otherwise provided for by law.

(b) Nothing in this act shall limit the availability of any defense otherwise available in law or equity.

**Committee Comment**

This Section is intended to preserve all remedies and defenses currently available under Alabama law.

**Section 7. Professional exemptions.**

Nothing in this act shall be construed to eliminate any professional exemption recognized by Alabama law.

**Committee Comment**

This Section continues existing Alabama law under Alabama Code Section 8-1-1(a).

**Section 8. Declaration of fundamental public policy; conflicts of laws.**

It is hereby declared that this act expresses fundamental public policies of the State of Alabama. Therefore, this act shall govern and shall be applied instead of any foreign laws that might otherwise be applicable in those instances when the application of those foreign laws would violate a fundamental public policy expressed in this act.

### **Committee Comment**

This section is intended to codify current Alabama case law. *See, e.g., Blalock v. Perfect Subscription Co.*, 458 F. Supp. 123 (S.D. Ala. 1978), *aff'd*, 599 F.2d 743 (5th Cir. 1979) and *Cherry, Bekaert & Holland v. Brown*, 582 So.2d 502 (Ala. 1991).

#### **Section 9. Repeals.**

Section 8-1-1 is hereby repealed on the effective date of this act.

#### **Section 10. Effective Date.**

This act shall be effective January 1, 2015.