

NON-COMPETE, NON-SOLICITATION AND NON-DISCLOSURE CLAUSES IN NORTH CAROLINA AND BEYOND

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RESTRICTIVE COVENANTS USUALLY ARISE OUT OF:

- ✓ **Employment relationship**
- ✓ **Independent contractor relationship**
- ✓ **Sale of business**
- ✓ **Sale of partial interest in business**

TYPES OF RESTRICTIVE COVENANTS

- **Non-competition**
- **Non-solicitation of customers**
- **Non-solicitation of employees**
- **Non-disclosure of company information**

- **Non-competition and non-solicitation covenants are contracts “in restraint of trade” and are “carefully scrutinized” by North Carolina courts.**
- **Non-disclosure covenants are not considered “restraints of trade” subject to the same careful scrutiny.**

REQUIREMENTS FOR ENFORCEABLE COVENANTS

To be enforceable, non-competition and non-solicitation covenants must be:

- 1. In writing;**
- 2. Part of a contract concerning employment or sale of business;**
- 3. Based on valuable consideration;**
- 4. Reasonably necessary to protect a recognized business interest of the company; and**
- 5. Reasonable as to time and territory (and scope of activities)**

Also, not against public policy

1. "In Writing"

- ✓ Because non-competition and non-solicitation agreements are contracts in restraint of trade, they must be in writing and signed by the party to be restricted. N.C.G.S. § 75-4.

2. Part of Contract of Employment or Sale of Business

- ✓ Arises out of employment or independent contractor relationship;
- or
- ✓ Arises out of sale of business or sale of interest in business

3. Valuable Consideration

Types of “Valuable Consideration”:

1. Promise of **new** employment;
2. Provision of meaningful changes in terms or conditions of employment;
3. Other “new consideration”

NEW EMPLOYMENT

- **Promise of new employment will constitute consideration if covenants are entered into before employment begins**
- **Covenants need not be reduced to writing before employment begins if terms of restrictive covenants were clearly stated and agreed to before employment begins**

WHAT IF NO AGREEMENT WHEN EMPLOYMENT BEGINS?

- ✓ In North Carolina, continued employment is not “valuable consideration.” New consideration is needed.

WHAT QUALIFIES?

- ✓ Change in employment terms and conditions
- ✓ Additional money (either bonus or salary increase) if it is linked to signing agreement
- ✓ Changes in responsibilities (e.g., promotion)
- ✓ Changes must not be illusory (e.g., change in employment benefits at discretion of employer)

NOTE: There is no requirement that the consideration given by the employer be stated in writing

4. Necessary to Protect Recognized Business Interest

Two interests have been recognized as supporting a restrictive covenant:

- 1. If the nature of employment is such that the employee will be in personal contact with customers of the employer (“Good Will”); or**
- 2. If the nature of employment will enable the employee to acquire valuable business information (e.g., trade secrets or confidential information)**

CUSTOMERS AND “GOOD WILL”

- One of the primary purposes of a covenant not to compete is to protect the relationship between an employer and its customers
- Customers developed by an employee in the course of employment are the property of the employer and can be protected by a valid covenant not to compete
- “Good Will” is established when an employee, during the course of his or her employment, develops and/or improves customer relationships

CONFIDENTIAL OR TRADE SECRET INFORMATION

- Courts generally require an employer to show that the information sought to be protected by restrictive covenants constitutes trade secrets and/or confidential information worthy of protection
- Duty of confidentiality also arises out of common law even absent a confidentiality agreement
- “Inevitable Disclosure” Rule

5. Reasonableness of Restriction

- a. Reasonable as to time
- b. Reasonable as to territory
- c. Reasonable as to scope of activities

TIME AND TERRITORY ARE INTERDEPENDENT

- **North Carolina Courts evaluate temporal and territorial restrictions in tandem to determine whether they produce a reasonable restriction upon the employee**

TEMPORAL RESTRICTIONS

- **The shorter the term, the more likely it will be considered reasonable**
- **Temporal restriction will need to be justified by employer based upon employee's position and nature of business**
- **In determining reasonableness, some courts look to see if restrictive covenant "reaches back" to include clients of the employer during some period in the past**

GEOGRAPHIC RESTRICTIONS

- To prove the reasonableness of a geographic restriction, the employer must show where its customers are located and that the geographic restriction is necessary to maintain and protect those customer relationships
- The employer must show that the territory embraced by the covenant is no more than necessary to secure the protection of its business or good will

FACTORS CONSIDERED IN DETERMINING REASONABLENESS OF GEOGRAPHIC RESTRICTION:

- 1. The area or scope of restriction;**
- 2. The area assigned to the employee;**
- 3. The area where the employee actually worked or was subject to work;**
- 4. The area in which the employer operated;**
- 5. The nature of the business involved; and**
- 6. The nature of the employee's duty and his knowledge of the employer's business operation**

REASONABLENESS AS TO SCOPE OF ACTIVITY

- Restrictive covenant cannot unjustifiably prevent employee from engaging in unrelated work in the territory—subject to “common sense” analysis
- Especially where interest to be protected is customer contact, restriction should be limited to employee engaging in similar activities/scope of work on behalf of new employer
- Scope of activity objection may be avoided by using non-solicitation clause instead of non-competition clause

RESTRICTIVE COVENANTS FOUND TO BE REASONABLE

- A six-month covenant potentially extending throughout North and South America and restricting employment with a direct competitor of the employer in a related job capacity
- A two-year non-compete covenant restricting a former employee from competing with the former employer in any county in which he had worked during last two years of employment and within 100 miles of those counties
- A two-year, two-county covenant restricting former employees from “dealing with, soliciting the business of, or otherwise conducting business” of a type similar to that of the former employer
- A two-year covenant prohibiting franchisees of a pizza restaurant chain from operating within 5 miles of the former location or from operating within a specified distance of other franchisees

RESTRICTIVE COVENANTS FOUND TO BE REASONABLE

- A three-year, 15-mile radius covenant preventing a dentist from opening a practice near the dental office where he had worked
- A covenant-not-to-compete barring a former employee from working in a specific industry in two states for a one-year period
- A covenant preventing employee from calling upon any customer of the employer for a period of two years within a 150-mile radius from the town where the employer was located
- A five-year covenant in the city in which the employee had been employed by the employer

RESTRICTIVE COVENANTS FOUND TO BE UNREASONABLE

- A three-year non-competition covenant given by a caregiver in the mental health care industry
- A three-year covenant containing a territorial limitation purporting to preclude all similar employment in the Commonwealth of Virginia
- A post-employment covenant containing a geographical limitation broader than the area in which the former employer conducted business

RESTRICTIVE COVENANTS FOUND TO BE UNREASONABLE

- **A five-year non-competition covenant purporting to cover any county where the employer actually had worked or intended to work**

WHAT IF THE COVENANT IS FOUND TO BE UNREASONABLE?

- Courts will not rewrite the restrictive covenants to make them reasonable and enforceable
- However, courts will apply “blue pencil” doctrine. If the contract is severable and one part of covenant is reasonable and can stand alone, the courts will enforce the reasonable provision
- Drafter may use a “stair-step” approach including less restrictive alternative restrictive covenants

IF ENFORCEABLE RESTRICTIVE COVENANTS ARE VIOLATED, WHAT TYPE OF RELIEF?

- **Injunctive relief**
- **Damages**
- **Attorneys' fees? (not under NC law)**

POTENTIAL DEFENSES

- **Breach of contract by employer—defense of excuse**
- **Against public policy**

OTHER ISSUES

- Liquidated damages provisions
- Choice of law provisions
- Where to sue?
- Who to sue?

RISKS TO “NEW” EMPLOYER

- **Potential tortious interference with contract claim**
- **Possible under Unfair Trade Practice claim**
- **Punitive damages/Attorneys’ Fees**
- **Tip to New Employers: ask for employee representation that he/she is not bound by restrictive covenants, and for indemnification as to same**

PRACTICAL CONSIDERATIONS

- **Look Before you Leap**
- **Winning the Battle but Losing the War – the Bond Requirement**
- **Hot Tip -- Consult a Lawyer!**