Covenants not to compete in employment agreements must meet particular requirements in order to be enforceable under North Carolina law because they have the effect of restricting employment. Such covenants must be (1) in writing, (2) made a part of the contract of employment, (3) based on valuable consideration, (4) reasonable as to time and territory, and (5) designed to protect a legitimate business interest of the employer. Hartman v. W.H. Odell & Assoc., Inc., 117 N.C. App. 307, 311, 450 S.E.2d 912, 916 (1994).

Most of the cases involving noncompetes evaluate the reasonableness of the restrictions or the legitimate business interests that the covenant is intended to protect. Recently, for example, the North Carolina Supreme Court stressed that noncompete covenants cannot protect geographical areas in which a business has no customers and that trial courts cannot just rewrite such overly broad territorial restrictions. Two other recent cases in North Carolina, however, also have addressed the requirement that the employer give something to the employee – referred to as “consideration” – in exchange for entering into the noncompete. All of these decisions offer some practical guidance to employers on how to ensure that these requirements for an enforceable noncompete are satisfied.

Territorial Restrictions Should Not be Too Broad, and North Carolina Trial Courts – Even if the Parties Try to Agree – Cannot Rewrite Noncompete Covenants

In Beverage Systems of the Carolinas, LLC v. Associated Beverage Repair, LLC, 2016 WL1084177 (N.C., March 18, 2016), the North Carolina Supreme Court addressed issues arising out of a covenant not to compete in the sale of a business. The Court, however, made no distinction in its analysis between an employment covenant and a sales covenant. Specifically, the case involved a buyer trying to require a seller not to work for a competing entity anywhere in North Carolina or South Carolina. The noncompete covenant at issue listed only those two states in their entirety as the “restricted territory.” The contract containing the covenant also provided that the parties consented to a court
revising the covenant’s “temporal and territorial restrictions” if a court found them to be too broad. Evidence established that the plaintiff did not do business in most parts of the Carolinas, and thus, the territorial restriction of the entire two states was too broad to protect the plaintiff’s legitimate business interests. The Court of Appeals sought to salvage the noncompete by allowing a revision of the territorial restrictions, as agreed by the parties, just to those portions of the Carolinas where the plaintiff actually did business.

The Supreme Court reversed. In doing so, it stressed two key learnings for employers seeking to enforce noncompetes. First, territorial restrictions should be narrowly tailored only to areas in which the enforcing entity does business or has clients. Here, the plaintiff only did business in relatively restricted portions of North Carolina and South Carolina, not anywhere near the entirety of either state. Second, North Carolina courts do not have the power to “reform for reasonableness” overly broad noncompetes. Instead, North Carolina embraces a strong “blue-penciling doctrine” that only allows courts to strike portions of a covenant that are discretely and separately stated and severable. Here, if a court “blue-penciled” or removed North Carolina and South Carolina as restricted territories, there would have been no territory left in which the covenant could be enforced. Accordingly, employers in North Carolina should use “step-down provisions” in their noncompetes that clearly provide for alternative geographic restrictions (i.e., certain cities, certain counties, contiguous counties and then the entire state) if employers want to try and push any protected territory beyond where they actually do business.

A Payment of $100 Can Support a Noncompete Even if Not Mentioned in the Written Agreement

If the individual is not yet employed, the offer of employment can serve as adequate consideration for the covenant not to compete. If the employment relationship already exists, however, the employee must receive something else of value.

In Employment Staffing Group, Inc. v. Little, 777 S.E.2d 309 (N.C. App. 2015), an existing employee received $100 for entering into a covenant not to compete. After her employment ended, she challenged the enforceability of the covenant on the basis that the $100 payment was not mentioned anywhere in her employment agreement. Her agreement contained a “merger clause” — a provision that bars evidence of prior negotiations that are inconsistent with the written agreement. The North Carolina Court of Appeals held, however, that evidence of an oral agreement by the employer to pay the employee $100 in exchange for the noncompete was admissible because consideration was not otherwise addressed in the employment agreement and thus not inconsistent with its terms. Accordingly, evidence of the oral agreement for the $100 payment could be used to show that the element of consideration was met.

The Court of Appeals also rejected the argument that the payment of $100 was inadequate to support the restriction because the employee felt pressure to sign the covenant in order continue her employment. The Court reaffirmed the principle that courts generally will not evaluate the adequacy of the consideration because the contracting parties are in the best position to do so. In this case, there was no dispute that the parties agreed to the payment of $100 and that the payment was in fact received. As a result, the Court found that $100 was sufficient to meet the element of consideration.
Notwithstanding the outcome in the Employment Staffing Group case, employers should be thoughtful with respect to the requirement of providing consideration to existing employees. In general, the best practice is to refer to consideration within the written contract itself in order to avoid factual disputes later about whether the employee in fact received something of value in exchange for agreeing to the restriction. In addition, while North Carolina law is clear that a court should not second guess the adequacy of consideration, an employer may want to think twice about providing nominal consideration in certain circumstances. As a practical matter, noncompetes are disfavored generally, and the assessment of certain elements, such as the reasonableness of time and territory, often involve the exercise of discretion by the judge. As a result, employers may want to avoid a situation in which they are asking a court to enforce broad restrictions against a former employee who received only a minor payment in exchange for entering into an agreement that significantly limits his or her employment options.

Be Careful With Offer Letters When Relying on the Start of Employment as Consideration

In RLM Communications, Inc. v. Tuschen, 66 F.Supp.3d 681 (E.D.N.C. 2014), a new employee accepted employment by signing an offer letter, which included terms of position title, salary, benefits and work hours, but did not include a covenant not to compete. The offer letter stated: “Your signature and date constitutes ‘Full’ acceptance of this job offer.” On her first day of work, one week later, the employee signed a covenant not to compete containing post-employment restrictions.

When the employee left and began competing, her former employer brought an action in federal court to enforce the noncompete restrictions. The court refused to do so on the basis that the employee’s execution of the offer letter contained the full employment agreement, and it did not state or suggest that a covenant not to compete was one of its terms. The court observed that employment was not contingent on execution of the noncompete because the offer letter indicated that the employee’s signature and date constituted “full acceptance” of the offer. Thus, even though the noncompete was entered into before employment began, the court held that it required new consideration because it was not included in the original employment agreement.

The Tuschen case provides a cautionary tale about the use of offer letters. In particular, if an initial offer letter is intended to serve as the written documentation of the employment terms, it should include the covenant not to compete. Alternatively, the offer letter should state that employment is subject to entering into an agreement setting forth the terms of employment, including a covenant not compete, and the covenant should be signed prior to or simultaneously with the commencement of employment. Importantly, the offer letter should avoid the language in Tuschen indicating that the terms of employment would be accepted by the employee’s signature.

In short, employers need to limit the territorial breadth of noncompete covenants to where they actually have customers. If the employer wants to include more expansive territorial areas, it can do so as long as it drafts the covenant with different territorial restrictions that can be blue-penciled if necessary under North Carolina law. Employers also can avoid the pitfalls associated with proving the requirement of consideration by documenting the consideration provided to the employee and doing so in the written employment agreement. The amount can be relatively minimal, but it needs to be paid. The consideration also can be the start of employment, but the employer
needs to make sure the requirement is communicated to the employee with any offer letter.