

COURT REJECTS EFFORT TO REWRITE NON-COMPETE TO MAKE IT ENFORCEABLE

A recent South Carolina Supreme Court decision, *Poynter Investments, Inc. v. Century Builders of Piedmont, Inc.* (May 24, 2010), serves as a reminder that only restrictive covenants that are carefully and narrowly drafted are likely to be enforced. The *Poynter Investments* ruling reversed a trial court's decision to modify an overly broad geographic restriction in a covenant not to compete and to enforce the modified non-compete.

Enforceable Non-Competes

Covenants not to compete are disfavored by the courts because they restrict competition and may deprive employees of their ability to earn a living when they leave an employer. But in South Carolina, non-competes are generally upheld if they are:

- Necessary to protect a legitimate business interest of the employer;
- Reasonably limited as to time and place;
- Not unduly restrictive;
- Reasonable from a public policy standpoint; and
- Supported by valuable consideration.

Under North Carolina law, non-competes will generally be upheld if they are:

- In writing;
- Made part of a contract of employment;
- Based on valuable consideration;
- Reasonable both as to time and territory; and
- Not against public policy.

In both states, a covenant that fails to meet any one of the five criteria will likely not be enforced.

Geographic Restrictions

A geographic restriction is generally reasonable if the area covered by the restraint is limited to the territory in which the employee was able, during the term of his or her employment, to establish contact with the employer's customers.

In a 1992 decision, the South Carolina Court of Appeals struck down a veterinary practice's covenant not to compete because the court determined it prohibited competition in an area broader than necessary to protect the employer's legitimate interest. The covenant prohibited competition within 15 miles of the former employer's three locations even though 55 percent of the practice's clients lived within 10 miles of at least one of the practice locations, and 84 percent of the practice's clients lived within 10 miles of at least one of the practice locations. The court ruled that because an "overwhelming majority" of the practice's clients lived much closer than 15 miles from at least one of the practice's locations, and because the 15-mile restriction reached into adjoining counties and an adjoining state, the restriction was "unreasonable and unenforceable."

In some cases, however, statewide and even nationwide protection may be appropriate if the employee has active contact with customers across the state or across the country, provided the activities being restricted are clearly and narrowly described.

“Blue Pencil” Rule and “Step-Down” Restrictions

Courts generally take one of three approaches to overly broad non-compete agreements. In some states, if an agreement is unreasonable as written by the parties, the courts will invalidate it. In other states, overly broad covenants will be “blue-penciled,” meaning courts may strike through unreasonable terms and enforce the remaining terms, but will not rewrite the agreement; this approach is referred to as the strict blue pencil approach. In still other states, courts may rewrite restrictive covenants to make them reasonable and enforceable; this approach is known as the liberal blue pencil approach.

Some non-competes contain “step-down” provisions, which are alternative provisions relating to prohibited competition. If one provision is struck down, an alternative may give the employer an enforceable fallback position. For example, the agreement may provide that the employee is restricted from working for a competitor within 100 miles of the employer, but that if a court finds such a restriction to be overly broad, the restriction is automatically scaled back to 50 miles.

Geographic Restriction in *Poynter Investments*

In *Poynter Investments*, Clyde Rector sold his business to Poynter Investments and signed an employment agreement containing a four-year non-compete clause with a step-down geographic restriction that prohibited him from competing in an area described as follows:

- (i) *An area encompassing seventy-five (75) miles in any direction from the Premises.*
- (ii) *In the event the preceding subparagraph (i) shall be determined by judicial action to be unenforceable, the “Restricted Territory” shall be Greenville County, South Carolina and any county that borders Greenville County, South Carolina.*
- (iii) *In the event the preceding subparagraph (ii) shall be determined by judicial action to be unenforceable, the “Restricted Territory” shall be Greenville County, South Carolina.*

In subsequent litigation to enforce the non-compete, the trial court did not choose between the step-down restrictions. Instead, the trial court in effect rewrote the geographic restriction, enforcing the agreement only to the extent it prohibited Rector from competing “within Greenville County, South Carolina and within an area encompassing 15 miles in any direction from [the Premises].”

The Court’s Decision

Rector appealed, arguing that the trial court exceeded its authority in blue-penciling the non-compete. The Supreme Court agreed, finding, in a brief decision, that no South Carolina appellate decision “has directly addressed the authority of a court to decrease the geographical limitations in an overly broad non-compete agreement.” The court went on to find that “in South Carolina, the restrictions in a non-compete clause cannot be rewritten by a court or limited by the parties’ agreement, but must stand or fall on their own terms.”

The *Poynter Investments* decision thus rejects the liberal blue pencil approach. It also leaves open to question the extent to which South Carolina courts may follow the strict blue pencil approach.

The decision does not indicate how the court views step-down provisions. Nor does it indicate whether the trial court in this case would have been permitted to enforce the third step of the step-down geographic restriction and not the other two, broader steps, as the restriction fashioned by the trial court was broader than the third alternative provided by the parties.

Finally, the *Poynter Investments* decision does not indicate whether Rector’s employment agreement contained a severability clause or whether non-competes with an overly broad provision that is severable can still be enforced. A severability clause typically states that the provisions of a contract are severable and if one part of the contract is invalidated by a court, the rest of the contract should still be enforced.

Non-Competes in North Carolina

North Carolina courts utilize a similar approach in evaluating and enforcing restrictive covenants. Under North Carolina law, if a restrictive covenant is overreaching, the most a court is permitted to do is to blue-pencil it by striking through unreasonable terms. However, if the restriction remains unenforceable after the overly broad provision has been excised, or if the offending language for some reason cannot be removed, then it will simply not be enforced.

For example, in a recent North Carolina case, a court attempted to blue-pencil an agreement that contained both non-compete and non-solicitation provisions. The court determined that the non-compete was overly broad because no geographic area was defined and struck that provision. However, the non-compete language, which had been blue-penciled out of the document, contained the only time restriction in the agreement. As such, the Court of Appeals concluded that the non-solicitation provision was also unenforceable - due to lack of a time restriction.

Additionally, North Carolina courts have applied the blue pencil rule to step-down provisions in restrictive covenants, striking the overly broad provisions while enforcing those that are more narrowly drawn. However, North Carolina courts have not yet addressed the question of whether attempting to blue-pencil a restriction with a number of step-down provisions would be tantamount to a court rewriting the covenant, and potentially barred as an impermissible application of the liberal blue pencil approach.

Conclusion

In both Carolinas, restrictive covenants can be powerful tools in protecting a company's business interests. It is important to use reasonable and carefully considered geographic and other limitations, however, to increase the likelihood the covenants will be enforced.

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