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North Carolina Supreme Court Reiterates Limited Blue Pencil Approach to Overbroad Non-Competes

By M. Robin Davis and Conrad S. Kee

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Historically, North Carolina has been in the minority of states in taking the limited "blue pencil" approach to overbroad non-compete agreements — *i.e.,* an overbroad covenant cannot be rewritten. North Carolina courts are limited to striking discrete overbroad provisions of the covenant. A 2014 North Carolina Court of Appeals decision, however, challenged that view and directed a trial court to rewrite a non-compete agreement when the agreement included an express provision allowing for court modification. *See* North Carolina Court of Appeals Directs Trial Court to Rewrite Non-Compete Agreement.

Reiterating that North Carolina courts are limited to striking unreasonable portions of non-compete agreements, the North Carolina Supreme Court has reversed that 2014 North Carolina Court of Appeals decision. *Beverage Sys. of the Carolinas, LLC v. Associated Beverage Repair, LLC,* No. 316A14 (Mar. 18, 2016).

The parties had executed a non-compete agreement as part of a sale of a business. The agreement contained a contractual provision that specifically allowed for a court to revise its duration, scope, or geographic area in the event any of them were determined to be overly broad. (Restrictive covenants in connection with the sale of a business have traditionally been more liberally construed under North Carolina law than restrictive covenants entered in the employment context.) That agreement restricted the seller from engaging in competition within the states of North Carolina and South Carolina, even though the business was only in parts of those states at the time of entry of the contract.

The trial court ruled that it could not make the agreement reasonable by striking language; instead, it would need to rewrite the agreement to designate the areas within North Carolina and South Carolina where the businesses competed, which it declined to do. Accordingly, the trial court found the agreement to be overbroad and therefore unenforceable.

On appeal, the North Carolina Court of Appeals reversed the trial court and distinguished the subject agreement from prior cases because of the express language in the contract permitting reformation of the agreement.

The North Carolina Supreme Court, in turn, reversed the North Carolina Court of Appeals' decision. It noted that non-compete agreements in connection with the sale of a business will be enforced when they:

1. are reasonably necessary to protect the legitimate interest the purchaser;
2. are reasonable with respect to both time and territory; and
3. do not interfere with the interest of the public.

The North Carolina Supreme Court agreed with both the trial court and the North Carolina Court of Appeals that the agreement as drafted was not reasonable as to territory. However, the Supreme Court held that blue penciling could not save the agreement because striking the unreasonable geographic territory would leave no reasonable territory to enforce. Making the covenant reasonable would require a court to rewrite the terms and insert a reasonable geographic territory. While the agreement

Meet the Authors

M. Robin Davis
Principal
Raleigh
919-760-6464
Robin.Davis@jacksonlewis.com

Conrad S. Kee
Principal
Salt Lake City
385-419-3529
KeeC@jacksonlewis.com

contained a provision expressly permitting the court to reform the agreement, the Supreme Court refused to enforce that provision, holding that North Carolina law does not allow for judicial reformation of a contract and the "parties cannot contract to give a court power that it does not have."

States take different approaches to non-compete agreements that are overbroad in time or territory. Some, such as Virginia, take an all-or-nothing approach and will not enforce non-compete agreements that are overbroad in time or territory at all. Others, such as Arizona (*see* Non-Compete Overbroad, Business Tort Claims Preempted by Arizona Trade Secrets Act, Federal Court Rules) follow the blue pencil approach used by the North Carolina Supreme Court in potentially striking through overbroad terms if the agreement is written in a manner such that reasonable limits would remain. Many states, however, may reform (that is, rewrite) a covenant when appropriate under the circumstances.

Please contact a Jackson Lewis attorney with any questions about this decision or drafting non-compete agreements.

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