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Employers Beware! North Carolina Business Court Establishes New Standard for Consideration for Restrictive Covenants

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Restrictive covenants are valuable tools employers can use to protect their proprietary interests. Covenants *not to compete* and covenants *not to solicit* an employer's clients or employees are the most common forms of restrictive covenants employers use to prevent their former employees from going to work for a competitor or from luring away former co-workers or clients after they depart.

North Carolina courts have a long history of scrutinizing covenants that prevent an employee from competing with his or her former employer. As a general rule, judges in North Carolina have disfavored enforcing restrictive covenants unless they are thoughtfully crafted to meet certain requirements. For restrictive covenants to be enforceable, they must be (1) in writing, (2) made part of a contract of employment, (3) based on valuable consideration, (4) reasonable both as to time and territory and (5) not against public policy.

Automatic renewal provisions – often described as “evergreen provisions” – are common in employment agreements. A recent decision by the North Carolina Business Court adds a new dimension to the analysis of whether adequate consideration exists for enforcing a restrictive covenant and is likely to have a dramatic impact on whether covenants not to compete are enforceable after an employment contract automatically renews.

In the case of *American Air Filter Company v. Samuel C. Price, Jr. and Camfil USA, Inc.*, the employee entered into an employment contract 17 years after his employment began. The one-year contract contained a provision indicating that the agreement would automatically renew from year to year, as well as a covenant not to compete with his employer for a one-year time frame after his employment ended. The employee was provided compensation over and above his salary in exchange for his execution of this agreement. Years later, and after the employment contract had automatically renewed several times, the employee resigned and obtained employment with a competitor. His former employer filed suit alleging breach of the covenant not to compete.

In ruling in favor of the employee's motion to dismiss his former employer's complaint, Judge Gregory McGuire determined that while the employer had adequately alleged the employee had received sufficient consideration to make the restrictive covenants enforceable at the time the agreement was signed, the employer failed to allege it had provided additional consideration each time the contract automatically renewed. As a result, the Business Court held that "[a]ny failure to provide consideration for a given year's renewal would break the 'chain' and render the [original employment agreement] unenforceable as to subsequent years."

It is worth noting that while the Business Court applied Kentucky law in its analysis, and although Kentucky law regarding the enforceability of non-compete covenants differs from North Carolina law in some respects, courts in both Kentucky and North Carolina require that a post-employment covenant not to compete be supported by consideration other than continued employment to be enforceable. Thus, there is no reason to believe that the Business Court would have reached a different conclusion utilizing North Carolina law.

It is further worthy of note that decisions of the North Carolina Business Court — a special Superior Court designed for complex business disputes — are not binding on other state trial courts unless and until the North Carolina appellate courts (the Court of Appeals or the Supreme Court) adopt the Business Court's reasoning. That being said, the Business Court is the arbiter of many of the state's employment disputes and North Carolina's trial and appellate courts often rely upon the Business Court's decisions for guidance in cases involving restrictive covenants.

As this decision is likely to become persuasive authority in future cases, North Carolina employers would be wise to evaluate the status of current contractual obligations that contain automatic renewal provisions to ensure that consideration for a restrictive covenant is provided each time the contract renews. If this can be demonstrated, be sure to include this detail in future enforcement litigation. If this has not been a standard practice, it may be appropriate to consult with counsel and revise any employment agreement templates currently in use.

At a minimum, this recent decision by the North Carolina Business Court is instructive for guiding employers on how to craft enforceable restrictive covenants concerning the elusive element of consideration. If you have questions regarding this court decision or other legal matters involving the employment relationship, please contact Connie Carrigan at ccarrigan@smithdebnamlaw.com.

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