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Business Court tackles validity of employment covenants

By: Jeff Jeffrey August 18, 2016

Judge Gregory McGuire of the North Carolina Business Court recently put a set of restrictive employment covenants under the microscope in a lengthy opinion that should serve as a primer for attorneys drafting employment contracts.

McGuire's 39-page Aug. 1 opinion in Sandhills Home Care v. Companion Home Care meticulously examined the wording of noncompete, noninducement and nonsolicitation agreements signed by Sandhills employees to determine their validity. The judge found that many of the restrictions were overly broad and thus unenforceable. That led McGuire to dismiss many of Sandhills' claims against 11 former employees who allegedly quit en masse to join the home health care company's chief competitor.

McGuire's analysis signaled that common language found in many employment covenants will be viewed with a heavy dose of skepticism by the Business Court. Sweeping restrictions on the actions of former employees, as well as tight limits on how they engage with the clients of their former employer, may not survive judicial review any longer.

The opinion out of the Business Court follows a national trend of judges cracking down on overly restrictive employment covenants that unfairly limit former employees' ability to earn a living.

Adam Hocutt, an attorney with Dozier Miller Law Group has written about the evolving judicial view of employment covenants. He said these days, attorneys who draft noncompete and noninducement agreements have to pay more attention to the specific tasks the employee's job requires and how their actions are restricted after they leave.

"It used to be that attorneys could focus on the time and territory aspects of noncompete and noninducement agreements. If the restrictions were two years or less and 100 miles or less, you were probably OK," Hocutt said. "But that two-prong test is now much more frequently a three-prong test. If you restrict a former employee from performing actions above and beyond the tasks they carried out during the course of their employment, courts are much more likely to take a hard line."

Devious defections?

Pembroke-based Sandhills Home Care and Lumberton-based Companion Home Care are both in the business of providing in-home health care to customers in and around Robeson County.

Sandhills requires all of its employees to sign restrictive employment agreements because the one-on-one nature of in-home care creates a strong bond between the caregiver and the patient.

But according to a Dec. 31, 2015 complaint, two of Sandhills former employees allegedly conspired with Companion owner Charles Graham to convince nine certified nursing assistants and patient care aides to ditch Sandhills to go work at Companion.

Sandhills staff allegedly sent letters to Graham and the former employees, seeking to find out whether the former employees had begun working at Companion "in violation of their employment agreements." When those letters went unanswered, Sandhills decided to pursue litigation.

The complaint alleges claims of breach of contract, tortious interference with contract, unfair and deceptive trade practices, misappropriation, breach of fiduciary duty and conspiracy.

Sandhills also requested a preliminary injunction barring the former employees from soliciting Sandhills customers and from inducing Sandhills to end their employment to work at Companion. That request was granted earlier this year.

Sandhills is represented by Thomas Van Camp of Van Camp, Meacham & Newman in Pinehurst. Van Camp did not return calls seeking comment.

Problem provisions

In March the defendants sought to have the case dismissed because the employment agreements were overly restrictive. And on at least some of the claims, McGuire agreed with the defendants.

McGuire's Aug. 1 opinion walks through the restrictive covenants in Sandhills' employment agreements and weighs their validity.

The first provision to fall under McGuire's analysis is the noncompete clause of Sandhills' standard at-will agreement. Former employees who have signed that agreement are barred from "working for, providing services for, consulting with or otherwise assisting" a competitor for one year after they leave the company.

McGuire determined that Sandhills had overreached because the restriction goes far beyond prohibiting former employees from performing the same type of work or services for a competitor that they carried out while working for Sandhills. McGuire said the way the Sandhills agreement reads, former health care employees couldn't even work for a competitor in a wholly unrelated role, such as a janitor. That, McGuire said, is unreasonable.

Next, McGuire took issue with Sandhills' noncompete covenants definition of "compete," which included a one-year ban on "holding any ownership interest in," "advising" or providing "any work or services" to a competing home health business. Read literally, that would prevent former employees from owning shares of a mutual fund that had a "tiny" holding in a publicly traded home health care company, McGuire said.

McGuire said the phrases "advising" and "any work or services" were problematic because they would affect former employees who go into a completely different line of business like, say, interior decorating.

"Such a broad ban is an unreasonable and unenforceable restriction that fails to narrowly protect Sandhills' legitimate business interests," McGuire said.

McGuire also took a blue pencil to Sandhills' nonsolicitation agreement. While McGuire found that nonsolicitation agreements do not need to be tied to a geographic territory, he said the covenant employed by Sandhills went too far because it sought to bar former employees from contacting even "prospective customers" of the company for two years. That too went beyond Sandhills' legitimate business interests, McGuire said.

Complicated clauses

But not all of the issues before McGuire were so clear cut.

Sandhills' nonsolicitation agreement also includes a provision that forbids former employees from contacting any of its customers for one year, regardless of whether the employee worked with them during their time at Sandhills.

McGuire said it was too early in the case to determine whether that provision was also overly broad. Accordingly, McGuire allowed Sandhills' breach of contract claims stemming from that provision to proceed.

McGuire noted that the standard used by North Carolina courts to enforce nonsolicitation provisions is more liberal than the standard that applies to noncompete agreements.

Employment attorney Steve Dunn of Van Hoy, Reutlinger, Adams & Dunn in Charlotte said federal courts across the country have reached different conclusions about the validity of restrictions aimed at customers that a former employee didn't interact with.

"The plaintiffs in this case have a very small and discreet base of customers," Dunn said. "That could lead a court to reasonably conclude that keeping former employees from contacting customers they didn't work with is not unreasonably restrictive."

That was not the only aspect of Sandhills' complaint that survived the motions to dismiss.

McGuire sided with Sandhills on the enforceability of noninducement provisions. The judge said those covenants,

which bar former employees from encouraging other employees to jump to a competitor, do not violate National Labor Relations Act protections on employees' right to engage in concerted activity, as the defendants claimed. Nor do they unfairly suppress competition, McGuire ruled.

In all, seven of Sandhills' claims will be allowed to proceed in the Business Court.

The defendants' attorneys from Teague Campbell Dennis & Gorham; Locklear, Jacobs, Hunt & Brooks; and Hedrick, Gardner, Kincheloe & Garofalo could not be reached for comment.

Be specific

Dozier Miller's Hocutt said his advice to attorneys writing employment covenants is to be as specific as possible. The best agreements, he said, are those that include clear, tightly written definitions for important terms.

When addressing the tasks and activities that a former employee cannot engage in, Hocutt said to begin by focusing on the specific tasks the employee carried out during their employment and then move outward to include broader restrictions. That way, if a court determines the broader restrictions are unreasonable, they can blue pencil them out without making the entire agreement unenforceable.

"It's a lot cheaper to have a lawyer draft a good noncompete the first time than to try to enforce a bad one through litigation at a later time," Hocutt said.

The 39-page opinion is Sandhills Home Care v. Companion Home Care, et. al. (Lawyers Weekly No. 020-056-16). An opinion digest can be found at nclawyersweekly.com.

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