Looking to hire? Be careful with non-compete deals

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American businesses are starting to hire again. Figures from the Department of Labor show that the unemployment rate dropped to 8.8% in March - down from a peak of 10.6% in January of 2010. As businesses look to hire, many managers will want their new employees to sign non-compete agreements. Such covenants can be beneficial for employers, but only if executed correctly.

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.

A covenant that fails to meet any one of these 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 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 fall-back 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.

A Case Study

In 2010 the South Carolina Supreme Court issued its ruling in *Poynter Investments, Inc. v. Century Builders of Piedmont, Inc.* The court's decision serves as a reminder - in order to be enforced, restrictive covenants must be drafted carefully and narrowly.

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 Supreme Court's decision

Rector appealed, arguing that the trial court exceeded its authority in "blue penciling" the non-compete. The Supreme Court agreed, finding 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.

The Bottom Line

Restrictive covenants can be powerful tools in protecting a company's business interests. But, because the *Poynter Investments* decision indicates that overly broad restrictions should not be rewritten by South Carolina courts, it is important to use reasonable and carefully considered geographic and other limitations to increase the likelihood the covenants will be enforced.

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