

North Carolina Business Court Decision Could Impact Enforceability of Many Non-Competition Covenants

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A recent decision in the North Carolina Business Court could have significant implications on non-competition covenants in employment agreements that contain a very common automatic renewal term. The decision, if followed by North Carolina courts in other cases, could signal an important development in the law and call into question the enforceability of many non-competition covenants.

On June 26, 2017, in the case of *American Air Filter Company, Inc. v. Samuel C. Price, Jr. and Camfil USA, Inc.*, the North Carolina Business Court dismissed, without prejudice, a company's claim of breach of a non-competition covenant against a former employee in North Carolina, finding that the employment agreement lacked consideration to support the covenant. The rule at issue in the case is sometimes called the "additional consideration" rule. Under the law of many states, a non-competition covenant entered into after the employment relationship begins is not enforceable unless the employee is given some additional consideration beyond continued employment, such as a bonus, pay increase, promotion, etc.

In 2006, the employment agreement at issue was entered into seventeen years after the employee started working. Importantly, the employment agreement contained a very common automatic renewal provision (sometimes called an "evergreen" provision) that stated that the agreement would automatically renew from year to year. In ruling on the employee's motion to dismiss, the Business Court found the company adequately alleged that it provided the employee with sufficient additional consideration for the agreement when it was signed. However, because the Company did not allege that the employee received new consideration for *each of the subsequent automatic renewal terms*, the Business Court concluded that there was no legal consideration alleged in the complaint to support the non-competition covenant after the first year of the term expired.

On that basis, and without citing to any precedent for this specific point, the court concluded that the agreement, including its covenant not to compete, was unenforceable as to the years subsequent to the initial term. Thus, the Court held that an employer's failure to allege that it provided additional consideration for an employment agreement's renewal "breaks the chain" of employment and renders the employment agreement unenforceable as to subsequent years.

Two points are very important in the analysis of this case and its potential implications. First, the Business Court was applying Kentucky law to this contract claim. However, North Carolina, like Kentucky and many other states, also requires additional consideration for a post-employment restrictive covenant and has a well-established body of precedent on that point. Nothing in the decision suggests that the Business Court's reasoning would be any different if North Carolina law were applied. Second, this decision is not issued by the North Carolina appellate courts, so it is not binding on North Carolina courts unless such reasoning is one day affirmed in the appellate courts. Importantly, however, the Business Court has jurisdiction over many non-competition matters and many such cases are litigated in that court. Its decisions, particularly regarding restrictive covenants, are often persuasive authority to other courts, including the North Carolina appellate courts.

If this decision is followed in cases applying North Carolina law, it would represent a substantial development in the law of restrictive covenants, which deserves the close attention of any business using restrictive covenants for employees in North Carolina. At a minimum, businesses with restrictive covenants contained in automatically renewing employment agreements should be prepared to address this argument in future enforcement actions and should consult with counsel to consider whether changes to standard agreements are warranted.

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