No. 316A-14 22A Judicial District

SUPREME COURT OF NORTH CAROLINA

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BEVERAGE SYSTEMS OF THE CAROLINAS, LLC,	)	
Plaintiff-Appellee	)	
	)	From Iredell County
vs.	)	No. 12-CVS-1519
	)	No. COA 14-188
ASSOCIATED BEVERAGE REPAIR, LLC LUDINE DOTOLI and CHERYL DOTOLI,	)	
Defendants-Appellants	)	

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AMICUS CURIAE BRIEF

(North Carolina Advocates for Justice)

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AMICUS CURIAE BRIEF
(North Carolina Advocates for Justice)

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Pursuant to Rule 28(i) of the North Carolina Rules of Appellate Procedure, the North Carolina Advocates for Justice, as *amicus curiae*, submits this brief in support of Defendants-Appellants' position that the Court of Appeals erred.

ISSUE PRESENTED

North Carolina has a long-standing practice of applying the strict blue-pencil doctrine to reform overbroad terms in covenants not to compete ("noncompetition agreements"). Should the Court now jettison this legal framework and mandate that trial courts rewrite unenforceable contract terms, simply because the parties authorized the court to do so?

ARGUMENT

Noncompetition Agreements, also called "noncompete clauses" and "covenants not to compete" are contract clauses used to prevent a party from later competing with the other party by restricting specific activities for a specific length of time in a particular territory or region. In this case, the North Carolina Court of Appeals has directed the superior court to rewrite an overly broad noncompete provision between business owners, ignoring long-standing policies and precedent that limit the courts' authority to "blue-lining": striking the overly broad restriction and enforcing the remainder. If the Court of Appeals' decision is upheld, parties will routinely include similar savings clauses in their contracts, including employment agreements, and courts will be enlisted to rewrite parties' contracts. The result will be more uncertainty in the business community, heightened restrictions on development and growth, and increased litigation, burdening the lower and appellate courts. This Court should reverse the Court of Appeals' decision or limit its application so that this kind of savings clause cannot be used to "fix" noncompetition provisions in employment agreements.

I. THE COURT OF APPEALS' DECISION VIOLATES LONG-STANDING POLICIES AND PRECEDENT.

A. Courts Cannot Enforce Agreement Where There Has Been No Meeting of Minds.

Contract law fundamentally requires a meeting of the minds on material terms in order to have an enforceable contract. *See Snyder v. Freeman*, 266 S.E.2d 593, 602 (N.C. 1980) ("The essence of any contract is the mutual assent of both parties to the terms of the agreement so as to establish a meeting of the minds."); *Horton v. Humble Oil & Refining Co.*, 122 S.E.2d 716, 719 (N.C. 1961) (action for breach of contract properly dismissed where testimony revealed uncertainty in terms of contract, and thus no meeting of minds necessary to formation of binding agreement); *Wilson v. W.M. Storey Lumber Co.*, 104 S.E. 531 (N.C. 1920) (letter offering to deliver "possibly three" carloads of lumber was too indefinite and uncertain to constitute a binding contract).

In this case the parties agreed that the defendant would be restricted from competing, but failed to agree on enforceable terms. By leaving terms open for a future court's determination, the parties failed to agree on material terms relating to the noncompetition provisions, and the entire clause failed.

B. Courts Will Not Rewrite the Parties' Agreement.

Even if the parties in this case had a meeting of minds as to material terms, North Carolina has long refused to rewrite contracts for parties. *See Penn v.*

Standard Life Ins. Co., 76 S.E. 262, 263 (N.C. 1912) ("Courts are not at liberty to rewrite contracts for the parties. We are not their guardians, but the interpreters of their words. We must, therefore, determine what they meant by what they have said – what their contract is, and not what it should have been. ..."). *See also Troitino v. Goodman*, 35 S.E.2d 277, 283 (N.C. 1945) ("Liberty to contract carries with it the right to exercise poor judgment as well as good judgment. It is the simple law of contracts that 'as a man consents to bind himself, so shall he be bound.'") (citations omitted). *See also Torrington Co. v. Aetna Casualty & Sur. Co.*, 216 S.E.2d 547, 550 (S.C. 1975) ("[T]he parties [had] a right to make their own contract and it is not the function of this Court to rewrite it or torture the meaning [of the agreement the parties willingly executed.]").

By directing the trial court to rewrite the agreement according to what is reasonable at the time of the dispute, the Court of Appeals turns that principle on its head, and asks the trial judge to step into the scrivener's role, requiring the court somehow to divine the intent of the parties at the time the agreement was executed, or to modify its terms materially according to what one party now believes is "reasonable." It is not the role of the courts to become a party's scrivener. *See Daston Corp. v. MiCore Solutions, Inc.*, 80 Va. Cir. 611, 617-18, 2010 Va. Cir. LEXIS 94 (Fairfax Co. 2010)(declining invitation to "'become the employer's scrivener' and modify the agreement so that it complies with law'"); *Northern Va.*

Psychiatric Group, P.C. v. Halpern, 19 Va. Cir. 279, 282, 1990 Va. Cir. LEXIS 115 (Fairfax Co. 1999) (savings clause in employment agreement allowing court to narrow effect of restrictive covenant violated public policy; court "decline[d] to rewrite the offending covenant to the court's own notion of what restriction would comply with Virginia legal principles."); *Hurwitz Group, Inc. v. Ptak*, No. 02-2599, 2002 Mass. Super. LEXIS 565 at *13 (Mass., Suffolk County Super. Ct. June 27, 2002 ("...there is a point beyond which it is unreasonable to expect the parties to submit themselves to the post-hoc judgment of a court of equity, as a substitute for their own bargain. A contract should inform the parties with reasonable clarity of their rights and obligations. ...").

C. Restrictive Covenants Are Disfavored and May Not Be Rewritten.

The problem of authorizing lower courts to rewrite unenforceable provisions is even more untenable when one considers that this Court has clearly stated: "If a contract by an employee in restraint of competition is too broad to be a reasonable protection to the employer's business *it will not be enforced. The courts will not rewrite a contract if it is too broad but will simply not enforce it. ..." Whittaker Gen. Med. Corp. v. Daniel*, 379 S.E.2d 824, 828 (N.C. 1989) (adopting "blue pencil rule": if the contract is separable, and one part is reasonable, the courts will enforce the reasonable provision) (emphasis added). *See also Hartman v. W.H. Odell & Assocs., Inc.*, 450 S.E.2d 912, 917 (N.C. App. 1994) ("equity will neither

enforce nor reform an overreaching and unreasonable covenant,'" but may choose not to enforce distinctly severable part of covenant in order to render provision reasonable) (quoting *Beasley v. Banks*, 368 S.E.2d 885, 886 (N.C. App. 1988).

In *Whittaker General*, this Court recognized the trial court's ability to "blue line" by striking out clearly severable provisions, and enforcing the remainder to the extent that it is logically coherent. North Carolina's Court of Appeals has thereafter occasionally approved the blue-lining of unreasonable provisions. However, it is a far cry to go from excising clearly distinguishable provisions, to rewriting provisions altogether. Fundamentally, "the blue pencil marks, but does not write." *Hamrick v. Kelley*, 392 S.E.2d 518, 519 (Ga. 1990).

By authorizing the State's superior courts to rewrite restrictive covenants, this Court would have to ignore precedent and abandon not only the delicate balancing that permits these restraints of trade, but also the long-standing principles of equity that have governed whether and how a court should intervene to enforce an overly broad provision. Because noncompetition agreements are disfavored in the law, *Kadis v. Britt*, 29 S.E.2d 543 (1944); *Farr Assocs., Inc. v. Baskin,* 530 S.E.2d 878, 881, *quoting Hartman v. W.H. Odell & Assocs.,* 450 S.E.2d 912, 916 (1994), it makes no sense to now elevate noncompetes to favored status by granting a special tool to permit extra-contractual, universal enforcement of these covenants.

D. Parties May Not Grant Courts Authority Held Only by Judiciary.

The fact that the contract here allowed the court to rewrite unenforceable terms does not help with the analysis. Ingenious drafters have previously attempted to imbue the courts with powers they would not otherwise have. For example, it is settled in North Carolina that because a consent judgment is a private agreement by the parties, a trial court's contempt powers may not be enlisted to secure its performance (outside the domestic law arena). *Crane v. Crane*, 441 S.E.2d 144, 145 (N.C. App. 1994). In *Ibele v. Tate*, 594 S.E.2d 793 (N.C. App. 2004), the Court of Appeals considered whether to make an exception for a contract specifically stating that it could be enforced using the court's contempt powers. The Court rejected the notion, noting that "the parties have no right to grant or accept a power held only by the judiciary." *Id.* at 795. Likewise here, the Court should reject the proposition that parties can by private contract mandate the future use of the court's equitable powers.

Moreover, as Virginia courts have recognized, a clause specifically granting a court authority to reduce or modify invalid terms of a noncompete provision magnifies the chilling effect and ambiguity of a disfavored covenant because the extent to which a court might later "reduce" a term cannot be known to the parties at the time of execution, or any time before the court rules. *Lasership, Inc. v. Watson*, 79 Va. Cir. 205, 2009 Va. Cir. LEXIS 64 (2009); *Clark Sales & Serv., Inc.*

v. Smith, 4 N.E.3d 772 (Ind. Ct. App. 2014) (recognizing *in terrorem* effect, court concluded it should not rewrite covenant as "the courts need not do for the employer what it should have done in the first place—write a reasonable covenant.") (internal cites omitted); *Northern Va. Psychiatric Group, P.C. v. Halpern*, *supra*.

E. Requiring Court Intervention Is Impractical.

Practical realities also militate against the court's intervention where noncompete provisions are overly broad. Should the court rewrite the provision based upon the parties' understanding at the time of execution? Or at the time of enforcement? What if the parties disagree as to their understanding or intent with respect to the proposed areas for revision? How does the court create an enforceable agreement when there is arguably no meeting of the minds, and potentially never was? Should the moving party be required to demonstrate the nonmovant's understanding and knowledge of important facts, such as the identity of the employer's customers, actual and projected territorial operations, and the information it actually keeps secret rather than merely claims is confidential? Should the court even undertake this complicated analysis when the parties did not themselves do so, in the first place? If it does, can the parties come back for more modifications, when/if circumstances change? If so, must they seek relief from the same superior court judge, or will any judge do? Where does the parties'

responsibility for their own transaction begin and end? Should the courts allow themselves to be placed in this position?

If this Court affirms the Court of Appeals' majority opinion, lawyers in a variety of contexts will begin including similar savings clauses in their agreements, so that any potential flaw to enforceability can be corrected by the courts' rewrite. Do the courts really want to be the parties' scrivener?

II. ALLOWING COURTS TO REWRITE DEFECTIVE AGREEMENTS INHIBITS BUSINESS GROWTH AND JOB DEVELOPMENT.

When noncompete provisions are unclear, employees are likely to assume that the provision is nevertheless enforceable, and feel compelled to remain in a job to avoid litigation. This is referred to as the "*in terrorem*" effect of overly broad restrictions, as explained more than 50 years ago by Professor Harlan Blake:

> For every covenant that finds its way to court, there are thousands which exercise an *in terrorem* effect on employees who respect their contractual obligations and on competitors who fear legal complications if they employ a covenantor, or who are anxious to maintain gentlemanly relations with their competitors. Thus, the mobility of untold numbers of employees is restricted by the intimidation of restrictions whose severity no court would sanction. If severance is generally applied, employers can fashion truly ominous covenants with confidence that they will be pared down and enforced when the facts of a particular case are not reasonable. This smacks of having one's employee's cake, and eating it too.

Harlan M. Blake, *Employee Agreements Not To Compete*, 73 HARV. L. REV. 625, 682-83 (Feb. 1960).

Courts around the country have recognized this *in terrorem* effect. *See*

Tradesman, Int'l, Inc. v. Black, 724 F.3d 1004, 1018 (7th Cir. 2013)(if courts are willing to rewrite overly broad covenants for sake of being reasonable, employers have powerful incentive to draft oppressive, overly broad covenants; in the few cases that go to court, the employer can retreat to reasonable position without suffering any penalty or disadvantage of its oppressive drafting); *Dearborn v. Everette J. Prescott, Inc.*, 486 F. Supp.2d 802, 816 (S.D. Ind. 2007) (where restriction is overly broad, employee cannot have clear understanding of what conduct is prohibited, cannot seek meaningful legal advice, and cannot ask employer to decide without effectively burning bridges with the employer); *Product Action Int'l, Inc. v. Mero*, 277 F. Supp.2d 919, 930-31 (S.D. Ind. 2003) (current employee may be frozen in job by unreasonably broad covenant, as he (and potential new employer) cannot know what activities are prohibited, and can only test proposition through expensive and risky litigation); *Latona v. Aetna U.S. Healthcare, Inc.*, 82 F. Supp.2d 1089, 1096 (C.D. Cal. 1999) (rejecting defendant's argument that its agreement is a nullity because employees will tend to assume employer's terms are legal, if draconian, and thus "will tend to secure employee compliance with its illegal terms in the vast majority of cases"); *Valley Medical Specialists v. Farber*, 982 P.2d 1277 (Ariz. 1999) ("for every agreement that makes its way to court, many more do not;" court will not rewrite unreasonable agreement because to do so encourages employers to create oppressive covenants

with *in terrorem* effect on departing employees); *Reddy v. Community Health Found.*, 298 S.E.2d 906, 916 (W. Va. 1982)(overbroad provisions have *in terrorem* effect of subjugating employees unaware of tentative nature of such covenant); *Richard P. Rita Person. Servs., Int'l, Inc. v. Kot*, 191 S.E.2d 79 (Ga. 1972)("mobility of untold numbers of employees is restricted by the intimidation of restrictions whose severity no court would sanction"); *Arthur Murray Dance Studios v. Witter*, 105 N.E.2d 685, 687-88 (Ohio, Cuyahoga Co. Ct. C.P. 1952) (no layman could realize the legal complications involved in enforcing noncompetes). *See generally* Griffin Toronjo Pivateau, *Putting the Blue Pencil Down: An Argument for Specificity in Noncompete Agreements*, 86 NEB. L. REV. 672, 673-74 (2008) ("The employer … receives what amounts to a free ride on a contractual provision that the employer is well aware would never be enforced.").

Noncompetition agreements are bad for business, job creation, and employee productivity. A recent article reviewed research on the economic impact of noncompetes on business growth and development and concluded that the mere existence of a noncompete (much less the possibility of court intervention to rewrite its provisions) is *detrimental* to business:

- Noncompetes prevent bidirectional knowledge spillovers that contribute to innovation and invention;
- Noncompetes drive away inventors (and other creative people) who have

the greatest human and social capital, while retaining those who are less productive and connected;

- Areas that enforce strong post-employment controls have higher rates of departure of inventive talent, while areas that weakly enforce noncompetes have higher rates of newcomers;

- In states that enforce noncompetes, professionals are more likely to take career detours, which further inhibits inventions and innovation;

- Employees who believe their market opportunities are significantly reduced due to a noncompete restrictions are less driven to perform well and to invest in their own human capital;

- Companies provide lower compensation and invest less in R&D when noncompetes are strongly enforced (since they know their employees are effectively "captive");

- Human capital controls (restricting people from moving among jobs, competing in the market, and using acquired professional skills) make prime labor markets more rigid and obstruct trial-and-error in matching compatible jobs and talent.

See On Amir & Orly Lobel, *Driving Performance: A Growth Theory of Noncompete Law,* 16 STANFORD TECH. L. REV. No. 3, p. 833 at 846, 857-62, 865-66 (2013). By contrast:

• States that refuse to enforce noncompetes, or only weakly enforce noncompetes, have greater inventor mobility, which spurs the creation of more new companies;

• States that do not enforce or weakly enforce noncompetes experience twice the increase in patents in response to an influx of venture capital than do States that enforce noncompetes, and enjoy three times the employment growth;

• Nonenforcing States gain doubly: first, from the positive effects of their own policy, and second from the restrictive attitude of their competitor States. *Id.* at 858, 860-61.

If these are the effects where the courts enforce noncompetes, what is the impact upon business where the ultimate enforceability (and scope) of the contract is unknown? If a potential employer cannot review the potential employee's existing noncompete and know what activities would be prohibited, it may well avoid the risk altogether by not hiring the employee.

III. AFFIRMING THE COURT OF APPEALS WILL RESULT IN OVEREACHING AND INCREASE IN CIVIL LITIGATION.

Allowing courts to rewrite contractual provisions will increase litigation. If a party believes that the court will rewrite an unenforceable agreement to make it enforceable, the incentive to narrowly tailor its provisions disappears. With respect to noncompetition agreements, the drafting party would have no incentive to narrowly draw restrictions to the scope, territorial and temporal requirements

that are actually necessary to protect its legitimate interests.

Rather, to best discourage competition -- and in the employment context, discourage employee turnover and control (or punish) employee behavior post-employment -- covenantees will most likely write the noncompete as broadly and vaguely as possible, secure in the knowledge that the courts will bail them out if the covenantor has the means and audacity to challenge its enforcement. *Cf. Delaware Elev., Inc. v. Williams*, No. 5596-VCL, 2011 Del. Ch. LEXIS 47 at *28-30 (Del. Ch. Mar. 16, 2011) (the threat of losing all protection gives employers an incentive to restrict themselves to reasonable clauses); *Deutsche Post Global Mail, Ltd. v. Conrad*, 292 F. Supp.2d 748, 754 n.3 (D. Md. 2003) (permitting revision encourages employer to impose overly broad restrictions, since the only consequence if challenged will be to have the court write a narrower restriction). *See also* Charles A. Sullivan, *The Puzzling Persistence of Unenforceable Contract Terms*, 70 Ohio St. L.J. 1127, 1151, 1176-77 (2009) (overbroad noncompetes create incentive for employers: "ask for as much as possible, with the expectation that you will get at least what you're entitled to should the matter go to court"); Pivateau, *supra*, 86 NEB. L. REV. at 695-96 ("When gifted with a court that will create a narrow agreement after the fact, employers have little incentive to draft narrowly tailored agreements on their own.").

A covenantee that knows it is assured of victory without risk of loss and has

a motive to punish or interfere with its covenantor will pursue its remedies in court. The better policy choice is to require that a covenantee create an enforceable agreement at the outset.

IV. COURT OF APPEALS' "REMEDY" WAS INAPPROPRIATE.

A. Courts Cannot Reform Agreement Absent Mistake or Fraud.

As discussed above, with very limited exceptions, contracts must be enforced as written, or not at all. *See Masterclean, Inc. v. Guy,* 345 S.E.2d 692 (N.C. App. 1986) (where territory is unreasonably extensive, the entire covenant fails because equity will neither enforce nor reform an overreaching and unreasonable agreement); *Stonhard, Inc. v. Carolina Flooring Specialists, Inc.,* 621 S.E.2d 352 (S.C. 2005) (in refusing to blue-pencil noncompetition agreement, South Carolina Supreme Court holds that "[t]o add or enforce such a term requires this Court to bind these parties to a term that does not reflect the parties' original intent" and "would be arbitrary and set precedent allowing a court to disrupt a party's private right to contract").

In this case the Court of Appeals effectively granted the plaintiff reformation of the parties' overbroad and unenforceable agreement, even though the plaintiff did not plead that remedy, and despite the rule in North Carolina that contracts may not be equitably reformed absent mutual mistake of fact, or unilateral mistake accompanied by fraud. *See Matthews v. Shamrock Van Lines, Inc.*, 142 S.E.2d

665, 667 (N.C. 1965); *Welch v. Sun Underwriters Ins. Co.*, 146 S.E. 216, 218 (N.C. 1929). Where one party overreaches or contracts based on a misapprehension of the law, the courts will not step in to "fix" the problem for one party. *See Wright v. McMullan*, 107 S.E.2d 98, 101 (N.C. 1959) ("It is settled that mere ignorance of the law, unless there be some fraud or circumvention, is not a ground in equity to *set aside* conveyance or avoid the legal effects of acts which have been done") (emphasis in original) (internal citations omitted).

The point of reformation, in any event, is to revise the agreement to reflect the parties' original agreement; there are no reported cases permitting reformation where the parties merely failed to agree to enforceable terms, as in this case. Here, no facts justify the court's use of reformation.

B. Appellant Has Other Protections and Remedies.

A party wronged by another party's diversion of customers or use/disclosure of trade secrets has other remedies including common law claims for tortious interference, fraud, misrepresentation and defamation. The party may also have statutory claims under N.C. GEN. STAT. § 66-153 (trade secrets) or § 75-1.1 (unfair and deceptive practices). Courts should avoid creating a new agreement as a remedy for the party's initial attempt to impose an overly broad restriction.

CONCLUSION

For the foregoing reasons, *amicus curiae* North Carolina Advocates for Justice respectfully urges the Court to reverse the decision of the Court of Appeals, and find in favor of the Defendant-Appellants.

Respectfully submitted, this, the 16th day of October, 2014.

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CERTIFICATE OF COMPLIANCE

I certify that the foregoing document was prepared using Times New Roman 14-point type, and does not contain more than 3,750 words, as reported by Microsoft Word, exclusive of covers, indexes, table of contents, table of authorities, certificate of service, or this Certificate of Compliance.

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CERTIFICATE OF FILING AND SERVICE

I certify that the foregoing *Amicus Curiae* brief of the North Carolina Advocates for Justice has been:

1. Filed electronically with the North Carolina Supreme Court pursuant to Rule 26(a)(2) of the North Carolina rules of Appellate Procedure; and,

2. Served upon all parties to this action pursuant to Rule 26(c) of the North Carolina Rules of Appellate Procedure via electronic mail and first-class U.S. mail, addressed as noted below:

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