



## Sharpening the Blue Pencil: NC Court of Appeals Decision May Give Business Buyers More Power over Non-Competes

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With its split decision in *Beverage Systems of the Carolinas, LLC v. Associated Beverage Repair, LLC, et al.* (No. COA14-185), the North Carolina Court of Appeals has created a new question about the universal application of the state's "blue pencil doctrine." The decision required the trial court to revise an otherwise-unenforceable part of a non-compete agreement arising from the sale of a business, based on the agreement's grant of editorial authority.

In September 2009, Beverage Systems of the Carolinas, LLC, acquired substantially all of the business and assets of Imperial Unlimited Services, Inc., and Elegant Beverage Products, LLC. As a condition of the asset purchase, each of the proprietors of the two selling businesses, including Ludine Dotoli, executed an agreement prohibiting them from directly or indirectly competing with the buyer's business anywhere in North Carolina or South Carolina for a period of five years after closing. In recognition of the reasonableness limitations imposed on covenants not to compete under North Carolina law, the agreement further provided that, in the event a court ruled the non-compete unenforceable as written, "the maximum period, scope or geographical area that are reasonable under such circumstances shall be substituted" and that the court shall be allowed to revise the restrictions "to cover the maximum period, scope and area permitted by law."

Less than two years after the transaction, Dotoli began to engage in activities that were allegedly competitive with Beverage Systems' business through a new company organized by his wife, Associated Beverage Repair, LLC. When Beverage Systems sued Associated Beverage Repair and Dotoli to enforce the non-compete, the trial court granted summary judgment to the defendants. The court deemed the geographic reach of the restriction to be unreasonably broad, because the seller's former and buyer's current business extended only to parts of North Carolina and South Carolina. Applying the state's strict "blue pencil doctrine," the trial court declared itself powerless to reform the territory covered by the non-compete in order to make it enforceable in any smaller areas, eviscerating the entire non-compete agreement as a result.

When given by a seller to a buyer incident to the sale of a business, a covenant not to compete is enforceable in North Carolina only if, *inter alia*, the restrictions cover a reasonable geographic territory. A reasonable territory covers only the areas necessary to protect the buyer's business and goodwill among the seller's and buyer's current and former customers. Future prospects do not justify extension of the territory any further.

In *Beverage Systems*, the Court of Appeals agreed with the trial court that, because the customer base of the buyer and sellers reached only limited parts of North Carolina and South Carolina, the non-compete at issue unreasonably overreached in extending to all corners of those states. But did the trial court have any way to shrink the reach of the covenant to a justifiably enforceable area?

At its core, the North Carolina blue pencil doctrine allows a court to make a non-compete enforceably reasonable by striking, but not revising, the distinctly separable and unreasonable words used by the parties to define the covenant's scope. In recognition of this longstanding principle, many non-compete agreements are drafted with discrete, severable components, each covering an increasingly broad increment of time or territory, in a manner designed to allow a trial court to draw a clear line between the reasonable and enforceable increments and those it opts to delete. On the other hand, if monolithic language defines the covenant's scope, and no reasonable, divisible parts are available for the court to separately enforce, to the exclusion of unreasonable parts, then the blue pencil doctrine strictly prohibits the court from revising or rewriting the covenant, rendering the entire covenant void.

Applying the blue pencil doctrine, the *Beverage Systems* trial court determined it could not make the non-compete reasonable by striking either North Carolina or South Carolina and leaving the non-compete enforceable in the other state—the only traditional blue penciling option—in its entirety. But the Court of Appeals took a radical step away from the strict blue pencil approach. It jettisoned the blue pencil doctrine entirely, opting to give effect to the parties' derogation of blue pencil restrictions by enforcing the non-compete agreement's express grant of revisionary authority to the trial court. The Court remanded *Beverage Systems* to the trial court to revise the non-compete provisions to match the areas within North Carolina and South Carolina where application of the non-compete would be reasonable under the law.

The Court's reasoning in *Beverage Systems* evokes a theme of fairness and a desire for modernization of the strict blue pencil doctrine under certain circumstances. Recalling that North Carolina law generally gives greater latitude to non-competes arising from the sale of a business than from

employment?and carefully circumscribing its holding to that context?it argued that the parties ?were at arms-length with equal bargaining power? when they mutually agreed to grant trial court authority to re-write the non-compete to match the extent permitted by law. The Court reasoned that enforcing the mutual exclusion of blue pencil limitations creates economic benefit for each party in the sale of a business by protecting the buyer?s purchased interests and, arguably, raising the price paid to the seller for its business and goodwill. In a footnote, the Court amplified its emphasis on the business benefits of flexibly enforcing non-compete clauses by challenging the North Carolina Supreme Court to re-think its historically strict stance on blue penciling.

The practical implications of the Court?s opinion in *Beverage Systems* remain to be seen. As a split decision, the North Carolina Supreme Court will necessarily review the case. In his dissent, Judge Elmore focused on the words ?permitted by law? included in the authorizing language of the non-compete. Consistent with the traditionally strict approach to the blue pencil doctrine, he applied the clause ?permitted by law? not to the scope of the restrictive covenant, but to the scope of the trial court?s authority to revise the covenant at all. Concluding the applicable ?law? to be the blue pencil doctrine, he argued that the trial court correctly declined to revise the non-compete.

Even if *Beverage Systems* stands, parties to non-compete covenants and their drafters should keep in mind the fences drawn around the holding by the Court of Appeals. Given the Court?s emphasis on the context of the non-compete, employers cannot rely on *Beverage Systems* to avoid blue penciling. And the Court?s emphasis on mutual economic benefit and the equal bargaining power of the parties cautions against the buyer of a business excessively overreaching when crafting a non-compete in reliance on trial court reformation. For the time being, we think it prudent to continue to draft non-compete clauses with the expectation that a reviewing court will wield the traditionally blunt blue pencil, but the North Carolina Court of Appeals has created a new fissure in the blue pencil doctrine that may ultimately give the buyers of businesses a flexible new tool to protect their investments.

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