

Court of Appeals Strikes Non-Compete for Being Overbroad

In a recent case decided by the North Carolina Court of Appeals, *Carolina Pride Carwash v. Kendrick*, a covenant not to compete was invalidated for having an overbroad geographic restriction. While the case did not involve a health care provider, it is instructive on how courts in our state view covenants against competition, which are prevalent in physician employment agreements.

Typical Covenant

A covenant not to compete found in a physician's employment agreement will usually restrict an activity (the practice or medicine or perhaps more specifically, the practice of a particular specialty), for a period of time during employment until after employment terminates (from three months up to two years or even longer), in a specific geographic area. Geographic area restrictions are often tied to a specific radius around the physician's practice location (e.g., ten miles), the city or cities in which the physician practices or from which the physician draws patients.

North Carolina Law

While covenants not to compete are generally disfavored, they are enforceable in our state. To be enforceable, a covenant must be in writing. Additionally, a covenant must be ancillary to an employment agreement or other agreement, such as the sale of a practice. A covenant must be supported by a need to protect a legitimate business interest. Further, a covenant must be no wider in geographic and temporal scope than is necessary to protect the interest of the employer. Finally, a covenant must be supported by adequate consideration to be enforceable. North Carolina courts will not rewrite a covenant that is too broad, they will simply not enforce it.

Issue in *Carolina Pride*

In the *Carolina Pride*, Tim Kendrick became employed as a service technician by Carolina Pride Carwash in 2000 when he signed an employment agreement containing a covenant not to compete that prohibited him from competing in North Carolina, South Carolina and Virginia during the three year period following termination of his employment. The contract also contained a liquidated damages clause requiring the him to pay the employer \$50,000 if he breached the covenant. Kendrick served customers predominantly in North Carolina and occasionally in South Carolina.

In 2001, Kendrick left Carolina Pride to work as a manager of repair, maintenance and supply with Water Works Management Company, a car wash supply and maintenance company who had facilities in Greensboro, Mt. Airy, Elkin and Boone. In 2002, Carolina Prided sued the Kendrick for interfering with customer relationships in violation of the non-compete signed by Kendrick. The trial court determined that Kendrick had breached the covenant, and ordered him to pay damages in the amount of \$50,000. Kendrick appealed.

The North Carolina Court of Appeals reversed the trial court, and held that the covenant's geographic restriction was unreasonable. The court held that in order for an employer to prove that a covenant is reasonable, it must show where its customers are located and that the geographic scope of the covenant is necessary to maintain those customer relationships. Further, the court reiterated the North Carolina rule that if the restricted territory is too broad, the entire covenant fails since equity will neither enforce nor reform an overreaching covenant.

The Court of Appeals cited evidence adduced at the trial court that indicated that Carolina Pride's customers were drawn from North Carolina, South Carolina, and the lower half of Virginia. Thus, the court held, including the entire state of Virginia when Carolina Pride's customers were only in the lower half of the Commonwealth rendered the covenant overbroad and therefore unenforceable.

Why it Matters

The most important tenet that physicians can glean from this case is that the scope of geographic restrictions is monumentally important. A noncompete should be limited to the practice's market. Admittedly, a practice's market for the duration of a physician's employment may be difficult to ascertain at the time the covenant is signed. Further, there is no hard and fast rule for the determination of markets, a ten-mile radius around a practice site might be too broad in some cases, while a forty-mile radius around other practices might not provide enough protection. Often, it is advisable for practices to perform an analysis of the zip codes of their patients to determine the practice's market. If the geographic scope of the restriction extends beyond the actual market, then the covenant is at risk.

While the case in Carolina Pride had nothing to do with health care, it did provide health care providers with guidance on covenants not to compete.