ONE STEP FORWARD AND TWO STEPS BACK:
NORTH CAROLINA RESTRICTIVE COVENANTS IN
THE WAKE OF BEVERAGE SYSTEMS I AND II

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I. INTRODUCTION

Restrictive covenants increasingly pervade the world of employment, and while the law does not favor such covenants, courts recognize the importance of restrictive covenants in protecting businesses. North Carolina has a well-developed body of restrictive covenant case law, but the North Carolina Supreme Court has been reluctant to weigh in on restrictive covenant issues in recent years. On March 18, 2016, however, the North Carolina Supreme Court broke its silence in Beverage Systems of the Carolinas, L.L.C. v. Associated Beverage Repair

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3. Farr Assoc., Inc., 138 N.C. App. at 279, 530 S.E.2d at 881 (stating that one of the elements of an enforceable restrictive covenant is that it be “designed to protect a legitimate business interest of the employer”).

In breaking that silence, the North Carolina Supreme Court solidified its strict position on the “blue penciling” doctrine in the restrictive covenant context and set back the recent progress made by the North Carolina Court of Appeals in the state’s restrictive covenant law.

In order to understand the North Carolina Supreme Court’s error in *Beverage Sys. II*, it is first important to understand the background of restrictive covenants in North Carolina and the various approaches taken by other jurisdictions to the blue penciling rule. North Carolina courts require businesses to show five elements to enforce restrictive covenants in the employee-employer context, and each of those elements has its own body of case law, with some lines of cases still developing. One such line of cases is the body of case law surrounding the reasonableness of the geographic and temporal scope of restrictive covenants and North Carolina’s application of the blue penciling doctrine to those restrictions, and the *Beverage Systems* case represents the newest development in that law.

After examining the background of restrictive covenants and the various approaches to the blue penciling doctrine, an analysis of North Carolina’s application of the strict severability blue penciling rule makes apparent that the rule is not the optimal way to accomplish the goals of restrictive covenant law. This examination provides context for the North Carolina Court of Appeals’ and supreme court’s consideration of the blue penciling doctrine in the *Beverage Systems* case, and for why the opinions may be seen as “one step forward and two steps back” for North Carolina law.

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6. See infra Part III (defining and discussing blue penciling in the restrictive covenant context).
10. See infra Part III.B.
II. AN OVERVIEW OF NORTH CAROLINA RESTRICTIVE COVENANT LAW

Restrictive covenants come in two main flavors that protect businesses in different ways: (1) covenants not to compete, which prohibit individuals from engaging in competing business activities for a specific time period in a discrete geographic area, and (2) non-solicitation agreements, which prohibit individuals from actively pursuing customer, vendor, or employee bases.\(^{11}\) North Carolina has five requirements for enforcement of both types of restrictive covenants: (1) the covenant must be in writing; (2) the covenant must be part of a contract for employment;\(^{12}\) (3) the covenant must be supported by valid consideration; (4) the covenant must be reasonable as to time and territory; and (5) the covenant must not violate public policy.\(^{15}\) Courts sometimes state the fifth element as being that the covenant be “designed to protect a legitimate business interest of the employer”\(^{14}\); however, protection of legitimate business interests is actually the umbrella under which restrictive covenants live.\(^{15}\) The courts’ listing of protection of a legitimate business interest as the fifth element is an unfortunate misstatement of the law resulting from an inaccurate citation of law by the North Carolina Court of Appeals.\(^{16}\) Each element contains its own unique nuances and body of case law.

\(^{11}\) Kenneth P. Carlson, Jr., The Road to Redemption: Saving North Carolina Noncompete Law from Itself, 12 WAKE FOREST J. BUS. & INTELL. PROP. L. 199, 201–02 (2012).

\(^{12}\) This element only applies in the employee-employer context on which this comment will focus, but restrictive covenants are also enforced in the business-to-business context, as seen in the Beverage Systems cases. See Beverage Sys. II, 308 N.C. 693, 695, 784 S.E.2d 457, 459 (2016); Beverage Sys. of the Carolinas, L.L.C. v. Associated Beverage Repair (Beverage Sys. I), 235 N.C. App. 438, 440, 762 S.E.2d 516, 518–19 (2014).

\(^{13}\) Whittaker, 324 N.C. at 525, 579 S.E.2d at 826.


\(^{15}\) Carlson, supra note 11, at 207-08.

\(^{16}\) Id. at 208 (citing Young v. Mastrom, Inc., 99 N.C. App. 120, 122–23, 392 S.E.2d 446, 448 (1990)) (discussing the misstatement of law in Young v. Mastrom, Inc. by the court of appeals).
A. The Agreement Must Be in Writing and Part of a Contract for Employment

The first two elements, that the covenant be in writing and part of a contract for employment, are simple on their faces. The restrictive covenant must be written and part of the overall employment relationship of the parties. North Carolina’s law, however, reveals three important observations that must be made.

First, the writing requirement may not be as strict as once thought when the restrictive covenant is not a standalone contract but is rather one part of a larger employment agreement. The North Carolina Business Court recently held that employment contracts with the same terms and conditions may be implied-in-fact when an employee remains in his or her position after the term of a written employment contract ends. Therefore, it is conceivable that a restrictive covenant, which was in writing and signed by the employee as part of a larger employment agreement and has expired by its own terms, may be enforceable against an employee if the employee remains with the employer performing the same duties. The terms and conditions that survive are those “provisions and restrictions forming essential parts of the original contract, even [if some are] collateral to the employment itself.” Therefore, when a restrictive covenant is included within a larger employment agreement, employers may be protected by an “implied” restrictive covenant even if the original writing has expired, depending on whether the employer can show that the

17. Id. at 208–09.
18. Id. (discussing two of the important observations).
19. See Talisman Software Sys. & Servs., Inc. v. Atkins, No. 14-CVS5834, 2015 WL 7356386, at *5–7 (N.C. Super. Ct. Nov. 18, 2015) (precluding an unjust enrichment claim on the basis that an actual employment contract existed). The argument presented in the following sentences of this comment raises an interesting question about the enforceability of “lapsed” restrictive covenants not yet approached by the North Carolina appellate courts and a further, more detailed resolution of which is beyond the scope of this comment.
20. Id. at *6 (explaining that “upon the expiration of a contract of employment for a definite term, the employee continues to render the same services as he rendered during the term of the contract without expressly entering into any new agreement, it will be presumed that he is serving under a new contract having the same terms and conditions as the original one and provisions and restrictions forming essential parts of the original contract, even though collateral to the employment itself, continue in force.” (quoting George v. LeBeau, 455 F.3d 92, 94 (2d Cir. 2006))).
21. Id. at *6 (emphasis added) (quoting George, 455 F.3d at 94).
restrictive covenant was an “essential part” of the original agreement.

The second crucial observation is that a restrictive covenant may stand alone or be part of a larger employment agreement. Therefore, employers are able to selectively choose when they wish to have restrictive covenants included in larger employment agreements and when they would prefer to have stand-alone restrictive covenant contracts. This consideration becomes most relevant when considering possible litigation because including the restrictive covenant in a larger employment agreement opens the employer to potential counterclaims for breach of the same contract. Not only could the counterclaims cause the employer to incur liability, but their mere presence may sway the opinions of jurors away from the employer at trial.

Lastly, only the party subject to the terms of the restrictive covenant needs to sign the writing. Therefore, in the employer-employee setting, only the employee must sign the agreement. A consideration one may make, however, is that signing the agreement may appear favorably to a judge or jury because it connotes a mutuality of the obligations even if the covenant is a stand-alone agreement imposing no obligations on the employer. Therefore, some employers may sign stand-alone restrictive covenants despite not being required to do so.

B. The Covenant Must Be Supported By Adequate Consideration

The third element, that the covenant be supported by consideration, is also relatively simple and comes directly from traditional contract law. In order to restrict an individual’s ability to compete with the employer, the individual must receive some

24. Id.
25. Id.
27. Id.
value for that restriction.\textsuperscript{29} New employment qualifies as valid consideration for a restrictive covenant entered into at the beginning of an employment relationship.\textsuperscript{30} “However, when the restrictive covenant is entered into after an already existing employment relationship, the covenant must be supported by ‘new consideration.’”\textsuperscript{31} Some examples of proper new consideration are: “continued employment for a stipulated amount of time; a raise, bonus, or other change in compensation; a promotion; additional training; uncertificated shares; or some other increase in responsibility or number of hours worked.”\textsuperscript{32} The foregoing are merely examples of what may constitute new consideration, and other forms of consideration may be acceptable. It is important to note that “[t]he slightest consideration is sufficient to support the most onerous obligation, the inadequacy is for the parties to consider at the time of making the agreement, and not for the court when it is sought to be enforced,” and “the Court cannot relieve one [party] because the contract has proven to be a hard one.”\textsuperscript{33} However, illusory or falsely stated consideration will not suffice.\textsuperscript{34}

\textit{C. The Covenant Must Not Be Against Public Policy}

The fifth element, that the covenant not be against public policy, is more complex and often becomes the subject of litigation in cases of physicians and other professionals.\textsuperscript{35} The key inquiry when a covenant is challenged as a violation of public policy is whether the restricted party’s “obligation [creates] a substantial question of potential harm to the public ... [or] will merely inconvenience the public without causing substantial

\textsuperscript{30} \textit{Id.} at 304, 674 S.E.2d at 428.
\textsuperscript{31} \textit{Id.} (quoting James C. Greene Co. v. Kelley, 261 N.C. 166, 168, 134 S.E.2d 166, 167 (1964)).
\textsuperscript{32} \textit{Id.} at 304, 674 S.E.2d at 428-29 (footnotes omitted).
\textsuperscript{33} \textit{Id.} at 305, 674 S.E.2d at 429 (first quoting Catawba Valley Mach. Co. v. Aetna Ins. Co., 15 N.C. App. 85, 90-91, 185 S.E.2d 308, 311-12 (1971); then quoting Bald Head Island Utils., Inc. v. Vill. of Bald Head Island, 165 N.C. App. 701, 704, 599 S.E.2d 98, 100 (2004)).
\textsuperscript{34} \textit{Id.}
harm.  

This inquiry becomes incredibly fact-intensive and greatly depends on the nature of the work done by the restricted party. Outside of the context of professionals, however, the public policy argument rarely comes into play, and the fourth element, reasonableness of the time and geographic restrictions, is the most common argument.

D. The Covenant Must be Reasonable as to Time and Territory

Perhaps the most nuanced, the fourth element is the battleground of restrictive covenant litigation.

In evaluating the reasonableness of time and territory restrictions, the two elements must be considered in tandem because the two requirements are not independent and unrelated. Although either the time or the territory restriction, standing alone, may be reasonable, the combined effect of the two may be unreasonable. A longer period of time is acceptable where the geographic restriction is relatively small, and vice versa.

Unreasonableness of time and/or territory is the most common way a restrictive covenant is struck down. One notable nuance of the reasonableness inquiry is that non-solicitation

36. Id. at 673, 418 S.E.2d at 258 (quoting Iredell Digestive Disease Clinic, P.A. v. Petrozza, 92 N.C. App. 21, 27-28, 373 S.E.2d 449, 453 (1988)).

37. Compare Dickey, 106 N.C. App. 669, 418 S.E.2d 256 (invalidating as against public policy a restriction on an endocrinologist that prohibited him from practicing within a certain county for two years), with Kennedy v. Kennedy, 160 N.C. App. 1, 10-12, 584 S.E.2d 328, 334-35 (2003) (upholding as not against public policy a restrictive covenant against a dentist that prohibited the dentist from practicing within a fifteen mile radius of the former employer for three years).

38. See Carlson, supra note 11, at 212.


41. Carlson, supra note 11, at 213.
agreements do not require geographic limitations but may be limited by a “customer-contact theory.”

Another important aspect of the time and territory inquiry is that each jurisdiction typically creates rebuttable presumptions of enforceability or non-enforceability for discrete geographical or temporal restrictions. For instance, North Carolina will only uphold a restrictive covenant with a time restriction over five years “under extreme conditions.”

Many other factors also come into play when courts consider the reasonableness of restrictive covenants. For instance, when North Carolina courts consider geographic restrictions, the courts must weigh six factors:

(1) the area, or scope, of the restriction; (2) the area assigned to the employee; (3) the area where the employee actually worked or was subject to work; (4) the area in which the employer operated; (5) the nature of the business involved; and (6) the nature of the employee’s duty and his knowledge of the employer’s business operation.

It is in the context of weighing such factors and considering the reasonableness of covenants that the blue penciling doctrine and its various applications come into play in restrictive covenant litigation because some courts will modify unreasonable and unenforceable covenants to enforce only the reasonable parts of the covenants. This makes each jurisdiction’s

42. Id. at 219 (citing United Laboratories, Inc. v. Kuykendall, 322 N.C. 643, 651, 370 S.E.2d 375, 381 (1988)).

43. See, e.g., Fla. STAT. ANN. § 542.335(1)(d)(1) (West 2015) (six months or less presumed reasonable and greater than two years presumed unreasonable against employees); MO. ANN. STAT. § 431.292(1)(4) (2016) (less than one year presumed reasonable); Hartman v. Odell & Assocs., Inc., 117 N.C. App. 307, 313, 450 S.E.2d 912, 918 (1994). Notice that some states have chosen to codify these presumptions while others, like North Carolina, have left restrictive covenant law to the courts.

44. Hartman, 117 N.C. App. at 315, 450 S.E.2d at 918 (quoting Eng’g Assocs., Inc. v. Pankow, 268 N.C. 137, 139, 150 S.E.2d 56, 58 (1966)).

45. Id. at 312, 450 S.E.2d at 917 (quoting Clyde Rudd & Assocs., Inc. v. Taylor, 29 N.C. App. 679, 684, 225 S.E.2d 602, 605 (1976)).

46. See infra Part III.
application of the doctrine a crucial piece of that jurisdiction’s restrictive covenant law.47

III. Blue Penciling in the Restrictive Covenant Context

A. Generally

The blue penciling concept is a form of judicial modification of the terms of a contract that comes in three main varieties: (1) refusal of any modification; (2) strict severability; and (3) liberal judicial modification.48 Under the refusal of any modification approach, courts broadly strike down restrictive covenants that have any unreasonable part regardless of whether the terms are severable.49 This harsh approach leads to the total invalidation of an agreement that includes an unenforceable term,50 and special drafting considerations must be taken in jurisdictions that refuse to engage in any blue penciling whatsoever.51

Courts applying the strict severability rule will remove unreasonable terms from the restrictive covenant, but these courts will also refuse to add any terms.52 This raises crucial questions regarding the definition of “severable” in each jurisdiction applying the rule, and some jurisdictions have not provided much, if any, guidance on that key question.53 “The rationale of the

47. See, e.g., Cent. Ind. Podiatry, P.C. v. Krueger, 882 N.E.2d 723, 730-31 (Ind. 2008) (applying the blue pencil rule to a non-compete agreement).
48. See Bess v. Bothman, 257 N.W.2d 794, 794-95 (Minn. 1977) (applying liberal judicial modification and noting the other approaches taken by courts, particularly that some courts “state[d] as a general rule that unreasonable noncompetitive covenants may not be modified”); Burk v. Heritage Food Serv. Equip., Inc., 757 N.E.2d 803, 811-12 (Ind. Ct. App. 2000) (applying the severability method with the requirement that the covenant be “clearly divisible into parts” and only allowing judicial removal of unreasonable parts with no addition of new terms); Rogers v. Runfola & Assocs., Inc., 565 N.E.2d 540, 543 (Ohio 1991) (applying a judicial modification rule where restrictions are only “enforced to the extent necessary to protect an employer’s legitimate interests”).
49. Bess 257 N.W.2d at 794 (citation omitted).
50. Id.
51. Such drafting considerations would include drafting the covenant as a stand-alone agreement instead of incorporating the covenant into a larger agreement, thus avoiding a court invalidating a larger employment agreement containing other provisions that the former employee may have violated and for which the employee may be liable to the employer. See Carlson, supra note 11, at 209 n.26.
52. Burk, 757 N.E.2d at 811.
53. See infra Part III.B (discussing North Carolina’s application of the rule and the lack of guidance from the courts concerning what “distinctly severable” actually means).
[strict severability rule] is that a court is merely enforcing the legal parts of a divisible contract rather than making a new contract for the parties[,] [b]ut this distinction and the doctrine itself emphasize form over substance.”54 Such an approach converts the attorneys who draft restrictive covenants in these jurisdictions into “scribes of form over substance . . . [who must use] as many finely-tuned brush strokes as a Van Gogh painting in hopes that at least one provision will be found enforceable.”55

The judicial modification rule gives courts the most freedom in modifying unreasonable restrictive covenants to balance the interests of the employer and former employee.56 While each approach, in its own way, seeks to further the policies underlying the allowance of restrictive covenants and general contract law, including limitations on employers’ abilities to restrict former employees, the judicial modification approach most effectively balances all of the competing policy considerations. This is because the judicial modification method allows the court to limit its enforcement of an otherwise unreasonable restrictive covenant to protect the legitimate business interests of the employer while minimizing the negative impact of the restrictive covenant on the former employee.57 The other rules are too rigid when applied in a vacuum and reach harsh results that do not comport with the policy underlying the allowance of restrictive covenants. Therefore, under the modification rule, courts may protect businesses from unfair competition that is detrimental to economic markets while also protecting employees from unreasonable restrictions, truly embodying the purpose of restrictive covenants.

B. North Carolina’s Application of the Strict Severability Rule

Contrary to the optimal judicial modification rule, North Carolina applies a convoluted version of the strict severability

54. Bess 257 N.W.2d at 794–95 (citations omitted).
55. Carlson, supra note 11, at 253.
56. Bess 257 N.W.2d at 794; see also Rogers v. Runfola & Assocs., Inc., 565 N.E.2d 540, 543 (Ohio 1991) (noting that courts are given the power to fashion a reasonable covenant between two parties).
57. Rogers 565 N.E.2d at 543.
rule. The North Carolina Court of Appeals provided a compelling example of this in Electrical South, Inc. v. Lewis by applying unnecessarily complex reasoning and engaging in significant grammatical acrobatics to twist and invalidate the restrictive covenant at issue. The opinion provides two prime examples of the court’s contrived reasoning. First, the court treats the covenant’s use of “or” as creating an ambiguity in the covenant and goes on to interpret “or” to mean “and” as a way to invalidate the covenant. The court then goes on to expand the geographic scope of the covenant from the expressly stated 200-mile radius to having no limitation by unnecessarily parsing the words of the covenant to focus on the former employee’s association with a competitive business instead of the employee’s competition with the former employer, despite the language of the covenant.

Another line of North Carolina Court of Appeals cases “add[s] another unique twist” to North Carolina’s blue penciling rule. The North Carolina Court of Appeals in Hartman v. W.H. Odell & Associates, Inc. stated that “a court at most may choose not to enforce a distinctly severable part of a covenant in order to render the provision reasonable.” The court’s inclusion of “distinctly” to the severability language was new and has yet to be defined by any of Hartman’s progeny. Distinctly severable could mean that the provisions must be separate paragraphs, separate clauses, separate items in a list, or entirely separate contractual provisions, but the courts have left this question unanswered. The lack of guidance on what is distinctly severable has left a gap in North Carolina restrictive covenant law that has inspired some

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58. Elec. S., Inc. v. Lewis, 96 N.C. App. 160, 167 385 S.E.2d 352, 356 (1989); see also Carlson, supra note 11, at 244-46 (discussing Electrical South as “a poster child for how not applying a proper severability rule can result in running roughshod over a company’s legitimate business interests in a noncompete context”).
60. Id. at 163, 167-68, 385 S.E.2d at 354, 356-57.
61. Id. at 163, 385 S.E.2d at 354.
62. Id. at 167-68, 385 S.E.2d at 356-57.
63. Carlson, supra note 11, at 246-48 (discussing the Hartman line of cases).
65. Carlson, supra note 11, at 247.
creative drafting of restrictive covenant language, much like the covenant at issue in the recent Beverage Systems cases.66

IV. THE IMPACT OF BEVERAGE SYSTEMS ON NORTH CAROLINA RESTRICTIVE COVENANTS

In an effort to circumvent the uncertainty associated with North Carolina’s application of the strict severability blue penciling rule, some businesses began drafting restrictive covenants with new clauses purporting to enable the courts reviewing the covenant for enforceability to modify the covenants to make them enforceable.67 Such clauses come in many forms but generally follow the following form:

If, at the time of enforcement of any provisions of [this covenant], a court holds that the restrictions stated herein are unreasonable under circumstances then existing, the parties hereto agree that the maximum period, scope or geographical area that are reasonable under such circumstances shall be substituted for the stated period, scope or area, and that the court shall be allowed to revise the restrictions contained in [this covenant] to cover the maximum period, scope and area permitted by law.68

These covenants essentially empower the courts to use the judicial modification rule by agreement of the parties and circumvent North Carolina’s convoluted application of the strict severability rule, allowing the parties and the courts to enforce the restrictive covenants at issue only to the extent that most effectively balances the interests of the parties under the circumstances.

Many businesses began utilizing “modification clauses” in their restrictive covenants in both the employee-employer setting and in the sale of businesses, but the North Carolina courts chose

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68. Beverage Sys. I 235 N.C. App. at 441, 762 S.E.2d at 519.
to analyze one of these covenants in the business-to-business context. This distinction is important because “restrictive covenants obtained as part of the sale of a business are subject to less stringent analysis.” Therefore, the courts considering modification clauses did so with more leniency than modification clauses would receive in the employee-employer context. It was in this lenient business-to-business context that the North Carolina Court of Appeals and supreme court considered a modification clause in *Beverage Systems*.

A. One Step Forward: Beverage Systems I

*Beverage Systems of the Carolinas, L.L.C. (“Beverage Systems”)* is a North Carolina “company that supplies, installs, and services beverage products and beverage dispensing equipment in North Carolina.”*Imperial Unlimited Services, Inc. and Elegant Beverage Products, L.L.C. (the “Businesses”) engaged in the same areas of business, and Beverage Systems negotiated an “Asset Purchase Agreement” with the Businesses and the owners of the Businesses, Thomas, Kathleen, and Loudine Dotoli, whereby Beverage Systems would acquire the “assets, trade names, customer lists, accounts receivable, current customers and customer contracts, all equipment, and real property” of the Businesses. As part of the Asset Purchase Agreement, the Dotolis also agreed to execute a restrictive covenant that prohibited the individuals from, among other activities, owning or managing a business engaging in the same business activities as Beverage Systems in North or South Carolina for a period of five (5) years. The restrictive covenant also contained a modification clause that stated that “the court shall be allowed to revise the restrictions

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69. See id. at 441, 762 S.E.2d at 319; *Beverage Sys. II*, 368 N.C. at 694, 784 S.E.2d at 458.
70. *Campbell Oil I*, 2016 WL 197132 at *15.
71. Id.
74. Id. at 440, 762 S.E.2d at 318–19.
75. Id. at 440–41, 762 S.E.2d at 319.
contained [therein].” The parties executed the agreement on September 30, 2009.

Loudine Dotoli’s wife, Cheryl, subsequently created Associated Beverage Repair, L.L.C., (“Associated Beverage”) and Loudine Dotoli served as the manager of Associated Beverage. Beverage Systems discovered this activity in 2011, and Beverage Systems later filed suit against Associated Beverage, Loudine Dotoli, and Cheryl Dotoli alleging a litany of causes of action, including breach of the restrictive covenant against Loudine Dotoli. Loudine Dotoli responded by alleging that the restrictive covenant was geographically overbroad by including all of North and South Carolina because Beverage Systems did not do business in the entirety of each state. On motion by the Defendants, the trial court granted summary judgment on all of Beverage Systems’ claims, and Beverage Systems promptly appealed.

i. The Decision and the Court of Appeals’ Reasoning

The North Carolina Court of Appeals reversed the trial court based on the modification clause, holding that “the trial court had express authority to revise the territorial restrictions of the non-compete pursuant to the terms of the agreement.” The court of appeals recognized that North Carolina applies the strict severability rule but used the modification clause to distinguish the case “from those in which the trial court’s authority to revise a non-compete is substantially limited by the [strict severability rule].” According to the court of appeals, the modification clause removed the restrictions on the trial court’s ability to judicially modify the scope of the restrictive covenant.

The court of appeals held that courts could take advantage of the modification clause because the parties had dealt at arms

76. Id. at 441, 762 S.E.2d at 319; see supra text accompanying note 60 (quoting the full text of the modification clause at issue).
77. Beverage Sys. I 235 N.C. App at 441, 762 S.E.2d at 319.
78. Id.
79. Id.
80. Id. at 441–42, 762 S.E.2d at 319.
81. Id. at 442, 762 S.E.2d at 319.
82. Id. at 442, 762 S.E.2d at 320.
83. Id. at 445, 762 S.E.2d at 322.
84. Id. at 445, 762 S.E.2d at 321.
length and agreed to give the courts that power.\textsuperscript{85} The court of appeals also noted that a similar clause had been upheld in the franchisor-franchisee context.\textsuperscript{86} Finally, the court of appeals recognized that allowing modification clauses in restrictive covenants “makes good business sense and better protects both a seller’s and purchaser’s interests in the sale of a business.”\textsuperscript{87} On those bases, the court of appeals determined that the modification clause was valid and empowered the trial court to circumvent the strict severability rule as applied by North Carolina.\textsuperscript{88}

One judge dissented from the majority’s use of the modification clause.\textsuperscript{89} The dissent agreed with the majority that the geographical scope of the restrictive covenant at issue was overly broad, but it reasoned that the modification clause did not give the court the power to rewrite the scope of the covenant.\textsuperscript{90} The dissent argued that, even giving force to the modification clause, the terms of the modification clause limited any judicial modification to “that permitted by law,” and that the law of North Carolina only permitted revision through strict severability.\textsuperscript{91} Therefore, according to the dissent, the trial court was without power to modify the scope of the restrictive covenant beyond omitting the unreasonable territorial restrictions.\textsuperscript{92}

ii. One Step Forward for Businesses and the Gap that Remained in the Law

The court of appeals’ decision in \textit{Beverage Systems I} was monumental and represented a large step forward in North Carolina restrictive covenant law. By upholding the use of modification clauses in restrictive covenants in the business-to-business setting, the court of appeals allowed parties to contract around North Carolina’s sub-optimal blue penciling rule to utilize the judicial modification rule. This result brought North Carolina

\textsuperscript{85} \textit{Id.} at 446, 762 S.E.2d at 322.

\textsuperscript{86} \textit{Id.} (citing Outdoor Lighting Perspectives Franchising, Inc. v. Harders, 228 N.C. App. 613, 747 S.E.2d 256 (2013) (permitting modification clause allowing the franchisor to modify the scope of a non-compete)).

\textsuperscript{87} \textit{Id.} at 446, 762 S.E.2d at 322.

\textsuperscript{88} \textit{Id.} at 447, 762 S.E.2d at 323.

\textsuperscript{89} \textit{Id.} at 452–55, 762 S.E.2d at 326 (Elmore, J., dissenting).

\textsuperscript{90} \textit{Id.} at 453, 762 S.E.2d at 326–27.

\textsuperscript{91} \textit{Id.} at 454, 762 S.E.2d at 327.

\textsuperscript{92} \textit{Id.}
one step closer to applying the judicial modification rule in limited circumstances and to joining the jurisdictions that optimally enforce restrictive covenants. Due to the leniency afforded to restrictive covenants in the business-to-business context, however, the question of how courts would treat modification clauses in the employee-employer context remained unanswered, leaving a significant gap in the law.\textsuperscript{93} The court of appeals’ apparent support for modification clauses as “good business sense”\textsuperscript{94} did, however, give businesses hope that such clauses would be permitted in the employee-employer context.\textsuperscript{95}

\textbf{B. Two Steps Back: Beverage Systems II}

After a distinct period of silence in the realm of restrictive covenants, the North Carolina Supreme Court agreed to take up the issue of modification clauses in the \textit{Beverage Systems} case.\textsuperscript{96} In breaking that silence, the state supreme court managed to set back North Carolina restrictive covenant law by entrenching itself deeper into the court’s extreme devotion to the strict severability rule.\textsuperscript{97}

i. The Decision and the North Carolina Supreme Court’s Reasoning

The supreme court quite summarily dismissed the reasoning of the court of appeals, stating that “parties cannot contract to give a court power that it does not have.”\textsuperscript{98} The court noted that “[i]f the parties have agreed upon territorial limits of competition, those limits will be enforced as written or not at all,

\begin{itemize}
\item[\textsuperscript{94}] \textit{Beverage Sys. I} 235 N.C. App. at 446, 762 S.E.2d at 322.
\item[\textsuperscript{96}] \textit{Beverage Sys. II}, 368 N.C. 693, 784 S.E.2d 457 (2016).
\item[\textsuperscript{97}] See David C. Lindsay & Matthew D. Duncan, \textit{North Carolina’s Strict Blue Pencil Doctrine & Written in Ink: The Supreme Court Rules that Courts Cannot Revise Noncompete Agreements}, K&L GATES (Apr. 5, 2016), http://www.klgates.com/north-carolina stricter blue pencil doctrine is written in ink the supreme court rules that courts cannot revise noncompete agreements 04042016.
\item[\textsuperscript{98}] \textit{Beverage Sys. II}, 368 N.C. at 699, 784 S.E.2d at 462.
\end{itemize}
for courts will not carve out reasonable subdivisions of an otherwise overbroad territory.” 99 The court also reasoned that matters of policy dictated rejection of modification clauses and stated:

Allowing litigants to assign to the court their drafting duties as parties to the contract would put the court in the role of scrivener, making judges postulate new terms that the court hopes the parties would have agreed to be reasonable at the time the covenant was executed or would find reasonable after the court rewrote the limitation.100

The court put the final nail in the coffin with its remark that “[w]e see nothing but mischief in allowing such a procedure.” 101 Thus, the supreme court stated that the modification clause could not save the restrictive covenant, and the covenant was unenforceable as a matter of law.102

ii. The Expected Fallout and Why This Was Two Steps Back

The stark dichotomy between the decisions of the court of appeals and supreme court in Beverage Systems reflects two competing views of restrictive covenants. The court of appeals focused on freedom of contract and what made “good business sense,”103 while the supreme court rooted itself in general disfavor for restrictive covenants and solidified North Carolina’s irrationally rigorous application of the strict severability rule.104 This raises two main concerns moving forward.

First, the North Carolina Supreme Court not only undid the progress made by the court of appeals in Beverage Systems I, but the court’s decision effectively prohibits modification clauses in the employment context, taking the one step forward made by the court of appeals and turning it into two steps back. Since

99. Id. at 699, 784 S.E.2d at 461.
100. Id. at 700, 784 S.E.2d at 462.
101. Id.
102. Id.
104. Beverage Sys. II, 368 N.C. at 699, 784 S.E.2d at 462.
restrictive covenants are given more leniency in the business-to-business setting and the court has prohibited modification clauses in that context, the many modification clauses already in place in employee restrictive covenants are most likely invalid. This will create a need for many employers, big and small, to revisit and redraft their restrictive covenants to ensure that the restrictions are enforceable as written. Many small to mid-sized businesses may not have the resources to employ a restrictive covenant attorney to conduct such a review or simply may not be aware of the change in the law, and such businesses will be at a distinct disadvantage.\(^{105}\)

Second, the attorneys and businesses drafting restrictive covenants are back to square one, so to speak, with the strict severability rule of North Carolina. The distinct lack of guidance on what is “distinctly severable” will convert attorneys drafting and litigating restrictive covenants to mere scriveners—searching for a comma here and a semicolon there—instead of focusing on the substance of the covenants at issue. In its attempt to save the courts from becoming scriveners, the North Carolina Supreme Court did not eliminate the role but merely shifted it to attorneys.

V. Conclusion

Restrictive covenants pervade employment, and the conversation surrounding their enforcement is increasingly in the spotlight. North Carolina has a well-developed body of restrictive covenant case law, but the supreme court has left some significant gaps in the law. North Carolina has established five requirements for enforcing restrictive covenants, and the requirement that the geographic and temporal scope of the restriction be reasonable is highly litigated. Some courts will “blue pencil” or modify a restrictive covenant that is unenforceable as drafted to make the covenant enforceable, but different states have taken three different approaches to blue penciling. North Carolina takes the “strict severability” approach and will not modify a covenant apart

from deleting a distinctly severable part of the covenant. North Carolina courts, however, have left the definition of “distinctly severable” in the air and have not provided much guidance on the issue. North Carolina’s indeterminate application of the strict severability approach led to the creative drafting of “modification clauses” in restrictive covenants that purported to empower the courts to judicially modify the scope of the restrictive covenant and to enforce the covenant only to the extent reasonable under the circumstances. Such an approach allows the courts to optimally enforce restrictive covenants for the benefit of businesses and markets while minimizing the negative impacts on employees.

In *Beverage Systems of the Carolinas, L.L.C. v. Associated Beverage Repair, L.L.C.*, the North Carolina Court of Appeals upheld a modification clause, taking North Carolina restrictive covenant law one step forward and closer to applying the optimal blue penciling rule, but the North Carolina Supreme Court reversed, invalidating modification clauses in the business-to-business setting. Since restrictive covenants in the business-to-business setting are given more leniency than those in the employment context, the supreme court’s decision necessarily rules out modification clauses in the employment realm. Therefore, the North Carolina Supreme Court took North Carolina restrictive covenant law two steps back, running the risk of crippling some small and mid-sized businesses that rely on restrictive covenants to protect themselves from unfair competition. Further, the court’s ruling runs the risk of converting attorneys that draft and litigate restrictive covenants into mere scriveners more concerned with the form of covenants than the substance. The North Carolina Supreme Court’s decision in *Beverage Systems* departed from the purpose and spirit of restrictive covenants and from the law of freedom of contract, and the decision was in error.

106. See *supra* Parts IV.A and IV.B.