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North Carolina: Enforceability of Non-Compete Agreements During a Pandemic

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During the COVID-19 crisis, in order to maintain fiscal health, businesses have been forced to furlough or terminate employees to ensure their business survives. One question I continue to see from my business owner clients is whether they can enforce non-compete agreements against laid off employees. The answer to this question is complex, and depends on state law, public policy, and the terms of specific agreements.

For starters, a non-compete is a restrictive agreement prohibiting former employees from working for a competitor, or otherwise compete with them. As employees re-enter the job market or start their own businesses as a result of COVID-19, the viability of their non-competes may be a growing concern in the coming months and courts will have to weigh-in on how best to resolve.

Employers sign non-compete agreements or restrictive covenants to protect its legitimate business interest, including trade secrets and confidential information. Research estimates suggest nearly 20 percent of U.S. employees are subject to non-compete agreements, which means millions of laid-off or terminated employees within the last few months are subject to these agreements.

As a threshold matter, a court examining a non-compete agreement faces two questions.

Is the non-compete agreement enforceable? North Carolina courts enforce non-competes that are:

- In writing;
- Part of an employment contract;
- Based on valuable consideration;
- Reasonable time and territory; and

→ Designed to protect a legitimate business interest.

These factors are balanced against one another on a case-by-case basis.

If the non-compete is enforceable, should it be enforced after balancing the prevailing equities between the presenting employer and employee?

Specifically, North Carolina courts will refuse to enforce non-competes that are against the state's public policy interest (United Labs., Inc. v. Kuykendall, 370 S.E.2d 375, 380 (N.C. 1988)).

Given the circumstances of COVID-19, even in states otherwise friendly to enforcing reasonable non-compete agreements, courts may think twice about doing so, especially when they take into account public policy and the reasons for the termination. For example: given the high rate of unemployment throughout the country, courts might view a non-compete agreement as not only keeping an individual from a job with another company but keeping that individual out of employment entirely in a tough job market.

For employers contemplating non-compete agreement enforcement, here are some steps that can and should be taken to protect confidential information and customer goodwill, and preserve its rights until this crisis passes.

→ Assess the current legal landscape for enforcement of non-competes where affected employees are located, or where their employment agreements require claims to be brought.

According to the latest edition of Seyfarth's 50 State Desktop Reference: What Businesses Need to Know about Non-Competes and Trade Secrets Law, 28 states permit enforcement of non-competes against discharged employees (to include North and South Carolina), three likely would do so, nine would not, and the issue remains unresolved in 10 states. There are, of course, nuances in each state employers should be aware of – especially, with the advent of its workforce being displaced throughout the U.S.

→ Prior to taking any action against a departing employee during a time of high unemployment, companies should consider the actual risk the former employee poses by working for a competitor, potential alternatives to a lawsuit, and the public relations ramifications of seeking enforcement of such agreements during the pandemic. Nevertheless, companies should not tolerate misappropriation of trade secrets under any circumstances, and should take whatever action they deem necessary to protect those rights.

→ Companies genuinely and immediately harmed by trade secret or the misappropriation of confidential information covenants should still consider seeking injunctive relief, particularly if the activity is causing significant harm to their business.

We do not know when this will end, but it will. As businesses pivot and emerge from the pandemic, owners should consider how they want employees and customers —past, current, and future—to perceive their business when we reach the light at the end of the tunnel, while also ensuring they have taken reasonable steps to protect trade secrets and confidential information.

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