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NO. COA09-596

NORTH CAROLINA COURT OF APPEALS

Filed: 20 July 2010

MJM INVESTIGATIONS, INC.,
Plaintiff-Appellee,

v.

Wake County
No. 08 CVS 19165

BRIAN SJOSTEDT, and
VETTED INTERNATIONAL LTD.,
Defendants-Appellants.

Appeal by Defendants from order entered 12 February 2009, by Judge Paul C. Ridgeway in Superior Court, Wake County. Heard in the Court of Appeals 13 January 2010.

Shanahan Law Group, PLLC, by I. Beverly Lake, Jr., Kieran J. Shanahan, Steven K. McCallister, and John E. Branch, III, for Plaintiff-Appellee.

Moore & Van Allen PLLC, by Willis P. Whichard, David E. Fox, and John A. Zaloom, for Defendants-Appellants.

McGEE, Judge.

Brian Sjostedt (Sjostedt) founded Vatted International Ltd. (Vatted) (together Defendants) in May of 2005. Vatted's business included assisting insurance carriers in investigating and processing claims under the Defense Base Act and the War Hazards Compensation Act, which concern insurance coverage for employees contracted by the United States government for work overseas. From its inception, Vatted had a consulting agreement with Plaintiff MJM

Investigations, Inc. (MJM). Vetter was hired as an independent consultant for investigations that MJM was conducting in the Middle East. In October of 2005, Sjostedt accepted a position with MJM as Assistant Vice President of International Investigations. Sjostedt ended his direct employment with MJM in 2007. Defendants then entered into a new consulting agreement with MJM on 30 March 2007 (the agreement).

Pursuant to the agreement, Defendants again agreed to provide consulting services for MJM's insurance-related work in the Middle East. The agreement included non-compete and non-solicitation clauses that are the subject of this appeal. Subsequent to entering into the agreement, issues arose that negatively impacted the working relationship between Defendants and MJM. Defendants sent MJM a sixty-day notice of their intent to terminate their business relationship on 4 April 2008. That relationship ended 4 June 2008. MJM alleged that Defendants violated the terms of the agreement, and thereby caused MJM to lose clients and prospective clients, as well as business market share.

MJM filed a verified complaint and motion for temporary restraining order and preliminary injunction on 3 November 2008. By order entered 18 November 2008, the trial court denied MJM's motion for a temporary restraining order. The trial court granted MJM's motion for a preliminary injunction, in part, by order entered 12 February 2009. The trial court ruled that the non-compete clause in the agreement was overly broad and, therefore, unenforceable. The trial court struck the non-compete portion of

the agreement and ruled that the remaining non-solicitation clause in the agreement was enforceable, and granted MJM a preliminary injunction on that basis. Defendants appeal. Additional relevant facts will be addressed in the body of the opinion.

In Defendants' first argument, they contend that the trial court erred in ruling that MJM could succeed on the merits and, therefore, erred by granting MJM a preliminary injunction. We agree.

"The party who seeks the enforcement of the covenant not to compete has the burden of proving that the covenant is reasonable." *Hartman v. Odell and Assoc. Inc.*, 117 N.C. App. 307, 311, 450 S.E.2d 912, 916 (1994) (citations omitted).

Covenants not to compete between an employer and employee are "not viewed favorably in modern law." To be enforceable, a covenant must meet five requirements - it must be (1) in writing; (2) made a part of the employment contract; (3) based on valuable consideration; (4) reasonable as to time and territory; and (5) designed to protect a legitimate business interest of the employer. The reasonableness of a non-compete agreement is a matter of law for the court to decide.

Farr Assocs., Inc. v. Baskin, 138 N.C. App. 276, 279, 530 S.E.2d 878, 881 (2000) (internal citations omitted). In the case before us, Defendants do not argue factors (1), (2), or (3). Defendants argue that the non-solicitation clause is overly broad, and thus fails to meet the requirements of both factors (4) and (5). "The protection of customer relations against misappropriation by a departing employee is well recognized as a legitimate interest of an employer." *Id.* at 280, 530 S.E.2d at 881 (citing *United*

Laboratories Inc. v. Kuykendall, 322 N.C. 643, 651, 370 S.E.2d 375, 381 (1988)).

In evaluating reasonableness as to time and territory restrictions, we must consider each element in tandem - 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*.

Farr, 138 N.C. App. at 280, 530 S.E.2d at 881 (citations omitted).

"In addition, our Supreme Court has recognized the validity of geographic restrictions that are limited not by area, but by a client-based restriction." *Id.* at 281, 530 S.E.2d at 882 (citation omitted).

The covenant in this case consisted of two parts: a non-compete clause and a non-solicitation clause. The trial court found that the non-compete clause was "overly broad inasmuch as it fails to confine itself to any geographic territory[.]" The non-compete clause states:

From the date of the execution of this Agreement, and for a period of two years from the last date services are performed under this Agreement or any other agreement with MJM, [Defendants] agree[] not to compete, either directly or indirectly, with MJM in its present line(s) of business or in future line(s) of business that may be disclosed to [Defendants] or learned of by [Defendants] through [their] association with MJM.

However, the trial court then determined that the non-solicitation clause was enforceable, and that the two clauses were severable, stating:

The second restraint of trade in Paragraph 14 of the Consulting Agreement is a non-solicitation agreement, and reads as follows: "[Defendants] will also specifically not solicit any current or prospect client of MJM for the purposes of providing the following services: Insurance Claims Investigations, Insurance Claims Task Service (excluding medical care services), Surveillance, Independent Adjusting, Fire Investigations, International Investigations and any related types of insurance or corporate services. [Portion of non-solicitation clause not relevant to this appeal omitted.]

The trial court then struck, or "blue penciled," the non-compete clause, stating: "Because the non-compete and non-solicitation provisions of Paragraph 14 of the Consulting Agreement are distinctly separable parts of the entire covenant, the Court, without revising or rewriting the covenant, chooses to 'blue pencil' the portion of the covenant found to be unenforceable, namely the non-compete provision of the paragraph."

The trial court then granted MJM a preliminary injunction based upon the non-solicitation clause, concluding "that this restraint, standing alone, is reasonable in light of all of the circumstances of this case." The trial court then ordered

that the Defendants are enjoined from "soliciting any current or prospect client of MJM for the purposes of providing the following services: Insurance Claims Investigations, Insurance Claims Task Service (excluding medical care services), Surveillance, Independent Adjusting, Fire Investigations, International Investigations and any related types of insurance or corporate services." . . . For purposes of the instant Preliminary Injunction Order, the clients that Defendants are enjoined from soliciting as set forth above are identified more specifically in Exhibit A attached hereto[.]

Exhibit A includes a list of more than 800 purported "clients" of MJM, a list that MJM provided to the trial court through its amended answer to Defendants' first set of interrogatories the day before the preliminary injunction was issued. In its original answer to Defendants' first set of interrogatories, dated 15 December 2008, MJM had listed only forty-two "clients," some of which are affiliates of one another. In *Farr*, 138 N.C. App. at 282, 530 S.E.2d at 882, our Court noted that

the client-based restriction is unduly vague. The covenant does not define whether the term "client or customer" includes one-time attendees of [one of the plaintiff's] workshop[s]. And the covenant may extend to clients' offices that never contacted [the plaintiff]. If [the plaintiff] worked for a client in one city, but that client has offices in other cities, the non-compete agreement ostensibly prevents [defendant] from working for that client in any of its offices, not merely the office with which [the plaintiff] once worked.

In the agreement in this case, MJM did not define "current or prospect client of MJM." It is unclear whether a "current client" would be a client current at the time the agreement was executed, or current at the time Defendants left MJM's employ. Further, because "client" is not defined, it can be read to cover all branches, divisions, and affiliates of a "client." This would likely cover many entities with which MJM has never had any contact.

Even more nebulous is the meaning of "prospect client." It could mean a client prospect at the time the agreement was executed, at the time Defendants left MJM's employ, or a client

unknown at either of these times that only became a prospect client at some later time during the effective period of the injunction. Therefore, by the terms of the agreement, if MJM contacted a small division of a large multi-national corporation to solicit business for the first time after Defendants ceased working for MJM, Defendants could be barred from attempting to solicit particular business from some other small division of that corporation, located in a different country, and having no direct relationship with the division MJM had contacted. In light of our decision in *Farr*, we hold that MJM's failure to provide any definition for "current or prospect client" renders the non-solicitation clause vague and unenforceable. *Id.*

Furthermore, "a client-based limitation [such as the one in the case before us] cannot extend beyond contacts made during the period of the employee's employment." *Id.* at 282, 530 S.E.2d at 883; *see also Medical Staffing Network, Inc. v. Ridgway*, __ N.C. App. __, __, 670 S.E.2d 321, 327-28 (2009) (concluding that the plaintiff had no legitimate business interest in, *inter alia*, foreclosing solicitation of clients of "an unrestricted and undefined set of [the plaintiff's] affiliate companies and that the restrictive covenants were unenforceable). The language of the agreement clearly extends the non-solicitation clause to cover "clients" and, in particular, "prospect clients" with which Defendants had never made contact.

[T]o prove that a geographic restriction in a covenant not to compete is reasonable, an employer must first show where its customers are located and that the geographic scope of

the covenant is necessary to maintain those customer relationships. "A restriction as to territory is reasonable only to the extent it protects the legitimate interests of the employer in *maintaining* [its] customers." *Manpower of Guilford County, Inc. v. Hedgecock*, 42 N.C. App. 515, 523, 257 S.E.2d 109, 115 (1979) (emphasis added).

Hartman, 117 N.C. App. at 312, 450 S.E.2d at 917. The non-solicitation clause in the agreement is not limited to maintaining MJM's customers; it also prevents Defendants from attempting to solicit clients who are not customers of MJM, and who may have been unknown to both Defendants and MJM at the time of Defendants' departure from MJM.

We recognize our Court has upheld non-solicitation agreements that included clients with which the employee might not have had direct contact. For example, in *Wade S. Dunbar Ins. Agency, Inc. v. Barber*, 147 N.C. App. 463, 556 S.E.2d 331 (2001), our Court upheld a non-solicitation agreement that restricted the employee "for two years, from soliciting any customers having an active account with [employer] at the time of [employee's] termination or prospective customer whom [employee] himself had solicited within the six months immediately preceding his termination." *Id.* at 469, 556 S.E.2d at 335. In *Wade*, however, the meanings of "customer" and "prospective customer" were clear, and the "customers" and "prospective customers" were identifiable.

It is true that *after* the trial court had decided to grant the preliminary injunction, Defendants, apparently not certain what businesses might be covered by the phrase "current or prospect client of MJM," requested that the trial court limit the prohibited

businesses to those forty-two businesses identified by MJM in its answer to Defendants' first set of interrogatories. MJM then submitted its amended list of over 800 businesses, which the trial court adopted without any evident inquiry into whether these 800 businesses constituted "current or prospect clients" under the agreement. We hold that this wholesale adoption of a "client" list, the day before the trial court entered its preliminary injunction order, constituted improper modification of the non-solicitation clause.

When the language of a covenant not to compete is overly broad, North Carolina's "blue pencil" rule severely limits what the court may do to alter the covenant. A court at most may choose not to enforce a distinctly separable part of a covenant in order to render the provision reasonable. It may not otherwise revise or rewrite the covenant. "The courts will not rewrite a contract if it is too broad but will simply not enforce it (citations omitted). If the contract is separable, however, and one part is reasonable, the courts will enforce the reasonable provision (citations omitted)." *Whittaker*, 324 N.C. at 528, 379 S.E.2d at 828.

Hartman, 117 N.C. App. at 317-18, 450 S.E.2d at 920. By including the list of over 800 "clients" and affirmatively determining that those businesses constituted all of MJM's "current or prospect clients," the trial court improperly revised and rewrote the agreement. The proper action when the language of a non-solicitation agreement is too broad is to "simply not enforce it." *Id.*

Furthermore, when the trial court "blue-penciled" the agreement, it struck the entire first sentence, which constituted

the non-compete clause of the agreement. This sentence included the *only* time restriction in the agreement. The remaining non-solicitation clause includes no time restriction. A plain reading of the non-solicitation agreement would permit MJM to prohibit Defendants from soliciting "current or prospect clients" indefinitely. A non-solicitation clause without any time restriction is clearly too broad and, therefore, unenforceable, no matter the scope of the territorial limitation. *Id.* at 315, 450 S.E.2d at 918 ("The North Carolina Supreme Court has stated that only 'extreme conditions' will support a five-year covenant: 'It may be held that in some instances and *under extreme conditions* five years would be held to not be unreasonable.' *Engineering Associates, Inc. v. Pankow*, 268 N.C. 137, 139, 150 S.E.2d 56, 58 (1966) (emphasis added).").

For the reasons stated above, we hold the non-solicitation agreement is unenforceable against Defendants. The trial court erred in granting MJM a preliminary injunction based upon this agreement. We reverse and remand to the trial court for further action consistent with this opinion.

Reversed and remanded.

Judge BEASLEY concurs

Judge STEELMAN concurs with a separate opinion.

Report per Rule 30(e).

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STEELMAN, Judge, concurring in the result.

I concur in the result reached by the majority, but write separately to express concern over the present state of the law in the context of an increasingly integrated global economy.

At the time that our law in the area of restrictive covenants was developed, much of our commerce was local, and restrictive covenants were enforced only to protect specific local interests. Any covenants that attempted to protect broader commercial interests were held to be invalid as an improper restraint of trade. However, today's economy is global in nature. In the instant case, plaintiff conducts a very specialized niche type of business, but its scope is worldwide, rather than being focused in one or two counties in North Carolina. The law of restrictive covenants should be re-evaluated by our Supreme Court in the context of changing economic conditions to allow restrictions upon competing business activity for a specific period of time, limited to a specific, narrow type of business, but with fewer geographic limitations.

It is clear from the facts of this case that defendants flagrantly violated the terms of the non-solicitation agreement that they voluntarily executed. Then, when confronted with their breach of contract, sought to have the courts relieve them of their contractual obligations.

I agree with the majority that the term "prospect client" is undefined and overbroad. If the trial court had limited its injunction of the list of 42 current clients listed in plaintiff's answers to interrogatories, I would hold that the restrictive covenant would be enforceable. However, we must review the order of the trial court as written. I know of no authority for an appellate court to engage in further "blue penciling" of the agreement.

I would further construe the agreement so that the two-year time limitation was applicable to all provisions.