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Strict Non-Compete Agreement Standards Upheld

By: Chad J. Cochran

Non-compete agreements can have huge ramifications. Sometimes, they serve to protect a company's vital clients. At other times, they prohibit an employee from finding gainful employment to support his family. As a result, judges generally look very carefully at these agreements. Historically, North Carolina courts have generally disfavored non-compete agreements in favor of a competitive marketplace. A recent North Carolina Court of Appeals case demonstrates the strict regime by which non-compete agreements must abide in our state.

In *Phelps Staffing v. C.T. Phillips*, two competing staffing agencies found themselves in expensive litigation after C.T. Phillips successfully acquired several of Phelps Staffing's clients. Specifically, the Defendant convinced several temporary employees to switch staffing agencies while keeping the same daily responsibilities with the same client companies. After losing several clients due to these switches, the Plaintiff required its temporary employees to execute non-compete agreements. Several temporary employees signed the non-compete agreements, the terms of which prohibited the employees from working for any of Plaintiff's clients for one year. Despite signing the agreement, several more employees "flipped" staffing agencies and cost Plaintiff further clients.

Despite facts which plainly violated the contract's terms, the Court of Appeals sided with the employees' right to earn a livelihood. Once again, the court held non-compete agreements to a very high standard. In North Carolina, courts will only uphold a restrictive covenant if it is: (1) in writing; (2) made as part of a contract of employment; (3) based on valuable consideration; (4) reasonable as to time and territory; and (5) not against public policy. In this case, the court seemed satisfied that the agreement met the first three requirements. As to the fourth requirement, the court seemed satisfied at the one year employment prohibition but raised concern that the agreement forbid temporary employees from working for the same company at a different location than originally contracted. This is a very narrow interpretation of the geographic

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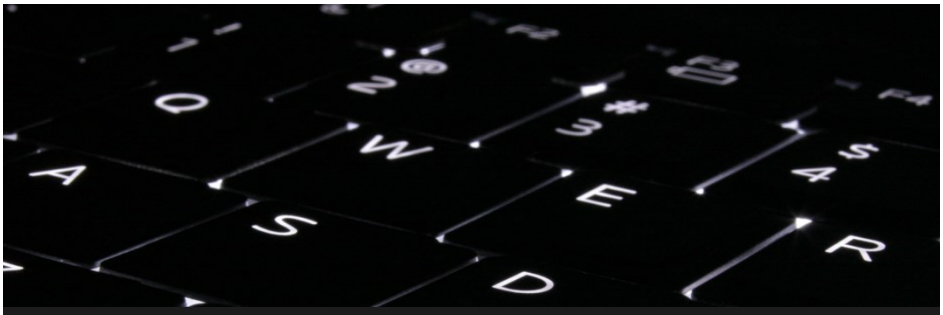

Business Litigation

Deception, Ruse & Subterfuge:
When does act rise to Fraud or Unfair and Deceptive Trade Practice

By: Cody R. Loughridge

Often, when business people feel they have been wronged or misled by another, their immediate response is: "This is ***fraud*** or "I've been ***deceived*** and it's ***unfair***". While these are certainly justified responses to the perceived bad acts of another, quite often those misdeeds do not rise to the level of "fraud" or "unfair and deceptive trade practices" in North Carolina. Oftentimes, the victims of bad acts in a business setting are left with less glamorous causes-of-action, such as: "breach of contract" or "misrepresentation". This begs the questions: What constitutes civil fraud in North Carolina? What must be proven in order to maintain an action for unfair and deceptive trade practices?

FRAUD: The Supreme Court has concluded that there are two types of fraud in a civil context: Actual and Constructive. The Court has determined that *Active Fraud* is the false representation of a material fact or, in the alternative, the concealment of a material fact. Moreover, the misrepresented material fact must be known to be false or made recklessly, without any knowledge of its truth or falsity. A fact is considered "material" if, had it been known to the party, it would have influenced that party's decision in making the contract at all. *Constructive Fraud*, on the other hand, is based on the relationship between the parties. It requires the existence of a relation of trust and confidence, in which the bad actor is alleged to have taken advantage of his position of trust, resulting in injury to the harmed party. Constructive fraud is often seen in the context of business partners, where one partner takes advantage of the other, for his own benefit in the transaction.

UNFAIR AND DECEPTIVE TRADE PRACTICES: The North Carolina General Statutes explicitly state that "unfair or deceptive acts or practices in or affecting commerce, are declared unlawful" (N.C.G.S. § 75-1.1). Because the statutes give little guidance as to what does, or does not, constitute "unfair or deceptive acts", one must turn to the judiciary for direction. The Supreme Court of North Carolina has stated that "a practice is unfair when it offends established public policy as well as when the practice is immoral, unethical, oppressive, unscrupulous, or substantially injurious to consumers." (182 N.C. App 657). This creates a standard higher than that of a normal breach of contract. Presuming the injured party can prove the egregious behavior of the bad actor, the injured party must also show that the bad act affects commerce. It must be shown, not simply whether a contract existed between the parties, but rather whether the bad actor's practices affect commerce. Most often, this is seen in transactions involving individuals or businesses who, in their ordinary course of business, buy and sell goods or products, as their ordinary trade. Presuming it can be shown 1) that an egregious act was committed and 2) that it affects commerce, the aggrieved party must also show distinct and palpable injury.

It is worth noting that the Courts have also determined that there are certain transactions, such as fraudulent securities transactions, employee-employer relationships and matters of internal corporate management which do not affect commerce, that are not subject to the unfair and deceptive trade practice analysis.

In the end, a case-by-case review is needed to determine whether a bad act may constitute fraud and/or an unfair and deceptive trade practice. If you have additional questions regarding breaches of contract, fraud, unfair and deceptive trade practices or other transactional disputes, please contact our office.

HSLC Attorneys Receive Super Lawyers Recognition

Hannah Sheridan Loughridge & Cochran, LLP is proud to announce that Nan E. Hannah has been selected to the 2014 North Carolina Super Lawyers in Construction Law. No more than 5 percent of the lawyers in the state are selected by the research team at Super Lawyers to receive this honor.

The firm is also proud to announce that Cody R. Loughridge and Chad J. Cochran have both been selected to the 2014 North Carolina Rising Stars list. Each year, no more than 2.5 percent of the lawyers in the state are selected by the research team at Super Lawyers to receive this honor.

Super Lawyers is a rating service which selects outstanding lawyers from more than 70 practice areas who have attained a high degree of peer recognition and professional achievement. Annual selections are made using a patented multiphase process that includes a statewide lawyer survey, an independent research evaluation and peer reviews by practice area. The result is a credible, comprehensive and diverse listing of exceptional attorneys.

Non-Compete Continued

restriction as the agreement allowed the temporary employees to work the same job in the same city for a non-client company.

The majority of the court's analysis turned on the final, public policy requirement. Even where an agreement is otherwise allowable and follows settled drafting requirements, "the restraint is unreasonable and void if it is greater than is required for the protection of the promisee or it if imposes and undue hardship upon the person who is restricted."

The court noted that the temporary employees were referred to as "general laborers" who did not have access to trade secrets or proprietary information. Reading between the lines, it appears that the court determined that the temporary employees were simply too low on the totem pole to become subject to these prohibitions.

Once again, the North Carolina courts upheld the harsh, unforgiving, yet well-established non-compete requirements.

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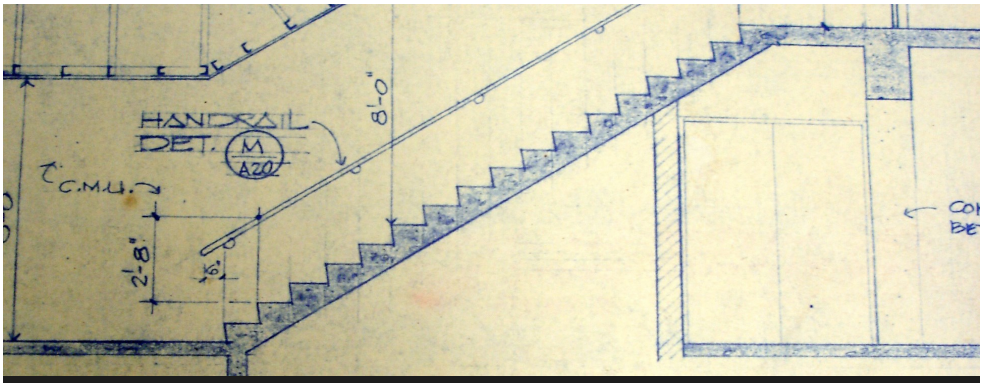

Construction Law

Legislature Looking at Lien Law … Again

By: Nan E. Hannah

Have you ever started the lien process only to discover that the entity for which you performed the work was leasing the real property? Has your attorney explained that your lien is only as good as the terms of the lease and that most leases have a clause that terminates the lease in the event a lien is filed? The North Carolina Court of Appeals was asked to review a case that took this kink in the lien law one step further – owner of the real property leased to a developer who subsequently entered into a sublease with a builder. As soon as the builder completed construction and sold the house, the sublease terminated and with it any real property lien rights of subcontractors. In a concurring opinion, one of the judges begged the legislature to examine this loophole.

Beginning with a meeting on January 21, 2014, a study committee authorized by the North Carolina General Assembly took on the judge's challenge. From a legal and constitutional standpoint, this issue is extremely complicated which is why it has waited to be considered alone as opposed to being part of last year's revisions to Chapter 44A.

Representatives Sarah Stevens and Dean Arp are co-chairing this study committee. They are actively seeking input from those in the industry impacted by this loophole. Think of this scenario – an electrician (or pick your trade) comes to you and is upfitting a restaurant in a new high-rise building downtown. They need $35,000 worth of wiring and lighting and related materials, much of which is specially-ordered. You provide all the materials, provide your notices as required by the new lien statute, but after 90-days you are unpaid so you have your attorney begin the lien process. You discover that the property is leased, that the tenant for whom the work was performed ran out of money and had its lease terminated, and another tenant has taken the space and is using it with only minor retrofitting. Your lien on the real property under current law is no better than the leasehold interest of the original tenant who was responsible for paying for all upfit. Since that lease was terminated, you have a lien upon any funds the now defunct tenant might owe the contractor or the contractor owes the electrician, but you have no lien against the real property. The current law places the duty upon subcontractors and suppliers to determine the nature of the business relationship of the owner/tenant(s) before making credit decisions on a project.

We will be following this legislative process and will report back as events unfold. Feel free to contact our office if you have questions.

Utilizing Contract Negotiation and Formation

By: Paul A. Sheridan

Contract Law

Contracts happen almost every day to everyone. We enter into contracts with the people that we deal with on a daily basis, often without giving it much thought. Contracts can be created with a simple conversation of a verbal offer and acceptance between two parties, with some consideration thrown in to make it enforceable.

An enforceable contract requires the following: (i) offer, (ii) acceptance, (iii) competent parties with legal capacity to contract, (iv) lawful subject matter, (v) mutuality of agreement, (vi) consideration, (vii) mutuality of obligation, and (viii), a writing if required under the Statute of Frauds. Rather than focus on the many types of contracts or delve into the finer points of contract formation, this article will discuss the contract negotiation process to lay the groundwork for future articles exploring common contractual clauses.

Complex business contracts are usually entered into after a formal negotiation process, with the details of the terms integrated into a written instrument that is ultimately signed by the contracting parties. Negotiating and drafting any type of commercial or transactional contract, whether it be an open account agreement, construction contract, or complex corporate acquisition, is an exercise in risk allocation. It is crucial that you read and understand the contracts that you sign, as contracts govern the terms of the agreement, and if valid, will be enforced by the courts. Changes, modifications and clarification of issues can be handled easily at the front end of a contract negotiation; however, once the contract is executed the parties are legally obligated to follow the terms of the contract. In order to allocate that risk, the individual reviewing the agreement must first be able to identify and understand the risks likely to be encountered. The ability to do this effectively, is driven not simply by a familiarity with the law, but by a fuller understanding of your business operations and the project itself.

A detailed risk identification and assessment exercise, performed early during project development, and prior to executing contracts, will identify the legal questions, business risks, and issues inherent in a project. Through the process of negotiation and the communication chains created therein, all participants are better informed at the outset of the project. The contract will likely better serve the parties, and the odds are enhanced that the participants' anticipated benefits and goals from the transaction will be met. As a direct result of time spent at the front end understanding the contract terms and risk allocation, everyone should benefit by the end of a project.

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