CHANGING VIRGINIA LAW AS TO THE ENFORCEABILITY OF NON-COMPETE AGREEMENTS

Recent Developments and Historical Background

The Virginia Supreme Court has struck another blow against employers in their ongoing efforts to draft enforceable covenants not to compete. First, in 2001, the Court narrowed the scope of the activities into which an employer could restrict a former employee from engaging. *Motion Control Systems, Inc. v. East,* 262 Va. 33, 546 S.E.2nd 424 (2001). Recently, the Court went further by affirming a trial court's finding that a restrictive covenant was over-broad on its face because it potentially prevented a former employee from working in any capacity for a competitor of the former employer. *Modern Environments, Inc. v. Johnetta R. Stinnett,* Supreme Court of Virginia, Record No. 011268 (April 19, 2002). While the *Modern Environments* case was peculiar procedurally (discussed below), it confirms an increasing trend of judicial hostility in Virginia towards restrictive covenants and increases the burden on employers to show that their non-compete agreements are reasonable and no greater than necessary to protect the employer's legitimate business interests.

Previously, the law of covenants not to compete in Virginia had been guided by the following tests:

1) Is the restraint in the covenant, from the standpoint of the employer, reasonable and no greater than necessary to protect some legitimate interest of the employer?
2) Is the restraint in the covenant, from the standpoint of the employee, reasonable and not unduly harsh or oppressive in curtailing the employee's efforts to earn a living?
3) Is the restraint in the covenant reasonable in light of sound public policy?

In applying this test, Virginia courts for the past quarter century have considered a number of factors when determining the reasonableness of the restraints in covenants, including, but not limited to, the geographical scope of the restriction, the duration of the restrictions, and the overall nature of the activities from which the individual is restricted from engaging in. Both the *Motion Control* and *Modern Environments* cases seem to indicate that the Court has recently been focused on what the employer is actually attempting to restrain the former employee from doing, along with what the employee is actually restrained from doing by the wording of the restriction itself.

In *Motion Control*, the employee worked for a company that designed and built very specialized drive systems, including brushless motors. The non-compete that the employee signed restricted the employee (for two-years after termination of employment and within a 100 mile radius of the employer's main plant) from working for a business similar to the business conducted by the employer. "Similar business" was defined as "any business that designs, manufactures, sells or distributes motors, motor drives or motor controls." After leaving Motion Control, the employee went to work for Litton Systems, Inc. Litton, among many other things,

made brushless motors in the same plant location but an entirely different division than where the employee was then working with Litton. The two-year term and geographic area were not at issue and, as historically indicated from previous cases, were not unreasonable on their face. However, the Court upheld the trial court in its finding that the definition of "similar business" was overbroad and unenforceable because it "imposed additional restraints which are greater than reasonably necessary to protect [the employer] in [its] legitimate business enterprise." The Court added that the "covenant also prohibits employment in any business, for example, that sells motors, regardless of whether the motors are the specialized types of brushless motors sold by [the employer]." Had "similar business" not been defined, the covenant may well have been upheld in *Motion Control.* However, the Court in *Modern Environments* has now seemingly put a new spin on this speculation.

In *Modern Environments*, the employee worked for a company that engaged in the business of selling and installing office furniture. He had signed an employment agreement containing a non-compete clause that restricted him (for one year after termination of his employment and within a 50 mile radius of locations where the employee had worked for the employer) from "directly or indirectly, . . . be[ing] employed by, . . . any business similar to the type of business conducted by the [employer] or any of its affiliates (a 'competing business'). . . ." Within one year from leaving the employer, the employee accepted a job with a competitor of the employer. When the employer threatened to sue, the former employee filed a suit seeking a declaratory judgment that the non-compete provisions of the employment agreement were unenforceable because they were over-broad and contrary to public policy. The trial court held that the restrictive covenants in this employment agreement were "over-broad and unenforceable as a matter of law." The employer appealed to the Virginia Supreme Court.

While the Court has repeatedly upheld covenants with identical and similar language to the covenant at issue in *Modern Environments* in other cases, the Court stated that in those cases, the "Court did not limit its review to considering whether the restrictive covenants were facially reasonable." The Court went further by stating that in previous cases, "[t]he language of the non-compete agreement[s] [were] considered in context of the facts of the specific case. In no case did this Court hold that the language contained in the restrictive covenant at issue was valid and enforceable as a matter of law under all circumstances." The Court is seemingly saying that even though it indicated in *Motion Control* that the "similar business" language, when not defined as to unduly broaden its scope, had been and would be upheld, an employer, when seeking to enforce a similarly worded covenant, still bears the significant burden of showing that the restrictive covenant at issue is reasonable and no greater than necessary to protect a legitimate business interest by offering some additional argument or evidence in support. Thus, it would seem, the Court has effectively removed any notion that one can use any particular "magic language" that would make a covenant not to compete valid and enforceable as a matter of law.[1]

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[1] An interesting procedural aside in the *Modern Environments* case is that the trial court below struck down the non-compete in the context of ruling on a demurrer (motion to dismiss). On the appeal, the Court held that the employer offered neither argument nor evidence of any legitimate business interest that was served by prohibiting the former employee from being employed in any capacity by a competing company. However, one must question how the employer could be expected to

Lessons Learned and Tips for the Future

Virginia's courts will not use the *blue pencil rule* on those provisions of a non-compete agreement that are offensive to public policy so that the remaining provisions may be enforced. The courts believe that it is not their role to re-write an unenforceable covenant to make it enforceable. Thus, if a court determines that a specific term of a non-compete provision fails to be reasonable, the whole agreement will be struck down. Additionally, it is established law that non-compete agreements will be strictly construed, and, in the event of an ambiguity, the ambiguity will be construed in favor of the employee. Finally, the *Motion Control* and *Modern Environments* cases seem to indicate that a restrictive covenant must be carefully worded and, when tested for reasonableness, will always be considered in the context of the facts of the specific case. So how can an employer actually draft a non-compete agreement that is likely to be upheld? Here are some guideposts.

1) The employer must determine if it can accomplish what it is trying to do without using a non-compete provision. Confidentiality agreements are much more likely to be enforceable in Virginia, and they protect an employer's information, data, trade secrets, etc. If protection of a client or customer base as well as prospective clients or customers is what the employer wants, non-solicitation agreements are also historically much more likely to be enforced by the courts as they do not prohibit, overtly, the former employee's right to earn a livelihood. Finally, for employees occupying ministerial and strictly administrative positions that have little to no exposure to any information that is of a confidential nature, no agreement at all may be the answer.

2) If restricting a former employee from directly competing with the employer is the goal of the covenant, the restrictive covenants should restrict the former employer from competing only with the divisions, branches and/or lines of the business of the former employer in which the former employee actually worked or played a role. Given both *Motion Control* and *Modern Environments* cases, overreaching the employer's actual legitimate business interest by restricting a former employee from being employed in *any* capacity by a competing company of the employer likely will be a fatal flaw for the foreseeable future in the Virginia courts. In this same vein, an express statement in a non-compete agreement that the agreement does not restrict the former employee from performing a role that is different and not in direct competition with the former employer is likely to be looked upon favorably by the courts.

3) As was seen in *Motion Control,* defining what a "similar business" is can be a double-edged sword. However, a thoughtful statement of what the employer actually does, when coupled with a statement that the former employee is not to do for a

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shoulder that supposed evidentiary burden when a party is precluded from submitting evidence on a demurrer? It would seem the answer comes from the employer's filing of the cross-bill in which it must have made admissions about the scope of its business that were fatal to the language of the covenant and were taken into consideration by both the trial and Supreme courts.

competitor what he/she did with the former employer, could vastly improve the chance that the covenant will pass the test of reasonableness.

4) Two to three year durations for restrictive covenants have been upheld in Virginia, although shorter is clearly better in the eyes of the courts. Furthermore, any payment made to prevent a former employer from competing will usually pass the reasonableness test. With concern to geographical restrictions, some limitation of scope is clearly required as the Court recently held that a restrictive covenant was too broad in scope because there was no geographical limitation, despite the defined geographical parameters of the employer's business. *See Simmons v. Miller,* 261 Va. 561 (2001). What the limitation should be is most likely defined by the role the employee plays in an organization. More often than not, a geographic restriction should be some radius of an area in which the employee actually performed work/services for the employer, because extending the areas to encompass large portions of the country or world, even in today's day and age, have consistently been held to be overbroad. An exception to the geographic restriction limitation can probably be made for employees with significant control, responsibility and/or access to confidential information, customers and the like. In these instances, the legitimate business interest of curtailing direct competition from an employee who, for example, directed the entire east coast sales operation, would warrant having a much larger geographic area restriction. *See Roanoke Engineering,* 290 S.E.2nd at 885.

5) Finally, employers can be a little more aggressive with employees who have direct access to and interaction with the employer's customers and clients. Non-competes for employees with such interaction seem to be less offensive to the courts as they seem reasonable to protect a very real and legitimate business interest of the employer's livelihood. When coupled with severance payments for the term of the non-compete, this is a very effective way of restricting an ex-executive from poaching clients and/or customers.

If you have any additional questions concerning covenants not to compete in Virginia, please do not hesitate to contact me, Paul Economon, at Koltun & King, P.C., (202) 331-0123, or peconomon@koltunlaw.com.

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