

Enforcement of Non-Competition Clauses in Employment Contracts in Virginia

Introduction

At common law, non-competition agreements once were unenforceable as a restraint of trade. However, since early this century Virginia courts have recognized and enforced such covenants in employment agreements and other contracts. A three-part test determines the reasonableness of a non-competition agreement. This test considers the scope of protection afforded the legitimate business interests of the employer, the restraint on the employee's ability to earn a livelihood, and the effect of the restriction on the public interest. Traces of the court's skepticism towards such agreements can be seen throughout the case law. For example, where there is ambiguity in the language of these agreements, the court will construe the covenant in the way most favorable to the employee.

Test for Enforcing Non-Competition Agreements

In Virginia, a non-competition agreement in an employment contract is subject to a three-prong test to determine its enforceability. Virginia courts look to the reasonableness of the clause to ensure that it is: (1) no greater than necessary to protect the legitimate business interests of the employer, (2) not an unduly harsh or oppressive restraint on the employee's efforts to earn a living, and (3) consistent with sound public policy. Meissel v. Finley, 95 S.E.2d 186, 188 (Va. 1956). Application of this rule is more difficult than it may appear, as each agreement must be considered in light of the "circumstances and conditions under which it is to be performed." Worrie v. Boze, 62 S.E.2d 876, 881 (Va. 1951) (enforcing a restraint on competition for two years within a 25-mile radius of the Arthur Murray dance studio by a former dance instructor).

Looking at the first prong of the test, the court has said that the focus of the inquiry must be on "the effect of [the prohibited employment] upon the business sought to be protected." Stoneman v. Wilson, 192 S.E. 816, 819 (Va. 1937). In Stoneman, the court explained that the nature of the business and the employee's control of the business were necessary factors to consider. Id. at 819. The court held that a former employee and stock holder of a hardware

store was not precluded from working as a clerk for another hardware store by the non-competition agreement he signed in conjunction with the sale of his company stock. Id. at 820. The agreement provided that he would not “go in the Hardware business for a period of 5 years in Galax, Va. or a radius of 5 miles.” Id. at 817. In light of the specially valuable information to which the plaintiff had access from his former employer, the court found that he could not occupy a significantly similar position with the new company. However, the evidence failed to show how his new position as a clerk was similar to his previous one. Id. at 820. Apparently, the court believed that as a clerk, the plaintiff was not in a position to abuse the knowledge he had gained from his former employer. The court, however, did not consider the difficulty his former employer would have in monitoring the influence that the plaintiff could have on the business of his new employer.

Virginia courts have frequently found that non-competition agreements are reasonable if needed to protect client contacts. In Blue Ridge Anesthesia & Critical Care, Inc. v. Gidick, the court held that a salesman and two service technicians were bound by a non-competition agreement despite their limited customer contact. 389 S.E.2d 467 (Va. 1990). The covenant prohibited employment with “any competitor of Employer which renders the same or similar services as Employer, within any of the territories serviced” by the former employee for three years after termination. Id. at 468. The agreement also provided that the covenant would not preclude the former employee from working in the medical industry “in some role which would not compete with the business of” the former employer. Id. at 468. Because Blue Ridge’s business was extremely competitive, any contact the defendants had with their former employer’s clients could adversely affect Blue Ridge. Id. at 469.

Likewise, in Worrie, the plaintiff was a dance instructor at the defendants’ dance school. He signed an agreement that, for two years and within 25-miles of the defendants’ studio or in the city of Richmond, he would not work in “any manner relating to dancing” or “solicit business for himself or any other [dancing-related] business . . . from any of the employer’s pupils or patrons” upon termination of his employment. 62 S.E.2d at 878. After leaving the defendants’ employ, the plaintiff opened his own dance school in town and solicited clients of his former employer. Id. at 880. The court found his contact with pupils during his employment

at defendants' school was a sufficiently legitimate business interest to warrant protection through enforcement of the non-competition agreement. Id. at 880.

Additional legitimate business interests include:

- protection of the investment of time and money, see New River Media Group, Inc. v. Knighton, 429 S.E.2d 25 (Va. 1993) (enforcing a non-competition agreement signed by a disc jockey after his former radio station invested substantially to create defendant's "air personality"); Meissel, 95 S.E.2d 186 (Va. 1956) (upholding an agreement not to compete between former partner and insurance company because the plaintiff could use confidential information he acquired while working to the "very great disadvantage of the partnership")
- protection of confidential financial information, see Roanoke Eng'g Sales Co., Inc. v. Rosenbaum, 290 S.E.2d 882 (Va. 1982) (holding that an agreement not to compete as it applied to a former corporate Executive Vice President and Treasurer was reasonably necessary to protect legitimate business interests of the employer)
- protection of business techniques, see Paramount Termite Control Co., Inc. v. Rector, 380 S.E.2d 922 (Va. 1989) (enforcing a non-competition agreement against two sales representatives, a service coordinator and a service technician, where the employees not only had frequent client contacts, but were also familiar with the company's cost estimating procedures, work specifications and pest control techniques)

Under the second prong of the test, courts will find the restraint unduly harsh or oppressive on the employee where the restraint sought is greater than necessary for the former employer's protection, or where it curtails the employee's legitimate efforts to earn a livelihood. Richardson v. Paxton, 127 S.E.2d 113, 117 (Va. 1962). The plaintiff in Richardson, formerly a salesman for the defendant's marine and industrial supply company in the Tidewater area of Virginia, signed an agreement that "for the term of three years. . . [he would not] engage in any branch of marine or industrial supplies [business]" in his territory. Id. at 115. Applying an 'all or nothing' approach, the court found the covenant void and unenforceable even though the plaintiff's new job was substantially the same as the position he held with the defendant in the same geographic region. Id. at 117. The requirement that

plaintiff not participate in *any* job in the marine and industrial supply business was too broad because it encompassed activities which the employee had not performed for his former employer. Id. See also Foti v. Cook, 263 S.E.2d 430 (Va. 1980) (holding enforceable an agreement allowing the former accounting firm to collect from the withdrawing partner one-third of all fees earned over the next three years from clients of the partnership during the two years after his withdrawal because it did not in any way limit plaintiff's employment, but merely prohibited him from taking clients away from his former employer without appropriate compensation).

In Power Distribution, Inc. v. Emergency Power Eng'g, Inc., the court found unenforceable a provision prohibiting the employee from accepting employment or directly or indirectly working "in competition with" the former employer for one year from termination. 569 F. Supp. 54, 55 (E.D. Va. 1983). There, the defendant was a sales representative for plaintiff computer power supply equipment company. Id. at 55. After his resignation, the former employee announced plans to become a sales representative for a competitor. Id. at 55. The court acknowledged that the former employee had access to confidential information significant enough to harm the plaintiff if misused, but that was insufficient to justify the "inordinately oppressive terms" of the agreement. Id. at 57. By applying the all or nothing approach, the court refused to enforce the covenant because it was unreasonable for a Virginia company to prohibit a former employee from working in other states "simply because this fledgling company has once done business there or hopes to do business there." Id. at 57. Cf. National Homes Corp. v. Lester Indus., Inc., 404 F.2d 225 (4th Cir. 1970) (holding that a clause restricting the defendant's direct or indirect competition "anywhere in the United States" for ten years from the *beginning* of the employment contract was enforceable in Maryland, West Virginia and Virginia, but declining to address whether or not the agreement would be enforceable in a state where the plaintiff or its subsidiaries was not doing business).

In Grant v. Carotek, Inc., the Fourth Circuit Court of Appeals held that a lack of restriction to actual competition rendered the covenant not to compete unenforceable. 737 F.2d 410 (4th Cir. VA 1984). After the plaintiff was fired from his position as manager of Virginia operations with the defendant, a chemical processing equipment distributor, he started a new company in

the same business and began contracting with manufacturers who had formerly worked with the defendant. Id. at 410. At issue was a non-competition clause calling for a five-year ban on contracting with any of the former employers' contacts in states where the defendant conducted business. Id. at 411. The court found this prohibition overbroad because it precluded the plaintiff from all contacts with his former employer's clients, even for business unrelated to Carotek's, and was thus an unreasonable restraint of trade under Virginia law. Id. at 412. This is another example of the "all or nothing approach," as the covenant was held unenforceable even though Grant was actually contracting with former clients in direct competition with the defendant.

Similarly, in Alston Studios, Inc. v. Lloyd V. Gress & Assoc., the court found unenforceable a non-competition provision that lacked geographic limitation and was excessively broad as to the activities prohibited to the employee after his termination. 492 F.2d 279 (4th Cir. 1974). The plaintiff, a company providing school photography services, employed the defendant as a regional agent in Maryland, Virginia, and the District of Columbia. The non-competition agreement provided that the former employee would not "continue in the school picture business, either directly or indirectly for himself or any individual or company in said business for a period of two (2) years." Id. at 282. Upon his resignation, the defendant began working for a competitor, calling on plaintiff's customers. Id. at 282. The court noted that the Virginia Supreme Court had not decided any cases with a similarly geographically and functionally unrestricted non-competition clause. Nevertheless, the federal court of appeals, applying the 'all or nothing' approach, held the agreement "far broader than necessary to protect Alston's legitimate business interests." Id. at 283. The most significant problem with the provision was that it did not limit the restriction to areas where Gress actually worked for Alston or activities in which he was engaged. Id. at 283.

However, provisions that are geographically unlimited are not always unreasonable or oppressive. Comprehensive Technologies Intern., Inc. v. Software Artisans, Inc., 3 F.3d 730, vacated and appeal dismissed (4th Cir. 1993). In this case, which the parties subsequently settled, the court found a 12-month ban throughout the United States to be reasonably necessary to protect the employer. Id. at 739. This provision was enforced primarily because it

was limited to the specific type of software in which the former employer specialized, but left open the possibility for the former employee to work for other, non-competing software companies. Id. at 740. The software sold by the plaintiff (CTI) had only been licensed in approximately ten states. However there was evidence that CTI had specific prospective customers in at least twelve other states and the District of Columbia. Id. at 740. CTI also faced direct and potential competition in more than half of the states in the country. Id. at 740. Of additional importance to the court was that the employee had been a Vice President, with access to confidential company information that could be used to the detriment of the former employer. Id. at 739. However, one judge dissented, suggesting certification of the question of a nationwide ban to the Virginia Supreme Court. Id. at 742. Of primary concern to the dissenting judge was that this application contradicted his prediction of what the Virginia courts would do with this agreement. Id. at 743.

In determining the enforceability of covenants not to compete under the third prong of the reasonableness test, the courts struggle to resolve the tension between several policy concerns. On one hand, Virginia law does not look favorably on restraints of trade by an employer. Grant, 737 F.2d at 411. On the other hand, the Virginia Supreme Court has recognized that an employer has a legitimate interest in protecting his business through reasonable restrictions. Worrie, 62 S.E.2d at 882. In reconciling this conflict, the courts tend to incorporate their policy concerns into the first two prongs of the test.

However, these tensions are magnified in cases where the provisions of the covenant are sufficiently vague or ambiguous so as to make their meaning unclear to the employee who is a party to the agreement. Several recent cases may be illustrative of the technical difficulties the courts face when interpreting the reasonableness of these agreements.

In Clinch Valley Physicians, Inc. v. Garcia, S.E.2d 599 (Va. 1992), the defendant's employment contract was not renewed, and he sought a declaratory judgment to void the non-competition provision contained therein. The agreement at issue provided for a three-year, twenty-five-mile ban on the practice of medicine or surgery by the terminated physician. Id. at 600. Despite the fact that this provision covered terminations "for any reasons whatsoever," the court held that the non-competition agreement applied only to situations where the

employee was terminated for cause and not to those where the contract was not renewed. Id. at 601. In coming to this decision, the court looked to wording in other sections of the employment contract that provided for its termination only for justifiable cause. The court said that if Clinch Valley had intended for the non-competition provision to apply in situations of non-renewal, they should have specified so in explicit terms. Id. at 290, 414 S.E.2d at 601. Additionally, the court held that where a provision can be reasonably interpreted in more than one way, the “construction most favorable to the employee” should be adopted. Id.

A federal district court faced ambiguous wording in Power Distribution and found the difficulty in determining the reach of the provision a significant factor in not enforcing the agreement. 569 F. Supp at 58 (1983). At issue was a clause prohibiting “*any* employment with any person or entity, or engag[ing] in *any* activity either directly or on behalf of any person or entity in competition with” the former employer for one year from termination. 569 F. Supp. at 55 (emphasis added). The plaintiff contended that the phrase “in competition with” provided “functional limitations” both with respect to the territory and the employment activities proscribed. Id. at 57. The court found the wording “so vague that it [was] indeed susceptible of a meaning that would not involve an overbroad proscription,” but it could likewise be construed to “prohibit much more.” Id. at 57-58. This ambiguous construction would have had a deleterious effect on the employee who was trying to decide whether or not the provision covered a particular job. Despite the fact that the defendant was engaging in activities that were directly in competition with the plaintiff's business, the court determined that “[t]he fact that [the covenant's] reach is so difficult to determine and may so easily exceed . . . the permissible reach renders the covenant overbroad.” Id. at 58.

Burden of Proof and Damages/Remedies

In cases where the enforceability of a non-competition agreement is at issue, the burden falls on the employer to prove that

the restraint is reasonable and the contract is valid. Since the restraint sought to be imposed restricts the employee in the exercise of a gainful occupation, it is a restraint in trade, and it is carefully examined and strictly construed before the covenant will be enforced. Moreover, the scope of permissible restraint is more

limited between employer and employee than between seller and buyer, and the covenant is construed favorably to the employee.

Richardson, 127 S.E.2d at 117 (Va. 1962). See also Linville v. Servisoft of Va., Inc., 174 S.E.2d 785, 787 (Va. 1970).

For example, in Roto-Die Company, Inc. v. Lesser the court granted summary judgment for the defendant, a former employee who had signed a non-competition covenant in conjunction with the sale of his portion of company stock. 899 F. Supp. 1515 (W.D. Va. 1995). The restriction prohibited the defendant from working in the rotary tooling industry for five years in any capacity worldwide. Despite the wider latitude provided in contracts for the sale of a business, the court held that the former employer "failed in its burden to come forward with evidence on which a reasonable finder of fact could determine that it [was] entitled to world-wide protection." Id. at 1521. Similarly, in Grant the court found that the former employer failed to carry its burden of proof with respect to the reasonableness of the provision. 737 F.2d at 412. There, the agreement was overbroad and unenforceable because it prohibited the plaintiff from contracting with *all* of the former employer's clients for *any* purposes. Id. at 411.

More recently, the court held that a non-competition clause in a partnership agreement did not bind an employee who accepted a partnership interest in the firm, but did not actually sign the agreement. Persinger & Co. v. Larrowe, 477 S.E.2d 506 (Va. 1996). The firm argued that the offer they made to the defendant was for him to become a party to the partnership agreement. However, the court held that the firm failed to carry its burden of proof in establishing that Larrowe was bound by the non-competition agreement. Id. at 509.

The enforceability of the non-competition clause does not seem to depend upon the method of termination. While most of these types of cases arise when the employee leaves a job, whether the employee leaves voluntarily or is fired does not have much bearing on the enforceability of the clause itself. See New River Media Group, 429 S.E.2d 25 (Va. 1993) (enforcing a non-competition agreement when the employer fired the employee); Paramount Termite, 380 S.E.2d at 926 (Va. 1989) (stating that "Paramount could have terminated the employees at will after they signed the non-competition agreement").

Once the employer has carried the burden of proof, and the court has found the covenant reasonable under the three-prong test, the court must decide on an appropriate remedy. There is no question among Virginia courts that such reasonable restrictive covenants are enforceable in equity. Worrie, 62 S.E.2d at 881. In Worrie, the court also enforced the payment of a promissory note executed by the plaintiff when he signed the agreement. Id. at 879. In looking at the employer's interests, it is not necessary to show any actual damages, but "it is sufficient if such competition, in violation of the covenant, may result in injury." Id. at 882. Cf. Hallmark v. Jones, 154 S.E.2d 5 (Va. 1967) (holding that the question of enforceability was moot because the time during which competition had been prohibited had expired and there was *no* evidence of any actual damage even though the former employer may have had legitimate business interests to protect).

The court is also willing to provide equitable relief when the former employees, though perhaps not technically engaging in competitive activities, are nevertheless violating the spirit of their agreement. In Rash v. Hilb, Rogal & Hamilton Co. of Richmond, the former Senior Vice President of defendant insurance company signed an agreement that he would "not directly or indirectly . . . for a period of three (3) years . . . engage in *any* manner in *any* business competing directly or indirectly with" the defendant. 467 S.E.2d 791, 794 (Va. 1996) (emphasis added). The court held that he violated this non-competition agreement by allowing his wife to use assets they owned jointly to establish a competitive business. Id. at 794. This was true even though the wife was not a party to the agreement nor did the employee's name appear on any documents relating to his wife's company. Id. at 793. The court determined that there was sufficient evidence to show that the plaintiff was "at the very least, indirectly engaged in a business that competed against" the defendant. Id. at 794.

In Catercorp, Inc. v. Catering Concepts, Inc., although none of the defendants was a party to the non-competition agreement in question, the court denied them summary judgment. Catercorp, 431 S.E.2d 277 (Va. 1993). At issue was a competitive catering business established by a former employee of the plaintiff, who was not bound by the covenant, and the wife of the employee who was a party to the covenant. The agreement prohibited the former employee from contacting any of plaintiff's customers for the purpose of providing services

similar to plaintiff's services. Id. at 280. The court held that the plaintiff might be entitled to an injunction if it could be proven that they would “suffer irreparable injury” because of the former employee’s connection with the defendants. Id. at 282.

Conclusion

Virginia courts are willing to enforce non-competition agreements to the extent necessary to protect legitimate business interests. However, the courts are wary of employer overreaching through overbroad covenants. Using the three-prong test, courts are unlikely to enforce a covenant that is either so ambiguous that it is difficult to determine its reach or overbroad in the protection it affords the employer. As evidenced by many decisions cited above, Virginia courts will likely enforce an agreement that uses clear and precise language to restrict only the areas and activities necessary for protection of the employer.