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## **CLIENT ALERT**

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Virginia Supreme Court Clarifies Law on Enforceability of Covenants Not to Compete

Covenants that restrict competition are not favored by the courts because of the public policy against restraints of trade and the hardship that can result to former employees who are trying to earn a living. In some states (e.g., California), all non-compete agreements in an employment setting are held to be unenforceable and void as against public policy. Even in states that do allow non-compete agreements, an employer who seeks to restrain competition by former employees must demonstrate the existence of a legitimate business interest as a condition for seeking enforcement of a covenant. In that respect, judges will often look for reasons not to issue injunctions enforcing covenants not to compete.

This principle is illustrated by a recent decision of the Virginia Supreme Court, Home Paramount Pest Control Cos. v. Shaffer (No. 101837, Nov. 4, 2011), where the court held that language in a restrictive covenant was overbroad and not enforceable against a former employee of Paramount Pest Control ("Paramount") even though the Court had previously held the same broad restriction to be enforceable twenty-two years earlier in another case involving Paramount. The court acknowledged that it upheld the identical non-compete provision in its previous decision but stated that it had "incrementally clarified the law since [the 1989 case] was decided." Accordingly, the court overruled its previous decision and concluded that that the trial court had correctly refused to enforce the restrictive covenant against the company's former employee.

In evaluating the reasonableness of a covenant not to compete, courts in Virginia look at three elements of the restrictive clause; its duration, its geographic scope and the functional aspect of the restriction. With regard to the first two elements, an employee's agreement not to compete with his employer upon leaving employment will be upheld if the restraint is confined within limits which are no wider as to area and duration than are reasonably

necessary for the protection of the business of the employer. Covenants with durations of two years or less are usually deemed reasonable by the courts. With respect to the allowable geographic scope of a non-compete clause, courts normally will only enforce a restrictive covenant that is limited to the company's "market area" or the geographic area where the company actually conducts its business. The duration and geographic scope of the covenant not to compete was not at issue in the Paramount Pest Control decision. Instead, it was a broad functional restriction in the covenant that troubled the court.

The clause at issue in the Paramount Pest Control case attempted to prevent the employee from "engag[ing] indirectly or concern[ing] himself . . . in any manner whatsoever" in pest control "as an owner, agent, servant, representative, or employee, and/or as a member of a partnership and/or as an officer, director or stockholder of any corporation, or in any manner whatsoever." The court found the covenant to be a "sweeping prohibition" that unduly burdened the employee's attempt to earn a living because it went beyond protecting Home Paramount Pest Control's business interest. The court said: "On its face, it prohibits [the employee] from working for . . . any other business in the pest control industry in any capacity. It bars him from engaging even indirectly . . . in the pest control business, even as a passive stockholder of a publicly traded international conglomerate with a pest control subsidiary." The court said the employer's failure to confine the scope of the "function" element in its covenant not to compete to activities in which the business actually engaged proved fatal to its enforcement action.

Despite the substantial obstacles that may be faced by an employer attempting to stop a former employee from engaging in competition with the company, a reasonable non-compete agreement can be useful in discouraging employees from opening up a competing business if they believe they may incur immediate legal consequences for such conduct. At the very least, a clearly defined non-solicitation covenant prohibiting direct solicitation of customers with whom the employee had dealings while employed with the company will normally be enforced by the courts. In *Advanced Marine Enterprises, Inc. v. PRC Inc.*, 256 Va. 106 (1998), the Virginia Supreme Court upheld a provision that restricted employees from "rendering competing services to" the company's customers.

Finally, the employment agreement should have a clause by which the employee is prohibited from using trade secrets after the employment. The combined force of such a covenant and the statutory prohibition against the use of trade secrets, including confidential customer lists, should be enough to protect the employer against unfair competition by a former employee.

Attorneys at Kruchko & Fries will continue to monitor court decisions in Virginia relating to the enforcement of covenants not to compete. If you have questions about the reasonableness of a non-compete agreement you are asking employees to sign, contact any attorney at Kruchko & Fries.

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