A Timely Analysis of Legal Developments

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December 2011

Virginia Supreme Court Further Narrows Non-Compete Covenant Enforceability

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In *Home Paramount Pest Control Cos. v. Shaffer*, No. 101837, 2011 Va. LEXIS 222 (Nov. 4, 2011), the Virginia Supreme Court ruled that a covenant not to compete was overbroad and unenforceable, even though it was identical to a covenant the court had upheld 22 years earlier in *Paramount Termite Control Co. v. Rector,* 238 Va. 171 (1989). Acknowledging this, the court expressly overruled its holding in *Paramount Termite*.

Shaffer represents the culmination of 20 years of narrowing the enforceability of restrictive covenants in Virginia. In overruling *Paramount Termite*, the court's ruling both confirms and reflects this major shift in the law governing non-compete covenants in Virginia.

Facts

While employed by Home Paramount Pest Control, Mr. Shaffer signed an employment agreement prohibiting him from ". . . engag[ing] directly or indirectly or concern[ing] himself . . . in any manner whatsoever in the carrying on or conducting the business of exterminating, pest control, termite control and/or fumigation services" in any city or county in which he worked for two years after separating from employment. After resigning from the company, and within the two-year period, he became employed by another pest control company and engaged in competing activities. The company filed suit to enforce the covenant.

Ruling

The court recited the long-standing, general rule that non-competition agreements are enforceable in Virginia if they are narrowly drawn to protect the employer's legitimate business interests, not unduly burdensome on the employee's ability to earn a living, and not against public policy. After noting that the employer has the burden of proof on all of these elements, the court applied its recent, more restrictive interpretation of the general rule.

Emphasizing that the restrictive covenant was not limited to preventing the former employee from engaging in activity that competes with the company, the court found the blanket prohibition against working in any capacity for a competitor overbroad and unenforceable. The court observed that it "bars [the former employee] from engaging even indirectly . . . in the pest control business," even as a stockholder in a public company with a pest control subsidiary. The court rejected the

company's argument that its ruling would invite the courts to contemplate "hypothetical job duties," noting that the company's failure to confine the "function element" of the non-compete provision – the prohibited activities – to those activities in which the company actually engaged required the company to prove its legitimate business interest in prohibiting the former employee from engaging in "all reasonably conceivable activities while employed by a competitor." In the court's view, this provision was so overbroad that it could not be saved by the agreement's limited geographic scope and duration (two years). Thus, while observing that these elements are "considered together," the court continued its recent practice of giving increased scrutiny and increased weight to the scope of the "function element."

The court expressly overruled its 1989 *Paramount Termite* decision, in which it had upheld a non-compete covenant identical to the one at issue in *Shaffer*. The court noted that in the 20 years since it issued its ruling in that case, it had gradually refined the law, in cases such as *Blue Ridge Anesthesia & Critical Care. v. Gidick*, 239 Va. 369 (1990), *Motion Control Sys. v. East*, 262 Va. 33 (2001), and, most recently, *Omniplex World Servs. Corp. v. U.S. Investigs. Servs.*, 270 Va. 246 (2005).

Significance for Employers

In the *Shaffer* decision, the Virginia Supreme Court has made it clear that a non-competition agreement with an overbroad function element will be deemed presumptively unreasonable and unenforceable, even if its duration and geographic scope are reasonable. Therefore, it is important to review the scope of the function element in non-compete agreements. Provisions that attempt to prohibit employees from directly or indirectly owning, managing, being employed by, or involved in any capacity with any business or entity that competes with or is similar to the business of the employer are now less likely to be enforceable. For now, non-competition provisions should be narrowly tailored to prohibit a former employee only from performing competitive activity for a competitor – as the court phrased it, "activity of the same type as that actually engaged in by the former employer."

Three points await future clarification. First, the court cited with approval its prior decisions that "assessed the function element . . . by determining whether the prohibited activity is of the same type as that actually engaged in by the former employer," although the court in this newest case appears to focus less on the employee's specific, prior job duties and more on the activities engaged in by the employer itself. Second, rather than finding the agreement here unenforceable per se, the court noted that the company had the burden of proving "a legitimate business interest in such a sweeping prohibition." Conceivably, this leaves the door open for future review of a case involving a high-level executive or owner of a business. Finally, the Virginia Supreme Court has also granted review in BB&T Ins. *Servs., Inc. v. Thomas Rutherfoord, Inc.*, 80 Va. Cir. 174 (2010), in which several important unfair competition issues are raised, including whether having a "blue-pencil" provision automatically renders a restrictive covenant invalid.

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