

Emerging Issues

Challenges to enforceability of restrictive covenants in employment agreements:

Looking past the two-year, 50-mile non-compete

by Blackwell N. Shelley, Jr.

A casual internet search for non-compete agreement templates will return hundreds of forms, in all price ranges, for every line of work from accountants to zookeepers. Most of these agreements come with a broad disclaimer that urges the purchaser to consult with counsel before using them, which is good, because most of these agreements fail to be enforceable, for one reason or another. Virginia courts have said, over and over, that restrictive covenants, such as non-compete and non-disclosure agreements, must be narrowly tailored to meet the needs of the employer and the employee. One size does not fit all.

A loosely drafted non-compete agreement offers lots of opportunities for an employee to challenge its efficacy. What are some of the most common challenges to restrictive covenants, as well as some others that may arise when an employer relies on a boilerplate agreement?

The basic rule is this: restrictive covenants are disfavored restraints on trade, but will be enforced if the contract:

- (1) is narrowly drawn to protect the employer's legitimate business interest;
- (2) is not unduly burdensome on the employee's ability to earn a living; and,
- (3) is not against public policy.¹

Virginia courts, like those of other jurisdictions, look to the covenant's duration, territorial scope, and the type and description of the prohibited employment function. To a lesser extent, courts will also look at the relative bargaining positions of the parties.² Each non-compete agreement is evaluated on its own merits, balancing the provisions of the contract with the circumstances of the businesses and employees involved. Accordingly, there is no precise formulation of terms that will always pass muster with the courts.³

Usually, the covenant's geographic scope can be shown to be reasonable with proof that it encompasses an area equal to or smaller than the region in which the employee performed services for the company.⁴ Likewise, the duration of the covenant can be justified by tying it to some business cycle, such as the amount of time it takes for a salesman to capture and cultivate a new customer,⁵ or

the employer's business cycle,⁶ but courts often will simply hold, without analysis of the relationship between the time period and the business, that a period of two years or less is reasonable.⁷

As a practical matter, however, it is the description of the prohibited employment that offers the most challenges to a covenant's enforceability. Because restrictive covenants restrain free trade, any ambiguities in the contract are construed in favor of the employee.⁸ The description of prohibited employment must therefore do no more than prevent an employee from engaging in activities that actually compete with the employer.⁹ In discussing this sort of over breadth, the Virginia Supreme Court has given examples such as blanket prohibitions against "working for a competitor,"¹⁰ or prohibitions against *any* form of employment in the field.¹¹

The "reasonableness" requirements for non-competes only address the first two prongs of the test. The "public policy" part of the test – the third prong – usually comes into play in an agreement where any part of the restrictive covenant is ambiguous or vague. If an employee must try to interpret an ambiguous provision to decide whether it is prudent, from a standpoint of possible legal liability, to accept a particular job or whether it might be necessary to resist the employer's efforts to assert that the provision covers a particular job, the ambiguity is deemed to have an *in terrorem* effect on the employee. Virginia courts, state and federal, have held that the mere act of subjecting the employee to such uncertainty offends public policy.¹²

Whether the duration or territorial coverage of a non-compete is reasonable will usually involve some questions of fact that are extrinsic to the pleadings or the contract, particularly with regard to the employer's business interests or with regard to the employee's ability to earn a livelihood. Such questions will likely make a demurrer inappropriate, which is good for the plaintiff. If some part of the restrictive covenant is ambiguous, though, whether the contract is enforceable becomes a question of law.¹³

The courts' rules of strict construction make ambiguity fatal to a restrictive covenant. Virginia courts will not attempt to reform an ambiguous agreement to make it clear or more reasonable. While

the Virginia Supreme Court has neither adopted nor expressly rejected the “blue pencil rule” as it applies to restrictive covenants in employment contracts, the case law suggests that, in assessing the validity of such covenants, Virginia follows an “all-or-nothing” rule.¹⁴ Likewise, Virginia circuit courts have uniformly declined to “blue pencil” the terms of restrictive covenants in order to make them enforceable.¹⁵

This is not the case in every jurisdiction. Some states, such as Maryland, West Virginia, and South Carolina, allow a court the power to excise portions of a restrictive covenant to reduce its scope to something the court finds reasonable. This lack of uniformity among the states has led to a proliferation of boilerplate provisions which may work in some states, but do not work here. One such provision is a “savings” clause, which usually recites that a court of competent jurisdiction may “modify” or “amend” any unenforceable provision of the agreement so as to make it enforceable. A few Virginia circuit courts have held that such a “savings” clause is against public policy.¹⁶

In this regard, however, there is an important distinction between “savings” and “severability.” Where the intention of the contracting parties is manifest and shows that the parties intended for the restrictive covenants to be separate and distinct from the rest of the agreement, Virginia courts have excised the entire restrictive covenant, but allowed the rest of the agreement to remain.

In *Roto-Die Company, Inc. v. Lesser*, Judge Kiser suggested that the distinction between a savings clause and a severability clause made all the difference.¹⁷ He stated:

The difference between ‘blue penciling’ and severing is a matter of focus. The former emphasizes deleting, and in some jurisdictions adding, words in a particular clause. The latter emphasizes construing independent clauses independently.

The two propositions, he suggested, were not inconsistent and would allow a court, under the proper circumstances, to strike out an unenforceable restrictive covenant and enforce the remainder of the agreement, so long as the parties had agreed that the contract was thus divisible.¹⁸

Apart from “savings” and “severability” clauses, another form of boilerplate – the assignment clause – can also wreck a non-compete. Under Virginia law, contracts for personal services, including employment agreements, are not assignable, unless both parties agree to the assignment.¹⁹ Although the restrictive covenants in an employment agreement are part of the whole agreement, they are not, strictly speaking, personal service agreements. No Virginia state court has expressly addressed whether a covenant not to compete contained in an employment contract may be assignable apart from the whole contract, despite the personal nature of the whole agreement and the non-assignability of the agreement as a whole.²⁰

However, in *Reynolds and Reynolds Company v. Hardee*,²¹ the plaintiff acquired defendant employee’s former employer and, as part of the deal, acquired defendant’s employment agreement, which contained a non-compete provision. After the acquisition, plaintiff sought to have defendant sign a new employment agreement that was less favorable to the employee. Defendant employee refused and was terminated, and thereafter plaintiff filed suit to enforce the non-compete provision of the agreement. Judge Smith, noting the absence of Virginia law on this point, reviewed cases from other jurisdictions and held that a non-compete agreement could not be assigned.

In particular, Judge Smith relied on the following passage from a Vermont decision:²²

The employee entrusted to his employer the important privilege of discharging him at will and without cause. This eventuality would at once invoke the severe detriment of foreclosing him from employment elsewhere in that community in his chosen occupation. The restriction, in its own terms, was designed to protect a fiduciary relationship which emanated solely from the master and servant relationship.

Knowing the character and personality of his master, the employee might be ready and willing to safeguard the trust which his employer had reposed in him by granting a restrictive covenant against leaving that employment. His confidence in his employer might be such that he could scarcely anticipate any rupture between them. As to that particular employer, if a break did occur, he might be willing to pledge that his fidelity would continue after the employment had ended, even at the cost of forsaking the vocation for which he was best suited. This does not mean that he was willing to suffer this restraint for the benefit of a stranger to the original undertaking.

If Judge Smith’s rationale is correct, then it is probable that a Virginia court would find that an assignable non-compete provision is ambiguous – or a least too vague to be enforced – because of the possibility that a stranger to the original agreement might attempt to enforce the restrictive covenant. The Virginia Supreme Court has not weighed in on this question yet, but several circuit courts have adopted Judge Smith’s rationale.²³

In addition to “savings” and “assignment” clauses, boilerplate contracts also may contain a “no defense” clause. A “no defense” clause generally provides that an employer’s breach of the employment agreement does not amount to a defense to the employer’s subsequent efforts to enforce a restrictive covenant. Usually, the language of a “no defense” clause provides that the employee cannot assert, for example, a wrongful termination as a defense against enforcement of a non-compete. Whether such a provision is

enforceable in Virginia depends upon an examination of the entire agreement.

There is not much law in Virginia on this point, but in *Standard Laundry Service v. Pastelnick*,²⁴ the Virginia Supreme Court considered whether an employer who wrongfully discharged an employee could enforce a covenant not to compete against that employee. The employer contended that the covenant not to compete “was an independent one” effective upon “termination of his employment for any cause whatever.”²⁵ The Court rejected that argument and stated, “The contract of employment was an entire and inseparable one.” The court concluded that the employer would “not be allowed to breach the contract by wrongfully discharging Pastelnick before the end of his term and then later hold him bound to the covenant under the contract.”

The Court’s finding that the contract was “entire and inseparable” was essential to the holding in *Standard Laundry Service*. The Court’s language suggests that, if the contract were not found “entire and inseparable,” the employer would have been able to enforce the covenant not to compete, despite its breach.²⁶

Two circuit court cases follow this reasoning. In *Weiss v. E.V.M.S. Academic Physicians*,²⁷ the court held that parties to an employment contract may agree that a covenant not to compete will be enforceable even if the employer first breaches other provisions of the contract, so long as the restrictive covenant is separable from the rest of the contract. The court specifically found that a “No Defense” clause is enforceable and is not repugnant to public policy.

Similarly, in *Hilb, Rogal, & Hamilton Co. of Tidewater v. Jennings*,²⁸ the employment agreement specifically stated that “no covenant or provision shall be dependant upon any other covenant or provision unless so expressed herein.” The contract also provided for liquidated damages in the event of a wrongful discharge. Concluding that the parties could not have intended for the employee to receive liquidated damages and be able to compete with the employer in the event of a wrongful discharge, the court held that the non-compete clause “was separate and independent of the other provisions of the Employment agreement.” Thus, the employer could enforce the terms of the covenant not to compete even if the employer had first materially breached the contract.

One final area of examination in reviewing a boilerplate non-compete agreement should be the choice of law provision. Parties have a right to enter into choice of law provisions and those provisions will be upheld as long as there is a reasonable basis for choosing the law of that forum. The Supreme Court of Virginia has held that, where parties to a contract have expressly declared that it is to be construed with reference to the law of a particular jurisdiction, the court will recognize such agreement and enforce it, applying the law of the stipulated jurisdiction.²⁹ If,

however, the law of the stipulated jurisdiction leads to a result that violates Virginia public policy, the court may refuse to enforce the agreement.³⁰ There is a great diversity among the states on policy issues related to restrictive covenants and many states have policies that Virginia might find repugnant; accordingly, the choice of law provision is always worth a close look.

Unlike most areas of employment law which tend to run in favor of the employer, the law governing restrictive employment covenants favors the employee. The courts have placed the burden on the employer, not only to identify the business interest that the covenant is supposed to protect, but to show that it is particularly important to the business and that the covenant is narrowly written to protect that interest and, at the same time, not unduly deprive the employee of a livelihood.³¹ In addition to placing these burdens of proof on the employer, courts also consistently construe any ambiguities in the contract in favor of the employee.³² Moreover, these burdens rest on the employer regardless of whether the suit is brought by the employer to enforce the covenant, or by the employee, to have it declared unenforceable.

Even with all of these additional burdens on the employer and even with the disfavored nature of the agreements themselves, Virginia courts enforce restrictive employment covenants. A written contract, after all, has a certain amount of dignity that courts are reluctant to ignore, but boilerplate – particularly boilerplate that does not fit – reduces this dignity and may cause the court to be less concerned about the sanctity of the parties’ agreement. For that reason, it is worth counsel’s time to look beyond the basics in analyzing restrictive covenants in an employment agreement. Even if the agreement appears to be reasonable in terms of its temporal and geographic scope, it may yet fail for a variety of public policy or even technical reasons.

Endnotes

1. *Omniplex World Services Corporation v. U.S. Investigations Services, Inc., et al.*, 270 Va. 246, 249, 618 S.E.2d 340, 342 (2005); *Modern Environments, Inc. v. Stinnett*, 263 Va. 491, 493, 561 S.E.2d 694, 695 (2002); *Simmons v. Miller*, 261 Va. 561, 580-81, 544 S.E.2d 666, 678 (2001).
2. *Foti v. Cook*, 220 Va. 800, 806, 263 S.E.2d 430, 433 (1980) (“...it is relevant to consider the parties involved, their respective positions, and the circumstances of the transaction.”)
3. *See Modern Env’ts*, 263 Va. at 494-95, 561 S.E.2d at 696; *Paramount Termite Control Co. v. Rector*, 238 Va. 171, 174, 380 S.E.2d 922, 924 (1989); *Roanoke Engineering Sales Co., Inc. v. Rosenbaum*, 223 Va. 548, 552, 290 S.E.2d 882, 884 (1982); *Meissel v. Finley*, 198 Va. 577, 579, 95 S.E.2d 186, 188 (1956).
4. *See, e.g., Blue Ridge Anesthesia v. Gidick*, 239 Va. 369, 389 S.E.2d 467 (1990)(upholding territorial restriction that was conterminous with employee’s sales area, but less than company’s market area).

5. *James, Ltd. v. Saks Fifth Avenue, Inc.*, 67 Va. Cir. 126 (Arlington County Cir. Ct. 2005), *rev'd on other grounds, Saks Fifth Ave. v. James, Ltd.*, 272 Va. 177, 630 S.E.2d 304 (2006)
6. *See Consolidated Indus. Roofing v. Williams*, 17 Va. Cir. 341, 343 (Roanoke Cir. Ct. 1989)(time frame necessary in the roofing industry for calling on customers, attending pre-bid meetings, preparing material takeoffs, submittals, final bids and pre-installation notices makes two-year restriction appropriate).
7. *See, e.g., Paramount Termite Control Co. v. Rector*, 238 Va. at 175, 380 S.E.2d at 924 (pest control); *Foti v. Cook*, 220 Va. at 806, 263 S.E.2d at 433 (accounting partnership); *Worrie v. Boze*, 191 Va. 916, 927, 62 S.E.2d 876, 881 (1951)(dance instructors).
8. *Simmons v. Miller*, 261 Va. at 581, 544 S.E.2d at 678.
9. *See, e.g., Motion Control Sys.*, 262 Va. at 37-38, 546 S.E.2d at 426 (covenant not to compete restricting employment with motor manufacturers that did not manufacture motors similar to employer overbroad because covenant did not protect against competition); *Richardson v. Paxton Co.*, 203 Va. 790, 795, 127 S.E.2d 113, 117 (1962)(covenant not to compete that restricted former employee, who sold specific supplies and services, from working for any employer involved with any kind of supplies, equipment, or services in the same industry overbroad because covenant encompassed business for which employer did not compete); *Blue Ridge Anesthesia and Critical Care, Inc. v. Gidick*, 239 Va. 369, 373, 389 S.E.2d 467, 469 (1990)(non-competition agreement reasonable because restriction protected against direct competition by prohibiting former employees from employment with another company in a position selling similar medical equipment to that sold by former employer).
10. *Advanced Marine Enters. v. PRC, Inc.*, 256 Va. 106, 119, 501 S.E.2d 148, 155 (1998).
11. *Richardson v. Paxton Co.*, 203 Va. at 795, 127 S.E.2d at 117. *See also infra* note 12.
12. *See Meissel v. Finley*, 198 Va. at 580, 95 S.E.2d at 188; *see also Roto-Die Company, Inc. v. Lesser*, 899 F. Supp. 1515, 1522 (W.D. Va. 1995)(restriction against work for "competitive business" without functional limitation on term or type of work contemplated too vague to be enforceable); *Power Distribution, Inc. v. Emergency Power Engineering, Inc.*, 569 F. Supp. 54, 57 (E.D. Va. 1983)(invalidating covenant not to compete where territorial restriction included areas where employer could, but did not, do business).
13. *Clinch Valley Physicians, Inc. v. Garcia*, 243 Va. 286, 289, 414 S.E.2d 599, 601 (1992) (if one provision of contract, considered in context of other language used in contract, is capable of more than one reasonable construction, it is ambiguous).
14. *See Rash v. Hilb, Rogal & Hamilton*, 251 Va. 281, 285-86, 467 S.E.2d 791, 794 (1996) (parties' contract becomes law of the case unless repugnant to rule of law or public policy); *Foti v. Cook*, 220 Va. at 805, 263 S.E.2d at 433 (court will give effect to intention of parties as expressed in language of contract, and rights of parties must be determined accordingly).
15. *See, e.g., Nida v. Business Advisory Systems, Inc.*, 44 Va. Cir. 487 (Winchester County Cir. Ct. 1998); *Pais v. Automation Products, Inc.*, 36 Va. Cir. 230 (Newport News Cir. Ct. 1995); *Northern Virginia Psychiatric Group, P.C. v. Halpern*, 19 Va. Cir. 279 (Fairfax County Cir. Ct. 1990).
16. *Better Living Components, Inc. v. Willard Coleman & Blue Ridge Truss & Supply*, 67 Va. Cir. 221, 227 (Albemarle County Cir. Ct. 2005); *Totten v. Employee Benefits Mgmt.*, 61 Va. Cir. 77, 78 (Roanoke Cir. Ct. 2003); *Northern Virginia Psychiatric Group, P.C. v. Halpern*, 19 Va. Cir. 279, 282 (Fairfax County Cir. Ct. 1990). *Cf. Orkin Exterminating Company, Inc., v. Farmer*, 1988 U.S. Dist. LEXIS 16432, *8-10 (W.D. Va. 1988) (Kiser, J.) (in contract apparently providing for severability, court penciled out counties and towns in which employee had not provided services, and enforced non-compete as thus modified).
17. *Roto-Die Company, Inc. v. Lesser*, 899 F. Supp. at 1523.
18. *See also Better Living Components, Inc. v. Willard Coleman & Blue Ridge Truss & Supply*, 67 Va. Cir. at 226 ("There is a distinction between severing, where a covenant is excised entirely from the agreement, and 'blue penciling,' where the court rewrites invalid language to make it fit within the bounds of the law.")
19. *McGuire v. Brown*, 114 Va. 235, 76 S.E. 295 (1912).
20. *But see Burchell v. Capitol City Dairy, Inc.*, 158 Va. 6, 10, 163 S.E. 81, 82 (1932)(holding that non-compete clauses in contracts for the sale of businesses are assignable along with the entire sales contract of which they are a part).
21. *Reynolds and Reynolds Company v. Hardee*, 932 F. Supp. 149, 151 (E.D. Va. 1996).
22. *Smith, Bell & Hauck, Inc. v. Cullins*, 123 Vt. 96, 101, 183 A.2d 528, 532 (1962).
23. *See, e.g., SmartMail Service v. Ellis*, 66 Va. Cir. 507 (Chesterfield Cir. Ct. 2003); *Christian Defense Fund v. Stephen Winchell & Assocs., Inc.*, 47 Va. Cir. 148 (Fairfax County Cir. Ct. 1998).
24. *Standard Laundry Service v. Pastelnick*, 166 Va. 125, 127, 130, 184 S.E. 193, 194, 195 (1936).
25. *Id.* at 130, 184 S.E. at 195.
26. *Id.* at 130, 184 S.E. at 195. *See also Parr v. Alderwoods Group, Inc.*, 268 Va. 461, 469, 604 S.E.2d 431, 436 (2004) (finding several agreements to be integrated and holding restrictive covenant not enforceable because of breach of material provision of integrated contract).
27. *Weiss v. E.V.M.S. Academic Physicians*, 68 Va. Cir. 433 (Norfolk Cir. Ct. 2005).
28. *Hilb, Rogal, & Hamilton Co. of Tidewater v. Jennings*, 32 Va. Cir. 514 (Chesapeake Cir. Ct. 1992).
29. *Paul Bus. Sys., Inc. v. Canon U.S.A., Inc.*, 240 Va. 337, 342, 397 S.E.2d 804 (1990).
30. For example, in *SmartMail Service v. Ellis*, 66 Va. Cir. 507 (Chesterfield Cir. Ct. 2003), the agreement provided that Minnesota law would apply. Minnesota law, however, allows for the assignment of personal service contracts, whereas Virginia's does not. Because of this public policy factor, the court denied the employer's motion for an injunction against the employee.
31. *See Omniplex World Services Corporation v. U.S. Investigations Services, Inc., et al.*, 270 Va. at 249, 618 S.E.2d at 342; *Simmons v. Miller*, 261 Va. at 581, 544 S.E.2d at 678.
32. *Simmons v. Miller*, 261 Va. at 581, 544 S.E.2d at 678.



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