A Shift in Judgment: The Evolution of Non-Competition Agreement Law in Virginia

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I. INTRODUCTION

Non-compete clauses have been an essential part of Virginia employment agreements for decades. Naturally, in many cases, these clauses have also been contested by employees who wish to change their employment but remain in the same industry. Conversely, employers have not hesitated to enforce non-competition agreements in appropriate circumstances.

In 1989, the Virginia Supreme Court confirmed a three-part test used for years in Virginia to determine the validity of these non-competition agreements in the then seminal case or *Paramount Termite Control Company v. Rector*[1]:

(1) Is the restraint, from the standpoint of the employer, reasonable in the sense that it is no greater than is necessary to protect the employer in some legitimate business interest?

(2) From the standpoint of the employee, is the restraint reasonable in the sense that it is not unduly harsh and oppressive in curtailing his legitimate efforts to earn a livelihood?

(3) Is the restraint reasonable from the standpoint of sound public policy?

The Court held that non-competition covenants which pass these tests in light of the facts of each case will be enforced in equity.

In the 1989 *Paramount* case, employees who worked for a pest control company signed a non-compete agreement in which they were to refrain from working in the pest control industry "in any county or counties in the state in which Employee works in which the Employee was

assigned" for the two years subsequent to termination of employment or resignation.[2] Additionally, in accordance with the agreement, the employee was not to "solicit business from any customer of Paramount where the purpose thereof is to provide, or offering to provide, the services of pest control" within the same two year period.[3] The employees resigned from the company and started working for a competing pest control company, and Paramount Termite Control Company brought suit in response.

In the trial court, the former employees successfully argued that the non-compete agreement was geographically overbroad and overly restrictive. However, on appeal, the Virginia Supreme Court held otherwise. The Court concluded that the scope of the agreement was not geographically overbroad, as it did not prohibit employment in the counties in which the employees were not assigned while working for Paramount. Moreover, the Court found that the agreement was reasonable in that it was "no greater than necessary to protect Paramount's legitimate business interest in the counties in which the employees worked for Paramount in the two years preceding their terminations of employment."[4] Further, the Court found that the agreement did not "unreasonably curtail the employees' legitimate efforts to earn a livelihood," as the former employees were not prohibited from working in surrounding counties that were within commuting distance.[5] Lastly, the Court found that the agreement did not "unreasonably restrain trade or violate public policy" because both sides realized the highly competitive nature of the pest control industry.[6] Ultimately, when taking each of these factors into account

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[1] *Paramount Termite Control Co. v. Rector*, 238 Va. 171, 174 (1989).
[2] *Id*. at 173.
[3] *Id*.
[4] *Id*. at 175.
[5] *Id*.
[6] *See Paramount Termite Control Co.*, *supra* note 1 at 175.

separately, the Virginia Supreme Court held that the non-competition agreements were valid, and reversed the rulings of the trial court.

Despite the Court's seemingly definitive holdings in *Paramount*, the next decades harbored a shift in the policy behind non-competition agreements. The Court's perspective on non-competition agreements evolved into a policy that promoted free trade and discouraged restrictive covenants. Beginning in approximately 2001, and continuing until the present, Virginia courts' decisions evolved and created a shift in non-competition agreements, in that they enhanced the employee's right to participate in free trade. Specifically, this evolution culminated in the landmark 2011 decision of *Home Paramount Pest Control Companies, Inc. v. Shaffer*, coincidentally involving the same non-competition agreement as the 1989 Paramount agreement.[7]

II. THE 1990'S: ADHERING TO THE *PARAMOUNT* RULING

In the decade immediately following the 1989 *Paramount* decision, the Virginia Supreme Court ruled in accordance with their prior holdings in *Paramount*. As a result, non-competition agreements were rarely found unenforceable pursuant to the three-prong *Paramount* test.[8]

On March 2, 1990, the Virginia Supreme Court handed down a decision in which it declared a non-competition agreement to be valid and enforceable.[9] In this case, involving employer Blue Ridge Anesthesia and Critical Care, Incorporated, the employees signed a non-competition covenant in which they agreed to not "open or be employed by or act on behalf of any competitor of Employer which renders the same or similar services as Employer, within any

[7] *Home Paramount Pest Control Cos. v. Shaffer*, 282 Va. 412 (2011).
[8] *See Roanoke Engineering Sales Co. v. Rosenblaum*, 223 Va. 548 (1982) (where the Virginia Supreme Court first established the three-prong test to determine the enforceability of non-competition agreements).
[9] *Blue Ridge Anesthesia & Critical Care, Inc. v. Gidick*, 239 Va. 369 (1990).

of the territories serviced by agent of Employer."[10] The Court found that the employees were only prohibited from working in the medical industry in a role that would compete with the employer, and, thus, the agreement was not overbroad. Although the Court's ruling was in favor of the restrictive covenant, the Virginia Supreme Court did narrow and further define its holding to enforcing those non-competition agreements that forbid former employees from working in direct competition with their former employer. Still, the Court did favor the employer in analyzing the market: the Court determined that there was a legitimate need to protect the employer's interests because this was "a wide open field with heavy competition and multiple competing products."[11]

Three years later, in *New River Media Group, Incorporated*, the Virginia Supreme Court found another restrictive covenant valid and enforceable.[12] Consistent with precedent, the Court applied the three-part test to determine the validity of the covenant. In a very short opinion, the Court quickly dismissed the former employees' arguments and declared the non-competition agreement valid. In particular, the Court found that the agreement was reasonable from the employer's standpoint, and it was no greater than was necessary to protect its legitimate business interest.[13] The Court also disposed of any of the former employees' other arguments, in determining that the restraint was not geographically overbroad, the twelve-month limit was not unduly harsh and oppressive, and there was nothing that appeared to be unreasonable from a public policy standpoint.[14] This case exemplified the Virginia Supreme Court's strict adherence to the precedent set forth in the 1989 *Paramount* case in the years subsequent to that decision.

[10] *Id*. at 370.
[11] *Id*. at 373-74.
[12] *New River Media Group, Inc. v. Knighton*, 245 Va. 367 (1993).
[13] *See Id*. at 370.
[14] *Id*.

The final significant decision that took place in the decade following the 1989 *Paramount* decision involved employees who secretly agreed with a competing engineering firm to resign from their positions and join the competing firm.[15] Consequentially, Advanced Marine Enterprises brought suit against their former employees to enforce the non-competition agreement that prevented the employees from providing competing services to the former employer's customers for eight months after termination or resignation from the company.[16] Because this case involved allegations of malice and bad faith, it is not surprising that the Virginia Supreme Court found in favor of the employer's restrictive covenant.

However, it is significant that the Court did not quickly dismiss the employees' non-competition arguments but instead provided further guidance to lower courts as to when these non-compete provisions may be held invalid. Here, the Court stated that the provision was enforceable where it "did not contain a blanket prohibition against working for a competitor. Instead, it merely prohibits an employee… from rendering competing services to the former employer's customers."[17] The Court's ruling in this case for the first time demonstrated a narrowing of its broad ruling in *Paramount* that had been handed down almost ten years earlier.

Although trial courts in the decade following *Paramount* adopted and adhered to prior holdings, as evidenced through the Supreme Court's unwavering rulings in favor of the employer's restrictive covenants, the twenty-first century would prove to bring a gradual shift in this area of the law, culminating in the emphatic reversal of the 1989 *Paramount Pest Control* decision in 2011.

[15] *Advanced Marine Enters. v. PRC, Inc.*, 256 Va. 106 (1998).
[16] See *Id.*

III. THE TWENTY-FIRST CENTURY: THE IMPORTANCE OF FREE TRADE

The beginning of the twenty-first century marked a gradual shift in the law governing non-competition agreements in Virginia. While in earlier years the Virginia Supreme Court favored restrictive covenants as protecting the interests of businesses, the Court started to deviate from its role as protector of the employer to promoter of the institution of free trade. Interestingly, the Court continued to apply the same three-part test established in the 1980's in order to determine the validity of the non-competition agreements. Still, there was a clear shift in policy during this time, in which the Court's interest in free trade began to mirror those interests of the employee: the unrestricted ability to work for various employers in the same industry.

In *Simmons v. Miller* in 2001, the Virginia Supreme Court found the non-competition agreement to be overbroad and, thus, unenforceable.[18] In *Simmons*, the Court found that the non-compete provision at issue was "considerably broader than the former employer's business activity, which was limited to the importation of a single particular brand of cigars grown and manufactured in the Canary Islands."[19] It is noteworthy that the Court still utilized the three-part test in *Paramount* to test the validity of the agreement, yet this is one of the first cases in which the Court noted that each of the parts of the test must be considered together.[20] The Court found that upon consideration of all of these factors, including the geographical limitation, the fact that the covenant was broader than necessary to protect the employer's business interests, and the covenant was unduly harsh and oppressive on the employee's ability to pursue a livelihood, the covenant was overly restrictive. The Court went even further and stated that "as an unnecessary and unreasonable restraint of trade, the non-competition clause is offensive to the public policy

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[17] Id. at 119.
[18] *Simmons v. Miller*, 261 Va. 561 (2001).
[19] *Home Paramount Pest Control Cos.*, *supra* note 7 at 417.
[20] *See generally Simmons*, *supra* note 18.

of the Commonwealth and is not enforceable."[21] Thus, while using the same test they had in previous cases, the Virginia Supreme Court considered the test as a whole under the facts of the case and found the covenant to be overly restrictive and unenforceable. The shift in the analysis of the Court in *Simmons* is clear in its decision to look at the test in totality, rather than look at each component individually, which, among other factors, clearly impacted the outcome in this case.

In mid-2001 and 2002, the Virginia Supreme Court mirrored its quick disposal of arguments in its brief opinion, *New River Media Group,* which it handed down approximately eight years earlier.[22] However, this time, the Court held just the opposite: that the non-competition agreements were overbroad and unenforceable. In *Motion Control Systems,* before even analyzing the non-compete agreement, the Court asserted that "covenants not to compete are restraints on trade and accordingly not favored."[23] In addition, the Court explained that "the employer bears the burden to show that the restraint is reasonable and no greater than necessary to protect the employer's legitimate interests…. As a restraint of trade, the covenant must be strictly construed and, if ambiguous, it must be construed in favor of the employee."[24] In *Modern Environments, Incorporated*, the Virginia Supreme Court found the covenant to be overbroad and unenforceable, and that the employer failed to meet its burden of proof.[25] In finding that the employer failed to meet its burden, the Court held that "when a former employer seeks to prohibit its former employees from working for its competitors in any capacity it must prove a legitimate business interest for doing so."[26] Because the employer failed to assert a rationale for

[21] *Id*. at 582.
[22] *See generally New River Media Group, Inc., supra* note 13; *Motion Control Sys. v. E.*, 262 Va. 33 (2001).
[23] *Motion Control Sys. v. E.*, 262 Va. 33 (2001).
[24] *Id*. at 37.
[25] *Modern Env'ts v. Stinnett*, 263 Va. 491 (2002).
[26] *Home Paramount Pest Control Cos., supra* note 7 at 417-18.

the restrictive covenant, the agreement was found to be invalid. Through both of these short opinions, the court demonstrated a shift in its analysis of non-competition agreements, in interpreting covenants in favor of the employee.

Another compelling decision was handed down by the Supreme Court in 2005. In *Omniplex World Services Corporation*, the Court found the covenant to be invalid.[27] This opinion expanded on decisions from the previous decade, in that the Court explained that "covenants not to compete have been upheld only when employees are prohibited from competing directly with the former employer or through employment with a direct competitor."[28] In this case, because the restrictive covenant was not limited to employment that would be in competition with the employer, the agreement was overbroad and unenforceable. The *Omniplex* Court appeared to view the three-part test as a balancing approach in determining the validity of the provision: "these standards have been developed over the years to strike a balance between an employee's right to secure gainful employment and the employer's legitimate interest in protection from competition by a former employee based on the employee's ability to use information or other elements associated with the employee's former employment."[29] Although interpreted as a balancing act in this case, this ruling seems to be part of the evolution of the Court's favoring free trade and, consequentially, the employee.

IV. *HOME PARAMOUNT PEST CONTROL COMPANIES V. SHAFFER*: A NOTABLE SHIFT IN VIRGINIA NON-COMPETE AGREEMENT RULINGS

Many lawyers and legal scholars view the 2011 *Home Paramount* decision as a dramatic shift in the Virginia Supreme Court's perspective on non-competition agreements. In reality, this shift was much more gradual, as it occurred over the previous decade. Still, this decision, which

[27] *Omniplex World Servs. Corp. v. US Investigations Servs.*, 270 Va. 246 (2005).
[28] *Id*. at 249.
[29] *Id*.

is the Virginia Supreme Court's unequivocal reversal of the 1989 *Paramount* decision based on the identical non-compete covenant, is the strongest example of the Virginia Supreme Court's policy shift in non-compete agreement rulings.

In *Home Paramount Pest Control Company*, decided in 2011, the employees signed a non-competition agreement that was identical to the agreement in the 1989 *Paramount* case. The Court used the same three-part test but this time, the Court found that "although we weigh the function element of a provision that restricts competition together with its geographic scope and duration elements, the clear overbreadth of the function here cannot be saved by narrow tailoring of geographic scope and duration." Thus, because the employer failed to "confine the function element of the Provision to those activities it actually engaged in," and because the employer failed to prove a legitimate business interest in prohibiting the employee from "engaging in all reasonably conceivable activities while employed by a competitor," the Court found that the provision was overbroad and unenforceable. In its ruling, the Court explicitly overruled the1989 *Paramount*, and that *"[s]tare decisis* is not an inexorable command." Within a brief span of twenty years, the Virginia Supreme Court went from consistently ruling in favor of restrictive covenants to advocating for free trade and, thus, expanded employee freedom to engage in unrestricted trade.

V. CONCLUSION

In the wake of the Virginia Supreme Court's reversal of its 1989 *Paramount* decision, Virginia courts have followed the legal roadmap set out in the 2011 *Home Paramount* case.[30] This new test allows for a clear approach to quickly determine whether or not non-competition agreements withstand legal scrutiny. The 2011 *Home Paramount* case is a dramatic shift in employment law in Virginia advocating free trade and imposing stringent standards on

employers seeking to impose non-competition agreements on their employees. Practitioners on both sides of the employment aisle should study the evolution of employment law from *Paramount* to *Home Paramount* to understand the legal pitfalls associated with this sea change in the law.

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[30] *See Home Paramount Pest Control Cos, supra* note *7.*