Where Does Your State Stand on Non-Compete Agreements?

By James J. Briody

While non-compete agreements are fairly common in today's business world, states treat them differently. For example, Virginia disfavors non-compete agreements and will not enforce them unless they are narrowly tailored to protect legitimate business interests. In Georgia, recently passed business-friendly legislation makes non-competes easier to enforce. In addition, some states like Virginia will not modify or "blue-pencil" overly restrictive non-compete agreements to make them reasonable and enforceable; while other states, like Georgia, endorse "blue-penciling." In states where "blue-penciling" is permitted, a court may find a non-compete provision to be overbroad and modify the provision so that it is reasonable. As a result, employers in those jurisdictions can be more aggressive in defining broad restrictions. In contrast, in states like Virginia where "blue-penciling" appears to be prohibited[1], it is an all-or-nothing situation for the employer—the non-compete is either enforceable as drafted or invalid if overly broad. It is crucial for an employer to know the law of the state or states that it is operating in and keep abreast of changes.

James J. Briody is a member of Sutherland's Litigation Practice Group and the firm's Employment, Dealer and Franchise, and Construction Teams. He focuses his practice on the defense and prosecution of business-related disputes, with an emphasis on employment and the automotive, government contracting and construction industries. Jim's experience includes serving as counsel in trials, arbitrations, appeals, administrative hearings and mediations. He has represented employers in litigation against former employees for breach of fiduciary duties, improper use of confidential information and conspiracy, and defended employers against Fair Labor Standards Act (FLSA) wage and hour claims.

The Virginia Supreme Court recently reiterated its tough stance on non-compete agreements in *Home Paramount Pest Control Company, Inc. v. Shaffer*, 282 Va. 412, 718 S.E.2d 762 (2011)[2], when it ruled a non-compete provision in an exterminator's employment contract was unenforceable because the terms were too restrictive. The Virginia General Assembly also defeated a bill introduced in its 2012 session (House Bill 1187) that proposed to ban most restrictions on former employees' ability to engage in lawful professions, trades or businesses. While that bill was not passed, the *Shaffer* decision makes clear that Virginia courts still remain hostile to non-compete agreements. The opinion in *Shaffer* not only provides insight into the rationale underlying Virginia's tough stance on non-competes, it offers best practices for avoiding drafting pitfalls in states that are hostile to these provisions.

The *Shaffer* Case

In *Shaffer*, an exterminator company sued its former employee for breach of its non-compete provision. The Virginia Supreme Court reversed its 1989 ruling involving the very same employer in which it held that the same non-compete provision was enforceable. The *Shaffer* court justified its reversal on incremental changes in Virginia non-compete law in cases decided between 1989 and 2011, ruling that the non-compete agreement in the employment contract was unenforceable because its terms were overly restrictive, preventing the employee from engaging in work activities that the employee never performed for his former employer.

The Court's critical finding was that the functional scope of the non-compete was broader than necessary to protect the employer's legitimate business interest. This tends to be the area where many employers stumble in drafting non-competes. They look at the temporal and geographic scope but neglect to carefully analyze the breadth of the functional scope. In general, under Virginia law, a non-compete agreement is enforceable if the employer establishes that the restriction: (a) is narrowly drafted to protect the employer's legitimate business interest; (b) does not unduly burden the employee's ability to earn a living; and (c) does not violate public policy. In the context of examining these elements, Virginia courts, like courts in many other states, determine whether non-compete agreements are appropriately limited in time, geography and scope before inquiring whether the employee breached the non-compete agreement. That is, Virginia courts tend to analyze whether the agreement is enforceable on its face rather than as applied. Some refer to this approach as the "janitor" test. If a non-compete agreement would preclude an employee, who was not a janitor, from working as a janitor at a competitor, then the agreement is overly broad and unenforceable.

The *Shaffer* non-compete provision prohibited the employee exterminator, for a period of two years, from engaging directly or indirectly "in any manner whatsoever in the carrying on or conducting the business of exterminating, pest control, termite control and/or fumigation services as an owner, agent, servant, representative or employee. . ." This restriction was limited to cities and counties where the employee worked. Accordingly, on its face, the *Shaffer* court did not take issue with the agreement's temporal and geographic restrictions (and, in fact, these restrictions were not challenged as unreasonable or overly broad by the employee). Instead, the *Shaffer* court focused on whether the non-compete was drafted narrowly in scope by assessing whether "the prohibited activity is of the same type as that actually engaged in by the former employee."

The Virginia Supreme Court held that not only did the employer fail to prove that the provision was narrowly drafted to protect the employer's legitimate business interest, but the court ruled that the non-compete was overly broad because it prohibited the employee from working for a competitor in any capacity, including as a janitor. The employer in *Shaffer* argued that it was improper for the court to adopt an approach that reviewed the agreement facially, focusing on hypothetical job duties that might violate the agreement, rather than focusing on the work the former employee was actually performing for the competitor (which was the same type as he had performed for his former employer). The Court rejected this argument, noting that the employer invited this inquiry by failing to limit the restriction to specific activities in which the employee had been engaged. The Court held that the employer failed to prove it had a legitimate business interest in prohibiting the employee from working for a competitor in *any* capacity.

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Lessons Learned from *Shaffer*

The *Shaffer* case provides many takeaways for employers and their counsel, including:

- In states that are hostile to non-compete agreements, resist the temptation to impose non-compete restrictions with broad, catch-all language designed to protect the employer against any and all potentially competitive conduct, including conduct that cannot be anticipated. This may prove important in the event of litigation.
- Depending on the context and circumstances, phrases such as "directly or indirectly" and "related to" can be found vague and fatal to a non-competition covenant. Specificity is helpful.
- Identify in specific terms the limitations that the provision is placing on the employee, paying particular attention to the existing employment relationship and the employee's duties and responsibilities. This may reduce challenges based on vagueness.
- To the extent catch-all language is appropriate, limit the language to address potential changes in job positions or responsibilities during an employee's tenure with the company.
- Before imposing any non-compete restrictions in Virginia, perform a "janitor" analysis on the restriction, explaining and defending the scope of the restriction.
- Include language identifying certain jobs or functions that the non-compete does not preclude the employee from performing for a competitor. This approach may help defend against an overbreadth argument and allows the employer to point out that the employee has options notwithstanding the agreed-upon restrictions.
- Consider using a combination of carefully, clearly and narrowly drafted non-compete, non-solicitation and confidentiality agreements to protect against the harms that can occur when employees leave for competitors. You may want to set these provisions out separately to reduce the likelihood of a court ruling all such provisions invalid if it finds one to be unenforceable.

Following these best practices may help employers protect the goodwill they have in their businesses and employment relationship by creating enforceable non-compete agreements.

Georgia Statutory Changes

In contrast to Virginia, the Georgia General Assembly has enacted legislation called the Georgia Restrictive Covenants Act (RCA) that is much more favorable to employers with respect to non-compete provisions. The General Assembly found that "reasonable restrictive covenants contained in employment and commercial contracts serve the legitimate purpose of protecting legitimate business interests and creating an environment that is favorable to attracting commercial enterprises to Georgia and keeping existing businesses within the state." Ga. Code Ann. Sec. 13-8-50. The RCA also provides statutory guidance so that parties to non-compete agreements have more certainty as to the validity of the provisions and their respective rights. *Id*[3].

A provision of the Georgia legislation provides that any employee can agree to an appropriate customer non-solicitation provision or a non-disclosure of confidential information provision, and courts will enforce these if they use language consistent with the Georgia statute. Ga. Code Sec. 13-8-53(a)(b) and (e). However, other restrictive covenants—even if reasonable in time, geography and scope of prohibited activities—may only be enforced against employees who have certain roles and/or perform certain job activities identified in the statute. *Id*. In addition, this provision stipulates that descriptions of prohibited activities that specify fair notice of the maximum reasonable scope of the restraint will be upheld even if the description is "generalized or could possibly be stated more narrowly to exclude extraneous matters." Ga. Code Ann. Sec. 13-8-53(c)(1). Thus, unlike Virginia, Georgia will not apply the "janitor" test to determine enforceability. The Georgia statute provides a rebuttable presumption for employees; a duration of up to two years is reasonable, and a duration of more than two years is not. Ga. Code Ann. Section 13-8-57(b). When seeking to enforce the restriction against the owner or seller of a business, an employee has up to five years, or the time period in which payments are made to the owner, whichever is longer, for rebuttal. Ga. Code Ann., Sec. 13-8-57(d).

A significant aspect of the Georgia RCA is that it now allows blue-penciling. Thus, where a court finds a restrictive covenant that is not reasonably limited in temporal or geographic scope or in the scope of activities prohibited, the court may modify the provision to make it enforceable "so long as the modification does not render the contract more restrictive with regard to the employee than as originally drafted by the parties." Ga. Code Ann. Sec. 1-8-53(d). In addition, Section 13-8-54(a) states that a "court shall construe a restrictive covenant to comport with the reasonable intent and expectation of the parties to the covenant in favor of providing reasonable protection to all legitimate business interests established" by the person seeking protection. While "may" can be found to be permissive—meaning courts can but do not have to "blue-pencil" an overly broad restriction—the directive in Section 13-8-54(a) supports an argument that Georgia courts should look to blue-pencil restrictive covenants whenever possible.

While the Georgia statute puts the burden on the party seeking to enforce a restrictive covenant to prove the existence of one or more legitimate business interests justifying the restraint, it also allows that party to shift the burden if it can establish by "prima facie" evidence that the proposed restraint complies with the terms of Section 13-8-53. If that "prima facie case" is made, the person opposing enforcement must prove non-compliance or that the restriction is unreasonable.

Georgia's RCA likely will make it easier for employers to draft and enforce non-compete provisions and harder to lure away the employees of competitors. The RCA provides language that employers can feel relatively safe using to enforce non-compete restrictions. The courts will address any ambiguities in the new legislation, providing employers further guidance on how to draft and use non-compete provisions effectively to help their business.

Conclusion

As the review of recent developments in Virginia and Georgia non-compete law demonstrates, each state treats the enforceability of these provisions differently. Changes in this area of the law are frequent and must be monitored. Employers need to know the limits as to what is reasonable and whether the court will be able to fix a clause that is overbroad or otherwise unenforceable. Employers should avoid the tendency to negotiate a contract that affords the most protection possible in broad terms until they know if their state is favorable to employers and allows blue-penciling. Instead, employers should exercise caution and seek only restrictions that are necessary to protect the employer's legitimate business interests.

1. While the Virginia Supreme Court has not specifically addressed "blue-penciling," lower courts in the state have consistently rejected the practice.
2. It should be noted that Virginia courts are more likely to enforce non-compete provisions outside the garden-variety employer-employee situation. In a recent decision by the U.S District Court for the Eastern District of Virginia, *Capital One Financial Corporation v. Kanas*, 871 F.Supp.2d 520, 530 (E.D. Va. 2012), the Court ruled that the restrictions of a separation agreement for two executives was reasonable and narrowly tailored. In upholding the restrictions, the court considered the scale of compensation the executives received in return for the covenant not to compete ($42 million in restricted stock), their sophistication, the fact that the executives had sophisticated counsel, and the fact that the executives proposed the initial draft of the separation agreement. Where bargaining power is equal, Virginia courts will be more willing to enforce non-compete agreements.
3. Before the Georgia statutory amendments became effective, the Georgia Constitution had to be amended to allow for this treatment of restrictive covenants. The General Assembly ratified the constitutional amendment on November 3, 2010. Some believed the laws went into effect on that date, while others believed that the laws did not become effective until January 1, 2011, since the Georgia Constitution says that unless otherwise stated, constitutional amendments take effect on January 1 following ratification. In an attempt to create greater certainty, the Georgia House passed a bill that effectively reintroduced the statutes, providing that they would take effect when signed into law by the Governor. The Governor signed the bill on May 11, 2011. Thus, it is clear that any agreements entered into after May 11, 2011 will be governed by the RCA. There is an argument that agreements entered into after November 3, 2010 or January 1, 2011 might also fall under the RCA. Agreements entered into prior to that time likely will not be governed by the RCA but by Georgia common law, which is less clear and less favorable to employers.