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Business Law Newsletter

BLUE PENCIL PROVISION MAY DEFEAT NON-COMPETITION AGREEMENTS

By James V. Irving

On September 28, 2007, Judge Margaret P. Spencer of the Circuit Court of the City of Richmond ruled on cross Motions for Summary Judgment on the enforceability of a non-competition agreement. The Court had little difficulty in granting the former employee's Motion and finding the agreement unenforceable. The Court's ruling reminds us that non-competition agreements must be narrowly drawn, that they are subject to strict scrutiny, and that a presumption against enforceability is established by state policy. The opinion is instructive on a number of other points, in particular, the risk associated with including a "blue pencil" provision in a non-competition agreement.

While employed by Retirement Plan Administrative Services, Ltd. ("RPAS"), Leah K. Pace had entered into a written non-competition agreement with her employer. In May of 2007, she informed RPAS that she would be leaving RPAS to form a new company (VPC), engaged in a similar business. RPAS notified Pace that they intended to enforce the agreement and contended that Pace's involvement in the new business would result in a violation of her non-competition obligations. Pace countered by arguing that the agreement was unenforceable. Agreeing that the facts were not in dispute, the parties filed cross Motions for Summary Judgment.

Pace contended that the agreement was overbroad and unenforceable because: it prohibited solicitation of referral sources but was not limited to RPAS referral sources; prohibited solicitation of clients, but was not limited to RPAS clients; prohibited competition with business activities beyond those pursued by RPAS; the geographic scope was vague and not related to RPAS legitimate business interests; and because a "blue pencil" clause, an assignment provision and a liquidated damages provision were all contrary to public policy. Any one of these arguments would have proved a winner for Pace. Each point is a reminder of the care required in drafting a non-competition agreement.

Paragraph 6(d) of the agreement provided, in pertinent part, that the "employee shall not...solicit...any referral source" of RPAS and "shall not... interfere with the relationship [of RPAS] with any such referral source."

Inside This Issue:

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Blue Pencil Provision May Defeat Non-Competition Agreements

Continued from Page 1

The Court found both elements of this provision to be overbroad because "referral source" was not limited to businesses with a direct relationship to RPAS or its clients.

Paragraph 6(e) prohibited Pace from competing with RPAS in any form of business employment [within the geographical and duration limitations]. The Court found this provision to be overbroad because "competing" was not limited to other business engaged in direct competition with RPAS and because it was overbroad geographically.

Business owners sometimes advocate the inclusion of wide ranging provisions, arguing that they don't intend to broadly enforce them, but desire leverage and flexibility. Such arguments miss the point. The employer's intention is irrelevant; enforcement of a non-competition provision is tested according to the worst case scenario from the employee's point of view.

The Court also agreed with Pace that inclusion of a liquidated damages provision and a provision providing for assignment of the agreement rendered the agreement unenforceable.

These findings conform to well-established precedent laid down by the Supreme Court of Virginia and outlined in prior articles appearing in this newsletter.

Of greater concern is another conclusion reached by Judge Spencer. The non-competition agreement at issue included a "blue pencil" provision, purporting to authorize the court to modify offensive language to bring it into conformity with the law. Judge Spencer not only refused the invitation to rewrite the overbroad agreement, she ruled that the inclusion of such language alone can "render the agreement unenforceable." Although the Supreme Court of Virginia has not weighed in on this issue, Judge Spencer is the third Circuit Court Judge to reach this conclusion, following judges in Albemarle and Rockingham Counties.

While Judge Spencer's opinion on blue pencil provisions is not the law in Virginia, it appears to represent a trend that may jeopardize existing non-competition arrangements. Interested parties are advised to review their own non-competition agreements in light of Judge Spencer's ruling.

ENHANCED ELIGIBILITY FOR UNEMPLOYMENT BENEFITS

By James V. Irving

A liberal approach to awarding unemployment benefits is embodied within the public policies of the Commonwealth of Virginia. In November of 2007, this policy was invoked by the Court of Appeals in *Chauncey F. Hutter, Inc. v. VEC*, a case with potentially broad implications for the business community. In *Hutter*, the Court addressed the availability of unemployment benefits to employees who leave work after the conclusion of a term contract.

Hutter arose from the claim of Charmine Key, who in January, 2005 entered into a written employment contract to act as the receptionist for Hutter, a tax preparation business. The contract provided the following: "... this employment is temporary. However, based upon performance, we may offer you the opportunity to work with us until the end of our tax season, on April 15, 2005."

When "no work was available" after April 15, Key's employment came to and end and she filed for unemployment benefits, relying on the accepted test that her termination was not "voluntary". Hutter objected, arguing to the Employment Commission that Key "effectively resigned because she knew the employment was temporary when she accepted it." In ruling for Key, the examiner wrote: "there was no voluntarily leaving on her part. She worked through the agreed upon date and would have continued had work been available for her." Thereafter, the commission affirmed, holding that

ENHANCED ELIGIBILITY FOR UNEMPLOYMENT BENEFITS

Continued from Page 2

Key's understanding that the agreement was for a limited term did not make her separation voluntary. "The fact remains that the claimant became unemployed because the employer no longer needed her services. Such a layoff amounts to a no fault discharge."

Although the Circuit Court affirmed, its opinion cast down on the VEC: the court merely acknowledged "its obligation to presume that the actions of the administrative agency are correct" while noting that the agency's ruling "appears... counterintuitive." Thereafter, the Court of Appeals became the fourth body to review on the matter.

After noting that the Unemployment Compensation Act is to be construed "liberally," the Court of Appeals addressed the central issue: what is a "voluntary" termination? Stating its essential holding, the Court concluded that "when an individual leaves work solely because that individual entered into as contract of employment for a defined term, that individual does not leave work 'voluntarily'," entitling Key to unemployment benefits.

The full impact of this ruling remains to be seen, but it may be that anyone, unless exempted by statute, who completes a term contract will be entitled to claim unemployment benefits as long as they were not terminated for cause.

CLAIMS BETWEEN PARTNERS

By James V. Irving

In another case arising from the Richmond Circuit Court, Judge Melvin R. Hughes, Jr. reminds us of the procedural prerequisites governing claims between business partners, in *Delforn v. Melton.*

Alan Delforn and Michael Melton operated JM Commercial Properties, LLC. When the business relationship soured, Delforn sued Melton and the LLC, claiming, among other things, that he was entitled to management fees paid by the LLC to a third party. Judge Hughes' opinion suggests that Melton operated the management company.

JM asserted that it was neither a party nor an intended beneficiary to the management agreement. Agreeing, Hughes dismissed that element of the suit. The dispute between Delforn and Melton promised to be complex and convoluted - except for one thing.

In his Complaint, Plaintiff Delforn alleged that he and Melton were operating as partners. This provided Judge Hughes with a vehicle for substantially streamlining the litigation. Citing a requirement embodied in the Virginia Code, Hughes ruled that the claims between Delforn and Melton individually could not proceed until the required precedent step had been taken - the partnership must be wound down and an accounting prepared.

Judge Hughes' ruling is not simply a matter of judicial convenience, for surely most financial claims or disputes between partners will be eliminated or illuminated once a formal accounting is prepared. *Delforn v. Melton* reminds us of the existence of this statutory requirement, and of its wisdom. Hopefully, it also reminds business partners of the need to maintain clear and thorough records to facilitate a wind-down and accounting, should it become necessary.

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GENERAL DISTRICT COURT JURISDICTION

By James V. Irving

Virginia law has long permitted a civil defendant in a matter brought in the General District Court to "remove" the case to Circuit Court within ten days of the "return date" provided three conditions are met: that the amount in controversy exceeds a specified amount ($4,500 since 2002); that the defendant reimburse the Plaintiff for the accrued costs and writ tax expended; and that the defendant file an affidavit of substantial defense attesting that he or she has a good faith defense to the claim.

Because District Court litigation is typically faster, less expense and less complex than in Circuit Court, selecting the lower forum is a tactical choice where District and Circuit Courts have overlapping jurisdiction. Similarly, the decision to remove a case is often the tactical choice of a party seeking to thwart the Plaintiff's strategy.

Beginning July 1, the option will no longer be available. With adoption of House Bill 2425, the right of removal is eliminated from Virginia Civil Procedure. Cases filed in General District Court will be tried there, however the losing party shall retain the right to a "De Novo" appeal, meaning that an aggrieved party can still get a second bite at the apple in the higher court.

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