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Supreme Court of Virginia Defines Damages Calculation for Breach of Noncompete

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In *Preferred Systems Solutions, Inc. v. GP Consulting, LLC*, Nos. 11906, 11907 (Sept. 14, 2012), the Supreme Court of Virginia, for the first time, defined how to calculate damages for the breach of a noncompete provision where the breach resulted in the loss of an expected contract.

The court found that damages calculated as the lost profits for the contract expectancy are appropriate even if there is no "guarantee" that the future contract would have been awarded, and the measure of lost profits can be determined by applying the profit margin of the losing party to the time billed by the benefitting party.

The Case

Preferred Systems Solutions, Inc. (PSS) and Accenture, LLP (Accenture) were two of ten contractors that performed information technology work for the Defense Logistics Agency (DLA) pursuant to task orders periodically issued under a blanket purchase agreement. GP Consulting, LLC (GP) was a subcontractor of PSS. GP, as subcontractor, provided the programming services of Sreenath Gajulapalli (the sole employee and manager of GP). Accenture was the team leader for the blanket purchase agreement, and a direct competitor of PSS. The DLA project at issue was the Business Systems Modernization (BSM) program.

The subcontractor agreement between PSS and GP (the "Agreement") included a noncompete covenant, which stated that during the term of the Agreement and for 12 months following GP would not, directly or indirectly: (a) enter into a contract as a subcontractor with Accenture and/or DLA "to provide the same or similar support that PSS is providing to Accenture, LLP and/or DLA and in support of" the BSM program; or (b) enter into an agreement with a "competing business and provide the same or similar support that PSS is providing to Accenture, LLP and/or DLA and in support of" the BSM program.

GP terminated the Agreement with PSS and, within several days, began working directly for Accenture. At the time GP stopped subcontracting for PSS, PSS was supporting the BSM successor program; GP continued the same work for Accenture.

PSS filed a lawsuit claiming breach of contract as to the noncompete, misappropriation of trade secrets, and tortious interference with contract. The trade secret claim was dismissed on demurrer. As to tortious interference with contract, the trial judge denied the claim, finding, in part, that

there was no guarantee of future contracts between PSS and DLA. The trial judge did, however, find that GP "plainly breached" the narrowly constructed and enforceable noncompete and awarded $172,395.96 in compensatory damages. The damages calculation multiplies PSS's profit rate against the work GP performed for Accenture. The calculation is for the full 12-month period of the noncompete, even though the task orders pending at the time of the breach did not extend for that entire 12-month period.

The Appeal

On appeal GP claimed (among other issues) that the damages award was in error, given the trial court's finding that there was no guarantee of future task orders or contracts between PSS and DLA. The Supreme Court of Virginia disagreed.

Future Contracts

When a noncompete is breached, the non-breaching party is entitled to the benefit of the bargain – which is to say, it is "entitled to be put in the same position, as far as money can do it, as he would have been had the contract been performed." Where the loss of future contracts is at issue, the future contracts need not be "guaranteed" in order to claim their lost profits. Rather, the plaintiff need only show that it is more likely than not that it would have had the benefit of the future contract. In *PSS*, the Supreme Court of Virginia held that the plaintiff met this standard given its history of BSM program purchase orders, its business expectancy of continued work from DLA, and the fact that no evidence was presented that, absent GP's move to Accenture, the work would have moved to Accenture.

Calculation of Lost Profits

As to the calculation of lost profits, the Supreme Court of Virginia repeated the longstanding principles that damages must be proved with reasonable certainty and are not to be speculative. In so stating, the court also acknowledged that the calculation of lost profits based on the track record of profits in established companies has long been an accepted method of estimating damages awards. After stating that Virginia has yet to address the issue directly in the context of a noncompete, the court recognized that several other states accept the subsequent profits of the benefiting competitors as evidence of damages, provided the profits can be sufficiently linked to the injured party. The court then affirmed the trial court's somewhat hybrid approach of calculating lost profits, in which the plaintiff's profit margin was applied to the lost contract work. This, the court stated, produced what the trial court deemed to be a reasonable, non-speculative award of damages.

What This Means for Employers

While this case presents a number of issues on appeal, it is notable for the guidance it provides as to the calculation of damages for the breach of a noncompete where future contracts are at issue – particularly where the party subject to the noncompete is key to an ongoing contract relationship, and one that is expected to be renewed. This issue often arises in the context of employee raiding and government contracting.

Whether enforcing the noncompete, or considering hiring one or more people subject to a noncompete, employers should be aware: (1) that Virginia permits breach of contract damages for the loss of future contracts (even if the future contract was not "guaranteed" to be awarded to the losing party); and (2) that damages for that future contract can include lost profits as calculated by the *losing party's* profit margin.