The Tie That Binds:

Non-Competition Covenants Under Maryland Law

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Introduction

A covenant not to compete is a limited restraint of trade that, in many situations, restricts the freedom of an individual or business seller who is no longer associated in any way with the person or entity that the covenant benefits. These restraints are most common in employment relationships and also are customarily included in franchise agreements. Because business covenants are almost always enforced, and there are few Maryland cases (none recent) evaluating them, in this article we address employer and franchise covenants.

Maryland courts will enforce such covenants if:

1. The bound party received adequate consideration in exchange for the restriction;
2. Enforcement is reasonably necessary to protect one or more classes of important business interests;
3. The restraint is confined within limits which are no wider as to area and duration than are reasonably necessary to protect that interest, subject to possible "blue penciling" as described below;
4. The relief sought in enforcement will not impose an "undue hardship" on the bound party; and
5. The relief sought will not harm the public interest.

See, e.g., Gen. Parts Distrib., LLC v. St. Clair, 2011 U.S. Dist. LEXIS 145055 (D. Md. Dec. 14, 2011); *SNS One, Inc. v. Hage*, 2011 U.S. Dist. LEXIS 74718 (D. Md. July 11, 2011); *Cleaning Auth., Inc. v. Neubert*, 739 F. Supp. 2d 807, 819 (D. Md. 2010); *Severn Mktg. Assocs. v. Doolin*, 2010 U.S. Dist. LEXIS 102992 (D. Md. Sept. 29, 2010); *TEKsystems, Inc. v. Bolton*, 2010 U.S. Dist. LEXIS 9651 (D. Md. Feb. 4, 2010); and *Mansell v. Toys "R" Us, Inc.*, 673 F. Supp. 2d 407, 416 (D. Md. 2009).

Employment Relationships

Consideration and Other Contract Defenses

In the employment context, initial hiring constitutes adequate consideration in exchange for a non-compete restriction, as does a bonus, pay raise, or promotion. Mere continuation of an at-will relationship for a "substantial" period of time after signing the covenant is also adequate consideration for a covenant. *Simko, Inc. v. Graymar Co.*, 55 Md. App. 561, 464 A.2d 1104 (1983) (ten years was sufficient consideration; also stated that three years was sufficient).

If an employer commits a material breach of the agreement, the former employee may be released from further obligation under the covenant; *see, e.g., Jorgensen v. United Communs. Group, Ltd. P'ship*, 2011 U.S. Dist. LEXIS 95426 (D. Md. Aug. 25, 2011) and *Bethesda Asset Svcs., Inc. v. Bank of New York*, 2005 WL 2106083, 2005 U.S. Dist. LEXIS 19677 (D. Md. 2005). Careful drafting sometimes can avoid this result, by preserving both the employee's right to sue for breach and the employer's right to enforce the non-compete.

Protection of Customer Goodwill and Relationships

Generally speaking, the most likely basis for finding an employer's "protectable business interest" is "if a part of the compensated services of the former employee consisted in creation of the good will of customers and clients which is likely to follow the person of the former employee." *Silver v. Goldenberger*, 231 Md. 1, 188 A.2d 155, 158 (1963).

Examples of cases where the employer has made the requisite showing are:

Hearn Insulation & Improvement Company, Inc. v. Bonilla, 2010 U.S. Dist. LEXIS 79032 (D. Md. 2010) (subcontractor enjoined from working directly for plaintiff's former customer; subcontractor had extensive dealings with customer's "designees" while working for plaintiff;

Intelus Corp. v. Barton, 7 F. Supp. 2d 635 (D. Md. 1998) (account manager for supplier of customer relationship management software);

Holloway v. Faw, Casson & Co., 319 Md. 324, 572 A.2d 510 (1990) (accountant with customer relationships).

Tuttle v. Riggs-Warfield-Roloson, Inc., 251 Md. 45, 246 A.2d 588 (1968) (insurance agent's relationship manager)

Ruhl v. F. A. Bartlett Tree Expert Co., 245 Md. 118, 225 A.2d 288 (Md. 1967) (manager & primary sales representation of tree care company's district office);

Fowler v. Printers II, Inc., 89 Md. App. 448, 598 A.3d 794 (1991) (printing company sales representative – non-solicitation covenant only).

Examples of cases where the employer was unable to make such a showing are:

Ecology Services, Inc. v. Clym Environmental Services, LLC, 181 Md. App. 1, 952 A.2d 999 (2008) (former employees went to work for replacement contractor after bid award and had no role in procuring new contract);

Labor Ready, Inc. v. Abis, 137 Md. App. 116, 767 A.2d 936, 946 (2001) (manager of temporary employment services agency; no solicitation of former employer's customers or employees shown);

Becker v. Bailey, 268 Md. 93, 299 A.2d 835 (1973) (company providing tag and title delivery services for car dealerships; no showing the former employee solicited employer's customers).

While a few cases have stated that covenants can be enforced against employees who "provide unique services," as opposed to being essentially unskilled workers, those "unique skills" must have induced the employer to hire the employee and then been used to develop customer relationships. Most prominently, *see Millward v. Gerstung International Sport Education, Inc.*, 268 Md. 483, 302 A.2d 14 (1973). Gerstung hired Millward, a well-known local professional soccer coach, used his likeness to develop its summer camp business, and promoted him to camp director, at which point he signed a two-year non-compete. The following year Millward tendered his resignation and became the director of a new camp, which was promoted in the same area with a heavy emphasis on Millward. A circuit court enjoined Millward's employment by the new camp for two summers, and the Court of Appeals affirmed on two grounds: (a) Gerstung's reliance on Millward's "unique skills" when hiring him, and (b) Millward's use of his subsequently-acquired reputation as a camp director to solicit Gerstung's customers.

Subsequent cases have not enforced covenants under Maryland law on the sole basis of "unique skills." Instead, the predominant themes are that skills developed in the course of employment do not rise to the level of uniqueness for non-compete purposes, *Ecology Services, Inc.*, 181 Md. App. At 30 and *Labor Ready, Inc.*, 137 Md. App. at 136. Further, "employees are free to use the knowledge they have gleaned from their past employers to become more efficient competitors in the marketplace, as long as they do not exploit personal contacts with customers or clients of the former employer." *Source Servs. Corp. v. Bogdan*, 1995 U.S. App. LEXIS 3352 at *10 (4th Cir. 1995) (Md. law).

Trade Secrets

Trade secrets are enforceable independent of a non-compete, under Md. Com. Law Code Ann. §11-1201 et seq. Cases are rare where a covenant not to compete is enforced where the interest being protected is predominantly protection of trade secrets or confidential information, *absent* a showing of impairment (or threatened impairment) of customer goodwill. *But see Tabs Associates, Inc. v. Brohawn*, 59 Md. App. 330, 475 A.2d 1203 (1984) focusing on protecting against the misuse of confidential business information; *see also, Nat'l Instrument v. Braithwaite*, Case No. 24-C-06-004840, 2006 Md. Cir. Ct. LEXIS 12 (Cir. Ct. Baltimore City, Aug. 3, 2006).

On a broader level, the more "senior" a person is within a business, the more likely it is that the plaintiff's confidential business plans may form a protectable interest justifying enforcement of the covenant. *See, e.g., Hekimian Labs. Inc. v. Domain Systems, Inc.*, 664 F. Supp. 493 (S.D. Ala. 1987) (under Maryland law, enjoining Plaintiff's former Director of Systems Engineering from moving to a comparable high-level position with a direct competitor).

Scope of Restriction

Maryland courts require that the duration of a post-termination restriction on competition be clear in the covenant. Therefore, a durational requirement of one year not from the date of termination but from the date that a court enjoins conduct violating the covenant was held unenforceable, because the obligations under the covenant could have continued indefinitely. *Nationwide Mut. Ins. v. Hart*, 73 Md. App. 406, 534 A.2d 999, 1002 (1988).

Maryland courts have often enforced a covenant of two years after termination. *See, e.g., Padco Advisors, Inc. v. Ohmdahl*, 179 F.Supp.2d 600 (D. Md., 2002) ; *Millward v. Gerstung International Sport Education, Inc., supra;* and *Tuttle v. Riggs-Warfield-Roloson, Inc., supra.* In addition, in *Holloway v. Faw, Casson & Co., supra*, the Court of Appeals did not disturb the decisions of the lower court granting a damage award to the accounting firm for the former partner's breaches of his obligations not to serve the firm's clients during a period of three years from the date of termination, where the stipulated measure of damages was one year's worth of the fees paid by each such client.

In general a geographic restriction limited to the area in which the employee has conducted the employer's business will be deemed reasonable. See, e.g., *Intelus Corp. v. Barton*, 7 F.Supp.2d 635 (D. Md. 1998) (nationwide restriction where employee had nationwide responsibility and contacts); *Hekimian Labs. Inc. v. Domain Systems, Inc., supra* (under Maryland law, a worldwide injunction where the former employee had had customer contact throughout the employer's worldwide marketing area); *Ruhl v. Bartlett Tree, supra* (enforcing contract's six-county restriction where employee had worked); and *Millward v. Gerstung Int'l. Sport, supra* (enforcing covenant in Baltimore City and surrounding counties). By contrast, in *Tawney v. Mutual Sys.*, 186 Md. 508, 47 A.2d 372 (1946), the covenant against competing in Baltimore City was held unenforceable because most of the city's population had no contact with the employee.

In the cases of salespeople and "relationship managers," as opposed to senior executives, some courts refuse to enforce covenants unless they are more narrowly tailored, to prevent the former employee from diverting customers with whom the employee actually developed relationships. For example, in *MCS Services, Inc. v. William T. Jones*, 2010 U.S. Dist. LEXIS 105013 (D. Md. 2010), Judge Nickerson found unenforceable a non-compete that prevented the employee from working for "any other entity engaged in a business in competition with, or similar in nature to, the Company's Business in any geographic area where the Company does business." The court found that sweeping prohibition to be unenforceable because it is "not reasonably necessary to protect the customer goodwill Jones created, and it is not narrowly tailored to that end. It constrains the list of Jones's potential employers instead of targeting possible goodwill-thieving activities." *Id.* at 12.

Undue Hardship on Employee

Virtually all non-compete cases involve injunctive relief. Even if the non-compete is valid on its face, a court in equity may determine that its enforcement will cause an "undue hardship" on the former employee. *See, Food Fair Stores, Inc. v. Greeley*, 264 Md. 105, 285 A.2d 632 (Md. 1972), (provision causing a former employee to forfeit his pension benefits if he worked for a "competitor" was unenforceable as an "undue hardship,") and *Ecology Services*, 181 Md. App. 1 at 24(undue hardship where compliance with the non-compete would require radioactive waste disposal workers to take a substantial pay cut and do heavy lifting). However, it is notable that in both cases the court had serious and substantial doubts about the employer's protectable interest. By contrast, in *Ruhl*, 245 Md. at 126, the Court of Appeals permitted enforcement against the plaintiff's former Eastern Shore manager despite the fact that he had worked virtually his entire life in the tree trimming industry in

that region, because he had an integral role in developing the employer's regional goodwill *and* he resigned to start a competing business.

Rewriting or "Blue-Penciling"

Maryland courts have enforced covenants against competition after striking portions found to be unreasonable. The law is unsettled as to whether the only permissible method is this, *i.e.*, to "blue pencil" an overly broad covenant or whether the court can actually *rewrite* the covenant. In *Holloway v. Faw, Casson & Co., supra*, the Court of Appeals did not disturb the decisions of the lower courts granting a liquidated damages award to the accounting firm for the former partner's breaches of his obligations not to solicit the firm's clients during a period of three years from the date of termination, rather than the five years of restriction stated in the actual covenant. However, the Court of Appeals expressly did not reach the holding of the Court of Special Appeals, 78 Md. 205, 237-38 (1989), that Maryland adopted the so-called "flexible approach" that allows courts even to rewrite a covenant to make it "reasonable" and therefore enforceable.

In *Deutsche Post Global Mail, Ltd v. Conrad*, 292 F. Supp. 2d 748 (D. Md. 2003), *aff'd*, 116 Fed. Appx. 435; 2004 U.S. App. LEXIS 24249 (4th Cir. 2004), the court was asked to modify the following post-termination restriction: a former employee cannot for two years "[e]ngage in any activity which may affect adversely the interests of the Company or any Related Corporation and the businesses conducted by either of them, including, without limitation, directly or indirectly soliciting or diverting customers and/or employees of the Company or any related Corporation or attempting to so solicit or divert such customers and/or employees." Both the trial

and appellate courts found the portion of the restriction before the comma to be unreasonably overbroad and therefore unenforceable under Maryland law. The U.S. District Court disdained "rewriting" but permitted "blue penciling" to solely restrict the solicitation or diversion of customers and/or employees, but then found even that restriction to be overbroad, 292 F. Supp. 2d at 754 – 56, and the Fourth Circuit held that, because the restrictions on solicitation and diversion were simply examples of activities prohibited by the broader "dominant portion" before the comma, the revision requested by the plaintiff was a "rewriting" impermissible under Maryland law. 2004 U.S. App. LEXIS 24249, *9 - *13.

Franchise and License Relationships

In *Sylvan Learning, Inc. v. Gulf Coast Education, Inc.*, 2010 U.S. Dist. LEXIS 107160, *7 (S.D. Ala., Oct. 6, 2010), the Court held that Maryland's law governing non-compete agreements "between employers and employees extends to agreements between the licensor and licensee of a franchise. *See Budget Rent A Car, Inc. v. Raab*, 268 Md. 478, 302 A.2d 11, 13-14 (Md. 1973)." Recent cases have found that the franchise relationship has its own unique dynamics which mandate more liberal enforcement of covenants.

In particular, courts have held that permitting franchisees to benefit but then "break away" from the franchise system ,while continuing to solicit and serve the same customer base, may effectively destroy the franchisor's goodwill in the community, prevent it from effectively resuming operations in that community, and adversely impact its ability to maintain its system in general. In *ATL Int'l Inc. v. Baradar*, Bus. Franchise Guide (CCH) 11,345 (D. Md. 1997) (Motz, C.J.), the Court granted a preliminary injunction under Maryland law (the law chosen in the franchise agreement) to an automotive repair franchisor, finding that the franchisor was likely to succeed on the merits. The Court enforced a two-year post-term non-compete within 10 miles of the former Oregon franchisee's All Tune & Lube location, finding that the franchisor would suffer irreparable harm if a "breakaway" franchisee was allowed to continue operating. According to the Court, such a breakaway would encourage other disgruntled franchisees to break away, would damage the franchisor's goodwill, and could unravel the entire franchise system. (Co-author Hillman represented the franchisor in that case.) *See, e.g., Naturalawn of America, Inc., v. West Group LLC*, 484 F.Supp.2d 392 (D. Md. 2007) (enforcing two-year non-compete within twenty miles of former franchisee's territory and of *any other* franchisees' territory) and *Wild Bird Centers of North America, Inc. v. Boyce Lee Duer*, Case No. 326421, Bus. Franchise Guide (CCH) 14,490 (Cir. Ct. Montgomery Cty. Md., September 2, 2010) (same).

The Court of Appeals' 1973 ruling in *Raab*, remains a point of potential danger for enforcing franchisors. In that case, Hans Raab began operating a Budget Rent a Car franchise adjacent to his existing BP service station and continued as a franchisee for five years, under a franchise agreement requiring him to refrain from engaging in any motor vehicle rental or leasing business in his assigned market area for two years after the franchise ended. After Raab decided not to renew the franchise, he resumed operating a rental car business at the same site, using many of the same cars but under a different name and telephone number. The Court held that the covenant was unenforceable because Raab was "an unskilled worker whose services are not unique; there was no solicitation of customers; nor was there any use of trade secrets, assigned routes, customer lists or development of personal contacts with customers as an integral part of the service rendered." 268 Md. at 482.

Two recent cases declined to enforce the covenant by injunction even where it was held lawful. In *Prosperity Systems, Inc. v. Nadeem Ali*, 2010 U.S. Dist. LEXIS 132414 (D. Md., December 15, 2010), the Court enjoined the terminated franchisee from continuing use of the franchisor's trademarks and held a one-year, twenty-mile covenant was lawful, but refused to enjoin the franchisee's continued operation of a pizza take-out and delivery business, finding it would cause an undue hardship to the former franchisee. The court subsequently ordered the former franchisee to transfer the telephone number it had used as Pizza Boli's to the franchisor, thereby reducing the former franchisee's ability to misappropriate goodwill built under the Pizza Boli's name. *See also, Sylvan Learning, Inc. v. Learning Solutions, Inc.*, 2011 U.S. Dist. LEXIS 64492 (S.D. Ala. June 17, 2011) (Md. law; enforcing numerous post-termination obligations but declining to enjoin violation of the non-compete).

Such decisions are cautionary outliers in the face of the general inclination of courts to enforce these covenants, not only in franchise cases but in general. It is therefore important for the party with weaker bargaining power to carefully draft such covenants to avoid undue hardship.

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