

## **RESTRICTIVE COVENANTS IN MARYLAND**

By James A. Johnson

One thing I've learned as a trial lawyer is that there are no sure things in litigation. When I first graduated from law school, I agonized over whether to estimate the chances for success in a case at 70% or 75%. Now, I know that there are only three choices: about even; a little better than even; and a little less than even.

While this degree of uncertainty may be acceptable among litigants, it is problematic when it comes to advising clients about restrictive covenants in employment agreements. When an employee resigns or is fired, both the employee and the former employer deserve a clear description of their rights and obligations. Only with a clear delineation of rights and obligations can the employee, the former employer and the new employer conform their actions to the law, enjoy their own rights and respect each other's rights.

Unfortunately, the enforceability of an employer-employee restrictive covenant rests on an imprecise standard: i.e. whether the particular restriction in the particular circumstance is "unreasonable." While the enforceability of most written contracts is determined on a more objective standard (the plain meaning of the words of the agreement), a restrictive covenant is treated differently because it is a restraint of trade which restricts, albeit temporarily, a person's freedom to compete with certain customers or in certain territories. Under Maryland law, "A person may not . . . by contract, combination, or conspiracy with one or more persons, unreasonably restrain trade or commerce . . ." Md. Code Ann., Commercial Law Article, §11-204(a)(1) (emphasis added). Therefore, a restrictive covenant will not be enforceable unless it constitutes a reasonable restraint.

As a result of this reasonableness standard, instead of a clear statement as to whether a covenant is enforceable, the courts only offer comments such as:

- a. It depends on whether under all the circumstances of each particular case, the restrictions are reasonable to protect the employer's legitimate interests, do not impose an undue burden on the employee and do not unnecessarily impact the public interest;
- b. The restriction must be reasonably limited in geographic scope but, in a particular case, might encompass the whole nation or the whole world;
- c. The restriction must be reasonably limited in time but, depending on the facts of the particular case, three years might be okay or one year might be too long; and
- d. The court might delete portions of the contract or even rewrite the provisions.

Such uncertainty regarding the enforceability of restrictive covenants creates a quagmire for both employers and employees. Reliance on a restrictive covenant may create a false sense of security and lead an employer to forego available safeguards to backup customer contacts and to protect confidential information. Further, the employer's post-employment decision whether to pursue enforcement in the courts is complicated by the reality that one court might find the covenant enforceable under one set of circumstances while another court might find the very same covenant unenforceable under other circumstances.

From the former employee's perspective, uncertainty as to the enforceability of a restrictive covenant serves only to exacerbate the force of the restraint by preventing the employee from knowing exactly what he can do and placing a cloud over his ability to work for another employer within his skill set. Who wants to hire a potential lawsuit?

## **BACKGROUND**

Given the degree of uncertainty, it might be helpful to review how we got here.<sup>1</sup>

In the Middle Ages, English courts found all restraints on trade to be void and unenforceable, including post-employment covenants not to compete.<sup>2</sup> Skill in a trade was the vital factor in economic status and was obtainable only through apprenticeship. The guild system permitted a man to work only in the trade in which he was apprenticed and membership in a guild was not easily attained. Travel was difficult and strangers were not welcome. If a man couldn't work at his trade in his hometown, he could hardly work at all.<sup>3</sup> If a master and apprentice entered into a restrictive covenant, the apprentice would not be able to practice his craft following the apprenticeship.<sup>4</sup> Craft guilds attempted to restrict competition through these covenants but courts showed an unwillingness to enforce them.<sup>5</sup>

It was in this background that when, in 1415, the celebrated Dyer's Case, the earliest known case of a contractual restraint of trade, came before the judge, he became so enraged by an attempt to restrain a dyer from working in a town for just a half year that he cursed the deal

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<sup>1</sup> I extend my profound thanks to Kevin Cox, an associate with Semmes, Bowen & Semmes, for his invaluable help in researching and explaining the development of the law of restrictive covenants in English courts.

<sup>2</sup> Harlan M. Blake, Employee Agreements Not to Compete, 73 HARV. L. REV. 625, 629 (1960).

<sup>3</sup> *Arthur Murray Dance Studios of Cleveland v. Witter*, 105 N.E.2d 685 (Ohio Com.Pl. 1952).

<sup>4</sup> *Id.* The indenture contract common in the era of guilds required the apprentice to refrain from competing with the master for a specified period of time after the completion of training. In the few cases which raised the issue, the courts consistently held that restraints restricting the right to work were unlawful. These cases are usually cited for the proposition that the common law originally treated all restraints as violating the principle of economic freedom and therefore void. *Id.*

<sup>5</sup> *Id.*

void: “By God, if the plaintiff were here he should go to prison until he paid a fine to the king.”<sup>6</sup>

By the early eighteenth century, English courts began issuing decisions which allowed limited restraints on trade. Thus, in *Mitchel v. Reynolds* (1711),<sup>7</sup> an English court upheld an agreement in which a baker assigned the lease of his shop and promised not to practice his trade in the same parish for the duration of the lease. The *Mitchel* decision established a new framework for analyzing restrictive covenants and ushered in the application of what became known as the “rule of reason” test for evaluating restrictive employment contracts. Although the traditional rule remained that restraints on trade were facially invalid, the courts allowed for reasonable exceptions.<sup>8</sup>

By the Nineteenth Century, the “rule of reason” test was modified to include balancing the interests of the parties with the interests of the public.<sup>9</sup> In *Horner v. Graves* in 1831,<sup>10</sup> the English court found that the element of reasonableness was not limited only to the consideration stated in the contract, but also its potential impact on the public welfare.<sup>11</sup> Horner concluded that, if a restrictive covenant within an employment agreement was likely to cause undue injury to the public, then the covenant should be found unenforceable.

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<sup>6</sup> Y.B. 2 Henry 5, fol. 5, pl. 26 (1414); *see also* Minda, *supra* note 6 (discussing Dyer's Case as the first reported case involving contractual restraint of trade).

<sup>7</sup> *Mitchel v. Reynolds*, 1 P. Wms. 181 (Q.B. 1711).

<sup>8</sup> *Mitchel*, *supra* note 12 at 248, 251-52.

<sup>9</sup> *Id.* at 366.

<sup>10</sup> 131 Eng. Rep. 284 (C.P. 1831)

<sup>11</sup> *Id.* (holding that a 100 mile restriction imposed on a dentist apprentice was unreasonable because the personal nature of dental services made it impossible for such a wide area to be serviced by only the previous employer himself).

## DEVELOPMENT IN THE UNITED STATES

The development of the law of covenants not to compete in the United States mirrors English common law. Many state courts began to adopt the “rule of reason” test and the proposition that the law upholds restraints on trade if the restraints are (1) reasonable under the circumstances;<sup>12</sup> (2) ancillary to a valid transaction or relationship;<sup>13</sup> and (3) limited in duration and geographic scope.<sup>14</sup>

## DEVELOPMENT IN MARYLAND

The modern day law of restrictive covenants in Maryland traces its roots to the decision of the Court of Appeals in *Silver v. Goldberger* in 1963.<sup>15</sup> That case involved a non-compete for two years with a fifty-mile, geographic limitation. The two departing employees opened their competing employment agency two blocks away. The Court held that enforceability depends on whether the restriction is “justified” or “unjustified.”

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<sup>12</sup> See, e.g., *Oregon Steam Navigation Co. v. Winsor*, 87 U.S. (20 Wall.) 64 (1874). In order for a noncompetition agreement “to be reasonable, the promisee must have an interest worthy of protection;” therefore, such a restraint must “be subsidiary to an otherwise valid transaction or relationship that gives rise to such an interest.”

<sup>13</sup> See *Blake*, *supra* note 1, at 630-31, 637-46.

<sup>14</sup> See *Pyke v. Thomas*, 7 Ky. (4 Bibb) 486, 488 (1817); *Pierce v. Woodward*, 23 Mass. (6 Pick.) 206, 206-08 (1828) (sale of grocery store with verbal agreement not to compete within certain distance); *Palmer v. Stebbins*, 20 Mass. (3 Pick.) 188, 193 (1825) (exclusive agreement to carry all goods of obligor and not encourage competition with boatman to carry goods); *Pierce v. Fuller*, 8 Mass. 223, 225 & n.[a] (1811) (purchase of stage line between Boston and Providence, Rhode Island); *Nobles v. Bates*, 7 Cow. 307, 309 (N.Y. 1827).

<sup>15</sup> *Silver v. Goldberger*, 231 Md. 7 (1963).

According to the Court, a restriction is justified when a part of the compensated services of the former employee consisted in the creation of the good will of customers and clients which was likely to follow the person of the former employee.

By contrast, the Court held that a restriction is not justified if the harm is merely that, through his work and experience, the employee has become a more efficient competitor.

In 1965, the Court of Appeals addressed a salesman of ten-pin pin setters in *MacIntosh v. Brunswick*.<sup>16</sup> The former employee notified Brunswick that he had taken a position with the Bowl-Mar Company. Brunswick withheld payment of an earned bonus and sued the employee. The Court held the restriction unenforceable because there was no geographic restriction.

The next decision appeared in 1968 in *Tuttle v. Riggs-Warfield-Roloson, Inc.*<sup>17</sup> Contrary to the *MacIntosh* decision, the Court, in *Tuttle*, issued an injunction based on a two-year restriction which had no geographic restriction. The restriction there was as to customers of the employer. The scope, customers of the employer, was considered to be a sufficiently narrow limitation so as to replace the requirement of a geographic limitation.

After he left Riggs-Warfield, Tuttle, an insurance agent, sold a policy to a customer with whom he had had close personal ties while employed at Riggs-Warfield. This action spurred the injunction.

By 1967, the Court of Appeals developed the basic statement of enforceability which continues today. In *Ruhl v. F. A. Bartlett Tree Experts Co.*, the restriction was for two years in

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<sup>16</sup> *MacIntosh v. Brunswick*, 241 Md. 24 (1965).

<sup>17</sup> *Tuttle v. Riggs-Warfield-Roloson, Inc.*, 251 Md. 45 (1968).

five Eastern Shore counties and a contiguous county in Delaware.<sup>18</sup> The Court upheld the restriction. The Court's description of the law gives virtually no assurance to an employer or former employee who wants to understand its/his/her rights.

This Court has had a number of cases involving the validity of restrictive covenants in a contract of employment. Covenants of this nature are in restraint of trade; the test is whether the particular restraint is reasonable on the specific facts. The general rule in Maryland, as in most jurisdictions, is that "restrictive covenants in a contract of employment, by which an employee as a part of his agreement undertakes not to engage in a competing business or vocation with that of his employer on leaving the employment, will be sustained 'if the restraint is confined within limits which are no wider as to area and duration than are reasonably necessary for the protection of the business of the employer and do not impose undue hardship on the employee or disregard the interests of the public.'" There is no arbitrary yardstick as to what protection of the business of the employer is reasonably necessary, no categorical measurement of what constitutes undue hardship on the employee, no precise scales to weigh the interest of the public. The decisions in this State and in other jurisdictions are helpful, but as in so many other fields of the law, the determination must be made on the particular circumstances.

One can only imagine an attorney giving this explanation to an employer or former employee.

The decision in *Ruhl* was particularly harsh because the employee had worked with Bartlett since he was 14. He had only a high school education, had a family to support, and the only business he knew was the tree business.

In 1972, in *Gill v. Computer Equipment Corp.*, the Court of Appeals again approved a restrictive covenant with no geographic limitation.<sup>19</sup> There the employer was a manufacturer's

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<sup>18</sup> *Ruhl v. F. B. Bartlett Tree Expert Co.*, 245 Md. 118 (1967).

<sup>19</sup> *Gill v. Computer Equipment Corp.*, 266 Md. 170 (1972).

representative. The two-year restriction was a restriction on doing business with any manufacturer which had been represented by the employer's division in the year immediately preceding the employee's discharge.

In 1973, the Court of Appeals summarized the law of restrictive covenants in *Becker v. Bailey*.<sup>20</sup> There the Court declined to enforce a restrictive covenant limited in time (two years) and geographic scope (D.C. and three Maryland counties) because the employee was an unskilled worker who provided no unique services and had no particular contact with customers. The Court provided guidance every bit as helpful as that in *Ruhl* and concluded:

While such restrictions may be enforced under some circumstances, there is no sure measuring device designed to calculate when they are. Rather, a determination must be made based on the scope of each particular covenant itself; and, if that is not too broad on its face, the facts and circumstances of each case must be examined. When such an analysis is made, some restrictive covenants are deemed enforceable while others are not. Maryland follows the general rule that restrictive covenants may be applied and enforced only against those employee who provide unique services, or to prevent the future misuse of trade secrets, routes or lists of clients, or solicitation of customers. *Ruhl v. Bartlett Tree Co., supra.* . .

However, in 1973, the wheels began to come off the cart in *Millward v. Gerstung*.<sup>21</sup> Millward, a well-known operator of sports camps, was restricted from running camps for two years in Baltimore City and surrounding counties. Millward was not trained by the employer, had no confidential information of the employer and had no ongoing contact with prospective customers. Nevertheless, the Court enforced the restriction because of Millward's unique

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<sup>20</sup> *Becker v. Bailey*, 268 Md. 93 (1973).

<sup>21</sup> *Millward v. Gerstung Int'l Sport Educ.*, 268 Md. 483, 302 A.2d 14 (1973).

reputation and qualifications even though that reputation and qualifications had preceded the employment.

In the early 1990's, things really got out of hand from the perspective of a lawyer looking for guidance to advise the employee and the employer as to their rights. *Halloway v. Faw Casson & Co.*, concerned an accounting firm.<sup>22</sup> The contractual restriction provided that, if, within the next five years, a departing accountant did work for any of the firm's clients, the accountant must pay the firm an amount equal to the firm's billings to the client for the previous twelve months, regardless of whether the accountant had any prior contact with the client. Apparently, the aspect which troubled the Court was the lengthy restriction against servicing clients with whom Halloway had had no contact while he was employed by Faw Casson. The Court of Special Appeals held that it could re-write the contract by charging the duration from five years to three years.<sup>23</sup>

The Court of Appeals reviewed some prior decisions.

Appellate courts in Maryland have addressed a large number of covenants not to compete and upheld varying temporal restrictions. *See, e.g., Millward v. Gerstung Int'l Sports Educ., Inc.*, 268 Md. 483, 302 A.2d 14 (1973) (two year prohibition against engaging in sports camp business upheld); *Gill v. Computer Equip. Corp.*, 266 Md. 70, 292 A.2d 54 (1972) (two year prohibition against serving customers of division of computer company upheld); *Tuttle v. Riggs-Warfield-Roloson*, 251 Md. 45, 246 A.2d 588 (1968) (two year restriction on employee of insurance general agency upheld); *Ruhl v. F.A. Bartlett Tree Expert Co.*, 245 Md 118, 225 A.2d 288 (1967) (two year prohibition against competition by area manager of tree care company upheld); *Western Maryland Dairy, Inc. v. Chenowith*, 180 Md. 236, 23 A.3d 660 (1942) (six month restriction on milk route salesperson held reasonable); *Griffin v.*

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<sup>22</sup> *Halloway v. Faw Casson & Co.*, 319 Md. 324 (1990).

<sup>23</sup> *Halloway v. Faw Casson & Co.*, 78 Md. App. 205 (1989).

*Guy*, 172 Md. 510, 192 A. 359 (1937) (restrictive covenant between barbers upheld although unlimited as to time); *Tolman Laundry, Inc. v. Walker*, 171 Md. 7, 187 A. 836 (1936) (one year restriction on employee of laundry business upheld); *Anderson v. Truitt*, 158 Md. 193, 148 A. 223 (1930) (sale of furniture business with twenty-five year restriction on competition held reasonable); *Deurling v City Baking Co.*, 155 Md. 280, 141 A. 542 (1928) (three month restriction on employee of bakery upheld); *Geurand v. Dandeleit*, 32 Md. 561 (1870) (sale of dyeing and scouring establishment and lease of premises which prevented seller, lessor from competing upheld although unlimited as to time). Cf. *Food Fair Stores, Inc. v. Greeley*, 264 Md. 105, 285 A.2d 632 (1972) (forfeiture clause in employee pension plan prohibiting competition was unreasonable because it contained no limitation as to area or duration); *Tawney v. Mutual Sys. of Md.*, 186 Md. 508, 47 A.2d 372 (1946) (two year prohibition on competition by small loan manager held unreasonable).

Without addressing or reversing the duration as re-written by the Court of Special Appeals, the Court of Appeals engaged in its own form of contract re-drafting, holding that the restriction was severable on a client-by-client basis: issuing an injunction as to some clients but not as to others.

The mischief continued in 1991 with *Fowler v. Printers II, Inc.*<sup>24</sup> There, the one-year restriction prohibited solicitation of both any actual customer of Printers and any potential customer to whom Printers had submitted a bid, even if the departed employee had never heard of the customer or the previous bid. The Court held that it could simply blue-pencil the offending language (prospective customers) and enforce the restriction only as to customers with whom the employee had dealt.

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<sup>24</sup> *Fowler v. Printers II, Inc.*, 89 Md. App. 448 (1991).

So, where are we now? To be enforceable, a restrictive covenant must be reasonably limited in duration. In some cases, a three year limitation might be acceptable, while, in other cases, one year would be too long.

The restriction must also be sufficiently limited in a geographic scope. But, in some cases, a world-wide restriction might be acceptable.

If the restrictive covenant is not sufficiently limited in duration and scope, it is not enforceable, unless, of course, the Court decides to rewrite the contract.

Further, the enforceability of a restrictive covenant depends on an analysis of the reasonableness of the restriction under all of the circumstances.

If you were a really good employee and contributed unique services to your former employer, you are more likely to be bound by the restriction.

But wait, it gets even more nebulous.

In *Deutsche Post Global Mail, Ltd. v. Conrad*, the Court refused to enforce the restrictive covenant because there was so little competition and the employer had such a large share of the market.<sup>25</sup> However, in *United Rentals, Inc. v. Davison*, the Court refused to enforce the non-compete because there were many competitors and the employer had a negligible share of the market.<sup>26</sup>

In *Hekiman Laboratories, Inc. v. Domain Systems, Inc.*, the Court enforced a broad, worldwide restriction against a defendant who the Court believed had not been honest in his

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<sup>25</sup> *Deutsche Post Global Mail, Ltd. v. Conrad*, 292 F.2d 748 (D.Md. 2003).

<sup>26</sup> *United Rentals, Inc. v. Davison*, 2002 WL 31994259 (2002).

testimony.<sup>27</sup> In *Deutsch Post Global Mail Limited*, the Court refused to enforce a strikingly similar covenant in the case of former employees who had met with the employer and disclosed the fact that they were opening up a competing business.

Thus, it appears, that one important factor is whether the judge approves of the employer's or employee's post-employment conduct. A few examples make the point:

- *MacIntosh v. Brunswick*: Employee meets with the employer and discloses the plan to compete . . . restriction held unenforceable.
- *Becker v. Bailey*: Former employee avoided working for customers of former employer . . . restriction not enforceable
- *Heikman v. Domain*: The Court believed that the employee gave false testimony . . . restriction enforced.
- *Deutsch Post Global Mail v. Conrad*: Employee meets with employer and discloses intent to compete . . . restriction held unenforceable.

While these principles might be appropriate in the context of litigation, they play absolute havoc with the ability of the employer and former employee to understand their rights and obligations prospectively.

In sum, restrictive covenants provide valuable protection to an employer's business. However, the squishy and uncertain unenforceability of restrictive covenants can cause more harm than good. If the courts were unable to provide more definitive guidance concerning enforceability, then the Maryland legislature might consider following California and declaring

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<sup>27</sup> *Heikman Laboratories, Inc. v. Domain Systems, Inc.*, 664 F. Supp. 493 (S.D. Fla. 1987) (applying Maryland law).

that restrictive covenants in employment agreements generally are unenforceable. What would happen? Perhaps:

- a. The playing field between employer and employee would be leveled so that powerful employers could no longer force on employees a contract of adhesion with severe restrictive covenants;
- b. Employers and employees would have a clearer understanding of their post-employment rights;
- c. Employers would realize that they would have to solidify customer relationships because they could not restrict departing employees;
- d. An employee would be free to leave his employment without fear of being banished from the career he knows;
- e. Job opportunities for former employees would not be restricted by prospective employers' fears of stepping into a lawsuit;
- f. Employers would be free to hire valuable employees without fear of a costly and time-consuming lawsuit from a former employer;
- g. Customers would benefit from the increased competition if the former employee and the employer both solicit the business actively; and
- h. Employers would still have protection for true trade secrets and confidential information, including customer lists and customer information, through Maryland's version of the Uniform Trade Secrets Act.<sup>28</sup>

From the various court decisions, attorneys, employers and employees can divine general principles in their predictions of the enforceability of restrictive covenants. However, the ambiguities and generalities of court analyses leave such considerations in the realm of predictions and estimates. Except in the most egregious situations, it is difficult to predict whether a court would enforce a particular restriction against a particular former employee in the particular circumstances. This may be the best that can be achieved from court decisions

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<sup>28</sup> Md. Code Ann., Commercial Law Art., §11-1201 *et seq.*

addressing a “reasonable” standard. While action declaring employee restrictive covenant unenforceable generally may help all parties to achieve relative certainty, this would probably require legislative action and could only apply prospectively.<sup>29</sup>

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<sup>29</sup> The doctrine of *stare decisis* would limit an action by Maryland’s Court of Appeals to reverse its field on the issue. Further, any legislative enactment would apply on prospectively because of the prohibitions on *ex post facto* laws and laws impairing the obligation of contracts. See, e.g., United States Constitution, Article I, Section 10.