Enforcement of Non-Competition Clauses in Employment Contracts – Maryland

Of the states neighboring Virginia, Maryland is the most restrictive with respect to enforcing non-competition clauses in employment contracts. In Maryland, non-competition agreements in employment contracts will be enforced if they: (1) are supported by adequate consideration; (2) are ancillary to an employment contract; (3) are limited to the area and duration which are reasonably necessary for the protection of the employer; and (4) do not impose an undue hardship on the employee or contravene public policy. Becker v. Bailey, 299 A.2d 835, 838 (Md. 1973). In comparison to Virginia law, the two most significant differences are the extremely limited 'legitimate business interests' recognized by the Maryland courts and the application of the 'blue-pencil' rule.

In Maryland, only two interests of the employer are considered protectable. But these interests are protected regardless of the method of termination. See Hebb, III v. Stump, Harvey, and Cook, Inc., 334 A.2d at 569 (Md. App. 1975)(holding the non-competition clause “binding where the employee has 'ceased' to be employed”). The first employer interest protected is unfair competition by the former employee through misuse of trade secrets, customer routes, or client lists. This distinction evolved out of the first few non-competition agreement cases decided in Maryland. In Deuerling v. City Baking Co., the Maryland Court of Appeals first looked at restrictive covenants in employment contracts. 141 A. 542 (Md. 1928). There, the plaintiff was a salesman and driver for the defendant bakery. His employment contract included a restriction against soliciting or selling any products similar to the defendant's for three months following his termination in the territory he covered during the last six months of his employment. Id. at 543. Several days after Deuerling's termination, he began working for a competitive bakery in the same territory where he had worked for the defendant. Id. The court held that the issuance of a preliminary injunction against the former employee was appropriate when the employee had frequent personal contact with the employer's customers. Id. at 545. The court found this contact could give clients a preference for dealing with a particular employee, rather than a particular bakery's products. Id. at 543. Because the covenant was limited to three months -- the time the court felt it would reasonably take the company to train a new salesman -- the restriction was enforceable. Id. at 545.
Several years later the court decided that an injunction should have been issued against a former laundry route salesman who resigned and went to work for a competitor, calling on many former clients along his old route. Tolman Laundry, Inc. v. Walker, 187 A. 836 (Md. 1936). At issue was a covenant prohibiting the defendant from soliciting customers along the route he serviced for the plaintiff for one year following his termination. Id. at 838. To determine whether the restriction was reasonable, the court looked to the nature of the business, the defendant’s personal contact with customers, and the information he learned about the "extent and scope of the business done on his route." Id. at 837. The court held that the employer had paid wages and commissions to the defendant based on the business he produced on his route. Therefore "it would be unjust for the servant . . . to take from his employer what the employer had paid the servant to produce." Id. at 838. Finding that the plaintiff’s business was "peculiarly dependent" on the employee’s loyalty, the court held the restriction reasonably necessary to protect the employer’s interests and appropriately "confined within limits which are no larger and wider than" necessary for such protection. Id. at 12, 187 A. at 838. See also Ruhl v. F.A. Bartlett Tree Expert Co., 225 A.2d 288 (Md. 1967) (finding reasonable a two-year restriction against competition in counties where the former employee had worked because of his close customer contacts, despite the fact that tree care was the only work he had ever known); Western Md. Dairy, Inc. v. Chenowith, 23 A.2d 660 (Md. 1942) (enforcing a restrictive covenant against soliciting former customers for six months in a labor union agreement against a dairy salesman who left defendant's employ to work in competitive business for his brother, bringing thirty-five percent of his customers with him).

Unfortunately, the year provided for in the covenant had already expired by the time the court heard the appeal from the dissolution of the preliminary injunction, and the court did not consider extending the injunctive relief from the date of the judgment. Id. at 14, 187 A. at 839. Cf. Roanoke Eng’g Sales Co., Inc. v. Rosenbaum, 290 S.E.2d 882 (Md. 1982) (granting an injunction for the term of the covenant from the date of the court order despite the fact that the period had ended prior to the appeal).

However, the restraint is unjustified "if the harm caused by service to another consists merely in the fact that the former employee becomes a more efficient competitor." Silver v.
Goldberger, 188 A.2d 155, 158 (Md. 1963). In Silver, the former employees of plaintiff's employment agency agreed not to compete with their employer for two years in "any community in which [plaintiff] has offices." Id. at 156. Two days after terminating their employment, the defendants opened their own employment agency two blocks from plaintiff's Baltimore office. Id. at 156. Although the former employer believe it needed protection from the misuse of information by the former employees, there was no proof that the defendants "had or were likely to take some of [plaintiff's] clients away." Id. at 159. Without such evidence, the court was unwilling to enforce the restriction. Id. at 159.

The second instance when the courts will enforce a restrictive covenant is where the employee provided unique services. Millward v. Gerstung Int'l Sport Educ., Inc., 302 A.2d 14, 16 (Md. 1973). There, the court enforced a restrictive covenant against a former camp director, who was previously the coach of a defunct professional soccer team in Baltimore. The former employee left Gerstung's employ to establish his own competing camp program, designed to confuse Gerstung's customers into thinking it was the Gerstung camp program. Id. at 17. The non-competition agreement prohibited Millward from "directly or indirectly, engag[ing] in the same or similar business, namely . . . physical education or sport instructions of any kind in the City of Baltimore or the surrounding counties" where Gerstung had sports programs for two years. Id. at 15. The employment contract also included a clause prohibiting diversion or solicitation of Gerstung's clientele. Id. at 485, 302 A.2d at 15. The court enforced the agreement, finding it reasonably necessary to protect Gerstung's business, given Millward's "reputation and qualifications[,] which had a direct bearing on the services" he provided for Gerstung's program. Id. at 17.

Several months before Millward was decided, the court refused to enforce a restrictive covenant where the defendant did not perform unique services. Becker v. Bailey, 299 A.2d at 838 (Md. 1973). At issue in Becker was a covenant by a former employee of a company providing tag and title service to automobile dealers prohibiting him from "engag[ing] in a similar or competitive business for himself or for any competitor, in [the counties where the plaintiff operated] for a period of two (2) years from the date this Agreement is terminated in any manner." Id. at 836-37. Becker terminated the defendant's services when he discovered that Bailey was "moonlighting" for some of his customers. Id. at 95, 299 A.2d at
837. Subsequently, the defendant opened up his own tag and title company, serving three of the plaintiff's former clients, although there was no indication that he solicited these clients from the plaintiff. Id. at 837. In refusing to enforce the covenant, the court found that Becker had no protectable business interest, as Bailey was "an unskilled worker whose services are not unique." Id. at 839. Given that all of Becker's customers were listed in the phone book, there were no secret client lists or routes at issue. Id. at 839. As in Silver, the court found "no justification for restraint where a former employee does no more than become an efficient competitor of his former employer." Id. at 840. Additionally, the court took into consideration the difficulty Mr. Bailey had in securing other employment: he was "forty-nine years old, in a poor financial condition and [was] not trained for any other type of work." Id. at 837. See also Food Fair Stores, Inc. v. Greeley, 285 A.2d 632 (Md. 1972) (holding unenforceable a pension plan provision, allowing the plan committee to terminate benefits upon competition by any participants, because it would prohibit the former employee from pursuing a profession which he had followed for twenty-three years with no limitations as to time or territory).

The other major difference between enforcement of non-competition agreements in Virginia and Maryland is that Maryland courts employ the "blue-pencil" approach whereas Virginia courts refuse to do so. This approach allows courts to strike unreasonable provisions of the covenant while enforcing the remainder of the restriction. In 1946, the court eliminated an overly broad provision in the covenant of a former manager of a small loan company prohibiting all competition in the entire city of Baltimore. Tawney v. Mut. Sys. of Md., 47 A.2d 372 (Md. 1946). However, the court enforced the provisions of the covenant pertaining to the solicitation of clients and misuse of client information. Id. at 521, 47 A.2d at 379. In refusing to enforce the non-competition portion of the covenant, the court found that the former employer was "entitled only to such relief as [was] necessary for the protection of [the] business." Id. at 376. While diverting former clients would be harmful to the employer's business, the non-competition provision went beyond such protection. Rather, it created an undue hardship on the former employees by preventing them from doing business with thousands of people in the Baltimore area that had no contact with the former employer's business. Id. at 521, 47 A.2d at 379. Cf. Worrie v. Boze.
62 S.E.2d 876 (Va. 1951) (holding that a dance instructor could not compete with his former employer for two years within twenty-five miles of the city of Richmond, even though the real concern seemed to be the possibility that he might misuse the client information he gained while employed).

A more recent decision shows that the Maryland courts are even willing to enforce a covenant that is reasonable in all aspects save the duration. In so doing, the courts judicially modify the length of the restriction to that which is necessary to protect the employer. Holloway v. Faw, Casson & Co., 572 A.2d 510 (Md. 1990). In Holloway, a partner at an accounting firm signed a partnership agreement that prohibited withdrawing partners from "engag[ing] in the general practice of public accountancy . . . at any place within a forty mile radius of any of [the partnership's] offices for a period of five years from the date of such withdrawal." Id. at 512. The agreement also provided for a fee equal to the full amount of the prior year's fee for any of the partnership's clients that the withdrawing partner serviced during that five year period. Id. at 512. Holloway voluntarily left the partnership to work for another accounting firm just five miles from one of his former partnership's offices. Id. at 511. The court determined that the covenant had two problems in that it covered clients of the partnership who were not Holloway's and its duration was unreasonably long. Id. at 512. However, the partnership had a protectable interest in that "it could be anticipated that those clients [who had established a relationship with Holloway] would follow him." Id. at 516. Additionally, the court looked at the impact on the public of such covenants (as they pertain to the accounting profession) and decided that there was not a sufficient interest to require a per se ban on such voluntary agreements. Id. at 517. Therefore, the restriction was partially enforced so as to last for three years and cover only Holloway's former clients. Id. at 512. As modified, the effect of the restriction was not to prohibit competition, but merely to force Holloway to compensate the partnership for any former clients he serviced, as the court held the fee provision was the only remedy available (and the only one sought). Id. at 346, 572 A.2d at 521. But see Mass. Indem. and Life Ins. Co. v. Dresser, 306 A.2d 213 (Md. 1973) (holding that a clause in a restrictive covenant allowing the former employer to choose not to pay certain commissions upon a former employee's breach of the non-competition agreement was not
a liquidated damages clause and did not preclude injunctive relief. However, the court did not address the question of whether the employer could seek both a forfeiture of the commissions and an injunction against competition). Cf. Worrie v. Boze, 62 S.E.2d 876 (Va. 1951) (allowing the former employer to collect both a promissory note, which was essentially liquidated damages, as well as an injunction against the future violation of the covenant).

Maryland courts take a much more employee-friendly approach to non-competition agreements than Virginia courts. The prongs of the test are quite similar, yet only two legitimate business interests are recognized as protectable in Maryland. However, Maryland courts are able to eliminate offending portions of restrictive covenants in order to enforce the reasonable restrictions contained therein using a "blue pencil" approach.