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The U.S. District Court for the District of Maryland Emphasizes Need for Narrow Tailoring of Non-compete Provisions

Tayman Lane Chaverri LLP December 2016

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Non-compete agreements have long been a part of the employment terms of executives and senior employees. More recently, non-compete agreements have also become more and more typical for lower level employees as well. As these kinds of agreements have become more common, questions about their enforceability have grown in relevance. While determining the enforceability of such a provision requires a highly fact intensive analysis, the law provides some general rules and standards which guide this analysis.

A recent decision by Judge Roger W. Titus of the United States District Court for the District of Maryland, Seneca One Finance, Inc. v. Bloshuk, __ F.Supp.3d ____, 2016 WL 5851626 (D. Md. 2016), gives a well articulated summary of the legal standard for determining the enforceability of these agreements. The case summarizes Maryland law on this issue, which is similar to, but not quite the same as, the law of other jurisdictions. In Seneca One, a financial services firm involved in the business of financing structured annuities and other deferred payment plans sought to enforce a non-compete agreement against an employee who worked as an "annuity specialist," a position in which the employee was responsible for managing the day-to-day relationships with customers and building new relationships with prospective customers. As part of her employment, the defendant in this case signed an agreement which provided that she would neither compete with her employer nor solicit any potential or existing customers during her employment and for a year after leaving.

After about two and a half years of employment at the plaintiff, the defendant quit her job and joined a competitor where she worked in a very similar role and allegedly solicited customers of her prior employer. In response, her former employer brought an action to enforce the non-compete agreement which resulted in Judge Titus' decision.

Under Maryland law, a non-compete provision will only be enforced if it meets four requirements:

1) the employer must have a legally protected interest in the activity being restricted;

2) the restrictions of the provision must be no broader than is necessary to protect the employer's interest;

3) the provision must not impose an undue hardship on the employee to be bound; and

4) the provision cannot violate public policy.

Although these criteria are the basic standard, what meets or does not meet the standard is not a hard and fast rule – evaluating the enforceability of a particular provision is highly dependent on the specific circumstances of the given situation.

With respect to the first requirement, courts recognize that an employer has a legally protected interest in preventing departing employees from taking the employer's customer goodwill, even if the employee helped to create that goodwill. The particular non-compete provision at issue in Seneca One prohibited the departing employee from engaging, directly or indirectly, in the same or similar business as the plaintiff employer. Similarly, the non-solicitation provision prohibited the departing employee from soliciting existing and potential "customers" of the employer, a term defined to include all persons who had "been in contact" with the employer. The provisions at issue in this case did not contain industry or geographic limitations.

The Court held that this broad restriction on post-employment competition was unenforceable because it was not limited to the work or type of work previously done for the employer. Instead, the non-compete in this case blocked the former employee's post-employment activities in a way that was far broader in scope than was necessary to protect the employer's customer goodwill. The non-compete provision was also found to be improper because it was designed to stop employees from working for any competitor of the employer, rather than to prevent employees from taking advantage of the first employer's customer goodwill. The Court also found the non-solicitation aspects of the provision too broad and, in particular, found the restriction against soliciting potential customers "breathtaking" (and not in a good way).

Narrow Tailoring of Non-compete Provisions

While it speaks more directly to what should be avoided, this case provides good guidance and specific factors to consider and think through with respect to the enforceability of non-compete provisions, both from a drafting and dispute perspective. One basic watchword is "tailoring" – in order to be enforceable a non-compete provision should be specifically tailored to protect the employer's interest in the customer goodwill which the employee is involved with managing or creating while employed. Similarly, the non-solicitation aspects of such a provision are more likely to be enforceable if they focus on customer relationships that the employee actually interacted with, or was involved in developing, during the course of employment. Putting an industry or a geographic limitation on the restrictions of a non-compete provision is another way to more narrowly tailor the provision. But this is not foolproof or even necessary in all instances – the Seneca One decision acknowledges that non-competes without an industry or geographic limitation may be enforceable in certain circumstances, such as where the provision is otherwise narrowly tailored to protect the employer's legally protected interest.

At its core, determining whether a non-compete provision is enforceable or not requires careful parsing of the factual details specific to each particular employer/employee situation. That being said, Seneca One (and the cases like it) are very helpful because these decisions can be used to inform and guide this analysis.

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