District of Columbia

Non-Competes

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1. Enforcement – General

Under what circumstances will a District of Columbia court enforce a non-compete agreement?

The District of Columbia Court of Appeals (the District's highest court of record) has frankly acknowledged that the District's law in the covenants not to compete area is underdeveloped. *Deutsch v. Barsky*, 795 A.2d 669, 675 (D.C. 2002). However, in *Ellis v. James V. Hurson Associates, Inc.*, 565 A.2d 615 (D.C. 1989), the court explicitly adopted §§186-188 of the Restatement (Second) of Contracts (1981) (hereafter cited as "Restatement"), concerning agreements in restraint of trade.

Under Restatement §186, "[a] promise is unenforceable on grounds of public policy if it is unreasonably in restraint of trade. A promise is in restraint of trade if its performance would . . . restrict the promisor in the exercise of a gainful occupation." Section 186 employs a "rule of reason" under which a restraint's reasonableness is viewed "in light of the circumstances of the transaction, including not only the particular facts but general social and economic conditions as well." Restatement §186 comment a.

Under §187, a covenant not to compete *must* be ancillary to an otherwise valid transaction or else it is unenforceable. *Deutsch v. Barsky*, 795 A.2d at 675; Restatement §187 comment b. Section 188 further illuminates when an ancillary covenant not to compete is unreasonable, namely: (a) the covenant is greater in scope than is necessary to protect the promisee's legitimate interest; or (b) the promisee's need for protection is outweighed by hardship to the promisor and likely injury to the public. See §188 comments b & c; *Barsky*, 795 A.2d at 675. Thus, a balancing of interests is often required. *Id.* at 676, citing §188 comment a.

Comment d to §188 provides that a covenant not to compete may be limited by geographical area, time and type of activity. A non-compete agreement based on the employee's ability to attract customers generally renders the nature, extent, and location of the employee's customer contacts relevant. Where the covenant is limited to soliciting the former employer's customers, it is more easily justified. *Id.* However, comment g states: "[p]ost-employment restraints are scrutinized with particular care because they are often the product of unequal bargaining power and because the employee is likely to give scant attention to the hardship he may later suffer through loss of his livelihood."

In any event, the reasonableness *vel non* of a covenant not to compete "is a fact intensive inquiry that depends on the totality of the circumstances." *Deutsch v. Barsky*, 795 A.2d at 677, quoting *Valley Medical Specialists v. Farber*, 982 P.2d 1277, 1283 (Ariz. 1999). Thus, obtaining summary judgment on the reasonableness of any particular non-compete agreement will likely be difficult.

In addition, D.C. Code §28-4502 (the District's counterpart to the Sherman Act) states: "Every contract, combination in the form of a trust or otherwise, or conspiracy in restraint of trade or commerce all or any part of which is within the District of Columbia is declared to be illegal." In *Ellis v. Hurson*, *supra*, the court noted that the legislative history of §28-4502 indicates it extends only to unreasonable restraints of trade. 565 A.2d at 618 n.12. Thus, §28-4502, as interpreted and applied to covenants not to compete, is apparently coextensive with the common law on the subject.

2. Protectable interests

Define the legitimate or protectable interests that give rise to enforcement of a non-compete agreement or other restrictive covenant.

Citing comment b to §187, the *Deutsch v. Barsky* court noted that legitimate interests of the promisee may include the promisee's acquisition from the promisor of a business; a principal-agent or employer-employee relationship between the promisor and promise; or a partnership relationship between the promisor and promise. 795 A.2d at 675. The comment makes clear that this enumeration is not exhaustive, but reiterates that the covenant not to compete must be ancillary to (*i.e.*, part of) "some such transaction or relationship" or else it is unreasonable. *Barsky*, 795 A.2d at 675-76.

Comment g to Restatement §188, concerning post-employment covenants not to compete, states that such restrictions usually rest on the employee's acquisition of confidential information or "the means

to attract customers away from the employer." Comment g further observes: "[whether] the risk that the employee may do injury to the employer is sufficient to justify [a non-compete agreement] after termination of the employment will depend on the facts of the particular case." As discussed above, the District hews closely to the RESTATEMENT. Further, in *Mercer Management Consulting, Inc. v. Wilde*, 920 F.Supp. 219 (D.D.C. 1996), the federal court, applying District of Columbia law, held that the employer's protection of the investment made in its employees, the preservation of confidential information, and protection from employees capitalizing on the employer's client base, were legitimate interests. *Id.* at 237.

The *Barsky* court, in a footnote, pointed to a law review article listing relationships covered by the First Restatement, but not included in the Second; those relationships may or may not in future cases be held to constitute a valid underlying relationship or transaction so as to support a non-compete agreement. 795 A.2d at 676 n.9, citing M. Handler & D. Lazaroff, "Restraint of Trade and the RESTATEMENT (SECOND) OF CONTRACTS," 57 N.Y.U. L.Rev. 669 (1982).

3. Reasonableness

What factors might a D.C. court consider in determining whether the scope of a restriction is reasonable in time, geography, or with respect to the type of activity prohibited?

Examples of reasonable and unreasonable covenants

• *Deutsch v. Barsky,* 795 A.2d 669 (D.C. 2002). A covenant not to compete ancillary to a valid transaction or agreement between dentists is not a *per se* violation of public policy. The court found a two-year, five-mile radius restriction of a competing dental practice was not facially invalid. The court remanded the case to employ the balancing required by RESTATEMENT §188.

• *Ellis v. James V. Hurson Associates, Inc.,* 565 A.2d 615 (D.C. 1989). The trial court entered injunctive relief enforcing a three-year covenant not to solicit the employer's clients or customers, which was part of a much broader covenant not to engage in any competing business during that time. The appellate court approved of the partial enforcement of the covenant's non-solicitation provisions, but remanded for further consideration in light of the court's adoption of RESTATEMENT §§186-88.

• *Allison v. Seigle*, 65 U.S.App.D.C. 45, 79 F.2d 170 (1935). A covenant not to compete by the seller of drug store was enforceable where seller agreed not to conduct, own or operate a competing drug store within a 10-block radius of the buyer during the time that buyer owned the purchased business.

• *Mercer Management Consulting, Inc. v. Wilde,* 920 F.Supp. 219 (D.D.C. 1996). The court, following *Ellis v. Hurson*, held that a one-year non-compete agreement in an employment contract was valid, where the reach of the non-compete provision was limited to restricting the former employee's rendering of services to the former employer's clients and hiring employees away from the former employer.

• *Meyer v. Wineburgh*, 110 F.Supp. 957 (D.D.C. 1953), *aff'd*, 95 U.S.App.D.C. 262, 221 F.2d 543 (1955). A temporary injunction was granted to enforce a five-year restriction on business competition within a 30-mile radius "of any office or offices with which [a pest control business employee was] directly connected." The court interpreted the restriction to apply only to the customers secured or solicited by the former employer.

• *Hartung v. Hilda Miller, Inc.*, 77 U.S.App.D.C. 164, 133 F.2d 401 (1943). The court upheld a 10-year restriction, precluding the seller of a D.C. furniture business from engaging in the same business within the District. The court prohibited the seller from advertising in D.C. newspapers to attract District residents to his Silver Spring, Maryland store (located just over the D.C. line).

• *Red Sage Ltd. Partnership v. DESPA Deutsche Sparkassen Immobilien-Anlage-Gasellschaft, mbH*, 254 F.3d 1120 (D.C.Cir. 2001). The court held valid an exclusive use covenant in a lease, wherein the landlord promised not to rent space in a building to food service business that would compete with the tenant restaurant. The covenant applied only to a single building, only lasted the length of the lease, and only prevented one type of retail activity (food service). The court noted that such an exclusive use covenant is not subject to the same concerns of unequal bargaining power and undue hardship as are post-employment covenants. Accord, *Venture Holdings, Ltd. v. Carr*, 673 A.2d 686 (D.C. 1996), which involved a use

restriction in a lease prohibiting a food court tenant from selling bagels and sandwiches. The covenant was held not to constitute an unreasonable restraint of trade—a use restriction is a promise to compete in a certain way, not to refrain from all competition.

• *Chemical Fireproofing Corp. v. Krouse*, 81 U.S.App.D.C. 145, 155 F.2d 422 (1946). A three-year covenant not to compete for customers of a kitchen cleaning business was held to be unreasonable and invalid. The court held the three-year time frame, as well as the covenant's geographic scope (D.C., Maryland, Virginia, West Virginia, Delaware and Pennsylvania) rendered the covenant unreasonable.

4. Customer non-solicitation agreements

Do the District of Columbia courts enforce covenants not to solicit customers more liberally than covenants not to compete?

Are geographic restrictions necessary to enforce a covenant not to solicit?

In *Ellis v. Hurson, supra,* the court held that a territorial limitation on a non-compete agreement is generally not required where the preliminary injunction merely enjoins the former employee from soliciting customers. 565 A.2d at 620, citing *Hebb v. Stump, Harvey & Cook, Inc.*, 334 A.2d 563, 569-70 (Md.App. 1975), and *Mills v. Murray*, 472 S.W.2d 6 (Mo.App. 1971). The court also noted with approval the proposition that prohibitions against solicitation of known customers are reasonable. 565 A.2d at 620-21, citing Annotation, "Enforceability of Contract not to Compete," 61 A.L.R.3d 397 §§16-20, 37 (1975), and *American Eutectic Welding Alloys Sales Co. v. Rodriguez*, 480 F.2d 223 (1st Cir. 1973); see also, 565 A.2d at 621 n.16 (citing cases).

Have the courts specifically addressed the enforceability of a covenant that prohibits the "acceptance" of business from customers who seek out the former employee to do business?

While District of Columbia courts have not specifically considered this question, the reliance by the *Ellis v. Hurson* court on the Restatement is instructive. As discussed above, comment g to §188 notes that a non-compete provision based on the employee's ability to attract customers generally renders the nature, extent, and location of the employee's customer contacts relevant to the reasonableness analysis. Thus, a District of Columbia court would be likely to scrutinize closely any non-compete agreement prohibiting acceptance of business from customers who affirmatively seek out the former employee. However, the *Ellis* court also cited approvingly to cases holding that non-solicitation agreements of customers merely known to the employee due to his former employment are reasonable. See *Ehlers v. Iowa Warehouse Co.*, 188 N.W.2d 368 (Iowa 1971) (enjoining contact with or solicitation of persons contacted by plaintiff while employed by defendant); *Morgan's Home Equipment Corp. v. Martucci*, 136 A.2d 838 (Pa. 1957) (enforcing covenant prohibiting former employees from competing for patronage of employer's customers). Thus, it is unclear how a District of Columbia court would resolve this question.

However, in *Smith, Bucklin & Associates, Inc. v. Sonntag*, 83 F.3d 476 (D.C.Cir. 1996), the D.C. Circuit, relying on *Ellis v. Hurson*, held under District of Columbia law that a covenant preventing an employee from soliciting *or accepting* the business of managing or advising management of the former employer's clients during the three years preceding the employee's termination was proper. The court then denied preliminary injunctive relief on the grounds that the employer had an adequate remedy in damages and had not demonstrated irreparable harm.

5. Blue-Penciling

If the restrictions are overly broad or unreasonable, is the court permitted to modify the covenant and enforce it as modified?

The District of Columbia rejects the view that a covenant not to compete must be enforceable as a whole for any part of it to be enforceable. *Ellis v. Hurson, supra*, 565 A.2d at 617. While the *Ellis* court explicitly declined to adopt a "blue pencil" rule, *id.* at 617-18, it did adopt the rule of Restatement §184: where some, but not all, of a covenant not to compete is unenforceable on public policy grounds, the remainder may be enforced "in favor of a party who did not engage in serious misconduct." *Id.* at 617, quoting Restatement §184(1). An unenforceable term is severable "if the party who seeks to enforce

the term obtained it in good faith and in accordance with reasonable standards of fair dealing." *Id.*, quoting Restatement §184(2). Applying these principles, the court found no abuse of discretion in the trial court's decision to enforce only the non-solicitation portion of a covenant not to compete. *Id.* at 618.

6. Defenses to enforcement

Failure of consideration. What constitutes sufficient consideration to support the enforcement of a non-compete agreement?

In *Ellis v. James V. Hurson Associates, Inc.*, 565 A.2d 615 (1989), the court rejected the argument that the non-compete agreement in question was unsupported by consideration. The court specifically found *Byram v. Vaughn*, 68 F.Supp. 981 (D.D.C. 1946), in which the federal court found want of consideration a basis to deny enforcement, to be weak persuasive authority. Instead, the *Ellis* court cited approvingly to *Meyer v. Wineburgh*, 110 F.Supp. 957 (D.D.C. 1953), *aff'd,* 221 F.2d 543 (D.C.Cir. 1955), in which the same federal district court noted that employment for a substantial period of time was sufficient consideration for the non-compete agreement.

The *Ellis* court also noted authority in other states for the proposition that equitable enforcement of a non-compete agreement is proper even absent an obligation for a stated or substantial period of continued employment. It cited *Meyer v. Wineburgh* and *Tasty Box Lunch Co. v. Kennedy*, 121 So.2d 52 (Fla. App. 1960). The *Ellis* court was, in fact, persuaded by the facts that the former employee had filled out an employment application, stating a non-compete agreement would be required, and that he was again informed of the non-compete provision during a job interview. Thus, the court found the non-compete agreement ancillary to his employment even though it was not signed at the same time he was accepted for employment. See *Seaboard Industries, Inc. v. Blair*, 178 S.E.2d 781 (N.C.App. 1971).

However, in *Deutsch v. Barsky*, 795 A.2d 669, 676 (D.C. 2002), the court stated that a promise not to compete made as part of an ongoing transaction or relationship is enforceable *so long as it is supported by consideration*. The cases thus suggest that in the District of Columbia, non-compete agreements ancillary to ongoing employment are supported by sufficient consideration, but that non-compete agreements ancillary to other ongoing relationships or transactions may or may not be supported by consideration, depending on the facts. In addition, the *Barsky* court clarified that a non-compete agreement must be made before termination of the relationship or transaction; post-termination agreements are unreasonable and unenforceable. *Id.*

Unclean hands/Prior material breach by employer. If the employer fails to compensate the employee or provide benefits as agreed, or as provided under the law, will the covenant be enforced?

The District's courts have not considered whether the employer's material breach of the employment agreement, or the doctrine of unclean hands, will bar enforcement of a covenant not to compete. However, the D.C. Circuit, in *Smith, Bucklin v. Sonntag, supra*, did decline to grant injunctive relief where the employer had an adequate remedy at law and the former employer did not show irreparable harm to justify an injunction. *Smith, Bucklin*'s holding suggests that, in an appropriate case, courts in the District would apply the equitable doctrine of unclean hands to bar enforcement of the covenant.

Involuntary termination of employment. If the employer terminates the employment relationship, will the covenant be enforced?

The District has not considered whether a covenant not to compete is enforceable when the employer terminates the relationship. However, in *Smith, Bucklin v. Sonntag*, the former employer had fired two employees after they accepted positions with a competitor and the customer primarily serviced by the employees switched its business to the employees' new company. The court did not find the employer's termination troubling; it held that the covenant not to compete was otherwise reasonable (even though unenforceable by way of preliminary injunctive relief for other reasons).

7. Assignment

Are covenants not to compete generally assignable by the employer? Is the covenant enforceable in the event the employer sells its stock to, or merges with, another entity? Would a different result obtain in the case of an asset sale?

The District of Columbia has not considered whether covenants not to compete are assignable by the employer, or enforceable if the employer merges with or sells out to another entity. However, in *Citibank (South Dakota), N.A. v. FDIC*, 857 F.Supp. 976 (D.D.C. 1994), the court held that the FDIC, as successor to a bank by virtue of receivership, was required to abide by a non-compete agreement contained in a contract made by the predecessor bank. *Id.* at 982.

8. Interpreting the covenant

In the absence of a specific choice of law provision, to which state's law or Restatement principles do the District of Columbia courts look in interpreting the enforceability of an agreement not to compete?

The District of Columbia has not addressed choice of law issues in the context of non-compete agreements. The District does, however, follow the Restatement's "most significant relationship" test in making choice of law determinations. See, *e.g., Coulibaly v. Malacquias*, 728 A.2d 595 (D.C. 1999). Under this test, the forum will apply the contract law of the jurisdiction having the "more substantial interest in the resolution of the issue." *Id.* at 606, quoting *McCrossin v. Hicks Chevrolet, Inc.*, 248 A.2d 917, 921 (D.C. 1969).

9. Anti-Raiding

Are covenants not to solicit or hire employees enforceable in the District of Columbia?

In *Mercer Management Consulting, Inc. v. Wilde*, 920 F.Supp. 219 (D.D.C. 1996), the federal court upheld a one-year non-compete agreement that limited the former employee's right, among other things, to hire away employees of his former employer.

10. Duty of loyalty

Do rank-and-file employees owe a common law or statutory duty of loyalty to their employers?

The District of Columbia courts have not squarely addressed the employee's duty of loyalty to his employer. However, federal decisions in the District have recognized an employee's common-law duty of loyalty. See *Riggs Investment Management Corp. v. Columbia Partners, LLC*, 966 F.Supp. 1250, 1264 (D.D.C. 1997), citing *Maryland Metals, Inc. v. Metzner*, 382 A.2d 564 (Md. 1978), and *C-E-I-R, Inc. v. Computer Dynamics Corp.*, 183 A.2d 374 (Md. 1962). The *Riggs* court did not state which state's law applied. See *Mercer Management, supra*, 920 F.Supp. at 233-34 (apparently applying Delaware law).

The duty of loyalty requires that "there shall be no conflict between [the employee's] duty and [his] self-interest." *Mercer Management*, 920 F.Supp. at 233, quoting *Guth v. Loft*, 5 A.2d 503, 510 (Del.Ch. 1939). It also requires an employee preparing to compete with his employer to refrain from fraudulent, unfair, or wrongful acts, such as misuse of confidential information or solicitation of the employer's customers. *Id.* at 234, citing *Science Accessories Corp. v. Summagraphics Corp.*, 425 A.2d 967, 965 (Del. 1980). Only upon termination of his employment may the employee freely compete with his former employer. *Id.* at 233-34.

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