

Department of Legislative Services
Maryland General Assembly
2013 Session

FISCAL AND POLICY NOTE

Senate Bill 51 (Senator Young)
Finance

Employment Contracts - Noncompetition Covenant - Conditions Affecting Enforcement

This bill exempts an individual who has applied for and is eligible to receive unemployment insurance (UI) benefits from being bound by a noncompetition covenant with the individual's prior employer. The bill applies only prospectively and has no effect on contracts entered into before its October 1, 2013 effective date.

Fiscal Summary

State Effect: None. The Department of Labor, Licensing, and Regulation (DLLR) can implement the bill with existing resources.

Unemployment Insurance Trust Fund (UITF): To the extent that the bill results in decreasing the duration of time an individual receives UI benefits, UITF expenditures may decrease beginning in FY 2014. Any such impact is expected to be minimal. UITF revenues are not affected.

Local Effect: None.

Small Business Effect: Potential meaningful.

Analysis

Current Law: Maryland does not have a general statute or regulation governing noncompetition covenants.

In a 1972 ruling in *Becker v. Bailey*, the Maryland Court of Appeals took up the issue of enforceable noncompetition agreements in employment contracts. The Court of Appeals found noncompetition agreements in employment contracts to be enforceable if they (1) are supported by adequate consideration; (2) are ancillary to an employment contract; (3) are limited to the area and duration which is needed to protect the employer; and (4) do not impose an undue hardship on the employee or disregard the interests of the public.

Maryland follows the general rule that restrictive covenants may be applied and enforced only against those employees who provide unique services, or to prevent the future misuse of trade secrets, routes or lists of clients, or solicitation of customers.

Maryland courts take a “blue-pencil” approach, which allows courts to strike or modify unreasonable provisions of a noncompetition covenant while enforcing the remainder of the covenant.

Background: Both the federal and state governments have responsibilities for unemployment compensation. The U.S. Department of Labor oversees the UI system, while each state has its own program that is administered pursuant to state law by state employees. Each state has laws that prescribe the tax structure, qualifying requirements, benefit levels, and disqualification provisions. These laws must, however, conform to broad federal guidelines.

Employers pay federal UI taxes to the U.S. Department of Labor, which are used to fund the administration of the state UI programs.

Maryland employers also pay State UI taxes which are used to fund UI benefits. All private business employers and nonprofit employers employing one or more persons, at any time, are subject to the Maryland UI Law. An employer’s tax rate is based on the employer’s unemployment history and ranges within a certain percentage of the total taxable wages of the employer’s employees. The taxes are deposited in UITF and can be used only to pay benefits to eligible unemployed individuals.

The balance of UITF has fluctuated over the years, growing in good economic times to over \$1 billion in each of calendar 2007 and 2008, and diminishing in bad economic times to a level that required UITF to borrow \$133.8 million from the federal government in February 2010. The balance of UITF (\$794.5 million as of September 30, 2012) increased significantly in the last year, allowing Maryland employers to go from paying from the highest tax table to paying from the middle tax table.

Table C requires employers to pay tax rates from 1.0% to 10.5% assessed on each employee's taxable wages (up to \$8,500). Accordingly, employers will pay from \$85 to \$892.50 per employee for calendar 2013.

UI provides temporary, partial-wage replacement benefits to individuals who are unemployed through no fault of their own and who are able to work, available to work, and actively seeking work. An individual performing services for a business in return for compensation in the form of wages is likely covered for UI purposes. The employer reports the wages to the Division of Unemployment Insurance and pays UI taxes on those wages. If a person is not a covered employee, the person's wages are not reported, and the employer does not pay UI taxes for those services.

Small Business Effect: The bill may have a meaningful impact on small businesses with noncompete covenants due to increased competition from unemployed former employees. On the other hand, some employers may be positively impacted if they are able to obtain more skilled employees.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): LexisNexis; University of Virginia Law School; Department of Labor, Licensing, and Regulation; Department of Legislative Services

Fiscal Note History: First Reader - January 22, 2013
mc/mcr

Analysis by: Heather N. Ruby

Direct Inquiries to:
(410) 946-5510
(301) 970-5510