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INSIDE

NON-COMPETE AGREEMENTS

Keys to Crafting Enforceable Provisions

by M. Bradley Blommer

Non-compete agreements in employment contracts, also referred to as covenants not to compete, are a valuable business tool for an employer interested in protecting business interests from unfair competition such as misuse of customer contacts or lists, or confidential information. Properly drafted, they define time and geographical restraints on an employee's ability to compete with the employer after the employment has ended.

The courts in Maryland, Virginia, and the District of Columbia apply similar legal tests in determining the validity of a non-compete agreement. These factors must be carefully considered when the employment contract is drawn up. Otherwise, the employer may not be able to enforce the agreement. The agreement must be tailored to each employee. Too often, employers recycle previously used agreement language. A non-compete agreement may be enforceable against one employee but unenforceable against another.

When the validity of a non-compete agreement is disputed, the first factor the courts will examine is the nature of the former employee's work. Did the employee provide a unique service? Were the employee's skills and know-how provided by the employer? Did the employee's contacts with the employer's customers contribute to the success of the employer's business? When disputes arise, it is a common claim that the former employee "stole" customers serviced by the employee for the former employer. In some businesses, customer lists can be misappropriated and misused in this same unfair way.

The second factor to be considered is the duration and geographical limitations specified in the non-compete agreement. Is the former employee barred from competing for two years, for ten years or for the rest of his life? Is the competition prohibited in the metropolitan region, in all states east of the Mississippi River, or in the entire Western Hemisphere? These details must be based on common sense and the nature of the business involved. Courts will frown on provisions that are unreasonable or over-reaching.

The ultimate role for the court is to apply equity or to be fair. In our country, each individual has a natural and inherent right to use ones talents, skills, and experience for ones own benefit, or to furnish them to another for fair compensation. On the other hand, the owner of a business has the right to appropriately protect legitimate business assets, including intellectual property. The courts will balance these two competing interests to do justice.

For example, the highest court in Maryland upheld a non-compete agreement which barred an employee of a general tree care employer from competing in six counties for two years. The court found the non-compete agreement was not unduly burdensome, even though the employee, who resigned his job, had been in the tree care business since the age of fourteen, and had only a high school education and no other skills. The court noted that the employee

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Honors

The December, 2002 issue of *Washingtonian Magazine* named P&F partner Nancy G. Fax as one of the area's top estate planners.

The Pasternak & Fidis Reporter

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Small Craft Warnings

FEDERAL TAX LIEN CAN ATTACH TO TENANCY BY THE ENTIRETY PROPERTY

by Mitchell I. Alkon

Tenancy by the entirety is a form of joint property ownership that exists only between spouses and has traditionally been considered a creditor-protected form of ownership. Typically, married couples own their homes as tenants by the entirety. For the purposes of tenancy by the entirety, the husband and wife are viewed as one person, each owning an undivided interest in the property. Consequently, a tenancy by the entirety can be terminated only by the death of one of the spouses, the joint action of the spouses, or their divorce. Since one spouse cannot mortgage, sell or gift any portion of the property without the consent of the other, it naturally follows that a claim or lien against one of the parties cannot attach to the property and impair the interest of the other spouse. As a result, for many years it has been uniformly held, and acknowledged by the Internal Revenue Service, that a federal tax lien cannot attach to tenancy by the entirety property to satisfy one spouse's tax liability.

The U.S. Supreme Court case of *United States v. Sandra L. Craft*, decided April 17, 2002, changed the road map that lenders, title companies and those planning for creditor protection had followed for decades by holding that a federal tax lien against one spouse could attach to tenancy by the entirety property. The Internal Revenue Service claimed that a federal tax lien attached to Mr. Craft's interest in tenants by the entirety property. The Court of Appeals for the Sixth Circuit held that the lien did not attach to the husband's interest as he did not have any separate interest in the entireties property under state law. In reversing this Court of Appeals decision, the Supreme Court found that the Sixth Circuit had erred in looking to state law. Describing property as a "bundle of sticks," the Supreme Court held that state law determines which sticks are in a person's bundle, but federal law determines whether these sticks are considered property for federal tax lien purposes. The Supreme Court stated that the broad statutory language authorizing tax liens reveals that Congress meant to reach each and every property interest that a taxpayer might have, and that a husband's right to the use, exclusion and income of tenancy by the entirety property gives him a substantial degree of control over the property even though he cannot unilaterally sell it. The court rejected the argument that tenants by the entirety property should not be subject to a federal tax lien because a debtor/taxpayer has only a mere expectancy in the property (*i.e.*, in the event of the death of his spouse) because then entireties property would not belong to either a husband or a wife, and such a result would allow spouses to shield tenancy by the entirety property from federal taxation, which would facilitate abuse of the federal tax system.

How does this case affect you? On a narrow level, this case can be read as turning upon the supremacy clause of the U.S. Constitution, which means that federal law, not state law, is supreme in determining federal issues. Thus, tenancy by the entirety property is subject to federal law liens against either of the spouses, but is not subject to other claims against one spouse. Indeed, while title companies have changed their underwriting requirements with respect to federal tax liens, they have not changed their underwriting requirements regarding other claims and judgments against one tenant by the entirety. However, should we be reading *Craft* more broadly? Might a court find that the control a tenant by the entirety has in and over the property is sufficient to make this interest attachable under state law and thus for other claims? If so, then it will be necessary to consider other forms of creditor protection, such as trusts and limited liability companies, instead of tenancy by the entirety ownership.

Why Domestic Partners Need Domestic Partnership Agreements

by Linda J. Ravdin

There was a time courts refused to enforce agreements between unmarried cohabitants to pool their income and other resources, to obligate themselves for support or to make provisions upon death or dissolution. Today domestic partners have the right to enter into property and support agreements. This article discusses why they should do so.

Domestic partnership agreements come in several different varieties:

- Simple property ownership or business partnership agreements. Parties who own real estate or other property together, or who enter into a business relationship, have always had the ability to enter into contracts. That they also share living quarters is incidental to the property or business relationship.
- An agreement that provides for a complete waiver of any claims to property or support. Such an agreement is analogous to a premarital agreement in which parties waive all claims. Domestic partners have always had the ability to enter into such a contract because it does no more than waive claims that, under current law, either do not exist or are marginal.
- An agreement that creates property or support rights that are not based solely on each party's direct financial contribution to a specific asset. Under such an agreement parties may make disproportionate financial contributions, or may make nonmonetary contributions, such as homemaker services, to their assets in the aggregate.

It was this latter type of agreement that courts traditionally refused to enforce because it was thought to promote prostitution. Things changed in 1976 when the California Supreme Court decided *Marvin v. Marvin*. In *Marvin* the court decided unmarried cohabitants could enter into valid contracts to share property or pay support in the event the relationship came to an end. Since then, at least 37 states and the District of Columbia have recognized express cohabitation agreements as valid, enforceable contracts. The issue has been addressed in Maryland but no in Virginia.

Today parties who could marry, but choose to live together without marrying, and same-sex cohabitants, who do not have that option, should consider entering into a written agreement spelling out their rights and obligations regarding property and support. Several trends in the law since *Marvin* make the case for a written domestic partnership agreement more compelling.

"Domestic partners do not have an automatic claim to a share of the estate of the deceased partner, nor do they have automatic rights to survivor benefits under each other's retirement plans."

AVOIDING EXPOSURE TO LITIGATION IF THE RELATIONSHIP IS DISSOLVED

Since courts have accepted the validity of cohabitation agreements, the frequency of claims arising out of purported oral agreements has been on a steady rise. Some courts have held that only express agreements—agreements under which parties clearly and unequivocally agreed to terms—may be upheld. Other courts have held that an implied agreement—an agreement implied from the conduct of the parties—may be enforced. Oral agreements can be difficult to prove or to disprove. Often the only evidence is the conflicting testimony of the parties. An oral agreement provides poor protection to the weaker party in the relationship. From the standpoint of the stronger party, even a claim which ultimately is unsuccessful will expose that party's assets to the risk of an adverse result. Both parties will incur substantial attorney's fees to resolve a conflicting claim, fees that could have been avoided with an agreement defining their rights executed before dissolution of the relationship or the death of a party.

AVOIDING THE WRONG RESULT AT DEATH

Many domestic partners may intend to provide for each other upon death. However, unlike spouses, domestic partners do not have an automatic claim to a share of the estate of the deceased partner, nor do they have automatic rights to survivor benefits under each other's retirement plans. Unless they make wills or execute beneficiary designations, their intentions may not be carried out. Like married persons, domestic partners may put off making a will or otherwise planning for death. Once a partner has died, there will likely be other claimants for the decedent's assets. Moreover, when parties have only an oral agreement to make provisions for each other at death, a surviving partner claim may have to be proven in court with all the attendant cost and risk of failure. State law will not step in to provide an automatic right to a share of the decedent's estate as it does for married persons. A written domestic partner agreement that spells out the parties' rights and obligations will insure that other claimants understand the terms of their agreement and will permit their intentions to be carried out. On the other hand, if parties intend that each will retain his or her property to dispose of at death as he or she wishes, a written agreement will avoid the risk of a challenge to the estate plan of the deceased partner.

WHO WILL WRITE THE DOMESTIC PARTNERSHIP AGREEMENT

When two people marry they may choose to enter into a premarital agreement that alters their rights under state law. If they do not, state law will determine their rights when the marriage ends, whether by death or divorce. The good news for domestic partners is that now they have the right to enter into contracts determining their economic rights upon dissolution of the relationship or the death of one of them. The bad news is they do not have state law to fall back on if they fail to enter into an agreement. Therefore, the burden is on them to take affirmative steps to protect their interests and that of their other loved ones by entering into a written agreement spelling out the rights and obligations of both parties. ●

Important Change in Maryland's Child Support Law

by Anne (Jan) White

Good news for custodial parents with children still in high school (or younger). As of October 2002, Maryland law requires that child support be paid for 18 year olds still in high school until the child graduates from high school or turns 19.

Under the old law, once the child reached age 18, the law did not require the payment of child support, even if the child was still in high school. All divorce judgments entered in Maryland prior to October 2002 required payment of child support only to age 18, unless the non-custodial parent voluntarily entered into a written agreement to pay longer.

Under the new law, if the child turns 18 and is still enrolled in high school, the non-custodial parent must continue to pay child support until the child graduates from high school, turns 19, is emancipated, marries or dies, whichever comes first. However, the new law does not automatically change these existing divorce judgments which require child support only to age 18. Custodial parents with an 18 year old still in high school should contact us to file the appropriate motion to change their existing court orders to conform to the new law. ●

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N E W S

Activities

P & F partners Marcia C. Fidis and Linda J. Ravdin co-hosted a program with Bernstein Investment Research and Management on November 13, 2002 entitled *The Cutting Edge: Domestic Partner Legal and Investment Issues and Solutions*. Marcia Fidis discussed estate planning for domestic partners and Linda Ravdin spoke about developments in the area of domestic partner contracts, particularly as applied to the dissolution of the relationship. James New and Joseph Perta from Bernstein discussed the current investment environment as well as investment planning considerations unique to both same-sex and opposite-sex domestic partners. Sponsoring this program with Bernstein, and working with Joe and Jim, gave us a wonderful opportunity to work on matters of common interest to our clients and colleagues in an area where the law is still developing.

P & F is pleased to announce the publication of two new books written by family law specialist and P & F partner Linda J. Ravdin. She is a co-author of *Domestic Relations Manual for the District of Columbia* (Lexis/Nexis, 2002), the first comprehensive treatise on divorce and family law in the District, and she is the author of *TM 849, Marital Agreements* (Tax Management, Inc., 2003) a guide to drafting and negotiating premarital, postmarital, and domestic partnership agreements.

In September, 2002, Pasternak & Fidis, P.C. presented a program for clients on 529 education savings plans featuring Joan Marshall, the Executive Director of the College Savings Plans of Maryland. Ms. Marshall spoke about the many advantages of college savings accounts to an enthusiastic audience.

Real Estate Transfer and Recordation Tax Developments

by Mitchell I. Alkon

While interest rates have come down, transfer, recordation and recording taxes and fees have gone up. The District of Columbia has increased its real estate recordation and transfer taxes. Effective January 1, 2003, these taxes increased from 1.1 % of the consideration to 1.5 % of the consideration. Home purchases for which the consideration is $ 250,000 or less will remain taxable at 1.1 % subject to additional requirements. Additionally, the District of Columbia's recording fees are increasing effective February 2, 2003. A surcharge of $ 6.50 for each document presented for record will be charged and the per page recording fee will increase from $ 5.00 to $ 7.00.

Transfers of interests in Montgomery County real estate are subject to a recordation tax. This tax was $ 4.40 per $ 1,000 of consideration, but effective for transactions occurring on or after July 1, 2002, increased to $6.90 per $1,000.

Montgomery County also imposes a tax equal to 1% of the amount of consideration on transfers of interests in real estate. There are certain exemptions to this transfer tax, including the transfer of an interest in real property between spouses or former spouses. On April 2, 2002, the Montgomery County Council unanimously enacted a bill, which became effective April 11, 2002, that confers a transfer tax exemption to domestic partners of the same sex. Regulations were to be issued establishing the requirements for proving that the relationship between the transferor and the transferee qualifies for the exemption. The requirements were to be substantially identical to the requirements that the domestic partner of a Montgomery County employee had to meet to qualify for county benefits under the Employee Benefits Equity Act of 1999.

Montgomery County's Revenue Office has taken the position that the individuals involved in the deed transfer must be domestic partners at the time of the transfer. As such, if the transfer is between former domestic partners or those in the process of dissolving their partnership, the exemption will not be applicable. This is in contrast to the exemption for both current and former spouses.

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N E W S

P & F partner Nancy G. Fax, in her capacity as chair of the Professional Advisors Council of the Montgomery County Community Foundation, hosted a reception and program at Chevy Chase Bank in Bethesda on October 16, 2002. A panel of professional advisors presented a roundtable discussion on how to talk to clients about charitable giving.

On September 30, 2002, Nancy G. Fax spoke at a D.C. Bar Taxation Section program entitled *Planning for $5 Million to $ 10 Million Estates.*

P & F partner Marcia C. Fidis spoke in November, 2002 on the topic of estate planning at the annual Law Day for Seniors program sponsored by The American Bar Association.

NON-COMPETE AGREEMENTS

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had gained much of his knowledge from the employer, and relied heavily on the limited duration of the covenant in finding it reasonable. Such a limitation, according to the court, was not overly burdensome to the employee because he could compete with the employer in two years.

The same Maryland court, however, found unenforceable non-compete provisions in employment contracts of a manager and cashier of a small loan company. The agreements provided that the employees would not engage directly or indirectly in competing business in the City of Baltimore for two years following their terminations. The court found that the restriction extended longer than the time required for new employees to reasonably become acquainted with existing customers. Furthermore, it found that the agreement went far beyond what was reasonably necessary to protect the legitimate business interests of the employer, *i.e.* the goodwill developed by the employer with its customers. Enforcing the agreement, according to the court, would work an undue hardship on the employee because it applied to too large a geographical area, *i.e.* to businesses in the entire Baltimore area, which was highly populated.

In sum, a non-compete agreement must be tailored to the work of each employee. If an employee's assignment or job description is changed, the agreement may need amendment as well. The details of the agreement must be fair and reasonable to employee and employer alike. Knowing what the courts have judged fair and reasonable is an important basis for crafting the agreement. If the agreement is reasonable on its face, a successful challenge is unlikely. However, poorly conceived agreements may result in lengthy and costly litigation. Worse, in the end, the employer could be left with an unenforceable agreement and no protection against a former employee's competition.

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NEWS

New P&F Associate

Pasternak & Fidis welcomes a new associate, M. Bradley Blommer to the firm. Mr. Blommer, a graduate of the University of Baltimore Law School, is a former law clerk to the Honorable J. James McKenna, an Associate Judge (retired) of the Circuit Court of Montgomery County, Maryland. Brad has extensive trial experience in commercial litigation, insurance defense, construction law, "Miss Utility" law, and personal injury. He works primarily with Roger A. Hayden, II and Mitchell I. Alkon on business, real estate and litigation matters.

Honors

P&F partner Nancy G. Fax has been appointed by the U.S. Department of Justice as a legal advisor to Kenneth Feinberg, Special Master of the 9/11 Victim Compensation Fund. The Fund, which is under the auspices of the U.S. Department of Justice, was established by Congress to disburse funds to the families of those who were killed or injured in the terrorist attacks of September 11, 2001. Nancy, with the assistance of other P & F attorneys, is providing counsel to the Special Master on estate and probate matters affecting claimants in the District of Columbia, Maryland and Virginia.

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