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Delaware Chancery Court Declines to Blue-Pencil Overly Broad Noncompete Agreement; Casts Doubt on Choice of Law Provisions

Article By:

Brooke Razor

David J. Woolf

A recent Delaware Chancery Court opinion has elucidated Delaware's approach to judicially modifying, or "blue-penciling," overly broad noncompete agreements and deferring to parties' choice of law provisions. The case, *FP UC Holdings, LLC, et al. v. James W. Hamilton, Jr., et al.*, C.A. No. 2019-1029-JRS (Del Ch. Mar. 27, 2020), highlights the importance of drafting well-tailored restrictive covenants, and shows that even in Delaware – where employers often have been reassured by the safe harbor of courts' relative willingness to blue-pencil problematic agreements and apply Delaware law to fact patterns that have developed in other states – employers must make careful drafting and choice of law decisions. It also emphasizes that if an employer's intent is to litigate in Delaware, the employer should do so from the beginning, without acquiescing to another court's jurisdiction.

Background

FP UC Holdings presented a unique fact pattern and procedural history for the court to consider. The employer, Fast Pace Medical Clinic (Fast Pace), runs more than 100 urgent care clinics throughout the southeastern United States. Fast Pace formerly employed James W. Hamilton, Jr. (Hamilton) as a certified nurse practitioner and director of education and development at a clinic in southern Tennessee. Hamilton resides in Florence, Alabama, a state in which Fast Pace had avoided opening clinics due to heightened regulatory requirements.

The parties disputed Hamilton's level of importance to his employer; Fast Pace claimed that he was involved in strategic decision-making across multiple locations, and Hamilton claimed that he was essentially mid-level management. Hamilton resigned his position in July 2019 and shortly thereafter leased office space in Florence, Alabama, approximately 26 miles from the Fast Pace location at which he worked in Tennessee. In fall 2019, Hamilton began advertising the opening of his own urgent care clinic, Thrive, which began seeing patients on November 20, 2019. Of the approximately 420 patients Thrive had seen by the time of the opinion, 35 of them were Tennessee residents and six had formerly visited a Fast Pace location.

Hamilton was party to various restrictions during his employment with Fast Pace, including:

- An Employment Agreement that contained no choice of law or forum selection clause and that prohibited Hamilton from owning or managing an urgent care clinic within 60 miles of any Fast Pace clinic

- A Grant Agreement (executed in connection with an acquisition in 2016, at which time Hamilton was awarded membership units in Fast Pace) that included a Delaware choice of law provision and that prohibited Hamilton from being employed by any business that engages in the same business as Fast Pace "anywhere in the United States where [Fast Pace] operates or proposes to operate"

- An LLC Agreement (executed at the same time as the Grant Agreement) that required Hamilton to bring certain business opportunities to his employer before pursuing them himself.

Procedural History

On November 4, 2019, Fast Pace sent Hamilton a cease-and-desist letter claiming that he was violating the Grant Agreement's noncompetition covenant and the LLC Agreement's business opportunity restriction. Fast Pace also decided to cancel Hamilton's membership units because of the alleged breaches. On November 14, Hamilton sued Fast Pace in Alabama, seeking a declaration that the noncompete provisions in the Grant Agreement and Employment Agreement were unenforceable as a matter of Alabama public policy and seeking damages related to the cancellation of his membership units. After litigating for six weeks in Alabama, Fast Pace filed suit on December 23 in Delaware, alleging breaches of all three agreements and seeking a temporary restraining order. The Delaware court declined Fast Pace's motion for a temporary restraining order on January 3, 2020.

In early February 2020, the Alabama court granted partial summary judgment in favor of Hamilton, and held that the Employment Agreement's noncompete was unenforceable in Alabama. The Alabama court declined to reach a conclusion on the Grant Agreement because of the Grant Agreement's Delaware choice of law provision. In late February, Fast Pace filed a motion for preliminary injunction in Delaware, seeking to enjoin Hamilton from owning or managing Thrive or any similar business in Alabama and within 60 miles of any Fast Pace location.

Court's Analysis

In its analysis of the Grant Agreement's noncompete under Delaware law, the Delaware Chancery Court found the restriction, which covered the entire United States and failed to define the employer's "business," was unenforceable. The court noted the poorly drafted nature of the restriction, which, because it did not define the "business" and included all states in the country in which the employer "proposed to" do "business," could have been interpreted to bar Hamilton from practicing as a nurse – in any setting – nationwide. Interestingly, regarding the geographic breadth, the court acknowledged that it previously had enforced nationwide restrictions, "but only in instances where the competing party agrees, in connection with the sale of a business, to stand down from competing in the relevant industry … for a stated period of time after the sale." The court also noted that Hamilton likely had received only "token considerations" for the "significantly ratcheted up" noncompete and other restrictions in the Grant and LLC Agreements as compared with those in his

Employment Agreement.

Significantly, the court declined to modify or blue-pencil the Grant Agreement's noncompete restriction to match the noncompete restriction contained in Hamilton's Employment Agreement, which would have prohibited him from owning or being employed by an urgent care clinic within 60 miles of a Fast Pace location. In declining this request, the court noted that prior decisions have viewed blue-penciling requests as "an implicit concession that the relevant noncompete is facially overbroad. The court also cited its "discretion in equity not to allow an employer to 'back away from an overly broad covenant by proposing to enforce it to a lesser extent than written.'"

Regarding the parties' choice of Delaware law under the Grant and LLC Agreements, the court suggested that Alabama law most likely applied to the question of whether the restrictions were enforceable. The court noted that Fast Pace is a Delaware corporation with its principal place of business in Tennessee, the parties had agreed to Delaware law in the Agreements, Hamilton worked for Fast Pace in Tennessee, and Hamilton lives in Alabama where he was being asked to "perform" the noncompete by refraining from certain activities. The court also discussed at length Alabama's interest in the particular issue of the enforceability of the noncompete, giving weight to the fact that Alabama's legislature had specifically declared the public policy of the state *not* to enforce such restrictions within its borders. After analyzing the relationship of each state to the dispute, the court found that, "even if Delaware's contractarian affinities were at stake, Alabama's interest … is likely more imperative."

Ultimately, the court held that under either state's law the restrictions were most likely unenforceable, and therefore Hamilton's activity did not warrant the issuance of a preliminary injunction.

Finally, and related to its choice of law analysis, the court denied the employer's request for an anti-suit injunction that specifically would have enforced the Delaware choice of law and forum selection provisions and prevented Hamilton from pursuing his first-filed action in Alabama. The court held that the employer's "call to equity [came] too late," because Fast Pace had already availed themselves of the judicial process – and in fact had litigated extensively – in Alabama.

Employer Takeaways

The *FP UC Holdings* case has very specific facts – ones that are not likely to repeat in future cases. The facts also were particularly challenging in numerous respects for Fast Pace (*e.g.*, the limited consideration in the Grant Agreement, the significant disparity between the geographic scope of the Grant Agreement noncompete and Fast Pace's places of business, and the fact that Fast Pace arguably tried its hand first in Alabama before acting in Delaware), and it is reasonable to think that they impacted how the court viewed the case. The decision is nevertheless instructive insofar as it touches on several common noncompete issues and carries certain lessons for employers and practitioners.

First, if an employer desires Delaware law, it should ensure that there is a clear nexus between the employee's "performance" of the restrictions and the state of Delaware. If there is not, and the employer wants to rely on, for example, the fact that the employer is incorporated in Delaware as a basis for Delaware choice of law, the employer would be wise also to consider the laws of the state with the clearest relationship to the employee's performance of the restrictions, as there is a chance that that state's law may end up applying. If as in *FP US Holdings*, that state is Alabama or one with a similar view of noncompete restrictions, the employer will want to know that going in and plan accordingly.

Second, while employers often pick Delaware law at least in part because Delaware courts have long permitted judicial modification or blue-penciling of overly broad agreements, the *FP UC Holdings* decision is a reminder that even Delaware courts have their limits, and blue-penciling is entirely within the court's discretion and thus should be relied on with caution. Attempting to impose a nationwide noncompete when the employer is limited in its operation to one section of the United States, for example, puts the employer in somewhat of a hole off the bat.

Finally, employers seeking to enforce choice of law and forum selection clauses should avail themselves of their chosen jurisdiction *as soon as possible*, without first participating in litigation elsewhere. Any litigant in a noncompete case needs to convince the court that its immediate action is required, and, as the *FP UC Holdings* decision makes clear, courts are generally not willing to enforce these clauses as a matter of last resort – particularly when the party seeking enforcement already has lost on the merits in another jurisdiction.

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