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William W. Bowser, Editor; Scott A. Holt and Adria B. Martinelli, Associate Editor
Young, Conaway, Stargatt & Taylor

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EMPLOYEE RIGHTS

Restrictive covenants: to compete or to noncompete?

by Lauren E. Moak

A recent decision from the Delaware Court of Chancery has provided additional guidance on what types of noncompetition restrictions are acceptable in the employment context. Although the case applied Maryland law, the court provided useful insights on Delaware courts' willingness to reform overly broad noncompetition provisions. The court's guidance can help you decide on an appropriate noncompetition provision based on the specific facts of the employment relationship at issue.

Background

John Williams' former employer sued him when he violated the terms of a noncompetition provision that he agreed to at the beginning of his employment. Because Williams admitted that he had engaged in conduct that violated the terms of the noncompete, the only question before the court was whether the agreement was overly broad and therefore unenforceable.

Williams was hired by Delaware Elevator in 2004, after a 10-year career in the elevator production and repair business. The Maryland-based company hired Williams to open a branch office in Newark, Delaware. Because a significant portion of his work would involve sales and marketing based on personal relationships, the company required him to sign a noncompetition agreement.

Williams' noncompetition agreement consisted of two provisions, each of which restricted his conduct for three years after he left his employment with Delaware Elevator. First, he was prohibited from competing with the company within 100 miles of the Newark office. Second, he was prohibited from soliciting any customer who had been a current or prospective client of Delaware Elevator during the last six months of his employment.

Williams resigned from Delaware Elevator in 2010. Soon after, the company discovered that he was competing within 100 miles of the Newark office and using a customer list that he developed while he was employed there. When he refused to cease and desist, Delaware Elevator filed suit, seeking to enjoin, or bar, him from violating the agreement.

Come on — be reasonable!

Williams' noncompetition agreement indicated that it was governed by Maryland law; however, the analysis provided by the court of chancery is equally applicable under Delaware law. In analyzing the scope of the agreement, the court emphasized that reasonableness is the ruler against which noncompetes are measured. In assessing the reasonableness of a noncompetition agreement, a court will focus on two significant factors: geographical and temporal scope. The court indicated that the broader the geographical restriction, the more limited the temporal restriction must be in order to maintain reasonableness. And vice versa.

In Williams' case, not only was he prohibited from competing with Delaware Elevator for three years within 100 miles of his office, but he was also prohibited from doing business with any of its clients, no matter where he encountered them. The court declared those restrictions to be overly broad. When combined with the vast geographical scope of the restriction — 100 miles equates to a region of "31,000 square miles in the heart of the Northeast Corridor," according to the court — the three-year time restriction was found unreasonable as well.

In reaching its conclusion, the court focused on several factors, including the fact that Americans save very little money, making it difficult for a family to ride out a three-year loss of income. It also considered Williams' age, health problems, and long-standing ties in the area, all of which made it unrealistic for him to relocate so that he could continue working in his chosen profession.

Don't you blue-pencil me . . .

Under a doctrine known as the blue-pencil rule, a court may rewrite overly broad contract provisions, making them reasonable under the circumstances. In the face of the overly broad provisions of Williams' noncompetition agreement, Delaware Elevator asked the court to apply the blue-pencil rule and restrict him from competing in a more limited temporal and geographical scope, to be determined by the court.

Because Maryland law was at issue in this case, the court was required to apply the blue-pencil rule, restricting Williams from competing within 30 miles of the Newark office for two years. Before imposing this restriction, however, the court indicated that it had grave misgivings about the use of the blue-pencil rule for noncompetition agreements.

The court stated that reformation of overly broad contracts puts an employer in a no-lose situation. If the agreement will be enforced to some lesser extent even if it's overly broad, an employer has no incentive to draft a reasonable provision in the first place. The court also noted that for every employee who challenges the provision, others would choose not to, thereby harming consumers and interfering with labor and product markets. As a result, the court declared that under Delaware law, "when a restrictive covenant is unreasonable, the court should strike the provision in its entirety." *Delaware Elevator, Inc. v. John Williams.*

Bottom line

The court of chancery has provided a very strong indication that it will not reform overly broad restrictive covenants. Consequently, if you overreach, you will be left with no protection at all. That gives employers a strong incentive to draft reasonable provisions that take into consideration the employee's position in the company and his surrounding circumstances.