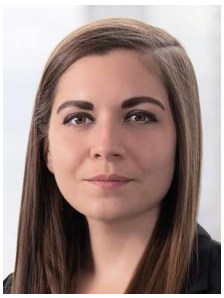
Buyer Beware Of Restrictive Covenants In Delaware

By **Justin Beyer and Bethany Beaver** (May 29, 2025)

Justin Beyer



Bethany Beaver

Delaware is viewed as being friendly to corporations. It is the state when it comes to forming new companies, and its reputation anecdotally extended to its courts.

But over the past several years, several decisions have raised questions as to that anecdotal reputation, and Delaware's courts are making clear that they will not just rubber-stamp what a business includes in its purchase documents. To that end, the Delaware Chancery Court has issued several recent opinions, including two this year, in which it rejected restricted covenants contained in agreements arising in the sale-of-business context.

This article examines these decisions and warns corporations to draft their restrictive covenants carefully under Delaware law, because they may just be unenforceable.

The broad-strokes takeaway from these decisions is that businesses need to craft narrowly tailored restrictions that have legitimate business interests. If you do not, your restriction may be unenforceable, and the Delaware courts are unlikely to blue pencil those restrictions.

Legitimate Business Interest

First, Delaware courts are closely examining whether the restriction in an agreement — whether it is an employment agreement or a buy-sell agreement — serves a legitimate business interest. If it does not, then the restrictive covenant will be deemed unenforceable. This includes in the buy-sell context where Delaware courts ask, as in the 2023 Chancery decision in Intertek Testing Inc. v. Eastman, if the restriction is "essential to the protection of the buyer's legitimate interests in the acquired company."[1]

In one such case, Kodiak Building Partners, the Chancery Court held in 2022 that the restrictive covenants protecting all the plaintiff's business lines were unenforceable because they were broader than the plaintiff's legitimate business interest in the purchased assets.[2]

The plaintiff was in the business of acquiring wholly owned subsidiaries around the country operating four business lines: (1) lumber and building materials, (2) gypsum, (3) construction supplies and (4) kitchen interiors.

The court found the nonsolicitation and noncompete provisions were not protecting a legitimate business interest when the goodwill it sought to protect included not only the acquired company the defendant had worked for but also all of the plaintiff's goodwill and the goodwill of the members of the plaintiff's other acquired companies.

Geographic Restrictions

Second, Delaware courts are looking closely at the geographic restrictions contained in

agreements. If a business is restricting competition in areas in which it is not conducting business, the courts will not enforce the restriction. The same is true for customers: If customers or hypothetical customers are restricted in areas in which the employee — or the acquired business — did not do business, then the entire restriction is likely invalid.

In the March 2 decision in Weil Holdings II LLC v. Alexander, the Chancery Court held that a noncompete provision was unenforceable as overbroad where a doctor entered into one in connection with his investment in the limited liability corporation's employer.[3]

There, the noncompete prohibited a shareholder from competing with the company until two years after the shareholder divested his interests, but left divestment or repurchase solely within the plaintiff's discretion. This made the agreement temporally overbroad in the court's determination.

Additionally, the court also found that the geographic scope was overly broad where it included any area within 15 miles of the principal place of business of any affiliate of the company.

The court found that the duration and geographic scope were unreasonable where it included affiliates and therefore included states where the defendant never even serviced customers. The court found it even more concerning that the geographical scope was drafted to allow it to expand as the plaintiff's company acquired additional affiliates.

In the Feb. 28 decision in Cleveland Integrity Services v. Byers, the Court of Chancery held that the noncompetition provision against a former founder and employee of the plaintiff — an oil and gas pipeline inspection company — was unenforceable as overbroad.[4]

The court found the noncompete was overbroad geographically because it included Canada and Mexico in addition to the U.S., but the plaintiff only serviced customers in U.S. The court found neither operations or assets in Mexico and Canada, nor plans to expand to these markets, justified the geographical overreach.

In Intertek Testing, the Chancery Court deemed a noncompete clause that applied to a former co-founder, major stockholder and CEO of one of the plaintiff's acquired companies unenforceable and unreasonable because the geographical region was overbroad.[5] The noncompete geographically restricted the defendant's employment anywhere in the world, but in the complaint the plaintiff did not allege it provided services globally — it alleged it served clients nationwide.[6]

Likewise, the Kodiak Building Partners court also found the scope of the noncompete and nonsolicitation provisions overbroad when the noncompete extended to the geographical regions around the plaintiff's other subsidiaries and the nonsolicitation included customers, clients and prospective customers of the plaintiff's other subsidiaries.

In the 2023 decision in Centurion Service Group LLC v. Wilensky, the Court of Chancery found a noncompete against a former vice president of marketing and operations — enforced after he left the plaintiff's employment and acquired another business that the plaintiff viewed as a direct competitor — was unreasonable.[7]

It banned the defendant, according to the decision, "for two years from competing nationwide and in any additional area in which the plaintiff conducts, solicits, or plans to conduct or solicit any actual activity or activity planned at any time during [the defendant's] seventeen year employment."

The court found this area contemplated in the noncompete "casts a limitless net over [the defendant] in both scope of geography and scope of conduct" because it prohibited the defendant from working in any geographic field where the plaintiff planned to enter.

Business-Friendly Provisions

Third, Delaware courts are going to closely examine aspects of the agreement that traditionally favor a business, such as choice-of-law provisions, forfeiture provisions or waiver of right to challenge provisions.

In a host of decisions, the Delaware Chancery Court rejected such provisions, which inured to the employee or acquired business's shareholder's benefit.

For example, in Kodiak Building Partners, the Delaware Chancery Court held that a restrictive covenant agreement's waiver to contest the reasonableness of the restrictive covenants did not preclude the court from reviewing them for reasonableness.[8]

Delaware courts are frequently reviewing the choice-of-law selection with scrutiny, even where it decides to apply Delaware law.[9]

The Chancery Court's 2023 analysis in Hightower Holding LLC v. Gibson merits further consideration.[10] There, the Court of Chancery denied a plaintiff's request for a preliminary injunction after determining the plaintiff would not succeed on its breach of noncompete covenants claims.

Despite the contract's choice-of-law provision electing Delaware law, the court applied Alabama law, which the court found expressly has a public policy against broad noncompete provisions concerning professionals.

The defendant, John Gibson, was a partner of a company that sold its majority interest to Hightower. As part of the sale, Gibson and the other partners signed a standard protective agreement and formed an LLC with Hightower under an LLC agreement. Both the standard protective agreement and LLC agreement contained restrictive covenants and Delaware choice-of-law provisions.

The Chancery Court, after stating it follows the general principle that "contractual choice of law will generally control," noted an exception:

> The law of the default state will apply if "enforcement of the covenant would conflict with a 'fundamental policy'" of the default state's law and the default state "has a materially greater interest in the issues — enforcement (or not) of the contract at hand — than Delaware."

After determining that Alabama was the "default state" because of the "heavy weight of Alabama's relationship to this matter," the court found that Alabama's codified public policy voiding restrictive covenants against a professional rendered the subject covenants void.

The court considered one exception, which applied when goodwill was sold with a business, but found that the exception did not apply to professionals.

Sophistication

Fourth, the sophistication of the parties matters, and the Chancery Court will not save a sophisticated party from its overreach.[11] One of the main areas in which we see this arising is the Chancery Court's willingness to exercise its equitable discretion to modify an overbroad agreement.

For example, in Intertek Testing, the court refused to blue pencil the provision to make it reasonable in breadth.[12] It reasoned it would be inequitable to save the plaintiff — "a sophisticated party" — from its overreach.[13]

Drafting Errors

Fifth, the court is not going to save a buyer from a clear drafting error in the buy-sell agreement.

In the 2023 Frontline Technologies Parent LLC v. Murphy decision, the Court of Chancery held that the defendant former employees did not breach the restrictive covenants contained in their equity agreements because, despite the plaintiff holding company's and former employer's arguments to the contrary, the plain language of the covenants only applied to the holding company, not the operating subsidiary, as the buyer plainly intended.[14]

There, the plaintiff holding company entered into equity agreements with two former employees intending to prevent the employees from working for a competitor of its operating subsidiary.

However, the court found the noncompete clause did not apply to the plaintiff holding company's subsidiary when the contract prohibited former employees from "directly or indirectly participating in any activity" that would "qualify as Competition in the Territory" and "Competition" was defined to only include the plaintiff holding company and not its subsidiary.

While the plaintiff attempted to save its restriction by arguing for equitable recission based on a mutual mistake, the court found that the mistake was the plaintiff's and that the court would not save the plaintiff from its poor drafting.[15]

Key Takeaways

As a result of these more recent decisions, we think the following practical tips should guide businesses that are evaluating a restrictive covenant in a buy-sell agreement.

Don't overreach.

Whether it is overreaching in geography by attempting to prohibit competition or solicitation in areas in which you do not do business or seeking to insert provisions asking the other party to waive certain rights, the Court of Chancery is looking at such agreements with skepticism.

Don't assume Delaware law will apply simply because you selected It.

Delaware courts are analyzing parties' choice-of-law provisions carefully. Even where the court ultimately applies Delaware law, these decisions show that many courts are applying a

choice-of-law analysis and deciding whether another state's law should apply over Delaware's.

Be careful when defining your business.

These cases show that Delaware courts will analyze covenants carefully. If the business or area in which a restriction is slated to apply covers business segments, affiliates or other portions of the buyer's business that are broader than the area of the seller's business, the Delaware courts are far less likely to enforce the restriction.

Don't rely on Delaware courts blue penciling a potentially overbroad agreement.

While Delaware has never shown a propensity to blue pencil overly broad agreements, these decisions show that Delaware courts are even less likely to exercise their judicial discretion in narrowing an otherwise overly broad restriction to make it enforceable.

Justin K. Beyer is a partner and Bethany Beaver is an associate at Saul Ewing LLP.

[1] Intertek Testing Servs. NA Inc. v. Eastman, 2023 WL 2544236, at *4 (Del. Ch. Mar. 16, 2023) (citation omitted).

[2] Kodiak Building Partners, 2022 WL 5240507 (Del. Ch. Oct. 6, 2022).

[3] Weil Holdings II, LLC v. Alexander, C.A. No. 2024-0388-BWD, 2025 WL 689191 (Del. Ch. Mar. 2, 2025).

[4] Cleveland Integrity Services v. Byers, 2025 WL 658369 (Del. Ch. Feb. 28, 2025).

[5] Intertek, 2023 WL 2544236.

[6] Id. at 4.

[7] Centurion Service Group LLC v. Wilensky, C.A. No. 2023-0422-MTZ, 2023 WL 5624156 (Del. Ch. Aug. 31, 2023).

[8] 2022 WL 5240507, at *1.

[9] See, e.g., Centurion Serv. Grp., 2023 WL 5624156, at **1-2 (court applying Delaware law, only after determining that no conflict existed between Delaware (chosen law) and Illinois (law that would apply but for choice-of-law provision)).

[10] Hightower Holding LLC v. Gibson, C.A. 2022-0086-LWW, 2023 WL 1856651 (Del. Ch. Feb. 9, 2023).

[11] But see Ainslie v. Cantor Fitzgerald L.P., 312 A.3d 674 (Del. 2024) (Delaware Supreme Court finding that forfeiture-for-competition provision in a partnership agreement was valid,

as it was negotiated by sophisticated parties, and the decision to permit a forfeiture of partnership payments where the former partner improperly competed was valid).

[12] 2023 WL 2544236 at *4.

[13] Id.; see also Centurion Serv. Grp., 2023 WL 5624156, at *5 (declining to blue pencil agreement); Weil Holdings II, 2025 WL 689191, at **6-7 (refusing to blue pencil) (relying on Sunder Energy LLC v. Jackson, 2024 WL 5052887, at *8 (Del. Dec. 10, 2024) ("Delaware courts have the discretionary power to blue pencil overbroad restrictive covenants to align a company's legitimate interests and an individual's right to be free from unreasonable restrictions on their livelihood.")); Cleveland Integrity Servs., 2025 WL 658369, at *12 (declining to exercise discretion to blue pencil non-compete provision).

[14] Frontline Techs Parent LLC v. Murphy, C.A. 2023-0546-LWW, 2023 WL 5424802 (Del. Ch. Aug. 23, 2023).

[15] Id. at *5.