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Delaware's "Freedom of Contract" Approach to Non-Compete Agreements – Even Between Sophisticated Parties in the Sale-of-Business Context – Has Its Limits

Non-compete agreements have recently gained a new round of attention with the Federal Trade Commission's (FTC) [proposed rule](#) that would effectively ban employers from imposing non-competes (albeit not in certain sale-of-business scenarios). While lawyers and businesses wait to see whether the FTC rule materializes, the nation's most prominent business court – the Delaware Court of Chancery – recently issued two decisions demonstrating limits to its contractarian approach to restrictive covenants. Interestingly, both cases arose in the sale-of-business context, in which the court has traditionally enforced relatively broad restrictive covenants negotiated by sophisticated parties. In [HighTower Holding, LLC v. Gibson](#) (Vice Chancellor Will, Feb. 9, 2023), the court refused to enforce the parties' Delaware governing-law provision and, instead, after performing a choice-of-law analysis, applied Alabama law to invalidate the non-compete. In [Intertek Testing Services NA, Inc. v. Eastman](#) (Vice Chancellor Will, Mar. 16, 2023), the court found a non-compete provision that prohibited the defendant from competing "anywhere in the world" to be unreasonably broad and, therefore, unenforceable.

Delaware governing law provision rejected

[HighTower Holding, LLC v. Gibson](#). HighTower, a Delaware limited liability company, purchased a majority interest in an Alabama-based wealth advisory firm owned by Gibson, a licensed financial advisor, and other individuals. As part of the sale, Gibson and his former partners signed a protective agreement and an LLC agreement, both of which contained non-compete and Delaware governing-law provisions. When Gibson formed a registered investment advisory firm in Alabama within the non-competition

period, HighTower sued in Delaware and sought a preliminary injunction to enforce the non-compete.

In denying the preliminary injunction, the court refused to apply the parties' Delaware governing-law provision upon concluding that Alabama had "the most significant relationship to the transaction and the parties" and that Alabama's "legislatively expressed public policy against broad non-compete provisions (particularly concerning professionals)" was more significant than and outweighed "Delaware's interest in freedom of contract" between sophisticated parties. Alabama law, the court found, generally voids restrictive covenants unless one of a few exceptions applies. One exception, related to the sale of the goodwill of a business, does not apply to professionals such as Gibson. Second, even if Gibson were not a professional, the court held that the non-compete provisions likely constituted unreasonable time and place restraints because they were for five years (as compared to the "one year or less" restraint that is presumed to be reasonable under Alabama law) and covered the entire United States and any other jurisdiction in which the plaintiff does business (as compared to the defendant's limited area of business in Alabama). Therefore, because it found that HighTower had not demonstrated a likelihood of success on the merits of its claims under Alabama law, the court denied the motion for a preliminary injunction.

"Anywhere in the world" is too broad

[Intertek Testing Services NA, Inc. v. Jeff Eastman](#). Intertek acquired Eastman's workforce training, compliance, and consulting enterprise. The stock purchase agreement contained a non-compete provision that prohibited Eastman from competing with Intertek's newly acquired business "anywhere in the world" for five years. Two years after the closing, Eastman created another company that provides educational, training, safety, and compliance services to the cannabis industry. Intertek sued, and Eastman moved to dismiss, arguing, among other things, that the non-compete provision was "facially unenforceable due to its unreasonable geographic scope." The court agreed.

The court began by acknowledging that, although the Court of Chancery has historically enforced relatively broad non-compete

provisions in the sale-of-business context, it does so only when the provisions are “reasonable in scope and duration, both geographically and temporally,” and “advance a legitimate economic interest of the party enforcing the covenant.” Noting that it had previously struck down a 100-mile geographic restriction as overbroad, the court likewise determined that the Intertek agreement’s geographic scope – “anywhere in the world” – was “much larger than that where the plaintiff’s economic interests lie.” Moreover, the court denied Intertek’s request to “blue pencil” (or revise) the agreement to make it more reasonable, indicating that revising a non-compete agreement to save a sophisticated party from its own overreach would be inequitable.

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Delaware continues to enjoy its reputation as one of the nation’s most business-friendly states, where equally sophisticated parties may rely on their bargained-for contractual arrangements. However, as restrictive covenants continue to be scrutinized by regulators, legislators, and courts alike, businesses should be careful not to overly rely on Delaware’s traditional contractarian principles to enforce unreasonably broad non-compete agreements or Delaware governing-law provisions where perhaps another state’s law properly should be applied.

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