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Delaware Court of Chancery Invalidates Noncompete in Incentive Equity Agreements Due to Overbreadth

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In *Payscale Inc. v. Norman*, the Delaware Court of Chancery struck down a noncompete contained in incentive equity agreements between Payscale and a former employee, finding the noncompete unreasonable in scope. This decision is notable because the court questioned the appropriateness of broad, nationwide noncompetes outside the business sale context, where an employee receives minimal consideration from her employer in exchange for agreeing to a noncompete.

Background

Payscale sued a former sales executive, Erin Norman, and her new employer, BetterComp, to enforce restrictive covenants in two incentive equity agreements. Under these agreements, Norman received profit interest units that were nontransferable and had no value at issuance, with cancellation provisions that would be triggered upon breach of the covenants. The noncompete prohibited Norman from engaging in competitive activities anywhere in the U.S. for 18 months post-employment, covering any business conducted or proposed to be conducted by Payscale's parent and its subsidiaries as of Norman's departure.

Analysis

Delaware courts will not mechanically enforce noncompetes, as they are restrictive of trade. Under Delaware law, a noncompete must (i) be reasonable in geographic scope and temporal duration, (ii) advance a legitimate economic purpose of the enforcing party, and (iii) survive a balance of the equities. As part of its analysis, the court distinguished between noncompetes in the business sale context, where a buyer has paid a substantial price in exchange for the right to be free of competition from the seller, and noncompetes in the employment context, where employees typically receive minimal consideration.

According to the court, the noncompete was unreasonable in duration and geographic scope. The court concluded that the minimal consideration exchanged did not justify an 18-month, nationwide ban on Norman's work for any company engaged in business that Payscale's parent and its subsidiaries were conducting (or planning to conduct) when Norman left Payscale.

The court also held that the noncompete was broader than necessary to protect Payscale's legitimate business interests. In particular, the court concluded that the noncompete, in combination with a nonsolicitation provision that was unlimited in geographic scope, would transform the noncompete into a worldwide ban on Norman's ability to work as a salesperson in Payscale's parent or subsidiaries' lines of business, even though Payscale

only serves customers in the U.S.

The court also held that the noncompete was impermissibly vague, as it applied broadly to Payscale's parent and subsidiaries, but failed to describe the lines of business in which these entities operate. The court similarly noted that the noncompete prohibited Norman from working in the same line of business as Payscale's parent — managing investments — even though Norman, a sales executive, had no specialized knowledge regarding this line of business. Although the incentive equity agreements contained two limitations on the scope of the noncompete, the court held that these carve-outs did little to restrict the noncompete's scope, and thus, the noncompete was still broader than necessary to protect Payscale's legitimate business interests. Consistent with other recent Delaware Court of Chancery decisions, the court declined to blue-pencil the noncompete.

Takeaways

This case demonstrates that employers should carefully limit the scope of noncompetition provisions contained in employee equity agreements or other similar contracts. In the employment context, the Delaware Court of Chancery is reluctant to enforce nationwide noncompetes, particularly where the consideration the employee receives is minimal, illusory, or subject to forfeiture upon breach. Employers should also be sure to specify the lines of business covered by the noncompete, ensure that other restrictive covenant provisions do not broaden the noncompete's scope, and tailor the noncompete to only cover lines of business of which the employee has specialized knowledge. In sum, this decision underscores the importance of careful drafting and structuring of restrictive covenants in employment and equity agreements, particularly outside the business sale context.

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