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Delaware Chancery Court Points Out "Poor Contract Drafting" in Recent Dismissal

Law and the Workplace on **August 29, 2023**

On August 23, 2023, the Delaware Court of Chancery decided *Frontline Technologies Parent LLC et al. v. Brian Murphy et al.*, a case which, in the Court's view, "presents a textbook example of why parties should ensure their contracts say what they mean and mean what they say." The lawsuit, filed by Frontline Technologies Group, LLC ("Frontline") and its parent company Frontline Technologies Parent, LLC ("Parent"), advanced breach of contract claims against two former employees of Frontline for allegedly violating the non-competition provision outlined in Incentive Equity Grant Agreements ("Equity Agreements") they signed with Parent. The Chancery Court dismissed the suit, finding that the plaintiffs failed to state viable breach of contract claims because the language of the non-compete provision in the Equity Agreements with Parent did not prevent the employees from working at Frontline's competitor.

Factual Background

Frontline is a Delaware limited liability corporation that provides administration software for schools. Defendants Annamary Holbrook and Brian Murphy were hired to supervisory positions at Frontline in December 2017. During their employment, Holbrook and Murphy entered into multiple Equity Agreements in consideration for equity units in Parent. Through these Equity Agreements, Murphy received units worth $1.24 million, while Holbrook received units worth $773,000. Both Holbrook and Murphy resigned in April 2023 and joined LINQ, Inc. ("LINQ"), a competing school administration software company, shortly thereafter.

On May 19, plaintiffs filed claims for breach of contract against the defendants for allegedly violating the restrictive covenants in the Equity Agreements. Plaintiffs also sought a temporary restraining order, which was denied, to enjoin the defendants from working at LINQ. On June 12, plaintiffs filed an amended complaint reasserting the breach of contract claims and adding claims seeking equitable recission of the Equity Agreements.

The Equity Agreements

The Equity Agreements contained a non-competition provision whereby Holbrook and Murphy agreed not to "directly or indirectly participate in any activity" that would "qualify as Competition in the Territory." The Agreements describe "Competition" as,

"…render[ing] services to or for… any business…that participates in or constitutes a business or business line that the Company is conducting or that the Company conducted during the one (1) year period immediately preceding the date that Employee is no longer employed by the Company or any Company Subsidiary or Affiliate."

"Company" is defined as "Parent," and Frontline was not a party to any of the Agreements.

Court's Ruling

The Delaware Court found that the plaintiffs failed to demonstrate that the defendants breached their obligation to the plaintiffs. The court notes that the non-compete provisions are "expressly tailored" to prohibit competition with Parent's "business or business line" – not Frontline's. In the court's view, if plaintiffs wanted the non-compete provisions to apply to Frontline's business or business line, they could have defined Competition to include "a business or business line that the Company [*or its Affiliates*] is conducting."

The court also notes that the defendants were employed by Frontline, not Parent and the Equity Agreements with Parent "make no mention of Frontline." The court found that the plaintiffs' complaint failed to describe Parent's business or allege that LINQ competes with Parent in any way, therefore the Equity Agreements do not prevent the defendants from working at LINQ.

Further, the court held that the remedy of equitable rescission was unavailable "given the absence of any alleged mutual mistake of fact." The court concluded that "rescission simply cannot save a party from its agreement to unambiguous contract provisions that later prove disadvantageous." For the foregoing reasons, the complaint was dismissed.

Takeaways

This case underscores the importance of precision in drafting restrictive covenants. Employers should review their non-competition agreements to ensure they cover all the entities for which they are intended. We will monitor the Delaware Chancery Court for potential appeals and report on any updates.

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