Don't Count on a "Blue Pencil" Provision to Save Your Noncompete Clause — The Colorado Court of Appeals' Holding in *23 LTD v. Herman*

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Introduction

The Colorado Court of Appeals recently held in *23 LTD v. Herman*, 18CA0950 (July 25, 2019)[1] that a district court is not required to apply a contractual "blue pencil"[2] clause directing the court to reform an overbroad noncompete provision in order to render it enforceable. Rather, the district court has the discretion to either apply the blue pencil provision or void the entire noncompete provision. This case note discusses this recent holding and its impact on the enforceability of noncompete clauses and related contract provisions. The upshot is that Colorado business lawyers must remain vigilant in drafting contracts because they cannot rely on trial courts to reform overreaching or poorly drafted provisions to render them enforceable.

Factual Background

The Agreement

Tracy Herman worked for 23 LTD d/b/a Bradsby Group ("Bradsby") as a legal recruiter from 2009 to 2014. Her employment agreement contained a noncompete provision that stated, in pertinent part:

> Upon termination of his/her employment with Bradsby, Account Executive . . . shall not . . . within the Restricted Area from a period of twelve (12) months from the date of termination of employment become an owner, partner, investor, or shareholder in any entity that competes with Bradsby without prior written consent of Bradsby . . . .

The agreement's nonsolicitation provision stated:

> Upon termination of his/her employment with Bradsby, Account Executive . . . shall not within the Restricted Area, for a period of twelve (12) months from the date of termination of employment, contact or solicit the business of any person, entity, applicant, client, employer or prospective employer who Bradsby has contacted or solicited during the twelve (12) months prior to the Account Executive's termination . . . .

And the severability clause said:

> "In the event that any portion of this Agreement shall be held unenforceable, it is agreed that the same shall not affect any other

[1] Neither party has filed a writ for certiorari as of August 21, 2019. The deadline to file for certiorari is September 5, 2019.

[2] The Herman court used the term "'blue pencil' to refer to any modification of a noncompete or nonsolicitation provision by a court." *Id*. at Fn. 2.

> portions of this Agreement, and the remaining covenants and restrictions or portions thereof shall remain in full force and effect; further, if the invalidity or unenforceability is due to the *unreasonableness of the time or geographical area* covered by a covenant and restriction, the covenants and restrictions shall nevertheless be effective for the period of time and for such area as may be determined to be reasonable by a court of competent jurisdiction." (Emphasis added.)

Lastly, the agreement contained a confidentiality provision barring Herman from disclosing Bradsby's confidential information or using it for her own benefit.

Post Termination Activities

After Bradsby terminated Herman's employment in 2014, she asked Bradsby to reduce the area in which she was barred from competing with her former employer from a thirty mile radius around its downtown Denver office to a twenty-eight mile radius because her home was located twenty-eight miles from Bradsby's office. Bradsby refused. Herman formed a new company, Touchstone Legal Resources, LLC and listed its address in organizational documents as a mailbox at a UPS store in Monument, Colorado.

It appears that Herman testified at trial that legal recruiting only accounted for about 10% of her new business, and that she did not perform recruiting work from her home office. *Id*. at ¶10. In any event, Herman reached out to an applicant she had worked with at Bradsby to ask if he knew of anyone in his network that might be interested in applying for an open position with the City of Ft. Collins. The applicant ended up accepting an unrelated position with a Denver firm even though he had initially declined an offer for the same position when Herman was with Bradsby and she was recruiting candidates on behalf of that law firm. The Denver firm ultimately hired the applicant and paid Herman $12,000.00 for her role in the hiring. After learning of these developments, Bradsby sued Herman for breach of the nonsolicitation and noncompete provisions, "arguing that enforcement of those provisions was necessary to protect its trade secrets." *Id*. at ¶13. It appears that Bradsby did not bring a separate claim alleging violation of the contractual confidentiality provision.

District Court Ruling

The Court of Appeals summarized the district court's initial summary judgment holding as follows:[3]

> "The district court granted Herman's motion for summary judgment, concluding that the nonsolicitation provision "effectively prevents [Herman] from competing at all for a one year period unless she effectively removes herself from the Denver metropolitan area" because it "prohibits [Herman] from contacting any person or entity

[3] The quoted language appears at paragraph 14 of the Colorado Court of Appeals holding in *Bradsby II*. The district court's initial grant of summary judgment was reversed by a different division of the Court of Appeals in *23 LTD v. Herman*, (Colo. App. No. 16CA1095, Aug. 3, 2017) (not published pursuant to C.A.R. 35(e)). That division of the Court of Appeals held that the nonsolicitation provision was "fatally overbroad" but directed the district court on remand to determine whether Bradsby held trade secrets and to revisit its decision not to blue pencil the nonsolicitation provision based on those findings.

> in any of the industries to which [Bradsby] provides recruiting services if that person or entity had contact with any Bradsby employee."

The district court further concluded, in ruling on summary judgment, that the nonsolicitation provision was so broad that it rendered the noncompete provision superfluous and concluded, as a result, that both provisions are "void and in violation of Colorado law." The trial court refused to 'blue pencil' the Agreement in order to bring it into compliance, "stating that the agreement's confidentiality provisions adequately protect Bradsby's trade secrets." *Id*. at ¶ 14. The Court of Appeals ultimately adopted this reasoning in its decision.

The Court of Appeals Decision

The case had a rather complex procedural history that is not directly relevant to this case note. Although some aspects of the Court of Appeals holding appear driven by the unique facts in *Herman*, the Court of Appeals set forth a number of holdings and observations that are more broadly relevant to Colorado business lawyers.

General Principles

The *Herman* Court began by discussing general principles, noting that noncompete provisions represent a restraint on trade and thus are unenforceable as against public policy unless they fall within certain exceptions to this general rule. *Id*. at ¶ 20. "A nonsolicitation agreement is a form of noncompete agreement." *Id*. The court then noted that one exception to the general rule of unenforceablity is for clauses protecting trade secrets. *Id*. at ¶ 21; C.R.S. § 8-2-113(2)(b).

Other exceptions under C.R.S. § 8-2-113(2) arise in the context of the sale of a business or for executive or management personnel and their professional staff. The *Herman* holding discussed in this case note only explicitly addresses the exception for protection of trade secrets. With that said, the holding that it is not an abuse of discretion for a district court to refuse to apply a blue pencil provision to reform an unenforceable noncompete provision would appear to apply with equal force to each of the exceptions set forth in C.R.S. § 8-2-113(2).

Quoting *National Graphics Co. v. Dilley*, 681 P.2d 546, 547 (Colo. App. 1984), the *Herman* court noted that "a trial court has the discretion to reform an unreasonable territorial restriction set forth in a covenant not to compete in order to make the scope of the geographic area reasonable" but also noted with approval the *Dilley* court's holding that it is not an abuse of this discretion to refuse to reform the offending noncompete clause and instead simply hold that it is void. *Herman* at ¶ 25.

The *Herman* court also seemed skeptical regarding whether the noncompete and nonsolicitation provisions were actually necessary to protect Bradsby's trade secrets, noting that "protection for trade secrets is self-effectuating under the Colorado Uniform Trade Secrets Act," C.R.S. § 7-74-103. *Herman* at ¶ 41, n.5. That provision grants trial courts the authority to enter temporary or final injunctions "to prevent actual or threatened misappropriation of a trade secret." C.R.S. § 7-74-103.

Although the *Herman* court did not cite or discuss these related provisions, it is worth noting that C.R.S. § 7-74-102 defines a "trade secret" as "the whole or any portion or phase of any scientific or technical information, design, process, procedure, formula, improvement,

confidential business or financial information, listing of names, addresses, or telephone numbers, or other information relating to any business or profession which is secret and of value." C.R.S. § 7-74-102 also requires the company to take reasonable steps to prevent unauthorized disclosure of the confidential information in order for a court to treat information as a protected trade secret. C.R.S. § 7-74-104 provides for a statutory damages award, and C.R.S. § 7-74-105 provides for an award of attorney fees against a party acting willfully or in bad faith in either misappropriating the trade secret or seeking court protection of alleged trade secrets.

The Blue Pencil

The Court summarized its task on the blue pencil issue:

> "… we do not need to broadly decide when and to what extent a Colorado trial court may blue pencil an overly broad noncompete or nonsolicitation provision. We address only the questions of (1) whether the agreement or the law of the case required the district court to blue pencil the nonsolicitation provision; and (2) assuming the court had no such obligation, whether the district court abused its discretion in declining to do so.

The Court "squarely reject[ed] the proposition that contracting parties, by inclusion of language in a contract, may compel a court to blue pencil an agreement that violates the public policy of this state." *Id.* at ¶ 31. The Court said the district court is not a party to the agreement, and the parties cannot require the court to act as their agent in amending the contract.[4] *Id.* at ¶ 33.[5]

The Court then observed that "even if private parties could enlist a court to correct their contracts, the contract in this case does not do so." The Court pointed to the severability clause quoted above and said "… any conceivable mandatory duty (which we reject) to blue pencil this contract is limited to correcting overbreadth in the agreement's geographic and temporal restrictions. Those restrictions are not at issue." *Id.* at ¶ 34.

The Court ruled that the district court did not abuse its discretion in refusing to reform the contract, and cited the district court's reasons for doing so: Colorado public policy against non-compete provisions, the over-breadth of the provisions, and the significant modification that would be needed to render it enforceable. *Id.* at ¶ 42.

Attorney Fees for Prevailing Party

Lastly, the *Herman* court quoted with approval at ¶ 56 *Dennis I. Spencer Contractor, Inc. v. City of Aurora*, 884 P.2d 327,327 (Colo. 1994), which held that "[W]here a claim exists for violation of a contractual obligation, the party in whose favor the decision or verdict on liability is rendered is the prevailing party for purposes of awarding attorney fees." This appears to be an admonition to the trial court to avoid engaging in an unnecessarily technical analysis in applying

[4] This raises an intriguing question – which was not at play in *Herman* – of whether the contracting parties could compel an arbitrator to apply a blue pencil clause.

[5] In an interesting footnote, the Court rejected Bradsby's request that the Court of Appeals itself blue pencil the agreement, saying that there is no authority for a Colorado appellate court to do so. *Id*. at Fn 4.

contractual fee-shifting language, as the Court of Appeals reversed the trial court's denial of Herman's request for fees and directed the trial court to award attorney fees to Herman as the prevailing party.

Tips for Contract Drafting

Blue pencil clauses have always involved a degree of uncertainty because the question of what type of temporal and geographic restrictions are reasonable in noncompete clauses is a highly fact-specific analysis. *Herman* heightens this uncertainty because if the trial court finds that the noncompete is unreasonable as written there is no guaranty that the court will reform the clause to apply a less restrictive and, therefore, reasonable scope to the noncompete obligation. This means that the drafting lawyer should speak with the business client regarding why the noncompete is necessary and tailor the provision to meet those specific needs instead of relying on a blue pencil clause to save aggressive boilerplate noncompete or nonsolicitation provisions.

If multiple grounds exist to enforce the noncompete under C.R.S. § 8-2-113(2) – *e.g.*, protection of trade secrets *and* sale of a business or employment of an executive – then it would seem wise to specifically call out each exception in the contract in order to articulate distinct bases for enforcement of the noncompete. It could potentially be beneficial to include more tailored language explaining why the noncompete is reasonable in terms of the individual employee's circumstances; but if circumstances change, such bespoke language could backfire. It could also conceivably lead to charges of discrimination if an employee alleged that they were subject to more restrictive noncompete language because they are a member of a protected class.

With regard to drafting confidentiality clauses, lawyers should consider how the clause will interact with the Colorado Uniform Trade Secrets Act, C.R.S. § 7-74-101 *et seq*., and why the clause is necessary in light of the default statutory language.

Lastly, it would be wise to include a clause explicitly stating that if a specific provision is struck as void, the remaining contract provisions will remain in full force and effect--if that is the desired outcome. The *Herman* holding deals with noncompete provisions specifically, but the holding that a trial court is not required to reform an offending contract provision to render it enforceable would appear to have wider application outside of the context of noncompete clauses.

Conclusion

The *Herman* decision is interesting but draws few bright lines defining when nonsolicitation and noncompete clauses will be enforceable. The upshot is that lawyers should not use boilerplate or hastily drafted contract language with the expectation that the trial court will reform unenforceable provisions to render them "reasonable" and enforceable. Colorado lawyers will have to be prepared to argue that specific provisions are reasonable in light of the contracting parties' relationship and the fundamental purpose of the agreement and should discuss these concerns with their clients during the drafting process.