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Recent District of Arizona Opinion Holds Two Non-Compete Agreements Are Unenforceable



A recent District of Arizona opinion—*Berkadia Real Est. Advisors LLC v. Wadlund*, 2024 WL 4125533—found two different non-compete agreements to be unenforceable: one that was ancillary to the sale of a business and one that was part of an independent contractor agreement.

Typically, Arizona courts look to the reasonableness of a non-compete provision in light of the totality of the circumstances to determine its validity.

The district court in *Berkadia* first considered a non-compete agreement that was ancillary to the sale of a business. This non-compete had exclusion periods of 18 and 24 months following the restricted party’s independent contractor agreement termination date and applied geographically to the entire United States or, in the alternative, to several Southwestern states, including Arizona. The business scope reached any activities that were competitive with the business or any of its subsidiaries on or before the closing date of the sale of the business.

In considering whether the restriction was reasonably limited in time and space so as not to be broader than needed to protect the buyer’s legitimate interest, the *Berkadia* court found that although protecting the “good will” interest related to the sale of a business is a legitimate purpose for a non-compete, the scope of activity, the geographic scope, and the duration of the non-compete agreement at issue were unreasonable based on the facts presented in the case. The restricted party had never worked anywhere except Tucson, Arizona, and the non-compete restrictions reached persons that the court found had no connections to the business itself. Additionally, the court found that tying the duration of the non-compete to the termination of the restricted party’s independent contractor agreement was unreasonable when the non-compete was ancillary to the sale of a business—in that case, the court explained, the date of the sale should determine the duration of the non-compete.

The court in *Berkadia* next considered whether a non-compete provision in an independent contractor agreement was enforceable. Strictly construing the non-compete against the company, the court found that the non-compete

was overbroad in that it applied to all past, present, or prospective projects, services, and clients, as well as to all material submitted at or to the company by any means relating to any transactions or matters related to the company. The court also found that the duration of the non-compete was unreasonable because it applied to the independent contractor “at all times in the future.”

Although the “blue pencil rule” allows courts to eliminate unreasonable contract provisions that are grammatically severable to make an otherwise reasonable agreement enforceable, the *Berkadia* court found that the blue pencil rule could not fix either non-compete at issue. To make the non-compete ancillary to the sale of the business reasonable the court would have been required to add additional terms, and the duration of the non-compete in the independent contractor agreement, which applied “at all times in the future,” could not be blue penciled into a reasonable duration.

Companies with questions about non-compete agreements in Arizona should consult experienced counsel for guidance.

Authors

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