SUMMARY
March 8, 2018

2018COA33

No. 17CA0099, *Crocker v. Greater Colorado* — Corporations — Mergers and Sales — Dissenters' Rights; Labor and Industry — Covenants Not to Compete — Liquidated Damages and Penalties

A division of the court of appeals considers whether the liquidated damages term of a noncompete provision in a shareholder-employment agreement is enforceable against a doctor who has exercised his right to dissent from a corporate merger pursuant to section 7-113-102, C.R.S. 2017. The majority agrees with the district court in concluding that the term is not enforceable against the doctor because (1) it is unreasonable to enforce the provision against a dissenting shareholder forced out of employment by the action of a merger and (2) the liquidated damages are not reasonably related to the injury actually suffered

as required by section 8-2-113(3), C.R.S. 2017. The special concurrence agrees only with the latter conclusion.

The division further rejects the doctor's contention that the district court erroneously excluded the price paid to non-dissenting shareholders from its judicial appraisal of his share's "fair value," as defined in section 7-113-101(4), C.R.S. 2017 and by the Colorado Supreme Court in *Pueblo Bancorporation v. Lindoe, Inc.*, 63 P.3d 353, 363 (Colo. 2003).

Accordingly, the division affirms the judgment of the district court.

COLORADO COURT OF APPEALS **2018COA33**

Court of Appeals No. 17CA0099
City and County of Denver District Court No. 14CV34512
Honorable Karen L. Brody, Judge

Michael A. Crocker, M.D.,

Plaintiff-Appellee and Cross-Appellant,

v.

Greater Colorado Anesthesia, P.C., n/k/a Greater Colorado Anesthesia, Inc.,

Defendant-Appellant and Cross-Appellee.

JUDGMENT AFFIRMED

Division IV
Opinion by JUDGE DAVIDSON*
Hawthorne, J., concurs
J. Jones, J., specially concurs

Announced March 8, 2018

Zonies Law LLC, Sean Connelly, Denver, Colorado, for Plaintiff-Appellee and Cross-Appellant

Holland & Knight LLP, Leah E. Capritta, Thomas D. Leland, Denver, Colorado, for Defendant-Appellant and Cross-Appellee

*Sitting by assignment of the Chief Justice under provisions of Colo. Const. art. VI, § 5(3), and § 24-51-1105, C.R.S. 2017.

¶ 1 Greater Colorado Anesthesia, P.C. (old GCA), now known as Greater Colorado Anesthesia, Inc. (new GCA), (collectively GCA) appeals the district court's judgment finding that the noncompetition provision of an employment agreement between GCA and Michael A. Crocker, M.D., an anesthesiologist, is unenforceable. Crocker, a former shareholder of old GCA, cross-appeals the court's valuation of his share of old GCA upon exercising his right of dissent against a merger-acquisition with U.S. Anesthesia Partners (USAP) to form new GCA. We affirm.

I. Background

¶ 2 Crocker was a shareholder in Metro Denver Anesthesia from 2001 until 2013, when that entity merged with another to form old GCA. In conjunction with that merger, Crocker purchased one share of old GCA stock for $100. In April 2013, he signed a shareholder employment agreement (the Agreement), which contained a provision for liquidated damages to be paid to old GCA in the event that the former employee violated the "Damages Upon Competition" section within the two years immediately following termination of the Agreement.

¶ 3 In late 2014, old GCA began entertaining a "merger" with USAP. USAP would buy out all existing GCA shares for a substantial lump sum of cash plus USAP common stock. To receive that payment, shareholders of old GCA would be required to execute various agreements, including a new employment agreement reflecting a 21.3% reduction in pay and a five-year employment commitment. To effectuate the merger, old GCA would form an interim company (GCA Merger Sub, Inc.), file amended and restated articles of incorporation, and convert the company into a C-corporation, new GCA.

¶ 4 Crocker opposed the action. He voted against it on January 27, 2015, and provided notice pursuant to section 7-113-202, C.R.S. 2017, that he would demand payment for his share of old GCA if the shareholders approved the merger, in exercise of his dissenter's rights.

¶ 5 Shareholders approved the merger on January 30, 2015. The merger took place eleven days later. Each shareholder who had voted for the merger and had executed the related agreements would receive (1) $626,000 in cash; (2) $224,000 in USAP common

stock, to fully vest in five years; and (3) a signing/retention bonus reflective of his or her prior income. Old GCA sent Crocker $100 for his share, an amount that he refused. He later demanded payment in the amount of $1,030,996.

¶ 6 Crocker communicated that he did not understand how the merger would affect his employment status and offered to work under a temporary placeholder contract, which GCA did not offer. He did not return to work for GCA; he took a temporary position in Grand Junction. In March 2015, he signed an employment agreement with Guardian Anesthesia Services and began providing anesthesia services at Parker Adventist Hospital, a hospital within the noncompete area of the Agreement.

¶ 7 As relevant to this appeal, the district court held a trial to address (1) new GCA's claim for damages resulting from Crocker's alleged breach of the noncompete terms of the Agreement; and (2) new GCA's request for a judicial appraisal of the fair value of Crocker's 1.1% share of old GCA, pursuant to section 7-113-301, C.R.S. 2017.

¶ 8 The court found, in an extraordinarily thorough order, that Crocker was no longer bound by the Agreement and that the covenant not to compete could not be enforced against him because (1) the Agreement was no longer valid — it was terminated and superseded by a new GCA agreement to which Crocker was not a party; (2) Crocker's exercise of dissenter's rights forced him to cease his employment with GCA, and he was not bound by the terms of a subsequent merger agreement; and (3) even if Crocker remained bound by the covenant not to compete, the liquidated damages to be assessed according to the terms of the Agreement were not reasonably related to the injury suffered by GCA, and the noncompete provision was therefore unenforceable under section 8-2-113(3), C.R.S. 2017.

¶ 9 The district court also found, after considering expert testimony from each side, that the fair value of Crocker's share of old GCA under section 7-113-101(4), C.R.S. 2017, was $56,044, plus interest.

¶ 10 GCA appeals, contending that the district court erred by finding the noncompetition provision of the Agreement

unenforceable. Crocker cross-appeals, contending that the court erred by excluding evidence of the price USAP paid for old GCA in valuing his share. We reject each contention.

II. Enforceability of the Noncompete Provision

¶ 11 GCA argues that the district court erred in finding the noncompete provision of the Agreement unenforceable, specifically because the court (1) found that the noncompete provision did not survive termination of the Agreement; (2) found that new GCA could not enforce the Agreement entered into by old GCA; (3) considered Crocker's exercise of dissenter's rights in the context of his employment agreement; and (4) failed to consider evidence of the parties' intent at the time of contracting when evaluating the reasonableness of the liquidated damages formula.

¶ 12 In order to affirm, we need only find the noncompete provision unenforceable on one basis. However, because we find a dearth of Colorado case law dealing with two specific aspects of enforceability of a noncompete provision in this context, we discuss both below. First, we agree with the district court that new GCA could not enforce a noncompete provision against a dissenting shareholder

forced out of employment by the action of a merger. And second, we agree with the district court that any damages awarded pursuant to a noncompete agreement and section 8-2-113(3) must be reasonably related to the injury actually suffered and not simply related to an injury prospectively estimated at the time of contract formation.

A. The Agreement

¶ 13 As relevant to our analysis of the noncompete provision, the Agreement between Crocker and old CGA contained the following terms:

- It recited that "the Employee is a physician . . . and is a Shareholder of the Corporation."
- An employee was to be paid "in accordance with the then–effective Shareholder Compensation plan."
- As a condition of employment, "Employee must agree to hold their share of the Corporation's stock in accordance with the Corporation's Stock Sale Agreement."
- The agreement could be terminated, among other reasons, (1) by replacement, "should the Corporation

> replace it with a revised employment agreement, with such a revised agreement being offered to all existing doctors who are employees of the Corporation who were eligible to execute this agreement"; or (2) "[u]pon the dissolution of the Corporation for any reason."

¶ 14 The noncompete provision itself is quite lengthy, so we do not recite it in its entirety here. It provides, in relevant part, that (1) the employee acknowledges that GCA invests substantial sums to develop professional relationships to benefit the employee; (2) the employee understands that GCA will suffer damages upon the termination of his employment if he engages in a competing practice "at any time during the two . . . year period immediately following termination of this agreement"; (3) if the employee competes with GCA by participating in the practice of anesthesia within fifteen miles of a hospital serviced by GCA (an area encompassing nearly all of the Denver metro area, extending as far north as Broomfield and farther south than Castle Rock), in the two years following termination of the agreement, he will be liable for liquidated damages in accordance with a formula provided; (4) the terms of the

noncompete provision, which the agreement says are reasonable, are to be construed independently from any other provision of the Agreement and the terms therein are also reasonable; (5) "[i]t is the express intent of the parties that this . . . section comply with and effectuate the purposes of Colo. Rev. Stat. § 8-2-113," and a court may change unreasonable terms to the extent necessary to make the provision enforceable; and (6) "[t]he Terms of this Damages Upon Competition Section shall survive termination of this agreement for a period of two . . . years or, if later, until all amounts due by the Employee to the Corporation have been paid in full."

B. Standard of Review

¶ 15 We review the enforceability of a noncompete provision as a mixed question of fact and law. To the extent that a legal determination turns on questions of fact, such as a finding of reasonableness, we accept the district court's findings unless they are clearly erroneous. *See Reed Mill & Lumber Co. v. Jensen*, 165 P.3d 733, 736 (Colo. App. 2006). But we review de novo the district court's application of the law. *Phoenix Capital, Inc. v. Dowell*, 176 P.3d 835, 841 (Colo. App. 2007).

¶ 16 C. Effect of Merger on Dissenting Shareholder-Employee

¶ 17 As a threshold matter, we agree with GCA that, generally, a noncompete provision will survive a merger and the right to enforce the provision will vest in the surviving entity. *See* § 7-90-204(1)(a), C.R.S. 2017 (When a merger is effective, "[a]ll of the rights, . . . of each of the merging entities . . . , and all obligations due to each of the merging entities . . . , vest as a matter of law in the surviving entity and are thereafter the rights, . . . and obligations due to, the surviving entity.").

¶ 18 But we do not agree that the district court erred by considering Crocker's exercise of his dissenter's rights when determining that Crocker was no longer bound by the Agreement upon the merger. GCA urges a pure contract law analysis, arguing that Crocker's statutory rights as a dissenter apply only to Crocker's shareholder rights and not to his rights as an employee.[1] But under the terms of his agreements with old GCA, Crocker's shareholder rights are wed to his rights as an employee. Indeed,

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[1] Pursuant to such an analysis, we would have to conclude that the noncompete provision would continue to be enforceable against Crocker for the duration of the two-year post-termination period.

the Agreement, which incorporates by reference the Corporate Stock Sale Agreement, does not permit Crocker to be an employee and not a shareholder. And the Corporate Stock Sale Agreement, which incorporates by reference the Agreement, does not permit Crocker to be a shareholder and not an employee.[2] Accordingly, when he exercised his dissenter's rights, Crocker was forced to cease his employment with GCA. Thus, we cannot construe the enforceability of the Agreement without consideration of Crocker's rights as a dissenter.

¶ 19 The right to dissent is codified in section 7-113-102, C.R.S. 2017, and provides, as relevant here, that "[a] shareholder . . . is entitled to dissent and obtain payment of the fair value of the shareholder's shares in the event of . . . [c]onsummation of a plan of merger to which the corporation is a party." The dissenters' rights statute "exists to protect minority shareholders from oppressive conduct by the majority." *Pueblo Bancorporation v. Lindoe, Inc.*, 63

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[2] The Corporate Stock Sale Agreement states that "ownership in the Corporation is also governed by . . . the Shareholder's Employee Agreement" and requires the sale of a shareholder's share "in the event that the Corporation's employment of Shareholder shall be terminated for any reason."

P.3d 353, 363 (Colo. 2003). And it serves to assure minority shareholders that they "will be properly compensated for the involuntary loss of their investment." *Id.* at 364.

¶ 20 In this case, by exercising his dissenter's rights, Crocker lost his interest in old GCA not only as a shareholder, but also as an employee. The parties do not cite any authority evaluating the enforceability of a noncompete provision under similar circumstances, and we have not found any, in this or any other jurisdiction. But generally, a covenant not to compete is enforceable only if it is reasonable, and "[t]o be reasonable, . . . it must not impose hardship on the promisor." *Reed Mill*, 165 P.3d at 736.

¶ 21 It was undisputed that an anesthesiologist must reside within thirty minutes of where he or she works. As a practical matter, because Crocker lives well within the region covered by the noncompete provision of the Agreement, enforcement of the noncompete provision would require Crocker either to move or to pay GCA damages to practice his profession. Enforcement would

therefore further penalize Crocker's exercise of his right to dissent, rather than protect him from the conduct of the majority.

¶ 22 Under these circumstances, we conclude that the noncompete provision of the Agreement is unreasonable and imposes a hardship on Crocker, and it is thus not enforceable against him as of the date the merger was finalized.

D. No Damages Reasonably Related to the Injury Suffered

¶ 23 Even if we were to conclude that Crocker's exercise of his dissenter's rights does not preclude new GCA from enforcing the terms of the noncompete provision against Crocker, we would conclude that new GCA is not entitled to any damages because it did not present evidence of any losses, and the amount calculated pursuant to the liquidated damages formula in the Agreement is not reasonably related to any injury it actually suffered due to Crocker's departure.

¶ 24 Here, the district court determined, with record support, that the amount of injury old GCA suffered because of Crocker's departure was zero. In particular, the court heard testimony from two board members of old GCA and found no evidence of

- any work diverted from new GCA by Crocker's employment at Parker Adventist Hospital;
- any lost revenue or profit caused by Crocker's leaving; or
- anything other than conjecture to support the administrative costs portion of the formula.

¶ 25 However, the liquidated damages formula in the Agreement stated that a former employee violating the noncompete provision must pay (1) the three-year annual average of the gross revenues produced by the doctor's practice; (2) minus the three-year annual average of the "direct cost of [old GCA] employing Employee," which included "direct compensation paid to Employee and expenses paid directly on behalf of Doctor by [old GCA]"; (3) multiplied by two, to reflect two years of competition; and (4) plus $30,000 to cover the estimated internal and external administrative costs to terminate and replace the competing doctor. Applying this formula, GCA claimed $207,755 in damages for the alleged violation of the noncompete provision.

¶ 26 GCA argues that, notwithstanding the district court's factual determination of no injury, it used the wrong timeframe to evaluate

the extent of old GCA's losses. That is, it should not have assessed the injury in hindsight, after Crocker's departure, but at the time of contract formation. In support, GCA relies on the standards used to assess the validity of contractual liquidated damages provisions *viewed at the time the contract was executed*: was the provision so disproportionate on its face as to constitute a penalty, and if not facially disproportionate, can the challenging party meet its burden to prove a penalty? *See Bd. of Cty. Comm'rs v. City & Cty. of Denver*, 40 P.3d 25, 29 (Colo. App. 2001).

¶ 27 GCA is incorrect. These standards are insufficient to properly measure the enforceability of a liquidated damages provision in a covenant not to compete among doctors.

¶ 28 Colorado public policy disfavors covenants not to compete. *Reed Mill*, 165 P.3d at 737. And in 1982, the General Assembly enacted section 8-2-113(3) to specifically address covenants not to compete that restrict the practice of medicine — such provisions are void, but the law allows provisions for payment of damages. Ch. 41, sec. 1, § 8-2-113, 1982 Colo. Sess. Laws 232. The statute provides as follows:

¶ 29 > Any covenant not to compete provision of an . . . agreement between physicians which restricts the right of a physician to practice medicine . . . , upon termination of such agreement, *shall be void*; except that all other provisions of such an agreement enforceable at law, including provisions which require the payment of damages *in an amount that is reasonably related to the injury suffered by reason of termination of the agreement*, shall be enforceable. Provisions which require the payment of damages upon termination of the agreement may include, but not be limited to, damages related to competition.

§ 8-2-113(3) (emphases added).

¶ 30 The statute directs that a damages term in a noncompete provision such as here is enforceable only if the amount (whether a fixed sum or calculated pursuant to a formula) is reasonably related to "the injury suffered," in the past tense. Under this plain language, the reasonableness of the relationship between the two amounts must be demonstrated, and it cannot be analyzed prospectively; by definition, it can only be determined upon termination of employment. *See People v. Joyce*, 68 P.3d 521, 523 (Colo. App. 2002) ("The goal in interpreting any statute is to determine and give effect to the intent of the General Assembly by looking first to the language of the statute itself."); *see also*

Wojtowicz v. Greeley Anesthesia Servs., P.C., 961 P.2d 520, 522 (Colo. App. 1997) (stating that damages awardable pursuant to section 8-2-113(3) may not be (1) "based on speculation or conjecture" or (2) "sustained by evidence which is speculative, remote, imaginary, or impossible of ascertainment").

¶ 31 Here, there is no reasonable relationship — none — between the actual injury suffered and the $207,755 calculated by GCA per its liquidated damages formula.

¶ 32 In sum, we conclude that (1) new GCA has demonstrated no actual damages and (2) the amount calculated under the liquidated damages formula is not reasonably related to any injury suffered by new GCA as a result of Crocker's departure and competition.

¶ 33 Hence, we agree with the district court's ruling that the noncompete provision of the Agreement is not enforceable against Crocker.

III. Fair Value of One Share of Old GCA

¶ 34 A determination of fair value is a factual one, and we will not disturb the valuation assigned by the district court unless it is clearly erroneous. *Pueblo Bancorporation v. Lindoe, Inc.*, 37 P.3d

492, 495 (Colo. App. 2001), *aff'd*, 63 P.3d 353 (Colo. 2003). Crocker argues that the court should have heavily relied on, as market value, the price USAP paid for old GCA to appraise the fair value of his share pursuant to the dissenters' rights statute. *See* § 7-113-301. We disagree.

¶ 35 The district court considered reports and testimony by valuation experts from each side. GCA's expert valued Crocker's 1.1% share of old GCA between $50,549 and $56,044, and Crocker's expert valued his share between $893,400 and $987,400. The court found the testimony and the model employed by GCA's expert to be more credible, and we defer to the court's finding. *See Lawry v. Palm*, 192 P.3d 550, 558 (Colo. App. 2008); *see also Pueblo Bancorporation*, 37 P.3d at 496.

¶ 36 The district court determined that the cause of the disparity between the two experts' valuations was that one expert valued old GCA using actual physician compensation prior to the merger, while the other valued old GCA applying (1) a physician income reduction even greater than that which would occur after the merger and (2) the price paid by USAP on the date of the merger.

¶ 37 The applicable "fair value" has been statutorily defined as "the value of the shares immediately before the effective date of the corporate action to which the dissenter objects, excluding any appreciation or depreciation in anticipation of the corporate action except to the extent that exclusion would be inequitable." § 7-113-101(4). Our supreme court has further clarified that fair value in this context "does not mean 'fair market value'"; it means a dissenting shareholder's "proportionate interest in the corporation valued as a going concern." *Pueblo Bancorporation*, 63 P.3d at 361, 369.

¶ 38 The record supports the district court's finding that the price paid for old GCA by USAP not only did not reflect its value as a going concern, but also was, in substantial proportion, to compensate non-dissenting shareholders for their 21.3% pay reduction and additional concessions. Thus, the court determined that the price paid by USAP did not reflect a "fair value" of the corporation, excluding any appreciation in anticipation of the merger. *See id.*; *see also* § 7-113-101(4).

¶ 39 We perceive no error. The court did not "refus[e] to consider" the deal price, as Crocker asserts. To the contrary, the court considered and rejected it, not because it "believed it was statutorily precluded," as Crocker alleges, but because it found the deal price to be an unreliable starting point from which to determine fair value. And because the USAP price reflected the value of new GCA, a corporation of at least ninety doctors willing to accept 21.3% less pay than the doctors at old GCA, we agree that it is not, standing alone, an appropriate measure of old GCA's value as a going concern.

¶ 40 We are not persuaded by Crocker's assertion that fair value should be assessed *on* the closing date of the transaction and necessarily based on the deal price. Colorado law clearly states that "fair value" is "the value . . . *before the effective date* of the corporate action." § 7-113-101(4) (emphasis added). Nor are we persuaded by Crocker's reliance on Delaware law, which does not statutorily specify when valuation is to take place. *See* Del. Code Ann. tit. 8, § 262(h) (West 2017) ("In determining such fair value, the Court shall take into account all relevant factors.").

¶ 41 We perceive no clear error in the district court's findings of fact and, reviewing de novo, we conclude that the court correctly applied the law when it excluded the price paid by USAP from its judicial appraisal.

IV. Conclusion

¶ 42 The judgment is affirmed.

JUDGE HAWTHORNE concurs.

JUDGE J. JONES specially concurs.

JUDGE J. JONES, specially concurring.

¶ 43 I concur in the majority's analysis of the enforceability of the non-compete provision only with respect to whether the damages sought by new GCA under the liquidated damages clause are "reasonably related to the injury suffered by reason of termination of the agreement." § 8-2-113(3), C.R.S. 2017; *see Wojtowicz v. Greeley Anesthesia Servs., P.C.*, 961 P.2d 520, 522-23 (Colo. App. 1997). I also concur in the majority's analysis of the district court's factual determination of the fair value of Dr. Crocker's share in old GCA.