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Delaware Chancery Court Invalidates Forfeiture-for-Competition Provision in Partnership Agreement

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On January 4, 2023, in *Ainslie, et al. v. Cantor Fitzgerald, L.P.,* the Delaware Court of Chancery invalidated the forfeiture-for-competition provision in the financial services company's limited partnership agreement, based on the court's determination that the agreement's non-competition provision was unenforceable. (CA. No. 9436-VCZ (Del. Ch. Jan. 4, 2023). As a result, the court determined that Cantor Fitzgerald Limited Partnership (the "Partnership") owed withheld funds to several former partners (the "Former Partners"), which the Partnership withheld because it determined that the Former Partners engaged in competitive activity (as defined by the partnership agreement (the "Agreement")).

The Partnership Agreement

Pursuant to the terms of the Agreement, each of the Former Partners had agreed to a one-year non-competition provision and a two-year non-solicitation provision. In addition, the Former Partners had agreed that upon withdrawing from the Partnership, they would be paid the balances in their capital accounts in four equal installments over four years. The Agreement contained a "forfeiture for competition" provision providing that a Former Partner would not be entitled to additional capital disbursements if the Former Partner engaged in competitive activity during the four-year payout period or if the Former Partner breached the Agreement.

Court's Ruling

The court held that non-compete and non-solicitation provisions, which had a worldwide geographic scope, were geographically overbroad and unenforceable. Additionally, the court found the definition of "Competitive Activity" overbroad due to its inclusion of "any Affiliated Entity," reasoning that "it is highly possible that a partner could unknowingly engage in a Competitive Activity." *Id.* at 48. Notably, the court declined to "blue pencil" the provisions to make them more reasonable.

The court then focused on the forfeiture-for-competition provision triggered by "Competitive Activity." The court considered whether it should evaluate the forfeiture-for-competition provision (which the court called a "Conditioned Payment Device") for reasonableness or apply contractual deference under the "employee choice" doctrine. The court determined that "forfeitures do not enjoy this Court's contractarian deference" and conducted a reasonableness analysis. *Id.* at 62.

Although the court applied a "lenient" reasonableness test, it nonetheless determined that the Conditioned Payment Device was unreasonable and invalid, given the broad definition of "Competitive Activity," the lack of an established legitimate business interest for the broad restrictions, and the four-year temporal scope, which extended beyond the temporal scope of the contractual non-competition and non-solicitation provisions. *Id.* at 66-67.

Notably, the court refused to apply the "blue pencil" doctrine to limit the scope of the forfeiture provisions. The court concluded that "conditions in the Conditioned Payment Device did not operate to preclude Cantor Fitzgerald's duty to make those payments," and that the Plaintiffs were entitled to recover the amounts owed.

Takeaways

This case follows on the heels of another notable Delaware Chancery Court decision by the same Vice Chancellor, *Kodiak Bldg. P'rs, LLC v. Adams* (Del. Ch. Oct. 6, 2022). The *Kodiak* court invalidated a non-compete provision in an agreement for the sale of a business, notwithstanding the more lenient standard typically applied in the sale of business context, on the grounds that it was overbroad. The court then declined to blue pencil the provision. We will monitor decisions from the Delaware Chancery Court to see if they follow suit.

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