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Delaware Supreme Court Validates Forfeiture-For-Competition Provision in Unanimous Reversal of Chancery Court

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In a win for businesses that rely on restrictive covenants to protect their assets and investments, on January 29, 2024, the Delaware Supreme Court unanimously reversed a Chancery Court decision that invalidated a "forfeiture-for-competition" provision in Cantor Fitzgerald's limited partnership agreement.

As we previously reported on this blog, last January the Chancery Court invalidated the forfeiture-for-competition provision in Cantor Fitzgerald's limited partnership agreement, reasoning that such provisions must be scrutinized under the same "reasonableness" standard applied to non-competition and liquidated damages provisions. The Chancery Court held that the contractual provision, which permitted Cantor Fitzgerald to withhold disbursements from the capital accounts of partners if they left and engaged in competitive activity within four years after their departure, was overbroad and unenforceable. As a result, the Chancery Court ordered Cantor Fitzgerald to pay back a total of $12.5 million in capital account balances and interest to six former partners.

Reversing the Chancery Court, in *Cantor Fitzgerald, L.P. v Ainslie, et al*, .the Supreme Court drew a "significant" distinction between standard non-competition provisions, which restrict someone's livelihood, versus forfeiture clauses that allow competition, but at the cost of a contingent benefit. The Court concluded that standard non-competition covenants warrant a "reasonableness" review due to public policy concerns, because "the former employee is effectively deprived of his livelihood." The Court explained that the public policy concerns present with non-compete agreements, however, are not present with forfeiture-for-competition provisions, because they "do not prohibit employees from competing and remaining in their chosen profession, and do not deprive the public of the employee's services."

The difference in public policy interests, the Supreme Court reasoned, warrant examination of standard non-competes and forfeiture-for-competition clauses under different analytical frameworks. Whereas the “reasonableness” review is applied to standard non-compete provisions, the Court opined that forfeiture-for-competition clauses should be examined under traditional principles of contract law.

The Court held that among sophisticated parties, courts should enforce forfeiture-for-competition provisions freely agreed to, absent unconscionability or bad faith. While the ruling explicitly applies only to partnership agreements, it is an important win for employers and other businesses that rely on forfeiture agreements to incentivize compliance with restrictive covenants.

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Related Professionals

- **Allan S. Bloom**
  Partner
- **Steven J. Pearlman**
  Partner
- **Jonathan R. Gartner**
  Associate