

February 2024

Follow @Paul\_Hastings



## *Delaware Supreme Court Rejects "Reasonableness" Test for Forfeiture-for- Competition Provisions*

By [Jennifer Baldocchi](#), [Kenneth Gage](#), [Marc Bernstein](#), [Allison Talker](#) & [Dan Richards](#)

Last week, the Delaware Supreme Court reversed a Chancery Court decision that [we wrote about](#) previously, which invalidated a forfeiture-for-competition provision as an unreasonable restraint of trade. The *Ainslie et al. v. Cantor Fitzgerald L.P.* decision emphasized that the courts of Delaware "hold freedom of contract in high—some might say, reverential—regard." The high court endorsed what has commonly been referred to as "the employee-choice doctrine," and held that forfeiture-for-competition provisions in a limited partnership agreement will not be scrutinized for reasonableness as restraints of trade and are enforceable absent "unconscionability, bad faith, or other extraordinary circumstances." This is a welcome development for partnerships and other employers who use similar forfeiture provisions.

### **The Background**

In the *Ainslie* case, the plaintiffs were six former limited partners of Cantor Fitzgerald. Pursuant to Cantor Fitzgerald's Limited Partnership Agreement, the limited partners were subject to a one-year non-competition provision and a two-year non-solicitation provision following their departures from the firm. They agreed to forfeit their capital disbursements and certain earned compensation if they breached the restrictive covenants. The partnership agreement also provided that whether a limited partner breached the restrictive covenants would be determined in good faith by the Partnership's Managing General Partner.

Cantor Fitzgerald's Managing General Partner determined that the six plaintiffs breached the restrictive covenants, and the firm deemed amounts ranging from under \$100,000 to over \$5 million to be forfeited. In response, the former partners sued seeking recovery of the forfeited payments and a declaration rendering the forfeiture-for-competition provision unenforceable.

### **The Chancery Court Rules that Forfeiture-for-Competition Provisions Must Be Reasonable**

The Chancery Court entered summary judgment in favor of the former limited partners. They argued successfully that forfeiture-for-competition provisions should be reviewed for reasonableness because they operate as restraints of trade, and that the restrictive covenants were unreasonable under Delaware law. The Chancery Court agreed, explaining that "forfeitures do not enjoy this Court's

contractarian deference.” The Chancery Court held that the provision’s four-year temporal scope and definition of “Competitive Activity” were overbroad.

### **The Delaware Supreme Court Reverses**

Sitting *en banc*, the Delaware Supreme Court reversed and remanded for further proceedings. The Court unanimously disagreed with the Chancery Court’s “conclusion that forfeiture-for-competition provisions like the one at issue here are restraints of trade subject to review for reasonableness.” Endorsing the employee-choice doctrine, the Court explained that forfeiture-for-competition provisions are enforceable “absent unconscionability, bad faith, or other extraordinary circumstances.” The Court reversed primarily for three reasons.

- First, the Court rejected the Chancery Court’s comparison to the scrutiny of liquidated damages provisions because “the provision at issue here is not a penalty enforced against an employee based on the breach of a restrictive covenant; it is a condition precedent that excuses Cantor Fitzgerald from its duty to pay if the plaintiffs fail to satisfy the condition to which they agreed to be bound in order to receive a deferred financial benefit.”
- Second, the Court rejected the Chancery Court’s comparison with traditional non-competes. Forfeiture-for-competition provisions, the Court explained, “are not enforceable through injunctive relief, do not prohibit employees from competing and remaining in their chosen profession, and do not deprive the public of the employee’s services . . . .”
- Third, the Court emphasized that Delaware’s fundamental public policy, expressed in statute and the common law, embraces the freedom to contract, particularly where those parties are sophisticated. To that point, the Court highlighted that the Delaware Revised Uniform Limited Partnership Act was expressly designed “to give maximum effect to the principle of freedom of contract and to the enforceability of partnership agreements.”

On remand, the Chancery Court will evaluate whether there are genuine issues of material fact as to Cantor’s Managing General Partner’s determination that the former partners breached the restrictive covenants.

### **Takeaways and Lingering Questions for Employers**

The Chancery Court’s decision last year suggested a shift in the law. The Supreme Court’s decision last week, however, reaffirms the enforceability of similar forfeiture-for-competition provisions under Delaware law.

Still, open questions remain. While this case involved a forfeiture-for-competition provision in a limited partnership agreement, the Court’s reasoning does not appear limited to such agreements and may extend to forfeiture provisions found in employment, equity, and other agreements governed by Delaware law. In its analysis, the Court cited favorably a number of U.S. district court decisions enforcing forfeiture-for-competition provisions against former employees, outside the limited partnership agreement context. It is worth noting, however, that the Court did not foreclose all public policy and equitable arguments for avoiding forfeiture; it is, the Court said, “conceivable that a public-policy interest or inequitable outcome could, under some circumstances, outweigh the interest in freedom of contract.” These unanswered questions are likely subjects of future litigation.

◇ ◇ ◇

*If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:*

**Los Angeles**

Jennifer Baldocchi  
1.213.683.6133

[jenniferbaldocchi@paulhastings.com](mailto:jenniferbaldocchi@paulhastings.com)

**New York**

Marc E. Bernstein  
1.212.318.6907

[marcbernstein@paulhastings.com](mailto:marcbernstein@paulhastings.com)

Dan Richards  
1.212.318.6739

[danrichards@paulhastings.com](mailto:danrichards@paulhastings.com)

Kenneth W. Gage  
1.212.318.6046

[kennethgage@paulhastings.com](mailto:kennethgage@paulhastings.com)

Allison Talker  
1.212.318.6941

[allisontalker@paulhastings.com](mailto:allisontalker@paulhastings.com)

---

**Paul Hastings LLP**

Stay Current is published solely for the interests of friends and clients of Paul Hastings LLP and should in no way be relied upon or construed as legal advice. The views expressed in this publication reflect those of the authors and not necessarily the views of Paul Hastings. For specific information on recent developments or particular factual situations, the opinion of legal counsel should be sought. These materials may be considered ATTORNEY ADVERTISING in some jurisdictions. Paul Hastings is a limited liability partnership. Copyright © 2024 Paul Hastings LLP.