

## Employment Law Update: Delaware Supreme Court Takes a Stand on Restrictive Covenants

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In *Cantor Fitzgerald, L.P. v. Ainslie*, C.A. No. 9436 (Del. Jan. 29, 2024), the Delaware Supreme Court signaled to its lower courts that many well-drafted restrictive covenants remain valid and enforceable. The *Cantor* Court unanimously reversed the Delaware Chancery Court's ruling, which had rejected as unenforceable a financial services company's limited partnership agreement clause under which a limited partner's equity is forfeited if the partner violates non-competition provisions. The decision is noteworthy because the Court of Chancery has increasingly demonstrated a willingness to strike down overly broad non-compete agreements, accompanied by a growing reluctance to revise (or "blue pencil") agreements by narrowing their terms.

The Court of Chancery held that the non-compete and non-solicitation provisions contained in the limited partnership agreement, which had a worldwide geographic scope, were geographically overbroad and unenforceable. Additionally, the Court of Chancery 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." 2023 WL 106924, at \*18. Notably, the court declined to "blue pencil" the provisions to make them more reasonable.

The Court of Chancery then focused on the forfeiture-for-competition provision triggered by "Competitive Activity." The Court of Chancery considered whether it should evaluate the forfeiture-for-competition provision (which it 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 \*24. 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 \*26.

The Supreme Court disagreed, highlighting the distinction between non-competition clauses for former employees and those for former partners. It ruled that partnership agreements could include consequences not typical in standard contracts, like penalties and forfeitures. While the Delaware Supreme Court's decision was specific to limited partnership agreements, employers should still take note. Put another way: while employment-based non-compete clauses are still subject to a reasonableness standard, the tides in Delaware may be shifting back towards the employer-friendly interpretation of restrictive covenants, at least for now (and until there is more clarity surrounding the FTC's final rule). Moreover, such provisions may not be enforceable in specific industries, such as law firm partnership agreements where ethics rules may be implicated due to a chilling effect on a client's right to select counsel.

Furthermore, following the *Cantor* ruling, the Delaware Supreme Court accepted an interlocutory appeal regarding a Chancery Court ruling in *Sunder Energy, LLC, v. Jackson*, C.A. No. 455, 2023 (Del. Jan. 25, 2024). This case concerns the denial of a

preliminary injunction to enforce a non-compete provision in a limited liability company agreement and a refusal to engage in blue-penciling. The Delaware Supreme Court's stance on the matter remains to be determined.

Given the current state of Delaware jurisprudence on restrictive covenants, employers must carefully consider any restraints on employee mobility. They should also give similar consideration to the choice of law and forum selection provisions contained in employment agreements.

Thank you for reading our legal update- please get in touch with us if you have any questions or require any assistance. Sarah Goodman can be reached at [sarah.goodman@offitkurman.com](mailto:sarah.goodman@offitkurman.com) or 267-338-1319, and Charles McCauley can be reached at [cmccauley@offitkurman.com](mailto:cmccauley@offitkurman.com) or 484-531-1712.