Cantor Fitzgerald, L.P. v. Ainslie :

Competing Comes At A Cost

On January 29, 2024, the Delaware Supreme Court decided *Cantor Fitzgerald, L.P. v. Ainslie*, a closely-watched case involving the enforceability of forfeiture-for-competition provisions in a Delaware limited partnership agreement. The Delaware high court reversed a decision by the Court of Chancery, which invalidated the provisions as unreasonable restraints on trade. The Supreme Court's decision establishes that, absent exceptional circumstances, Delaware courts will enforce forfeiture-for-competition provisions as written between sophisticated parties, without subjecting them to a reasonableness review. Several other states have reached the opposite conclusion, and *Cantor Fitzgerald* reinforces Delaware's reputation as a contractarian jurisdiction that will hold parties to their bargain, good or bad. The decision has significant implications—particularly so for private investment firms, which are commonly structured as Delaware partnerships like Cantor Fitzgerald.

I. Background

Cantor Fitzgerald, L.P. is a financial services company operating under a Limited Partnership Agreement ("LPA") governed by Delaware law. At issue was the LPA's forfeiture-for-competition provision, called the "Competitive Activity Condition," which conditions departing limited partners' entitlement to future profits distributions. Under the LPA, former partners trigger the Competitive Activity Condition by engaging in broadly-defined "Competitive Activity" in the four years following their resignation. Partners who engage in Competitive Activity lose their right to distributions from the time at which they engage in such Competitive Activity.

Six former Cantor Fitzgerald partners put the enforceability of these restrictions to the test. The partners withdrew from the LPA between September 2010 and November 2011, taking positions at other brokerages. Cantor Fitzgerald determined that the former partners were engaged in Competitive Activity in their new roles, and forfeited their future distributions, which ranged from approximately $100,000 to $5 million.

The former partners then sued Cantor Fitzgerald in the Delaware Court of Chancery, asserting breach of contract and declaratory judgment claims and arguing, among other things, that the LPA's forfeiture-for-competition provisions were unenforceable restraints on trade. In January 2023, the Court of Chancery agreed, granting the former partners summary judgment. The Court of Chancery relied on precedent involving restrictive employment covenants reasoning that, like non-compete provisions, forfeiture-for-competition provisions should be scrutinized for reasonableness. According to the Court of Chancery, Cantor Fitzgerald's Competitive Activity Condition failed the reasonableness test, and thus was unenforceable.

II. Delaware Supreme Court's Reasoning

The Delaware Supreme Court reversed, holding that the Competitive Activity Condition was enforceable, and remanded to the Court of Chancery to determine whether the former partners had in fact engaged in Competitive Activity. Whereas the Court of Chancery concluded that Delaware's "interest in protecting competition outweighs [its] interest in enforcing voluntarily entered contracts," the Delaware Supreme Court weighed the public policy considerations differently, believing that the departing partners

should be held to the contractual bargain that "redounded to the plaintiffs' benefit during their tenure as partners." Cantor Fitzgerald, L.P. v. Ainslie, No. 162, 2023, --- A.3d ---, 2024 WL 315193, at *1 (Del. 2024).

The starting point for the Court's reasoning was Delaware's contractarian tradition. As the Opinion began: "The courts of this State hold freedom of contract in high—some might say, reverential—regard." Id. Consistent with this, the Court identified strong public policy supporting the enforceability of forfeiture provisions. The Court cited the Delaware Revised Uniform Limited Partnership Act, which gives partners broad discretion with regard to the drafting of partnership agreements and counsels courts to provide guidance only where partnership agreements are unclear.

The Court acknowledged that this presumption in favor of freedom of contract is not absolute; it can be displaced where the contract offends public policy. In this respect, the Court considered the argument that forfeiture-for-competition provisions may discourage competition. However, the Court distinguished between deterrents to competition and outright bars, like a non-competition restrictive covenant. The LPA had such a non-compete provision, which entitled Cantor Fitzgerald to pursue damages and injunctive relief. But Cantor Fitzgerald did not pursue damages or injunctive relief based on the non-compete, and the Court noted that the separate Competitive Activity Condition, which was the basis for the forfeiture at issue, contained language that expressly did not forestall competition:

> Each partner acknowledges that this Article XI is intended solely to reflect the economic agreement between the Partners with respect to amounts payable upon a Partner's Bankruptcy or Termination. Nothing in this Article XI shall be considered or interpreted as restricting the ability of a former Partner in any way from engaging in any Competitive Activity, or in other employment of any nature whatsoever, subject in either case to the restrictions elsewhere in this Agreement (including without limitation in Sections 3.05 and 8.06).

Id. at *11.

Because the Competitive Activity Condition at worst deterred competitive activity rather than preventing it, the Condition did not offend Delaware's public policy. Unlike a non-compete, a forfeiture-for-competition provision is "not a penalty enforced against an employee," but rather a condition precedent that excuses the firm "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." Id. at *9. The Court said a non-compete "effectively deprive[s] [the former employee] of his livelihood"; a forfeiture for competition provision does not deprive the former employee of his right to work, and "do[es] not deprive the public of the employee's services." Id. at *13. Accordingly, the Court was guided by the employee-choice doctrine, which allows employees to choose between competitive employment and retaining benefits from prior employers, and concluded the Competitive Activity Condition was not an unenforceable restriction on trade and did not need to be subjected to review for reasonableness.

III. Limitations and Considerations

While *Cantor Fitzgerald* was an important victory for Delaware partnerships that use forfeiture-for-competition provisions to deter competitive activity by their former professionals, those firms should be careful not to overread the decision.

First, as the *Cantor Fitzgerald* Court made clear, Delaware is more contractarian than many other states, and its view of forfeiture-for-competition provisions is not universally shared. The Court cited decisions from other states, such as California, Florida, Illinois, and New Jersey, which, unlike Delaware, will deem certain forfeiture provisions as subject to a reasonableness requirement or wholesale unenforceable restraints on trade.

For example, the Court cited two California cases that rejected forfeiture-for-competition provisions because the state's Business and Professions Code prohibited penalizing former employees from working for a competitor. *Muggill v. Reuben H. Donnelley Corp.*, 62 Cal.2d 239, 242-43 (Cal. 1965); *Frame v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 20 Cal. App.3d 668, 672-73 (Cal. Ct. App. 1971). Similarly, it referenced a Florida decision holding that forfeiture-for-competition provisions must contain reasonable time and geographic limitations to be enforceable despite their anti-competitive nature. *Flammer v. Patton*, 245 So.2d 854, 859 (Fla. 1971). The Court also drew attention to other jurisdictions, such as New York, which may not employ a reasonableness requirement, but do condition their use of the employee-choice doctrine. *See Lucente v. Int'l Bus. Machs. Corp.*, 310 F.3d 243, 254-55 (2d Cir. 2002) (explaining that New York limits its application of the employee-choice doctrine to situations where the employee was not terminated without cause and the employer is willing to re-hire the departing employee).

The bottom line is that a partnership's state of incorporation affects whether a forfeiture-for-competition provision will be subject to a reasonableness requirement. These differences should be carefully considered by firms as they consider how to structure and where to form their partnerships. Current employers should be cognizant of their state's rules when seeking to enforce a forfeiture provision and, if in a state where it is necessary, be prepared to argue that the provision is reasonable.

Second, while Delaware partnerships can expect the plain terms of their forfeiture provisions to hold firm as between sophisticated parties, the Court's decision reaches only as far as forfeiture-for-competition provisions in partnership agreements. It does not extend, for example, to non-competes or to provisions outside of the partnership context. One of the key bases for the Court's decision was the policy distinctions between restrictive competition covenants and forfeiture-for-competition provisions. In doing so, the court implicitly rejected arguments by the former partners and Small Business Majority amicus that the covenant at issue was tantamount to a traditional non-compete provision. *See generally*, Brief for Small Business Majority as Amicus Curiae Supporting Plaintiffs-Appellees, *Cantor Fitzgerald, L.P. v. Ainslie*, --- A.3d ---, 2024 WL 315193 (Del. 2024) (No. 162, 2023). It is well-established that the former are subject to review for reasonableness in Delaware. *See, e.g.*, *FP UC Holdings, LLC v. Hamilton*, No. 2019-1029, 2020 WL 1492783, at *6 (Del. Ch. Mar. 27, 2020). That remains the case following *Cantor Fitzgerald*, and the Court considered it significant that Cantor Fitzgerald had not pursued an injunction that would have barred the departing partners from pursuing their new positions. The Court's reasoning suggests that Delaware courts may look less favorably upon a firm exercising its right under a forfeiture-for-competition provision if it is accompanied by claims for injunctive relief to enforce a non-compete provision.[1]

Third, the court's decision "hinge[d] on public policy grounds," repeatedly emphasizing policy's role in shaping the opinion. *Cantor Fitzgerald*, 2024 WL 315193, at *8. The Court thus left open the possibility for competing policy considerations to lead to different results. Specifically, the court cited "unconscionability, bad faith, or other extraordinary circumstances" as possible exceptions to *Cantor Fitzgerald*'s rule. *Id.* at *1. At oral argument, at least one justice was interested in whether a forfeiture-for-competition clause could ever be so punitive as to make it a *per se* restraint on trade. Oral Argument at 10:12, *Cantor Fitzgerald, L.P. v. Ainslie*, --- A.3d ---, 2024 WL 315193 (Del. 2024) (No. 162, 2023), https://vimeo.com/880208004. It thus remains an open question whether a substantially more restrictive forfeiture-for-competition provision may blur the court's distinction between forfeiture provisions and outright non-compete provisions.

Fourth, both Cantor Fitzgerald and the Court emphasized the sophistication of the parties involved in this action. Cantor Fitzgerald relied heavily on this fact in its briefing and oral argument, distinguishing its highly-compensated limited partners from the situation of a departing employee who earned $55,000 annually.

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[1] Cantor Fitzgerald did sue two of the former partners, Brad Ainslie and Jason Boyer, in Hong Kong based on a separate agreement they entered into with Cantor Fitzgerald Hong Kong Capital Markets Limited. There, Cantor Fitzgerald sought to enforce an injunction and repayment of certain loans. The Hong Kong court rejected Cantor Fitzgerald's request for an injunction.

Opening Brief of Defendant-Appellant at 29-30, *Cantor Fitzgerald, L.P. v. Ainslie*, No. 162 (Del. June 27, 2023). Likewise, the Court reiterated that all six plaintiffs were equity-holding partners, describing their senior positions at Cantor Fitzgerald's affiliate: one former partner was the Chief Operating Officer; another was head of Asian equities; and a third was an executive managing director. *Cantor Fitzgerald*, 2024 WL 315193, at *4. The emphasis placed on the parties' sophistication leaves open the possibility for a different result if a future case involves less-senior employees.

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If you have any questions about the issues addressed in this memorandum, or if you would like a copy of any of the materials mentioned in it, please do not hesitate to reach out to:

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