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Noncompete Ban's Broad Sweep May Give Leeway for Conditional Pay

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The Federal Trade Commission is expected to vote on its sweeping proposal to ban noncompete agreements in April. Employers should note that labels for clauses won't be dispositive: The FTC's ban would forbid any restrictions that have the effect of prohibiting a worker from seeking or accepting competitive employment.

But what about agreements that don't seek to impose affirmative restraints on competition but seek only to deter competition through economic consequences?

The FTC's proposal suggests this is a distinction without a difference—under the FTC's rule, liquidated damages clauses and training repayment agreements triggered by post-employment competition may also be banned.

Still, the FTC's proposal doesn't mention forfeiture-for-competition provisions as an example that could be subject to the ban. These clauses don't expressly forbid competitive employment but seek to deter competition by conditioning the payment of benefits—such as deferred compensation—on an employee's compliance with restrictive covenants.

A majority of US jurisdictions treat such clauses leniently and don't subject them to the reasonableness review that's typically applied to noncompetes. The theory is that the employee isn't banned from pursuing a livelihood. Rather, they're afforded a choice between honoring the noncompete and preserving the benefits or competing and forfeiting the benefits.

Will forfeiture clauses continue to enjoy such lenient treatment under the FTC's final rule? A unanimous decision in January from the Delaware Supreme Court—*Cantor Fitzgerald L.P. v. Ainslie*—helps make the case they will.

There, Delaware's highest court reversed a Delaware Chancery Court decision declining to enforce a forfeiture-for-competition provision in a limited partnership agreement. The lower court had likened the clause to a disfavored liquidated damages provision that restrains trade. The Chancery Court thereafter reviewed the forfeiture-for-competition clause under a reasonableness standard akin to that applied to traditional noncompete clauses.

The Delaware Supreme Court disagreed. It held that there is a "significant" difference between noncompetes, which restrict an employee's right to earn a livelihood, and a forfeiture-for-competition clause that permits competition at the expense of a contingent benefit. While a noncompete serves as an outright bar to competition, a forfeiture-for-competition clause serves only as a deterrent.

Similar reasoning also caused the court to reject the analogy to a liquidated damages clause, which is a remedy. A forfeiture-for-competition clause, on the other hand, is merely a "condition precedent" to the employer's duty to pay the conditioned amounts—it doesn't deprive the former employee of a right to work. The Delaware Supreme Court thus held that forfeiture-for-competition clauses should be reviewed under traditional contract law principles, not under a reasonableness standard.

The Delaware high court's *Ainslie* decision affirms the vitality of the "employee choice" doctrine and is a win for employers in an era when many jurisdictions are curtailing, if not outright banning, noncompete clauses.

Given that such forfeiture clauses are often found in compensation packages for sophisticated parties at the upper end of the wage scale, they may continue to enjoy more lenient treatment, even after the FTC's final rule is issued.

Notably, the forfeiture clause in *Ainslie* contained express language that it wasn't intended to restrict "the ability of a former Partner in any way from engaging in any Competitive Activity, or in other employment of any nature whatsoever"—employers should consider including similar language in their forfeiture provisions.

It should be noted that the *Ainslie* decision was rendered explicitly in the context of a forfeiture provision in an agreement governed by the Delaware Revised Uniform Limited Partnership Act, which gives "maximum effect to the principle of freedom of contract and to the enforceability of partnership agreements."

The Third Circuit, however, invoked *Ainslie* to enforce a stock clawback provision in *W.R. Berkley Corp. v. Dunai* in February, supporting *Ainslie*'s application outside the partnership agreement context.

However, many jurisdictions—including California, Florida, Illinois, and New Jersey—continue to subject forfeiture provisions to reasonableness review under certain circumstances. As forfeiture clauses may survive an FTC ban, employers should consider using them instead of or alongside traditional noncompetes.

The case is Cantor Fitzgerald L.P. v. Ainslie, Del., 162 2023, decided 1/29/24.

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