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What Del. Supreme Court LKQ Decision Means For M&A Deals

By **Andrew Noreuil, Brian Massengill and Andrew Stanger** (April 25, 2025, 9:28 AM EDT)

In a notable holding, the Dec. 18 decision in LKQ Corp. v. Rutledge,[1] the Delaware Supreme Court confirmed that forfeiture-for-competition provisions generally are not subject to reasonableness review, greatly enhancing the likelihood of their enforceability.


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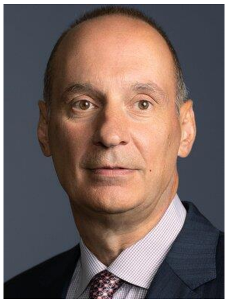
The holding represents an important affirmation of the extended reach of the court's earlier precedent and will likely make forfeiture-for-competition provisions a more common feature in merger and acquisition transactions.

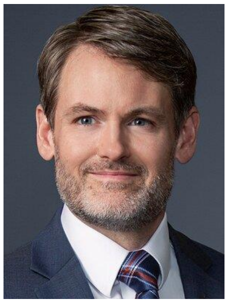
This article discusses the distinctions between noncompete covenants and forfeiture-for-competition provisions and suggests practical considerations for using the latter in M&A deals.


Brian Massengill

Noncompete Covenants vs. Forfeiture-for-Competition Provisions

Noncompete covenants are a common feature in M&A agreements. They help protect the value of the buyer's investment in the acquired company by requiring the selling parties to refrain from competing with the acquired company.

Typically, the buyer enforces such obligations through specific performance and monetary damages.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Under Delaware law, noncompete and other restrictive covenants must be reasonable. Applying reasonableness scrutiny, a noncompete covenant is valid if its restrictions (1) are reasonable in terms of their geographic scope and temporal duration, (2) advance the legitimate economic interests of the enforcing party in protecting the acquired business, and (3) survive a balancing of the equities.

When reviewing noncompete covenants as part of an M&A agreement, as opposed to an employment agreement, Delaware courts apply a less-searching reasonableness review.[2]

Nonetheless, several recent Delaware opinions have invalidated noncompete covenants as unreasonable, particularly when they impose restrictions on individuals.

Often, noncompete covenants are invalid because the restrictions last too long, their geographic scope is too wide — for example, worldwide or U.S.-wide restrictions have been found to be unreasonable — or the restrictions protect segments of the buyer's business beyond the acquired business.

In January 2024, the Delaware Supreme Court reviewed a specific form of noncompete restriction, often referred to as a forfeiture-for-competition, or FFC, provision. The case, Cantor Fitzgerald v. Ainslie,[3] involved a limited partnership agreement, under which any partner withdrawing from the partnership would receive certain payments in installments for a period of four years.

However, if a former partner competed with the partnership during that time, any unpaid amounts would be forfeited. The court held that the FFC provision was valid and not subject to reasonableness scrutiny for a number of reasons:

- An FFC provision is neither a liquidated damages provision nor a restraint on trade subject to reasonableness review, and unlike noncompete covenants, FFC provisions are a condition precedent to a deferred benefit that do not restrict competition or a person's ability to work, and do not support injunctive relief.

- Under the employee choice doctrine, courts do not review FFC provisions for reasonableness so long as the employee voluntarily terminates her employment.

- The policy of the Delaware Revised Uniform Limited Partnership Act is to give maximum effect to the principle of freedom of contract.

LKQ v. Rutledge

Cantor Fitzgerald left unclear whether FFC provisions outside of the limited partnership context would be subject to reasonableness review. The court has answered this question in its December 2024 LKQ opinion, holding that Cantor Fitzgerald's reasoning is not restricted to the limited partnership context.

In LKQ, an employer granted restricted stock units, or RSUs, to a plant manager of one of its facilities. The RSUs were subject to agreements under which the manager agreed not to compete with the company for a period of nine months after departure.

If he competed during that period, he would forfeit his RSUs, the shares of common stock underlying the RSUs, and any proceeds from the prior sale of such shares. Unlike the Cantor Fitzgerald FFC provision, the agreement included a clawback obligation, requiring the manager to promptly pay to the company any proceeds from the sale of shares of common stock underlying the RSUs.

The manager voluntarily resigned from the company and soon joined a competing business. The company sued the manager in the U.S. District Court for the Northern District of Illinois, which granted summary judgment in favor of the manager.

On appeal, the U.S. Court of Appeals Seventh Circuit submitted certified questions to the Delaware Supreme Court to resolve the issue of whether the Cantor Fitzgerald ruling applied outside of the limited partnership context, and if it were not to apply in all other circumstances, in what situations it would apply.

The Delaware Supreme Court responded by declaring that the reasoning of Cantor Fitzgerald applied broadly to FFC provisions, including clawbacks. As a result, absent extreme circumstances, FFC provisions are not subject to a review of reasonableness under Delaware law.

Key Takeaways

The Delaware Supreme Court's approval of FFC provisions is sweeping, noting that such provisions significantly reduce, if not eliminate, restraint of trade concerns, are supported by Delaware's fundamental policy of freedom of contract, and facilitate efforts by employers to offer additional benefits to employees.

Even though LKQ involved employee compensation outside the context of an M&A transaction, the court's expansive holding makes it clear that its principles apply to M&A transactions. Below are some considerations for parties that might contemplate whether and how to use FFC provisions in M&A transactions.

FFC provisions may be helpful in M&A transactions.

FFC provisions can be a viable means for buyers to obtain noncompete and similar benefits from sellers. For example, FFC provisions could be included in M&A agreements in the form of deferred consideration, holdbacks and escrow arrangements that are only paid if the sellers do not compete for a period of time after the closing. To obtain maximum protection, buyers could consider using an FFC provision together with a typical noncompete covenant.

Clawback features in FFC provisions are generally valid.

In LKQ, the court held that a term in an FFC provision that required the return of benefits already received did not render the FFC provision invalid. In the context of a sale of a business, this holding supports an FFC structure under which a seller must repay some or all of the proceeds from the sale of the business if the seller competes with the business post-closing.[4]

The court indicated there are limits to clawbacks in FFC provisions, noting that a clawback could be "so extreme in duration and financial hardship that it precludes employee choice by an unsophisticated party and should be reviewed for reasonableness."

Although the court focused on limits in the employment context, M&A parties should take from this that onerous clawbacks affecting sellers, especially sellers who are individuals that might be deemed unsophisticated, could be subject to reasonableness review.

FFC provisions offer more flexibility and certainty over noncompete covenants.

Noncompete covenants are subject to reasonableness scrutiny, which imposes significant limitations and renders their enforcement uncertain. Noncompete covenants must be reasonable in geographic scope and duration, and must advance the legitimate economic interests of the enforcing party.

Defining what is reasonable in various contexts is a fact-intensive exercise, and it may be difficult to anticipate how a particular court might rule. In addition, even though contracts might allow a court to revise, or blue pencil, defective noncompete covenants, Delaware courts have generally refused to do so. This means that if a noncompete, or even an element of the noncompete, is found to be overbroad, the entire provision is likely to be invalidated.

In contrast, as long as an FFC provision is structured as a voluntary condition precedent to the payment of deferred consideration or clawback of past consideration, as outlined in the Cantor Fitzgerald and LKQ rulings, it is not subject to the geographic or temporal limitations of reasonableness review.

For example, the FFC provision upheld in Cantor Fitzgerald had no geographic limitation and lasted four years, which would exceed typical Delaware reasonableness limits. In addition, FFC provisions are likely to be much easier and more cost-effective to enforce, given the broad endorsement by the Delaware Supreme Court and the reduced need to develop the type of fact-intensive record required to survive reasonableness review.

When considering whether to use FFC provisions, parties should be aware of potential limitations.

As a practical matter, FFC provisions, which are subject to limitations, are effective only for so long as the enforcing party can withhold payment of sufficient consideration — or threaten to force repayment of previous consideration — to incentivize compliance.

As a general matter, the deterrent effect of an FFC provision is limited to the extent of the amount subject to forfeiture. If the benefits to the seller of competing exceed the value of any consideration the seller would lose under the FFC provision, the seller might not have a disincentive to refrain from competing.

In addition, to support an effective FFC provision, the buyer may need to defer payment of a significant portion of the purchase price, otherwise the buyer would need to attempt to claw back previously paid amounts, which the seller might not be able to pay back.

A clawback provision can serve as a strong negative inducement to competing and can be an effective tool in enhancing the effect of an FFC provision when combined with a deferred consideration structure.

For example, instead of structuring a four-year FFC provision as annual installment payments to the seller, the provision could be structured to include a substantial payment at the end of the second year that would then be clawed back if the subject party competes any time before the end of the fourth year.

However, enforcing a clawback provision may be difficult, and as noted above, onerous clawbacks may still be subject to reasonableness review and risk being unenforceable.

A party enforcing an FFC provision has limited options.

Because an FFC provision is only a condition precedent to deferred compensation, if a party subject to the provision competes, the enforcing party's options are to (1) withhold the deferred compensation and (2) if the FFC provision includes a clawback, seek repayment of previously paid compensation.

The enforcing party is not entitled to seek specific performance or other injunctive relief to prevent competition as that would operate as a noncompete provision and be subject to review for reasonableness.

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[1] No. 110, 2024, ___ A.3d ___ (Del. Dec. 18, 2024, Seitz, C.J.).

[2] See, e.g., Kodiak Building Partners v. Adams, C.A. No. 2022-0311-MTZ at 9 (Del. Ch. 2022, Zurn, V.C).

[3] No. 162, 2023, 312 A.3d 674 (Del. 2024, Traynor, J.).

[4] In considering such clawback provisions in the context of an M&A transaction, thought should be given to the sellers' ability to repay such amount after the closing, particularly when the seller may be a financial sponsor that is likely to distribute sale proceeds shortly after closing.