

Articles + Publications | February 13, 2026

Delaware Supreme Court Reverses Chancery Court Opinion: Restrictive Covenants Not Rendered Unenforceable by Post-Formation Forfeiture of Consideration

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On February 3, 2026, the Delaware Supreme Court, sitting *en banc*, issued an order in *North American Fire Ultimate Holdings, LP v. Alan Doorly*, reversing the Court of Chancery's dismissal of claims to enforce restrictive covenants in an incentive unit grant agreement. As we previously reported, the Court of Chancery had held that the restrictive covenants were unenforceable because the incentive units — identified as the sole consideration for the covenants — had been forfeited upon the employee's for-cause termination. The Supreme Court disagreed, holding that consideration is measured at the time of contract formation and is not reevaluated at the time of enforcement.

Background

As discussed in our prior article, defendant Alan Doorly (Doorly) was a long-time employee of Cross Fire & Security, Inc., which was acquired by North American Fire. In connection with a post-acquisition restructuring, Doorly exchanged his common units for 300,000 Class B units of North American Fire subject to time and performance vesting requirements under an Incentive Unit Grant Agreement. The agreement contained restrictive covenants — including restrictions on the use of confidential information, nonsolicitation of employees and customers, and noncompetition — and identified the incentive units as "adequate and sufficient consideration" for those covenants. When Doorly subsequently was terminated for cause after forming a competing entity, both his vested and unvested units were automatically forfeited, per the terms of the agreement. North American Fire then sued to enforce the restrictive covenants.

The Court of Chancery dismissed the claims, finding that the forfeiture of the units eliminated the consideration supporting the restrictive covenants, rendering the covenants unenforceable.

The Supreme Court's Reversal

The Supreme Court reversed, applying the well-established principle that consideration is measured at the time the parties enter into a contract, and that a subsequent diminution — or even complete elimination — of the economic benefit conferred does not result in a failure of consideration. The court emphasized that neither party disputed that adequate consideration was exchanged at formation and that a valid contract existed at that point in time.

The court found the Court of Chancery's decision in *Newell Rubbermaid Inc. v. Storm* instructive. In *Newell*, the Court of Chancery rejected a former employee's argument that restricted stock unit (RSU) agreements lacked consideration because the RSUs were subject to vesting periods and automatic forfeiture upon termination. The *Newell* court held that, at the time of formation, the employee "was granted a benefit that held actual value," and although the value was "somewhat contingent," it was "not illusory."

Applying the same reasoning, the Supreme Court held that the incentive units granted to Doorly held actual value at the time of contracting, notwithstanding the contingencies built into the agreement. The court rejected Doorly's attempt to distinguish *Newell* on the basis that, unlike the RSU holder in *Newell* who had received dividend equivalents, Doorly's forfeiture left him with no consideration. The court found the receipt of dividend equivalents in *Newell* was independent of the lower court's holding and not material to the consideration analysis.

The Supreme Court also addressed the Court of Chancery's reliance on *NBTY, Inc. v. Vigliante*, a New York case in which restrictive covenants were found unenforceable when tied to unexercised and expired stock options. The court noted that *NBTY* was not clearly inconsistent with the principle that consideration is measured at formation, as the holdings in that case appeared to support the view that no benefit was received at the time of formation.

The Supreme Court remanded the case to the Court of Chancery for further proceedings.

Takeaways

The Supreme Court's decision is a significant win for employers — particularly sponsor-backed companies — who use equity incentive arrangements to support restrictive covenants. Key takeaways include:

- Consideration is measured at the time of formation, not enforcement. The decision reaffirms the fundamental contract law principle that adequacy of consideration is assessed when the parties enter into the agreement. A subsequent forfeiture or clawback of the equity does not retroactively eliminate consideration and render the covenants unenforceable.
- Contingent equity can serve as valid consideration. Incentive units, RSUs, and other equity awards subject to time or performance vesting — and even automatic forfeiture provisions — constitute valid consideration for restrictive covenants at the time of grant, so long as the equity holds actual value at formation.
- Forfeiture-for-cause provisions and restrictive covenants can coexist. The decision resolves a tension created by the Court of Chancery's ruling, which had effectively allowed an employee who breached restrictive covenants to benefit from that breach by arguing the resulting forfeiture eliminated the consideration for those same covenants.
- Drafting still matters. While the Supreme Court's ruling is favorable for employers, careful drafting remains critical. Companies should continue to ensure that equity incentive agreements clearly identify the consideration supporting restrictive covenants, that the covenants are reasonable in scope, duration, and geographic reach, and that the consideration supporting the covenants has actual value at the time of contract formation.

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