

Restrictive Covenants Unenforceable Where Consideration Forfeited

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In *North American Fire Ultimate Holdings, LP v. Alan Doorly*, the Delaware Court of Chancery held that the restrictive covenants included in an incentive unit grant agreement were unenforceable when the units received by the grantee, a now former employee, were forfeited.

Facts

Plaintiff North American Fire Ultimate Holdings, LP acquired Cross Fire & Security, Inc. (Cross Fire) to add to its portfolio of life services companies. Defendant Alan Doorly (Doorly) was a long-time employee of Cross Fire, who maintained his role post-acquisition. As part of a restructuring, the plaintiff's predecessor company entered into an incentive unit grant agreement with Doorly that contained time and performance vesting conditions, and included restrictive covenants related to the use of confidential information, solicitation of employees and customers, and competition. The agreement was governed by Delaware law and identified the issuance of the units as "adequate and sufficient consideration" for the restrictive covenants. The agreement further provided that if Doorly was terminated for cause or breached the restrictive covenants, his vested and unvested units would be "automatically forfeited." Relevant here, the agreement did not create a right of employment, nor were there any allegations that Doorly received a promotion, increased compensation, expanded responsibilities, or enhanced access to company information in exchange for signing the agreement.

Doorly eventually resigned from Cross Fire, but Cross Fire subsequently characterized the separation as "for-cause termination" because Doorly allegedly breached the restrictive covenants in the agreement by creating an entity that competed with Cross Fire customers and recruited a Cross Fire employee, resulting in the automatic forfeiture of the units. The plaintiff filed this action against Doorly seeking an injunction to enforce the restrictive covenants, damages for breach of contract, and a declaratory judgment. Doorly moved to dismiss and argued that the forfeiture of the units eliminated the consideration for the agreement, rendering the restrictive covenants unenforceable.

Holding and Takeaways

The court agreed with Doorly and dismissed the plaintiff's claims because the agreement explicitly provided that the units were the sole consideration for the restrictive covenants. Without the units, according to the court, there was no consideration to support the agreement, making the restrictive covenants unenforceable under basic contract law principles. In its analysis, the court emphasized the necessity of consideration for the enforceability of contracts, particularly when imposing new restrictive covenants on an existing employee. The decision is important

for employers, especially sponsor-backed companies, who intend to constrain employees with restrictive covenants, to ensure that any restrictive covenants are supported by valid consideration (e.g., promotion or bonus) to be enforceable.

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