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IN THE SUPREME COURT OF THE STATE OF DELAWARE

LKQ CORPORATION, Plaintiff/Counter-Defendant – Appellant, v. ROBERT RUTLEDGE, Defendant/Counter-Claimant – Appellee.	)	No. 110, 2024 Certification of Questions of Law from the United States Court of Appeals for the Seventh Circuit (No. 23-2330) There on appeal from the United States District Court for the Northern District of Illinois, Eastern Division (No. 1:21-cv-03022)

APPELLANT'S CORRECTED OPENING BRIEF

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NATURE OF PROCEEDINGS

This appeal arises from a contract dispute between Appellant LKQ Corporation ("LKQ") and its former key managerial employee, Robert Rutledge, with important implications for Delaware's adherence to the principle of freedom of contract. LKQ offers Restricted Stock Unit Agreements (RSU Agreements) to certain "Key Employees" through which they receive access to substantial restricted stock grants in exchange for a promise to return their value should they unfairly compete for a limited period of nine months after leaving Plaintiff LKQ's employ. Rutledge was not required as a condition of employment to enter into the RSU Agreements and was not prohibited from becoming employed with a competitor after leaving LKQ. Rather, he was simply required to return the stock grants (or their monetary equivalent) should he choose to compete—thus restoring the parties to the *status quo ante*. After Rutledge voluntarily resigned his employment with LKQ to obtain employment with a direct competitor, LKQ filed suit, alleging, *inter alia*, that Rutledge had breached the non-competition covenants in the RSU Agreements.

At summary judgment, the United States District Court for the Northern District of Illinois ("District Court") made a fundamental error by treating the RSU Agreements as traditional non-compete agreements subject to a reasonableness analysis. To the contrary, and pursuant to Delaware law, the District Court should

have evaluated Rutledge's RSU Agreements under the legal standards governing an ordinary contract, plain and simple.

LKQ appealed the District Court's summary judgment order to the Seventh Circuit Court of Appeals. Two weeks before oral argument was scheduled to take place, this Court reversed the Court of Chancery decision in *Ainsle* and held that the forfeiture-for-competition provisions at issue in a partnership agreement are not subject to review for reasonableness. *See Cantor Fitzgerald, L.P. v. Ainsle*, No. 162, 2023, 2024 WL 315193 (Del. Jan. 29, 2024). In so holding, the Court adopted the employee choice doctrine in analyzing the competitive activity restrictions present in the applicable partnership agreement. Under the employee choice doctrine, restrictive covenants that require an employee to forfeit an economic benefit without precluding competitive employment are not analyzed under the reasonableness analysis applied to restrictive covenants. Recognizing this distinction, the Seventh Circuit, in its opinion relating to the merits of LKQ's appeal, certified two legal questions to this Court relating to the scope of the Court's holding in *Ainsle.*

Throughout this litigation, Rutledge has attempted to have his cake and eat it, too—keeping hundreds of thousands of dollars (which he converted from LKQ restricted stock grants) while refusing to comply with his promise to LKQ not to compete for a limited, nine-month period. In accordance with Delaware law and this

Court's holding in *Ainsle*, LKQ should receive the benefit of its bargain by requiring Rutledge to return the proceeds from his sale of LKQ stock.

SUMMARY OF ARGUMENT

A. Certified Question No. 1: Whether *Cantor Fitzgerald* [*Ainsle*] precludes reviewing forfeiture-for-competition provisions for reasonableness in circumstances outside the limited partnership context? *See LKQ Corporation v. Rutledge*, 96 F.4th 977, 986-87 (7th Cir. Mar. 15, 2024) (certifying question for review).

The Court should not apply a reasonableness test to the analysis of the RSU Agreements or otherwise preclude the application of the employee choice doctrine to agreements outside the review of limited partnership agreements.

Freedom of contract is a fundamental public policy in the State of Delaware. This Court has made it quite clear that "[t]he courts of this State hold freedom of contract in high—some might say, reverential—regard." *Ainsle*, 2024 WL 315193, at *1. Delaware law strongly protects parties' contract rights and favors enforcing private parties' contracts as written. Only a strong showing that dishonoring a contract is required to vindicate a public policy interest even stronger than freedom of contract will induce Delaware courts to ignore unambiguous contractual undertakings.

Delaware law also seeks to promote reliable and efficient corporate laws in order to facilitate commerce. To that end, Delaware courts require stock grants to include conditions ensuring that the grants do not constitute waste or a gift of corporate assets. LKQ drafted the RSU Agreements in complete accordance with

fundamental Delaware public policy and is entitled to the benefit of the parties' bargain as written.

The Court's holding in *Ainsle* adopted the employee choice doctrine for the analysis of forfeiture-for-competition provisions under Delaware law. In reaching its holding, the Court relied on policy considerations that are not tethered to and apply outside the context of a partnership agreement. *First*, the Court recognized the distinction between traditional restrictive covenants and a provision that does not preclude competitive employment. Similarly, the RSU Agreements at issue in this litigation did not preclude Rutledge from obtaining employment. *Second*, the Court more generally relied upon the State of Delaware's fundamental public policy supporting freedom of contract. Weighing the competing interests in enforcing private agreements and concerns relating to restraint of trade, the Court found that a reasonableness analysis did not apply to the agreement at issue in that case. The same result should obtain here.

Unsurprisingly, other Delaware authorities support a more expansive application of the employee choice doctrine. In *Ainsle*, the Court cited with approval two decisions wherein courts enforced forfeiture-for-competition provisions in the context of a stock equity grant without subjecting the covenants to the traditional reasonableness analysis. Neither of these cases involved a partnership agreement. On the heels of the *Ainsle* decision, a recent Third Circuit Court of Appeals decision

held that there is no meaningful distinction between the analysis of a forfeiture-for-competition covenant in a stock equity agreement and a limited partnership agreement. *See W.R. Berkley Corp. v Dunai*, Nos. 22-2963 and 23-1079, 2024 WL 511040 (3d Cir. Feb. 9, 2024). There is also an abundance of additional authority wherein a court analyzed a forfeiture-for-competition agreement in the context of stock equity and other compensation agreements and did not apply a reasonableness test.

B. <u>Certified Question No. 2</u>: If *Cantor Fitzgerald* [*Ainsle*] does not apply in all other circumstances, what factors inform its application? For example, does it matter what type of agreement the forfeiture provision appears in, how sophisticated the parties are, whether the parties retained counsel to review the provision, whether the forfeiture involves a contingent payment or clawback, how far backward a clawback reaches, whether the employee quit or was involuntarily terminated, or whether the provision also entitled the company to injunctive relief? *See LKQ Corporation v. Rutledge*, 96 F.4th 977, 986-87 (7th Cir. Mar. 15, 2024) (certifying question for review).

This Court should also decline to adopt a multi-factor test to determine whether a forfeiture-for-competition agreement (such as the RSU Agreements at issue here) is enforceable. Examination of the various factors put forward by the Seventh Circuit Court of Appeals would be tantamount to subjecting a forfeiture

agreement such as the RSU Agreements at issue here to the kind of reasonableness test applied to traditional restrictive covenants. This would defeat the purpose of the bright-line distinction the Court drew in *Ainsle*.

The Court should decline to apply the Seventh Circuit Court of Appeals factors for multiple reasons. *First*, Delaware contract law already provides numerous defenses to the formation of a contract or enforcement of a contract. The Court should be circumspect about creating difficult to administer common law judicial tests that do not emanate from statutory mandates. *Second*, none of the courts applying Delaware law have set forth a gateway test to determine whether an ordinary contractual analysis should apply to a forfeiture-for-competition provision. *Third*, the administration of such a gateway test would be difficult, foster confusion as to the parties' rights, and contrary to the public policy considerations of stability and efficiency in Delaware law. This would increase judicial uncertainty and resulting litigation costs without promoting the wealth-creating effects of enforcing the parties' bargained agreements.

Finally, and to the extent this Court were to impose such a gateway test, the RSU Agreements do not constitute the type of inequitable agreement that would require anything other than a straightforward contractual analysis. To the contrary, Rutledge voluntarily entered into these agreements and received ample

consideration in support of the limited obligations not to engage in competitive employment for a period of nine months.

STATEMENT OF FACTS

A. PARTIES/EMPLOYMENT BACKGROUND

1. Appellant LKQ Corporation

LKQ is a company engaged in the auto salvage business. A120. As part of this business, LKQ is a national supplier of salvage and aftermarket automobile parts and products to mechanical shops, repair shops, and other customers. *Id.*; A003-004.

Much of LKQ's day-to-day operations are conducted out of its full-service, customer facilities located throughout the United States, such as the facility in Lake City, Florida that Rutledge headed for LKQ. At these facilities, LKQ employees engage in the full scope of the auto salvage and recycling business, including dismantling vehicles, the production of recycled parts, and the sales and distribution of such parts in the relevant market. A120; A153-159.

2. Rutledge's Employment As a Plant Manager with LKQ

a. Rutledge's Responsibilities as a Key Employee

Rutledge is a former senior management employee of LKQ. Before working for LKQ, Rutledge was employed as a Regional Director for Greenleaf Auto Recyclers ("Greenleaf"). A120; A143-144. Greenleaf was also an auto recycling company. *Id.* In this capacity, Rutledge was responsible for overseeing the individual plant managers for various facilities. *Id.*

In October 2009, LKQ acquired Greenleaf. A144. Shortly thereafter in 2009, Rutledge began his employment with LKQ in the position of Plant Manager for an LKQ facility located in Lake City, Florida (the "Lake City Facility"). A147-148.

As Plant Manager at the Lake City Facility, Rutledge was responsible for a large operation. In 2021-2022, the total employees at Lake City fluctuated between approximately 41 and 52 persons. A154. At the time of Rutledge's departure from LKQ, the Lake City Facility encompassed 60 acres. *Id.*

Rutledge had broad-based managerial responsibilities for the Lake City Facility. As Plant Manager, Rutledge supervised all the employees at the facility, including, but not limited to, yard pickers, dismantlers, sales employees, delivery drivers, quality control supervisors, a production manager, and an operations manager. A120-121; A115; A151-153; A155-162. Rutledge was also responsible for managing the various departments at the Lake City Facility, including production, sales, distribution, administration, safety, and finance. *Id.*

Rutledge oversaw the full gamut of LKQ's operations in his market. *Id.* This included business development, sales, quality control, and the distribution of parts to customers. *Id.* Rutledge also helped manage all aspects of human resources at the Lake City Facility, including hiring, terminating, and assigning personnel to tasks as appropriate. *Id.* Additionally, Rutledge was responsible for developing relationships with, and providing services to, LKQ's customers. *Id.* In that regard,

Rutledge interacted directly with LKQ customers, and participated on sales visits to obtain new customers. *Id.*

Rutledge was also responsible for the financial performance of the Lake City Facility, including profit and loss responsibility. *Id.* Rutledge managed costs, the purchase and installation of plant assets, and the fleet of vehicles that were used by LKQ to deliver parts. *Id.* He established budget projections for his facility. *Id.* Indeed, his annual bonus was based, in part, on the profitability of LKQ's operations at the plant level. A150-151.

Rutledge also had access to LKQ's competitively sensitive financial and customer data. For example, Rutledge reviewed reports with daily sales and revenue information for the Lake City Facility. A121; A153; A164-166. Rutledge also had access to and reviewed reports containing LKQ's revenue, inventory, profitability and margins, and customer sales volume for the Lake City Facility. *Id.*

In addition, Rutledge accessed a wide array of valuable information relating to LKQ's customers, pricing, and customer relationships. In his Plant Manager role, Rutledge had access to customer contact information, customer pricing, and sales figures. *Id.*; A168.

b. Rutledge's Compensation and Stock Grants

As of the date of Rutledge's voluntary resignation from the Company, he was paid a salary of $109,000 a year. A149-150. His compensation also included

medical, dental, and short-term disability benefits, eligibility for annual bonuses, and 401(k) benefits. *Id.* Wholly apart from his employment compensation, as a Key Employee of the Company, Rutledge was also eligible for, and received, substantial equity in LKQ in the form of restricted stock grants, as detailed in Section A(3) immediately below.

3. LKQ Designates Rutledge As a Key Employee Eligible to Receive Substantial Grants of LKQ Restricted Stock.

To better align its interests with the interests of its senior managerial employees, LKQ enters into agreements with its key management employees under which they receive equity in the company in the form of LKQ restricted stock (referred to generally as the "RSU Program"). LKQ designates less than 2% of its aggregate workforce as "key employees" eligible to partake in the RSU Program. A483-484. In the operations group, the RSU Program is generally limited to key employees in such positions as General Manager, Plant Manager, District Manager, Regional Vice President, and positions above the Regional Vice President level. *Id.*

An employee's participation in the RSU Program is not mandatory and an employee may elect not to participate without any repercussions for their employment. A121; A251-252. Generally, under the terms of the RSU Program, key management employees enter into an agreement with LKQ for the vesting of shares of LKQ restricted stock during their employment. *See* Rutledge's 2013-2020 RSU Agreements at A376-423. Once the shares have vested, the employee is free

to dispose of his or her shares of LKQ stock on the open market. *Id.* In exchange for this financial benefit and equity stake in the Company, the RSU Agreements are not conditioned upon anything except abiding by the terms of the RSU Agreements. *See Id.*

Rutledge entered into RSU Agreements with LKQ in each of the years 2013-2020. *See Id.*; A075; A122-23; A252-253; A264-268. Rutledge testified that he received the agreements each year for electronic signature. A252-253. Rutledge knew that he would not receive LKQ restricted stock if he did not sign them, and further testified that no one from LKQ compelled him to sign them. *Id.* Each year, Rutledge would receive an allotment of shares of LKQ stock based on a vesting schedule, whereby 10% of the stocks vested every six months. A289-302.

Rutledge profited handsomely from this arrangement. Rutledge received a total of 11,414 shares of LKQ restricted stock with a market value of $317,507.[1] A126; A256-260; A289-302. Rutledge sold all of the vested restricted stock units that were granted to him. *Id.*

[1] LKQ notes that the parties dispute the dollar value of the proceeds Rutledge obtained from the sale of restricted LKQ stock stemming from the 2013-2020 RSU Agreements. For purposes of this appeal, LKQ refers here to the market value of the stock upon issuance.

4. Rutledge's Contractual Obligations to LKQ

Under the RSU Agreements he signed each year, Rutledge agreed, in pertinent part, to the following non-competition covenant:

> 16. Non-Competition and Confidentiality…
>
> (a)(i) the Key Person shall not directly or indirectly (1) be employed by, engage or have any interest in any business which is or becomes competitive with the Company or its subsidiaries or is or becomes otherwise prejudicial to or in conflict with the interests of the Company or its subsidiaries... provided, however, that this restriction shall not prevent the Key Person from acquiring and holding up to two percent of the outstanding shares of capital stock of any corporation which is or becomes competitive with the Company or is or becomes otherwise prejudicial to or in conflict with the interests of the Company if such shares are available to the general public on a national securities exchange or in the over-the-counter market…

See A125; A377-424, ¶¶ 16-17 (the 2013-2015 and 2016-2020 RSU Agreements contain substantially similar language relating to the non-competition restriction).

In the RSU Agreements, LKQ and Rutledge also agreed that, if the "Key Person" is not in compliance with the restrictive covenants set forth in the respective RSU Agreements for a period of only **nine months** following Rutledge's separation of employment, then Rutledge agreed to forfeit the proceeds from the restricted stock:

> …the RSUs, the shares of common stock of the Company underlying the RSUs, or any proceeds received by the Key Person upon the sale of shares of common stock of the

> Company underlying the RSUs shall be forfeited by the Key Person to the Company without any consideration therefore, if the Key Person is not in compliance, at any time during the period commencing on the date of this Agreement and ending nine months following the termination of the Key Person's affiliation with the Company and/or its subsidiaries…

See Id. (the 2013-2015 RSU Agreements and the 2016-2020 RSU Agreements contain substantially similar language).

Further, the parties agreed to the following provisions governing the forfeiture and/or repayment of the restricted stock units under the RSU Agreements as follows:

> The forfeiture shall be effective as of the date of the occurrence of any of the activities set forth in Section 16(a) above. If the Shares underlying the RSUs have been sold, the Key Person shall promptly pay to the Company the amount of the proceeds from such sale.

See Id., ¶¶ 17 (the 2013-2015 RSU Agreements and the 2016-2020 RSU Agreements contain substantially similar language).

Each of the RSU Agreements contains a Delaware choice of law provision and there has been no dispute that Delaware law applies to the RSU Agreements, as also determined and applied by the Seventh Circuit Court of Appeals. *See, e.g.*, A401.

5. Rutledge Voluntarily Resigns His Employment with LKQ to Work for LKQ's Direct Competitor.

In April of 2021, Rutledge voluntarily resigned his employment with LKQ to work for Fenix Parts. LKQ and Fenix Parts are direct competitors in the auto

recycling and salvage business. A140-142; A342-345; A468-470. Like LKQ, Fenix Parts is also a national recycler and reseller of recycled and salvaged automotive parts and products. *Id.* Both LKQ and Fenix Parts compete for the same customers through the sale of recycled automotive parts to body shops, automotive dealerships, mechanical shops, and retail customers. *Id.*

Fenix Parts also competes with LKQ in various states throughout the country. As of July 21, 2022, Fenix Parts' operations include customer service locations throughout the country, including in the States of Florida, Texas, North Carolina, New York, New Jersey, Pennsylvania, and Massachusetts. A127; A355-358. This includes customer service facilities in the State of Florida, where Rutledge was previously employed with LKQ. *Id.*

On March 23, 2021, Rutledge signed an offer letter from Fenix Parts for the position of Vice President of Capital Projects. A204-205; A263. The letter further stated that Rutledge would commence employment with Fenix Parts on April 19, 2021. *Id.* On March 25, 2021, and despite his ongoing employment with LKQ, Rutledge entered into a Confidentiality, Non-Disclosure, and Non-Solicitation Agreement with Fenix Parts. A195-196; A199-200.

Rutledge voluntarily resigned his employment with LKQ on March 23, 2021, effective April 14. A211-212; A214-216. Between March 23 and April 14, Rutledge did not inform LKQ that he had accepted employment with Fenix Parts.

Id. Rather, when asked by District Manager Robert Six about his post-LKQ plans, Rutledge lied and stated that he was going to take some time off and think about his life. A215-216.

LKQ soon learned of this lie when Rutledge commenced employment with Fenix Parts in April of 2021. That same month, LKQ was alerted to a Facebook post showing Rutledge's presence at a Fenix Parts facility in the State of Florida. A114. The exact title and nature of Rutledge's initial position with Fenix Parts has been the subject of shifting explanations from Rutledge and Fenix Parts. Rutledge testified that he initially held the position of VP of Capital Procurement and Projects. A128; A222-223. The signed offer letter from Fenix Parts states that Rutledge would hold the position of Vice President of Capital Projects. A204-205; A263. Rutledge posted on his LinkedIn profile that he held the position of VP of Special Projects. A205; A222. As set forth in an affidavit signed by Paul Delaney, the Chief Operating Officer of Fenix Parts, Fenix Parts employed Rutledge in the position of VP of Capital Procurement. A237. Fenix Parts' Vice President of Operations Bill Stevens testified that Rutledge's role was VP of Capital Projects.[2] A128.

In his new position of Vice President, Rutledge reported directly to the Chief Operating Officer of Fenix Parts. A223. In this capacity, Rutledge was purportedly

[2] LKQ will refer to this role as "Vice President" for the remainder of the brief given the shifting titles ascribed to it by Rutledge and Fenix Parts.

responsible for overseeing capital assets. A127; A231; A238; A241. This involved the purchase, maintenance, construction, and reporting for the fleet and field assets for certain facilities. *Id.* Rutledge also developed transportation distribution procedures for Fenix Parts products. *Id.* Rutledge further engaged in the management of construction projects for Fenix Parts' facilities, which involved buying equipment, interacting with vendors, and negotiating pricing relating to purchases. *Id.*

Notably, Rutledge testified that, in his position as a Plant Manager for LKQ, he also had responsibilities for capital procurement and projects relating to the Lake City Facility. A225. Rutledge's purported job duties as Vice President dovetailed with many of his responsibilities as a Plant Manager for LKQ. Rutledge testified that, as a Plant Manager for LKQ, he had responsibility relating to distribution, the purchase of capital and plant assets, and negotiating and approving of vendor expenses. A128; A158; A161-162; A166.

In his position as Vice President for Fenix Parts, Rutledge worked with Fenix Parts' facilities in Florida, New Jersey, Pennsylvania, Texas, Houston, and North Carolina. A125; A228-220. After becoming employed by Fenix Parts, Rutledge worked part of the time from his Florida home office. A205-206. Fenix Parts competes directly with LKQ in the Lake City, Florida market. *Id.*

6. Rutledge Becomes a Southeast Area Manager for Fenix Parts, Overseeing Multiple Fenix Parts Facilities, Including Florida.

Beginning in April of 2022, Rutledge held the position of Southeast Area Manager for Fenix Parts. A128; A178; A224. In this position, Rutledge has managed facilities in Greensboro and Forest City, North Carolina, as well as Pensacola and Auburndale, Florida. A179. As Southeast Area Manager for Fenix Parts, Rutledge supervises four General Managers for these facilities. A185-186. The position of General Manager for a Fenix Parts facility is the equivalent of a Plant Manager for a LKQ facility—*i.e.*, Rutledge's old role at LKQ. *Id.*

Rutledge further testified that the local General Managers he supervises have oversight over sales employees. A116. Rutledge receives financial reports relating to sales for his facilities. *Id.* Rutledge has participated on calls and strategy relating to a sales blitz and plans to communicate with Fenix Parts' customers. *Id.* Rutledge has access to Fenix Parts' reports for the entire Southeast Region of the United States. *Id.*

In this position for Fenix Parts, Rutledge has responsibilities relating to profit and loss, plant costs, plant expenditures, and input relating to hiring decisions. A128; A188-189. Rutledge speaks with Jason Cox, his supervisor and the co-leader for Fenix Parts' Southeast Region, approximately four times a week. A181-182.

B. COURSE OF PROCEEDINGS AND DISPOSITION BELOW

1. The Lawsuit and Summary Judgment Proceedings

On January 4, 2022, LKQ filed its First Amended Complaint ("FAC") in this action. A045. In the FAC, LKQ asserted three counts against Rutledge. *Id.* The only Count that is germane to the proceeding before this Court is Count I, for breach of the RSU Agreements.

On January 20, 2023, the parties filed cross motions for summary judgment, including motions directed at Count I for breach of the RSU Agreements. On June 13, 2023, the District Court issued a Memorandum Opinion and Order on the cross-motions for summary judgment ("MSJ Order"). A464-486. In the MSJ Order, the District Court granted Rutledge's summary judgment motion and denied LKQ's summary judgment motion on Count I. *Id.*

In its MSJ Order as to Count I of the FAC, the District Court found that the RSUA Non-Competes were overbroad and legally unenforceable under Delaware law. The District Court rejected LKQ's Delaware legal authority on the distinction between a forfeiture provision in a stock equity agreement and the analysis that applies to traditional restrictive covenants. A470-471; 475-476. Instead, the Court applied a generalized "reasonableness" analysis to invalidate the covenants—treating the RSU Agreements as if they were ordinary non-compete agreements. *Id.* In addition, the District Court likened the forfeiture clause to a liquidated damages

provision, rejecting LKQ's authority that such forfeiture provisions are not liquidated damages under Delaware law. A474-475.

2. LKQ Appeals to the Seventh Circuit Court of Appeals.

LKQ appealed, *inter alia*, the District Court's order granting Rutledge's summary judgment motion and denying LKQ's summary judgment motion on Count I. *Id.* Two weeks before oral argument was scheduled to take place, this Court reversed the prior Court of Chancery decision in *Ainsle* and held that the forfeiture-for-competition provisions at issue there are not subject to review for reasonableness. *See Cantor Fitzgerald, L.P. v. Ainsle*, No. 162, 2023, 2024 WL 315193 (Del. Jan. 29, 2024). Although recognizing the potential significance of the *Ainsle* decision for this case, the Seventh Circuit Court of Appeals nevertheless found that the scope of the decision was open to differing interpretations as to whether and to what extent a strict contract-based analysis should apply in the context of a forfeiture-for-competition provision. *See LKQ Corporation v. Rutledge*, 96 F.4th 977, 983-87 (7th Cir. Mar. 15, 2024). Because of the importance of stability and predictability in Delaware corporate law and in light of the ubiquitousness of restrictive stock unit agreements governed by Delaware law, the Seventh Circuit Court of Appeals certified two questions of law to the Court. *Id.*, at 986-87.

ARGUMENT

I. THE COURT SHOULD NOT APPLY A REASONABLENESS TEST TO THE ANALYSIS OF FORFEITURE-FOR-COMPETITION PROVISIONS OUTSIDE THE REVIEW OF LIMITED PARTNERSHIP AGREEMENTS.

A. Question Presented

Whether *Cantor Fitzgerald* precludes reviewing forfeiture-for-competition provisions for reasonableness in circumstances outside the limited partnership context? *See LKQ Corporation v. Rutledge*, 96 F.4th 977, 986-87 (7th Cir. Mar. 15, 2024) (certifying question for review).

B. Standard of Review

When addressing a certified question of law, "the normal standards of review do not apply." *State v. Anderson*, 697 A.2d 379, 382 (Del. 1997). "This Court must review the certified questions in the context in which they arise." *Id*. The question presented arises as a question of law certified to this Court by the Seventh Circuit Court of Appeals with respect to the review of an order granting summary judgment. Federal courts review an order granting summary judgment, such as the Federal District Court's order at issue in this case, *de novo*. *Richards v. PAR, Inc.*, 954 F.3d 965, 967 (7th Cir. 2020). The questions posed by the Seventh Circuit Court of Appeals also involve matters of law that hinge on public policy grounds. This Court decides such questions *de novo*. *See RSUI Indem. Co. v. Murdock*, 248 A.3d 887, 902 (Del. 2021).

C. Merits Argument

1. Delaware Law Broadly Supports Freedom of Contract Between Competent Parties.

As noted at the outset of this brief, this Court has made quite clear that "[t]he courts of this State hold freedom of contract in high—some might say, reverential—regard." *Ainsle*, 2024 WL 315193, at *1. Delaware law strongly protects parties' contract rights and favors enforcing private parties' contracts as written. *See Nemec v. Shrader*, 991 A.2d 1120, 1126 (Del. 2010) ("Parties have a right to enter into good and bad contracts, [and] the law enforces both."). Under Delaware law, courts are not permitted "to deviate from the words of a clear and unambiguous" agreement. *Philadelphia Indemnity Insurance Company v. Bogel*, 2021 WL 5764538, at *9 (Del. Super. Dec. 6, 2021) (insurance contract) (citing *Hallowell v. State Farm Mut. Auto Ins. Co.*, 443 A.3d 1121, 1131 (Del. Supr. 2020)). Further, Delaware law rarely supports the invalidation of contract terms based on notions of public policy that are not enshrined in legislative enactments. *See Sycamore Partners Mgmt., L.P. v. Endurance Am. Ins. Co.*, 2021 WL 761639, *11 (Del Super. Feb. 26, 2021) ("As the Supreme Court has cautioned, public policy is the General Assembly's domain, and judges should avoid the temptation to legislate from the bench. Following these instructions, this Court has declined invitations to apply judicially-fashioned policy limitations."); *see also Sexton v.*

State Farm Fire and Cas. Co., 2003 WL 23274849, at *5 (Del. Super. Dec. 30, 2003) (the overuse of public-policy voiding would "unjustly interfere with the right of freedom to contract").

Only "a strong showing that dishonoring [a] contract is required to vindicate a public policy interest even stronger than freedom of contract" will induce our courts to ignore unambiguous contractual undertakings." *Ainsle*, 2024 WL 315193, at *1 (quoting *Libeau v. Fox*, 880 A.2d 1049, 1056 (Del. Ch. 2005), aff'd in pertinent part, 892 A.2d 1068 (Del. 2006)). As former Chief Justice Strine observed, "[s]uch public policy interests are not to be lightly found, as the wealth-creating and peace-inducing effects of civil contracts are undercut if citizens cannot rely on the law to enforce their voluntary-undertaken mutual obligations." *RSUI Indem. Co. v. Murdock*, 248 A.3d 887, 903 (Del. 2021) (internal quotation marks omitted).

Delaware law also seeks to promote reliable and efficient corporate laws in order to facilitate commerce. *NAF Holdings, LLC v. Li & Fung (Trading) Ltd.*, 118 A.3d 175, 180–81 (Del. 2015). This applies to the issuance of stock grants, such as are at issue here. "For decades, Delaware courts have required stock grants to include conditions ensuring that the grants do not constitute waste or a gift of corporate assets." *See Dunai*, 2021 WL 1751347, at *2, citing *Beard v. Elster*, 160 A.2d 731, 735-36 (Del. 1960). The plan "must contain consideration passing to the corporation, which could take variable forms, such as the retention of services of a

valued employee, or the gaining of services of a new employee." *Elster*, 160 A.2d at 735–36. In granting employees equity, a corporation must "reasonably be expected to receive the contemplated benefit from the grant of options." *Id.* at 735. Relying on the freedom of contract doctrine, Delaware corporations (such as LKQ) have drafted stock equity agreements that include post-termination conditions to align the parties' respective interests in exchange for the substantial financial benefits that employees receive. Indeed, the stability of wealth-creating equity agreements depends, in part, on a corporation's expectation that Delaware courts will enforce the terms of those agreements in accordance with the bargain the parties struck, consistent with long-standing Delaware contractarian doctrine.

Under the RSU Agreements, LKQ fashioned a limited, nine-month competitive restriction to ensure that the interests of LKQ and the Key Persons (such as Rutledge) were aligned and that LKQ received value for the granting of restricted stock. These provisions were drafted in furtherance of LKQ's legitimate economic interest in securing a benefit in return for the issuance of restricted stock. In return, Rutledge and other Key Employees had the opportunity to create wealth through the sale of LKQ restricted stock to which they would not have otherwise been entitled. This arrangement is emblematic of the "wealth creating effects" of civil contracts and does not require judicial intervention.

Here, Rutledge repeatedly accepted the RSU Agreements over a period of several years and understood the parties' bargain. Despite this, he chose to voluntarily resign his employment to immediately work for a competitor within the nine-month restricted period. Rutledge has now decided he does not want to honor his agreements for return of the stock and/or its proceeds. Under Delaware's strong public policy in support of the freedom of contract, and absent unconscionability, bad faith, or other extraordinary circumstances, LKQ should be able to avail itself of the benefit of the parties' contractual promises as written.

2. In *Ainsle,* this Court Adopted the Employee Choice Doctrine for the Analysis of "Forfeiture-for-Competition" Covenants.

The Court's holding in *Ainsle* adopted the employee choice doctrine for the analysis of forfeiture-for-competition provisions under Delaware law. *See Ainsle*, 2024 WL 315193. At issue in *Ainsle*, which involved a limited partnership agreement, were Cantor Fitzgerald's obligations to pay distributions from a partner's capital account (the "Conditioned Amounts")—which included capital contributions and profit-sharing— over a four-year period. *See Id.* at **2–4. Those obligations were contingent, in part, on whether a former partner refrains from engaging in certain defined "Competitive Activity" following the partner's withdrawal from the partnership. *See Id.*

In *Ainsle*, a breach of a provision in the Agreement referred to as the "Conditioned Payment Device" authorized the partnership to withhold distributions

to a partner who withdraws from the partnership if the partner engages in competition with the partnership in violation of the Competitive Activity restrictions. *Id.*, at **1, 4-5. After six partners left Cantor Fitzgerald to join a rival firm, Cantor Fitzgerald sought to suspend its obligations to pay the Conditioned Amounts to the former partners. *Id.*, at *3. The Competitive Activity restrictions remained operative for four years following a partner's withdrawal and, among the six plaintiffs, were enforced to withhold payments ranging from just under $100,000 to over $5 million. *Id.*, at *5.

The Delaware Court of Chancery found that the Conditioned Payment Device and resulting forfeiture were a "forfeiture for competition" provision. *Id.*, at *6. After noting that "jurisdictions are split" on the issue, the Court of Chancery found that the Conditioned Payment Device and the resulting forfeiture were subject to a reasonableness review that applies to traditional restrictive covenants. *Id.* Applying a reasonableness analysis, the Chancery Court found that the Competitive Activity restraints were unenforceable, due in large part to the four-year duration, which the Chancery Court found was an invalid restraint of trade. *Id.*, at **1, 6-7.

In reversing the Delaware Court of Chancery, this Court found that the scope of the Conditioned Payment Device and related forfeiture were not subject to the reasonableness analysis applied to traditional restrictive covenants. *Id.*, at *10. Therefore, the Court should enforce the agreements as written. *Id.* In reaching this

conclusion, the Court relied on policy considerations that are not tethered to and apply outside the context of a partnership agreement. The first policy consideration relates to the distinction between traditional restrictive covenants and a provision that works a forfeiture but does not preclude competitive employment. The second policy consideration concerns the State of Delaware's fundamental public policy supporting freedom of contract.

Turning to the first policy consideration, this Court recognized the fundamental distinction between a non-competition covenant that precludes employment and a non-competition covenant that merely results in the forfeiture of an economic benefit:[3]

> The distinction between a restrictive non-competition covenant that precludes a former employee from earning a living in his chosen field and an agreement that allows a former partner to compete but at the cost of relinquishing a contingent benefit is, in our observation, significant. In the restrictive-covenant context, the former employee is effectively deprived of his livelihood and, correspondingly, exposed to the risk of serious financial hardship. This gives rise to the strong policy interest that justifies the review of unambiguous contract provisions for reasonableness and a balancing of the equities, two exercises typically foreign to judicial review in contract actions. By contrast, however, forfeiture-for-competition provisions, which, unlike restrictive covenants, are not enforceable through injunctive relief, do not prohibit employees from competing and remaining in their chosen

[3] Rutledge's RSU Agreements did not prevent him from working in the auto salvage industry. All the RSU Agreements required of Rutledge is that he return the benefits he received under the RSU Agreements—which was far from a penalty.

> profession, and do not deprive the public of the employee's services, present no such concern.

Id., at *13.

Turning to the second policy consideration identified above, this Court observed that the public policy of the State of Delaware, as embodied in the Delaware Revised Uniform Partnership Act ("DRUPA"), was to give maximum effect to the freedom of contract and to enforceability of partnership agreements. *Id.* This contractarian policy consideration was not, however, limited to the narrow partnership agreement context. Significantly, the Court also found that the commitment to freedom of contract manifested in the DRUPA "corresponds with our courts' tradition of 'ensuring freedom of contract to facilitate commerce. We uphold [] the freedom of contract and enforce [] as a matter of *fundamental public policy*, the voluntary agreements of sophisticated parties.'" *See Id.* at *13, quoting *NAF Holdings, LLC, v. LI Fung (Trading) Ltd.*, 118 A.3d 175, 180 n. 14 (Del. 2015) (emphasis added). Thus, the Court found that the Conditioned Payment Device, because it did not prevent the former partners from being competitively employed, did not implicate restraint of trade in the manner of a standard restrictive covenant agreement, and hence the former partners' objections to it were insufficient to

overcome the strong, competing Delaware public policy considerations in support of freedom of contract.[4] *Id.*

This Court also rejected the Chancery Court's view of the forfeiture provision as analogous to an unenforceable liquidated damages provision. *Id.*, *9. The Court found that the provision at issue in *Ainsle* was not a penalty enforced against an employee based on the breach of a restrictive covenant, but rather, a condition precedent that excused Cantor Fitzgerald's duty to pay plaintiffs deferred compensation if they failed to satisfy the conditions to which they agreed to be bound. *Id.* In light of these considerations, the Court vacated the Chancery Court's finding that the Conditioned Payment Device (and underlying Competitive Activity restrictions) was unenforceable and remanded the case for further proceedings.

3. The Cases Cited by this Court in *Ainsle* and Analogous Authority Support the Application of the Employee Choice Doctrine to Agreements Beyond the Scope of Partnership Agreements.

In *Ainsle*, the Court cited with approval two decisions (*Dunai* and *Hall*) applying Delaware law wherein those courts enforced forfeiture-for-competition covenants in the context of a stock equity grant without subjecting the covenants to

[4] In adopting the employee choice doctrine in *Ainsle*, the Court stated that, "In *Pollard v. Autote*, 852 F.2d 67 (3rd Cir. 1998), the United States Court of Appeals for the Third Circuit surmised that we would follow this [the reasonableness] approach. By our decision today, we respectfully confute that prediction." *Ainsle*, 2024 WF 315193, at *12, fn 103.

the reasonableness analysis applicable to a non-compete agreement. *See Ainsle*, at **9-10. Neither of these cases involved a partnership agreement.

In *W.R. Berkley Corp. v. Dunai*, No. 1:19-cv-01223, 2021 WL 1751347 (D. Del., May 4, 2021), the defendant was a Vice President who received more than $200,000 in stock pursuant to a stock benefit plan from her prior company, which provided that the employee had to forfeit the stock or repay the granted value if she engaged in "competitive action" against the company within a year of termination. *Id.*, at *2. After resigning her employment, the defendant took a position with a rival company. *Id.* As articulated by the court in *Dunai*: "[Plaintiff's] employer gave her a generous bonus – with a catch. *Id.*, at *1. Now she says the catch was unreasonable. It was not." The court further held:

> W. R. Berkley granted Dunai—a corporate vice president—tremendous benefits. To make sure that was not for naught, it imposed a reasonable restriction on its grants: if Dunai competed against the company *within* one year of termination—an action the parties agreed "would result in irreparable injuries to [W. R. Berkley] and would cause loss in an amount that cannot be readily quantified," D.I. 1-1 at 4—she had to forfeit the stock or repay the granted value. Indeed, Dunai would never be worse off than she would have been before the agreements.

Id., at **3-4.

Indeed, the court in *Dunai* found: "Though Dunai improperly classifies her contract provision as a 'noncompete,' it is actually a clawback. She was free to work for a competitor right away. The only condition was, if she did so within

one year, she had to repay the stock grants that the company had given her." *Id.* at *2.

On the heels of this Court's decision in *Ainsle*, the Third Circuit Court of Appeals quickly affirmed the Federal District Court's decision in *Dunai*. *See W.R. Berkley Corp. v Dunai*, Nos. 22-2963 and 23-1079, 2024 WL 511040 (3d Cir. Feb. 9, 2024).[5] Relying on this Court's holding in *Ainsle*, the Third Circuit Court of Appeals considered—and rejected—the argument that the partnership agreement in *Ainsle* was distinguishable from the stock equity agreement in *Dunai*:[6]

> While Dunai contends that *Ainslie* is distinguishable because there the forfeiture-for-competition provision featured in a limited partnership agreement, which is not the case here, she offers no compelling argument why its reasoning does not apply with equal effect to her stock clawback provision. While the Delaware Supreme Court relied in part on the Delaware Revised Uniform Limited Partnership Act (DRULPA), *see, e.g.*, 6 Del. C. § 17-306, in reaching its conclusion that Delaware public policy favors freedom of contract with respect to forfeiture-for-competition provisions in limited partnership agreements, it also noted the State's broader common law tradition of supporting freedom of contract, *Ainslie*, 2024 WL 315193, at *10. That tradition of "contractarian deference," *see id.* at *13, supports upholding and enforcing Dunai's stock clawback provision.

[5] LKQ notes that the Third Circuit Court of Appeal's disposition of the *Dunai* appeal is not an opinion of the full court and does not constitute binding precedent.

[6] Not insignificantly, the Third Circuit Court of Appeals also found that the bargain struck between a Vice President and the corporation was a "bargained-for provision in agreements struck by *sophisticated parties*." *Id.*, at *3 (emphasis added).

Id., at *3.

In *W.R. Berkley Corporation v. Hall*, No. 03C-12-146WCC, 2005 WL 406348, *2 (Del. Super. Ct. Feb. 16, 2005), the employer "adopted an incentive stock option plan as a reward and incentive to its employees." *Id.* The relevant Incentive Stock Option Agreement provided that the employee could purchase stock in the employer's holding company at a significant discount. *Id.* at **2-4. The stock option agreement executed by the employee contained a provision that allowed the company to seek reimbursement of the difference between the option price and the stock price if an individual left their employment within six months of execution of the option if the employee "directly or indirectly ... (i) ... engages in any business activities which are competitive, to a material extent, with any substantial type or kind of business activities conducted by W.R. Berkley Corporation." *Hall*, 2005 WL 406348, *2. Despite the agreement, the employee nevertheless left his employment three months later to work for a competitor. *Id.* The Delaware Superior Court held, in pertinent part:

> Counsel may put whatever spin they want on this provision, but to the Court it is simply a contractual obligation that requires a senior management employee to remain with the company for six months if he wants to retain the full benefit of the stock option. If he does so, the financial savings he realized with the purchase of the stock is his to keep regardless of his future employment. On the other hand, if he leaves before the end of the six-month period, he must pay the market price of the stock. He knew

> of this obligation and simply now is asking the Court to free him of this responsibility. The Defendant's freedom of employment and his ability to seek or move to a new job was not abridged by the Plaintiff nor were there any limitations on the Defendant to seek any job he so desired. All that is being sought here is the repayment of the financial benefit provided by the Plaintiff to the Defendant when he decided to exercise the option to leave according to the terms of the option agreement. The Court finds that he is simply contractually obligated to do so.

Id. at *5.

Accordingly, the decisions in *Dunai* and *Hall* cited favorably by this Court did not involve partners or the analysis of a partnership agreement. Each of the cases: (1) involved the analysis of *clawback* provisions under a stock benefit plan offered to a member of senior management; (2) found such provisions were enforceable; and (3) did not apply a general reasonableness analysis to the scope of the non-competition covenant, including any analysis of its temporal or geographic scope. The *Dunai* and *Hall* cases also both categorically rejected the argument that the non-competition provisions constituted an unenforceable liquidated damages provision. Here, too, Rutledge, a Key Employee, was offered stock grants under a restricted stock benefit plan, under which such benefits could be clawed back if he violated the contractual terms by unfairly competing.

Furthermore, courts in numerous jurisdictions that have adopted the employee choice doctrine have applied that doctrine to various agreements outside of the partnership context—including stock equity agreements and other deferred

compensation agreements with employees. *See, e.g., J.P. Morgan & Co. v. Pierce*, 517 F. Sup. 2d 945 (E.D. Mich. 2007) (applying Delaware law) (enforcing a non-competition forfeiture provision in a stock award agreement that provided for reimbursement by the employee from amounts gained through the exercise of stock options after the employee resigned and obtained competitive employment); *Lucente v. Int'l Bus. Machs. Corp.*, 310 F.3d 243, 254 (2d Cir. 2002) (declining to apply a reasonableness analysis to a non-competition covenant in a restricted stock award that was subject to forfeiture); *Farm Bureau Mut. Ins. Co. of Idaho*, 456 P.3d 201, 212-213 (Idaho 2019) (declining to apply reasonableness analysis in the context of a service commission contract with an employee); *Press Ganey Assocs., Inc. v. Dye*, No. 3:12-CV-437-CAN, 2014 WL 1116890, **5-7 (N.D. Ind. Mar. 19, 2014) (declining to apply reasonableness analysis to a stock grant agreement conditioned on the defendant not working for a competitor for 12 months); *Fraser v. Nationwide Mut. Ins. Co.*, 334 F.Supp.2d 755, 760–61 (E.D. Pa. 2004) (rejecting the plaintiff's argument that a deferred compensation agreement with an insurance agent was an unenforceable restraint on trade under a reasonableness analysis); *In re Citigroup, Inc.*, 535 F.3d 45 (1st Cir. 2008) (finding that forfeiture provisions in a restricted stock unit agreement similar to the RSU Agreements were enforceable and not in violation of Florida public policy).

In none of these cases did the courts engage in an analysis of the background circumstances surrounding entry into the agreement in determining that the employee choice doctrine applied. Rather, the only salient consideration was whether the agreement restricted competition or merely required a forfeiture of contracted for benefits. This makes eminent logical sense as it is irrelevant from an individual decision-making standpoint whether the person is a partner subject to a partnership agreement or a member of management subject to a stock equity or benefits agreement. Either way, the individual can choose to accept the benefits of the agreement or can choose not to accept the benefits and be free to compete. It is simply a matter of what bargain the employee/partner chooses to strike.

Even if this Court were to impose some restriction on the application of the employee choice doctrine to some categories of agreements outside the partnership context (which is unwarranted for all of the reasons discussed above), there is absolutely no reason not to apply the employee choice doctrine to a stock equity agreement such as the one at issue in this case.

For the reasons established above, the distinction referenced in Certified Question No. 1 would be detrimental to Delaware's public policy of freedom of contract to promote wealth creation and reliable and efficient corporate law. Numerous companies that have relied on Delaware's adherence to freedom of contract and decisions upholding the enforceability of forfeiture-for-competition

covenants in stock equity agreements would have their agreements up-ended and enforceability called into question over a meaningless distinction between partnership agreements and other agreements conferring similar benefits to corporate employees.

II. THE COURT SHOULD DECLINE TO ADOPT A MULTI-FACTOR TEST TO DETERMINE WHETHER A FORFEITURE-FOR-COMPETITION AGREEMENT IS ENFORCEABLE UNDER DELAWARE CONTRACT LAW.

A. Question Presented

If *Cantor Fitzgerald* does not apply in all other circumstances, what factors inform its application? For example, does it matter what type of agreement the forfeiture provision appears in, how sophisticated the parties are, whether the parties retained counsel to review the provision, whether the forfeiture involves a contingent payment or clawback, how far backward a clawback reaches, whether the employee quit or was involuntarily terminated, or whether the provision also entitled the company to injunctive relief? *See LKQ Corporation v. Rutledge*, 96 F.4th 977, 986-87 (7th Cir. Mar. 15, 2024) (certifying question for review).

B. Standard of Review

For the reasons articulated in Argument Section I(B) above, the Court reviews this question of law *de novo.*

C. Merits Argument

1. Delaware Law and Policy Do Not Support Creating A Layered, Multi-Factor Analysis Implied by Certified Question No. 2.

With Certified Question No. 2, the Seventh Circuit Court of Appeals asks what factors might inform whether this Court's decision in *Ainsle* should apply outside the partnership agreement context. To that end, the Seventh Circuit Court

of Appeals provides examples of factors for this Court's consideration, "such as what type of agreement the forfeiture provision appears in, how sophisticated the parties are, whether the parties retained counsel to review the provision, whether the forfeiture involves a contingent payment or clawback, how far backward a clawback reaches, whether the employee quit or was involuntarily terminated, or whether the provision also entitled the company to injunctive relief."

The analysis starts—again—with relevant public policy considerations. Delaware law seeks to promote reliable and efficient corporate laws in order to facilitate commerce. *NAF Holdings*, 118 A.3d at 180–81. Delaware law strongly protects parties' contract rights and favors enforcing private parties' contracts as written. *See Nemec*, 991 A.2d at 1126. In the absence of a well-established and explicit public policy, or directive from the legislature, courts should be careful not to invoke public policy simply as a means to avoid what might be perceived by some as a harsh result in a given instance. *See Sexton*, 2003 WL 23274849, at *5.

Set against this backdrop, including the case law cited and discussed above, this Court should decline the Seventh Circuit Court of Appeals' invitation to apply a multi-factor enforceability test (hereafter referred to as a "gateway test") in this context for several reasons. *First*, Delaware common law already provides numerous defenses to a claim for breach of a contract, including safeguards relating to the formation of an agreement (such as the existence of fraud, coercion, or

duress), procedural and substantive unconscionability, and the good faith administration of contractual terms. *See, e.g., Fritz v. Nationwide Mut. Ins. Co.*, 1990 WL 186448 (Del. Ch. Nov. 26, 1990) (outlining the analysis to determine whether an agreement is substantively or procedurally unconscionable); *E.I. DuPont de Nemours & Co. v. Custom Blending Int'l, Inc.*, 1998 WL 842289, at *4 (Del. Ch. Nov. 24, 1998) (Strine, V.C.) (providing the elements of a claim for duress/coercion). Delaware courts have carefully considered the applicability of these clearly defined defenses in light of Delaware law's strong presumption of giving effect to the parties' written promises. Beyond these common law defenses to breach of contract, it should be up to the Delaware legislature to determine whether there should be any further restraints on freedom of contract in this context where restraint of trade is not at issue. *See, e.g.*, Delaware Wage Payment and Collection Act, 19 *Del. C.* § 1104(a) (requiring the payment of earned wages without condition and within the time set by statute).[7] Rutledge was free to compete with LKQ subject to return of the stock or stock proceeds. Unlike the factors posed by the Seventh Circuit Court of Appeals, legislatures have provided courts with well-defined mechanisms to prevent the withholding or forfeiture of earned employee compensation.

[7] *See also, e.g.*, The Illinois Wage Payment and Collection Act, 820 Ill. Comp. Stat. Ann. 115/2 (all final compensation defined as wages, salaries, earned commissions, and earned bonuses should be paid upon separation of the employee for any reason).

Second, none of the courts applying Delaware law in *Hall*, *Dunai* (including in the appeal to the Third Circuit Court of Appeals), *Pierce*, or *Ainsle* set forth a gateway test to determine whether a forfeiture-for-competition provision or a claw-back of benefits received by an employee should be subject to a straightforward breach of contract analysis. None of the courts in *Hall, Dunai*, and *Pierce* discussed threshold factors that inform the application of the employee choice doctrine. In this litigation, Rutledge has not cited any authority relating to the framework or administration of such a test, nor does the Seventh Circuit Court of Appeals' decision point to any legal authority that is instructive in this regard.[8] In accordance with Delaware law, this court should be circumspect in imposing new, judicially defined restrictions on freedom of contract.

Third—and perhaps most significantly—the administration of such a gateway test would be contrary to the public policy considerations of stability and efficiency in Delaware corporate law. The reasonableness test that is applied to the enforcement of restrictive covenants in a non-compete context is based on a complex

[8] While Rutledge has cited the *Pollard v. Autotote, Ltd.*, 852 F.2d 67 (3rd Cir. 1998) decision, which applied a reasonableness test to the applicable forfeiture-for-competition provision, the *Pollard* court was addressing "the enforceability of a forfeiture provision against an employee who was involuntarily terminated without fault." *Pollard*, 852 F.2d at 70. In any event, *Pollard* has since been overturned and the undisputed facts establish that Rutledge voluntarily resigned his employment with LKQ after engaging in negotiations with LKQ's direct competitor during his employment.

assessment of the unique facts of the individual case, the scope of the applicable covenants, and a balancing of the equities.[9] Even for the careful attorney, determining whether a restrictive covenant will be enforced under the individual circumstances of a given case is fraught with uncertainty. But Delaware courts have determined that this complex balancing process is necessary to vindicate the separate public policy of promoting free trade and free movement of workers. Here, however, that policy is not at issue as the RSU Agreements do not prevent Rutledge from competing.

In effect, the multiple background factors alluded to by the Seventh Circuit Court of Appeals in Certified Question No. 2 would impose a separate reasonableness test in the forfeiture-for-competition context (*e.g.*, "how sophisticated are the parties," "how far backward a clawback reaches," "what type of agreement the forfeiture appears in").[10] That is the very path this Court chose not to go down in the context of

[9] Delaware courts review the covenants to assure they (1) are reasonable in geographic scope and temporal duration, (2) advance a legitimate economic interest of the party seeking its enforcement, and (3) survive a balancing of the equities. *FP UC Holdings, LLC v. Hamilton*, No. CV 2019-1029-JRS, 2020 WL 1492783, at *6 (Del. Ch. Mar. 27, 2020). When assessing "reasonableness," the court then balances the employer's interests against the employee's interests. *Id.* When applying this balancing test, the court should take notice of the consideration an employee received in exchange for her promise not to compete before determining whether the non-compete is reasonable. *Id.* In addition, the court should pay particular attention to "the temporal and geographic restrictions" within the covenant. *Id.*

[10] The analysis of many of these factors in Certified Question No. 2 does not lend itself to bright-lines rules, and would prove expensive and problematic in litigation, certainly in tandem with multiple other factors. For example, just take the factor

clawback or forfeiture provisions. Analyzing each of those background "equitable" factors would promote uncertainty and confusion over the ability to enforce these types of agreements. Litigation over these factors would be complex, expensive, and uncertain for all parties. Companies would be discouraged from utilizing these agreements if they are uncertain whether they will derive the benefit that the parties contemplated under the agreements. This undermines the "wealth-creating" effects of civil contracts when parties cannot rely on the law to enforce their voluntarily undertaken mutual obligations. *Murdock*, 248 A.3d at 903. Moreover, these stock equity agreements subject to forfeiture redound to the benefit of the managerial employees as well, who obtain a valuable equity stake in the enterprise in exchange for the limited promise to return the benefits if they compete.

For all these reasons, the Court should decline to impose additional requirements for enforcing clawback provisions and instead apply the employee choice doctrine consistent with its holding in *Ainsle*. If there is a true hardship case, which this litigation does not present, standard contract law defenses such as bad faith, fraud, coercion, and unconscionability are potentially available.

"how far back a clawback reaches." What would be the guideposts? Two years? Four years? Ten years? Does it matter if the recovery involves a smaller amount over a longer duration or a larger and potentially more significant amount over a shorter duration? Again, the Court should be circumspect in imposing judge-made impediments to freedom of contract that are not well-defined and do not emanate from the legislature.

2. Even if this Court Were to Apply the Factors Suggested by the Seventh Circuit Court of Appeals, the Court Should Still Apply the Employee Choice Doctrine to the RSU Agreements.

Even applying the factors posed by the Seventh Circuit Court of Appeals, the RSU Agreements do not present inequitable circumstances and should be enforced under Delaware contract principles.

To begin, the bargain entered into between LKQ and Rutledge (entirely voluntarily) is not inequitable. Rutledge entered into each of these agreements voluntarily. There was no coercion nor assertion that Rutledge did not understand what he was signing. Each year, Rutledge reviewed and signed the respective RSU Agreements and accepted the financial benefits from these agreements. In repeatedly signing and accepting the benefits of these agreements, and accepting the benefits received each year under these agreements, Rutledge was aware of the limited nine-month non-competition covenant that he entered into in exchange for restricted stock valued in excess of $300,000—more than he received in a nine-month period working for either LKQ or Fenix Parts. Critically, Rutledge could have declined to participate in the RSU program and continued to work for LKQ in a senior management position. By accepting the RSU Agreements and restricted stock, Rutledge promised not to work for a direct competitor of LKQ for a limited and reasonable nine-month period. Instead, he refused to honor his contractual promises to LKQ, and *voluntarily* resigned his employment.

The other equitable factors raised by the Seventh Circuit Court of Appeals—such as degree of sophistication of the employee—simply do not apply to this case, even if there could ever be a circumstance where this Court would consider them outside of contract law defenses. For example, the District Court's depiction of Rutledge as an unsophisticated "middle manager" (if that paternalistic designation matters at all) is belied by the record evidence, which demonstrates the substantial role he played managing LKQ's operations in Lake City, Florida, and, later, in a quite similar role as a Regional Area Manager for Fenix Parts. Rutledge had access to all manner of LKQ's non-public, competitively sensitive trade information running a 40+ employee, 60-acre facility. *See W.R. Berkley Corp. v Dunai*, Nos. 22-2963 and 23-1079, 2024 WL 511040 (3d Cir. Feb. 9, 2024) (finding that the bargained-for agreement between a Corporate Vice President and the corporation constituted an agreement between two "sophisticated parties"). As previously established, Rutledge also voluntarily resigned his employment. Hence, even if this Court were to entertain a distinction between employees who are terminated, as opposed to employees who leave voluntarily, there is no dispute here that Rutledge left of his own accord.

Finally, the Seventh Circuit's reference to a provision for "injunctive relief" within the RSU Agreements is a red herring and irrelevant for the same reasons a

similar provision was irrelevant to this Court's holding in *Ainsle*.[11] In *Ainsle*, the Court noted that the limited partnership agreement contained a provision that allowed Cantor Fitzgerald to obtain injunctive relief. *Ainsle*, 2024 WL 315193, at **5-6. At summary judgment, the Court noted that Cantor Fitzgerald had not moved for and was not seeking injunctive relief—"[f]rom Cantor Fitzgerald's perspective, as far as the Conditioned Payment Device was concerned, the plaintiffs were free to compete but only at the cost of forfeiting their rights to the Conditioned Amounts." *Id.*, at *9. Similarly, here, LKQ is not seeking injunctive relief under the RSU Agreements in the First Amended Complaint and has not moved for injunctive relief under the RSU Agreements. *See* A045-103. LKQ's counsel likewise made this clear in oral argument before the Seventh Circuit. From LKQ's perspective, Rutledge is free to compete but only at the cost of reimbursing LKQ from the proceeds of his restricted stock obtained under the RSU Agreements.

[11] The provision for injunctive relief in the RSU Agreements is actually a single sentence at the bottom of Section 17 of the RSU Agreements and is not otherwise referenced in the respective RSU Agreements.

CONCLUSION

For all the above reasons, LKQ respectfully requests that this Court: (1) rule that the holding in *Ainsle* applies outside the narrow context of partnership agreements, including, specifically, stock equity agreements (and the RSU Agreements in this case); and (2) decline to apply the identified "gateway" equitable factors to consideration of enforcement of a forfeiture-for-competition provision.

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CERTIFICATE OF SERVICE

I hereby certify that on May 14, 2024, true and correct copies of the foregoing *Appellant's Corrected Opening Brief* were caused to be served on the following counsel by File & ServeXpress:

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