

Seventh Circuit Rules Forfeiture-for-Competition Clauses Under Delaware Law Enforceable and Not Subject to Reasonableness Review

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In 2021, LKQ Corporation (LKQ) filed suit against Robert Rutledge, its former plant manager, in the U.S. District Court for the Northern District of Illinois. LKQ alleged that Rutledge's working for a competitor within nine months of his leaving LKQ breached his restricted stock unit (RSU) agreements and his separate restrictive covenant agreements. LKQ also alleged that Rutledge was unjustly enriched under the RSU agreements.

The RSU agreements, governed by Delaware law, required Rutledge to forfeit his awards in the event of a breach. The district court found in favor of Rutledge on all claims.

Quick Hits

- The Seventh Circuit Court of Appeals ruled that under Delaware law, the forfeiture-for-competition provisions in a company's restrictive stock unit (RSU) agreements with a former employee were enforceable and not subject to judicial review for reasonableness.
- To improve the chances of obtaining a remedy against employees breaching their RSU agreements, employers that can take advantage of Delaware law as their contractual choice of law should include forfeiture-for-competition clauses in their RSU agreements and similar agreements along with traditional restrictive covenants.
- But note that Delaware courts are becoming increasingly hostile to serving as a venue for out-of-state litigants.
- Illinois law on forfeiture-for-competition clauses is distinguishable from Delaware law. Under the Illinois Freedom to Work Act, forfeiture-for-competition clauses are construed the same way as restrictive covenants, including requiring Illinois courts to determine whether they are reasonable.

In *LKQ Corporation v. Rutledge*, on LKQ's appeal, the Seventh Circuit Court of Appeals [affirmed](#) the district court's decision on the unjust enrichment and restrictive covenant claims but found that (applying Delaware law), the RSU agreements' forfeiture-for-competition provisions are not subject

to judicial review for reasonableness; meaning proving breach was sufficient. The Seventh Circuit sent the case back to the district court to determine (at summary judgment or trial) whether Rutledge breached the RSU agreements without consideration of whether the agreements are reasonable. If the district court or jury determines he did, Rutledge will have to forfeit his RSU awards under the agreements.

The Details Always Matter

Rutledge worked as a plant manager at LKQ Corporation for over a decade. The company designated Rutledge as a “key person” eligible to receive restricted stock unit awards on a vesting schedule. LKQ conditioned those awards on Rutledge’s execution of RSU agreements containing forfeiture-for-competition provisions. These provisions prohibited Rutledge from working for a competitor within nine months of leaving LKQ. In the event of a breach, the agreements permitted LKQ to claw back all proceeds from Rutledge’s stock unit awards.

Over the years, Rutledge received several stock awards and executed several accompanying RSU agreements. In 2021, Rutledge left LKQ and began working for a competitor five days later. LKQ sued Rutledge in the U.S. District Court for the Northern District of Illinois, alleging unjust enrichment and breach of both the RSU agreements and separate restrictive covenant agreements. The district court entered summary judgment in favor of Rutledge on all of LKQ’s claims, and LKQ appealed.

The Seventh Circuit affirmed the district court’s entry of judgment on the unjust enrichment and restrictive covenant claims but was unable to determine whether, under Delaware law, it should review the forfeiture-for-competition provisions in the RSU agreements for reasonableness before enforcing them. While LKQ’s appeal was pending, the Delaware Supreme Court decided in *Cantor Fitzgerald, L.P. v. Ainslie* that, in the context of limited partnership agreements, forfeiture-for-competition provisions are generally enforceable under the employee choice doctrine and, therefore, not subject to judicial review for reasonableness.

Unsure if *Cantor Fitzgerald* applied outside the limited partnership context, the Seventh Circuit certified two questions to the Delaware Supreme Court, only one of which needed answering for the Seventh Circuit to make a determination: Did *Cantor Fitzgerald* preclude reviewing forfeiture-for-competition provisions for reasonableness in circumstances outside the limited partnership context?

The Delaware Supreme Court provided a clear answer: No, *Cantor Fitzgerald* is not restricted to the limited partnership context.

Armed with this guidance, the Seventh Circuit determined that the forfeiture-for-competition provisions in Rutledge’s RSU agreements were not subject to judicial review for reasonableness. The court noted that in *Cantor Fitzgerald*, the Delaware Supreme Court had “weighed the competing policy concerns and chose the employee choice doctrine.” And under that doctrine, courts do not review forfeiture provisions for reasonableness so long as the employee voluntarily terminated his or her employment. The Delaware Supreme Court did leave open the possibility of recognizing an exception where a forfeiture provision is “so extreme in duration and financial hardship that it precludes employee choice by a sophisticated party.” However, it otherwise characterized *Cantor Fitzgerald*’s holding as “broad,” which the Seventh Circuit observed leaves “no doubt that any such exception is limited and would apply only in the most extraordinary of circumstances.”

Because the Delaware Supreme Court’s answer to the Seventh Circuit’s certified question only

spoke to the enforceability issue, the Seventh Circuit now leaves it to the district court on remand to determine whether to reopen summary judgment proceedings or proceed to trial (or some combination of both) with respect to determining whether Rutledge actually breached the RSU agreements.

What Does This Mean for Employers?

To improve chances for a remedy against employees breaching their restrictive covenants, employers that can take advantage of Delaware law as their contractual choice of law should include forfeiture-for-competition clauses in their RSU agreements and similar agreements along with traditional restrictive covenants. However, employers should note that Delaware courts are becoming increasingly hostile to serving as a venue for out-of-state litigants.

While the Seventh Circuit's decision would not likely be extended to forfeiture-for-competition clauses under the [Illinois Freedom to Work Act](#), the decision could nevertheless be a bellwether for how courts outside Illinois (and certainly applying Delaware law) could address restrictive covenant breaches in the context of forfeiture-for-competition clauses without directly impairing the mobility of the breaching employee.

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