



IN THE
Supreme Court of the State of Delaware

CANTOR FITZGERALD, L.P., a Delaware
limited partnership,

Defendant Below,
Appellant,

v.

BRAD AINSLIE, ANGELINA KWAN,
CHRISTOPHE CORNAIRE, JASON BOYER,
JOHN KIRLEY, and REMY SERVANT,

Plaintiffs Below,
Appellees.

No. 162,2023

COURT BELOW:
COURT OF CHANCERY
OF THE STATE OF DELAWARE,
C.A. No. 9436-VCZ

**BRIEF OF SMALL BUSINESS MAJORITY
AS *AMICUS CURIAE* IN SUPPORT OF
PLAINTIFFS-APPELLEES AND AFFIRMANCE**

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August 4, 2023

TABLE OF CONTENTS

	<u>Page</u>
TABLE OF CITATIONS	ii
IDENTITY AND INTEREST OF <i>AMICUS CURIAE</i>	1
SUMMARY OF ARGUMENT	3
ARGUMENT	4
I. FFCs Cause the Same Type of Harm as Noncompetes.	4
II. Noncompetes and FFCs Harm Small Businesses.	7
III. FFCs and Noncompetes Cause General Economic Harm.	10
CONCLUSION.....	16

TABLE OF CITATIONS

Page(s)

CASES

Kodiak Building Parts., LLC v. Adams,
2022 WL 5240507 (Del. Ch. 2022).....6

Ware v. Merrill Lynch, Pierce, Fenner & Smith, Inc.,
24 Cal. App. 3d 35 (Cal. App. 1972),
aff'd, 414 U.S. 117 (1973)..... 4-5

STATUTES

15 U.S.C. § 15

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Sherman Act, 26 Stat. 209 (1890).....5

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business-growth-insights-from-the-latest-data-on-black-owned-
businesses/](https://www.brookings.edu/articles/who-is-driving-black-business-growth-insights-from-the-latest-data-on-black-owned-businesses/)7

Bruce Fallick, Charles A. Fleischman, & James B. Rebitzer,
*Job-Hopping in Silicon Valley: Some Evidence Concerning the
Microfoundations of a High-Technology Cluster*,
88 REV. ECON. & STATISTICS 472 (2006).....12

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Secretary April J. Tabor, Federal Trade Comm’n, RE: Notice of
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Evan Starr, <i>Consider This: Training, Wages, and the Enforceability of Non-Compete Clauses</i> , 72 ILR REV. 783 (2019).	12, 14
Evan Starr, J.J. Prescott, & Norman Bishara, <i>The Behavioral Effects of (Unenforceable) Contracts</i> , 36 J. L., ECON., & ORG. 633 (2020).....	12
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Jessica Jeffers, <i>The Impact of Restricting Labor Mobility on Corporate Investment and Entrepreneurship</i> , REV. OF FIN. STUDIES (2023).	12
Kurt Lavetti, Carol Simon & William D. White, <i>The Impacts of Restricting Mobility of Skilled Service Workers: Evidence from Physicians</i> , 55 J. HUMAN RESOURCES 1025 (2020).	14
Liyan Shi, <i>Optimal Regulation of Noncompete Contracts</i> , 91 ECONOMETRICA 425 (2023) https://www.econometricsociety.org/doi/10.3982/ECTA18128	12-13, 14
Lynda Lee, <i>Minority Business Ownership Differs by Sector</i> , CENSUS.GOV (Jan. 4, 2023), https://www.census.gov/library/stories/2023/01/who-owns- americas-businesses.html	7-8
Mark J. Garmaise, <i>Ties That Truly Bind: Noncompetition Agreements, Executive Compensation, and Firm Investment</i> , 27 J. L., ECON., & ORG. 376 (2011).....	12

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Matthew S. Johnson, Kurt Lavetti, & Michael Lipsitz, <i>The Labor Market Effects of Legal Restrictions on Worker Mobility</i> (2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3455381 .	12, 14
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Naomi Hausman & Kurt Lavetti, <i>Physician Practice Organization and Negotiated Prices: Evidence</i> <i>from State Law Changes</i> , 13 AM. ECON. J.: APPLIED ECON. 258 (2021).	13-14
Natarajan Balasubramanian, Jin Woo Chang, Mariko Sakakibara, Jagadeesh Sivadasan, & Evan Starr, <i>Locked In? The Enforceability of Non-Compete Clauses and the</i> <i>Careers of High-Tech Workers</i> , 57 J. HUM. RES. S349 (2022).	12, 14
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*The Legal Infrastructure of High Technology Industrial Districts:
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IDENTITY AND INTEREST OF *AMICUS CURIAE*

Small Business Majority is a national small business organization that empowers America's diverse entrepreneurs to build a thriving and equitable economy. It engages its network of more than 85,000 small businesses and 1,500 business and community organizations to deliver resources to entrepreneurs and advocate for public policy solutions that promote inclusive small business growth. Its work is bolstered by extensive research, including a recent survey concerning noncompetes, and deep connections with the small business community that enable it to educate stakeholders about key issues impacting America's entrepreneurs, with a special focus on the smallest businesses and those facing systemic inequities.

Small Business Majority's members are particularly disadvantaged by noncompetes, including the forfeiture-for-competition clauses ("FFCs") at issue in this appeal. Such provisions are harmful to the free, fair, and open competition that is fundamental to a thriving and equitable economy. FFCs, like other restraints of trade, both discourage workers from finding employment with businesses that place the highest value on their skills and hinder innovators from creating startups and launching careers as entrepreneurs. A large body of academic research shows that noncompetes interfere with labor mobility, reduce competition, increase consumer prices, and stifle innovation and entrepreneurship, including

among vulnerable populations. Courts have subjected noncompetes and forfeitures of all kinds to heightened review due to their negative impacts, as they do for similar contractual provisions like liquidated damages. FFC clauses have the same purpose, and largely the same effect, as noncompetes. The Court of Chancery's application of reasonableness review to FFCs thus prevents businesses from evading the scrutiny that applies to noncompetes.

SUMMARY OF ARGUMENT

1. Forfeiture-for-competition clauses (“FFCs”) resemble covenants not to compete and raise similar public policy concerns. They are restraints of trade and cause public harm by interfering with competition. Thus, the traditional public policy reasons for scrutinizing noncompetes apply to FFCs as well.

2. FFCs and noncompetes harm small businesses. Small business owners and entrepreneurs who aspire to launch new businesses (including startups) have trouble hiring staff because so many workers are bound by noncompetes. FFCs and noncompetes thus hinder the ability of people to create startups and become entrepreneurs themselves.

3. Noncompetes harm innovation, new business formation, labor mobility, earnings, competition, and many other aspects of a healthy economy, according to a large body of economic research. Because FFCs operate like noncompetes, they cause similar harms. These harms are especially significant in the case of highly skilled workers since they are prevented from using their skills to compete in highly productive areas of the economy.

ARGUMENT

I. FFCs Cause the Same Type of Harm as Noncompetes.

As the opinion below explains, the Limited Partnership Agreement includes noncompete clauses and other restrictive covenants (the “Restrictive Covenants”), and what it calls a “Conditioned Payment Device,” under which ex-partners forfeit deferred payments if they violate any of the Restrictive Covenants (whose duration is one or two years) or engage in any competitive activity for up to four years. *Op.* at 2-3. The Conditioned Payment Device is a kind of Forfeiture-for-Competition provision (“FFC”), as it requires ex-employees to forfeit a benefit to which they would have been entitled had they not competed with their former employer. *Id.* at 53.

Noncompetes and FFCs are similar in purpose and effect: they discourage people from working for firms that are competitors of their former employers or setting up their own competing businesses. *Id.* at 65. A typical noncompete is enforced through a breach of contract action, with a remedy of damages or injunction if irreparable injury can be proved. An FFC, on the other hand, is a condition; it is self-enforcing because the employer is able to withhold money otherwise due to the former employee. The means are different, but the end is the same. Thus, in California, FFCs are unenforceable under the same statute that bans noncompetes. *See, e.g., Ware v. Merrill Lynch, Pierce, Fenner & Smith, Inc.,*

24 Cal. App. 3d 35, 43 (Cal. App. 1972), *aff'd*, 414 U.S. 117 (1973); Cal. Bus. & Prof. Code § 16600.

Noncompetes belong to a class of provisions known as restraints of trade, which have been regulated by the common law for centuries, and since 1890 have been subject to federal antitrust law as well. Sherman Act, 26 Stat. 209 (1890) (codified as amended at 15 U.S.C. §§ 1-7). Restraints of trade can be illegal because, unlike ordinary contractual activity, they may be used to reduce economic output and increase prices. People who agree not to compete may even be criminally prosecuted under Section 1 of the Sherman Act. 15 U.S.C. § 1. A covenant not to compete in an employment contract is not criminally illegal, but under the common law, courts refuse to enforce employment noncompetes if the restraint is unreasonable or oppressive. See Restatement (Second) of Contracts § 188 (1981). The purpose of this limitation on the enforceability of noncompetes is to ensure that the noncompete does not excessively restrain competition between the former employer and its competitors by depriving those competitors of skilled employees.

This logic applies to FFCs. An employer seeks to prevent employees from quitting and competing with it by stipulating that a portion of compensation will be paid after termination, conditional on non-competition. Unless restricted by law,

an employer may choose a very high amount of money to be subject to the condition in order to maximize the employee's incentive not to compete.

The difference between a promise by the employee not to compete (requiring the payment of damages if the promise is broken) and a right of payment to the employee (conditional on not competing) is a matter of degree, not kind. Indeed, an FFC can be a more powerful restraint than a noncompete since the employer need not seek a judicial remedy to enforce it. As in this case, an employer can simply withhold money, throwing the burden on the ex-employee to go to the court to challenge the FFC. Moreover, when employers seek to enforce noncompetes through a preliminary injunction, they must show irreparable injury. *Kodiak Building Parts., LLC v. Adams*, 2022 WL 5240507, at *4 (Del. Ch. 2022). A similar showing is not required to exercise an FFC.

The FFC at issue in this case converts the already broad group of Restrictive Covenants (including a noncompete) into an extreme 4-year barrier to competition through the threat of forfeiture. As the Opinion below discusses, such forfeitures “do not enjoy . . . contractarian deference.” Op. at 62. Reasonableness review of FFCs serves the same purpose as it does with noncompetes: it ensures that the penalty is not in fact excessive.

II. Noncompetes and FTCs Harm Small Businesses.

Noncompetes harm small business by hindering the ability of individuals to create startups and become entrepreneurs, and by preventing existing small business owners from hiring workers they need to staff their enterprises. Comment Letter from John Arensmeyer, Small Business Majority to Secretary April J. Tabor, Federal Trade Comm'n, RE: Notice of Proposed Rulemaking (Apr. 19, 2023).¹ Because of their small size, small businesses are more vulnerable to turnover than large corporations are, and thus are more dependent on lateral hiring. Large corporations can thus use noncompetes as barriers to entry, tying up their workforce so that entrepreneurs cannot acquire sufficient staff to challenge them in the product market.

This issue is particularly significant for business owners residing in under-resourced communities, where the surge in business establishment has been prominent and where entrepreneurship plays a crucial role in fostering a fairer economy.² *Id.* (noting the growth of Black-, Hispanic-, and female-owned new

¹ Available at <https://smallbusinessmajority.org/sites/default/files/policy-docs/41923-FTC-NonCompetes-Comment%20%281%29.pdf>.

² See also Andre Perry, Manann Donoghoe & Hannah Stephens, *Who Is Driving Black Business Growth? Insights from the Latest Data on Black-Owned Businesses*, BROOKINGS INSTITUTION (May 24, 2023), <https://www.brookings.edu/articles/who-is-driving-black-business-growth-insights-from-the-latest-data-on-black-owned-businesses/>; Lynda Lee, *Minority Business Ownership Differs by Sector*, CENSUS.GOV (Jan. 4, 2023), <https://www.census.gov/library/>

businesses). One scholar has found that noncompetes may disproportionately discourage female entrepreneurship. Matt Marx, *Employee Non-compete Agreements, Gender, and Entrepreneurship*, 33 ORG. SCI. 1756, 1769 (2022) (providing evidence that women are less likely than men to start rival businesses when subject to employee non-competition agreements).

Small Business Majority's recent poll of small business owners demonstrates the negative impact of noncompete clauses on small businesses. Small Business Majority, *Opinion Poll: Small Business Owners Support Banning Non-Compete Agreements* (Apr. 13, 2023).³ Almost half (46%) of small business owners reported having been the subject of a noncompete agreement that prevented them from starting or expanding a business. *Id.* And 35% said they have been prevented from hiring someone because of a noncompete agreement. *Id.* Notably, 59% of respondents support the Federal Trade Commission's proposed rule to ban noncompete agreements, with only 14% opposing the ban. *Id.* Entrepreneurial opposition to noncompete agreements reflected in the survey is consistent with

[stories/2023/01/who-owns-americas-businesses.html](https://www.nwbc.gov/wp-content/uploads/2022/12/NWBC-2022-Annual-Report.pdf); National Women's Business Council, ANNUAL REPORT (2022), <https://www.nwbc.gov/wp-content/uploads/2022/12/NWBC-2022-Annual-Report.pdf>.

³ Available at <https://smallbusinessmajority.org/our-research/fair-competition/opinion-poll-small-business-owners-support-banning-non-compete-agreements>.

academic research, which shows that noncompete agreements interfere with entrepreneurship and innovation. *See* Part III, *infra*.

FFCs, like noncompetes, harm small businesses. Like noncompetes, FFCs deter employees from exiting large business enterprises, preventing them from starting their own businesses, going to work for small businesses (including innovative startups), and in other ways contributing to a competitive environment in which small as well as large businesses flourish.

III. FFCs and Noncompetes Cause General Economic Harm.

A large body of academic literature studies the impact of noncompetes on a range of economic variables, and finds overwhelming evidence of negative impacts on innovation, entrepreneurship, competition, labor mobility, and other indications of economic health. This literature inspired the United States Federal Trade Commission to propose a rule that would make it illegal for employers to enter into or maintain a noncompete clause with a worker. *See* Federal Trade Commission, Non-Compete Clause Rule, 80 Fed. Reg. 3482, 3511 (proposed Jan. 19, 2023) (notice of proposed rulemaking) [hereinafter, “FTC Rule”]. In recent years, many states, including Oregon, Maine, Massachusetts, New Hampshire, and Washington, have enacted strengthened statutory restrictions on noncompetes. *Id.* at 3494. FFCs operate in a similar fashion as noncompetes to discourage employees from leaving their employers and starting competing businesses or working for competitors, and so the findings in the literature also shed light on the likely harms of FFCs.

An article by Columbia law professor Ronald Gilson sparked this literature over two decades ago. Ronald J. Gilson, *The Legal Infrastructure of High Technology Industrial Districts: Silicon Valley, Route 128, and Covenants Not to Compete*, 74 N.Y.U. L. REV. 575 (1999). Gilson argued that the prohibition on enforcement of noncompetes in California contributed to the extraordinary

technological innovation and economic prosperity of Silicon Valley. *Id.* at 577-78. He observed that although the Route 128 tech corridor near Boston and the Silicon Valley hub on the San Francisco peninsula benefited from similar advantages—proximity to major research universities, an agglomeration of computer-related businesses, a history of innovation, and a highly-educated population—it was Silicon Valley alone that produced startup culture and the innovative firms that would spark the tech boom. *Id.* at 593. The difference between the two hubs, Gilson argued, was the legal regime: Massachusetts enforced noncompetes while California banned them. *Id.* at 578. The result was that Silicon Valley was characterized by extraordinary labor mobility, as software engineers switched from firm to firm in rapid succession, while Route 128 firms were vertically integrated behemoths in which employees were more likely to spend a large portion of their careers. *Id.* at 591-94, 605-07. Contrary to normal expectations, the rapid labor turnover in Silicon Valley did not harm employers but instead spread expertise far and wide, creating “knowledge spillovers” that supercharged innovation. *Id.* at 596, 608-09.

Numerous peer-reviewed academic studies have tested Gilson’s hypothesis. An extensive FTC meta-analysis reports that studies have consistently found that in states in which businesses are given the greatest latitude to enforce noncompetes, there are “decreased rates of [labor] mobility, measured by job separations, hiring

rates, job-to-job mobility, implicit mobility defined by job tenure, and within- and between industry mobility.”⁴ FTC Rule at 3489. These results confirm Small Business Majority’s survey results showing that small business owners have trouble starting businesses and hiring workers because of the restraints imposed by noncompetes.

Similarly, the anticompetitive effects of noncompetes outweigh the benefits that may be generated by protecting firm investments in training. Liyan Shi makes this clear through a rigorous analysis in a recent 2023 study. See Liyan Shi, *Optimal Regulation of Noncompete Contracts*, 91 *ECONOMETRICA* 425 (2023). Shi

⁴ See also Bruce Fallick, Charles A. Fleischman, & James B. Rebitzer, *Job-Hopping in Silicon Valley: Some Evidence Concerning the Microfoundations of a High-Technology Cluster*, 88 *REV. ECON. & STATISTICS* 472 (2006); Matt Marx, Deborah Strumsky, & Lee Fleming, *Mobility, Skills, and the Michigan Non-Compete Experiment*, 55 *MGMT. SCI.* 875 (2009); Mark J. Garmaise, *Ties That Truly Bind: Noncompetition Agreements, Executive Compensation, and Firm Investment*, 27 *J. L., ECON., & ORG.* 376 (2011); Jessica Jeffers, *The Impact of Restricting Labor Mobility on Corporate Investment and Entrepreneurship*, *REV. OF FIN. STUDIES* (2023); Evan Starr, *Consider This: Training, Wages, and the Enforceability of Non-Compete Clauses*, 72 *ILR REV.* 783 (2019); Liyan Shi, *Optimal Regulation of Noncompete Contracts*, 91 *ECONOMETRICA* 425 (2023), <https://www.econometricsociety.org/doi/10.3982/ECTA18128>; Evan Starr, J.J. Prescott, & Norman Bishara, *The Behavioral Effects of (Unenforceable) Contracts*, 36 *J. L., ECON., & ORG.* 633 (2020); Natarajan Balasubramanian, Jin Woo Chang, Mariko Sakakibara, Jagadeesh Sivadasan, & Evan Starr, *Locked In? The Enforceability of Non-Compete Clauses and the Careers of High-Tech Workers*, 57 *J. HUM. RES.* S349 (2022); Michael Lipsitz & Evan Starr, *Low-Wage Workers and the Enforceability of Noncompete Agreements*, 68 *MGMT. SCI.* 143 (2021); Matthew S. Johnson, Kurt Lavetti, & Michael Lipsitz, *The Labor Market Effects of Legal Restrictions on Worker Mobility* (2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3455381.

studied a sample of highly compensated executives similar to the plaintiffs in this case. *Id.* at 444. While acknowledging the training benefits of noncompetes in enhancing the worker’s skills or “human capital,” she notes that “[t]he data reveal that noncompete contracts generate a sizable decline in executive mobility and a relatively mild effect on firm investments” in human capital. *Id.* at 427. She thus shows empirically that the noncompetes cause significant social harm by preventing the executives from working at firms where they may put their skills to better use. She concludes that “imposing a complete ban on noncompete clauses would be close to implementing the social optimum.” *Id.* For any given worker, the benefit a noncompete has on training incentives will almost always be outweighed by the negative impacts on competition, unless the noncompete is exceptionally narrow and brief in duration. *Id.* It follows that reasonableness review of noncompete clauses is desirable, as would be reasonableness review of the functionally similar FFCs in this case.

Still other studies show that noncompetes increase product market concentration and prices. Because noncompetes interfere with entrepreneurs’ efforts to recruit workers, they favor large incumbent firms, reducing the competition they face and thus enabling them to charge higher prices to consumers. *See, e.g.,* Naomi Hausman & Kurt Lavetti, *Physician Practice Organization and Negotiated Prices: Evidence from State Law Changes*, 13 AM. ECON. J.: APPLIED

ECON. 258, 262 (2021) (finding evidence that noncompetes result in higher prices in healthcare). By the same token, noncompetes reduce the rate of new business formation and reduce innovation. *See, e.g.*, Matthew S. Johnson, Michael Lipsitz & Alison Pei, *Innovation and the Enforceability of Noncompete Agreements* at 2-4 (National Bureau of Economic Research Working Paper, 2023) (finding that enforcement of noncompetes reduces patenting and the rate of new business formation). Finally, noncompetes appear to reduce earnings for most workers.⁵

A noncompete creates a social tradeoff. It increases a firm's incentive to invest in a worker's human capital, but it reduces the worker's mobility, which causes a range of social harms—including lower competition, and hence lower output and higher prices in the future. This is why courts have historically refused to enforce noncompetes when they are too broad. In the future, evidence may

⁵ While some studies find higher earnings, *see* Kurt Lavetti, Carol Simon & William D. White, *The Impacts of Restricting Mobility of Skilled Service Workers: Evidence from Physicians*, 55 J. HUMAN RESOURCES 1025, 1064 (2020) (noncompetes associated with higher earnings for physicians); Liyan Shi, *supra* n.4, at 427 (noncompetes associated with higher earnings for executives), more studies involving broader cross-sections of workers, find lower earnings. *See, e.g.*, Lipsitz & Starr, *supra* n.4, at 143 (noncompetes associated with lower earnings for low-wage workers); *see also* Balasubramanian, *supra* n.4, at S349 (noncompetes associated with lower earnings for high-tech workers in Hawaii); Johnson, Lavetti, & Lipsitz, *supra* n.4, at 2 (noncompetes associated with lower wages for all workers in all states from 1991 to 2014); Starr, *supra* n.4, at 785 (noncompetes associated with lower wages for all workers in all states from 1996 to 2008).

show that a stricter ban on noncompetes, as proposed in the new FTC rule, is a wise policy choice.

But this case is not about whether noncompetes should be abolished. It is simply about whether employers should be able to evade traditional Delaware reasonableness review of noncompetes by redesigning them as FFCs, even though FFCs have almost exactly the same negative effects as noncompetes. The answer is clearly no.

CONCLUSION

Amicus respectfully asks the Court to affirm the Court of Chancery.

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