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Back to the Future — Delaware and New York Part Ways, This Time on Treatment of Future Affiliates Covered by Contract Restrictions

In an [earlier note](#), we identified discernable gaps between Delaware and New York law relating to certain recurring issues that come up in transactions.

A [recent decision](#) from the Delaware Chancery Court highlights another important difference in approach that affects both drafting and due diligence considerations for dealmakers. In this case, the court addressed whether a non-compete in a joint venture agreement that binds a party and its “affiliates” restricts ownership of a competing business by a subsequent acquirer of one of the JV parties. Put simply, is a “future” affiliate captured by this restrictive covenant?

The Delaware court came down decisively on the side of measuring “affiliate” status on a rolling basis at each time that contract compliance was tested as opposed to the moment in time when the contract was signed. It is clear that Delaware courts view covered “affiliates” as a dynamic group, rather than the result of a one-time snapshot. While the specific language of the contract was a factor in the decision, the court also noted the practical absurdity of freezing the covered affiliate group at signing — a party would then be able to form a new subsidiary the day after signing and run competitive business through that newly formed affiliate.

The Delaware court noted that while this decision was consistent with prior Delaware precedent, it did depart from the leading [New York case](#) on this same topic. The New York court found that future “affiliates” were not captured by a provision that was written in the present tense (as most contract terms are). The Delaware court assertively rejected this grammatical focus, saying: “To the extent the [New York] decision announced a rule of law grounded solely in the use of the present tense, it is not persuasive authority for the interpretation of the plain language of an agreement under Delaware law.”

It is important to note that both the Delaware and New York courts recognized that specific drafting could result in a different outcome from their findings on generic phrasing. New York will enforce “explicit language demonstrating the parties' intent to bind future affiliates”, while Delaware intimates that it will respect language that speaks to “affiliates as of the date hereof”.

The court reaffirmed that, while covered by the provision, the future affiliate (here, the acquirer of the JV party) was not itself bound by the non-compete and therefore not exposed directly to injunctive relief; rather the JV party was in breach of the non-compete and liable for damages as a result of the non-party affiliate owning a competing business.

Parties should take note of these differences based on applicable state law when drafting new agreements and during due diligence review of existing agreements in advance of a transaction.

If you have any questions about the matters addressed in this *Kirkland M&A Update*, please contact the following Kirkland attorneys or your regular Kirkland contact.

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