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Federal Court Holds Massachusetts Employers May Use Stock Options As Consideration for Noncompetes

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US District Judge Patti B. Saris of the US District Court for the District of Massachusetts recently held that stock options will suffice as "mutually agreed upon consideration" and "fair and reasonable consideration" under the Massachusetts Noncompetition Agreement Act in *Cynosure LLC. v. Reveal Lasers LLC*, No. 22-cv-11176-PBS (D. Mass. Nov. 9, 2022). As explained in a 2018 Cooley alert, the Massachusetts Noncompetition Agreement Act requires employers to provide consideration to support a noncompete agreement in the form of either precisely defined "garden leave" payments or other undefined "mutually agreed upon consideration." For employees who enter into a noncompete agreement in the course of their employment, the Massachusetts Noncompetition Agreement Act requires employers to also provide consideration that's "fair and reasonable," which is another undefined term. By holding that stock options may suffice as both "mutually agreed upon consideration" and "fair and reasonable consideration," Judge Saris shed long-awaited insight into the question of "What quantum or type consideration is sufficient to serve as 'mutually agreed upon consideration'?"

Judge Saris also concluded that a Delaware governing law clause does not exempt a noncompete agreement from meeting the minimum requirements of the Massachusetts Noncompetition Agreement Act if the noncompete agreement is with a Massachusetts-based employee. In fact, Judge Saris declined to enforce a noncompete with a Delaware governing law clause for its failure to advise an employee of that employee's right to consult counsel, as required by the Massachusetts Noncompetition Agreement Act.

Massachusetts law

The Massachusetts Noncompetition Agreement Act, which took effect on October 1, 2018, sets forth certain minimum requirements that must be satisfied for a noncompete agreement to be enforceable under Massachusetts law. Among those requirements, employers must offer "garden leave" or other "mutually agreed upon consideration" in exchange for a noncompete. While the Massachusetts Noncompetition Agreement Act defines "garden leave" as 50% of a former employee's highest annualized base salary for the two years before separation, to be paid for the duration of the restricted period, it is silent as to the definition of "mutually agreed upon consideration."

The Massachusetts Noncompetition Agreement Act also requires that noncompetition agreements advise employees of their right to consult with counsel prior to entering into the agreement. For agreements entered into after the commencement of employment, a noncompetition agreement also must be "supported by fair and reasonable consideration independent from the continuation of employment."

Cynosure LLC v. Reveal Lasers LLC

In *Cynosure LLC v. Reveal Lasers LLC*, Cynosure sought a preliminary injunction to enforce noncompetition provisions entered into with former employees who allegedly left Cynosure to work for a competitor. Two of the employees were based in Massachusetts, and one entered into a noncompetition provision at the beginning of his employment through the "Cynosure Employee Intellectual Property Rights, Confidentiality and Protective Covenants Agreement" (CEIP). The other Massachusetts-based employee entered into a noncompetition provision during his employment, through an employee stock option agreement, also known as an equity agreement. Both the CEIP and the equity agreement were purported to be governed by Delaware law.

Governing law

For the two former employees who resided in Massachusetts prior to their separation from employment, the court acknowledged the Delaware choice of law provision, but held that such a provision "is valid only if it does

not have the primary effect of voiding Massachusetts law." Thus, the court analyzed whether the equity agreement and the CEIP satisfied the minimum requirements of the Massachusetts Noncompetition Agreement Act for the two former Massachusetts-based employees.

The equity agreement

The equity agreement conditioned a grant of options to purchase 500 shares of Cynosure's common stock on each employee's execution of restrictive covenants, including a 12-month noncompetition provision. The options would vest in five equal installments over a period of five years, subject to the employee's continuous employment. For the Massachusetts-based employee who entered into the equity agreement mid-employment, under the Massachusetts Noncompetition Agreement Act, Cynosure also needed to provide:

1. "Fair and reasonable consideration" distinct from continued employment.
2. "Mutually agreed upon consideration" or "garden leave."

The court found that Cynosure satisfied the "fair and reasonable consideration" and "mutually agreed upon consideration" requirements through the one stock option grant, which sufficed in lieu of the garden leave clause. As the equity agreement also satisfied the remainder of the Massachusetts Noncompetition Agreement Act's minimum requirements, the court held the noncompetition provision in the equity agreement to be enforceable under Massachusetts law.

The CEIP

The other former Massachusetts-based employee entered into the CEIP in connection with the commencement of his employment. Thus, the court acknowledged that the CEIP did not also require "fair and reasonable consideration" distinct from continued employment to comply with the Massachusetts Noncompetition Agreement Act. The former Massachusetts-based employee also argued that the CEIP was deficient for its failure to provide mutually agreed upon consideration or garden leave, which are two forms of consideration that the Massachusetts Noncompetition Agreement Act recognizes as distinct from the concept of "fair and reasonable consideration." However, the court did not need to address the defendants' consideration argument based on the CEIP's failure to advise the Massachusetts employee of his right to consult counsel. We note that the court's decision not to enforce the noncompete agreement based on its failure to include the right to consult counsel language is consistent with an earlier Massachusetts federal court opinion that we summarized in a July 2021 Cooley alert. That decision also declined to enforce a noncompete agreement for its failure to reference mutually agreed upon consideration or garden leave.

What's next?

Given the *Cynosure* decision, employers with Massachusetts employees should ensure that their noncompete agreements expressly reference and comply with all minimum requirements set forth by the Massachusetts Noncompetition Agreement Act, even if the noncompete agreement purports to be governed by Delaware law. Employers also may now take comfort that a grant of stock options will likely suffice to satisfy "mutually agreed upon consideration" in lieu of the Massachusetts Noncompetition Agreement Act's expensive garden leave requirement.

If you have any questions about the implications of this ruling, please reach out to a member of the Cooley employment team.

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