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PE Sponsors and Startups: Equity Award Noncompetes May Not Hold Up

When equity awards are issued by a holding company, fund vehicle, or parent LP, the noncompetes inside them may not be enforceable, unless the company that actually employs the person also signs. That is the takeaway from a November 17 decision by Massachusetts' highest court, and it hits the structure most PE portfolio companies and venture-backed startups use to roll out equity.

What Happened

An Anaplan employee received equity from Anaplan's top-level parent partnership in exchange for a 12-month noncompete. The parent company signed the award agreements, but the operating company he worked for did not. When he left for a competitor, the court refused to block him.

Massachusetts requires a noncompete to be signed by both the employer and employee. The court said the "employer" is the company the person actually works for, not its parent. Naming the operating company in the agreement as entitled to enforce it didn't fix the problem. Neither did the companies' tax and partnership reasons for the structure.

Why PE and Startups Should Care

Holding-company equity is the norm. Profits interests, options, and LTIP awards often come from a topco or parent LP. In Massachusetts, a noncompete in that paperwork fails unless the employing entity signs too.

Founder and key-hire agreements are exposed. If a founder's or executive's noncompete sits only in a parent-level equity document, it may not survive a departure.

Other protections still work. Confidentiality, non-solicit, and non-disparagement terms aren't covered by the Massachusetts law. Anaplan still won a separate order protecting its trade secrets.

It's Not Just Massachusetts

Other states have similar rules, and courts there may follow this reasoning:

- **Alabama:** Noncompetes must be "signed by all parties" (Ala. Code § 8-1-192), which is arguably stricter than Massachusetts.
- **Oregon:** A noncompete must be a written agreement "between an employer and employee." The *employer* must also give the departing employee a signed copy within 30 days (ORS 653.295). A parent-issued award may not qualify.
- **Colorado:** The *employer* must give a separate notice of the noncompete, signed by the worker. Violations carry a $5,000 penalty per worker (C.R.S. § 8-2-113). The employer's signature isn't required, but a parent that isn't the employer may struggle to show it met the rule.

None of these statutes has yet been tested on the parent-signature question. *Anaplan* should be viewed as a warning, not a Massachusetts-only quirk.

What Employers Should Do Now

Audit award agreements across the portfolio. Check every noncompete in an equity grant and which entity signed it, starting with those for Massachusetts employees.

Add the employer's signature. Have the operating company co-sign award agreements or use a separate noncompete signed by the employer.

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Re-paper key people. New Massachusetts agreements need real added value beyond continued employment, 10 business days' notice, and a statement of the right to consult a lawyer.

Match the signer to the true employer. Make sure HR records, payroll, and covenant documents line up entity by entity.

Don't rely on the noncompete alone. Layer in confidentiality, non-solicit, and trade-secret protections.

FOR MORE INFORMATION

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