

Virginia

Regulatory Hot Tip 2009 – TWO

Professional Insurance Agents Association of Virginia and DC, Inc.

The Value of Restrictive Covenants

Business owners often ask whether or not they need a non-compete or other restrictive agreement for certain employees, agents, or brokers, and if so, what kind of agreement should be used for this purpose?¹

When asked this question, my first response always is to ask the employer the following question: What harm could be caused by the individual's departure? Generally, the business owner's answers include the fact that a departing employee could (i) solicit their clients, (ii) solicit another valuable member of the employer's staff, (iii) remove valuable papers, software, computer information, or other proprietary information which would be harmful to the employer if used by the exiting employee, (iv) go to work for a competitor, or (v) sell proprietary information to a third party.

As we all know, the business of insurance is a *personal* business, and a departing individual's very presence elsewhere, unfortunately, could cause customers to move their business, thereby harming the employer's business.

If a departing employee could bring such harm to the business, business owners should at least consider imposing some pre-employment restrictions. For different reasons and purposes, I have seen such restrictions included in employment agreements, separate restrictive covenant agreements, and even occasionally included in an agency's employee handbook or procedures

¹ For purposes of this Hot Tip, we are combining non-compete, non-piracy, non-solicitation agreements and any other similar type restriction that an employer might consider imposing on an employee. We will refer to all of them as as "Restrictive Covenants."

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manual. Oftentimes, restrictions may also be coupled with a request that the employee assign his or her rights to commissions over to the agency-employer as the employee may be compensated in a different manner.

But even if you go to the trouble of drafting the documents and having the employee sign, will your Restrictive Covenant withstand legal scrutiny?

When courts consider whether such Restrictive Covenants are enforceable, their analysis focuses on each of the following points:

- (i) An employer cannot keep a person from earning a livelihood.
- (ii) The restriction, whether it be a geographic restriction or otherwise, must be drawn broadly enough to protect the business owner's legitimate interests, but narrow enough to protect the employee's ability to earn a living.
- (iii) The restriction must be supported by consideration.

The issue of consideration in restrictive covenant agreements often proves to be the most troublesome, and over the years, courts have engaged in a lively debate over whether providing continued employment is sufficient consideration to support restrictions on an employee's conduct, if the Restrictive Covenant is imposed *after* the employee has been hired. Therefore, it is best to identify vulnerable positions *before* you fill them and include as separate compensation some dollar amount for the non-compete portion of the employment agreement along with the employment offer.

Unfortunately, employers who decide to make employees sign such restrictions *after* the employee is in place, without paying any additional compensation for the non-compete, often find themselves in the position of having to explain to the court exactly what constituted the agreed upon compensation for the restriction placed on the employee. Without proper consideration demonstrated, the employee often wins.

Additionally, don't forget that not every employee in your office has the ability to bring competitive harm to you and should be subject to such restrictive covenants. For restrictions on your employees, one size may not fit all! Therefore, be selective in determining which employees are required to execute non-compete agreements and/or employment agreements containing non-compete language.

If the employee is going to assist in developing a product, marketing plan, design a web page, or computer program, you might consider including a non-compete agreement stating which party such products belong to and the consequences of the employee violating the non-compete agreement.

Using non-compete agreements requires the employer to plan ahead - something that is not always easy for the small business owner; but to be enforceable, such restrictions must be as narrowly drawn as possible, and should be executed before the employee comes aboard. You should discuss with your legal advisor whether you need to draft a non-compete agreement for

an employee, make a list of the harms that could befall your agency should the employee you are getting ready to hire leaves, and tailor the agreement to those issues.

You and your legal advisor must carefully evaluate any attempt to implement a non-compete agreement for an existing employee. Asking a current employee to sign a non-compete may not be enforceable, may insult your employee, and might even trigger an undesired resignation.² But, you have to weigh those consequences and discuss the personality of the employee with your legal advisor. That will assist both you and your legal advisor in drafting the best document possible for your specific situation.

² This kind of agreement must be analyzed very differently than a pre-employment non-compete and is not intended to be included in the scope of this Hot Tip.