Idea Exchange

Agency Management

Overcoming Roadblocks

A Look at Restrictive Covenants and Obstacles that Keep Producers from Making a Move

By Jeff Lagos and Tony Tatum

If someone were to offer you $1 million to make a job move, would you? What if that move meant you'd go through some lean years?

For $1 million, you'd likely tolerate several lean years. An entrepreneurial model that offers higher commissions makes this kind of income possible. But with a respectable book of business, a mortgage, and children headed to college, change is not a comfortable prospect.

Successful insurance producers by nature appreciate setting their own limits. When you work for an agency that does not allow that kind of freedom, it can be an underlying frustration, one not realized until a better option presents itself.

When that better option becomes clear, what can stop you?

The most obvious answers are the confines of restrictive covenants, what will be lost in the transition, and the lack of a guarantee. It's not easy to take one step back to take two steps forward. You must have patience, confidence, and, above all, vision.

Here, we'll look at these roadblocks and how to overcome some of these challenges for the prize of a vastly better future.

Roadblock: Restrictive Covenants

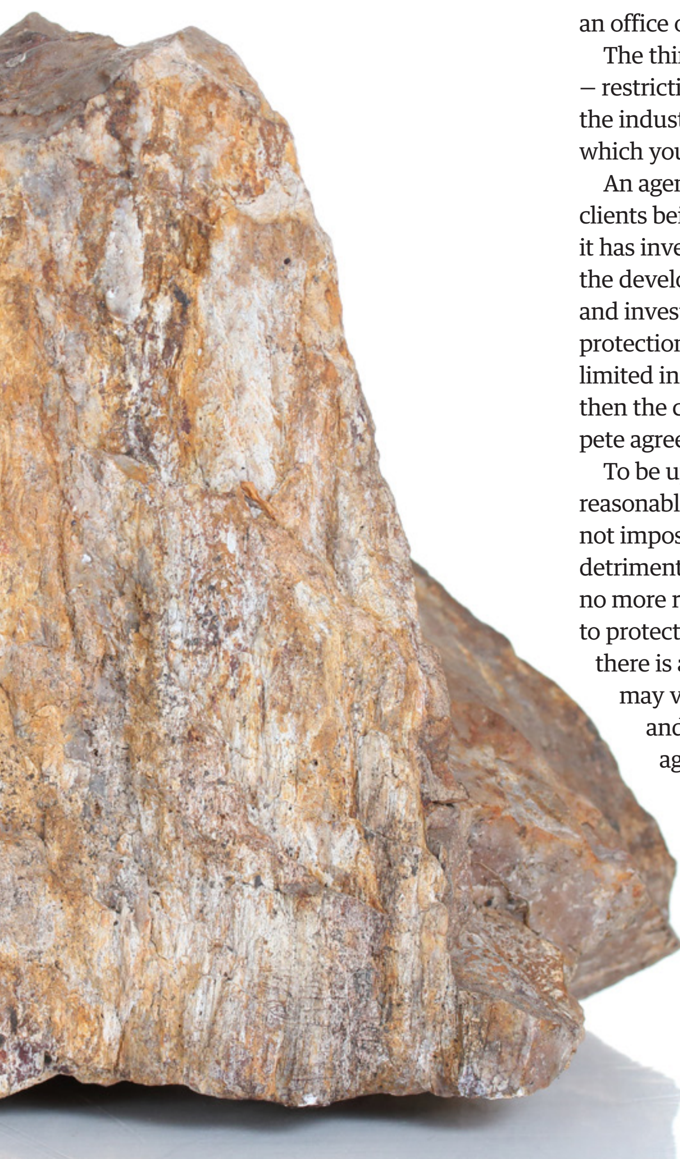
Restrictive covenants are all about protection – protect the business and the investment it has made in its producers and clients. These agreements are considered critical to the strength and stability of an agency. Without them, the agency is far too vulnerable to ruin.

It also means a diminished valuation of the business.

However, the law often recognizes the right to compete for client relationships under the right circumstances; it does not always recognize an ownership of those relationships. There are three main approaches to restrictive covenants.

The Noncompete. In the insurance industry, as in many others, insurance producers can expect to be required to sign a noncompete

Nonsolicitation agreements are the most popular restrictive covenants in the insurance industry because they directly protect the agency client base.



agreement. While California is a state that is the exception to this rule by declaring noncompetes a violation of the California Business Code, other states are currently adopting statutes to further clarify and restrict traditional noncompete elements, such as time and geographical scope.

Time is the first element of a typical noncompete, which is usually somewhere between six months and two years in length. Two years is the most popular choice for duration because it is considered the maximum amount of time that likely will be upheld in court if contested.

The second element is geographical area, often a set number of miles, e.g., 50 miles or the surrounding counties in proximity of an office or headquarters.

The third element is the type of business – restricting direct competition within the industry served by the company with which you've signed the contract.

An agency is most concerned with its clients being taken away, especially when it has invested in training the producer and the development of clients. Where training and investment are involved, courts allow protection. If the restraint is reasonably limited in scope, duration, and geography, then the court is likely to find the noncompete agreement enforceable.

To be upheld, a noncompete must be reasonable, must not be one-sided, should not impose undue hardship, must not be detrimental to the public, and should be no more restrictive than what is necessary to protect the company's interests. Where there is a perceived overreach, the courts may view it as restraint of free trade, and that's where the next type of agreement comes in.

The Confidentiality and Nondisclosure Agreement. Seen as much less problematic than a noncompete, the nondisclosure agreement restricts producers more from a communications perspective. It restricts them from using or disclosing proprietary and confidential information – such as trade secrets, customer lists, processes, business activities or other internal information – to competitors when they leave an agency.

A nondisclosure agreement generally is more accepted by the courts. Although the typical duration is one year to 18 months, courts will uphold longer periods if a legitimate business need is demonstrated. Nondisclosures are seen as less of a restraint on free trade than noncompetes, so the courts are more willing to uphold them, including those in California. Employment law attorneys will often recommend this type of restrictive covenant in lieu of a noncompete.

A basic nonpiracy covenant may be part of a nondisclosure agreement or larger contract, such as for employment terms, and some agencies require support personnel to sign a nondisclosure or nonpiracy agreement, as well, as a way to prevent a producer from poaching the firm's account managers. However, some agencies may allow you to buy your book and take your employees with you without a penalty since the staff would be left without revenue support once the producer leaves. In some cases, this is an attractive option for the agency.

The Nonsolicitation Agreement. Narrower in scope than the noncompete but more restrictive than the nondisclosure agreement is the nonsolicitation agreement. It restricts the producer from soliciting established or prospective clients of the agency and usually prohibits the recruitment of employees for a period of time. With this simple focus, they are more widely upheld if they are properly written. Some agreements protect key clients by prohibiting the solicitation of those clients.

Nonsolicitation agreements are the most popular restrictive covenants in the insurance industry because they directly protect the agency client base. They generally allow an employee or independent contractor to continue to work in the same industry and in the same city, so they are viewed more favorably by the courts than

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a noncompete. The same elements of valid noncompete agreements apply to valid nonsolicitation agreements. They must be reasonable in scope and time, may not impose undue hardship, must not be detrimental to the public, and should be no more than what is necessary to protect the company's legitimate business interests.

Nonsolicitation agreements also are barred by the California Business Code but are widely accepted elsewhere if properly written. Producers leaving an agency with a valid nonsolicitation agreement who wish to maintain their current book of business may want to explore the purchase of the book in order to facilitate a smooth transition without legal entanglement.

What Are Your Options?

It's wise to start by hiring a lawyer to review your restrictive covenants to understand the details of your agreements and know exactly what your contractual obligations are. In rare cases, they may not be in force or may be rightfully contestable.

If you've never signed an agreement and it does not come up until you leave, you're lawfully unrestricted. In some instances, you may have some room even if you have signed an agreement. For example:

- The agency may have overstepped its bounds of enforceability, such as an excessive time period or too broad a restricted territory, and therefore, it may be worth litigating enforcement of the agreement.
- Previous contracts may not be in effect where multiple mergers or acquistions have occurred. In *Acordia of Ohio LLC v. Fishel*, an insurance agency filed for injunctive relief against a competing agency and four former employees for alleged violation of the employee's non competition agreement. The court ruled that, although noncompetition agreements from a predecessor entity were inherited by the successor entity, mistakes in drafting resulted in unenforceable agreements. Depending on the structure of the agreement, if the employer is not the surviving entity in a merger or consolidation, the transaction may trigger the unintended running of the noncompetition period. This case shows that careful wording of the document makes all the difference, especially after multiple mergers.
- Have the documents been drafted to comply with new state statutes? For example, when Georgia law changed a few years ago, a producer found that his contract had become unenforceable, and in 2016, Utah enacted a law limiting covenants to a one-year duration.

An agreement will most likely not be upheld if challenged in court when it is overly broad or doesn't include reasonable parameters. The courts look for a reasonable balance between the protections of the agency's business and the employee's ability to continue to earn a living. Where there is an overreach, you may have grounds to get the contract overturned, although most jurisdictions allow the court to rework the agreement to one that is considered reasonable for the jurisdiction.

Since every state is a little different, it's important to find an attorney who is on top of the applicable details and recent developments pertaining to restrictive covenants to determine what is enforceable and what is not.

Be sure to have your documents reviewed. If the agency you're moving to has an attorney, do not depend on their opinion only. Get your own attorney to look things over. Since every state is a little different, it's important to find an attorney

who is on top of the applicable details and recent developments pertaining to restrictive covenants to determine what is enforceable and what is not.

Other Roadblocks

Once you know the details of your restrictive covenants, you can look at the money side of a move. You may think you can't move your book and there are very few options to making the transition worth it. However, there are plenty of options available to those who believe in themselves — because that is really what it boils down to. Here, we'll look at some of the other roadblocks.

Tony Tatum

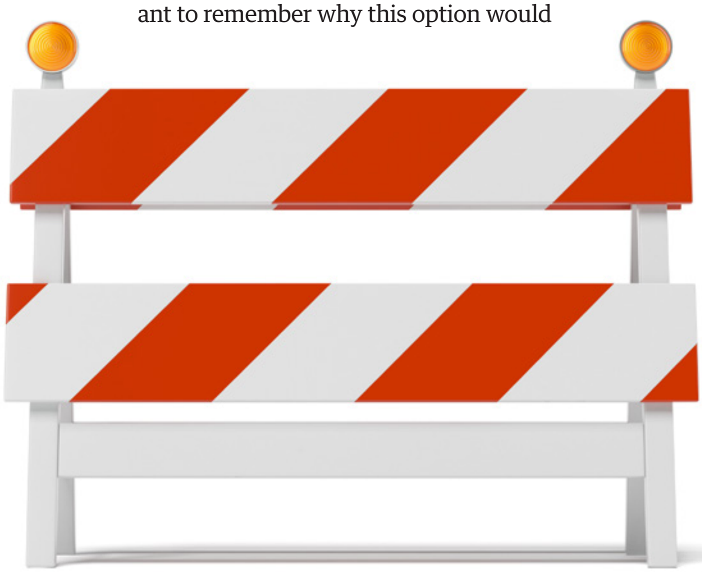
"I don't want to lose my book." Of course you'll want to take your book of business with you, and most agencies will allow your book to be purchased. But before you make an offer, research not only the value but also your agency's past behavior in similar negotiations, which will dictate the amount, e.g., one or two times the revenue. This will be a large commitment, but it will pay off in the long run. However, some agencies may get into a price war with you.

There are options to covering the cost of purchasing your book:

- ***Pay over time.*** You may have the option to negotiate paying the agency a portion of the commissions earned for a fixed period of time. Many finance the purchase of their book with premium financing. Rates are generally reasonable at 4 percent to 5 percent, and some agencies may be willing to guarantee the loan. When you make the move to an agency that pays higher commission rates, you can use the difference to pay off the book purchase, which greatly accelerates the payoff.
- ***Use Leverage.*** The leverage you have in the negotiations is important to understand. On average, the agency will lose 70 percent of your book over a three-year period. Producers can use that fact when they present their offer to buy the book and negotiate payment. Additionally, agencies know that personnel may need to be let go when producers leave and take revenue with them, at least for a transitional period. There is a lot of risk involved in using this tactic, but it is reasonable and generally pays off in the long run.

Stock may play a huge part in the equation. It can be more valuable than the book. When you leave your agency, you may have to pay back the company, typically over a period of time. This will be another element that you may need to finance.

"I can't move because I must have a certain level of income." If you cannot purchase your book, an option may be to use a draw for the duration of the noncompete or other restrictive agreement. It's important to remember why this option would be worth it and keep the payoff in mind.



Jeff Lagos

"It's too late in my career." If this is your roadblock, you need to calculate carefully what a change would look like. Most make the transition more quickly than expected and are happy they made the change, even later in life.

"I'm afraid of the unknown." Ask questions — you may be surprised by the options available. The right agency will work with top performers under all kinds of circumstances.

A move to the entrepreneurial model is not for everyone; it may not be for you. There are two types for which this lucrative model does not work: (1) someone who needs to be micromanaged or must have regular meetings with leadership and (2) someone who does not appreciate working as a partner or sharing commissions with another producer to work with a client.

For the right personality type, the jump to a model that offers high commissions, equity in your book of business, and stock ownership options is a must. Don't leave possibly millions on the table out of fear. Ask the questions required to push every roadblock aside. Your future and your family's future are worth it. IJ ***Share this article with a colleague.***

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